DELUXE CORP
Form 10-Q
October 30, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

x	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the quarterly period ended September 30, 2014
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: 1-7945

DELUXE CORPORATION
(Exact name of registrant as specified in its charter)

Minnesota (State or other jurisdiction of incorporation or organization)	41-0216800 (I.R.S. Employer Identification No.)
3680 Victoria St. N., Shoreview, Minnesota (Address of principal executive offices)	55126-2966 (Zip Code)

(651) 483-7111
(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. þYes o No

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

o Yes þ No

The number of shares outstanding of registrant’s common stock, par value $1.00 per share, at October 20, 2014 was 49,671,746.

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PART I – FINANCIAL INFORMATION
Item 1. Financial Statements.
DELUXE CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands, except share par value)
(Unaudited)

	September 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$188,001	$121,089
Trade accounts receivable (net of allowances for uncollectible accounts of $3,464 and $3,861, respectively)	91,368	88,049
Inventories and supplies	36,099	28,966
Deferred income taxes	5,695	6,946
Funds held for customers	39,546	42,425
Other current assets	34,287	31,838
Total current assets	394,996	319,313
Deferred income taxes	1,510	1,851
Long-term investments (including $2,332 and $2,407 of investments at fair value, respectively)	46,025	44,451
Property, plant and equipment (net of accumulated depreciation of $367,021 and $360,926, respectively)	94,448	101,343
Assets held for sale	26,798	25,451
Intangibles (net of accumulated amortization of $380,883 and $346,086, respectively)	147,169	153,576
Goodwill	822,920	822,777
Other non-current assets	137,598	100,767
Total assets	$1,671,464	$1,569,529
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$74,280	$71,492
Accrued liabilities	177,115	162,990
Long-term debt due within one year	254,291	255,589
Total current liabilities	505,686	490,071
Long-term debt	390,321	385,115
Deferred income taxes	83,941	82,814
Other non-current liabilities	87,348	61,072
Commitments and contingencies (Notes 11 and 12)		
Shareholders' equity:		
Common shares $1 par value (authorized: 500,000 shares; outstanding: 2014 – 49,670; 2013 – 50,344)	49,670	50,344
Additional paid-in capital	2,849	22,596
Retained earnings	586,739	510,941
Accumulated other comprehensive loss	(35,090)	(33,424)
Total shareholders' equity	604,168	550,457
Total liabilities and shareholders' equity	$1,671,464	$1,569,529

See Condensed Notes to Unaudited Consolidated Financial Statements

DELUXE CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands, except per share amounts)
(Unaudited)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Product revenue	$350,607	$342,187	$1,040,734	$1,014,853
Service revenue	62,597	55,893	184,835	152,214
Total revenue	413,204	398,080	1,225,569	1,167,067
Cost of products	(125,917)	(116,721)	(363,852)	(340,442)
Cost of services	(24,233)	(25,502)	(77,117)	(68,625)
Total cost of revenue	(150,150)	(142,223)	(440,969)	(409,067)
Gross profit	263,054	255,857	784,600	758,000
Selling, general and administrative expense	(175,661)	(173,359)	(527,138)	(513,013)
Net restructuring charges	(4,193)	(2,780)	(8,507)	(5,075)
Asset impairment charge	(6,468)	—	(6,468)	—
Operating income	76,732	79,718	242,487	239,912
Interest expense	(9,580)	(9,662)	(28,677)	(28,704)
Other income	321	557	820	1,048
Income before income taxes	67,473	70,613	214,630	212,256
Income tax provision	(23,042)	(23,710)	(72,800)	(71,326)
Net income	$44,431	$46,903	$141,830	$140,930
Comprehensive income	$41,585	$48,907	$140,164	$140,945
Basic earnings per share	$0.89	$0.93	$2.83	$2.77
Diluted earnings per share	0.88	0.92	2.80	2.75
Cash dividends per share	0.30	0.25	0.85	0.75

See Condensed Notes to Unaudited Consolidated Financial Statements

DELUXE CORPORATION
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(in thousands)
(Unaudited)

	Common shares	Common shares par value	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Total
Balance, December 31, 2013	50,344	$50,344	$22,596	$510,941	$(33,424)	$550,457
Net income	—	—	—	141,830	—	141,830
Cash dividends	—	—	—	(42,631)	—	(42,631)
Common shares issued	525	525	10,580	—	—	11,105
Tax impact of share-based awards	—	—	2,225	—	—	2,225
Common shares repurchased	(1,133)	(1,133)	(35,585)	(23,401)	—	(60,119)
Other common shares retired	(66)	(66)	(3,304)	—	—	(3,370)
Fair value of share-based compensation	—	—	6,337	—	—	6,337
Other comprehensive income	—	—	—	—	(1,666)	(1,666)
Balance, September 30, 2014	49,670	$49,670	$2,849	$586,739	$(35,090)	$604,168

See Condensed Notes to Unaudited Consolidated Financial Statements

DELUXE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2014	2013
Cash flows from operating activities:		
Net income	$141,830	$140,930
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	12,700	13,443
Amortization of intangibles	35,845	34,878
Asset impairment charge	6,468	—
Amortization of contract acquisition costs	13,180	12,633
Deferred income taxes	116	1,563
Employee share-based compensation expense	6,997	5,554
Other non-cash items, net	7,708	7,979
Changes in assets and liabilities, net of effect of acquisitions:		
Trade accounts receivable	(5,547)	(7,492)
Inventories and supplies	(2,016)	(1,541)
Other current assets	(4,730)	(527)
Non-current assets	(1,860)	(5,731)
Accounts payable	1,598	(2,043)
Contract acquisition payments	(9,831)	(10,551)
Other accrued and non-current liabilities	901	(5,122)
Net cash provided by operating activities	203,359	183,973
Cash flows from investing activities:		
Purchases of capital assets	(29,649)	(26,786)
Payments for acquisitions, net of cash acquired	(12,144)	(48,114)
Proceeds from company-owned life insurance policies	897	4,599
Other	462	1,472
Net cash used by investing activities	(40,434)	(68,829)
Cash flows from financing activities:		
Net payments on short-term debt	(125)	—
Payments on long-term debt	(820)	(1,456)
Payments for debt issue costs	(1,085)	(236)
Change in book overdrafts	—	(270)
Proceeds from issuing shares under employee plans	8,814	12,881
Excess tax benefit from share-based employee awards	2,581	1,582
Payments for common shares repurchased	(60,119)	(33,798)
Cash dividends paid to shareholders	(42,631)	(38,027)
Net cash used by financing activities	(93,385)	(59,324)
Effect of exchange rate change on cash	(2,628)	(1,215)
Net change in cash and cash equivalents	66,912	54,605
Cash and cash equivalents, beginning of year	121,089	45,435
Cash and cash equivalents, end of period	$188,001	$100,040

See Condensed Notes to Unaudited Consolidated Financial Statements

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DELUXE CORPORATION
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(dollars and shares in thousands, except per share amounts)

Note 1: Consolidated financial statements

The consolidated balance sheet as of September 30, 2014, the consolidated statements of comprehensive income for the quarters and nine months ended September 30, 2014 and 2013, the consolidated statement of shareholders' equity for the nine months ended September 30, 2014, and the consolidated statements of cash flows for the nine months ended September 30, 2014 and 2013 are unaudited. The consolidated balance sheet as of December 31, 2013 was derived from audited consolidated financial statements, but does not include all disclosures required by generally accepted accounting principles (GAAP) in the United States of America. In the opinion of management, all adjustments necessary for a fair statement of the consolidated financial statements are included. Adjustments consist only of normal recurring items, except for any discussed in the notes below. Interim results are not necessarily indicative of results for a full year. The consolidated financial statements and notes are presented in accordance with instructions for Form 10-Q, and do not contain certain information included in our annual consolidated financial statements and notes. The consolidated financial statements and notes appearing in this report should be read in conjunction with the consolidated audited financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2013 (the "2013 Form 10-K").

Note 2: New accounting pronouncements

On January 1, 2014, we adopted Accounting Standards Update (ASU) No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. This standard provides guidance regarding when an unrecognized tax benefit should be classified as a reduction to a deferred tax asset or when it should be classified as a liability in the consolidated balance sheet. Adoption of this standard resulted in an increase of $669 in non-current deferred income tax liabilities and a corresponding decrease in other non-current liabilities.

In April 2014, the Financial Accounting Standards Board (FASB) issued ASU No. 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. This standard changes the criteria for determining which disposals should be presented as discontinued operations and modifies the related disclosure requirements. Additionally, the new guidance requires that a business which qualifies as held for sale upon acquisition should be reported as discontinued operations. The new guidance is effective for us on January 1, 2015 and is to be applied prospectively. As such, we will apply this standard to any new disposals or new classifications of disposal groups as held for sale which occur on or after January 1, 2015.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. The new standard provides revenue recognition guidance for any entity that enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets, unless those contracts are within the scope of other accounting standards. The new standard also expands the required financial statement disclosures regarding revenue recognition. The new guidance is effective for us on January 1, 2017. We are currently assessing the impact of this new standard on our consolidated financial statements, as well as the method of transition that we will use in adopting the new standard.

In June 2014, the FASB issued ASU No. 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. The new standard requires that a performance target that affects vesting and that could be achieved after the requisite service period should be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. The new guidance is effective for us on January 1, 2016. We currently have share-based payment awards that fall within the scope of this standard. Our current accounting treatment is in compliance with the new standard, so we expect no impact on our consolidated financial statements.

Note 3: Supplemental balance sheet information

Inventories and supplies – Inventories and supplies were comprised of the following:

	September 30, 2014	December 31, 2013
Raw materials	$5,761	$5,426
Semi-finished goods	8,948	8,361
Finished goods	18,264	11,948
Supplies	3,126	3,231
Inventories and supplies	$36,099	$28,966

Available-for-sale securities – Available-for-sale securities included within cash and cash equivalents, funds held for customers and other current assets were comprised of the following:

	September 30, 2014			
	Cost	Gross unrealized gains	Gross unrealized losses	Fair value
Canadian and provincial government securities (funds held for customers)[1]	$9,553	$—	$(211)	$9,342
Money market securities (cash equivalents)	2,996	—	—	2,996
Canadian money market fund (other current assets)	1,958	—	—	1,958
Total available-for-sale securities	$14,507	$—	$(211)	$14,296

[1] Funds held for customers, as reported on the consolidated balance sheet as of September 30, 2014, also included cash of $30,204.

	December 31, 2013			
	Cost	Gross unrealized gains	Gross unrealized losses	Fair value
Money market securities (cash equivalents)	$70,001	$—	$—	$70,001
Funds held for customers:				
Canadian and provincial government securities	9,901	—	(343)	9,558
Canadian guaranteed investment certificate	5,178	—	—	5,178
Available-for-sale securities (funds held for customers)[1]	15,079	—	(343)	14,736
Canadian money market fund (other current assets)	2,045	—	—	2,045
Total available-for-sale securities	$87,125	$—	$(343)	$86,782

[1] Funds held for customers, as reported on the consolidated balance sheet as of December 31, 2013, also included cash of $27,689.

Expected maturities of available-for-sale securities as of September 30, 2014 were as follows:

	Fair value
Due in one year or less	$4,954
Due in two to five years	6,502
Due in six to ten years	2,840
Total available-for-sale securities	$14,296

Further information regarding the fair value of available-for-sale securities can be found in Note 8: Fair value measurements.

Assets held for sale – Assets held for sale included the operations of small business distributors which we previously acquired and which consisted primarily of customer list intangible assets. The net assets of one of the small business distributors were sold during 2014, realizing a net pre-tax gain of $430. We are actively marketing the remaining assets and expect the selling prices will exceed the carrying values. Net assets held for sale consisted of the following:

	September 30, 2014	December 31, 2013	Balance sheet caption
Current assets	$136	$727	Other current assets
Intangibles	25,910	24,603	Assets held for sale
Other non-current assets	888	848	Assets held for sale
Accrued liabilities	(932)	(733)	Accrued liabilities
Non-current deferred income tax liabilities	(8,748)	(7,821)	Other non-current liabilities
Other non-current liabilities	(13)	(32)	Other non-current liabilities
Net assets held for sale	$17,241	$17,592	

Intangibles – Intangibles were comprised of the following:

	September 30, 2014			December 31, 2013		
	Gross carrying amount	Accumulated amortization	Net carrying amount	Gross carrying amount	Accumulated amortization	Net carrying amount
Indefinite-lived:						
Trade name	$19,100	$—	$19,100	$19,100	$—	$19,100
Amortizable intangibles:						
Internal-use software	363,093	(300,849)	62,244	339,995	(275,159)	64,836
Customer lists/relationships	70,418	(37,039)	33,379	63,282	(31,606)	31,676
Trade names	67,281	(36,594)	30,687	67,961	(33,642)	34,319
Other	8,160	(6,401)	1,759	9,324	(5,679)	3,645
Amortizable intangibles	508,952	(380,883)	128,069	480,562	(346,086)	134,476
Intangibles	$528,052	$(380,883)	$147,169	$499,662	$(346,086)	$153,576

Amortization of intangibles was $11,730 for the quarter ended September 30, 2014 and $11,880 for the quarter ended September 30, 2013. Amortization of intangibles was $35,845 for the nine months ended September 30, 2014 and $34,878 for the nine months ended September 30, 2013. Based on the intangibles in service as of September 30, 2014, estimated future amortization expense is as follows:

	Estimated amortization expense
Remainder of 2014	$10,376
2015	35,567
2016	23,597
2017	11,785
2018	8,041

We acquire internal-use software in the normal course of business. We also acquire internal-use software and other intangible assets in conjunction with acquisitions (Note 6). The following intangible assets were acquired during the nine months ended September 30, 2014:

	Amount	Weighted-average amortization period (in years)
Internal-use software	$26,769	4
Customer lists/relationships	9,996	10
Other	50	2
Acquired intangibles	$36,815	5

Goodwill – Changes in goodwill during the nine months ended September 30, 2014 were as follows:

	Small Business Services	Financial Services	Direct Checks	Total
Balance, December 31, 2013:				
Goodwill, gross	$652,554	$41,717	$148,506	$842,777
Accumulated impairment charges	(20,000)	—	—	(20,000)
Goodwill, net of accumulated impairment charges	632,554	41,717	148,506	822,777
Adjustment for acquisition of Destination Rewards, Inc. (Note 6)	—	(1,375)	—	(1,375)
Acquisition of NetClime, Inc. (Note 6)	1,615	—	—	1,615
Currency translation adjustment	(97)	—	—	(97)
Balance, September 30, 2014:				
Goodwill, gross	654,072	40,342	148,506	842,920
Accumulated impairment charges	(20,000)	—	—	(20,000)
Goodwill, net of accumulated impairment charges	$634,072	$40,342	$148,506	$822,920

Other non-current assets – Other non-current assets were comprised of the following:

	September 30, 2014	December 31, 2013
Contract acquisition costs	$77,570	$35,421
Postretirement benefit plan asset	26,177	24,981
Loans and notes receivable from distributors	15,237	16,162
Deferred advertising costs	8,190	10,447
Other	10,424	13,756
Other non-current assets	$137,598	$100,767

Changes in contract acquisition costs during the nine months ended September 30, 2014 and 2013 were as follows:

	Nine Months Ended September 30,	
	2014	2013
Balance, beginning of year	$35,421	$43,036
Additions[1]	55,659	8,333
Amortization	(13,180)	(12,633)
Other	(330)	(381)
Balance, end of period	$77,570	$38,355

[1] Contract acquisition costs are accrued upon contract execution. Cash payments made for contract acquisition costs were $9,831 for the nine months ended September 30, 2014 and $10,551 for the nine months ended September 30, 2013.

Accrued liabilities – Accrued liabilities were comprised of the following:

	September 30, 2014	December 31, 2013
Funds held for customers	$38,687	$41,810
Performance-based compensation	24,602	29,544
Deferred revenue	20,771	16,897
Customer rebates	20,131	21,623
Contract acquisition costs due within one year	13,397	3,880
Interest	11,613	8,869
Restructuring due within one year (Note 9)	5,387	5,609
Other	42,527	34,758
Accrued liabilities	$177,115	$162,990

Note 4: Earnings per share

The following table reflects the calculation of basic and diluted earnings per share. During each period, certain stock options, as noted below, were excluded from the calculation of diluted earnings per share because their effect would have been antidilutive.

	Quarter Ended September 30, 2014	2013	Nine Months Ended September 30, 2014	2013
Earnings per share – basic:				
Net income	$44,431	$46,903	$141,830	$140,930
Income allocated to participating securities	(256)	(160)	(743)	(689)
Income available to common shareholders	$44,175	$46,743	$141,087	$140,241
Weighted-average shares outstanding	49,594	50,443	49,889	50,579
Earnings per share – basic	$0.89	$0.93	$2.83	$2.77
Earnings per share – diluted:				
Net income	$44,431	$46,903	$141,830	$140,930
Income allocated to participating securities	(255)	(159)	(738)	(684)
Re-measurement of share-based awards classified as liabilities	(66)	133	43	158
Income available to common shareholders	$44,110	$46,877	$141,135	$140,404
Weighted-average shares outstanding	49,594	50,443	49,889	50,579
Dilutive impact of potential common shares	448	451	448	450
Weighted-average shares and potential common shares outstanding	50,042	50,894	50,337	51,029
Earnings per share – diluted	$0.88	$0.92	$2.80	$2.75
Antidilutive options excluded from calculation	276	440	276	440

Note 5: Other comprehensive income

Reclassification adjustments – Information regarding amounts reclassified from accumulated other comprehensive loss to net income was as follows:

Accumulated other comprehensive loss components	Amounts reclassified from accumulated other comprehensive loss				Affected line item in consolidated statements of comprehensive income
	Quarter Ended September 30,		Nine Months Ended September 30,		
	2014	2013	2014	2013	
Amortization of loss on interest rate locks[1]	$(427)	$(418)	$(1,282)	$(1,255)	Interest expense
Tax benefit	167	158	501	475	Income tax provision
Amortization of loss on interest rate locks, net of tax	(260)	(260)	(781)	(780)	Net income
Amortization of postretirement benefit plan items:					
Prior service credit	355	355	1,066	1,066	[2]
Net actuarial loss	(854)	(1,110)	(2,563)	(3,330)	[2]
Total amortization	(499)	(755)	(1,497)	(2,264)	[2]
Tax benefit	139	229	418	685	[2]
Amortization of postretirement benefit plan items, net of tax	(360)	(526)	(1,079)	(1,579)	[2]
Total reclassifications, net of tax	$(620)	$(786)	$(1,860)	$(2,359)	

[1] Relates to interest rate locks executed in 2004. See the caption "Note 6: Derivative financial instruments" in the Notes to Consolidated Financial Statements appearing in the 2013 Form 10-K.
[2] Amortization of postretirement benefit plan items is included in the computation of net periodic benefit income. Additional details can be found in Note 10: Postretirement benefits.

Accumulated other comprehensive loss – Changes in the components of accumulated other comprehensive loss were as follows:

	Postretirement benefit plans, net of tax	Loss on derivatives, net of tax[1]	Net unrealized loss on marketable securities, net of tax[2]	Currency translation adjustment	Accumulated other comprehensive loss
Balance, December 31, 2013	$(34,874)	$(781)	$(276)	$2,507	$(33,424)
Other comprehensive income (loss) before reclassifications	—	—	88	(3,614)	(3,526)
Amounts reclassified from accumulated other comprehensive loss	1,079	781	—	—	1,860
Net current-period other comprehensive income (loss)	1,079	781	88	(3,614)	(1,666)
Balance, September 30, 2014	$(33,795)	$—	$(188)	$(1,107)	$(35,090)

[1] Relates to interest rate locks executed in 2004. See the caption "Note 6: Derivative financial instruments" in the Notes to Consolidated Financial Statements appearing in the 2013 Form 10-K.

(2) Other comprehensive income before reclassifications is net of income tax expense of $31.

Note 6: Acquisitions

During the nine months ended September 30, 2014, we made the following payments, net of cash acquired, for business acquisitions:

	Payments for acquisitions, net of cash acquired
Small business distributors	$7,841
NetClime, Inc.	2,011
Gift Box Corporation of America[1]	1,750
Other	542
Total	$12,144

[1] We are operating this business under the name WholeStyle Packaging™.

In May 2014, we acquired selected assets of Gift Box Corporation of America (GBCA), a supplier of retail packaging solutions, including gift boxes, bags, bows, ribbons and wraps. The allocation of the purchase price to the assets acquired and liabilities assumed was finalized during the third quarter of 2014, as we finalized the valuation of acquired inventory. Transaction costs related to the acquisition were expensed as incurred and were not significant to the consolidated statement of comprehensive income for the nine months ended September 30, 2014. The results of operations of this business from its acquisition date are included in our Small Business Services segment. Intangible assets acquired consisted primarily of a customer list with a value of $1,095 and a useful life of five years, which is being amortized using the straight-line method. Further information regarding the calculation of the estimated fair value of the customer list can be found in Note 8.

In January 2014, we acquired all of the outstanding capital stock of NetClime, Inc., a provider of website development software. The allocation of the purchase price, based upon the estimated fair value of the assets acquired and liabilities assumed, resulted in goodwill of $1,615. The acquisition resulted in goodwill as we expect to drive future revenue as we incorporate NetClime's software solution into our technology platform and the marketing solutions services we offer our customers. Transaction costs related to the acquisition were expensed as incurred and were not significant to the consolidated statement of comprehensive income for the nine months ended September 30, 2014. The results of operations of this business from its acquisition date are included in our Small Business Services segment. Intangible assets acquired consisted primarily of internal-use software with an aggregate value of $1,050 and a useful life of four years, which is being amortized using the straight-line method. Further information regarding the calculation of the estimated fair value of the internal-use software can be found in Note 8.

In December 2013, we acquired substantially all of the assets of Destination Rewards, Inc., a rewards and loyalty program provider. During the first quarter of 2014, we adjusted the valuation of the intangibles acquired, and we finalized the determination of the intangible useful lives, resulting in tax-deductible goodwill of $11,705. This is a decrease of $1,375 from the amount of goodwill as of December 31, 2013. The acquisition resulted in goodwill as we plan to offer Destination Rewards to our clients as a key component of our marketing solutions product set. The acquired intangible assets consisted primarily of customer relationships of $4,400 with a useful life of 10 years, internal-use software with an aggregate value of $4,100 and a weighted-average useful life of four years, and supplier relationships of $1,100 with a useful life of five years. All of the intangibles are being amortized using the straight-line method. Further information regarding the calculation of the estimated fair values of these assets can be found in Note 8.

During the nine months ended September 30, 2014, we acquired the operations of several small business distributors for aggregate cash payments of $7,841. The assets acquired consisted primarily of customer lists, $6,501 of which are being amortized using the straight-line method over a weighted-average useful life of nine years. The remaining portion of the acquired customer lists are being held for sale and are classified as such in our consolidated balance sheet as of September 30, 2014. The distributors' results of operations are included in our Small Business Services segment from their acquisition dates. Further information regarding the calculation of the estimated fair values of the customer lists can be found in Note 8 and further information regarding net assets held for sale can be found in Note 3.

As our acquisitions were immaterial to our operating results both individually and in the aggregate, pro forma results of operations are not provided.

Note 7: Derivative financial instruments

We have entered into interest rate swaps to hedge against changes in the fair value of a portion of our long-term debt. We entered into these swaps, which we designated as fair value hedges, to achieve a targeted mix of fixed and variable rate debt, where we receive a fixed rate and pay a variable rate based on the London Interbank Offered Rate (LIBOR). Changes in the fair value of the interest rate swaps and the related long-term debt are included in interest expense in the consolidated statements of comprehensive income. The interest rate swaps related to our long-term debt due in 2020 meet the criteria for using the short-cut method for a fair value hedge based on the structure of the hedging relationship. As such, the changes in the fair value of the derivative and the related long-term debt are equal. The short-cut method is not being used for the interest rate swaps related to our long-term debt due in October 2014. When the change in the fair value of these interest rate swaps and the hedged debt are not equal (i.e., hedge ineffectiveness), the difference in the changes in fair value affects the reported amount of interest expense in our consolidated statements of comprehensive income. Information regarding hedge ineffectiveness in each period is presented in Note 8.

Information regarding interest rate swaps as of September 30, 2014 was as follows:

	Notional amount	Fair value of interest rate swaps	Increase (decrease) in debt due to fair value adjustment	Balance sheet caption including interest rate swaps
Fair value hedge related to long-term debt due in 2014	$198,000	$745	$6	Other current assets
Fair value hedge related to long-term debt due in 2020	200,000	(11,180)	(11,180)	Other non-current liabilities
Total fair value hedges	$398,000	$(10,435)	$(11,174)	

Information regarding interest rate swaps as of December 31, 2013 was as follows:

	Notional amount	Fair value of interest rate swaps	Increase (decrease) in debt due to fair value adjustment	Balance sheet caption including interest rate swaps
Fair value hedge related to long-term debt due in 2014	$198,000	$2,158	$1,569	Other current assets
Fair value hedge related to long-term debt due in 2020	200,000	(16,239)	(16,239)	Other non-current liabilities
Total fair value hedges	$398,000	$(14,081)	$(14,670)	

Note 8: Fair value measurements

2014 annual impairment analyses – We evaluate the carrying value of goodwill and our indefinite-lived trade name as of July 31 of each year and between annual evaluations, if events or circumstances occur that would indicate a possible impairment. As such, during the quarter ended September 30, 2014, we completed our annual impairment analyses. Our policy on impairment of indefinite-lived intangibles and goodwill, which is included under the caption "Note 1: Significant accounting policies" in the Notes to Consolidated Financial Statements appearing in the 2013

Form 10-K, provides further information regarding our methodology.

In completing the 2014 annual goodwill impairment analysis, we elected to perform a quantitative assessment for all of our reporting units to which goodwill is assigned, as our previous quantitative analysis was completed during 2010. First, we calculated the estimated fair value of each reporting unit to which goodwill is assigned and compared this estimated fair value to the carrying amount of the reporting unit's net assets. In calculating the estimated fair value, we used the income approach. The income approach is a valuation technique under which we estimated future cash flows using the reporting unit's financial forecast from the perspective of an unrelated market participant. Using historical trending and internal forecasting techniques, we projected revenue for the next five years. We applied our fixed and variable cost experience rates to the projected revenue to arrive at the future cash flows. A terminal value was then applied to the projected cash flow stream. Future estimated cash flows were discounted to their present value to calculate the estimated fair value. The discount rate used was the value-weighted average of our estimated cost of capital derived using both known and customary market metrics. In determining the estimated fair values of our reporting units, we were required to estimate a number of factors, including projected operating results, terminal growth rates, economic conditions, anticipated future cash flows, the discount rate and the allocation of shared or corporate items. For reasonableness, the summation of our reporting units' fair values was compared to our consolidated fair value as indicated by our market capitalization. If the carrying amount of a reporting unit's net assets exceeds its estimated fair value, the second step of the goodwill impairment analysis requires us to measure the amount of the impairment loss. An impairment loss is calculated by comparing the implied fair value of the goodwill to its carrying amount. To calculate the implied fair value of goodwill, the fair value of the reporting unit's assets and liabilities, excluding goodwill, is estimated. The excess of the fair value of the reporting unit over the amount assigned to its assets and liabilities, excluding goodwill, is the implied fair value of the reporting unit's goodwill. We were not required to complete the second step of the goodwill impairment analysis for any of our reporting units. Our 2014 analysis indicated that the calculated fair values of our reporting units' net assets exceeded their carrying values by approximate amounts between $74,000 and $1,128,000, or by amounts between 47% and 482% above the carrying values of their net assets.

In completing the 2014 annual impairment analysis of our indefinite-lived trade name, we elected to perform a quantitative assessment which indicated that the calculated fair value of the asset exceeded its carrying value of $19,100 by approximately $31,000 as of July 31, 2014. As such, we recorded no impairment charges as a result of our 2014 impairment analyses.

Non-recurring asset impairment analysis – During the quarter ended September 30, 2014, we performed an impairment analysis related to our Small Business Services search engine marketing and optimization business. Revenue and the related cash flows from this business have been lower than previously projected, and as a result of our annual planning process completed during the third quarter of 2014, we decided to reduce the revenue base of this business in order to improve its financial performance. As such, we revised our estimates of future revenues and cash flows to reflect these decisions during the quarter ended September 30, 2014. We calculated the estimated fair values of the assets as the net present value of estimated future cash flows (level 3 fair value measurement). Our analysis resulted in an impairment charge of $6,468 during the quarter ended September 30, 2014, which reflects writing down the net book value of the related intangible assets to zero.

The asset impairment charge included the following intangible assets:

	Impairment charge
Internal-use software	$4,036
Customer relationships	1,952
Trade name	480
Total impairment charge	$6,468

2014 acquisitions – For all acquisitions, we are required to measure the fair value of the net identifiable tangible and intangible assets and liabilities acquired, excluding goodwill and deferred income taxes. The identifiable net assets acquired during the nine months ended September 30, 2014 were comprised primarily of customer lists associated with acquisitions of small business distributors and GBCA, as well as internal-use software associated with the acquisition of NetClime, Inc. (Note 6). The aggregate fair value of the acquired customer lists was $7,796 and was estimated using an income approach. The fair value of the acquired internal-use software was estimated using a cost of reproduction method. The primary components of the software were identified and the estimated cost to reproduce the software was calculated based on data provided by NetClime. The calculated fair value of the acquired internal-use software was $1,050.

During the first quarter of 2014, we finalized the valuation of the intangible assets acquired in the acquisition of Destination Rewards, Inc. in December 2013 (Note 6). The acquired intangibles consisted primarily of customer relationships, internal-use software and supplier relationships. The fair value of the customer relationships was estimated using the multi-period excess earnings method. Assumptions used in this calculation included same-customer revenue growth rates and estimated customer retention rates based on the acquirees' historical information. The fair value of the acquired customer relationships was $4,400, which represents an increase of $2,200 from the December 31, 2013 amount. The fair value of the acquired internal-use software was estimated using a cost of reproduction method. The primary components of the software were identified and the estimated cost to reproduce the software was calculated using estimated time and labor rates derived from our historical data from previous upgrades of a similar size and nature. The fair value of the acquired internal-use software was $4,100. The fair value of the supplier relationships was estimated by comparing the forecasted gross margin with the supplier relationships in place compared to the forecasted gross margin without the supplier relationships. The fair value of the acquired supplier relationships was $1,100.

Recurring fair value measurements – Cash and cash equivalents as of September 30, 2014 and December 31, 2013 included available-for-sale marketable securities (Note 3). These securities consisted of investments in money market funds which are traded in active markets. As such, the fair value of the securities is determined based on quoted market prices. Because of the short-term nature of the underlying investments, the cost of these securities approximates their fair value. The cost of securities sold is determined using the average cost method. No gains or losses on sales of these marketable securities were realized during the quarters and nine months ended September 30, 2014 and 2013.

Funds held for customers included available-for-sale marketable securities (Note 3). These securities consisted of a mutual fund investment which invests in Canadian and provincial government securities, and as of December 31, 2013, an investment in a six-month Canadian guaranteed investment certificate (GIC) which matured in February 2014. The mutual fund is not traded in an active market and its fair value is determined by obtaining quoted prices in active markets for the underlying securities held by the fund. The fair value of the GIC approximated cost due to its relatively short duration. Unrealized gains and losses, net of tax, are included in accumulated other comprehensive loss in the consolidated balance sheets. The cost of securities sold is determined using the average cost method. Realized gains and losses are included in revenue in the consolidated statements of comprehensive income and were not significant for the quarters and nine months ended September 30, 2014 and 2013.

Other current assets included available-for-sale marketable securities (Note 3). These securities consisted of a Canadian money market fund which is not traded in an active market. As such, the fair value of this investment is determined by obtaining quoted prices in active markets for the underlying securities held by the fund. Because of the short-term nature of the underlying investments, the cost of these securities approximates their fair value. The cost of securities sold is determined using the average cost method. No gains or losses on sales of these marketable securities were realized during the quarters and nine months ended September 30, 2014 and 2013.

We have elected to account for a long-term investment in domestic mutual funds under the fair value option for financial assets and financial liabilities. The fair value option provides companies an irrevocable option to measure many financial assets and liabilities at fair value with changes in fair value recognized in earnings. The investment is included in long-term investments in the consolidated balance sheets. Long-term investments also include the cash surrender values of company-owned life insurance policies. Realized and unrealized gains and losses, as well as dividends earned by the mutual fund investment, are included in selling, general and administrative (SG&A) expense in the consolidated statements of comprehensive income. This investment corresponds to a liability under an officers' deferred compensation plan which is not available to new participants and is fully funded by the investment in mutual funds. The liability under the plan equals the fair value of the investment in mutual funds. Thus, as the value of the investment changes, the value of the liability changes accordingly. As changes in the liability are reflected within SG&A expense in the consolidated statements of comprehensive income, the fair value option of accounting for the investment in mutual funds allows us to net changes in the investment and the related liability in the statements of comprehensive income. The cost of securities sold is determined using the average cost method. During the quarters and nine months ended September 30, 2014 and 2013, net realized gains were not significant. Net unrealized losses were not significant during the nine months ended September 30, 2014 and net unrealized gains of $140 were recognized during the nine months ended September 30, 2013.

The fair value of interest rate swaps (Note 7) is determined at each reporting date by means of a pricing model utilizing readily observable market interest rates. The change in fair value is determined as the change in the present value of estimated future cash flows discounted using the LIBOR rate. The interest rate swaps related to our long-term debt due in 2020 meet the criteria for using the short-cut method for a fair value hedge based on the structure of the hedging relationship. As such, the changes in the fair value of the derivative and related long-term debt are equal. The short-cut method is not being used for our other interest rate swaps. Changes in the fair value of the interest rate swaps, as well as changes in the fair value of the hedged debt, are included in interest expense in the consolidated statements of comprehensive income and were as follows:

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
(Loss) gain from derivatives	$(1,292)	$399	$3,646	$(10,782)
Gain (loss) from change in fair value of hedged debt	1,334	(411)	(3,496)	10,852
Net decrease (increase) in interest expense	$42	$(12)	$150	$70

Information regarding recurring fair value measurements completed during each period was as follows:

	Fair value as of September 30, 2014	Fair value measurements using Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Available-for-sale marketable securities (cash equivalents)	$2,996	$2,996	$—	$—
Available-for-sale marketable securities (funds held for customers)	9,342	—	9,342	—
Available-for-sale marketable securities (other current assets)	1,958	—	1,958	—
Long-term investment in mutual funds	2,332	2,332	—	—
Derivative assets	745	—	745	—
Derivative liabilities	(11,180)	—	(11,180)	—

	Fair value as of December 31, 2013	Fair value measurements using Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Available-for-sale marketable securities (cash equivalents)	$70,001	$70,001	$ —	$—
Available-for-sale marketable securities (funds held for customers)	14,736	—	14,736	—
Available-for-sale marketable securities (other current assets)	2,045	—	2,045	—
Long-term investment in mutual funds	2,407	2,407	—	—
Derivative assets	2,158	—	2,158	—
Derivative liabilities	(16,239)	—	(16,239)	—

Our policy is to recognize transfers between fair value levels as of the end of the reporting period in which the transfer occurred. There were no transfers between fair value levels during the nine months ended September 30, 2014.

Fair value measurements of other financial instruments – The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate fair value.

Cash, excluding cash equivalents, and cash included within funds held for customers – The carrying amounts reported in the consolidated balance sheets approximate fair value because of the short-term nature of these items.

Loans and notes receivable from distributors – We have receivables for loans made to certain of our Safeguard® distributors. In addition, we have acquired the operations of several small business distributors which we then sold to our Safeguard distributors. In most cases, we entered into notes receivable upon the sale of the assets to the distributors. The fair value of these loans and notes receivable is calculated as the present value of expected future cash flows, discounted using an estimated interest rate based on published bond yields for companies of similar risk.

Long-term debt – The fair value of long-term debt is based on quoted prices for identical liabilities when traded as assets in an active market. The fair value of long-term debt included in the table below does not reflect the impact of hedging activity. The carrying amount of long-term debt includes the change in fair value of hedged long-term debt.

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The estimated fair values of these financial instruments were as follows:

	September 30, 2014		Fair value measurements using		
			Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs
	Carrying value	Fair value	(Level 1)	(Level 2)	(Level 3)
Cash (excluding cash equivalents)	$185,005	$185,005	$185,005	$—	$—
Cash (funds held for customers)	30,204	30,204	30,204	—	—
Loans and notes receivable from distributors	17,555	16,618	—	—	16,618
Long-term debt, including portion due within one year[1]	642,326	675,050	675,050	—	—

[1] Amounts exclude capital lease obligations.

	December 31, 2013		Fair value measurements using		
			Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs
	Carrying value	Fair value	(Level 1)	(Level 2)	(Level 3)
Cash (excluding cash equivalents)	$51,088	$51,088	$51,088	$—	$—
Cash (funds held for customers)	27,689	27,689	27,689	—	—
Loans and notes receivable from distributors	18,047	17,051	—	—	17,051
Long-term debt, including portion due within one year[1]	638,787	684,133	684,133	—	—

[1] Amounts exclude capital lease obligations.

Note 9: Restructuring charges

Net restructuring charges for each period consisted of the following components:

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Severance accruals	$4,546	$2,512	$7,213	$4,386
Severance reversals	(271)	(210)	(866)	(688)
Operating lease obligations	—	214	—	216
Operating lease obligations reversals	—	—	—	(157)
Net restructuring accruals	4,275	2,516	6,347	3,757
Other costs	80	563	2,464	1,822
Net restructuring charges	$4,355	$3,079	$8,811	$5,579

The net restructuring charges are reflected in the consolidated statements of comprehensive income as follows:

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Total cost of revenue	$162	$299	$304	$504
Operating expenses	4,193	2,780	8,507	5,075
Net restructuring charges	$4,355	$3,079	$8,811	$5,579

2014 restructuring charges – During the quarter and nine months ended September 30, 2014, the net restructuring accruals included severance charges related to employee reductions across functional areas as we continue to reduce costs, primarily within our sales and marketing, information technology and fulfillment functions. The restructuring accruals included severance benefits for approximately 145 employees for the quarter ended September 30, 2014 and severance benefits for approximately 210 employees for the nine months ended September 30, 2014. These charges were reduced by the reversal of restructuring accruals recorded primarily in previous years, as fewer employees received severance benefits than originally estimated. Other restructuring costs, which were expensed as incurred, included items such as information technology costs, employee and equipment moves, training and travel related to our restructuring activities.

2013 restructuring charges – During the quarter and nine months ended September 30, 2013, the net restructuring accruals included severance charges related to employee reductions across functional areas as we continued to reduce costs. The restructuring accruals included severance benefits for approximately 75 employees for the quarter ended September 30, 2013 and severance benefits for approximately 125 employees for the nine months ended September 30, 2013. These charges were reduced by the reversal of restructuring accruals recorded primarily in previous years, as fewer employees received severance benefits than originally estimated. Other restructuring costs, which were expensed as incurred, included items such as information technology costs, employee and equipment moves, training and travel related to our restructuring activities.

Restructuring accruals of $5,387 as of September 30, 2014 are reflected in the consolidated balance sheet in accrued liabilities. Restructuring accruals of $5,638 as of December 31, 2013 are reflected in the consolidated balance sheet as accrued liabilities of $5,609 and other non-current liabilities of $29. The majority of the employee reductions are expected to be completed in 2014, and we expect most of the related severance payments to be paid by mid-2015, utilizing cash from operations. The remaining payments due under operating lease obligations will be paid through February 2015. As of September 30, 2014, approximately 130 employees had not yet started to receive severance benefits. Further information regarding our restructuring accruals can be found under the caption “Note 8: Restructuring charges” in the Notes to Consolidated Financial Statements appearing in the 2013 Form 10-K.

Accruals for our restructuring initiatives, summarized by year, were as follows:

	2012 initiatives	2013 initiatives	2014 initiatives	Total
Balance, December 31, 2013	$409	$5,229	$—	$5,638
Restructuring charges	21	237	6,955	7,213
Restructuring reversals	(11)	(775)	(80)	(866)
Payments	(344)	(4,379)	(1,875)	(6,598)
Balance, September 30, 2014	$75	$312	$5,000	$5,387
Cumulative amounts:				
Restructuring charges	$8,012	$7,616	$6,955	$22,583
Restructuring reversals	(1,362)	(912)	(80)	(2,354)
Payments	(6,575)	(6,392)	(1,875	