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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarter Ended September 30, 2003

OR

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

For the transition period from to

Commission File Number: 001-15749

ALLIANCE DATA SYSTEMS CORPORATION

(Exact Name of Registrant as Specified in its Charter)

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

17655 Waterview Parkway
Dallas, Texas 75252
(Address of Principal Executive Office, Including Zip Code)

(972) 348-5100
(Registrant's Telephone Number, Including Area Code)

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 o

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

As of October 31, 2003, 79,641,338 shares of the registrant's common stock, par value $0.01 per share, were outstanding.

ALLIANCE DATA SYSTEMS CORPORATION

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PART I

Item 1. Financial Statements

ALLIANCE DATA SYSTEMS CORPORATION
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(amounts in thousands, except per share amounts)

	December 31, 2002	September 30, 2003
ASSETS		
Cash and cash equivalents	$ 30,439	$ 45,057
Due from card associations	27,294	29,460
Trade receivables, net	89,097	105,579
Seller's interest and credit card receivables, net	147,899	225,250
Deferred tax asset, net	37,367	37,608
Other current assets	56,844	66,704
Total current assets	388,940	509,658
Redemption settlement assets, restricted	166,293	207,766
Property and equipment, net	119,638	126,215
Deferred tax asset, net	10,144	20,137
Other non-current assets	17,131	25,388
Due from securitizations	235,890	209,165
Intangible assets, net	76,774	125,106
Goodwill	438,608	444,377
Total assets	$ 1,453,418	$ 1,667,812
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable	$ 72,586	$ 80,591
Accrued expenses	87,568	119,431
Merchant settlement obligations	49,063	59,754
Other current liabilities	33,220	53,984
Debt, current portion	184,993	152,101
Total current liabilities	427,430	465,861
Other liabilities	15,268	10,145
Deferred revenue—service	106,504	110,853
Deferred revenue—redemption	253,560	306,628
Long-term and subordinated debt	107,918	96,931
Total liabilities	910,680	990,418
Stockholders' equity:		
Common stock, $0.01 par value; authorized 200,000 shares; issued and outstanding 74,938 shares as of December 31, 2002, 79,586 shares as of September 30, 2003	749	796
Additional paid-in capital	522,209	601,631
Treasury stock	(6,151)	(6,151)
Retained earnings	34,341	77,217
Accumulated other comprehensive income (loss)	(8,410)	3,901
Total stockholders' equity	542,738	677,394
Total liabilities and stockholders' equity	$ 1,453,418	$ 1,667,812

See accompanying notes to unaudited condensed consolidated financial statements.

ALLIANCE DATA SYSTEMS CORPORATION
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(amounts in thousands, except per share amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2002	2003	2002	2003
Revenues				
Transaction and marketing services	$ 128,854	$ 133,558	$ 379,666	$ 393,772
Redemption	36,817	42,568	101,936	118,543
Financing charges, net	49,157	73,744	144,206	214,189
Other income	3,911	5,803	8,811	16,924
Total revenue	218,739	255,673	634,619	743,428
Operating expenses				
Cost of operations	164,852	191,241	490,328	558,188
General and administrative	14,342	12,945	39,240	40,835
Depreciation and other amortization	11,107	13,382	30,274	39,676
Amortization of purchased intangibles	5,520	4,760	18,915	14,222
Total operating expenses	195,821	222,328	578,757	652,921
Operating income	22,918	33,345	55,862	90,507
Fair value loss on interest rate derivative	5,155	462	10,415	2,407
Interest expense	4,969	2,678	16,263	14,341
Other debt-related expenses	—	—	834	4,275
Income before income tax expense	12,794	30,205	28,350	69,484
Income tax expense	5,022	11,590	12,727	26,608
Net income	$ 7,772	$ 18,615	$ 15,623	$ 42,876
Net income per share—basic	$ 0.10	$ 0.23	$ 0.21	$ 0.55
Net income per share—diluted	$ 0.10	$ 0.23	$ 0.20	$ 0.54
Weighted average shares—basic	74,557	79,227	74,199	77,452
Weighted average shares—diluted	76,416	82,352	76,617	79,715

See accompanying notes to unaudited condensed consolidated financial statements.

ALLIANCE DATA SYSTEMS CORPORATION
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(amounts in thousands)

	Nine months ended September 30,	
	2002	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 15,623	$ 42,876
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	49,189	53,898
Deferred income taxes	(475)	(1,594)
Accretion of deferred income	(1,166)	(547)
Fair value loss on interest rate derivative	10,415	2,407
Provision for doubtful accounts	7,106	12,497
Change in operating assets and liabilities, net of acquisitions:		

Change in trade receivables	(1,274)	(10,678)
Change in merchant settlement activity	(21,042)	8,525
Change in other assets	(3,042)	(12,607)
Change in accounts payable and accrued expenses	11,530	29,196
Change in deferred revenue	21,736	25,378
Change in other liabilities	557	609
Purchase of credit card receivables	(93,582)	(271,251)
Proceeds from sale of credit card receivable portfolios	92,720	202,322
Other operating activities	2,948	2,654
Net cash provided by operating activities	91,243	83,685
CASH FLOWS FROM INVESTING ACTIVITIES:		
Change in redemption settlement assets	(6,601)	(12,724)
Acquisitions, net of cash acquired	(35,209)	(48,010)
Change in seller's interest	(74,000)	(46,536)
Change in due from securitizations	44,292	26,997
Capital expenditures	(31,114)	(29,758)
Other investing activities	(634)	324
Net cash used in investing activities	(103,266)	(109,707)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings under debt agreements	396,400	501,709
Repayment of borrowings	(423,141)	(558,641)
Proceeds from public stock offering	—	61,910
Proceeds from other issuance of common stock	7,672	14,905
Net cash (used in) provided by financing activities	(19,069)	19,883
Effect of exchange rate changes	(5,992)	20,756
Change in cash and cash equivalents	(37,084)	14,617
Cash and cash equivalents at beginning of period	117,535	30,439
Cash and cash equivalents at end of period	$ 80,451	$ 45,057
Non-cash transactions:		
Capital expenditures financed by capital leases	$ —	$ 8,034
Supplemental cash flow information:		
Interest paid	$ 20,140	$ 17,236
Income taxes paid	$ 17,584	$ 11,996

See accompanying notes to unaudited condensed consolidated financial statements.

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, 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, 2002.

The unaudited condensed consolidated financial statements included herein reflect all 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 the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

In April 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections." SFAS No. 145 eliminates Statement 4 and, thus, the exception to applying Opinion 30 to gains and losses related to extinguishments of debt (other than extinguishment of debt to satisfy sinking-fund requirements—the exception to application of Statement 4 noted in Statement 64). As a result, gains and losses from extinguishments of debt should be classified as extraordinary items only if they meet the criteria in Opinion 30. This provision of SFAS No. 145 is effective for fiscal years beginning after May 15, 2002. The Company has adopted this statement in its 2003 financial statements and has accordingly reclassified an extraordinary item of $0.8 million related to the write-off of debt issuance costs upon the repayment of a subordinated note for the nine months ended September 30, 2002 to other debt-related expenses. During the nine months ended September 30, 2003, the Company wrote off $4.3 million of debt issuance costs related to the refinancing of its prior credit facilities and repayment of a subordinated note.

For purposes of comparability, certain prior period amounts have been reclassified to conform with the current year presentation. Such reclassifications have no impact on previously reported net income.

2. ACQUISITIONS AND DISPOSITIONS

In January 2003, the Company purchased substantially all of the assets of Exolink Corporation, a provider of utility back office support services, for approximately $1.0 million.

In March 2003, the Company purchased the customer care back office operations of American Electric Power Company ("AEP") related to the deregulated Texas marketplace for approximately $30.0 million. The purchase price allocation resulted in identifiable intangible assets of $24.9 million that are being amortized over approximately six years and net tangible assets of $5.1 million. As part of

the transaction, the Company will provide billing and customer care services to over 800,000 accounts that were recently acquired by a U.S. subsidiary of Centrica plc.

In the first quarter of 2003, as a result of certain milestones being achieved by previously acquired entities, the Company paid an additional cash consideration of $2.0 million. The additional consideration was treated as additional purchase price and was recorded as an increase to intangible assets.

In September 2003, the Company purchased the stock of Conservation Billing Services Inc., a utilities sub-metering business, for approximately $14.2 million. The preliminary purchase price allocation resulted in identifiable intangible assets of $7.9 million, goodwill of $5.5 million and net other assets of $0.8 million.

During the third quarter of 2003, the Company sold its software development operations in New Zealand to an employee. The operations had previously generated approximately $1.0 million in annual revenue. The Company will receive consideration from the buyer contingent on future operating results measured against predetermined thresholds. Goodwill of $1.9 million related to the New Zealand operations has been retained by the Company in its transaction processing segment due to integration of the operations across the segment, as provided for under SFAS 142. The gain on disposition was not significant. The New Zealand operations are not presented as a discontinued operation due to their insignificance.

3. INTANGIBLE ASSETS

Intangible assets consist of the following:

	December 31, 2002	September 30, 2003	Amortization Life and Method
	(in thousands)		
Premium on purchased credit card portfolios	$ 16,566	$ 39,307	3-10 years—straight line
Customer contracts and lists	77,876	112,492	2-20 years—straight line
Noncompete agreements	4,300	4,300	1-5 years—straight line
Sponsor contracts	38,306	38,306	5 years—declining balance
Collector database	47,043	47,043	15%—declining balance
Total	184,091	241,448	
Accumulated amortization	(107,317)	(116,342)	
Intangible assets, net	$ 76,774	$ 125,106	

During the third quarter of 2003, the Company completed the acquisition and conversion of approximately $223.6 million associated with Stage Stores, Inc.'s portfolio of approximately 800,000 active private label credit card accounts, and has assumed overall operation of Stage Stores' private label credit card program. The Company paid approximately $236.1 million for this portfolio. The preliminary purchase price allocation resulted in identifiable intangible assets of $27.0 million that are being amortized over approximately 10 years and net tangible assets of $209.1 million. Going forward, the Company's bank subsidiary will also own the new accounts and balances generated during the 10-year term of this arrangement.

The Company accounts for its intangible assets under SFAS No. 142 "Goodwill and Other Intangible Assets." SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually. The Company previously selected July 31 as its annual assessment date in accordance with the standard. Accordingly, the Company has completed its annual impairment test for goodwill as of July 31, 2003 and determined that no impairment exists. No further testing of goodwill impairment will be performed until July 31, 2004, unless circumstances exist which indicate an impairment may have occurred.

4. DEBT

Debt consists of the following:

	December 31, 2002	September 30, 2003
	(in thousands)	
Certificates of deposit	$ 96,200	$ 97,300
Subordinated notes	52,000	—
Credit facility	139,500	140,000
Other	5,211	11,732
	292,911	249,032
Less: current portion	(184,993)	(152,101)
Long term portion	$ 107,918	$ 96,931

On April 10, 2003, the Company entered into three new credit facilities to replace its prior credit facilities. The first facility provides for a $150.0 million revolving commitment and matures in April 2006. The second facility is a 364-day facility and provides for an additional $150.0 million revolving commitment that matures in April 2004. The third facility provides for a $100.0 million revolving commitment to Loyalty Management Group Canada Inc., a wholly owned Canadian subsidiary, and matures in April 2006. The covenants contained in the three credit facilities are substantially identical to each other and to the covenants contained in the prior credit facilities.

Advances under the credit facilities are in the form of either base rate loans or eurodollar loans. The interest rate on base rate loans fluctuates based upon the higher of (1) the interest rate announced by the administrative agent as its "prime rate" or (2) the Federal funds rate plus 0.5%, in each case with no additional margin. The interest rate on eurodollar loans fluctuates based upon the rate at which eurodollar deposits in the London interbank market are quoted plus a margin of 1.0% to 1.5% based upon the ratio of Total Debt under the credit facilities to Consolidated Operating EBITDA, as each term is defined in the credit facilities. The credit facilities are secured by pledges of stock of certain subsidiaries and pledges of certain intercompany promissory notes.

As of September 30, 2003, the certificates of deposit had effective annual fixed rates ranging from 1.7% to 4.0% and the credit facilities had an average interest rate of 3.1%.

5. STOCKHOLDERS' EQUITY

In April 2003, the Company completed a public offering of 10,350,000 shares of the Company's common stock at $19.65 per share. 7,000,000 shares were sold by one of the Company's largest stockholders, Limited Commerce Corp., an affiliate of Limited Brands, Inc., and the remaining 3,350,000 shares were sold by the Company. The net proceeds to the Company from the offering were $61.9 million after deducting its pro-rata underwriting discounts and commissions and offering expenses. Concurrently with the closing of the public offering, the Company used $52.7 million of the net proceeds to repay in full $52.0 million of debt outstanding, plus accrued interest, under a 10% subordinated note that the Company issued in September 1998 to an affiliated entity of Welsh, Carson, Anderson & Stowe, the Company's largest stockholder.

6. INCOME TAXES

For the three months ended September 30, 2003 and the nine months ended September 30, 2003, the Company has utilized an effective tax rate of 38.3% to calculate its income tax expense. In accordance with Accounting Principles Board ("APB") Opinion No. 28, "Interim Financial Reporting", this effective tax rate is the Company's expected annual effective tax rate for calendar year 2003 based on all known variables.

7. COMPREHENSIVE INCOME

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

	Three months ended September 30,		Nine months ended September 30,	
	2002	2003	2002	2003
	(in thousands)			
Net income	$ 7,772	$ 18,615	$ 15,623	$ 42,876
Change in fair value of derivatives	916	—	(99)	99
Reclassifications into earnings(1)	(1,538)	(963)	(242)	586
Unrealized gain (loss) on securities available-for-sale	736	792	950	307
Foreign currency translation adjustments(2)	(555)	4,020	(3,005)	11,318
Total comprehensive income	$ 7,331	$ 22,464	$ 13,227	$ 55,186

(1) Reclassifications into earnings arise from interest rate swaps, a foreign currency hedge, and amortization of amounts recorded in connection with the adoption of SFAS No. 133.

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

8. STOCK COMPENSATION

At September 30, 2003, the Company had three stock-based employee compensation plans. The Company accounts for those plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees", and related Interpretations. No stock-based employee compensation cost is reflected in net income for stock options, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation", to stock-based employee compensation.

	Three months ended September 30,		Nine months ended September 30,	
	2002	2003	2002	2003
	(in thousands, except per share amounts)			
Net income, as reported	$ 7,772	$ 18,615	$ 15,623	$ 42,876
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	—	—	1,916	1,725
Deduct: Total stock-based employee compensation expense determined under fair value based method for all stock option awards, net of related tax effects	(3,182)	(3,671)	(11,461)	(9,972)
Net income, pro forma	$ 4,590	$ 14,944	$ 6,078	$ 34,629
Net income per share:				
Basic—as reported	$ 0.10	$ 0.23	$ 0.21	$ 0.55
Diluted—as reported	$ 0.10	$ 0.23	$ 0.20	$ 0.54
Basic—pro forma	$ 0.06	$ 0.19	$ 0.08	$ 0.45
Diluted—pro forma	$ 0.06	$ 0.18	$ 0.08	$ 0.43

The Board of Directors of the Company adopted the 2003 Long Term Incentive Plan on April 4, 2003 and the stockholders approved it at the Company's 2003 annual meeting of stockholders on June 10, 2003. The plan reserves 6,000,000 shares of common stock for grants of incentive stock options, nonqualified stock options, restricted stock awards and performance shares to officers, employees, non-employee directors and consultants performing services for the Company or its affiliates.

9. SEGMENT INFORMATION

Consistent with prior periods, the Company continues to classify its businesses into three segments: Transaction Services, Credit Services and Marketing Services.

	Transaction Services	Credit Services	Marketing Services	Other/ Elimination	Total
			(in thousands)		
Three months ended September 30, 2002					
Revenues	$ 133,916	$ 84,753	$ 61,495	$ (61,425)	$ 218,739
Depreciation and amortization	11,135	1,756	3,736	—	16,627
Operating income	10,866	6,945	5,107	—	22,918
Fair value loss on interest rate derivative	—	5,155	—	—	5,155
Three months ended September 30, 2003					
Revenues	$ 152,167	$ 107,042	$ 68,085	$ (71,621)	$ 255,673
Depreciation and amortization	12,823	1,148	4,171	—	18,142
Operating income	10,742	17,764	4,839	—	33,345
Fair value loss on interest rate derivative	—	462	—	—	462

	Transaction Services	Credit Services	Marketing Services	Other/ Elimination	Total
			(in thousands)		
Nine months ended September 30, 2002					
Revenues	$ 396,044	$ 244,111	$ 174,219	$ (179,755)	$ 634,619
Depreciation and amortization	32,946	4,933	11,310	—	49,189
Operating income	24,721	17,068	14,073	—	55,862

Fair value loss on interest rate derivative	—	10,415	—	—	10,415
Nine months ended September 30, 2003					
Revenues	$ 446,641	$ 314,184	$ 195,190	$ (212,587)	$ 743,428
Depreciation and amortization	37,305	3,665	12,928	—	53,898
Operating income	28,961	47,036	14,510	—	90,507
Fair value loss on interest rate derivative	—	2,407	—	—	2,407

10. RECENTLY ISSUED ACCOUNTING STANDARDS

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." The statement amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under Statement 133. The statement is generally effective for contracts entered into or modified after June 30, 2003. The Company has adopted this statement and it did not have a material impact on its financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within the scope of SFAS No. 150 as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. SFAS No. 150 is generally effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company has adopted this statement and it did not have a material impact on its financial statements.

11. SUBSEQUENT EVENTS

In November 2003, the Company facilitated a secondary public offering of 8,663,382 shares of the Company's common stock at $26.95 per share. 7,533,376 shares were sold by the Company's second largest stockholder, Limited Commerce Corp., a wholly-owned subsidiary of Limited Brands, which together with its retail affiliates is our largest customer, and the remaining 1,130,006 shares were sold by the Company's largest stockholder, Welsh Carson, through two of its affiliated entities. The Company sold no stock and received none of the proceeds from the secondary offering. In connection with the secondary offering, the Company incurred approximately $450,000 in registration costs, which will be expensed in the fourth quarter. As a result of the secondary offering, Limited Commerce Corp. is no longer a stockholder of the Company.

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 with the consolidated financial statements and the notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our annual report filed on Form 10-K for the year ended December 31, 2002.

Recent Developments

In November 2003, we facilitated a secondary public offering of 8,663,382 shares of our common stock at $26.95 per share. 7,533,376 shares were sold by our second largest stockholder, Limited Commerce Corp., a wholly-owned subsidiary of Limited Brands, which together with its retail affiliates is our largest customer, and the remaining 1,130,006 shares were sold by our largest stockholder, Welsh Carson, through two of its affiliated entities. We sold no stock and received none of the proceeds from the secondary offering. In connection with the secondary offering, we incurred approximately $450,000 in registration costs, which will be expensed in the fourth quarter. As a result of the secondary offering, Limited Commerce Corp. is no longer a stockholder of ours.

Use of Non-GAAP Financial Measures

EBITDA is a non-GAAP financial measure equal to net income, the most directly comparable GAAP financial measure, plus income tax expense, interest expense, fair value loss on interest rate derivative, other debt-related expenses, depreciation and other amortization. Operating EBITDA is a non-GAAP financial measure equal to EBITDA plus the change in deferred revenue less the change in redemption settlement assets. We have presented EBITDA and operating EBITDA because we use them to monitor compliance with the financial covenants in our credit agreements, such as debt-to-operating EBITDA and operating EBITDA to interest expense ratios. We also use EBITDA and operating 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. Therefore, we believe that EBITDA and operating EBITDA provide useful information to our investors regarding our performance and overall results of operations. EBITDA and operating EBITDA are not intended to be performance measures 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 the statement of cash flows as a measure of liquidity. In addition, EBITDA and operating EBITDA are 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. The EBITDA and operating EBITDA measures presented in this quarterly report may not be comparable to similarly titled measures presented by other companies, and may not be identical to

corresponding measures used in our various agreements. The following sets forth a reconciliation of net income to EBITDA and operating EBITDA:

	Three months ended September 30,	Nine months ended September 30,

	2002	2003	2002	2003
	(in thousands)			
Net income	$ 7,772	$ 18,615	$ 15,623	$ 42,876
Income tax expense	5,022	11,590	12,727	26,608
Interest expense	4,969	2,678	16,263	14,341
Fair value loss on interest rate derivative	5,155	462	10,415	2,407
Other debt-related expenses	—	—	834	4,275
Depreciation and other amortization	11,107	13,382	30,274	39,676
Amortization of purchased intangibles	5,520	4,760	18,915	14,222
EBITDA	39,545	51,487	105,051	144,405
Plus change in deferred revenue	(1,024)	10,667	20,286	57,417
Less change in redemption settlement assets	5,481	(6,110)	(6,600)	(41,473)
Operating EBITDA	$ 44,002	$ 56,044	$ 118,737	$ 160,349

Results of Operations

Three months ended September 30, 2002 compared to the three months ended September 30, 2003

	Three months ended September 30,							
	Revenue		EBITDA		Depreciation & amortization		Operating income	
	2002	2003	2002	2003	2002	2003	2002	2003
	(in thousands)							
Transaction Services	$ 133,916	$ 152,167	$ 22,001	$ 23,565	$ 11,135	$ 12,823	$ 10,866	$ 10,742
Credit Services	84,753	107,042	8,701	18,912	1,756	1,148	6,945	17,764
Marketing Services	61,495	68,085	8,843	9,010	3,736	4,171	5,107	4,839
Other/Eliminations	(61,425)	(71,621)	—	—	—	—	—	—
Total	$ 218,739	$ 255,673	$ 39,545	$ 51,487	$ 16,627	$ 18,142	$ 22,918	$ 33,345

Revenue. Total revenue increased $37.0 million, or 16.9%, to $255.7 million for the three months ended September 30, 2003 from $218.7 million for the comparable period in 2002. The increase was due to a 13.6% increase in Transaction Services revenue, a 26.3% increase in Credit Services revenue and a 10.7% increase in Marketing Services revenue as follows:

- *Transaction Services.* Transaction Services revenue increased $18.3 million, or 13.6%, primarily due to an increase in the volume of statements and in the revenue per statement generated, partially offset by a decrease in merchant services revenue as a result of the pruning of non-core accounts. During the three months ended September 30, 2003, statements generated increased 22.2%, led by the addition of Pottery Barn, Restoration Hardware, Crate & Barrel and Ann Taylor private label accounts during 2002, Centrica and American Electric Power utility services accounts during the first quarter of 2003 and Enlogix utility services accounts during 2002.

- *Credit Services.* Credit Services revenue increased $22.3 million, or 26.3%, primarily due to a 48.4% increase in finance charges, net. Finance charges, net increased $24.0 million primarily as a result of an approximate 244 basis point increase in the net yield. The increase in the net yield is primarily related to an increase in finance charges and late fees as well as a significant

reduction in cost of funds as a result of the refinancing of our public securitization bonds. Average core accounts receivable increased 10.6% over the prior year balance.

- *Marketing Services.* Marketing Services revenue increased $6.6 million, or 10.7%, primarily due to an increase in redemption revenue related to a 21.9% increase in the redemption of AIR MILES® reward miles and an increase in the accretion of deferred services revenue. Our deferred revenue balance increased 2.6% to $417.5 million at September 30, 2003 from $406.8 million at June 30, 2003 due to continued growth in the program, including a 16.1% increase in AIR MILES reward miles issued during the three months ended September 30, 2003 over the comparable period in 2002.

Operating Expenses. Total operating expenses, excluding depreciation and amortization, increased $25.0 million, or 14.0%, to $204.2 million during the three months ended September 30, 2003 from $179.2 million during the comparable period in 2002. Total EBITDA margin increased to 20.1% for the three months ended September 30, 2003 from 18.1% for the comparable period in 2002, primarily due to the increased margin for Credit Services partially offset by decreases in the margins for Transaction Services and Marketing Services.

- *Transaction Services.* Transaction Services operating expenses, excluding depreciation and amortization, increased $16.7 million, or 14.9%, to $128.6 million for the three months ended September 30, 2003 from $111.9 million for the comparable period in 2002, and EBITDA margin decreased to 15.5% for the three months ended September 30, 2003 from 16.4% for the comparable period in 2002. The EBITDA margin decrease is related to start-up costs in our utility services business related to the current year additions of Centrica and American Electric Power accounts.

- *Credit Services.* Credit Services operating expenses, excluding depreciation and amortization, increased $12.0 million, or 15.8%, to $88.1 million for the three months ended September 30, 2003 from $76.1 million for the comparable period in 2002, and EBITDA margin increased to 17.7% for the three months ended September 30, 2003 from 10.3% for the comparable period in 2002. The increased margin is the result of favorable revenue trends from an increase in the average outstanding core accounts receivable, increased yield and lower financing costs.

- *Marketing Services.* Marketing Services operating expenses, excluding depreciation and amortization, increased $6.4 million, or 12.1%, to $59.1 million for the three months ended September 30, 2003 from $52.7 million for the comparable period in 2002, and EBITDA margin decreased to 13.2% for the three months ended September 30, 2003 from 14.4% for the comparable period in 2002. The EBITDA margin in the three months ended September 30, 2003 was negatively impacted by the sharp appreciation in the Canadian dollar. We are exposed to fluctuations in the exchange rate between the U.S. and Canadian dollar through our significant Canadian operations. Specifically, revenue is generated at the time AIR MILES reward miles are issued, but is deferred and recorded on the balance sheet at historical exchange rates. Revenue is then recognized over a period of time at this historical exchange rate. Operating costs, however, are expensed in the period incurred at the then prevailing exchange rate. EBITDA was negatively impacted as revenue at lower historical exchange rates was matched against expenses at higher current exchange rates. We do not hedge our net investment exposure in our Canadian subsidiary.

- *Depreciation and Amortization.* Depreciation and amortization increased $1.5 million, or 9.0%, to $18.1 million for the three months ended September 30, 2003 from $16.6 million for the comparable period in 2002 due primarily to an increase in depreciation and other amortization of $2.3 million related to increased capital expenditures, offset by a $0.7 million decrease in the amortization of purchased intangibles relating to certain intangibles becoming fully amortized in 2002.

Operating Income. Operating income increased $10.4 million, or 45.4%, to $33.3 million for the three months ended September 30, 2003 from $22.9 million for the comparable period in 2002. Operating income increased due to the changes in revenues and expenses described above.

Fair Value Loss on Interest Rate Derivative. The fair value loss improved $4.7 million, or 90.4%, to $0.5 million for the three months ended September 30, 2003 from $5.2 million for the comparable period in 2002. The improvement is the result of a realized gain of $2.4 million in the three months ended September 30, 2003 compared to a realized loss of $2.7 million for the three months ended September 30, 2002. The remaining change is the result of the difference in swap payments between periods.

Interest Expense. Interest expense decreased $2.3 million, or 46.0%, to $2.7 million for the three months ended September 30, 2003 from $5.0 million for the comparable period in 2002 due to lower interest rates as a result of the new credit facilities and repayment of a subordinated note.

Taxes. Income tax expense increased $6.6 million to $11.6 million for the three months ended September 30, 2003 from $5.0 million in 2002 due to an increase in taxable income. Our effective tax rate of 38.3% for the three months ended September 30, 2003 improved from the 39.3% effective rate for the comparable period in 2002 due to lower tax rates in Canada and the reduced impact of non-deductible permanent items in 2003.

Transactions with Limited Brands. Revenue from Limited Brands and its affiliates, which includes merchant and database marketing fees, increased $0.9 million to $11.7 million for the three months ended September 30, 2003 from $10.8 million for the comparable period in 2002. We generate a significant amount of additional revenue from our cardholders who are customers of Limited Brands and its affiliates.

Nine months ended September 30, 2002 compared to the nine months ended September 30, 2003

	Nine months ended September 30,							
	Revenue		EBITDA		Depreciation & amortization		Operating income	
	2002	2003	2002	2003	2002	2003	2002	2003
	(in thousands)							
Transaction Services	$ 396,044	$ 446,641	$ 57,667	$ 66,266	$ 32,946	$ 37,305	$ 24,721	$ 28,961
Credit Services	244,111	314,184	22,001	50,701	4,933	3,665	17,068	47,036
Marketing Services	174,219	195,190	25,383	27,438	11,310	12,928	14,073	14,510
Other/Eliminations	(179,755)	(212,587)	—	—	—	—	—	—
Total	$ 634,619	$ 743,428	$ 105,051	$ 144,405	$ 49,189	$ 53,898	$ 55,862	$ 90,507

Revenue. Total revenue increased $108.8 million, or 17.1%, to $743.4 million for the nine months ended September 30, 2003 from $634.6 million for the comparable period in 2002. The increase was due to a 12.8% increase in Transaction Services revenue, a 28.7% increase in Credit Services revenue and a 12.0% increase in Marketing Services revenue as follows:

- *Transaction Services.* Transaction Services revenue increased $50.6 million, or 12.8%, primarily due to an increase in the volume of statements and in the revenue per statement generated, partially offset by a decrease in merchant services revenue as a result of the pruning of non-core accounts. During the nine months ended September 30, 2003, statements generated increased 20.6%, led by the addition of Pottery Barn, Restoration Hardware, Crate & Barrel and Ann Taylor private label accounts during 2002, Centrica and American Electric Power utility services accounts during the first quarter of 2003 and Enlogix utility services accounts during 2002.

- *Credit Services.* Credit Services revenue increased $70.1 million, or 28.7%, primarily due to a 45.5% increase in finance charges, net. Finance charges, net increased $67.1 million primarily as a result of an approximate 248 basis point increase in the net yield. The increase in the yield is primarily related to an increase in finance charges and late fees as well as a significant reduction in cost of funds as a result of the refinancing of our public securitization bonds. Average core accounts receivable increased 10.0% over the prior year balance.

- *Marketing Services.* Marketing Services revenue increased $21.0 million, or 12.0%, primarily due to an increase in redemption revenue related to a 14.1% increase in the redemption of AIR MILES reward miles and an increase in the accretion of deferred services revenue. Our deferred revenue balance increased 15.9% to $417.5 million at September 30, 2003 from $360.1 million at December 31, 2002 due to continued growth in the program, including an 11.0% increase in AIR MILES reward miles issued during the nine months ended September 30, 2003 over the comparable period in 2002.

Operating Expenses. Total operating expenses, excluding depreciation and amortization, increased $69.4 million, or 13.1%, to $599.0 million during the nine months ended September 30, 2003 from $529.6 million for the comparable period in 2002. Total EBITDA margin increased to 19.4% for the nine months ended September 30, 2003 from 16.6% for the comparable period in 2002, primarily due to increased margins for Transaction Services and Credit Services, partially offset by a decrease in the margin for Marketing Services.

- *Transaction Services.* Transaction Services operating expenses, excluding depreciation and amortization, increased $42.0 million, or 12.4%, to $380.4 million for the nine months ended September 30, 2003 from $338.4 million for the comparable period in 2002, and EBITDA margin increased to 14.8% for the nine months ended September 30, 2003 from 14.6% for the comparable period in 2002. The EBITDA margin improved primarily due to revenue growth.

- *Credit Services.* Credit Services operating expenses, excluding depreciation and amortization, increased $41.4 million, or 18.6%, to $263.5 million for the nine months ended September 30, 2003 from $222.1 million for the comparable period in 2002, and EBITDA margin increased to 16.1% for the nine months ended September 30, 2003 from 9.0% for the comparable period in 2002. The increased margin is the result of favorable revenue trends from an increase in the average outstanding core accounts receivable, increased yield and lower financing costs.

- *Marketing Services.* Marketing Services operating expenses, excluding depreciation and amortization, increased $19.0 million, or 12.8%, to $167.8 million for the nine months ended September 30, 2003 from $148.8 million for the comparable period in 2002, and EBITDA margin decreased to 14.1% for the nine months ended September 30, 2003 from 14.6% for the comparable period in 2002. The EBITDA margin in the nine months ended September 30, 2003 was negatively impacted by the sharp appreciation in the Canadian dollar. We are exposed to fluctuations in the exchange rate between the U.S. and Canadian dollar through our significant Canadian operations. Specifically, revenue is generated at the time AIR MILES reward miles are issued, but is deferred and recorded on the balance sheet at historical exchange rates. Revenue is then recognized over a period of time at this historical exchange rate. Operating costs however, are expensed in the period incurred at the then prevailing exchange rate. EBITDA was negatively impacted as revenue at lower historical exchange rates was matched against expenses at higher current exchange rates. We do not hedge our net investment exposure in our Canadian subsidiary.

- *Depreciation and Amortization.* Depreciation and amortization increased $4.7 million, or 9.6%, to $53.9 million for the nine months ended September 30, 2003 from $49.2 million for the comparable period in 2002 due primarily to an increase in depreciation and other amortization of $9.4 million related to increased capital expenditures, partially offset by a $4.7 million

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decrease in the amortization of purchased intangibles relating to certain intangibles becoming fully amortized in 2002.

Operating Income. Operating income increased $34.6 million, or 61.9%, to $90.5 million for the nine months ended September 30, 2003 from $55.9 million for the comparable period in 2002. Operating income increased due to the changes in revenues and expenses described above.

Fair Value Loss on Interest Rate Derivative. The fair value loss improved $8.0 million, or 76.9%, to $2.4 million for the nine months ended September 30, 2003 from $10.4 million for the comparable period in 2002. The improvement is the result of a realized gain of $5.9 million in the nine months ended September 30, 2003 compared to a realized loss of $3.5 million for the nine months ended September 30, 2002. The remaining change is the result of the difference in swap payments between periods.

Interest Expense. Interest expense decreased $2.0 million, or 12.3%, to $14.3 million for the nine months ended September 30, 2003 from $16.3 million for the comparable period in 2002 due to lower interest rates as a result of the new credit facilities and repayment of a subordinated note, partially offset by a loss on the termination of a cross currency interest rate swap in conjunction with the refinancing of the prior credit facilities and repayment of the associated term debt. The associated costs of terminating the swap were recognized in the nine months ended September 30, 2003.

Other Debt-Related Expenses. During the nine months ended September 30, 2003, the Company wrote off $4.3 million of debt issuance costs related to the refinancing of our prior credit facilities and repayment of a subordinated note. During the nine months ended September 30, 2002, we wrote off $0.8 million of debt issuance costs related to the repayment of a subordinated note.

Taxes. Income tax expense increased $13.9 million to $26.6 million for the nine months ended September 30, 2003 from $12.7 million in 2002 due to an increase in taxable income. Our effective tax rate of 38.3% for the nine months ended September 30, 2003 improved from the 44.9% effective rate for the comparable period in 2002 due to lower tax rates in Canada and the reduced impact of non-deductible permanent items in 2003.

Transactions with Limited Brands. Revenue from Limited Brands and its affiliates, which includes merchant and database marketing fees, increased $3.5 million to $34.2 million for the nine months ended September 30, 2003 from $30.7 million for the comparable period in 2002. We generate a significant amount of additional revenue from our cardholders who are customers of Limited Brands and its affiliates.

Asset Quality

Our delinquency and net charge-off rates reflect, among other factors, the credit risk of credit card receivables, the average age of our various credit card account portfolios, the success of our collection and recovery efforts, and general economic conditions. The average age of our credit card portfolio affects the stability of delinquency and loss rates of the portfolio. We continue to focus on refining our credit underwriting standards for new accounts and on collections and post charge-off recovery efforts to minimize net losses.

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. It is our policy to continue to accrue interest and fee income on all credit card accounts, except in limited circumstances, until the account balance and all related interest and other fees are paid or charged off. When an account becomes delinquent, we print a message on the cardholder's billing statement requesting payment. After an account becomes 30 days past due, a proprietary collection scoring algorithm automatically scores the risk of the account rolling to a more delinquent status. The collection system then recommends a

collection strategy for the past due account based on the collection score and account balance and dictates the contact schedule and collections priority for the account. If we are unable to make a collection after exhausting all in-house efforts, we engage collection agencies and outside attorneys to continue those efforts.

The following tables reflect statistics for our securitization trusts as reported to the trustee for compliance reporting. Management also uses core receivables to manage and analyze the portfolios. Core receivables are defined as securitized receivables less those receivables whereby we do not assume any risk of loss. These losses are passed on to the respective client. The following table presents the delinquency trends of our securitized credit card portfolio.

	December 31, 2002	% of total	September 30, 2003	% of total
	(dollars in thousands)			
Receivables outstanding	$ 2,775,138	100.0%	$ 2,792,342	100.0%
Loan balances contractually delinquent:				
31 to 60 days	53,893	1.9	53,247	1.9
61 to 90 days	33,332	1.2	35,537	1.3
91 or more days	64,295	2.3	64,222	2.3
Total	$ 151,520	5.5%	$ 153,006	5.5%

Net Charge-Offs. Net charge-offs comprise the principal amount of losses from cardholders unwilling or unable to pay their account balances, as well as bankrupt and deceased cardholders, less current period recoveries. Net charge-offs exclude accrued finance charges and fees. The following table presents our net charge-offs for the periods indicated on a securitized basis. Average credit card portfolio outstanding represents the average balance of the securitized receivables at the beginning of each month for the period indicated.

	Nine months ended September 30,	
	2002	2003
	(dollars in thousands)	
Average securitized portfolio	$ 2,352,829	$ 2,595,513
Net charge-offs	129,708	138,523
Net charge-offs as a percentage of average securitized portfolio (annualized)	7.4%	7.1%

We believe, consistent with our statistical models and other credit analyses, that our securitized net charge-off ratio will continue to fluctuate.

Liquidity and Capital Resources

Operating Activities. We have historically generated cash flow from operating activities, as detailed in the table below, although that amount may vary based on fluctuations in working capital and the timing of merchant settlement activity.

	Nine months ended September 30,	
	2002	2003
	(in thousands)	
Cash provided by operating activities before change in merchant settlement activity	$ 112,285	$ 75,160
Net change in merchant settlement activity	(21,042)	8,525
Cash provided by operating activities	$ 91,243	$ 83,685

We generated cash flow from operating activities before change in merchant settlement activity of $75.2 million for the nine months ended September 30, 2003 compared to $112.3 million for the comparable period in 2002. The decrease in operating cash flows before change in merchant settlement activity is related to private label credit card portfolio purchases, which had yet to be securitized, partially offset by improved operating results for the nine months ended September 30, 2003. Merchant settlement activity fluctuates significantly depending on the day in which the quarter ends. We utilize our cash flow from operations for ongoing business operations, acquisitions and capital expenditures.

Investing Activities. We utilized cash flow for investing activities of $109.7 million for the nine months ended September 30, 2003 compared to $103.3 million for the comparable period in 2002. Significant components of investing activities are as follows:

- *Acquisitions.* Cash outlays, net of cash received, for acquisitions for the nine months ended September 30, 2003 were $48.0 million compared to $35.2 million for the comparable period in 2002. The outlay for acquisitions in 2003 relates to the January 2003 purchase of substantially all of the assets of ExoLink Corporation, a provider of utility back office support services, the March 2003 purchase of the customer care back office operations of American Electric Power related to the deregulated Texas marketplace and the September 2003 purchase of the stock of Conservation Billing Services Inc. related to the utilities sub-metering business.

- *Securitizations and Receivables Funding.* We generally fund all private label credit card receivables through a securitization program that provides us with both liquidity and lower borrowing costs. As of September 30, 2003, we had over $2.7 billion of securitized credit card receivables. Securitizations require credit enhancements in the form of cash, spread accounts and additional receivables. The credit enhancement is funded through the use of certificates of deposit issued through our subsidiary, World Financial Network National Bank. Net securitization activity utilized $19.5 million for the nine months ended September 30, 2003 and $29.7 million for the comparable period in 2002. We intend to utilize our securitization program for the foreseeable future.

Financing Activities. Net cash provided by financing activities was $19.9 million for the nine months ended September 30, 2003 compared to $19.1 million of net cash used for the comparable period in 2002. Our financing activities are primarily related to the following events in the first nine months of 2003:

- refinancing of our credit facilities in April 2003;

- receipt of net proceeds of $61.9 million from the issuance of equity securities in April 2003;

- repayment of $52.7 million of subordinated debt from a portion of those proceeds; and

- exercise of stock options.

Liquidity Sources. In addition to cash generated from operating activities, we have four main sources of liquidity: securitization program, certificates of deposit issued by World Financial Network National Bank, our credit facilities and issuances of equity securities. We believe that internally generated funds and existing sources of liquidity are sufficient to meet current and anticipated financing requirements during the next 12 months.

Securitization Program and Off-Balance Sheet Transactions. As of September 30, 2003, World Financial Network Credit Card Master Trust, World Financial Network Credit Card Master Note Trust, World Financial Network Credit Card Master Trust II and World Financial Network Credit Card Master Trust III ("the WFN Trusts") had over $2.7 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 private

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label credit cards in the securitization trust and their related performance. During the period from November to January, the WFN Trusts are required to maintain a credit enhancement level of 6% of securitized credit card receivables as compared to 4% to 6% for the remainder of the year. Accordingly, at December 31, the WFN Trusts typically have their highest balance of credit enhancement assets. The WFN Trusts completed a $600 million offering of asset backed notes, issued in multiple offerings as follows:

- In June 2003, we issued $100.0 million of Class A-1 Series 2003-A asset backed notes that have an interest rate not to exceed one-month LIBOR plus 0.42% per year and which will mature in May 2008 and $40.0 million of Class C-1 Series 2003-A asset backed notes that have an interest rate not to exceed one-month LIBOR plus 2.95% per year and which will mature in May 2008.

- In August 2003, we issued $368.0 million Class A-2 Series 2003-A asset backed notes that have an interest rate not to exceed one-month LIBOR plus 0.37% per year and which will mature in May 2008, $51.0 million Class B Series 2003-A asset backed notes that have an interest rate not to exceed one-month LIBOR plus 1.10% per year and which will mature in May 2008, and $41.0 million Class C-2 Series 2003-A asset backed notes that have an interest rate not to exceed one-month LIBOR plus 2.45% per year and which will mature in June 2008.

The notes are rated AAA through BBB, or its equivalent, by each of Moody's Investors Service, Standard & Poor's and Fitch. The WFN Trusts entered into interest rate swaps which effectively fix the interest rates on the notes starting at 5.0% and averaging 4.8% over the term of the interest rate swap. We intend to utilize our securitization program for the foreseeable future.

Certificates of Deposit. We utilize certificates of deposit to finance the operating activities of our credit card bank subsidiary, World Financial Network National Bank, and to fund securitization enhancement requirements. World Financial Network National Bank issues certificates of deposit in denominations of $100,000 in various maturities ranging between three months and two years and with effective annual fixed rates ranging from 1.7% to 4.0%. As of September 30, 2003, we had $97.3 million of certificates of deposit outstanding. Certificate of deposit borrowings are subject to regulatory capital requirements.

Credit Facilities. On April 10, 2003, we entered into three new credit facilities to replace our prior credit facilities. The first facility provides for a $150.0 million revolving commitment and matures in April 2006. The second facility is a 364-day facility and provides for an additional $150.0 million revolving commitment that matures in April 2004. The third facility provides for a $100.0 million revolving commitment to Loyalty Management Group Canada Inc., a wholly owned Canadian subsidiary, and matures in April 2006. The covenants contained in the three credit facilities are substantially identical to each other and to the covenants contained in the prior credit facilities.

Advances under the credit facilities are in the form of either base rate loans or eurodollar loans. The interest rate on base rate loans fluctuates based upon the higher of (1) the interest rate announced by the administrative agent as its "prime rate" or (2) the Federal funds rate plus 0.5%, in each case with no additional margin. The interest rate on eurodollar loans fluctuates based upon the rate at which eurodollar deposits in the London interbank market are quoted plus a margin of 1.0% to 1.5% based upon the ratio of Total Debt under the credit facilities to Consolidated Operating EBITDA, as each term is defined in the credit facilities. The credit facilities are secured by pledges of stock of certain of our subsidiaries and pledges of certain intercompany promissory notes.

As of September 30, 2003, we had borrowings of $140.0 million outstanding under these credit facilities (with an average interest rate of 3.1%), we had issued no letters of credit and we had available unused borrowing capacity of approximately $260.0 million. The credit facilities limit our aggregate outstanding letters of credit to $50.0 million. We can obtain an increase in the total

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commitment under the credit facilities of up to $50.0 million if we are not in default under the credit facilities, one or more lenders agrees to increase its commitment and the administrative agent consents.

We utilize our credit facilities and excess cash flows from operations to support our acquisition strategy and to fund working capital and capital expenditures.

Issuances of Equity. In April 2003, we completed a public offering of 10,350,000 shares of our common stock at $19.65 per share. 7,000,000 shares were sold by one of our largest stockholders, Limited Commerce Corp., an affiliate of Limited Brands, and the remaining 3,350,000 shares were sold by us. The net proceeds to us from the offering were $61.9 million after deducting our pro-rata underwriting discounts and commissions and offering expenses. Concurrently with the closing of the public offering, we used $52.7 million of the net proceeds to repay in full $52.0 million of debt outstanding, plus accrued interest, under a 10% subordinated note that we issued in September 1998 to an affiliated entity of Welsh Carson, our largest stockholder, and have used and anticipate continuing to use the balance of the proceeds for general corporate purposes.

Contractual Obligations. There has been no material change from our annual report on Form 10-K, except for repayment of $52.7 million of subordinated debt.

Recently Issued Accounting Standards

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." The statement amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under Statement 133. The statement is generally effective for contracts entered into or modified after June 30, 2003. We have adopted this statement and it did not have a material impact on our financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within the scope of SFAS No. 150 as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. SFAS No. 150 is generally effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. We have adopted this statement and it did not have a material impact on our financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market Risk

There has been no material change from our annual report on Form 10-K related to our exposure to market risk from off-balance sheet risk, interest rate risk, credit risk, and redemption reward risk.

Foreign Currency Exchange Risk. We are exposed to fluctuations in the exchange rate between the U.S. and Canadian dollar through our significant Canadian operations. Specifically, revenue is generated at the time AIR MILES reward miles are issued, but is deferred and recorded on the balance sheet at historical exchange rates. Revenue is then recognized over a period of time at this historical exchange rate. Operating costs however, are expensed in the period incurred at the then prevailing exchange rate. Due to the sharp appreciation in the Canadian dollar during the first nine months of 2003, reported EBITDA and net income were negatively impacted as revenue at lower historical exchange rates was matched against expenses at higher current exchange rates. We do not hedge our net investment exposure in our Canadian subsidiary.

Item 4. Controls and Procedures

Evaluation

As of September 30, 2003, 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 our disclosure controls and procedures were effective to ensure as of September 30, 2003 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.

There have been no changes in our internal controls over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Audit Committee Pre-Approval

Our audit committee has resolved to pre-approve all audit and non-audit services to be performed for us by our independent auditors, Deloitte & Touche LLP. Non-audit services that have received pre-approval include tax preparation and related tax consultation and advice, consultation with respect to our securitization program, review and support for securities issuances, SAS 70 reporting and acquisition assistance.

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 our Annual Report on Form 10-K for the year ended December 31, 2002.

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.

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 affect on our business or financial condition, including claims and lawsuits alleging breaches of contractual obligations.

Item 2. Changes in Securities and Use of Proceeds.

On April 30, 2003, we completed a public offering of 10,350,000 shares of our common stock at a public offering price of $19.65 per share. Of the shares sold in the offering, 7,000,000 shares were sold by one of our largest stockholders, Limited Commerce Corp., an affiliate of Limited Brands, and the remaining 3,350,000 shares were sold by us. The offering was completed pursuant to a Registration Statement on Form S-3, File No. 333-104314, which was declared effective by the SEC on April 24, 2003. Bear, Stearns & Co. Inc., Credit Suisse First Boston LLC and J.P. Morgan Securities Inc. acted as joint book-running managers for the offering and Adams, Harkness & Hill, Inc., CIBC World Markets Corp. and Lehman Brothers Inc. served as co-managers. Aggregate proceeds from the offering to us were $65.8 million and to the selling stockholder were $137.5 million. After deducting our pro-rata underwriting discounts and commissions of $3.3 million and offering expenses, we received net offering proceeds of approximately $61.9 million.

Concurrently with the closing of the public offering, we used $52.7 million of net proceeds to repay in full $52.0 million of debt outstanding, plus accrued interest, under a 10% subordinated note that we issued in September 1998 to an affiliated entity of Welsh Carson, our largest stockholder. We have used and anticipate continuing to use the balance of the proceeds, approximately $9.3 million, for acquisitions and general corporate purposes, including working capital and capital expenditures. The amounts and timing of our expenditures for general corporate purposes will vary depending on a number of factors, including the amount of cash generated or used by our operations, competitive and technological developments and the rate of growth of our business. As a result, we have retained broad discretion in allocating the remaining proceeds from the public offering. No payments of expenses or uses of net proceeds constituted direct or indirect payments to any of our directors, officers or general partners or their associates, persons owning 10% or more of any class of our equity securities, or to any of our affiliates other than (1) the repayment in full of the $52.7 million of debt outstanding held by Welsh Carson and (2) reimbursements to the selling stockholder for expenses related to the offering as required under our stockholders agreement.

Item 3. Defaults Upon Senior Securities.

None

Item 4. Submission of Matters to a Vote of Security Holders.

None

Item 5. Other Information.

None

Item 6. Exhibits and Reports on Form 8-K.

(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).
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. 038-327007.
10.1	Form of Change in Control Agreement, dated as of September 25, 2003, by and between ADS Alliance Data Systems, Inc. and each of Michael A. Beltz, Edward J. Heffernan, John W. Scullion, Ivan M. Szeftel, Dwayne H. Tucker and Alan M. Utay (incorporated by reference to Exhibit No. 10.1 to our Registration Statement on Form S-3 filed with the SEC on October 22, 2003, File No. 333-109713).
10.2	Change in Control Agreement, dated as of September 25, 2003, by and between ADS Alliance Data Systems, Inc. and J. Michael Parks (incorporated by reference to Exhibit No. 10.2 to our Registration Statement on Form S-3 filed with the SEC on October 22, 2003, File No. 333-109713).
10.3	Capital Assurance and Liquidity Maintenance Agreement, dated August 28, 2003, by and between Alliance Data Systems Corporation and World Financial Network National Bank (incorporated by reference to Exhibit No. 10.3 to our Registration Statement on Form S-3 filed with the SEC on October 22, 2003, File No. 333-109713).
*31.1	Certification of Chief Executive Officer of Alliance Data Systems Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*31.2	Certification of Chief Financial Officer of Alliance Data Systems Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*32.1	Certification of Chief Executive Officer of Alliance Data Systems Corporation pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*32.2	Certification of Chief Financial Officer of Alliance Data Systems Corporation pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith

(b) Reports on Form 8-K:

On October 15, 2003, we furnished to the SEC a Current Report on Form 8-K, dated October 15, 2003. The Current Report on Form 8-K relates to our earnings for the third quarter of 2003.

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
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: November 12, 2003

By: /s/ MICHAEL D. KUBIC

Michael D. Kubic
Senior Vice President, Corporate Controller and
Chief Accounting Officer
(Principal Accounting Officer)

Date: November 12, 2003

EXHIBIT INDEX

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* Filed herewith

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Exhibit 31.1

**CERTIFICATION OF THE
CHIEF EXECUTIVE OFFICER
OF
ALLIANCE DATA SYSTEMS CORPORATION**

I, J. Michael Parks, Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Alliance Data Systems Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2003

/s/ J. MICHAEL PARKS

J. Michael Parks
Chief Executive Officer

Exhibit 31.2

CERTIFICATION OF THE
CHIEF FINANCIAL OFFICER
OF
ALLIANCE DATA SYSTEMS CORPORATION

I, Edward J. Heffernan, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Alliance Data Systems Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

    (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2003

/s/ EDWARD J. HEFFERNAN

Edward J. Heffernan
Chief Financial Officer

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Exhibit 32.1

**CERTIFICATION OF
CHIEF EXECUTIVE OFFICER
OF
ALLIANCE DATA SYSTEMS CORPORATION**

This certification is provided pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and accompanies the quarterly report on Form 10-Q for the quarter ended September 30, 2003 (the "Form 10-Q") of Alliance Data Systems Corporation (the "Registrant").

I, J. Michael Parks, the Chief Executive Officer of the Registrant certify that to the best of my knowledge:

(i) the Form 10-Q fully complies with the requirements of section 13(a) or section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and

(ii) the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Dated: November 12, 2003

/s/ J. MICHAEL PARKS

Name: J. Michael Parks
Chief Executive Officer

Subscribed and sworn to before me
this 12th day of November, 2003.

/s/ JANE BAEDKE

Name: Jane Baedke
Title: Notary Public
My commission expires:

October 23, 2004

A signed original of this written statement required by Section 906 has been provided to the Registrant and will be retained by the Registrant and furnished to the Securities and Exchange Commission or its staff upon request.

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Exhibit 32.2

CERTIFICATION OF
CHIEF FINANCIAL OFFICER
OF
ALLIANCE DATA SYSTEMS CORPORATION

This certification is provided pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and accompanies the quarterly report on Form 10-Q for the quarter ended September 30, 2003 (the "Form 10-Q") of Alliance Data Systems Corporation (the "Registrant").

I, Edward J. Heffernan, the Chief Financial Officer of the Registrant certify that to the best of my knowledge:

(i) the Form 10-Q fully complies with the requirements of section 13(a) or section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and

(ii) the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Dated: November 12, 2003

/s/ EDWARD J. HEFFERNAN

Name: Edward J. Heffernan
Chief Financial Officer

Subscribed and sworn to before me
this 12th day of November, 2003.

/s/ JANE BAEDKE

Name: Jane Baedke
Title: Notary Public
My commission expires:

October 23, 2004

A signed original of this written statement required by Section 906 has been provided to the Registrant and will be retained by the Registrant and furnished to the Securities and Exchange Commission or its staff upon request.

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