

AVEO PHARMACEUTICALS INC

Form 10-Q

May 10, 2013

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2013

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 001-34655

**AVEO PHARMACEUTICALS, INC.**

(Exact Name of Registrant as Specified in Its Charter)

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<b>Delaware</b> (State or Other Jurisdiction of Incorporation or Organization)	<b>04-3581650</b> (I.R.S. Employer Identification No.)
<b>75 Sidney Street, Cambridge, Massachusetts 02139</b> (Address of Principal Executive Offices) (Zip Code)	
<b>(617) 299-5000</b> (Registrant's Telephone Number, Including Area Code)	

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

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

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

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Large accelerated filer  Accelerated filer  x  
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No  x

Number of shares of the registrant's Common Stock, \$0.001 par value, outstanding on May 1, 2013: 51,885,668

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**AVEO PHARMACEUTICALS, INC.**

**FORM 10-Q**

**FOR THE QUARTER ENDED March 31, 2013**

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements.****AVEO PHARMACEUTICALS, INC.****Condensed Consolidated Balance Sheets****(In thousands, except par value amounts)***(Unaudited)*

	March 31, 2013	December 31, 2012
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 85,898	\$ 76,134
Marketable securities	105,736	84,468
Accounts receivable	9,181	20,649
Prepaid expenses and other current assets	9,744	9,430
<b>Total current assets</b>	<b>210,559</b>	<b>190,681</b>
Property and equipment, net	13,331	12,867
Other assets	367	321
Restricted cash	3,558	3,600
<b>Total assets</b>	<b>\$ 227,815</b>	<b>\$ 207,469</b>
<b>Liabilities and stockholders equity</b>		
Current liabilities:		
Accounts payable	\$ 8,083	\$ 10,628
Accrued expenses	18,067	19,543
Loans payable, net of discount	9,384	6,809
Deferred revenue	1,294	1,294
Deferred rent	918	856
<b>Total current liabilities</b>	<b>37,746</b>	<b>39,130</b>
Loans payable, net of current portion and discount	16,731	19,228
Deferred revenue, net of current portion	18,067	18,391
Deferred rent, net of current portion	12,851	10,544
Other liabilities	1,238	1,238
Stockholders equity:		
Preferred stock, \$.001 par value; 5,000 shares authorized; no shares issued and outstanding		
Common stock, \$.001 par value; 100,000 shares authorized; 51,848 and 43,780 shares issued and outstanding at March 31, 2013 and December 31, 2012, respectively	52	44
Additional paid-in capital	495,461	439,173
Accumulated other comprehensive income (loss)	14	(19)
Accumulated deficit	(354,345)	(320,260)
<b>Total stockholders equity</b>	<b>141,182</b>	<b>118,938</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 227,815</b>	<b>\$ 207,469</b>

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

**Table of Contents****AVEO PHARMACEUTICALS, INC.****Condensed Consolidated Statements of Operations****(In thousands, except per share amounts)***(Unaudited)*

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
Collaboration revenue	\$ 323	\$ 860
Operating expenses:		
Research and development	20,962	24,776
General and administrative	12,449	8,983
Restructuring	67	
	33,478	33,759
Loss from operations	(33,155)	(32,899)
Other income and expense:		
Other (expense) income, net	(101)	299
Interest expense	(870)	(845)
Interest income	41	199
Other expense, net	(930)	(347)
Net loss	\$ (34,085)	\$ (33,246)
Net loss per share basic and diluted	\$ (0.69)	\$ (0.77)
Weighted average number of common shares outstanding	49,380	43,254

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

**Table of Contents****AVEO PHARMACEUTICALS, INC.****Condensed Consolidated Statements of Comprehensive Loss****(In thousands)***(Unaudited)*

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
Net loss	\$ (34,085)	\$ (33,246)
Other comprehensive income:		
Unrealized gains on available-for-sale securities	7	231
Foreign currency translation adjustment	26	(4)
Comprehensive loss	\$ (34,052)	\$ (33,019)

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



**Table of Contents****AVEO PHARMACEUTICALS, INC.****Condensed Consolidated Statements of Cash Flows****(In thousands)***(Unaudited)*

	<b>Three Months Ended March 30,</b>	
	<b>2013</b>	<b>2012</b>
<b>Operating activities</b>		
Net loss	\$ (34,085)	\$ (33,246)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	900	546
Net loss on disposal of fixed assets	50	
Stock-based compensation	2,588	2,202
Non-cash interest expense	81	135
Amortization of premium on investments	339	785
Changes in operating assets and liabilities:		
Accounts receivable	11,468	(2,279)
Prepaid expenses and other current assets	(317)	2,565
Other noncurrent assets	(46)	23
Restricted cash	42	
Accounts payable	(2,545)	(1,349)
Accrued expenses	(2,128)	333
Deferred revenue	(324)	(323)
Deferred rent	2,369	(18)
Net cash used in operating activities	(21,608)	(30,626)
<b>Investing activities</b>		
Purchases of property and equipment	(762)	(1,107)
Purchases of marketable securities	(48,951)	(34,074)
Proceeds from maturities and sales of marketable securities	27,351	93,687
Net cash (used in) provided by investing activities	(22,362)	58,506
<b>Financing activities</b>		
Proceeds from issuance of common stock, net of issuance costs	53,638	
Proceeds from exercise of stock options and issuance of common and restricted stock	70	183
Proceeds from refinancing of loans payable		3,672
Principal payments on loans payable		(2,172)
Net cash provided by financing activities	53,708	1,683
Net increase in cash and cash equivalents	9,738	29,563
Effect of exchange rate changes on cash and cash equivalents	26	(4)
Cash and cash equivalents at beginning of period	76,134	43,506
Cash and cash equivalents at end of period	\$ 85,898	\$ 73,065
<b>Supplemental cash flow and noncash investing and financing</b>		
Cash paid for interest	\$ 788	\$ 731
Cash paid for income taxes	\$	\$

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



**Table of Contents****AVEO Pharmaceuticals, Inc.****Notes to Condensed Consolidated Financial Statements****(Unaudited)****(1) Organization**

AVEO Pharmaceuticals, Inc. (the Company), which does business as AVEO Oncology, a cancer therapeutics company committed to discovering, developing and commercializing targeted cancer therapies to impact patients' lives. The Company's product candidates are directed against important mechanisms, or targets, known or believed to be involved in cancer.

Tivozanib, the Company's lead product candidate, which the Company partnered with Astellas Pharma Inc. and its wholly-owned direct subsidiaries (Astellas), is a potent, selective, long half-life inhibitor of all three vascular endothelial growth factor (VEGF) receptors which is designed to optimize VEGF blockade while minimizing off-target toxicities. In 2012, the Company announced detailed data from its global, phase 3 clinical trial comparing the efficacy and safety of tivozanib with Nexavar® (sorafenib), an approved therapy, for first-line treatment in advanced RCC (the TIVO-1 study). On November 27, 2012, the U.S. Food and Drug Administration (the FDA) accepted for filing the Company's New Drug Application, (NDA) for tivozanib with the proposed indication for the treatment of patients with advanced renal cell carcinoma (RCC). On May 2, 2013, the FDA's Oncologic Drugs Advisory Committee (the ODAC), which provides the FDA with independent expert advice and recommendations, reviewed the Company's NDA for tivozanib and voted 13 to 1 that the application for tivozanib did not demonstrate a favorable benefit/risk evaluation for the treatment of advanced RCC in an adequate and well-controlled trial. Furthermore, the ODAC's vote was consistent with the position taken by the FDA at the ODAC meeting. Given the ODAC's determination, as well as the position taken by the FDA at the ODAC meeting, it is now significantly more likely that the FDA will make an adverse determination with respect to the Company's current NDA and there is an increased probability that the FDA will conclude that an additional trial or trials are needed before marketing approval for tivozanib can be granted, if it is granted at all. The FDA's review of the NDA is expected to be complete by July 28, 2013 according to the timelines established by the Prescription Drug User Fee Act (PDUFA). In view of the current FDA-related uncertainties with respect to the NDA for tivozanib to treat advanced RCC, the Company and Astellas, are evaluating the clinical and regulatory path forward for tivozanib, including Astellas' decision as to whether to submit a Marketing Authorization Application (MAA) for RCC to the European Medicines Agency (EMA).

The Company also has a pipeline of monoclonal antibodies, including ficlatuzumab, a product candidate that is currently in phase 2 clinical development, and AV-203, a monoclonal antibody that targets the ErbB3 receptor, which the Company has partnered with Biogen Idec, Inc. Both ficlatuzumab and AV-203 were derived from the Company's Human Response Platform, a novel method of building preclinical models of human cancer. As used throughout these consolidated financial statements, the term AVEO, refers to AVEO Pharmaceuticals, Inc. and its wholly-owned subsidiaries, AVEO Pharma Limited and AVEO Securities Corporation.

The Company has generated an accumulated deficit as of March 31, 2013 of approximately \$354.3 million since inception, and will require substantial additional capital for research and the development of tivozanib, ficlatuzumab, AV-203 and its other antibody programs. The Company believes that its existing cash, cash equivalents, and marketable securities are sufficient to fund its operations through at least the next twelve months.

**(2) Basis of Presentation**

These condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. The Company has eliminated all significant intercompany accounts and transactions in consolidation.

The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals and revisions of estimates, considered necessary for a fair presentation of the condensed consolidated financial statements have been included. Interim results for the three months ended March 31, 2013 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2013 or any other future period.

The information presented in the condensed consolidated financial statements and related footnotes at March 31, 2013, and for the three months ended March 31, 2013 and 2012, is unaudited and the condensed consolidated balance sheet amounts and related footnotes at December 31, 2012 have been derived from the Company's audited financial statements. For further information, refer to the consolidated financial statements

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and accompanying footnotes included in the Company's annual report on Form 10-K for the fiscal year ended December 31, 2012, which was filed with the U.S. Securities and Exchange Commission (SEC) on March 11, 2013.

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**Table of Contents****(3) Significant Accounting Policies*****Revenue Recognition***

The Company's revenues are generated primarily through collaborative research, development and commercialization agreements. The terms of these agreements generally contain multiple elements, or deliverables, which may include (i) licenses, or options to obtain licenses, to the Company's technology, (ii) research and development activities to be performed on behalf of the collaborative partner, and (iii) in certain cases, services in connection with the manufacturing of pre-clinical and clinical material. Payments to the Company under these arrangements typically include one or more of the following: non-refundable, up-front license fees; option exercise fees; funding of research and/or development efforts; milestone payments; and royalties on future product sales.

When evaluating multiple element arrangements, the Company considers whether the deliverables under the arrangement represent separate units of accounting. This evaluation requires subjective determinations and requires management to make judgments about the individual deliverables and whether such deliverables are separable from the other aspects of the contractual relationship. In determining the units of accounting, management evaluates certain criteria, including whether the deliverables have standalone value, based on the consideration of the relevant facts and circumstances for each arrangement. The consideration received is allocated among the separate units of accounting using the relative selling price method, and the applicable revenue recognition criteria are applied to each of the separate units.

The Company determines the estimated selling price for deliverables within each agreement using vendor-specific objective evidence (VSOE) of selling price, if available, third-party evidence (TPE) of selling price if VSOE is not available, or best estimate of selling price if neither VSOE nor TPE is available. Determining the best estimate of selling price for a deliverable requires significant judgment. The Company typically uses best estimate of selling price to estimate the selling price for licenses to the Company's proprietary technology, since the Company often does not have VSOE or TPE of selling price for these deliverables. In those circumstances where the Company utilizes best estimate of selling price to determine the estimated selling price of a license to the Company's proprietary technology, the Company considers market conditions as well as entity-specific factors, including those factors contemplated in negotiating the agreements as well as internally developed models that include assumptions related to the market opportunity, estimated development costs, probability of success and the time needed to commercialize a product candidate pursuant to the license. In validating the Company's best estimate of selling price, the Company evaluates whether changes in the key assumptions used to determine the best estimate of selling price will have a significant effect on the allocation of arrangement consideration between multiple deliverables.

The Company typically receives up-front, non-refundable payments when licensing its intellectual property in conjunction with a research and development agreement. When management believes the license to its intellectual property does not have stand-alone value from the other deliverables to be provided in the arrangement, the Company generally recognizes revenue attributed to the license on a straight-line basis over the Company's contractual or estimated performance period, which is typically the term of the Company's research and development obligations. If management cannot reasonably estimate when the Company's performance obligation ends, then revenue is deferred until management can reasonably estimate when the performance obligation ends. When management believes the license to its intellectual property has stand-alone value, the Company generally recognizes revenue attributed to the license upon delivery. The periods over which revenue should be recognized are subject to estimates by management and may change over the course of the research and development agreement. Such a change could have a material impact on the amount of revenue the Company records in future periods.

Payments or reimbursements resulting from the Company's research and development efforts for those arrangements where such efforts are considered as deliverables are recognized as the services are performed and are presented on a gross basis so long as there is persuasive evidence of an arrangement, the fee is fixed or determinable, and collection of the related receivable is reasonably assured. Amounts received prior to satisfying the above revenue recognition criteria are recorded as deferred revenue in the accompanying balance sheets.

At the inception of each agreement that includes milestone payments, the Company evaluates whether each milestone is substantive and at risk to both parties on the basis of the contingent nature of the milestone. This evaluation includes an assessment of whether (a) the consideration is commensurate with either (1) the entity's performance to achieve the milestone, or (2) the enhancement of the value of the delivered item(s) as a result of a specific outcome resulting from the entity's performance to achieve the milestone, (b) the consideration relates solely to past performance, and (c) the consideration is reasonable relative to all of the deliverables and payment terms within the arrangement. The Company evaluates factors such as the scientific, regulatory, commercial and other risks that must be overcome to achieve the respective milestone, the level of effort and investment required to achieve the respective milestone and whether the milestone consideration is reasonable relative to all deliverables and payment terms in the arrangement in making this assessment.

The Company aggregates its milestones into four categories: (i) clinical and development milestones, (ii) regulatory milestones, (iii) commercial milestones, and (iv) patent-related milestones. Clinical and development milestones are typically achieved when a product candidate advances into a defined phase of clinical research or completes such phase. For example, a milestone payment may be due to the Company upon the

initiation of a phase 3 clinical trial for a new indication, which is the last phase of clinical

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development and could eventually contribute to marketing approval by the FDA or other global regulatory authorities. Regulatory milestones are typically achieved upon acceptance of the submission for marketing approval of a product candidate or upon approval to market the product candidate by the FDA or other global regulatory authorities. For example, a milestone payment may be due to the Company upon the FDA's acceptance of an NDA. Commercial milestones are typically achieved when an approved pharmaceutical product reaches certain defined levels of net sales by the licensee, such as when a product first achieves global sales or annual sales of a specified amount. Patent-related milestones are typically achieved when a patent application is filed or a patent is issued with respect to certain intellectual property related to the applicable collaboration.

Revenues from clinical and development, regulatory and patent-related milestone payments, if the milestones are deemed substantive and the milestone payments are nonrefundable, are recognized upon successful accomplishment of the milestones. The Company has concluded that the clinical and development, regulatory and patent-related milestones pursuant to its research and development arrangements are substantive. Milestones that are not considered substantive are accounted for as license payments and recognized on a straight-line basis over the remaining period of performance. Revenues from commercial milestone payments are accounted for as royalties and are recorded as revenue upon achievement of the milestone, assuming all other revenue recognition criteria are met.

**Principles of Consolidation**

The Company's consolidated financial statements include the Company's accounts and the accounts of the Company's wholly-owned subsidiaries, AVEO Pharma Limited and AVEO Securities Corporation. All intercompany transactions have been eliminated.

**Research and Development Expenses**

Research and development expenses are charged to expense as incurred. Research and development expenses consist of costs incurred in performing research and development activities, including personnel-related costs, stock-based compensation, facilities, research-related overhead, clinical trial costs, manufacturing costs and costs of other contracted services, license fees, and other external costs.

Nonrefundable advance payments for goods and services that will be used in future research and development activities are expensed when the activity has been performed or when the goods have been received rather than when the payment is made in accordance with the provisions of Accounting Standards Codification (ASC) 730, *Research and Development* (ASC 730).

**Cash and Cash Equivalents**

The Company considers highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents at March 31, 2013 and December 31, 2012 consisted of money market funds, asset-backed commercial paper, and corporate debt securities, including commercial paper, maintained by an investment manager.

**Marketable Securities**

Marketable securities at March 31, 2013 consisted of municipal bonds, asset-backed securities, and corporate debt securities, including commercial paper, maintained by an investment manager. Marketable securities at December 31, 2012 consisted of municipal bonds, asset-backed commercial paper, asset-backed securities, and corporate debt securities, including commercial paper, maintained by an investment manager. Credit risk is reduced as a result of the Company's policy to limit the amount invested in any one issue. Marketable securities consist primarily of investments which have expected average maturity dates in excess of three months, but not longer than 24 months. The Company classifies these investments as available-for-sale. Unrealized gains and losses are included in other comprehensive (loss) income until realized. The cost of securities sold is based on the specific identification method. There were no realized gains or losses recognized on the sale or maturity of securities during the three months ended March 31, 2013 and 2012.

Available-for-sale securities at March 31, 2013 and December 31, 2012 consist of the following:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
<b>March 31, 2013:</b>				

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Corporate debt securities	\$ 74,117	\$ 17	\$ (6)	\$ 74,128
Municipal bonds	10,250			10,250
Asset-backed securities	21,355	3		21,358
	\$ 105,722	\$ 20	\$ (6)	\$ 105,736



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	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
<b>December 31, 2012:</b>				
Corporate debt securities	\$ 58,751	\$ 16	\$ (11)	\$ 58,756
Municipal bonds	10,545			10,545
Asset-backed securities	6,359			6,359
Asset-backed commercial paper	8,806	2		8,808
	\$ 84,461	\$ 18	\$ (11)	\$ 84,468

The aggregate fair value of securities in an unrealized loss position for less than 12 months at March 31, 2013 was \$38.1 million, representing ten securities. There were no securities that were in an unrealized loss position for greater than 12 months at March 31, 2013. The unrealized loss was caused by a temporary change in the market for those securities primarily caused by changes in market interest rates. There was no change in the credit risk of the securities. To determine whether an other-than-temporary impairment exists, the Company performs an analysis to assess whether it intends to sell, or whether it would more likely than not be required to sell, the security before the expected recovery of the amortized cost basis. Where the Company intends to sell a security, or may be required to do so, the security's decline in fair value is deemed to be other-than-temporary and the full amount of the unrealized loss is recorded in the statement of operations as an other-than-temporary impairment charge. When this is not the case, the Company performs additional analyses on all securities with unrealized losses to evaluate losses associated with the creditworthiness of the security. Credit losses are identified where the Company does not expect to receive cash flows, based on using a single best estimate, sufficient to recover the amortized cost basis of a security and these are recognized in other income (expense), net.

Marketable securities in an unrealized loss position at March 31, 2013 and December 31, 2012 consist of the following:

	Aggregate Fair Value	Unrealized Losses
	(in thousands)	
<b>March 31, 2013:</b>		
Corporate debt securities	\$ 32,401	\$ (6)
Asset-backed securities	5,721	
	\$ 38,122	\$ (6)
<b>December 31, 2012:</b>		
Corporate debt securities	\$ 29,806	\$ (11)
Asset-backed securities	6,359	
	\$ 36,165	\$ (11)

Based on consideration of those factors described in the previous paragraph, the Company does not believe an other-than temporary impairment exists with respect to those securities in an unrealized loss position at March 31, 2013.

**Concentrations of Credit Risk**

Financial instruments that potentially subject the Company to credit risk primarily consist of cash, cash equivalents and available-for-sale marketable securities. The Company maintains deposits in federally insured financial institutions in excess of federally insured limits.

Management believes that the Company is not exposed to significant credit risk due to the financial position of the depository institutions in which those deposits are held.

The Company's credit risk related to marketable securities is reduced as a result of the Company's policy to limit the amount invested in any one issue.

***Fair Value Measurements***

The Company records cash equivalents and marketable securities at fair value. ASC 820, *Fair Value Measurements and Disclosures* ( ASC 820 ), establishes a fair value hierarchy for those instruments measured at fair value that distinguishes between fair value measurements based on market data (observable inputs) and those based on the Company's own assumptions (unobservable inputs). The hierarchy consists of three levels:

Level 1 Quoted market prices in active markets for identical assets or liabilities. Assets utilizing Level 1 inputs include money market funds.

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Level 2 Inputs other than Level 1 inputs that are either directly or indirectly observable, such as quoted market prices, interest rates and yield curves. Assets utilizing Level 2 inputs include municipal bonds, asset-backed securities, asset-backed commercial paper, and corporate bonds, including commercial paper. These investments have been initially valued at the transaction price and subsequently valued, at the end of each reporting period, utilizing third party pricing services or other market observable data. The pricing services utilize industry standard valuation models, including both income and market based approaches and observable market inputs to determine value. These observable market inputs include reportable trades, benchmark yields, credit spreads, broker/dealer quotes, bids, offers, current spot rates and other industry and economic events. The Company validates the prices provided by third party pricing services by reviewing their pricing methods and matrices, obtaining market values from other pricing sources, analyzing pricing data in certain instances and confirming that the relevant markets are active. After completing its validation procedures, the Company did not adjust or override any fair value measurements provided by the pricing services as of March 31, 2013 or December 31, 2012.

Level 3 Unobservable inputs developed using estimates and assumptions developed by the Company, which reflect those that a market participant would use. The Company currently has no assets or liabilities recorded at fair value that utilize Level 3 inputs. The following tables summarize the cash equivalents and marketable securities measured at fair value on a recurring basis in the accompanying consolidated balance sheets as of March 31, 2013 and December 31, 2012.

**Fair Value Measurements of Cash Equivalents and  
Marketable Securities as of March 31, 2013**

	Level 1	Level 2 (in thousands)	Level 3	Total
Cash equivalents	\$ 38,321	\$ 37,300	\$	\$ 75,621
Marketable securities		105,736		105,736
	\$ 38,321	\$ 143,036	\$	\$ 181,357

**Fair Value Measurements of Cash Equivalents and  
Marketable Securities as of December 31, 2012**

	Level 1	Level 2 (in thousands)	Level 3	Total
Cash equivalents	\$ 51,182	\$ 18,121	\$	\$ 69,303
Marketable securities		84,468		84,468
	\$ 51,182	\$ 102,589	\$	\$ 153,771

The carrying amounts of the Company's financial instruments not required to be measured at fair value, which include accounts receivable and accounts payable, approximate their fair values at March 31, 2013 and December 31, 2012.

The fair value of the Company's loans payable at March 31, 2013, computed pursuant to a discounted cash flow technique using the effective interest rate under the loan, is \$26.6 million and is considered a level 2 fair value measurement. The effective interest rate considers the fair value of the warrant issued in connection with the loan, loan issuance costs and the deferred charge.

**Property and Equipment**

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the respective assets. Maintenance and repair costs are charged to expense as incurred.

**Long-lived Assets**

The Company reviews long-lived assets, including property and equipment, for impairment whenever changes in business circumstances indicate that the carrying amount of the asset may not be fully recoverable. The Company has not recognized any impairment losses through

March 31, 2013.

***Basic and Diluted Loss per Common Share***

Basic net loss per common share is computed by dividing net loss by the weighted-average number of common shares outstanding during the reporting period. Preferred shares are not included in the calculation of net loss per share until their conversion to common shares. Diluted net loss per common share is computed by dividing net loss by the weighted-average number of common shares and dilutive common share equivalents then outstanding. Potential common stock equivalent shares consist of the incremental common shares issuable upon the exercise of stock options and warrants. Since the Company had a net loss for all periods presented, the effect of all potentially dilutive securities is anti-dilutive. Accordingly, basic and diluted net loss per common share is the same.

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The following table sets forth for the periods presented the potential common shares (prior to consideration of the treasury stock method) excluded from the calculation of net loss per common share because their inclusion would have been anti-dilutive:

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(in thousands)</b>	
Weighted average options outstanding	5,393	4,329
Weighted average warrants outstanding	10	10
	5,403	4,339

**Stock-Based Compensation**

The Company applies the provisions of ASC 718, *Compensation-Stock Compensation ( ASC 718 )*, to share-based payments. All awards are recognized in the Company's statements of operations on a straight-line basis over their requisite service periods based on their grant date fair values as calculated using the measurement and recognition provisions of ASC 718. During the three months ended March 31, 2013 and 2012, respectively, the Company recorded the following stock-based compensation expense:

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(in thousands)</b>	
Research and development	\$ 1,114	\$ 949
General and administrative	1,474	1,253
<b>Total stock-based compensation expense</b>	<b>\$ 2,588</b>	<b>\$ 2,202</b>

Allocations to research and development and general and administrative expense are based upon the department to which the associated employee reported. No related tax benefits of the stock-based compensation expense have been recognized. Share-based payments issued to nonemployees are recorded at their fair values, and are periodically revalued as the equity instruments vest and are recognized as expense over the related service period.

**Income Taxes**

The Company provides for income taxes using the liability method. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

The Company accounts for income taxes under ASC 740, *Income Taxes ( ASC 740 )*, which provides a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. Unrecognized tax benefits represent tax positions for which reserves have been established.

**Segment and Geographic Information**

Operating segments are defined as components of an enterprise engaging in business activities for which discrete financial information is available and regularly reviewed by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company views its operations and manages its business in one operating segment, principally in the United States. The Company has \$1.2 million of gross assets located in the United Kingdom.

**Use of Estimates**

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The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the Company's management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

### ***Recently Adopted Accounting Pronouncements***

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update ( ASU ) No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* ( ASU 2013-02 ). This newly issued accounting standard requires an entity to provide information about the amounts reclassified out of

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accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income (loss) is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income (loss) but only if the amount reclassified is required under U.S. Generally Accepted Accounting Principles ( GAAP ) to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. This ASU is effective for reporting periods beginning after December 15, 2012. The Company adopted this standard in the first quarter of 2013 and presented this information in the condensed consolidated financial statements. The adoption of this standard did not have an impact on the Company's financial position or results of operations.

For a discussion of recent accounting pronouncements adopted by the Company, please refer to Note 2, Significant Accounting Policies, included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, filed with the SEC on March 11, 2013. The Company did not adopt any new accounting pronouncements during the three months ended March 31, 2013 that had a material effect on the Company's condensed consolidated financial statements.

***Subsequent Events***

The Company has evaluated all events or transactions that occurred after March 31, 2013 through the date the Company issued these financial statements.

**(4) Collaborations and License Agreements*****Astellas Pharma***

On February 16, 2011, the Company, together with its wholly-owned subsidiary AVEO Pharma Limited, entered into a Collaboration and License Agreement with Astellas (the Astellas Agreement ), pursuant to which the Company and Astellas plan to develop and commercialize tivozanib, the Company's product candidate currently in phase 3 clinical development, for the treatment of a broad range of cancers, including RCC, breast and colorectal cancers. For a discussion of recent regulatory developments relating to the planned development and commercialization of tivozanib for its lead indication in advanced RCC, see Footnote 10 Subsequent Events. In view of the FDA-related uncertainties described therein, the Company and Astellas are currently evaluating the clinical and regulatory path forward for tivozanib, including Astellas' decision as to whether to submit a MAA for RCC to the EMA.

Under the terms of the Astellas Agreement, the Company and Astellas share responsibility for continued development and commercialization of tivozanib in the United States, Canada and Mexico ( North America ) and in Europe under a joint development plan and a joint commercialization plan, respectively. Throughout the rest of the world (the Royalty Territory ), excluding Asia, where Kyowa Hakko Kirin ( KHK ) has retained all development and commercialization rights, Astellas has an exclusive, royalty-bearing license to develop and commercialize tivozanib. The terms of the Astellas Agreement are subject to the Company's obligations to KHK under a license agreement entered into with KHK in 2006 pursuant to which the Company acquired exclusive rights to develop and commercialize tivozanib worldwide outside of Asia.

If tivozanib is approved by applicable regulatory agencies, the Company will have lead responsibility for formulating the commercialization strategy for North America under the joint commercialization plan, with each of the Company and Astellas responsible for conducting 50% of the sales efforts and medical affairs activities in North America. Astellas will have lead responsibility for commercialization activities in Europe under the joint commercialization plan, with each of the Company and Astellas responsible for conducting 50% of the medical affairs activities in the major European countries. All costs associated with each party's conduct of development and commercialization activities (including clinical manufacturing and commercial manufacturing costs, if any) in North America and Europe, and any resulting profits or losses, are shared equally between the parties.

Under the Astellas Agreement, the Company received an initial cash payment of \$125 million, comprised of a \$75 million license fee and \$50 million in research and development funding. The Company retained net proceeds of approximately \$97.6 million of the initial cash payment from Astellas, after payments to KHK and strategic, legal and financial advisors. In December 2012, the Company received a \$15.0 million milestone payment from Astellas in connection with the acceptance by the FDA of the NDA filing for tivozanib. The milestone was considered substantive and revenue was recognized upon achievement of the milestone. The Company is also eligible to receive from Astellas an aggregate of approximately \$1.3 billion in potential future milestone payments, comprised of (i) up to \$85 million in substantive milestone payments upon achievement of specified clinical and development milestone events, (ii) up to \$475 million in substantive milestone payments upon achievement of specified regulatory milestone events, including up to \$75 million in milestone payments in connection with specified regulatory filings and receipt of marketing approvals, for tivozanib to treat RCC in the United States and Europe, and (iii) up to approximately \$780 million in milestone payments upon the achievement of specified commercial sales events. The first anticipated clinical and development

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milestone is due to the Company upon initiation of its next phase 3 clinical trial of tivozanib in RCC in combination with another therapeutic, or in breast cancer, colorectal cancer or another indication. The timing of this milestone is uncertain, as the Company has not finalized plans for its future trials, and the Company may need to undertake further trials that do not result in any milestone payments coming due. A potential significant near-term regulatory milestone is acceptance by the EMA of the first filing of a MAA (\$15 million), if Astellas elects to submit a MAA to the EMA. In addition, if tivozanib is successfully developed and launched in the Royalty Territory, Astellas will be required to pay to the Company tiered, double digit royalties on net sales of tivozanib in the Royalty Territory, if any, subject to offsets under certain circumstances. The Company is required to pay KHK low to mid-teen royalties on its net sales in North America, and 30% of certain amounts the Company may receive from Astellas in connection with Astellas' development and commercialization activities in Europe and the Royalty Territory, including up-front license fees, milestone payments and royalties.



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Unless terminated earlier in accordance with its terms, the Astellas Agreement expires (a) with respect to the Royalty Territory, on a country-by-country basis, upon the latest to occur of: (i) the expiration of the last-to-expire valid claim of an AVEO patent or joint patent covering the composition of tivozanib, (ii) the expiration of the last-to-expire valid claim of an AVEO patent or joint patent covering the use of tivozanib, but only for so long as no generic competition exists in such country, and (iii) twelve years from first commercial sale of tivozanib in such country; and (b) with respect to North America and Europe as a whole, upon the expiration of all payment obligations between the parties related to development and commercialization of tivozanib in North America and Europe. Astellas has the right to terminate the Astellas Agreement, in its entirety or solely with respect to the Royalty Territory, at any time upon 180 days prior written notice to the Company. Either party may terminate the Astellas Agreement with respect to a specified territory or country as set forth in the Astellas Agreement, if the other party fails to cure a material breach related to such territory or country, as applicable. The Company may also terminate the Astellas Agreement in its entirety upon a patent-related challenge by Astellas, its affiliates or sublicensees if such patent-related challenge is not withdrawn within 30 days following the Company's notice to Astellas of such termination. There are no refund provisions in the Astellas Agreement.

The Company is accounting for the joint development and commercialization activities in North America and Europe as a joint risk-sharing collaboration in accordance with ASC 808, *Collaborative Arrangements*. In addition, these activities were not deemed to be separate deliverables under the Astellas Agreement.

Payments from Astellas with respect to Astellas' share of tivozanib development and commercialization costs incurred by the Company pursuant to the joint development plan are recorded as a reduction to research and development expense and general and administrative expense in the accompanying consolidated financial statements due to the joint risk-sharing nature of the activities in North America and Europe. As a result of the cost-sharing provisions in the Astellas Agreement, the Company reduced research and development expense by \$6.3 million and \$8.0 million during the three months ended March 31, 2013 and 2012, respectively. The Company also reduced general and administrative expense by \$1.3 million and \$0.6 million during the three months ended March 31, 2013 and 2012, respectively, as a result of the cost-sharing provisions in the Astellas Agreement. The net amount due to the Company from Astellas pursuant to the cost-sharing provisions was \$7.2 million at March 31, 2013.

Activities under the Astellas Agreement outside of the joint development and commercialization activities in North America and Europe, including the co-exclusive license to develop and commercialize tivozanib in North America and Europe that was delivered prior to the initiation of the collaborative activities in North America and Europe, were evaluated under ASC 605-25, *Revenue Recognition - Multiple Element Arrangements* (ASC 605-25) (as amended by ASU 2009-13, *Revenue Recognition* (ASU 2009-13)) to determine if they represented a multiple element revenue arrangement. The Astellas Agreement includes the following deliverables: (1) a co-exclusive license to develop and commercialize tivozanib in North America and Europe (the License Deliverable); (2) a combined deliverable comprised of an exclusive royalty-bearing license to develop and commercialize tivozanib in the Royalty Territory and the Company's obligation to provide access to clinical and regulatory information resulting from the activities in North America and Europe to Astellas for its development and commercialization of tivozanib in the Royalty Territory (the Royalty Territory Deliverable); and (3) the Company's obligation to supply clinical material to Astellas for development of tivozanib in the Royalty Territory (the Clinical Material Deliverable). The License Deliverable is not sublicenseable. Astellas has the right to sublicense the exclusive royalty-bearing license to develop and commercialize tivozanib in the Royalty Territory. The Company's obligation to provide access to clinical and regulatory information as part of the Royalty Territory Deliverable includes the obligation to provide access, upon request, to all clinical data, regulatory filings, safety data and manufacturing data to Astellas for use in the development and commercialization of tivozanib in the Royalty Territory. The Clinical Material Deliverable includes the obligation to supply clinical material to Astellas in accordance with current good manufacturing practices applicable to clinical materials and other relevant regulatory authority requirements, upon request, for the development of tivozanib in the Royalty Territory. All of these deliverables were deemed to have stand-alone value and to meet the criteria to be accounted for as separate units of accounting under ASC 605-25. Factors considered in this determination included, among other things, the subject of the licenses and the research and development and commercial capabilities of Astellas.

The Company allocated the up-front consideration of \$125 million to the deliverables based on management's best estimate of selling price of each deliverable using the relative selling price method as the Company did not have VSOE or TPE of selling price for such deliverables. The Company's best estimate of selling price considered discounted cash flow models, the key assumptions of which included the market opportunity for commercialization of tivozanib in North America and Europe and the Royalty Territory, the probability of successfully developing and commercializing tivozanib, the remaining development costs for tivozanib, and the estimated time to commercialization of tivozanib. The Company's analysis included the following market conditions and entity-specific factors: (a) the specific rights provided under the license to develop and commercialize tivozanib in North America and Europe and the Royalty Territory, (b) the potential indications for tivozanib pursuant to the licenses, (c) the relevant territories for the respective licenses, (d) the stage of development of tivozanib by potential indication and estimated remaining development timelines and costs for each indication, (e) the development risk by indication, (f) the market size by indication, (g) the expected product life of tivozanib assuming commercialization and (h) the competitive environment. More specifically, the Company's discounted cash flow model included an assumption that the Company and Astellas would develop and commercialize tivozanib in North America and Europe as a monotherapy for RCC, and in combination with other known anti-cancer agents for RCC, breast cancer and colorectal cancer. Approximately 70% of the value of tivozanib in the discounted cash flow model was a result of the estimated market

opportunity for tivozanib as a monotherapy for RCC. The market opportunity for commercialization of tivozanib in North America

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and Europe was generated using a patient-based forecasting approach, with key epidemiological, market penetration, dosing, compliance, length of treatment, and pricing assumptions derived from primary and secondary market research. While the RCC monotherapy opportunity represented the majority of the market opportunity, clinical trials for tivozanib in the breast cancer and colorectal cancer indications were in earlier stages of development and therefore had more development risk and were assigned a lower probability of success relative to the RCC indication, with a longer timeline to potential cash inflows. The probability of successfully developing and commercializing tivozanib in the various indications throughout the world (other than Asia) was estimated based on standard industry averages for similar product candidates being developed for oncology indications. The remaining development costs were estimated based upon budgets and estimated costs for ongoing and planned clinical trials in all contemplated indications. The time to commercialization was based on the Company's estimates, which projected the launch of tivozanib for RCC monotherapy in 2013. The market opportunity for the Royalty Territory was estimated based upon a specified percentage of total projected European sales and costs of tivozanib. The Company believes that this method for estimating market opportunity outside of North America, Europe and Asia is common in the pharmaceuticals industry. The Company utilized a discount rate of 15% in its analysis, representing the weighted average cost of capital derived from returns on equity for comparable companies.

The Company concluded that a change in the key assumptions used to determine best estimate of selling price for each license deliverable would not have a significant effect on the allocation of arrangement consideration.

The Company allocated up-front consideration of \$120.2 million to the License Deliverable and up-front consideration of \$4.8 million to the Royalty Territory Deliverable. The relative selling price of the Company's obligation under the Clinical Material Deliverable had *de minimis* value.

The Company recorded the \$120.2 million relative selling price of the License Deliverable as collaboration revenue during the three months ended March 31, 2011 upon delivery of the license, and deferred approximately \$4.8 million of revenue representing the relative selling price of the Royalty Territory Deliverable. The Company is recording the \$4.8 million of revenue attributed to the Royalty Territory Deliverable ratably over the Company's period of performance through April 2022, the remaining patent life of tivozanib. The Company estimated the period of performance considering that the Company and Astellas plan to develop tivozanib in several indications outside of RCC, including in breast cancer and colorectal cancer and potentially in other cancer indications. The clinical development of tivozanib in these indications is in earlier stages of development and, as a result, the clinical development timeline is uncertain and is expected to change as the Company obtains additional clinical data in these indications. As a result, the Company estimated the period of performance as the remaining patent life of tivozanib as it represents the longest period over which development of tivozanib could occur. The Company reassesses the period of performance at each reporting period. The Company recorded approximately \$107,000 of revenue associated with the Royalty Territory Deliverable during each of the three month periods ended March 31, 2013 and 2012.

The Company believes the clinical and development and regulatory milestones that may be achieved under the Astellas Agreement are consistent with the definition of a milestone included in ASU 2010-17, *Revenue Recognition - Milestone Method*, and, accordingly, the Company will recognize payments related to the achievement of such milestones, if any, when such milestone is achieved. Factors considered in this determination included scientific and regulatory risks that must be overcome to achieve each milestone, the level of effort and investment required to achieve each milestone, and the monetary value attributed to each milestone. The Company did not recognize any milestone payments under the Astellas arrangement during the three months ended March 31, 2013 or 2012.

***Biogen Idec International GmbH***

In March 2009, the Company entered into an exclusive option and license agreement with Biogen Idec International GmbH, a subsidiary of Biogen Idec Inc., collectively referred to herein as "Biogen Idec", regarding the development and commercialization of the Company's discovery-stage ErbB3-targeted antibodies for the potential treatment and diagnosis of cancer and other diseases outside of North America.

The Company accounts for the Biogen Idec arrangement pursuant to ASC 605-25. The deliverables under the arrangement include an option for a co-exclusive, worldwide license to develop and manufacture ErbB3 antibody products and an option for an exclusive license to commercialize ErbB3 antibody products in all countries in the world other than North America. The Company determined that these deliverables did not have standalone value due to the fact that the program was still in preclinical development and required the Company's experience to advance development of the product. As such, the Company determined that the agreement should be accounted for as one unit of accounting.

Under the terms of the agreement, Biogen Idec paid the Company an up-front cash payment of \$5.0 million in March 2009, which is being amortized over the Company's period of substantial involvement, defined as the patent life of the development candidate. In addition, Biogen Idec purchased 7,500,000 shares of Series E Convertible Preferred Stock at a per share price of \$4.00,



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resulting in gross proceeds to the Company of \$30.0 million. In connection with the initial public offering consummated by the Company in March 2010 and the related 1:4 reverse stock split of the common stock, each four shares of outstanding Series E Convertible Preferred Stock were converted into one share of common stock. The Company determined that the price of \$4.00 paid by Biogen Idec included a premium of \$1.09 per share over the fair value of the Series E Convertible Preferred Stock of \$2.91 as calculated by the Company in its retrospective stock valuation. Accordingly, the Company is recognizing the premium of \$8.2 million as revenue on a straight-line basis over the period of substantial involvement. The Company earned a \$5.0 million milestone payment for achievement of the first pre-clinical discovery milestone under the agreement in June 2009 which was not considered at risk and was therefore deferred and is being recognized over the period of substantial involvement. The Company earned a second \$5.0 million milestone payment upon selection of a development candidate in March 2010. This milestone was considered substantive and was included in revenue for the quarter ended March 31, 2010. The Company earned a third \$5.0 million milestone payment based on achieving the GLP toxicology initiation milestone in June 2011. This milestone was considered substantive and was included in revenue for the quarter ended June 30, 2011. The Company could also receive an option exercise fee and regulatory milestone payments of up to \$45.0 million in the aggregate if Biogen Idec exercises its option to obtain exclusive rights to commercialize ErbB3 antibody products in its territory. The first regulatory milestone that the Company may receive pursuant to this agreement of \$25.0 million is due upon the receipt of the first regulatory approval of a licensed product from the EMA. The Company does not expect to achieve this milestone in the near future. The Company did not earn any milestones under the Biogen arrangement during the three months ended March 31, 2013 or 2012.

If Biogen Idec exercises its exclusive option under the agreement, Biogen Idec will pay the Company royalties on Biogen Idec's sales of ErbB3 antibody products in its territory, and the Company will pay Biogen Idec royalties on the Company's sale of ErbB3 antibody products in North America.

Under the agreement, the Company recorded revenue of \$0.2 million for the three months ended March 31, 2013 and 2012, respectively.

***OSI Pharmaceuticals Inc.***

In September 2007, the Company entered into a collaboration and license agreement with OSI Pharmaceuticals, Inc. (a wholly-owned subsidiary of Astellas US Holding Inc., a holding company owned by Astellas Pharma Inc.), or OSI, which provided for the use of the Company's proprietary *in vivo* models by the Company's scientists at its facilities, use of the Company's bioinformatics tools and other target validation and biomarker research to further develop and advance OSI's small molecule drug discovery and translational research related to cancer and other diseases. In July 2009, the Company and OSI expanded the strategic partnership, and the Company granted OSI a non-exclusive license to use the Company's proprietary bioinformatics platform, and non-exclusive perpetual licenses to use bioinformatics data and the Company's proprietary gene index related to a specific target pathway. Further, as part of the expanded strategic partnership, the Company granted OSI an option, exercisable upon payment of an option fee, to receive non-exclusive perpetual rights to certain elements of the Company's Human Response Platform and to use the Company's bioinformatics platform, and the Company granted OSI the right to obtain certain of its tumor models and tumor archives. In November 2010, OSI exercised its option under the July 2009 expanded agreement providing the right for OSI to license certain elements of the Company's proprietary technology platform, including components of the Human Response Platform for the identification/characterization of novel epithelial-mesenchymal transition agents and proprietary patient selection biomarkers, in support of OSI's clinical development programs. The Company received \$12.5 million of upfront payments from OSI and research funding payments on a quarterly basis that were recognized as revenue through July 2011. In addition, OSI purchased 1,833,334 shares of the Company's Series C Convertible Preferred Stock and 3,750,000 shares of the Company's Series E Convertible Preferred Stock that were converted into shares of common stock upon the Company's initial public offering. The Company determined that both equity issuances included a premium, which was recognized as additional license revenue through July 2011. The Company completed the transfer of the relevant technology to OSI in July 2011. The Company recognized \$25.0 million relating to the option exercise by OSI over the technology transfer period, which was completed in July 2011.

Under the July 2009 expanded agreement, if all applicable milestones are achieved, all remaining payments for the successful achievement of discovery, development and commercialization milestones could total, in the aggregate, over \$46.0 million, comprised of approximately (i) \$8.4 million in substantive milestone payments upon achievement of specified clinical and development milestone events, (ii) \$20.7 million in substantive milestone payments upon achievement of specified regulatory milestone events, and (iii) \$17.5 million in milestone payments upon the achievement of specified sales events. In addition, the Company is eligible to receive up to \$24.0 million in biomarker-related milestones.

In March 2011, the Company earned \$1.5 million related to achieving certain of the biomarker-related milestones under the agreement. These milestones were not considered to be substantive; therefore, the \$1.5 million in payments was deferred and was recognized ratably through July 2011. In May 2012, the Company earned a patent-related milestone payment of \$250,000 upon filing of a patent application by OSI, and the Company also earned a clinical and development milestone payment of \$750,000 for commencement by OSI of GLP toxicology studies. Since these milestones were considered substantive, they were recorded as revenue during the year ended December 31, 2012.



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The next milestone payment that the Company may receive pursuant to this agreement is a \$2.0 million clinical and development milestone for phase 1 clinical trial dosing in the United States. The Company does not expect to achieve this milestone in the near future. The next regulatory milestone payment the Company may receive pursuant to this agreement is \$7.0 million to be achieved for the filing of an NDA with the FDA. The Company does not expect to achieve this milestone in the near future. Upon commercialization of products under the agreement, the Company is eligible to receive tiered royalty payments on sales of products by OSI, its affiliates and sublicensees. All milestone payments earned prior to July 2011 are for selection of targets, delivery of models, delivery of tumor archives or delivery of cell lines.

***Centocor Ortho Biotech***

In May 2011, the Company entered into an exclusive license agreement (the Centocor License Agreement) with Centocor Ortho Biotech Inc. (Centocor), for the worldwide development and commercialization of the Company's internally-discovered antibodies targeting the RON receptor (Recepteur d'Origine Nantais), including the grant to Centocor of an exclusive, worldwide license to the Company's proprietary RON-driven tumor models. The Company also granted Centocor a non-exclusive, non-sublicensable, worldwide license to the Company's proprietary list of human genes intended to predict correlation of response to RON-targeted antibodies (the RON index). On September 7, 2012, the Company received notice from Centocor of termination of the Centocor License Agreement, effective on December 6, 2012, at which point all rights to and the responsibility for future research and development, manufacturing and commercialization activities and costs of the RON antibody program granted to Centocor under the Centocor License Agreement returned to the Company.

In connection with the Centocor License Agreement, the Company received a one-time cash payment in the amount of \$7.5 million and a separate equity investment in the amount of approximately \$7.5 million through the purchase by Johnson & Johnson Development Corporation, an affiliate of Centocor, of 438,340 newly issued shares of the Company's common stock at a purchase price of \$17.11 per share. Centocor also funded certain research which the Company conducted during the term of the Centocor License Agreement, which, as noted above, terminated on December 6, 2012.

As the relative selling price of the RON license and RON Index license (the delivered items) exceeded the up-front consideration attributable to the deliverables of \$7.0 million, the entire up-front payment was recognized as revenue upon delivery of the licenses during the three months ended June 30, 2011.

The Company has not recognized any revenue related to milestones under this arrangement and does not expect to recognize any revenue related to milestones in the future as a result of the termination of the agreement effective December 6, 2012. Under the agreement, the Company received cash payments related to research and development services of \$0.7 million for the three months ended March 31, 2012, and recorded revenue of \$0.5 million for the three months ended March 31, 2012.

***Kirin Brewery***

In December 2006, the Company entered into an exclusive license agreement, with the right to grant sublicensees, subject to certain restrictions, with Kirin Brewery Co. Ltd. (now Kyowa Hakko Kirin) (KHK) to research, develop, manufacture and commercialize tivozanib, pharmaceutical compositions thereof and associated biomarkers in all territories in the world except for Asia (the KHK Agreement). Upon entering into the KHK Agreement, the Company made a cash payment in the amount of \$5.0 million.

In March 2010, the Company made a \$10.0 million milestone payment to KHK in connection with the dosing of the first patient in the Company's phase 3 clinical trial of tivozanib. The Company recorded \$22.5 million of research and development expense during the year ended December 31, 2011 associated with a payment made to KHK related to the up-front license payment received under the Astellas Agreement. In December 2012, the Company made a \$12.0 million milestone payment to KHK in connection with the acceptance by the FDA of the Company's NDA filing for tivozanib, all of which was expensed as research and development expense during the year ended December 31, 2012. In connection with this payment, \$6.0 million was reimbursed from Astellas and recorded as a reduction of research and development expense.

Under the KHK Agreement, the Company may be required to (i) make future milestone payments upon the achievement of specified regulatory milestones in the United States, (ii) pay tiered royalty payments on net sales it makes of tivozanib in its territory ranging from the low to mid-teens as a percentage of the Company's net sales of tivozanib, and (iii) pay 30% of certain amounts the Company receives under the Astellas Agreement in connection with Astellas' development and commercialization activities in Europe and the Royalty Territory related to tivozanib, including up-front license fees, milestone payments and royalties the Company may receive from Astellas (including a potential \$4.5 million milestone payable to KHK in connection with the acceptance by the EMA of the filing of a MAA and \$9.0 million to KHK in connection with the EMA granting marketing approval in Europe), other than amounts the Company receives in respect of research and development funding or equity investments, subject to certain limitations.





**Table of Contents****(5) Accrued Expenses**

Accrued expenses consisted of the following as of March 31, 2013 and December 31, 2012:

	March 31, 2013	
	(in thousands)	
\$		6,22
		3,02
Investments in marketable securities, net		(17,97
Investing activities		(741,81
<b>FINANCING ACTIVITIES:</b>		
		2,858,50
		(2,524,72
		842,50
		(332,60
backed		1,126,92
		(1,703,77
		(3,92
based		(27,36
		12,10
non		22,94
		(186,32
financing activities		84,26
on cash and cash equivalents		(4,49
ents		100,45
860 and ASC 810		
inning of period		139,11
\$		239,57

d of

W INFORMATION:

\$

177,30

\$

87,18

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, 2010, filed with the SEC on February 28, 2011. With respect to information concerning principal geographic areas, revenues are attributed to respective countries based on the location of the subsidiary, which generally correlates with the location of the customer.

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, fraud losses of \$0.9 million and \$2.8 million for the three and nine months ended September 30, 2010, respectively, have been reclassified from provision for loan loss to cost of operations in the prior period financial statements to conform to the current year presentation. Such reclassifications have no impact on previously reported net income.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In October 2009, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2009-13, “Multiple-Deliverable Revenue Arrangements,” which supersedes certain guidance in Accounting Standards Codification (“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 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 is effective for revenue arrangements entered into or materially modified beginning on or after January 1, 2011. The Company elected to adopt this ASU prospectively. Revenue associated with the service element of the Company’s AIR MILES® Reward Program has historically been determined using the residual method. Based on the sponsor contracts expected to be signed, renewed or materially modified in 2011, the adoption of ASU 2009-13 did not and is not expected to have a material impact on the Company’s unaudited condensed consolidated financial statements for 2011. Should one of the AIR MILES Reward Program’s top five sponsors materially modify its agreement with the Company in 2011, it could significantly shift the allocation of deferred revenue between the service element and redemption element. This change in allocation between the deferred revenue elements could impact the timing of revenue recognition, as the redemption element is recognized as AIR MILES reward miles are redeemed while the service element is recognized on a pro-rata basis over the estimated life of an AIR MILES reward mile, or 42 months.

In April 2011, the FASB issued ASU 2011-02, “Receivables (Topic 310): A Creditor’s Determination of Whether a Restructuring Is a Troubled Debt Restructuring.” ASU 2011-02 provides additional guidance to creditors for evaluating whether a modification or restructuring of a receivable is a Troubled Debt Restructuring (“TDR”) and also requires additional disclosures about TDR activities along with the disclosures required by ASU 2010-20, “Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses,” that were previously deferred. The amendments in ASU 2011-02 were effective for the first interim or annual period beginning on or after June 15, 2011 and are applied retrospectively to the beginning of the annual period of adoption. For purposes of measuring impairment of receivables that are newly considered impaired as a

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result of ASU 2011-02, the amendments are applied prospectively for the first interim or annual period beginning on or after June 15, 2011. The adoption of ASU 2011-02 did not have a material impact on the Company's financial condition, results of operations or cash flows.

In May 2011, the FASB issued ASU 2011-04, "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards ("IFRS")", which amends ASC 820, "Fair Value Measurement." ASU 2011-04 revises the application of the valuation premise of highest and best use of an asset. It also enhances disclosure requirements and will require entities to disclose, for their recurring Level 3 fair value measurements, quantitative information about unobservable inputs used, a description of the valuation processes used by the entity and a qualitative discussion about the sensitivity of the measurements. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011 and will require prospective application. The Company does not expect the adoption of ASU 2011-04 to have a material impact on the Company's financial condition, results of operations or cash flows.

In June 2011, the FASB issued ASU 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income." ASU 2011-05 eliminates the current option to report other comprehensive income and its components in the statement of changes in equity and requires the presentation of net income and other comprehensive income in one continuous statement or in two separate, but consecutive, statements. ASU 2011-05 is effective for interim and annual periods beginning after December 31, 2011. Early adoption is permitted but full retrospective application is required. ASU 2011-05 only impacts financial statement presentation; accordingly, it will have no impact on the Company's financial condition, results of operations or cash flows.

In September 2011, the FASB issued ASU 2011-08, "Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment," which amends ASC 350, "Intangibles – Goodwill and Other." ASU 2011-08 adds a qualitative assessment to the annual goodwill impairment test, providing the option of first performing a qualitative assessment in testing goodwill for impairment before calculating the fair value of the reporting unit. A company will be required to perform the current quantitative two-step impairment test if, based on the qualitative assessment, it determines that more likely than not, the fair value of the reporting unit is not less than the carrying value. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. ASU 2011-08 only impacts the process of testing goodwill for impairment; accordingly, it will have no impact on the Company's financial condition, results of operations or cash flows.

### 3. 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		Nine Months Ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
	(In thousands, except per share amounts)			
Numerator:				
Net Income	\$ 93,981	\$ 53,059	\$ 249,380	\$ 147,033
Denominator:				
Weighted average shares, basic	50,644	52,584	50,948	52,743
Weighted average effect of dilutive securities:				
	5,138	1,454	4,195	1,785

Shares from assumed conversion of convertible senior notes				
Shares from assumed conversion of convertible note warrants	1,750	—	1,306	—
Net effect of dilutive stock options and unvested restricted stock	1,047	1,180	928	1,292
Denominator for diluted calculations	58,579	55,218	57,377	55,820
Basic net income per share	\$ 1.86	\$ 1.01	\$ 4.89	\$ 2.79
Diluted net income per share	\$ 1.60	\$ 0.96	\$ 4.35	\$ 2.63

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The Company calculates the effect of its convertible senior notes, consisting of \$805.0 million aggregate principal amount of convertible senior notes due 2013 (the “Convertible Senior Notes 2013”) and \$345.0 million aggregate principal amount of convertible senior notes due 2014 (the “Convertible Senior Notes 2014”), 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.

Concurrently with the issuance of the Convertible Senior Notes 2013 and the Convertible Senior Notes 2014, the Company entered into hedge transactions which are generally expected to offset the potential dilution of the shares from assumed conversion of convertible senior notes.

The Company is also party to prepaid forward contracts to purchase 1,857,400 shares of its common stock 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.

For the three and nine months ended September 30, 2011, the Company excluded 10.3 million warrants, respectively, from the calculation of net income per share as the effect was anti-dilutive. For the three and nine months ended September 30, 2010, the Company excluded 17.5 million warrants, respectively, from the calculation of net income per share as the effect was anti-dilutive.

#### 4. ACQUISITION

On May 31, 2011, the Company acquired all of the stock of Aspen Marketing Holdings, Inc. (“Aspen”). Aspen specializes in a full range of digital and direct marketing services, including the use of advanced analytics to perform data-driven customer acquisition and retention campaigns. Aspen is also a leading provider of marketing agency services, with expertise in the automotive and telecommunications industries. The results of Aspen have been included since the date of acquisition and are reflected in the Company’s Epsilon® segment. The acquisition enhances Epsilon’s core capabilities, strengthens its competitive advantage, expands Epsilon into new industry verticals and adds a strong, talented team of marketing professionals.

The final purchase price for Aspen was \$359.1 million, net of \$13.5 million of cash and cash equivalents acquired. The purchase was subject to customary working capital adjustments, which were finalized in August 2011, resulting in a \$0.9 million increase to goodwill. The goodwill resulting from the acquisition is not deductible for tax purposes. The following table summarizes the allocation of the consideration and the respective fair values of the assets acquired and liabilities assumed in the Aspen acquisition as of the date of purchase:

	As of May 31, 2011 (In thousands)
Current assets	\$ 39,924
Property and equipment	4,829
Other assets	1,600
Capitalized software	24,000
Intangible assets	140,000
Goodwill	232,910
Total assets acquired	443,263

Current liabilities	30,099
Other liabilities	3,904
Deferred tax liabilities	50,184
Total liabilities assumed	84,187
Net assets acquired	\$ 359,076

As part of the acquisition, the Company assumed two interest rate caps with a notional amount of \$42.5 million that were to mature November 2012. The derivatives did not qualify for hedge accounting treatment and were terminated in July 2011. The fair value of the derivatives from May 31, 2011 through termination was de minimis.

Additionally, at the date of the acquisition, Aspen had a tax net operating loss carryforward totaling approximately \$140 million resulting from a previous merger. This potential tax benefit is contingent on the prior merger qualifying as a reorganization under Internal Revenue Code section 368. At this time, the potential tax benefits from the tax net operating loss carryforward have not been recognized in the Company's unaudited condensed consolidated financial statements.



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## 5. CREDIT CARD RECEIVABLES

The Company's credit card receivables are the only portfolio segment or class of financing receivables. Quantitative information about the components of total credit card receivables is presented in the table below:

	September 30, 2011	December 31, 2010
	(In thousands)	
Principal receivables	\$ 4,741,569	\$ 5,116,111
Billed and accrued finance charges	205,412	214,643
Other receivables	27,846	25,669
Total credit card receivables	4,974,827	5,356,423
Less credit card receivables – restricted for securitization investors	4,342,167	4,795,753
Other credit card receivables	\$ 632,660	\$ 560,670

## Allowance for Loan Loss

The Company maintains an allowance for loan loss at a level that is appropriate to absorb probable losses inherent in credit card receivables. The allowance for loan loss covers forecasted uncollectable principal as well as unpaid interest and fees. The allowance for loan loss is evaluated monthly for adequacy.

In estimating the allowance for principal loan losses, 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 allowance is maintained through an adjustment to the provision for loan losses. Charge-offs of principal amounts, net of recoveries are deducted from the allowance.

Net charge-offs include the principal amount of losses from credit cardholders unwilling or unable to pay their account balances, as well as bankrupt and deceased credit cardholders, less recoveries and exclude charged-off interest, fees and fraud losses. Charged-off interest and fees reduce finance charges, net while fraud losses are recorded as an expense. Credit card receivables, including unpaid interest and fees, 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 or death. Credit card receivables, including unpaid interest and fees, associated with customer bankruptcies or death are charged-off at the end of each month subsequent to 60 days after the receipt of notification of the bankruptcy or death, but in any case, not later than the 180-day contractual time frame.

The Company records the actual charge-offs for unpaid interest and fees as a reduction to finance charges, net. For the three and nine months ended September 30, 2011 and 2010, actual charge-offs for unpaid interest and fees were \$43.3 million, \$147.8 million and \$49.3 million, \$163.8 million, respectively. In estimating the allowance for uncollectable unpaid interest and fees, the Company utilizes historical charge-off trends, analyzing actual charge-offs for the prior three months. The allowance is maintained through an adjustment to finance charges, net.

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In evaluating the allowance for loan loss for both principal and unpaid interest and fees, management also considers factors that may impact loan loss experience, including seasoning, loan volume and amounts, payment rates and forecasting uncertainties. The following table presents the Company's allowance for loan loss for the periods indicated:

	Three Months Ended		Nine Months Ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
	(In thousands)			
Balance at beginning of period	\$ 461,015	\$ 526,845	\$ 518,069	\$ 54,884
Adoption of ASC 860 and ASC 810	—	—	—	523,950
Provision for loan loss	70,697	89,559	198,739	272,259
Change in estimate for uncollectible unpaid interest and fees	(5,000)	—	(5,000)	—
Recoveries	20,858	18,762	68,600	61,546
Principal charge-offs	(93,905)	(120,870)	(326,743)	(398,343)
Other	(5,000)	—	(5,000)	—
Balance at end of period	\$ 448,665	\$ 514,296	\$ 448,665	\$ 514,296

## Delinquencies

A credit card account is contractually delinquent if the Company does not receive the minimum payment by the specified due date on the cardholder's statement. It is the Company's policy to continue to accrue interest and fee income on all credit card accounts beyond 90 days, except in limited circumstances, until the credit card account balance and all related interest and other fees are paid or charged off, typically at 180 days delinquent. When an account becomes delinquent, a message is printed on the credit 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 becoming further delinquent. 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 the Company is unable to make a collection after exhausting all in-house collection efforts, the Company will engage collection agencies and outside attorneys to continue those efforts.

The following table presents the delinquency trends of the Company's credit card portfolio:

	September 30, 2011	% of Total	December 31, 2010	% of Total
	(In thousands, except percentages)			
Receivables outstanding – principal	\$ 4,741,569	100%	\$ 5,116,111	100%
Principal receivables balances contractually delinquent:				
31 to 60 days	79,154	1.6%	87,252	1.7%
61 to 90 days	50,624	1.1	59,564	1.2
91 or more days	103,230	2.2	130,538	2.5
Total	\$ 233,008	4.9%	\$ 277,354	5.4%

## Modified Credit Card Receivables

The Company holds certain credit card receivables for which the terms have been modified. Interest income on these modified loans is accounted for in the same manner as other accruing loans. Cash collections on these modified loans are allocated according to the same payment hierarchy methodology applied to loans that are not in such programs. The Company's modified credit card loans include loans for which temporary hardship concessions have been granted and loans in permanent workout programs. These modified loans include concessions consisting primarily of a reduced minimum payment and an interest rate reduction. The temporary programs' concessions remain in place for a period no longer than twelve months, while the permanent programs remain in place through the payoff of the loan if the credit cardholder complies with the terms of the program. These concessions do not include the forgiveness of unpaid principal, but may involve the reversal of certain unpaid interest or fee assessments. In the case of the temporary programs, at the end of the concession period, loan terms revert to standard rates. These arrangements are automatically terminated if the customer fails to make payments in accordance with the terms of the program, at which time their account reverts back to its original terms. In assessing the appropriate allowance for loan loss, these loans are included in the general pool of credit

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cards with the allowance determined under the contingent loss model of ASC 450-20, "Loss Contingencies." If the Company applied accounting standards under ASC 310-40, "Troubled Debt Restructurings by Creditors," to loans in these programs, there would not be a significant difference in the allowance for loan loss. Credit card receivables for which temporary and permanent concessions were granted comprised \$126.2 million, or less than 3%, of the Company's total credit card receivables at September 30, 2011.

The following tables indicate the modifications related to troubled debt restructurings within credit card receivables as of the three and nine months ended September 30, 2011:

	Three Months Ended September 30, 2011			Nine Months Ended September 30, 2011		
	Number of Restructurings	Pre-modification Outstanding Principal Balance	Post-modification Outstanding Principal Balance	Number of Restructurings	Pre-modification Outstanding Principal Balance	Post-modification Outstanding Principal Balance
Troubled debt restructurings – credit card receivables	36,576	\$ 32,665	\$ 31,398	119,614	\$ 104,483	\$ 101,019

(Dollars in thousands)

	Three Months Ended September 30, 2011		Nine Months Ended September 30, 2011	
	Number of Restructurings	Outstanding Balance	Number of Restructurings	Outstanding Balance
Troubled debt restructurings that subsequently defaulted – credit card receivables(1)	12,627	\$ 11,413	20,899	\$ 18,953

(Dollars in thousands)

(1) Represents those troubled debt restructurings that occurred since January 1, 2011 that have defaulted during the reporting period.

#### Age of Credit Card Receivables

The following table sets forth, as of September 30, 2011, the number of active credit card accounts with balances and the related principal balances outstanding based upon the age of the active credit card accounts from origination:

Age Since Origination	Number of Active Accounts with Balances	Percentage of Active Accounts with Balances	Principal Receivables Outstanding	Percentage of Receivables Outstanding
0-12 Months	2,883,748	24.8%	\$ 929,383	19.6%

(Dollars in thousands)

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13-24 Months	1,516,285	13.1	603,421	12.7
25-36 Months	1,198,243	10.3	573,477	12.1
37-48 Months	957,825	8.2	427,124	9.0
49-60 Months	793,908	6.8	358,624	7.6
Over 60 Months	4,269,538	36.8	1,849,540	39.0
Total	11,619,547	100.0%	\$ 4,741,569	100.0%

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## Credit Quality

The Company uses proprietary scoring models developed specifically for the purpose of monitoring the Company's obligor credit quality. The proprietary scoring model is used as a tool in the underwriting process and for making credit decisions. The proprietary scoring model is based on historical data and requires various assumptions about future performance. Information regarding customer performance is factored into these proprietary scoring models to determine the probability of an account becoming 90 or more days past due at any time within the next 12 months. Obligor credit quality is monitored at least monthly during the life of an account. The following table reflects composition by obligor credit quality as of September 30, 2011:

Probability of an Account Becoming 90 or More Days Past Due or Becoming Charged off (within the next 12 months)	Total Principal Receivables Outstanding	Percentage of Principal Receivables Outstanding
	(In thousands, except percentages)	
No Score	\$ 80,233	1.7%
27.1% and higher	274,486	5.8
17.1% - 27.0%	467,977	9.9
12.6% - 17.0%	561,270	11.8
3.7% - 12.5%	1,951,653	41.2
1.9% - 3.6%	916,800	19.3
Lower than 1.9%	489,150	10.3
Total	\$ 4,741,569	100.0%

## Securitized Credit Card Receivables

The Company regularly securitizes its credit card receivables through its credit card securitization trusts, consisting of World Financial Network Credit Card Master Trust, World Financial Network Credit Card Master Note Trust, World Financial Network Credit Card Master Note Trust II and World Financial Network Credit Card Master Trust III (collectively, the "WFN Trusts"), and World Financial Capital Credit Card Master Note Trust (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 card receivables, collect payments, and charge-off uncollectable receivables. These fees are eliminated and therefore are not reflected in the unaudited condensed consolidated statements of income for the three and nine months ended September 30, 2011 and 2010.

The WFN Trusts and the WFC Trust are variable interest entities ("VIEs") and the assets of these consolidated VIEs include certain credit card receivables that 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.

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

September 30, 2011	December 31, 2010
-----------------------	----------------------

	(In thousands)	
Total credit card receivables – restricted for securitization investors	\$ 4,342,167	\$ 4,795,753
Principal amount of credit card receivables – restricted for securitization investors, 90 days or more past due	\$ 93,820	\$ 117,594

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(In thousands)			
Net charge-offs of securitized principal	\$ 65,993	\$ 91,467	\$ 231,919	\$ 297,476

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## Portfolio Acquisition

In February 2011, World Financial Capital Bank, one of the Company's wholly-owned subsidiaries, acquired the existing private label credit card portfolio of J.Jill and entered into a multi-year agreement to provide private label credit card services. The total purchase price was approximately \$42.7 million, which consisted of \$37.9 million of credit card receivables and \$4.8 million of intangible assets that are included in the unaudited condensed consolidated balance sheets as of September 30, 2011.

## 6. 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, 2011				December 31, 2010			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cost	Unrealized Gains	Unrealized Losses	Fair Value
(In thousands)								
Cash and cash equivalents	\$ 38,770	\$ —	\$ —	\$ 38,770	\$ 74,612	\$ —	\$ —	\$ 74,612
Government bonds	4,858	178	—	5,036	15,235	161	(34)	15,362
Corporate bonds (1)	397,072	8,790	(1,034)	404,828	380,605	3,212	(1,363)	382,454
Total	\$ 440,700	\$ 8,968	\$ (1,034)	\$ 448,634	\$ 470,452	\$ 3,373	\$ (1,397)	\$ 472,428

(1) As of September 30, 2011 and December 31, 2010, LoyaltyOne® had investments in retained interests in the WFN Trusts with a fair value of \$64.9 million in each case. These amounts are eliminated and therefore not reflected in the unaudited condensed consolidated financial statements and notes thereof as of September 30, 2011 and December 31, 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, 2011 and December 31, 2010, aggregated by investment category and the length of time that individual securities have been in a continuous loss position:

	Less than 12 months		September 30, 2011 12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(In thousands)						
Corporate bonds	\$ 10,753	\$ (1,023)	\$ 13,533	\$ (11)	\$ 24,286	\$ (1,034)
Total	\$ 10,753	\$ (1,023)	\$ 13,533	\$ (11)	\$ 24,286	\$ (1,034)



	Less than 12 months		December 31, 2010 12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Government bonds	\$ 10,119	\$ (34)	\$ —	\$ —	\$ 10,119	\$ (34)
Corporate bonds	128,349	(1,363)	—	—	128,349	(1,363)
Total	\$ 138,468	\$ (1,397)	\$ —	\$ —	\$ 138,468	\$ (1,397)

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 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, 2011, the Company does not consider the investments to be other-than-temporarily impaired.

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The net carrying value and estimated fair value of the redemption settlement assets at September 30, 2011 by contractual maturity are as follows:

	Amortized Cost	Estimated Fair Value
	(In thousands)	
Due in one year or less	\$ 65,546	\$ 65,151
Due after one year through five years	375,154	383,483
<b>Total</b>	<b>\$ 440,700</b>	<b>\$ 448,634</b>

## 7. INTANGIBLE ASSETS AND GOODWILL

## Intangible Assets

Intangible assets consist of the following:

	September 30, 2011			
	Gross Assets	Accumulated Amortization (In thousands)	Net	Amortization Life and Method
<b>Finite Lived Assets</b>				
Customer contracts and lists	\$ 316,245	\$ (134,361)	\$ 181,884	3-12 years—straight line
Premium on purchased credit card portfolios	156,203	(78,087)	78,116	3-10 years—straight line, accelerated
Collector database	66,664	(59,020)	7,644	30 years—15% declining balance
Customer database	175,391	(91,281)	84,110	4-10 years—straight line
Noncompete agreements	1,024	(911)	113	2-3 years—straight line
Tradenames	38,141	(6,649)	31,492	5-15 years—straight line
Purchased data lists	23,119	(15,559)	7,560	1-5 years—straight line, accelerated
	<b>\$ 776,787</b>	<b>\$ (385,868)</b>	<b>\$ 390,919</b>	
<b>Indefinite Lived Assets</b>				
Tradenames	12,350	—	12,350	Indefinite life
<b>Total intangible assets</b>	<b>\$ 789,137</b>	<b>\$ (385,868)</b>	<b>\$ 403,269</b>	

	December 31, 2010			
	Gross Assets	Accumulated Amortization (In thousands)	Net	Amortization Life and Method
<b>Finite Lived Assets</b>				
Customer contracts and lists	\$ 211,413	\$ (123,932)	\$ 87,481	5-10 years—straight line
Premium on purchased credit card portfolios	151,430	(63,115)	88,315	3-10 years—straight line, accelerated
Collector database	70,211	(61,075)	9,136	30 years—15% declining balance
Customer database	175,397	(76,002)	99,395	4-10 years—straight line
Noncompete agreements	1,062	(668)	394	2-3 years—straight line

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Tradenames	14,169	(5,070)	9,099	5-10 years—straight line
Purchased data lists	20,506	(12,285)	8,221	1-5 years—straight line, accelerated
	\$ 644,188	\$ (342,147)	\$ 302,041	
<b>Indefinite Lived Assets</b>				
Tradenames	12,350	—	12,350	Indefinite life
Total intangible assets	\$ 656,538	\$ (342,147)	\$ 314,391	

With the J.Jill portfolio acquisition in February 2011, the Company acquired \$4.8 million of intangible assets, consisting of a customer relationship of \$2.6 million and a marketing relationship of \$2.2 million, which are being amortized, in each case, over a weighted average life of 7.0 years. See Note 5, “Credit Card Receivables,” for more information regarding the J.Jill portfolio acquisition.

With the Aspen acquisition on May 31, 2011, the Company acquired \$140.0 million of intangible assets, consisting of \$116.0 million of customer relationships and \$24.0 million of trade names, which are being amortized over a weighted average life of 8.3 years and 15 years, respectively. See Note 4, “Acquisition,” for more information regarding the Aspen acquisition.

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## Goodwill

The changes in the carrying amount of goodwill for the nine months ended September 30, 2011 are as follows:

	LoyaltyOne	Epsilon	Private Label Services and Credit	Corporate/ Other	Total
	(In thousands)				
December 31, 2010	\$ 246,930	\$ 713,161	\$ 261,732	\$ —	\$ 1,221,823
Effects of foreign currency translation	(11,902)	(135)	—	—	(12,037)
Goodwill acquired during the year	—	232,910	—	—	232,910
September 30, 2011	\$ 235,028	\$ 945,936	\$ 261,732	\$ —	\$ 1,442,696

## 8. DEBT

Debt consists of the following:

Description	September 30, 2011	December 31, 2010	Maturity	Interest Rate
	(Dollars in thousands)			
<b>Certificates of deposit:</b>				
Certificates of deposit	\$ 1,369,005	\$ 859,100	Three months to five years	0.10% to 5.25%
Less: current portion	(752,532)	(442,600)		
Long-term portion	\$ 616,473	\$ 416,500		
<b>Asset-backed securities debt – owed to securitization investors:</b>				
Fixed rate asset-backed term note securities	\$ 1,772,815	\$ 1,772,815	Various - Nov 2011 – Jun 2015	3.79% to 7.00%
Floating rate asset-backed term note securities	703,500	1,153,500	Various - Apr 2012 – Apr 2013	— (1)
Conduit asset-backed securities	606,972	733,827	Various - Jun 2012 – Sept 2012	–1.26% to 1.97%
Total asset-backed securities – owed to securitization investors	3,083,287	3,660,142		
Less: current portion	(1,769,122)	(1,743,827)		
Long-term portion	\$ 1,314,165	\$ 1,916,315		
<b>Long-term and other debt:</b>				
2011 credit facility	\$ 495,000	\$ —	May 2016	(2)
2011 term loan	787,547	—	May 2016	(2)
2006 credit facility	—	300,000	—	—
Series B senior notes	—	250,000	—	—
2009 term loan	—	161,000	—	—

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2010 term loan	—	236,000	—	—
Convertible senior notes due 2013	697,977	659,371	August 2013	1.75%
Convertible senior notes due 2014	273,655	257,687	May 2014	4.75%
Capital lease obligations and other debt	41	5,714	July 2013(3)	7.10%(3)
Total long-term and other debt	2,254,220	1,869,772		
Less: current portion	(19,834)	(255,679)		
Long-term portion	\$ 2,234,386	\$ 1,614,093		

(1) 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 interest rate for the floating rate debt is equal to the London Interbank Offered Rate (“LIBOR”) as defined in the respective agreements plus a margin of 0.1% to 2.5% as defined in the respective agreements. The weighted average interest rate of the fixed rate achieved through interest rate swap agreements is 5.75% at September 30, 2011.

(2) At September 30, 2011, the weighted average interest rate for the 2011 Credit Facility and 2011 Term Loan was 2.51% and 2.49%, respectively.

(3) The Company has other minor borrowings, primarily capital leases.

At September 30, 2011, the Company was in compliance with its covenants.

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 NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## 2011 Credit Agreement

The Company is party to a credit agreement, among the Company as borrower, and ADS Alliance Data Systems, Inc., ADS Foreign Holdings, Inc., Alliance Data Foreign Holdings, Inc., Epsilon Marketing Services, LLC, Epsilon Data Management LLC, Comenity LLC and Alliance Data FHC, Inc., as guarantors, SunTrust Bank and Bank of Montreal, as co-administrative agents, and Bank of Montreal as letter of credit issuer, and various other agents and banks, dated May 24, 2011 (the “2011 Credit Agreement”). The 2011 Credit Agreement provides for a \$792.5 million term loan (the “2011 Term Loan”) and a \$792.5 million revolving line of credit (the “2011 Credit Facility”) with a U.S. \$65.0 million sublimit for Canadian dollar borrowings and a \$65.0 million sublimit for swing line loans. The 2011 Credit Agreement includes an uncommitted accordion feature of up to \$415.0 million in the aggregate allowing for future incremental borrowings, subject to certain conditions, for a maximum total facility size of \$2.0 billion, both of which were increased by a subsequent amendment.

The loans under the 2011 Credit Agreement are scheduled to mature on May 24, 2016. The 2011 Term Loan provides for aggregate principal payments equal to 2.5% of the initial term loan amount in each of the first and second year and 5% of the initial term loan amount in each of the third, fourth and fifth year of the term loan, payable in equal quarterly installments beginning September 30, 2011. The 2011 Credit Agreement is unsecured.

Advances under the 2011 Credit Agreement are in the form of either base rate loans or Eurodollar loans and may be denominated in U.S. dollars or Canadian dollars. The interest rate for base rate loans denominated in U.S. dollars fluctuates and is equal to the highest of (i) the Bank of Montreal’s prime rate; (ii) the Federal funds rate plus 0.5% and (iii) the LIBOR rate as defined in the 2011 Credit Agreement plus 1.0%, in each case plus a margin of 0.75% to 1.25% based upon the Company’s senior leverage ratio as defined in the 2011 Credit Agreement. The interest rate for base rate loans denominated in Canadian dollars fluctuates and is equal to the higher of (i) the Bank of Montreal’s prime rate for Canadian dollar loans and (ii) the Canadian Dollar Offered Rate (“CDOR”) plus 1%, in each case plus a margin of 0.75% to 1.25% based upon the Company’s senior leverage ratio as defined in the 2011 Credit Agreement. 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 1.75% to 2.25% based upon the Company’s senior leverage ratio as defined in the 2011 Credit Agreement.

Concurrently with entering into the 2011 Credit Agreement, the Company terminated the following credit facilities: (i) a credit agreement, dated September 29, 2006, which consisted of a \$750.0 million unsecured revolving credit facility (the “2006 Credit Facility”); (ii) a term loan agreement, dated May 15, 2009 (the “2009 Term Loan”); and (iii) a term loan agreement, dated August 6, 2010 (the “2010 Term Loan”). The 2006 Credit Facility, the 2009 Term Loan and the 2010 Term Loan were scheduled to expire on March 30, 2012.

On September 20, 2011, the Company entered into a First Amendment to the 2011 Credit Agreement (the “First Amendment”). The First Amendment, among other things, (a) increases the uncommitted accordion feature to up to \$915.0 million in the aggregate to allow a maximum total facility size of \$2.5 billion, up from \$2.0 billion, (b) permits any incremental term loans to be secured in such collateral as may be agreed to by the Company and the banks advancing the incremental term loans, with the existing loans to be equally and ratably secured in the same collateral, (c) except with respect to terms relating to amortization and pricing of the incremental term loans, requires that the incremental term loans may not otherwise have terms and conditions materially different from those of the existing loans and (d) permits the co-administrative agents, the Company and the banks advancing the incremental term loans to amend the 2011 Credit Agreement, without further consent of any other banks, as necessary to allow the issuance of the incremental term loans.

Total availability under the 2011 Credit Facility at September 30, 2011 was \$297.5 million.

#### Series B Senior Notes

The Company repaid the \$250.0 million aggregate principal amount of the 6.14% Series B senior notes at their scheduled maturity of May 16, 2011.

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## Convertible Senior Notes

The Company has outstanding \$1.15 billion of convertible senior notes, consisting of \$805.0 million scheduled to mature on August 1, 2013 and \$345.0 million scheduled to mature on May 15, 2014. The table below summarizes the carrying value of the components of the convertible senior notes:

	September 30, 2011	December 31, 2010
	(In thousands)	
Carrying amount of equity component	\$ 368,678	\$ 368,678
Principal amount of liability component	\$ 1,150,000	\$ 1,150,000
Unamortized discount	(178,368)	(232,942)
Net carrying value of liability component	\$ 971,632	\$ 917,058
If-converted value of common stock	\$ 1,623,007	\$ 1,243,605

The discount on the liability component will be amortized as interest expense over the remaining life of the convertible senior notes which, at September 30, 2011, is a weighted average period of 2.1 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, 2011 and 2010 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(In thousands, except percentages)			
Interest expense calculated on contractual interest rate	\$ 7,619	\$ 7,619	\$ 22,856	\$ 22,856
Amortization of discount on liability component	18,692	16,752	54,574	48,914
Total interest expense on convertible senior notes	\$ 26,311	\$ 24,371	\$ 77,430	\$ 71,770
Effective interest rate (annualized)	11.0%	11.0%	11.0%	11.0%

## Asset-backed Securities – Owed to Securitization Investors

## Conduit Facilities

During the second quarter of 2011, the Company renewed its \$1.2 billion 2009-VFN conduit facility under World Financial Network Credit Card Master Note Trust and its \$275.0 million 2009-VFN conduit facility under World Financial Capital Credit Card Master Note Trust, extending their maturities to June 13, 2012 and June 1, 2012, respectively.



In September 2011, the Company renewed its 2009-VFC1 conduit facility under World Financial Network Credit Card Master Trust III, extending the maturity to September 28, 2012 and reducing the total capacity from \$550.0 million to \$400.0 million.

#### 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 enter 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.

These interest rate contracts involve the receipt of variable rate amounts from counterparties in exchange for the Company making fixed 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."

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The following tables identify the notional amount, fair value and classification of the Company's outstanding interest rate contracts for the credit card securitization trusts at September 30, 2011 and December 31, 2010 in the unaudited condensed consolidated balance sheets:

	September 30, 2011		December 31, 2010	
	Notional Amount	Weighted Average Years to Maturity (Dollars in thousands)	Notional Amount	Weighted Average Years to Maturity
Interest rate contracts not designated as hedging instruments	\$ 703,500	1.63	\$ 1,153,500	1.72

	September 30, 2011		December 31, 2010	
	Balance Sheet Location	Fair Value (In thousands)	Balance Sheet Location	Fair Value
Interest rate contracts not designated as hedging instruments	Other current liabilities	\$ —	Other current liabilities	\$ 4,574
Interest rate contracts not designated as hedging instruments	Other liabilities	\$ 46,685	Other liabilities	\$ 65,257

The following table summarizes activity related to and identifies the location of the Company's outstanding interest rate contracts for the credit card securitization trusts for the three and nine months ended September 30, 2011 and 2010 recognized in the unaudited condensed consolidated statements of income:

	2011		2010	
	Income Statement Location	Gain on Derivative Contracts (In thousands)	Income Statement Location	Loss on Derivative Contracts
For the three months ended September 30,				
Interest rate contracts not designated as hedging instruments	Securitization funding costs	\$ 8,543	Securitization funding costs	\$ 59
For the nine months ended September 30,				
Interest rate contracts not designated as hedging instruments	Securitization funding costs	\$ 23,146	Securitization funding costs	\$ 5,443

The Company limits its exposure on derivatives by entering into contracts with institutions that are established dealers who maintain certain minimum credit criteria established by the Company. At September 30, 2011, 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, 2011, these thresholds were not breached and no amounts were held as collateral by the Company.

## 9. 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. The Company’s estimate of breakage is 28%.
- **Service element.** The service element consists of marketing and administrative services provided to sponsors. Revenue related to the service element has been determined in accordance with ASU 2009-13. It is initially deferred and then amortized pro rata over the estimated life of an AIR MILES reward mile. With the adoption of ASU 2009-13, the residual method will no longer be utilized for new sponsor agreements entered into on or after January 1, 2011 or existing sponsor agreements that are materially modified subsequent to that date; for these agreements, the Company will measure the service element at its estimated selling price.

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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.

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

	Service	Deferred Revenue Redemption (In thousands)	Total
December 31, 2010	\$ 339,514	\$ 881,728	\$ 1,221,242
Cash proceeds	163,534	395,201	558,735
Revenue recognized	(144,610)	(399,437)	(544,047)
Other	—	1,184	1,184
Effects of foreign currency translation	(18,461)	(44,336)	(62,797)
September 30, 2011	\$ 339,977	\$ 834,340	\$ 1,174,317
Amounts recognized in the unaudited condensed consolidated balance sheets:			
Current liabilities	\$ 160,782	\$ 834,340	\$ 995,122
Non-current liabilities	\$ 179,195	\$ —	\$ 179,195

## 10. STOCKHOLDERS' EQUITY

### Stock Repurchase Program

On September 13, 2010, the Company's Board of Directors authorized a stock repurchase program to acquire up to \$400.0 million of the Company's outstanding common stock from September 13, 2010 through December 31, 2011, subject to any restrictions pursuant to the terms of the Company's credit agreements or otherwise.

For the nine months ended September 30, 2011, the Company acquired a total of 2,313,078 shares of its common stock for \$187.7 million. As of September 30, 2011, the Company has \$140.3 million available under the stock repurchase program.

### 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, 2011 and 2010 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(In thousands)			
Cost of operations	\$ 7,762	\$ 6,598	\$ 19,672	\$ 18,801

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General and administrative	4,519	4,377	12,799	15,195
Total	\$ 12,281	\$ 10,975	\$ 32,471	\$ 33,996

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During the nine months ended September 30, 2011, the Company awarded 425,328 performance-based restricted stock units with a weighted average grant date fair value per share of \$83.72 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 earnings before taxes for the period from January 1, 2011 to December 31, 2011 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 21, 2012, an additional 33% of the award on February 21, 2013 and the final 34% of the award on February 21, 2014, provided that the participant is employed by the Company on each such vesting date.

During the nine months ended September 30, 2011, the Company awarded 149,324 service-based restricted stock units with a weighted average grant date fair value per share of \$85.52 as determined on the date of grant. Service-based restricted stock units typically vest ratably over three years provided that the participant is employed by the Company on each such vesting date.

## 11. COMPREHENSIVE INCOME

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(In thousands)			
Net income	\$ 93,981	\$ 53,059	\$ 249,380	\$ 147,033
Adoption of ASC 860 and ASC 810 (1)	—	—	—	55,881
Unrealized gain (loss) on securities available-for-sale	13,989	(1,535)	13,045	(3,283)
Foreign currency translation adjustments (2)	7,281	(3,909)	3,750	(5,791)
Total comprehensive income, net of tax	\$ 115,251	\$ 47,615	\$ 266,175	\$ 193,840

(1) These amounts related to retained interests in the WFN Trusts and the WFC Trust were previously reflected in accumulated other comprehensive income. Upon the adoption of ASC 860, "Transfers and Servicing," and ASC 810, "Consolidation," which was effective January 1, 2010, these interests and related accumulated other comprehensive income have been reclassified, derecognized or eliminated upon consolidation.

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

## 12. 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.



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

	September 30, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In thousands)			
<b>Financial assets</b>				
Cash and cash equivalents	\$ 239,570	\$ 239,570	\$ 139,114	\$ 139,114
Trade receivables, net	265,156	265,156	260,945	260,945
Credit card receivables, net	4,526,162	4,526,162	4,838,354	4,838,354
Redemption settlement assets, restricted	448,634	448,634	472,428	472,428
Cash collateral, restricted	654,705	654,705	185,754	185,754
Other investment securities	80,160	80,160	104,916	104,916
<b>Financial liabilities</b>				
Accounts payable	122,055	122,055	121,856	121,856
Certificates of deposit	1,369,005	1,390,828	859,100	883,405
Asset-backed securities debt – owed to securitization investors	3,083,287	3,140,758	3,660,142	3,711,263
Long-term and other debt	2,254,220	2,999,681	1,869,772	2,393,124
Derivative financial instruments	46,685	46,685	69,831	69,831

Fair Value of Assets and Liabilities Held at September 30, 2011 and December 31, 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 — The 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.

Other investment securities — Other investment securities consist primarily of U.S. Treasury and government securities. The fair value is based on quoted market prices for the same or similar securities.

Certificates of deposit — The fair value is estimated based on the current rates available to the Company for similar certificates of deposit with similar remaining maturities.

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.



Long-term and other debt — 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.

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## Assets and Liabilities Measured on a Recurring Basis

ASC 820, "Fair Value Measurement," 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;
- 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 where 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, 2011 and December 31, 2010:

	Balance at September 30, 2011	Fair Value Measurements at September 30, 2011 Using		
		Level 1	Level 2	Level 3
		(In thousands)		
Government bonds (1)	\$ 5,036	\$ —	\$ 5,036	\$ —
Corporate bonds (1)	404,828	20,680	384,148	—
Cash collateral, restricted	654,705	—	496,991	157,714
Other investment securities (2)	80,160	61,016	19,144	—
Total assets measured at fair value	\$ 1,144,729	\$ 81,696	\$ 905,319	\$ 157,714
Derivative financial instruments (3)	\$ 46,685	\$ —	\$ 46,685	\$ —
Total liabilities measured at fair value	\$ 46,685	\$ —	\$ 46,685	\$ —

	Balance at December 31, 2010	Fair Value Measurements at December 31, 2010 Using		
		Level 1	Level 2	Level 3
		(In thousands)		
Government bonds (1)	\$ 15,362	\$ —	\$ 15,362	\$ —
Corporate bonds (1)	382,454	164,706	217,748	—
Cash collateral, restricted	185,754	—	—	185,754

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Other investment securities (2)	104,916	86,881	18,035	—
Total assets measured at fair value	\$ 688,486	\$ 251,587	\$ 251,145	\$ 185,754
Derivative financial instruments (3)	\$ 69,831	\$ —	\$ 69,831	\$ —
Total liabilities measured at fair value	\$ 69,831	\$ —	\$ 69,831	\$ —

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

(2) Amounts are included in other current assets and other 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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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, 2011 and 2010:

	Cash Collateral, Restricted (In thousands)
June 30, 2011	\$ 175,826
Total losses (realized or unrealized):	
Included in earnings	(311)
Purchases	11,656
Settlements	(29,457)
Transfers in or out of Level 3	—
September 30, 2011	\$ 157,714
Losses for the period included in earnings attributable to the change in unrealized gains or losses related to assets still held at September 30, 2011	\$ (311)

	Cash Collateral, Restricted (In thousands)
December 31, 2010	\$ 185,754
Total gains (realized or unrealized):	
Included in earnings	147
Purchases	13,947
Settlements	(42,134)
Transfers in or out of Level 3	—
September 30, 2011	\$ 157,714
Gains for the period included in earnings attributable to the change in unrealized gains or losses related to assets still held at September 30, 2011	\$ 147

	Cash Collateral, Restricted (In thousands)
June 30, 2010	\$ 171,790
Total gains (realized or unrealized):	
Included in earnings	473
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

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	Corporate Bonds	Seller's Interest	Due from Securitized (In thousands)	Cash Collateral, Restricted
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
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

Gains and losses included in earnings attributable to cash collateral, restricted are included in interest 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, 2011, the Company had no impairments related to these assets.

#### 13. INCOME TAXES

For the three and nine months ended September 30, 2011, the Company utilized an effective tax rate of 38.7%, in each case, to calculate its provision for income taxes. For the three and nine months ended September 30, 2010, the Company utilized an effective tax rate of 38.2%, in each case, 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 2011 based on all known variables is 38.7%.

#### 14. SEGMENT INFORMATION

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.



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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 are included in “Corporate/Other.” Total assets are not allocated to the segments.

Three Months Ended September 30, 2011	LoyaltyOne	Epsilon	Private Label Services and Credit	Corporate/ Other	Eliminations	Total
(In thousands)						
Revenues	\$ 209,634	\$ 248,405	\$ 389,051	\$ 211	\$ (2,457)	\$ 844,844
Adjusted EBITDA (1)	59,920	58,528	187,712	(21,513)	(1,454)	283,193
Depreciation and amortization	5,130	24,899	8,950	4,254	—	43,233
Stock compensation expense	2,047	3,617	2,098	4,519	—	12,281
Operating income (loss)	52,743	30,012	176,664	(30,286)	(1,454)	227,679
Interest expense, net	—	—	—	74,356	—	74,356
Income (loss) before income taxes	52,743	30,012	176,664	(104,642)	(1,454)	153,323

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) before income taxes	38,137	20,313	133,223	(104,199)	(1,584)	85,890

Nine Months Ended September 30, 2011	LoyaltyOne	Epsilon	Private Label Services and Credit	Corporate/ Other	Eliminations	Total
(In thousands)						
Revenues	\$ 630,470	\$ 592,545	\$ 1,108,679	\$ 924	\$ (6,880)	\$ 2,325,738
Adjusted EBITDA (1)	171,114	131,518	534,713	(54,483)	(4,362)	778,500
Depreciation and amortization	15,564	65,519	26,818	6,750	—	114,651
Stock compensation expense	5,379	8,765	5,528	12,799	—	32,471
Operating income (loss)	150,171	57,234	502,367	(74,032)	(4,362)	631,378
Interest expense, net	—	—	—	224,609	—	224,609
	150,171	57,234	502,367	(298,641)	(4,362)	406,769



## Income (loss) before income taxes

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) before income taxes	133,578	38,648	385,647	(314,949)	(5,010)	237,914

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

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ALLIANCE DATA SYSTEMS CORPORATION  
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## 15. DISCONTINUED OPERATIONS

In November 2009, the Company terminated operations of its credit program for web and catalog retailer VENUE. This has been treated as a discontinued operation under ASC 205-20, "Presentation of Financial Statements — Discontinued Operations." The underlying assets of the discontinued operation for the periods presented in the unaudited condensed consolidated balance sheets are as follows:

	September 30, 2011	December 31, 2010
	(In thousands)	
Assets:		
Credit card receivables, net	\$ 3,851	\$ 11,920
Assets of discontinued operations	\$ 3,851	\$ 11,920

## 16. 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. However, 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 of the unaudited condensed consolidated statements of cash flows 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.

## 17. COMMITMENTS AND CONTINGENCIES

## Cyber Incident

On March 30, 2011, an incident was detected where a subset of Epsilon clients' customer data was exposed by an unauthorized entry into Epsilon's email system. The information obtained was limited to email addresses and/or customer names only. A rigorous assessment determined that no personal information associated with those names or email addresses was at risk. Client marketing campaigns were restarted and Epsilon's email volumes have not been, and are not expected to be, significantly impacted. At this time, the Company has not incurred, and does not expect it will incur, any significant costs arising from the incident. The Company does not expect that the incident will have a material impact to the Company's liquidity, capital resources or results of operations.

## Regulatory Matters

During the third quarter of 2011, the Company's credit card bank subsidiary, World Financial Network National Bank, converted from a national banking association and limited purpose credit card bank to a Delaware State FDIC-insured bank and limited purpose credit card bank and changed its name to World Financial Network Bank. World Financial

Network Bank is regulated, supervised and examined by the State of Delaware and the Federal Deposit Insurance Corporation (“FDIC”). As a result, agreements previously entered into with, or required by, the Office of the Comptroller of the Currency were also terminated.

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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, 2010, filed with the Securities and Exchange Commission, or SEC, on February 28, 2011. With respect to information concerning principal geographic areas, revenues are attributed to respective countries based on the location of the subsidiary, which generally correlates with the location of the customer.

Year in Review Highlights

For the nine months ended September 30, 2011, revenue increased 14.2% to \$2.3 billion and adjusted EBITDA increased 23.8% to \$778.5 million as compared to the prior year period as each of the three segments had solid operating results.

LoyaltyOne®

Revenue increased 9.5% to \$630.5 million and adjusted EBITDA increased 7.8% to \$171.1 million for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010.

The LoyaltyOne segment generates revenue primarily from our coalition loyalty program in Canada and, as such, the segment can be impacted by changes in the foreign currency exchange rate between the U.S. dollar and the Canadian dollar.

A stronger Canadian dollar benefitted the nine months ended September 30, 2011 as the average foreign currency exchange rate for the nine months ended September 30, 2011 was \$1.02 as compared to \$0.96 in the same prior year period, which added \$34.7 million and \$10.0 million to revenue and adjusted EBITDA, respectively.

During the nine months ended September 30, 2011, LoyaltyOne announced a long-term contract renewal with Sobey's, a leading Canadian grocer and retailer, and with The Jean Coutu Group, one of Canada's leading pharmacy chains. In addition, LoyaltyOne signed new agreements with The Children's Place, a children's specialty apparel retailer, and Zale Canada, a specialty jewelry retailer, to participate as national sponsors in the AIR MILES® Reward Program.

AIR MILES reward miles issued during the nine months ended September 30, 2011 increased 6.8% compared to the same prior year period due to positive growth in consumer credit card spending, as well as increased promotional activity in the gas and grocer sectors. We expect issuance growth to be at least five percent for the fourth quarter of 2011. The number of AIR MILES reward miles issued impacts the number of future AIR MILES reward miles available to be redeemed. This can also impact our future revenue recognized with respect to the number of AIR MILES reward miles redeemed and the amount of breakage for those AIR MILES reward miles expected to go unredeemed.

AIR MILES reward miles redeemed during the nine months ended September 30, 2011 increased 5.4%. During the first quarter of 2011, AIR MILES reward miles redeemed increased 10.7% compared to the prior year quarter due to increased travel rewards, as collectors took advantage of the ability to book flights on-line, a capability launched in the fourth quarter of 2010. Due to recent modifications implemented in the AIR MILES Reward Program, which were completed during 2011 in the ordinary course to manage the program, the increase in AIR MILES reward miles redemptions slowed to 2.0% for the second quarter of 2011 and 3.0% for the third quarter of 2011 as compared to the respective prior year quarter. We expect redemption growth to remain at low single-digit year-over-year increases for 2011.

During the quarter, we increased our investment in CBSM-Companhia Brasileira De Servicos De Marketing, operator of the dotz coalition loyalty program in Brazil, to 37%. In May 2011, CBSM signed a multi-year agreement with Banco do Brasil and in September 2011, through its relationship with Banco do Brasil, expanded the dotz coalition loyalty program across Brazil. Additionally, in September 2011, the program expanded into Brasilia, the nation's capital, which represents a significant population demographic, allowing continued growth in attracting both new sponsors and program members. We also invested approximately \$3.6 million to obtain a 26% ownership in Direxions Global Solutions Private Ltd., a leading loyalty, customer relationship management (CRM) solutions and data analytics provider in India. During the nine months ended September 30, 2011, we have invested an aggregate of \$18.0 million in these international ventures.

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Epsilon®

Revenue increased 36.6% to \$592.5 million and adjusted EBITDA increased 28.1% to \$131.5 million for the nine months ended September 30, 2011 as compared to the same period in the prior year, driven by strong organic growth as well as the acquisition of Aspen Marketing Services, or Aspen, in May 2011.

During the nine months ended September 30, 2011, Epsilon announced signings with Norwegian Cruise Line to manage and host their consumer database, and provide analytics and marketing strategy support, and a multi-year renewal and expansion agreement with Helzberg Diamonds to optimize and continue to support their multi-channel direct marketing efforts. In August 2011, Epsilon announced its partnership with Kellogg to help enhance Kellogg's customer relationship management, or CRM, activities and further increase customer engagement.

Overall, the outlook for Epsilon's business remains strong as the segment continues to benefit from client wins and recent acquisitions. As previously discussed, on May 31, 2011, we acquired Aspen, which specializes in a full range of digital and direct marketing services, including the use of advanced analytics to perform data-driven customer acquisition and retention campaigns. Aspen is also a leading provider of marketing agency services, with expertise in the automotive and telecommunications industries. The acquisition enhances Epsilon's core capabilities, strengthens its competitive advantage, expands Epsilon into new industry verticals and adds a strong, talented team of marketing professionals.

Private Label Services and Credit

Revenue increased 7.4% to \$1.1 billion and adjusted EBITDA increased 28.3% to \$534.7 million for the nine months ended September 30, 2011 as compared to the same period in the prior year, driven by improvements in gross yield due to program changes made throughout 2010, and improvements in the provision for loan loss due to improving trends in credit quality.

During the nine months ended September 30, 2011, we announced the signing of a new, long-term agreement to provide private label credit card services to J.Jill, a leading multichannel fashion retailer of women's apparel, accessories and footwear, and purchased their existing private label credit card accounts, a moderate size portfolio of approximately \$40 million. In addition, we signed new long-term agreements to provide credit card services with Sycle, LLC, a fast-growing provider of subscription-based practice management software for audiology clinics, and Petland, a franchise driven pet and animal care retailer. We signed a new long-term agreement to provide private label and co-branded credit card services for Marathon Petroleum Corporation, or Marathon. Concurrently, we entered into a purchase and sale agreement to acquire the existing private label portfolio of Marathon, with closing expected in the fourth quarter of 2011. We expect the portfolio to be in the \$30 million range. We also signed long-term extension agreements with Victoria's Secret, a subsidiary of Limited Brands, Inc., J.Crew and The RoomPlace providing for the continuation of credit, loyalty and multi-channel marketing services. In October 2011, we announced that we signed a new agreement to provide private label credit card services for Pier 1 Imports and to acquire their existing credit card portfolio. We expect closing to be in the first quarter of 2012 and for the program portfolio to be in the \$120 million range by the end of 2012.

Credit sales increased 8.3% for the nine months ended September 30, 2011 as consumer spending accelerated. Specialty retailers and catalogers were particularly strong during the nine months ended September 30, 2011, while some of the larger ticket merchants continued to be impacted by the macroeconomic environment. Average credit card receivables, conversely, declined 2.7% from the nine months ended September 30, 2010 due to increases in customer payment rates as consumers continued to reduce their debt levels. These payment rates reflect credit cardholder payment behavior returning to pre-recessionary patterns. In the fourth quarter of 2011, we expect payment rates to be consistent with the prior year fourth quarter.

Delinquency rates improved to 4.9% of principal receivables at September 30, 2011, down from 6.1% at September 30, 2010. The principal charge-off rate was 7.0% for the nine months ended September 30, 2011, representing a 190 basis point improvement over the same prior year period. We expect these metrics to continue to improve throughout the remainder of the year.

#### Critical Accounting Policies and Estimates

There have been no material changes 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 Annual Report filed on Form 10-K for the fiscal year ended December 31, 2010.

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## Recent Accounting Pronouncements

See Note 2, “Recent Accounting Pronouncements,” of the Notes to Unaudited Condensed Consolidated Financial Statements for a discussion of certain accounting standards that have been adopted during 2011 and certain accounting standards which we have not yet been required to adopt and may be applicable to our future financial condition, results of operations or cash flows.

## Use of Non-GAAP Financial Measures

Adjusted EBITDA is a non-GAAP financial measure equal to net income, the most directly comparable financial measure based on accounting principles generally accepted in the United States of America, or GAAP, plus stock compensation expense, provision for income taxes, interest expense, net, 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, 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.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(In thousands)			
Net income	\$ 93,981	\$ 53,059	\$ 249,380	\$ 147,033
Stock compensation expense	12,281	10,975	32,471	33,996
Provision for income taxes	59,342	32,831	157,389	90,881
Interest expense, net	74,356	84,119	224,609	250,673
Depreciation and other amortization	20,304	17,196	53,908	50,101
Amortization of purchased intangibles	22,929	20,711	60,743	56,398
Adjusted EBITDA	\$ 283,193	\$ 218,891	\$ 778,500	\$ 629,082



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## Results of Operations

Three months ended September 30, 2011 compared to the three months ended September 30, 2010

	Three Months Ended September 30,		Change	
	2011	2010	\$	%
	(In thousands, except percentages)			
<b>Revenue:</b>				
LoyaltyOne	\$ 209,634	\$ 184,411	\$ 25,223	13.7%
Epsilon	248,405	170,468	77,937	45.7
Private Label Services and Credit	389,051	349,642	39,409	11.3
Corporate/Other	211	357	(146)	(40.9)
Eliminations	(2,457)	(2,435)	(22)	nm*
Total	\$ 844,844	\$ 702,443	\$ 142,401	20.3%
<b>Adjusted EBITDA (1):</b>				
LoyaltyOne	\$ 59,920	\$ 46,478	\$ 13,442	28.9%
Epsilon	58,528	44,091	14,437	32.7
Private Label Services and Credit	187,712	143,894	43,818	30.5
Corporate/Other	(21,513)	(13,988)	(7,525)	53.8
Eliminations	(1,454)	(1,584)	130	nm*
Total	\$ 283,193	\$ 218,891	\$ 64,302	29.4%
<b>Stock compensation expense:</b>				
LoyaltyOne	\$ 2,047	\$ 2,514	\$ (467)	(18.6)%
Epsilon	3,617	2,305	1,312	56.9
Private Label Services and Credit	2,098	1,779	319	17.9
Corporate/Other	4,519	4,377	142	3.2
Total	\$ 12,281	\$ 10,975	\$ 1,306	11.9%
<b>Depreciation and amortization:</b>				
LoyaltyOne	\$ 5,130	\$ 5,827	\$ (697)	(12.0)%
Epsilon	24,899	21,473	3,426	16.0
Private Label Services and Credit	8,950	8,892	58	0.7
Corporate/Other	4,254	1,715	2,539	148.0
Total	\$ 43,233	\$ 37,907	\$ 5,326	14.1%
<b>Operating income:</b>				
LoyaltyOne	\$ 52,743	\$ 38,137	\$ 14,606	38.3%
Epsilon	30,012	20,313	9,699	47.7
Private Label Services and Credit	176,664	133,223	43,441	32.6
Corporate/Other	(30,286)	(20,080)	(10,206)	50.8
Eliminations	(1,454)	(1,584)	130	nm*
Total	\$ 227,679	\$ 170,009	\$ 57,670	33.9%
<b>Adjusted EBITDA margin (2):</b>				
LoyaltyOne	28.6%	25.2%	3.4%	
Epsilon	23.6	25.9	(2.3)	
Private Label Services and Credit	48.2	41.2	7.0	
Total	33.5%	31.2%	2.3%	
<b>Segment operating data:</b>				
Private label statements generated	35,286	34,827	459	1.3%
Credit sales	\$ 2,245,718	\$ 2,046,490	\$ 199,228	9.7%
Average credit card receivables	\$ 4,859,421	\$ 4,909,977	\$ (50,556)	(1.0)%

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AIR MILES reward miles issued	1,222,633	1,124,363	98,270	8.7%
AIR MILES reward miles redeemed	869,802	844,509	25,293	3.0%

(1) Adjusted EBITDA is equal to net income, plus stock compensation expense, provision for income taxes, interest expense, net, depreciation and other amortization, and amortization of purchased intangibles. For a reconciliation of adjusted EBITDA to net income, 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 \$142.4 million, or 20.3%, to \$844.8 million for the three months ended September 30, 2011 from \$702.4 million for the three months ended September 30, 2010. The net increase was due to the following:

•**Transaction.** Revenue increased \$6.6 million, or 9.6%, to \$74.7 million for the three months ended September 30, 2011 due to AIR MILES reward mile issuance fees, or service element revenue, which increased \$5.9 million due in part to a favorable foreign currency exchange rate and recent increases in the number of AIR MILES reward miles issued. Our issuance fees, for which we provide marketing and administrative services, are recognized pro rata over the estimated life of an AIR MILES reward mile, or 42 months. There were no other significant changes in other transaction fees as small increases in other servicing fees were offset by minor declines in merchant fees.

•**Redemption.** Revenue increased \$20.7 million, or 17.2%, to \$141.2 million for the three months ended September 30, 2011. In local currency (Canadian dollars, or CAD), revenue increased approximately CAD \$13.0 million, or 10.4%, due to a 3.0% increase in AIR MILES reward miles redeemed and issuance growth over the past several quarters, which has increased revenue associated with breakage.

•**Finance charges, net.** Revenue increased \$38.2 million, or 11.7%, to \$365.9 million for the three months ended September 30, 2011. This increase was driven by improvement in our gross yield of 340 basis points, offset in part by a 1.0% decline in average credit card receivables as a result of higher payment rates. The expansion in our gross yield resulted from changes in cardholder terms made throughout 2010.

•**Database marketing fees and direct marketing.** Revenue increased \$63.3 million, or 37.9%, to \$230.4 million for the three months ended September 30, 2011. Strategic database continues to build from recent client signings and expansion of services to existing clients with revenue increasing \$12.6 million, or 17.3%. The Aspen acquisition contributed \$57.1 million to database marketing fees and direct marketing revenue. These increases were offset by a 3.3% decline in our targeting sector due to softness in the market and a decline in our production fulfillment due to lower volumes.

•**Other revenue.** Revenue increased \$13.6 million, or 71.1%, to \$32.7 million for the three months ended September 30, 2011 due to the Aspen acquisition, which added \$14.2 million in revenue associated with strategic consulting initiatives.

Cost of operations. Cost of operations increased \$91.8 million, or 23.8%, to \$477.0 million for the three months ended September 30, 2011 as compared to \$385.2 million for the three months ended September 30, 2010. The increase resulted from growth across each of our segments, including the following:

•**Within the Epsilon segment,** cost of operations increased \$64.8 million due to the Aspen acquisition, which added \$58.7 million to cost of operations. Excluding Aspen, the increase was \$6.1 million, which was related to payroll and benefits associated with the growth of the marketing technology sector.

•**Within the LoyaltyOne segment,** cost of operations increased \$11.3 million of which \$8.2 million relates to the increase in the exchange rate to \$1.02 from \$0.96. The remainder of the increase was attributable to a 3.0% increase in the number of AIR MILES reward miles redeemed and an increase in the costs associated with our international initiatives.

•**Within the Private Label Services and Credit segment,** cost of operations increased by \$14.8 million from increases in payroll and benefits of \$6.7 million resulting from growth and an increase in incentive compensation due to

over-performance of the segment. Credit card expenses, including marketing, postage and collection fees, also increased \$6.0 million due to increased volumes.

Provision for loan loss. Provision for loan loss decreased \$18.9 million, or 21.1%, to \$70.7 million for the three months ended September 30, 2011 as compared to \$89.6 million for the three months ended September 30, 2010. The decline in the provision for loan loss was driven by the improvement in the credit quality of our credit card receivables, as the net charge-off rate was 6.0% for the quarter ended September 30, 2011 as compared to 8.3% for the same period in 2010.

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General and administrative. General and administrative expenses increased \$6.4 million, or 32.8%, to \$26.2 million for the three months ended September 30, 2011 as compared to \$19.8 million for the three months ended September 30, 2010. The increase was driven by an increase in payroll and related benefits of \$3.3 million associated with higher medical and benefit costs, incentive compensation based on company performance and costs associated with the retirement of an executive. Additionally, we incurred an increase of approximately \$3 million in additional legal and consulting fees and other non-income tax based costs.

Depreciation and other amortization. Depreciation and other amortization increased \$3.1 million, or 18.1%, to \$20.3 million for the three months ended September 30, 2011 as compared to \$17.2 million for the three months ended September 30, 2010 due to additional capital expenditures, including internally developed software projects placed in service during 2010, the Aspen acquisition and the acceleration of depreciation on certain assets.

Amortization of purchased intangibles. Amortization of purchased intangibles increased \$2.2 million, or 10.7%, to \$22.9 million for the three months ended September 30, 2011. The increase was related to \$5.8 million in amortization of intangible assets acquired with Aspen, offset in part by certain fully amortized intangible assets at Epsilon.

Interest expense. Total interest expense, net decreased \$9.7 million, or 11.6%, to \$74.4 million for the three months ended September 30, 2011 from \$84.1 million for the three months ended September 30, 2010. The decrease was due to the following:

• Securitization funding costs. Securitization funding costs decreased \$12.8 million to \$30.2 million as a result of changes in the valuation in our interest rate swaps. In the third quarter of 2011, we incurred a gain of \$8.5 million in the valuation of our interest rate swaps as compared to a \$0.1 million loss in the prior year quarter, which resulted in a net decrease of \$8.6 million for the three months ended September 30, 2011 in the valuation of our interest rate swaps. Additionally, interest expense on asset-backed securities debt owed to securitization investors decreased \$2.9 million due to lower average borrowings for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010.

• Interest expense on certificates of deposit. Interest on certificates of deposit decreased \$1.7 million to \$5.6 million due to lower interest rates for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010.

• Interest expense on long-term and other debt, net. Interest expense on long-term and other debt, net increased \$4.7 million to \$38.5 million due to a \$1.9 million increase in the amortization of imputed interest associated with the convertible senior notes as compared to the same period in the prior year and interest expense associated with increased borrowings due in part to the Aspen acquisition.

Taxes. Income tax expense increased \$26.5 million to \$59.3 million for the three months ended September 30, 2011 from \$32.8 million for the comparable period in 2010 due to an increase in taxable income. The effective tax rate increased to 38.7% for the three months ended September 30, 2011 as compared to 38.2% for the three months ended September 30, 2010.

Segment Revenue and Adjusted EBITDA:

Revenue. Total revenue increased \$142.4 million, or 20.3%, to \$844.8 million for the three months ended September 30, 2011 from \$702.4 million for three months ended September 30, 2010. The net increase was due to the following:

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LoyaltyOne. Revenue increased \$25.2 million, or 13.7%, to \$209.6 million for the three months ended September 30, 2011. Revenue benefited from a favorable foreign currency exchange rate, which represented \$11.8 million of the increase. In local currency (CAD), revenue for the AIR MILES Reward Program increased CAD \$14.1 million as a result of an increase in both redemption revenue and issuance fees, which increased CAD \$13.0 million and CAD \$3.2 million, respectively. This increase in redemption revenue was attributable to a 3.0% increase in the number of AIR MILES reward miles redeemed as well as growth in the number of AIR MILES reward miles issued over the past several quarters, which has increased revenue associated with breakage. The increase in issuance fees, for which we provide marketing and administrative services, also increased because of the growth in the number of AIR MILES reward miles issued. These increases were offset by a CAD \$0.8 million decline in investment revenue due to lower interest earned on investments.

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• **Epsilon.** Revenue increased \$77.9 million, or 45.7%, to \$248.4 million for the three months ended September 30, 2011. Marketing technology revenue continues to build from client signings in 2010 and 2011 and the expansion of services to new and existing clients, growing \$14.0 million, or 14.9%. Additionally, Aspen added \$71.3 million to revenue. These increases were offset by a 3.3% decrease in revenue in our targeting sector due to lower volumes as clients reduced prospecting outlays over concerns with the macro economy as well as a decline in product fulfillment.

• **Private Label Services and Credit.** Revenue increased \$39.4 million, or 11.3%, to \$389.1 million for the three months ended September 30, 2011. Finance charges and late fees increased by \$38.2 million driven by an increase in our gross yield of 340 basis points, offset in part by a 1.0% decline in average credit card receivables. The expansion in our gross yield was due to changes in cardholder terms made throughout 2010, which positively impacted our gross yield in the third quarter of 2011. Servicing and other fees also increased \$1.1 million.

• **Corporate/Other.** Revenue decreased slightly to \$0.2 million for the three months ended September 30, 2011 as we are currently earning a minimal amount of revenue related to sublease agreements.

**Adjusted EBITDA.** For purposes of the discussion below, adjusted EBITDA is equal to net income plus stock compensation expense, provision for income taxes, interest expense, net, depreciation and other amortization, and amortization of purchased intangibles. Adjusted EBITDA increased \$64.3 million, or 29.4%, to \$283.2 million for the three months ended September 30, 2011 from \$218.9 million for the three months ended September 30, 2010. The increase was due to the following:

• **LoyaltyOne.** Adjusted EBITDA increased \$13.4 million, or 28.9%, to \$59.9 million for the three months ended September 30, 2011. A favorable foreign currency exchange rate contributed \$3.6 million to adjusted EBITDA. Adjusted EBITDA in local currency (CAD) for the AIR MILES Reward Program increased CAD \$11.6 million, or 22.8%, with adjusted EBITDA margin increasing to 28.6% from 25.2%. Adjusted EBITDA benefited from the growth in AIR MILES reward miles issued and increased margins on redemptions.

• **Epsilon.** Adjusted EBITDA increased \$14.4 million, or 32.7%, to \$58.5 million for the three months ended September 30, 2011. Adjusted EBITDA was positively impacted by double digit revenue growth in our strategic database business and the Aspen acquisition, which added \$11.8 million to adjusted EBITDA. Adjusted EBITDA margin decreased to 23.6% for the three months ended September 30, 2011 from 25.9% for the same period in the prior year due to a shift in revenue mix attributable to the Aspen acquisition.

• **Private Label Services and Credit.** Adjusted EBITDA increased \$43.8 million, or 30.5%, to \$187.7 million for the three months ended September 30, 2011 and adjusted EBITDA margin increased to 48.2% for the three months ended September 30, 2011 compared to 41.2% for the same prior year period. Adjusted EBITDA was positively impacted by the increase in our gross yield as described above and a decline in the provision for loan loss. The net charge-off rate for the three months ended September 30, 2011 was 6.0% as compared to 8.3% in the same period in 2010. The decline in the net charge-off rate reflected the continued improvement in credit quality of the credit card receivables. Net charge-off rates continue to trend lower and delinquency rates, historically a good predictor of future losses, improved to 4.9% of principal credit card receivables at September 30, 2011 from 6.1% at September 30, 2010.

• **Corporate/Other.** Adjusted EBITDA decreased \$7.5 million to a loss of \$21.5 million for the three months ended September 30, 2011 due to an increase of \$3.9 million in payroll and benefit costs associated with higher medical and benefit costs, incentive compensation based on company performance and costs associated with the retirement of an executive. In addition, we incurred approximately \$3 million in additional legal and consulting fees and non-income tax based costs.





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## Results of Operations

Nine months ended September 30, 2011 compared to the nine months ended September 30, 2010

	Nine Months Ended September 30,		Change	
	2011	2010	\$	%
	(In thousands, except percentages)			
<b>Revenue:</b>				
LoyaltyOne	\$ 630,470	\$ 575,612	\$ 54,858	9.5%
Epsilon	592,545	433,799	158,746	36.6
Private Label Services and Credit	1,108,679	1,032,106	76,573	7.4
Corporate/Other	924	1,510	(586)	(38.8)
Eliminations	(6,880)	(7,329)	449	nm*
Total	\$ 2,325,738	\$ 2,035,698	\$ 290,040	14.2%
<b>Adjusted EBITDA (1):</b>				
LoyaltyOne	\$ 171,114	\$ 158,731	\$ 12,383	7.8%
Epsilon	131,518	102,654	28,864	28.1
Private Label Services and Credit	534,713	416,878	117,835	28.3
Corporate/Other	(54,483)	(44,171)	(10,312)	23.3
Eliminations	(4,362)	(5,010)	648	nm*
Total	\$ 778,500	\$ 629,082	\$ 149,418	23.8%
<b>Stock compensation expense:</b>				
LoyaltyOne	\$ 5,379	\$ 7,042	\$ (1,663)	(23.6)%
Epsilon	8,765	6,441	2,324	36.1
Private Label Services and Credit	5,528	5,318	210	3.9
Corporate/Other	12,799	15,195	(2,396)	(15.8)
Total	\$ 32,471	\$ 33,996	\$ (1,525)	(4.5)%
<b>Depreciation and amortization:</b>				
LoyaltyOne	\$ 15,564	\$ 18,111	\$ (2,547)	(14.1)%
Epsilon	65,519	57,565	7,954	13.8
Private Label Services and Credit	26,818	25,913	905	3.5
Corporate/Other	6,750	4,910	1,840	37.5
Total	\$ 114,651	\$ 106,499	\$ 8,152	7.7%
<b>Operating income:</b>				
LoyaltyOne	\$ 150,171	\$ 133,578	\$ 16,593	12.4%
Epsilon	57,234	38,648	18,586	48.1
Private Label Services and Credit	502,367	385,647	116,720	30.3
Corporate/Other	(74,032)	(64,276)	(9,756)	15.2
Eliminations	(4,362)	(5,010)	648	nm*
Total	\$ 631,378	\$ 488,587	\$ 142,791	29.2%
<b>Adjusted EBITDA margin (2):</b>				
LoyaltyOne	27.1%	27.6%	(0.5)%	
Epsilon	22.2	23.7	(1.5)	
Private Label Services and Credit	48.2	40.4	7.8	
Total	33.5%	30.9%	2.6%	
<b>Segment operating data:</b>				
Private label statements generated	104,832	106,627	(1,795)	(1.7)%
Credit sales	\$ 6,624,780	\$ 6,119,733	\$ 505,047	8.3%
Average credit card receivables	\$ 4,892,198	\$ 5,029,052	\$ (136,854)	(2.7)%

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AIR MILES reward miles issued	3,552,866	3,327,131	225,735	6.8%
AIR MILES reward miles redeemed	2,675,374	2,538,773	136,601	5.4%

(1) Adjusted EBITDA is equal to net income, plus stock compensation expense, provision for income taxes, interest expense, net, depreciation and other amortization, and amortization of purchased intangibles. For a reconciliation of adjusted EBITDA to net income, 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 \$290.0 million, or 14.2%, to \$2.3 billion for the nine months ended September 30, 2011 from \$2.0 billion for the nine months ended September 30, 2010. The net increase was due to the following:

•**Transaction.** Revenue increased \$7.3 million, or 3.4%, to \$221.4 million for the nine months ended September 30, 2011 due to AIR MILES reward mile issuance fees, or service element revenue, which increased \$18.0 million attributable in part to a favorable foreign currency exchange rate and recent increases in the number of AIR MILES reward miles issued. Our issuance fees, for which we provide marketing and administrative services, are recognized pro rata over the estimated life of an AIR MILES reward mile, or 42 months. Other servicing fees charged to our credit cardholders also increased \$5.8 million. These increases were offset in part by a decline in merchant fees of \$16.5 million due to increased profit sharing and royalty payments to certain clients.

•**Redemption.** Revenue increased \$37.4 million, or 9.7%, to \$424.3 million for the nine months ended September 30, 2011. A favorable foreign currency exchange rate contributed \$23.5 million to the increase in revenue. In local currency (CAD), revenue increased approximately CAD \$13.9 million, or 3.5%, due to increases in redemption revenue of CAD \$16.3 million attributable to a 5.4% increase in AIR MILES reward miles redeemed, offset in part by the net decline in the amortization of deferred revenue related to the conversion of a certain split-fee to a non-split fee program.

•**Finance charges, net.** Revenue increased \$87.0 million, or 9.1%, to \$1.0 billion for the nine months ended September 30, 2011. This increase was driven by improvement in our gross yield of 310 basis points, offset in part by a 2.7% decline in average credit card receivables as a result of higher payment rates. The expansion in our gross yield was in part due to changes in cardholder terms made throughout 2010.

•**Database marketing fees and direct marketing.** Revenue increased \$138.1 million, or 32.3%, to \$565.3 million for the nine months ended September 30, 2011. The increase in revenue was driven by our acquisitions of the Direct Marketing Services and Database Marketing divisions of Equifax, Inc., collectively DMS, and Aspen as well as double digit growth in our marketing technology division. Strategic database continues to build from recent client signings and expansion of services to existing clients with revenue increasing \$44.3 million, or 22.6%. Within our targeting sector, the DMS acquisition added \$20.1 million to revenue. The Aspen acquisition contributed \$76.8 million to database marketing fees and direct marketing revenue.

•**Other revenue.** Revenue increased \$20.2 million, or 37.3%, to \$74.5 million for the nine months ended September 30, 2011, due to the Aspen acquisition, which added \$18.2 million in revenue associated with strategic consulting initiatives.

Cost of operations. Cost of operations increased \$207.9 million, or 18.8%, to \$1.3 billion for the nine months ended September 30, 2011 as compared to \$1.1 billion for the nine months ended September 30, 2010. The increase resulted from growth across each of our segments, including the following:

•**Within the Epsilon segment,** cost of operations increased \$132.2 million due to the DMS and Aspen acquisitions, which added \$16.0 million and \$78.6 million to cost of operations, respectively. Excluding these acquisitions, cost of operations increased \$37.6 million, which was associated with the growth of the marketing technology business where payroll related costs increased \$35.6 million.

•**Within the LoyaltyOne segment,** cost of operations increased \$40.8 million, of which \$24.9 million relates to the increase in the foreign currency exchange rate to \$1.02 from \$0.96. Excluding this foreign currency exchange rate impact, the cost of fulfillment for the AIR MILES Reward Program increased CAD \$10.7 million as a result of a

5.4% increase in the number of AIR MILES reward miles redeemed. In addition, cost of operations increased due to increases in costs associated with our international initiatives and certain gains in securities realized in 2010 but not in 2011.

• Within the Private Label Services and Credit segment, cost of operations increased by \$32.5 million from increases in payroll and benefits of \$14.8 million resulting from growth and an increase in incentive compensation due to over-performance of the segment. Credit card expenses, including marketing, postage and collection fees and other costs increased \$7.6 million and \$3.6 million, respectively, due to increased volumes.

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**Provision for loan loss.** Provision for loan loss decreased \$73.6 million, or 27.0%, to \$198.7 million for the nine months ended September 30, 2011 as compared to \$272.3 million for the nine months ended September 30, 2010. The provision was impacted by both a decline in the rate and volume of credit card receivables. Average credit card receivables declined 2.7% as a result of higher payment rates. Additionally, the net charge-off rate improved 190 basis points to 7.0% for the nine months ended September 30, 2011 as compared to 8.9% for the same period in 2010, with net losses decreasing \$78.7 million. The decline in the net charge-off rate reflected the continued improvement in credit quality of the credit card receivables. Net charge-off rates continue to trend lower and delinquency rates, historically a good predictor of future losses, improved to 4.9% of principal credit card receivables at September 30, 2011 from 6.1% at September 30, 2010.

**General and administrative.** General and administrative expenses increased \$4.8 million, or 7.5%, to \$68.2 million for the nine months ended September 30, 2011 as compared to \$63.4 million for the nine months ended September 30, 2010. The increase was driven by higher medical and benefit costs and incentive compensation due to company performance.

**Depreciation and other amortization.** Depreciation and other amortization increased \$3.8 million, or 7.6%, to \$53.9 million for the nine months ended September 30, 2011 as compared 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 2010, the Aspen acquisition and the acceleration of depreciation on certain assets.

**Amortization of purchased intangibles.** Amortization of purchased intangibles increased \$4.3 million, or 7.7%, to \$60.7 million for the nine months ended September 30, 2011 as compared to \$56.4 million for the nine months ended September 30, 2010. The increase relates to \$7.7 million and \$5.3 million of amortization associated with the intangible assets acquired in the Aspen and DMS acquisitions, respectively, offset in part by certain fully amortized intangible assets at Epsilon.

**Interest expense.** Total interest expense, net decreased \$26.1 million, or 10.4%, to \$224.6 million for the nine months ended September 30, 2011 from \$250.7 million for the nine months ended September 30, 2010. The decrease was due to the following:

- **Securitization funding costs.** Securitization funding costs decreased \$32.0 million to \$96.3 million primarily as a result of changes in the valuation in our interest rate swaps. In the nine months ended September 30, 2011, we incurred a gain of \$23.1 million in the valuation of our interest rate swaps as compared to a loss of \$5.4 million in the same prior year period, which resulted in a net decrease of \$28.5 million in the valuation of our interest rate swaps.

- **Interest expense on certificates of deposit.** Interest on certificates of deposit decreased \$6.7 million to \$16.8 million due to lower average borrowings for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010.

- **Interest expense on long-term and other debt, net.** Interest expense on long-term and other debt, net increased \$12.6 million to \$111.5 million due to a \$5.7 million increase in the amortization of imputed interest associated with the convertible senior notes as compared to the same period in the prior year, a \$2.6 million write-off of unamortized debt costs associated with the early extinguishment of term loans and interest expense associated with borrowings to acquire Aspen.

**Taxes.** Income tax expense increased \$66.5 million to \$157.4 million for the nine months ended September 30, 2011 from \$90.9 million for the comparable period in 2010 due to an increase in taxable income. The effective tax rate increased to 38.7% for the nine months ended September 30, 2011 as compared to 38.2% for the nine months ended September 30, 2010.



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## Segment Revenue and Adjusted EBITDA:

Revenue. Total revenue increased \$290.0 million, or 14.2%, to \$2.3 billion for the nine months ended September 30, 2011 from \$2.0 billion for the nine months ended September 30, 2010. The net increase was due to the following:

**LoyaltyOne.** Revenue increased \$54.9 million, or 9.5%, to \$630.5 million for the nine months ended September 30, 2011. Revenue benefited from a favorable foreign currency exchange rate, which represented \$34.7 million of the increase. Revenue for the AIR MILES Reward Program increased CAD \$20.0 million, or 3.4%. Redemption revenue increased a net CAD \$13.9 million, or 3.5%, due to a 5.4% increase in AIR MILES reward miles redeemed, which was offset in part by a net decrease in amortized revenue related to the conversion of a certain split-fee to non split-fee program. Revenue from issuance fees, for which we provide marketing and administrative services, increased CAD \$10.1 million due to recent increases in the total number of AIR MILES reward miles issued. These increases were offset in part by a decline in investment revenue of CAD \$3.2 million due to lower interest earned on investments.

**Epsilon.** Revenue increased \$158.7 million, or 36.6%, to \$592.5 million for the nine months ended September 30, 2011. Marketing technology revenue continues to build from client signings in 2010 and 2011 and the expansion of services to new and existing clients, growing \$47.5 million, or 18.3%. Additionally, the Aspen and DMS acquisitions added \$95.0 million and \$20.1 million to revenue, respectively.

**Private Label Services and Credit.** Revenue increased \$76.6 million, or 7.4%, to \$1.1 billion for the nine months ended September 30, 2011. Finance charges and late fees increased by \$87.0 million driven by an increase in our gross yield of 310 basis points, offset in part by a 2.7% decline in average credit card receivables. The expansion in our gross yield was in part due to changes in cardholder terms made throughout 2010, which positively impacted our gross yield for the nine months ended September 30, 2011. This increase was partially offset by a \$10.5 million reduction in transaction revenue as a result of lower merchant fees.

**Corporate/Other.** Revenue decreased slightly to \$0.9 million for the three months ended September 30, 2011 as we are currently earning a minimal amount of revenue related to sublease agreements.

Adjusted EBITDA. For purposes of the discussion below, adjusted EBITDA is equal to net income plus stock compensation expense, provision for income taxes, interest expense, net, depreciation and other amortization, and amortization of purchased intangibles. Adjusted EBITDA increased \$149.4 million, or 23.8%, to \$778.5 million for the nine months ended September 30, 2011 from \$629.1 million for the nine months ended September 30, 2010. The increase was due to the following:

**LoyaltyOne.** Adjusted EBITDA increased \$12.4 million, or 7.8%, to \$171.1 million for the nine months ended September 30, 2011. A favorable foreign currency exchange rate contributed \$10.0 million to adjusted EBITDA. Adjusted EBITDA in local currency (CAD) for the AIR MILES Reward Program increased CAD \$5.8 million, or 3.4%, with adjusted EBITDA margin decreasing to 27.1% from 27.6%. Adjusted EBITDA benefited from the growth in AIR MILES reward miles issued and increased margins on redemptions, but adjusted EBITDA margin was negatively impacted by the net decrease due to the runoff of amortized revenue.

**Epsilon.** Adjusted EBITDA increased \$28.9 million, or 28.1%, to \$131.5 million for the nine months ended September 30, 2011. Adjusted EBITDA was positively impacted by double digit growth in our strategic database business and the Aspen acquisition, which added \$15.6 million to adjusted EBITDA. Adjusted EBITDA margin decreased to 22.2% for the nine months ended September 30, 2011 from 23.7% for the same period in the prior year due to a shift in revenue mix attributable to the Aspen acquisition.

Private Label Services and Credit. Adjusted EBITDA increased \$117.8 million, or 28.3%, to \$534.7 million for the nine months ended September 30, 2011 and adjusted EBITDA margin increased to 48.2% for the nine months ended September 30, 2011 compared to 40.4% for the same prior year period. Adjusted EBITDA was positively impacted by the increase in our gross yield as described above and a decline in the provision for loan loss. The net charge-off rate for the nine months ended September 30, 2011 was 7.0% as compared to 8.9% in the same period in 2010. The decline in the net charge-off rate reflected the continued improvement in credit quality of the credit card receivables. Net charge-off rates continue to trend lower and delinquency rates, historically a good predictor of future losses, improved to 4.9% of principal credit card receivables at September 30, 2011 from 6.1% at September 30, 2010.



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Corporate/Other. Adjusted EBITDA decreased \$10.3 million to a loss of \$54.5 million for the nine months ended September 30, 2011 related to increases in medical and benefit costs, incentive compensation, legal and consulting costs and costs associated with the retirement of an executive.

## Asset Quality

Our delinquency and net charge-off rates reflect, among other factors, the credit risk of our private label credit card receivables, 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 credit 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 becoming further delinquent. 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 collection 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, 2011	% of Total	December 31, 2010	% of Total
	(In thousands, except percentages)			
Receivables outstanding – principal	\$ 4,741,569	100%	\$ 5,116,111	100%
Principal receivables balances contractually delinquent:				
31 to 60 days	79,154	1.6%	87,252	1.7%
61 to 90 days	50,624	1.1	59,564	1.2
91 or more days	103,230	2.2	130,538	2.5
Total	\$ 233,008	4.9%	\$ 277,354	5.4%

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 credit cardholders, less recoveries and exclude charged-off interest, fees and fraud losses. Charged-off interest and fees reduce finance charges, net while fraud losses are recorded as an expense. Credit card receivables, including unpaid interest and fees, 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 or death. Credit card receivables, including unpaid interest and fees, associated with customer bankruptcies or death are charged-off at the end of each month subsequent to 60 days after the receipt of notification of the bankruptcy or death, but in any case, not later than the 180-day contractual time frame.

The net charge-off rate is calculated by dividing net charge-offs of principal receivables 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, 2011	September 30, 2010	Nine Months Ended September 30, 2011	September 30, 2010
	(In thousands, except percentages)			
Average credit card receivables	\$ 4,859,421	\$ 4,909,977	\$ 4,892,198	\$ 5,029,052
	73,047	102,108	258,143	336,797

Net charge-offs of principal  
receivables

Net charge-offs as a percentage of average credit card receivables	6.0%	8.3%	7.0%	8.9%
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See Note 5, “Credit Card Receivables,” of the Notes to Unaudited Condensed Consolidated Financial Statements for additional information related to the securitization of our credit card receivables.

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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 \$762.5 million and \$693.5 million for the nine months ended September 30, 2011 and 2010, respectively. The increase in operating cash flows was due to a decrease in working capital of \$63.9 million for the nine months ended September 30, 2011 as compared to the same period in 2010.

**Investing Activities.** Cash used in investing activities was \$741.8 million for the nine months ended September 30, 2011 as compared to cash provided by investing activities of \$164.2 million for the nine months ended September 30, 2010. Significant components of investing activities are as follows:

• **Payments for Acquired Businesses, Net of Cash.** Cash decreased \$359.1 million due to the Aspen acquisition completed on May 31, 2011. In July 2010, \$117.0 million in cash was utilized for the DMS acquisition.

• **Purchase of Credit Card Receivables.** Cash decreased \$42.7 million for the nine months ended September 30, 2011 due to the acquisition of an existing private label credit card portfolio from J.Jill. There were no purchases of credit card portfolios during the nine months ended September 30, 2010.

• **Cash Collateral, Restricted.** Cash decreased \$468.7 million for the nine months ended September 30, 2011, as compared to an increase of \$12.5 million for the nine months ended September 30, 2010 due to an increase in excess funding deposits in 2011 and an increase in restricted cash associated with principal accumulation for the repayment of asset-backed securities debt maturing in November 2011.

• **Credit Card Receivables Funding.** Cash flow from credit card receivables was \$160.6 million for the nine months ended September 30, 2011 as compared to \$273.9 million for the nine months ended September 30, 2010. Cash flow from credit card receivables increased in both periods due to the seasonal pay down of credit card receivables.

• **Capital Expenditures.** Our capital expenditures for the nine months ended September 30, 2011 were \$48.5 million compared to \$48.3 million for the same period in 2010. We do not expect capital expenditures to exceed approximately 3% of annual revenue for the foreseeable future.

**Financing Activities.** Cash provided by financing activities was \$84.3 million for the nine months ended September 30, 2011 as compared to cash used in financing activities of \$759.3 million for the nine months ended September 30, 2010. Our financing activities during the nine months ended September 30, 2011 relate primarily to borrowings and repayments of certificates of deposit and debt, including the refinancing of our credit facility and certain maturing asset-backed securities debt, and repurchases of common stock.

Adoption of ASC 860, "Transfers and Servicing," and ASC 810, "Consolidation." The consolidation of World Financial Network Credit Card Master Trust, World Financial Network Credit Card Master Note Trust, World Financial Network Credit Card Master Note Trust II, and World Financial Network Credit Card Master Trust III, or collectively, the WFN Trusts, and World Financial Capital Credit Card Master Note Trust, or 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 credit card securitization program, certificates of deposit issued by World Financial Network Bank, or WFNB, and

World Financial Capital Bank, or WFCB, our credit facility and issuances of equity securities.

As of September 30, 2011, we had \$297.5 million of available borrowing capacity under our credit facility. Our key loan covenant ratio, core debt to adjusted EBITDA, was 2.3 to 1 at September 30, 2011 as compared to the covenant ratio of 3.5 to 1. Additionally, available liquidity at the bank subsidiary level totaled \$2.5 billion. The Tier 1 risk-based capital ratio, leverage ratio and total risk-based capital ratio for our main bank subsidiary, WFNB, were 14.9%, 14.5% and 16.3%, respectively, at September 30, 2011.

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.

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Securitization Program. We regularly securitize our credit card receivables through the WFN Trusts and the WFC Trust as part of our credit card securitization program. These securitization programs are the primary vehicle through which we finance WFNB's and WFCB's credit card receivables.

As of September 30, 2011, the WFN Trusts and the WFC Trust had approximately \$4.3 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 card programs in these securitization trusts.

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.

During the second quarter of 2011, we renewed our \$1.2 billion 2009-VFN conduit facility under World Financial Network Credit Card Master Note Trust and our \$275.0 million 2009-VFN conduit facility under World Financial Capital Credit Card Master Note Trust, extending their maturities to June 13, 2012 and June 1, 2012, respectively.

In September 2011, we renewed our 2009-VFC1 conduit facility under World Financial Network Credit Card Master Trust III, extending the maturity to September 28, 2012 and reducing the total capacity from \$550.0 million to \$400.0 million.

We have secured and continue to secure the necessary commitments to fund our portfolio of securitized credit card receivables originated by WFNB 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 as they are dependent on the asset-backed securitization markets at the time.

At September 30, 2011, we had \$3.1 billion of asset-backed securities debt – owed to securitization investors, of which \$1.8 billion is due within the next 12 months.

The following table shows the maturities of borrowing commitments as of September 30, 2011 for the WFN Trusts and the WFC Trust by year:

	2011	2012	2013	2014	2015 & Thereafter	Total
	(In thousands)					
Term notes	\$ 560,000	\$ 700,226	\$ 822,339	\$ —	\$ 393,750	\$ 2,476,315
Conduit facilities						
(1)	—	1,805,000	—	—	—	1,805,000
Total (2)	\$ 560,000	\$ 2,505,226	\$ 822,339	\$ —	\$ 393,750	\$ 4,281,315

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

(2) As of September 30, 2011, with the consolidation of the WFN Trusts and the WFC Trust effective January 1, 2010, \$609.7 million of debt issued by the credit card securitization trusts and retained by us has been eliminated in the unaudited condensed consolidated financial statements.

Early amortization events are generally driven by asset performance. We do not believe it is reasonably likely for an early amortization event to occur due to asset performance. However, if an early amortization event were declared, the trustee of the particular credit card securitization trust would retain the interest in the receivables along with the excess interest income that would otherwise be paid to our bank subsidiary until the credit card securitization investors were fully repaid. The occurrence of an early amortization event would significantly limit or negate our ability to securitize additional credit card receivables.

#### Debt

We are party to a credit agreement, dated May 24, 2011, or the 2011 Credit Agreement, among us as borrower, and ADS Alliance Data Systems, Inc., ADS Foreign Holdings, Inc., Alliance Data Foreign Holdings, Inc., Epsilon Marketing Services, LLC, Epsilon Data Management LLC, Comenity LLC and Alliance Data FHC, Inc., as guarantors, SunTrust Bank and Bank of Montreal, as co-administrative agents, and Bank of Montreal as letter of credit issuer, and various other agents and banks. The 2011 Credit Agreement provides for a \$792.5 million term loan, or the 2011 Term Loan, and a \$792.5 million revolving line of credit, or the 2011 Credit Facility, with a U.S. \$65.0 million sublimit for Canadian dollar borrowings and a \$65.0 million sublimit for swing line loans. The 2011 Credit Agreement includes an uncommitted accordion feature of up to \$415.0 million in the aggregate allowing for future incremental borrowings, subject to certain conditions, for a maximum total facility size of \$2.0 billion, both of which were increased by a subsequent amendment.

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Concurrently with entering into the 2011 Credit Agreement, we terminated the following credit facilities: (i) a credit agreement, dated as of September 29, 2006; (ii) a term loan agreement, dated as of May 15, 2009; and (iii) a term loan agreement, dated as of August 6, 2010.

On September 20, 2011, we entered into a First Amendment to the 2011 Credit Agreement, or the First Amendment. The First Amendment increased the uncommitted accordion feature to up to \$915.0 million in the aggregate allowing for future incremental borrowings, subject to certain conditions, for a maximum total facility size of \$2.5 billion.

We repaid the \$250.0 million aggregate principal amount of the 6.14% Series B senior notes at their scheduled maturity of May 16, 2011.

As of September 30, 2011, we were in compliance with our covenants.

See Note 8, "Debt," of the Notes to Unaudited Condensed Consolidated Financial Statements for additional information regarding our debt.

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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, 2010 related to our exposure to market risk from interest rate risk, credit risk, foreign currency exchange risk and redemption reward risk.

Item 4. Controls and Procedures.

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

As of September 30, 2011, 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, 2011 (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 May 2011, we acquired Aspen for approximately \$359.1 million. Because of the timing of the acquisition, it was excluded from our evaluation of and conclusion on the effectiveness of internal control over financial reporting as of September 30, 2011. We will expand our evaluation of the effectiveness of the internal controls over financial reporting to include Aspen beginning in May 2012.

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. When we 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, 2010 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, 2010.

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

On September 13, 2010, our Board of Directors authorized a stock 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 purchases of our common stock made during the three months ended September 30, 2011:

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 2011:				
July 1-31	10,234	\$ 95.92	8,100	\$ 210.6
August 1-31	614,005	86.91	608,637	157.7
September 1-30	192,946	91.16	191,089	140.3
Total	817,185	\$ 88.03	807,826	\$ 140.3

(1) During the period represented by the table, 9,359 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 September 13, 2010, our Board of Directors authorized a stock 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.

## 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:

EXHIBIT INDEX

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	First Amendment to Credit Agreement, dated as of September 20, 2011, by and among Alliance Data Systems Corporation, as borrower, and certain subsidiaries parties thereto, as guarantors, SunTrust Bank and Bank of Montreal, as Co-Administrative Agents, and various other agents and lenders (incorporated by reference to Exhibit No. 10.1 to our Current Report on Form 8-K, filed with the SEC on September 23, 2011, File No. 001-15749).
<u>*10.2</u>	Third Amendment to Series 2009-VFC1 Supplement, dated as of September 30, 2011, among WFN Credit Company, LLC, World Financial Network Bank, and Union Bank, N.A.
<u>*10.3</u>	Fifth Amendment to Amended and Restated Pooling and Servicing Agreement, dated as of September 30, 2011, among WFN Credit Company, LLC, World Financial Network Bank, and Union Bank, N.A.
<u>*10.4</u>	Third Amendment to Receivables Purchase Agreement, dated as of September 30, 2011, between World Financial Network Bank and WFN Credit Company, LLC.



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Exhibit

No.	Description
<u>*31.1</u>	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.
<u>*31.2</u>	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.
<u>*32.1</u>	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.
<u>*32.2</u>	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

\*\* Furnished 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

By: /s/ Edward J. Heffernan  
Edward J. Heffernan  
President and Chief Executive Officer

Date: November 7, 2011

By: /s/ Charles L. Horn  
Charles L. Horn  
Executive Vice President and Chief  
Financial Officer

Date: November 7, 2011