

INTERCEPT INC
Form 10-Q
November 14, 2003
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2003.

OR

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

For the transition period from _____ to _____, 19__.

Commission file number: 01-14213

InterCept, Inc.

(Exact name of registrant as specified in its charter)

Georgia
(State or other jurisdiction of

58 2237359
(I.R.S. Employer

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incorporation or organization)

Identification No.)

3150 Holcomb Bridge Road, Suite 200, Norcross, Georgia 30071

(Address of principal executive offices)

(770) 248-9600

(Registrant's telephone number including area code)

N/A

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

<u>Class</u>	<u>Outstanding at November 10, 2003</u>
Common Stock, no par value	20,210,350

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INTERCEPT, INC.

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InterCept, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands, except share amounts)

	September 30, 2003	December 31, 2002
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 11,668	\$ 24,071
Restricted short term investments	10	19,239
Accounts receivable, less allowance for doubtful accounts of \$2,142 and \$2,729 at September 30, 2003 and December 31, 2002, respectively	29,175	29,229
Advances to SLM	3,654	7,485
Deferred tax assets	158	2,536
Prepaid expenses	13,935	6,782
Inventory and other	11,113	15,537
	<hr/>	<hr/>
Total current assets	69,713	104,879
Property and equipment, net	53,145	42,324
Intangible assets, net	78,400	83,418
Goodwill	212,197	216,144
Other noncurrent assets	19,966	25,849
	<hr/>	<hr/>
Total assets	\$ 433,421	\$ 472,614
	<hr/>	<hr/>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt	\$ 5,253	\$ 23,740
Accounts payable and accrued liabilities	18,169	19,364
Client payouts	36,412	58,740
Deferred revenue	10,853	11,825
	<hr/>	<hr/>
Total current liabilities	70,687	113,669
Long-term debt, less current portion	28,100	39,425
Deferred revenue	359	376
Deferred tax liability	5,910	3,832
	<hr/>	<hr/>
Total liabilities	105,056	157,302
Minority interest	295	253
Shareholders' equity:		
Preferred stock, no par value; 1,000,000 shares authorized; 100,000 shares issued and outstanding	10,021	
Common stock, no par value; 50,000,000 shares authorized; 20,210,434 and 19,976,764 shares issued and outstanding at September 30, 2003 and December 31, 2002, respectively	302,005	301,152

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Retained earnings	16,396	14,255
Accumulated other comprehensive loss	(352)	(348)
	<hr/>	<hr/>
Total shareholders' equity	328,070	315,059
	<hr/>	<hr/>
Total liabilities and shareholders' equity	\$ 433,421	\$ 472,614
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The accompanying notes are an integral part of these condensed consolidated balance sheets.

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InterCept, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Revenues:				
Financial institution services	\$ 46,388	\$ 41,512	\$ 134,770	\$ 116,718
Merchant services	14,600	20,423	47,553	35,283
Customer reimbursements	3,100	4,360	11,068	9,573
Total revenues	64,088	66,295	193,391	161,574
Costs of services:				
Costs of financial institution services	24,056	19,145	67,786	53,240
Costs of merchant services	6,072	10,346	20,531	16,245
Customer reimbursements	3,100	4,360	11,068	9,573
Selling, general and administrative expenses	25,201	21,200	71,749	51,534
Depreciation and amortization	5,072	4,625	14,832	10,932
Total operating expenses	63,501	59,676	185,966	141,524
Operating income	587	6,619	7,425	20,050
Other (expense) income, net	(486)	9	(3,799)	1,760
Income before provision for income taxes, equity in loss of affiliates and minority interest	101	6,628	3,626	21,810
Provision for income taxes	49	2,466	1,421	8,072
Equity in loss of affiliates		(1,375)	(4)	(2,862)
Minority interest	(13)	(10)	(42)	(26)
Net income before preferred dividends	\$ 39	\$ 2,777	\$ 2,159	\$ 10,850
Preferred dividends	(21)		(21)	
Net income attributable to common shareholders	18	2,777	2,138	10,850
Net income per common share:				
Basic	\$ 0.00	\$ 0.15	\$ 0.11	\$ 0.59
Diluted	\$ 0.00	\$ 0.14	\$ 0.11	\$ 0.56
Weighted average shares outstanding:				
Basic	19,903	19,132	19,805	18,539
Diluted	20,618	19,947	20,389	19,402

The accompanying notes are an integral part of these condensed consolidated statements of operations.

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InterCept, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in thousands)

	Nine Months Ended September 30,	
	2003	2002
Cash flows from operating activities:		
Net income	\$ 2,138	\$ 10,850
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Preferred dividends	21	
Depreciation and amortization	14,831	10,932
WorldCom reserve		2,471
Loan cost amortization	253	255
Minority interest	42	26
Deferred income tax provision	4,456	3,925
Loss on sale of property and equipment	154	7
Gain due to stock issuance of subsidiary		(25)
Equity in net loss of affiliates	19	2,862
Income tax benefit related to exercise of stock options	65	766
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable, net	54	(4,243)
Inventory, prepaid expenses, and other current assets	6,418	1,419
Other assets	(7,941)	
Accounts payable and accrued liabilities	(1,270)	(8,186)
Client payouts	(22,328)	6,516
Interest accrued on notes receivable	(107)	(563)
SLM note receivable	3,390	
Deferred revenue	(989)	141
Net cash (used in) / provided by operating activities	(794)	27,153
Cash flows from investing activities:		
Acquisitions, net of cash acquired	5,859	(114,716)
Advances to EPX prior to acquisition		(8,585)
Proceeds from sale of investments, net	19,432	31,274
(Advances to) repayments from affiliate, net	3,210	(87)
Purchases of property and equipment, net	(19,395)	(10,363)
Patent costs incurred		(40)
Increases in capitalized software	(1,483)	(1,106)
Net cash provided by (used in) investing activities	7,623	(103,623)
Cash flows from financing activities:		
Proceeds from line of credit	89,156	143,213
Payments on notes payable and line of credit	(119,175)	(77,813)
Proceeds from issuance of common stock, net of related issuance costs		(23)
Proceeds from employee stock purchase plan	632	490
Preferred stock investment	10,000	

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Proceeds from exercise of stock options	155	1,378
	<u> </u>	<u> </u>
Net cash (used in) provided by financing activities	(19,232)	67,245
Net (decrease) increase in cash and cash equivalents	(12,403)	(9,225)
Cash and cash equivalents at beginning of the period	24,071	24,917
	<u> </u>	<u> </u>
Cash and cash equivalents at end of the period	\$ 11,668	\$ 15,692
	<u> </u>	<u> </u>
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 1,261	\$ 1,206
	<u> </u>	<u> </u>
Cash paid for income taxes	167	\$ 5,250
	<u> </u>	<u> </u>

The accompanying notes are an integral part of these condensed consolidated statements of cash flows.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Basis of Presentation

InterCept, Inc. ("InterCept" or "we") is a single-source provider of a broad range of technologies, products and services that work together to meet the electronic commerce and operating needs of financial institutions and merchants in the United States. Over 2,000 of these financial institutions have contracted with InterCept for one or more of InterCept's technologies, products and services, which include electronic funds transfer transactions, core bank processing systems, credit and debit card processing, check imaging systems, data communications management networks, laser document printing and automated mailing services, as well as services related to each of these products and systems. InterCept also offers a single-source end-to-end transaction processing solution that enables merchants to accept and process real-time payments for goods and services purchased from multiple distribution channels including internet, traditional point of sale, mail order and telephone order channels.

The consolidated financial statements include the accounts of InterCept and its wholly-owned subsidiaries: InterCept Communications Technologies, Inc., InterCept Data Services, Inc. (formerly known as SBS Data Services, Inc.), C-TEQ, Inc., InterCept Services, LLC, ICPT Acquisition I, LLC, DPSC Acquisition Corp., InterCept TX I, LLC, InterCept Payment Solutions, Inc., Internet Billing Company, LLC ("iBill"), InterCept Output Solutions, LP, and InterCept Supply, LP. In addition, ProImage, Inc., a corporation in which InterCept has a 67% ownership interest as of September 30, 2003, has been consolidated in InterCept's consolidated financial statements since its inception, due to InterCept's control of ProImage. Management of InterCept has responsibility for all day-to-day operations of ProImage and has and will continue to provide complete financial support for ProImage due to legal limitations on the other shareholder's ability to fund losses. All significant intercompany accounts and transactions have been eliminated in consolidation. Minority interest represents the minority shareholder's proportionate share of the equity and earnings of ProImage.

Through December 31, 2002, InterCept accounted for its investment in Netzee, Inc. under the equity method, under which the operations of Netzee were recorded on a single line item in the statements of operations, equity in loss of affiliate. During 2002, InterCept continued to record equity method losses in Netzee, resulting in the reduction of its investment in common stock of Netzee to zero. InterCept then applied EITF 99-10, "Percentage Used to Determine the Amount of Equity Method Losses," which addresses the percentage of ownership that an investor should use to compute equity method losses when the investment in a company's common stock has been reduced to zero and the investor holds other securities of the company such as preferred stock or loans to the company. Netzee had preferred stock outstanding. InterCept owned none of Netzee's preferred stock. Netzee also had an \$18.0 million line of credit, of which InterCept loaned approximately 78%. Under EITF 99-10, InterCept did not record any additional equity method losses until the preferred stockholders' investment was reduced to zero by absorbing Netzee's losses. During the third quarter of 2002, the preferred stockholders completed the reduction of their investment in Netzee to zero and InterCept then applied its relative ownership percentage in the next most senior level of capital the line of credit to record its share of Netzee's remaining losses. As of December 31, 2002, InterCept owned approximately 28% of Netzee's common stock. On December 31, 2002, Netzee sold substantially all of its assets to Certegy, Inc.

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The accompanying unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosure normally included in the annual financial statements, prepared in accordance with generally accepted accounting principles, have been omitted pursuant to those rules and regulations, although InterCept believes that the disclosures made are adequate to make information presented not misleading.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all necessary adjustments and reclassifications (all of which are of a normal, recurring nature) that are necessary for fair presentation for the periods presented. The results of the three and nine month periods are not necessarily indicative of the results to be expected for the full fiscal year. Please read these unaudited condensed consolidated financial statements in conjunction with the audited consolidated financial statements and the notes thereto included in InterCept's latest annual report to the Securities and Exchange Commission on Form 10-K for the year ended December 31, 2002.

2. Business Segment Reporting

InterCept's operations were classified as one business segment in 2001 and the first quarter of 2002. The acquisitions of iBill and InterCept Payment Solutions, Inc. (formerly named Electronic Payment Exchange, Inc. and sometimes referred to as EPX) during the three months ended June 30, 2002 have added merchant processing to InterCept's product offerings. Therefore, the operations are now classified into two business segments: financial institution services and merchant services. Summarized financial information by business segment is as follows (in thousands):

InterCept, Inc and Subsidiaries

Segment information

(in thousands)

	Three Months Ended, September 30, 2003			Three Months Ended, September 30, 2002		
	Financial Institution	Merchant		Financial Institution	Merchant	
	Services	Services	Total	Services	Services	Total
	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Revenues:						
Service fee	42,044	14,600	56,644	37,028	20,423	57,451
Data communications management	2,570		2,570	2,342		2,342
Equipment and product sales, services and other	1,774		1,774	2,142		2,142
Customer reimbursements	3,100		3,100	4,360		4,360
Total revenues	49,488	14,600	64,088	45,872	20,423	66,295
Costs of services:						
Costs of service fees	20,775	6,072	26,847	16,128	10,346	26,474
Costs of data communications	1,833		1,833	1,382		1,382
Costs of equipment and product sales, services and other	1,448		1,448	1,635		1,635
Customer reimbursements	3,100		3,100	4,360		4,360

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Selling, general and administrative expenses	17,459	7,742	25,201	13,370	7,830	21,200
Depreciation and amortization	3,361	1,711	5,072	2,879	1,746	4,625
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total operating expenses	47,976	15,525	63,501	39,754	19,922	59,676
Operating income	\$ 1,512	\$ (925)	\$ 587	\$ 6,118	\$ 501	\$ 6,619
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Nine Months Ended,

Nine Months Ended,

September 30, 2003

September 30, 2002

	September 30, 2003			September 30, 2002		
	Financial Institution	Merchant		Financial Institution	Merchant	
	Services	Services	Total	Services	Services	Total
	<u>(unaudited)</u>	<u>(unaudited)</u>	<u>(unaudited)</u>	<u>(unaudited)</u>	<u>(unaudited)</u>	<u>(unaudited)</u>
Revenues:						
Service fee	120,403	47,553	167,956	104,255	35,283	139,538
Data communications management	7,527		7,527	6,578		6,578
Equipment and product sales, services and other	6,840		6,840	5,885		5,885
Customer reimbursements	11,068		11,068	9,573		9,573
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total revenues	145,838	47,553	193,391	126,291	35,283	161,574
Costs of services:						
Costs of service fees	56,793	20,531	77,324	44,561	16,245	60,806
Costs of data communications	5,567		5,567	4,094		4,094
Costs of equipment and product sales, services and other	5,426		5,426	4,585		4,585
Customer reimbursements	11,068		11,068	9,573		9,573
Selling, general and administrative expenses	49,477	22,272	71,749	37,758	13,776	51,534
Depreciation and amortization	10,046	4,786	14,832	7,794	3,138	10,932
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total operating expenses	138,377	47,589	185,966	108,365	33,159	141,524
Operating income	\$ 7,461	\$ (36)	\$ 7,425	\$ 17,926	\$ 2,124	\$ 20,050
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Total assets for the Financial Institution Services segment and Merchant Services segment were approximately \$240.9 million and \$192.5 million, respectively, as of September 30, 2003.

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Net income has been adjusted to include preferred stock dividends to determine net income available to common shareholders. Basic earnings per share is computed based on the weighted average number of common shares outstanding, excluding the weighted average number of shares held in escrow to satisfy contingencies related to certain acquisitions. Diluted earnings per share is computed based on the weighted average number of common shares outstanding plus (1) the dilutive effect of outstanding stock options using the treasury stock method which is based on the average stock price for the period and (2) the dilutive effect of outstanding convertible preferred stock using the if converted method. The effects of anti-dilutive options and stock have been excluded. The weighted average number of anti-dilutive options totaled approximately 3.3 million and 2.7 million for the three months ended September 30, 2003 and 2002, respectively. Amounts shown are in thousands, except earnings per share data.

	Three Months Ended September 30, 2003			Three Months Ended September 30, 2002		
	Income	Shares	EPS	Income	Shares	EPS
Basic EPS	\$ 18	19,903	\$ 0.00	\$ 2,777	19,132	\$ 0.15
Dilutives:						
Stock options		328			358	
Shares held in escrow to satisfy contingencies					406	
Preferred	21	117				
Contingently issuable shares subject to earnout provisions		270			51	
Diluted EPS	\$ 39	20,618	\$ 0.00	\$ 2,777	19,947	\$ 0.14