EVERTEC, Inc.
Form 10-Q
November 07, 2013

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2013

or

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

For the transition period from __________ to __________

COMMISSION FILE NUMBER 001-35872

EVERTEC, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Puerto Rico	**66-0783622**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. employer identification number)**
Cupey Center Building, Road 176, Kilometer 1.3, San Juan, Puerto Rico	**00926**
(Address of principal executive offices)	**(Zip Code)**

(787) 759-9999

(Registrant s telephone number, including area code)

Not applicable

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes x 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 (as defined in rule 12b-2 of the Exchange Act).

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

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

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

At November 1, 2013, there were 81,938,299 outstanding shares of common stock of EVERTEC, Inc.

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FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of, and subject to the protection of, the Private Securities Litigation Reform Act of 1995. Such statements can be identified by the use of forward-looking terminology such as believes, expects, may, estimates, will, should, plans or anticipates negative thereof or other variations thereon or comparable terminology, or by discussions of strategy. Readers are cautioned that any such forward-looking statements are not guarantees of future performance and may involve significant risks and uncertainties, and that actual results may vary materially from those in the forward-looking statements as a result of various factors. Among the factors that significantly impact our business and could impact our business in the future are:

- our reliance on our relationship with Popular, Inc. (Popular) for a significant portion of our revenues and with Banco Popular de Puerto Rico (Banco Popular), Popular s principal banking subsidiary, to grow our merchant acquiring business;
- our ability to renew our client contracts on terms favorable to us;
- our dependence on our processing systems, technology infrastructure, security systems and fraudulent payment detection systems, as well as on our personnel and certain third parties with whom we do business;
- our ability to develop, install and adopt new software, technology and computing systems;
- a decreased client base due to consolidations and failures in the financial services industry;
- the credit risk of our merchant clients, for which we may also be liable;
- the continuing market position of the ATH network despite competition and potential shifts in consumer payment preferences;
- our dependence on credit card associations, including any adverse changes in credit card association or network rules or fees;
- changes in the regulatory environment and changes in international, legal, political, administrative or economic conditions;

- the geographical concentration of our business in Puerto Rico;
- operating an international business in multiple regions with potential political and economic instability, including Latin America;
- our ability to execute our geographic expansion and acquisition strategies;
- our ability to protect our intellectual property rights against infringement and to defend ourselves against claims of infringement brought by third parties;
- our ability to recruit and retain the qualified personnel necessary to operate our business;
- our ability to comply with federal, state and local regulatory requirements;
- evolving industry standards and adverse changes in global economic, political and other conditions;
- our high level of indebtedness and restrictions contained in our debt agreements, including the senior secured credit facilities, as well as debt that could be incurred in the future;
- our ability to generate sufficient cash to service our indebtedness and to generate future profits; and
- other factors discussed in this Report, including in the section entitled Risk Factors.

These forward-looking statements involve a number of risks and uncertainties that could cause actual results to differ materially from those suggested by the forward-looking statements. Forward-looking statements should, therefore, be considered in light of various factors, including those set forth under Risk Factors, in Management s Discussion and Analysis of Financial Condition and Results of Operations elsewhere in this Report and in the Company s Registration Statement on Form S-1 (File No. 333-186487) (as amended the Registration Statement). These forward-looking statements speak only as of the date of this Report, and we do not undertake any obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date of this Report or to reflect the occurrence of unanticipated events.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

EVERTEC, Inc. (Unaudited) Consolidated Balance Sheets

(Dollar amounts in thousands, except per share data)

	September 30, 2013	December 31, 2012
Assets		
Current Assets:		
Cash	$ 27,960	$ 25,634
Restricted cash	5,096	4,939
Accounts receivable, net	69,249	78,621
Deferred tax asset	383	1,434
Prepaid expenses and other assets	21,800	19,345
Total current assets	124,488	129,973
Investment in equity investee	10,827	11,080
Property and equipment, net	31,992	36,737
Goodwill	373,223	372,307
Other intangible assets, net	375,292	403,170
Other long-term assets	19,657	24,478
Total assets	$ 935,479	$ 977,745
Liabilities and stockholders equity		
Current Liabilities:		
Accrued liabilities	$ 28,778	$ 34,609
Accounts payable	14,912	24,482
Unearned income	3,791	1,166
Income tax payable	246	2,959
Current portion of long-term debt	19,000	6,052
Short-term borrowings	6,132	26,995
Deferred tax liability, net	658	632
Total current liabilities	73,517	96,895
Long-term debt	670,209	730,709
Long-term deferred tax liability, net	16,965	24,614
Other long-term liabilities	333	3,072

Total liabilities		761,024		855,290
Commitments and contingencies (Note 9)				
Stockholders equity				
Preferred stock, par value $0.01; 2,000,000 shares authorized; none issued				
Common stock, par value $0.01; 206,000,000 shares authorized; 81,909,582 and 72,846,144 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively		819		728
Additional paid-in capital		155,166		52,155
Accumulated earnings		17,562		70,414
Accumulated other comprehensive income (loss)		908		(842)
Total stockholders equity		174,455		122,455
Total liabilities and stockholders equity	$	935,479	$	977,745

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

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EVERTEC, Inc. (Unaudited) Consolidated Statements of Income (Loss) and Comprehensive Income (Loss)

(Dollar amounts in thousands, except per share data)

	Three months ended September 30, 2013	Three months ended September 30, 2012	Nine months ended September 30, 2013	Nine months ended September 30, 2012
Revenues				
Merchant acquiring, net	$ 18,211	$ 16,810	$ 53,835	$ 51,499
Payment processing (from affiliates: $7,338, $7,203, $21,846 and $22,005)	24,731	23,284	73,128	69,986
Business solutions (from affiliates: $33,500, $29,822, $102,996 and $90,866)	44,472	43,745	136,965	129,214
Total revenues	87,414	83,839	263,928	250,699
Operating costs and expenses				
Cost of revenues, exclusive of depreciation and amortization shown below	39,114	40,897	121,873	118,469
Selling, general and administrative expenses	8,779	7,295	29,780	24,759
Depreciation and amortization	17,657	17,765	53,074	53,517
Total operating costs and expenses	65,550	65,957	204,727	196,745
Income from operations	21,864	17,882	59,201	53,954
Non-operating (expenses) income				
Interest income	54	38	147	237
Interest expense	(6,403)	(14,784)	(31,414)	(39,214)
Earnings (losses) of equity method investment	198	(472)	823	103
Other income (expenses):				
Loss on extinguishment of debt			(58,464)	
Termination of consulting agreements			(16,718)	
Other income (expenses)	448	855	(1,838)	(9,802)
Total other income (expenses)	448	855	(77,020)	(9,802)
Total non-operating (expenses) income	(5,703)	(14,363)	(107,464)	(48,676)
Income (loss) before income taxes	16,161	3,519	(48,263)	5,278

Income tax expense (benefit)	1,358	1,243	(3,603)	1,501
Net income (loss)	14,803	2,276	(44,660)	3,777
Other comprehensive (loss) income, net of tax of $11, $0, $29 and $13				
Foreign currency translation adjustments	(210)	215	1,750	2,551
Total comprehensive income (loss)	$ 14,593	$ 2,491	$ (42,910)	$ 6,328
Net income (loss) per common share - basic	$ 0.18	$ 0.03	$ (0.57)	$ 0.05
Net income (loss) per common share - diluted	$ 0.18	$ 0.03	$ (0.57)	$ 0.05

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

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EVERTEC, Inc. (Unaudited) Consolidated Statement of Changes in Stockholders Equity

(Dollar amounts in thousands, except per share data)

	Number of Shares of Common Stock	Common Stock	Additional Paid-in Capital	Accumulated Earnings	Accumulated Other Comprehensive (Loss) Income	Total Stockholders Equity
Balance at December 31, 2012	72,846,144	$ 728	$ 52,155	$ 70,414	$ (842)	$ 122,455
Issuance of common stock upon initial public offering, net of offering costs	6,250,000	63	112,369			112,432
Share-based compensation recognized			5,719			5,719
Tax windfall benefit on exercises of stock options and vesting of restricted stocks			1,627			1,627
Stock options exercised, net of cashless exercise	2,813,438	28	(16,704)			(16,676)
Net loss				(44,660)		(44,660)
Cash dividends paid on common stock				(8,192)		(8,192)
Other comprehensive income					1,750	1,750
Balance at September 30, 2013	81,909,582	$ 819	$ 155,166	$ 17,562	$ 908	$ 174,455

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

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EVERTEC, Inc. (Unaudited) Consolidated Statements of Cash Flows

(Dollar amounts in thousands)

	Nine months ended September 30, 2013	2012
Cash flows from operating activities		
Net (loss) income	$ (44,660)	$ 3,777
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	53,074	53,517
Amortization of debt issue costs and premium and accretion of discount	3,136	3,748
Write-off of debt issue costs, premium and discount accounted as loss on extinguishment	16,555	
Provision for doubtful accounts and sundry losses	954	1,291
Deferred tax benefit	(6,723)	(4,662)
Share-based compensation	5,719	889
Unrealized gain of indemnification assets	(21)	(334)
Amortization of a contract liability		(703)
Loss on disposition of property and equipment	30	62
Earnings from equity method investment	(823)	(103)
Dividend received from equity method investment	500	728
Premium on issuance of long-term debt		2,000
(Increase) decrease in assets:		
Accounts receivable, net	9,035	(3,831)
Prepaid expenses and other assets	(2,591)	2,414
Other long-term assets	(1,928)	
Increase (decrease) in liabilities:		
Accounts payable and accrued liabilities	(18,485)	11,476
Income tax payable	(2,713)	(1,201)
Unearned income	2,625	35
Total adjustments	58,344	65,326
Net cash provided by operating activities	13,684	69,103
Cash flows from investing activities		
Net (increase) decrease in restricted cash	(157)	582
Intangible assets acquired	(9,591)	(5,430)
Property and equipment acquired	(7,380)	(7,540)
Proceeds from sales of property and equipment	16	80

Net cash used in investing activities	(17,112)	(12,308)
Cash flows from financing activities		
Proceeds from initial public offering, net of offering costs of $12,567	112,369	
Proceeds from issuance of debt	700,000	208,725
Statutory minimum withholding taxes paid on cashless exercises of stock options	(16,704)	
Debt issuance costs	(12,077)	(2,174)
Repayment of short-term borrowings, net	(22,663)	
Proceeds from new short-term borrowing for purchase of equipment	1,800	
Dividends paid	(8,192)	(269,772)
Tax windfall benefits on exercises of stock options and vesting of restricted stocks	1,627	
Issuance of common stock	91	450
Repayment of other financing agreement	(224)	(112)
Repayment of long-term debt	(750,273)	
Net cash provided by (used in) financing activities	5,754	(62,883)
Net increase (decrease) in cash	2,326	(6,088)
Cash at beginning of the period	25,634	56,200
Cash at end of the period	$ 27,960	$ 50,112
Supplemental disclosure of non-cash activities:		
Dividend declared not received from equity method investment	$ 500	$ 1,457
Trade payable due to vendor related to software acquired	$ 2,903	

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

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Notes to Unaudited Consolidated Financial Statements

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EVERTEC, Inc. Notes to Unaudited Consolidated Financial Statements

Note 1 The Company and Summary of Significant Accounting Policies

The Company

EVERTEC, Inc. (formerly known as Carib Latam Holdings, Inc.) and its subsidiaries (collectively the Company, EVERTEC, we, us, or our) is the leading full-service transaction processing business in Latin America and the Caribbean. We are based in Puerto Rico and provide a broad range of merchant acquiring, payment processing and business process management services across 19 countries in the region. We process over 1.8 billion transactions annually, and manage the electronic payment network for over 4,100 automated teller machines (ATM) and over 104,000 point-of-sale (POS) payment terminals. According to the July 2013 Nilson Report, we are the largest merchant acquirer in the Caribbean and Central America and the seventh largest in Latin America based on total number of transactions. We own and operate the ATH network, one of the leading ATM and personal identification number debit networks in Latin America. In addition, we provide a comprehensive suite of services for core bank processing, cash processing and technology outsourcing in the regions we serve. We serve a broad and diversified customer base of leading financial institutions, merchants, corporations and government agencies with mission critical technology solutions that are essential to their operations, enabling them to issue, process and accept transactions securely, and we believe that our business is well positioned to continue to expand across the fast growing Latin American region.

Our subsidiaries include EVERTEC Intermediate Holdings, LLC (Holdings, formerly known as Carib Holdings, Inc.), EVERTEC Group, LLC (EVERTEC Group), EVERTEC Dominicana SAS., EVERTEC Panamá, S.A., EVERTEC Latinoamérica, S.A., EVERTEC Costa Rica, S.A. (EVERTEC CR), Tarjetas Inteligentes Internacionales, S.A., EVERTEC Guatemala, S.A. and EVERTEC México Servicios de Procesamiento, S.A. de C.V.

Initial Public Offering

On April 17, 2013, the Company completed its initial public offering (Initial Public Offering) of 28,789,943 shares of common stock at a price to the public of $20.00 per share. A total of 6,250,000 shares were offered by the Company and a total of 22,539,943 shares were offered by selling stockholders of the Company, of which 13,739,284 shares were sold by an affiliate of Apollo Global Management, LLC (Apollo) and 8,800,659 shares were sold by Popular. The Company used net proceeds of approximately $117.4 million from its sale of shares in the Initial Public Offering and proceeds from borrowings under the 2013 Credit Agreement (as defined in Note 4), together with available cash on hand, to redeem its senior notes (as defined in Note 4) and to refinance its previous senior secured credit facilities.

Public Offering by Selling Stockholders

On September 18, 2013, the Company completed a public offering of 23,000,000 shares of its common stock by Apollo, Popular, and certain officers and current and former employees of the Company at a price to the public of $22.50 per share. The Company did not receive any proceeds from this offering. After completion of this offering, Apollo owned approximately 9.2 million shares of our common stock, or 11.2% and Popular owned approximately 17.5 million shares of our common stock, or 21.3%.

Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of EVERTEC, Inc. and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The preparation of the accompanying unaudited consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (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 unaudited consolidated financial statements. Actual results could differ from these estimates.

In the opinion of management, the accompanying unaudited consolidated financial statements, prepared in accordance with GAAP, contain all adjustments, all of which are normal and recurring in nature, necessary for a fair presentation. Certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted from the unaudited consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). As these unaudited consolidated financial statements are prepared using the same accounting principles and policies used to prepare the annual financial statements, they should be read in conjunction with the audited consolidated financial statements for the fiscal year ended December 31, 2012, included in the Company s Registration Statement on Form S-1 (File No. 333-186487) (as amended, the Registration Statement), which was declared effective by the SEC on April 11, 2013. The results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the results of operations for the full year or any future period.

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EVERTEC, Inc. Notes to Unaudited Consolidated Financial Statements

On April 1, 2013, EVERTEC s Board of Directors declared a two for one stock split of our outstanding Class A and Class B common stock. Accordingly, all shares of outstanding common stock or restricted stock, or shares of common stock underlying outstanding options, and all per share amounts for all periods presented in these consolidated financial statements and notes thereto, have been adjusted retroactively, where applicable, to reflect this stock split, except for the par value of the common stock, which was not adjusted by the stock split and the impact was recorded as additional paid-in capital. Under the certificate of incorporation, as amended by the certificate of amendment, which became effective on April 1, 2013, EVERTEC s authorized capital consists of 206,000,000 shares of common stock and 2,000,000 shares of preferred stock.

The Consolidated Balance Sheet as of December 31, 2012 was derived from the audited consolidated financial statements for the fiscal year ended December 31, 2012 included in the Registration Statement.

Certain reclassifications have been made to certain prior period notes to the unaudited consolidated financial statements to conform with the presentation in 2013.

Summary of Significant Accounting Policies

Share-based Compensation

Management uses the fair value method of recording stock-based compensation as described in the guidance for stock compensation in ASC topic 718. The fair value of the stock options granted during 2011 and 2012 was estimated using the Black-Scholes-Merton (BSM) option pricing model for Tranche A options granted under the EVERTEC, Inc. Amended and Restated 2010 Equity Incentive Plan (the Equity Incentive Plan) and the Monte Carlo simulation analysis for Tranche B and Tranche C options.

Upon option exercise, participants may elect to net share settle . Rather than requiring the participant to deliver cash to satisfy the exercise price and statutory minimum tax withholdings, the Company withholds a sufficient number of shares to cover these amounts and delivers the net shares to the participant. The Company recognizes the associated tax withholding obligation as a reduction of additional paid-in capital.

As compensation expense is recognized, a deferred tax asset is established. At the time stock options are exercised, a current tax deduction arises based on the value at the time of exercise. This deduction may exceed the associated deferred tax asset, resulting in a windfall tax benefit . The windfall is recognized in the unaudited consolidated balance sheet as an increase to additional paid-in capital, and is included in the unaudited consolidated statement of cash flows as a financing inflow.

Net Income (Loss) Per Common Share

Basic net income (loss) per common share is determined by dividing net income (loss) by the weighted-average number of common shares outstanding during the period.

Diluted net income (loss) per common share assumes the issuance of all potentially dilutive share equivalents using the treasury stock method.

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EVERTEC, Inc. Notes to Unaudited Consolidated Financial Statements

Note 2 Property and Equipment, net

Property and equipment, net consists of the following:

(Dollar amounts in thousands)	Useful life in years	September 30, 2013	December 31, 2012
Buildings	30	$ 1,731	$ 2,096
Data processing equipment	3 - 5	63,399	59,901
Furniture and equipment	3 -20	6,639	6,183
Leasehold improvements	5 - 10	2,860	2,380
		74,629	70,560
Less - accumulated depreciation and amortization		(44,172)	(35,331)
Depreciable assets, net		30,457	35,229
Land		1,535	1,508
Property and equipment, net		$ 31,992	$ 36,737

Depreciation and amortization expense related to property and equipment was $4.1 million and $12.2 million for the three and nine months ended September 30, 2013, respectively, and $4.0 million and $12.1 million for the corresponding 2012 periods.

Note 3 Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill, allocated by reportable segments, were as follows (See Note 11):

(Dollar amounts in thousands)	Merchant acquiring, net	Payment processing	Business solutions	Total
Balance at December 31, 2012	$ 138,121	$ 187,028	$ 47,158	$ 372,307
Foreign currency translation adjustments		666	250	916
Balance at September 30, 2013	$ 138,121	$ 187,694	$ 47,408	$ 373,223

Goodwill is tested for impairment at least annually using the qualitative assessment option or step zero process. Using this process, the Company first assesses whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount.

During the third quarter of 2013, we conducted a qualitative assessment of each reporting unit s fair value as of August 31, 2013. As part of our qualitative assessment, we considered the results of our 2011 impairment test (which indicated that the fair value of each reporting unit was in excess of 30% of its carrying amount) as well as current market conditions and changes in the carrying amount of our reporting units that occurred subsequent to the 2011 impairment test. Based on the results of this qualitative assessment, we believe the fair value of goodwill for each of our reporting units continues to exceed their respective carrying amounts and concluded that it was not necessary to conduct the two-step goodwill impairment test. Accordingly, no impairment losses for the period were recognized.

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The carrying amount of other intangible assets for the nine months ended September 30, 2013 and the year ended December 31, 2012 consisted of the following:

(Dollar amounts in thousands)	September 30, 2013			
	Useful life in years	Gross amount	Accumulated amortization	Net carrying amount
Customer relationships	14	$ 314,070	$ (67,577)	$ 246,493
Trademark	10 -15	39,950	(10,392)	29,558
Software packages	3 - 5	113,866	(59,856)	54,010
Non-compete agreement	15	56,539	(11,308)	45,231
Other intangible assets, net		$ 524,425	$ (149,133)	$ 375,292

(Dollar amounts in thousands)	December 31, 2012			
	Useful life in years	Gross amount	Accumulated amortization	Net carrying amount
Customer relationships	14	$ 313,726	$ (50,769)	$ 262,957
Trademark	10 -15	39,950	(7,794)	32,156
Software packages	3 - 5	110,478	(50,479)	59,999
Non-compete agreement	15	56,539	(8,481)	48,058
Other intangible assets, net		$ 520,693	$ (117,523)	$ 403,170

For the three and nine months ended September 30, 2013, the Company recorded amortization expense related to other intangibles of $13.6 million and $40.9 million, respectively, compared to $13.8 million and $41.4 million for the corresponding 2012 periods.

The estimated amortization expense of the balances outstanding at September 30, 2013 for the next five years is as follows:

(Dollar amounts in thousands)	
Remaining 2013	$ 13,054
2014	49,162

2015	44,780
2016	35,193
2017	32,008
2018	30,129

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EVERTEC, Inc. Notes to Unaudited Consolidated Financial Statements

Note 4 Debt and Short-Term Borrowings

Total debt as of September 30, 2013 and December 31, 2012 was as follows:

(Dollar amounts in thousands)		**September 30, 2013**		**December 31, 2012**
Senior Secured Credit Facility (Term A) due on April 17, 2018 paying interest at a variable interest rate (London InterBank Offered Rate (LIBOR) plus applicable margin[1])	$	295,881	$	
Senior Secured Credit Facility (Term B) due on April 17, 2020 paying interest at a variable interest rate (LIBOR plus applicable margin[2])		393,328		
Senior Secured Credit Facility due on September 30, 2016 paying interest at a variable interest rate (LIBOR plus applicable margin[3])				484,414
Senior Secured Revolving Credit Facility paying interest at a variable interest rate				14,000
Senior Notes due on October 1, 2018, paying interest semi-annually at a rate of 11% per annum				252,347
Other short-term borrowing		6,132		12,995
Total debt	$	695,341	$	763,756

(1) Applicable margin of 2.50% at September 30, 2013.
(2) Subject to a minimum rate (LIBOR floor) of 0.75% plus applicable margin of 2.75% at September 30, 2013.
(3) Subject to a minimum rate (LIBOR floor) of 1.50% plus applicable margin of 4.00% at December 31, 2012.

Senior Secured Credit Facilities

On April 17, 2013, EVERTEC Group entered into a credit agreement (the 2013 Credit Agreement) governing the senior secured credit facilities, consisting of a $300.0 million term loan A facility (the Term A Loan) which matures on April 17, 2018, a $400.0 million term loan B facility (the Term B Loan) which matures on April 17, 2020 and a $100.0 million revolving credit facility which matures on April 17, 2018. The net proceeds received by EVERTEC Group from the new senior secured credit facilities, together with other cash available to EVERTEC Group, were used to, among other things, refinance EVERTEC Group s previous senior secured credit facilities and redeem a portion of

EVERTEC s 11% Senior Notes due 2018 (the senior notes), as further described below.

As a result of the debt refinancing, EVERTEC Group s previous senior secured credit facilities were evaluated under ASC 470-50, *Debtor s Accounting for a Modification or Exchange of Debt Instruments (ASC 470-50).* Accordingly, a portion of the unamortized discount and debt issue costs amounting to $6.4 million and $5.9 million, respectively, were treated as a modification and will be amortized over the term of the new debt using the interest method. The remaining unamortized discount and debt issue costs of $3.4 million and $3.0 million, respectively, were considered to be related to the portion of the debt that was extinguished and written-off.

Senior Notes

On March 29, 2013, EVERTEC Group provided notice to Wilmington Trust, National Association (the Trustee) pursuant to the Indenture, dated as of September 30, 2010 (as supplemented by Supplemental Indenture No. 1, dated as of April 17, 2012, Supplemental Indenture No. 2, dated as of May 7, 2012 and Supplemental Indenture No. 3, dated as of May 7, 2012) between EVERTEC Group and EVERTEC Finance Corp. (together, the Co-Issuers), the Guarantors named therein and the Trustee (the Indenture), that the Co-Issuers had elected to (i) redeem $91.0 million principal amount of their outstanding senior notes, at a redemption price of 111.0%, plus accrued and unpaid interest, on April 29, 2013 (the Partial Redemption) and (ii) redeem all of their outstanding senior notes (after giving effect to the redemption of $91.0 million principal amount of the senior notes described in clause (i)) at a redemption price of 100.0% plus a make-whole premium and accrued and unpaid interest, on April 30, 2013 (the Full Redemption). On April 17, 2013, the Co-Issuers and the Trustee entered into a Satisfaction and Discharge Agreement whereby EVERTEC Group caused to be irrevocably deposited with the Trustee, to satisfy and to discharge the Co-Issuers obligations under

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EVERTEC, Inc. Notes to Unaudited Consolidated Financial Statements

the Indenture (a) a portion of the net cash proceeds received by the Company in the Initial Public Offering to Holdings, which contributed such proceeds to EVERTEC Group, in an amount sufficient to effect the Partial Redemption on April 29, 2013 and (b) proceeds from the 2013 Credit Agreement described above in an amount sufficient to effect the Full Redemption on April 30, 2013. On April 29, 2013, the Partial Redemption was effected and on April 30, 2013, the Full Redemption was effected.

Based on accounting guidance, the senior notes were considered extinguished. Accordingly, the outstanding premium of $1.8 million and unamortized debt issuance costs of $7.0 million were written-off and presented as a loss on extinguishment of debt. In addition, the redemption premium payments totaling $41.9 million were accounted for as a loss on extinguishment of debt.

New Senior Secured Credit Facilities

Term A Loan

As of September 30, 2013, the outstanding principal amount of the Term A Loan was $296.3 million. The Term A Loan requires principal payments on the last business day of each quarter equal to (a) 1.250% of the original principal amount commencing on September 30, 2013 through June 30, 2016; (b) 1.875% of the original principal amount from September 30, 2016 through June 30, 2017; (c) 2.50% of the original principal amount from September 30, 2017 through March 31, 2018; and (d) the remaining outstanding principal amount on the maturity of the Term A Loan on April 17, 2018. Interest is based on EVERTEC Group s first lien secured net leverage ratio and payable at a rate equal to, at the Company s option, either (a) LIBOR Rate plus an applicable margin ranging from 2.00% to 2.50%, or (b) Base Rate plus an applicable margin ranging from 1.00% to 1.50%. Term A Loan has no LIBOR Rate or Base Rate minimum or floor.

Term B Loan

As of September 30, 2013, the outstanding principal amount of the Term B Loan was $399.0 million. The Term B Loan requires principal payments on the last business day of each quarter equal to 0.250% of the original principal amount commencing on September 30, 2013 and the remaining outstanding principal amount on the maturity of the Term B Loan on April 17, 2020. Interest is based on EVERTEC Group s first lien secured net leverage ratio and payable at a rate equal to, at the Company s option, either (a) LIBOR Rate plus an applicable margin ranging from 2.50% to 2.75%, or (b) Base Rate plus an applicable margin ranging from 1.50% to 1.75%. The LIBOR Rate and Base Rate are subject to floors of 0.75% and 1.75%, respectively.

Revolving Credit Facility

The revolving credit facility has an available balance up to $100.0 million, with an interest rate on loans calculated the same as the applicable Term A Loan rate. The facility matures on April 17, 2018 and has a commitment fee payable one business day after the last business day of each quarter calculated based on the daily unused commitment during the preceding quarter. The commitment fee for the unused portion of this facility ranges from 0.125% to 0.375% and is based on EVERTEC Group s first lien secured net leverage ratio. As of September 30, 2013, the revolving credit facility was undrawn.

All loans may be prepaid without premium or penalty, except for a 1% premium payable if any of the Term B Loans are refinanced or repriced with syndicated secured term loans having a lower effective interest rate on or prior to April 17, 2014.

The new senior secured credit facilities were evaluated under accounting guidance and accordingly, $7.2 million of debt issue costs were capitalized and are being amortized over the term of the new debt using the interest method and $4.9 million of debt issue costs were expensed and are presented in our second quarter 2013 financials as a loss on the extinguishment of debt.

The new senior secured credit facilities contain various restrictive covenants. The Term A Loan and the revolving credit facility (subject to certain exceptions) require us to maintain on a quarterly basis a specified maximum senior secured leverage ratio of up to 6.60 to 1.00 as defined in the 2013 Credit Agreement (total first lien secured debt to adjusted EBITDA). In addition, the 2013 Credit Agreement, among other things: (a) limits our ability and the ability of our subsidiaries to incur additional indebtedness, incur liens, pay dividends or make certain other restricted payments and enter into certain transactions with affiliates; (b) restricts our ability to enter into agreements that would restrict the ability of our subsidiaries to pay dividends or make certain payments to us; and (c) places restrictions on our ability and the ability of our subsidiaries to merge or consolidate with any other person or sell, assign, transfer, convey or otherwise dispose of all or substantially all of our assets. As of September 30, 2013, the Company was in compliance with the applicable restrictive covenants under the 2013 Credit Agreement.

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Note 5 Financial Instruments and Fair Value Measurements

Recurring Fair Value Measurements

Fair value measurement provisions establish a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. This guidance describes three levels of input that may be used to measure fair value:

Level 1: Inputs are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.

Level 2: Inputs, other than quoted prices included in Level 1, which are observable for the asset or liability through corroboration with market data at the measurement date.

Level 3: Unobservable inputs that reflect management s best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The Company uses observable inputs when available. Fair value is based upon quoted market prices when available. If market prices are not available, the Company may employ internally-developed models that primarily use market-based inputs including yield curves, interest rates, volatilities, and credit curves, among others. The Company limits valuation adjustments to those deemed necessary to ensure that the financial instrument s fair value adequately represents the price that would be received or paid in the marketplace. Valuation adjustments may include consideration of counterparty credit quality and liquidity as well as other criteria. The estimated fair value amounts are subjective in nature and may involve uncertainties and matters of significant judgment for certain financial instruments. Changes in the underlying assumptions used in estimating fair value could affect the results. The fair value measurement levels are not indicative of risk of investment.

The following table summarizes fair value measurements by level at September 30, 2013 and December 31, 2012 for assets measured at fair value on a recurring basis:

(Dollar amounts in thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
September 30, 2013				
Financial assets:				
Indemnification assets:				
Software cost reimbursement	$	$	$ 4,173	$ 4,173
December 31, 2012				
Financial assets:				

Indemnification assets:				
Software cost reimbursement	$	$	$ 6,099	$ 6,099

The fair value of financial instruments is the amount at which an asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced liquidation sale. Fair value estimates are made at a specific point in time based on the type of financial instrument and relevant market information. Many of these estimates involve various assumptions and may vary significantly from amounts that could be realized in actual transactions.

For those financial instruments with no quoted market prices available, fair values have been estimated using present value calculations or other valuation techniques, as well as management s best judgment with respect to current economic conditions, including discount rates and estimates of future cash flows.

Indemnification assets include the present value of the expected future cash flows of certain expense reimbursement agreements with Popular. These contracts have termination dates up to September 2015 and were entered into in connection with the Merger. Management prepared estimates of the expected reimbursements to be received from Popular until the termination of the contracts, discounted the estimated future cash flows and recorded the indemnification assets as of the Merger closing date. Payments received during the quarters reduced the indemnification asset balance. The remaining balance was adjusted to reflect its fair value as of September 30, 2013, therefore resulting in a net unrealized gain of approximately $2,000 and $21,000 for the three and nine months ended September 30, 2013, respectively, and $0.6 million and $0.3 million for the corresponding 2012 periods, which are reflected within the other income (expenses) caption in the unaudited consolidated statements of income (loss) and comprehensive income (loss). The current portion of the indemnification assets is included within accounts receivable, net, and the other long-term portion is included within other long-term assets in the accompanying unaudited consolidated balance sheets.

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The unobservable inputs related to the Company s indemnification assets as of September 30, 2013 using the discounted cash flow model include the discount rate of 5.42% and the projected cash flows of $4.2 million.

For indemnification assets a significant increase or decrease in market rates and cash flows could result in a significant impact to the fair value. Also, the credit rating and/or the non-performance credit risk of Popular, which is subjective in nature, could also increase or decrease the sensitivity of the fair value of these assets.

The following table presents the carrying value, as applicable, and estimated fair values for financial instruments at September 30, 2013 and December 31, 2012:

	September 30, 2013		**December 31, 2012**	
(Dollar amounts in thousands)	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Financial assets:				
Indemnification assets:				
Software cost reimbursement	$ 4,173	$ 4,173	$ 6,099	$ 6,099
Financial liabilities:				
New senior secured term loans:				
Senior secured term loan A	$ 295,881	$ 292,695	$	$
Senior secured term loan B	393,328	384,038		
Senior secured term loan			484,414	497,498
Senior notes			252,347	275,550

The fair value of the new senior secured term loans at September 30, 2013, as well as the previous senior secured term loan and the senior notes at December 31, 2012 were obtained using the prices provided by third party service providers. Their pricing is based on various inputs such as: market quotes, recent trading activity in a non-active market or imputed prices. Also, the pricing may include the use of an algorithm that could take into account movement in the general high yield market, among other variants.

The previous senior secured term loan and senior notes as well as the new senior secured term loans, which are not measured at fair value in the balance sheets, if measured at fair value it will be categorized as Level 3 in the fair value hierarchy.

The following table provides a summary of the change in fair value of the Company s Level 3 assets:

Three months ended September 30,