EVERTEC, Inc.
Form 10-Q
November 06, 2014
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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, 2014

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 October 31, 2014, there were 77,972,633 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 revenue 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;
- the effectiveness of our risk management procedures;
- 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;
- the risk that our technology infrastructure and systems may experience breakdowns or fail to prevent security breaches or fraudulent transfers;0020
- 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;

- regulatory limitations on our activities due to our relationship with Popular and our role as a service provider to financial institutions;
- 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;
- operating in countries and with counterparties that put us at risk of violating U.S. sanctions laws;
- 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 U.S. federal, state, local and foreign 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. The Company does not undertake, and specifically disclaims any obligation, to update any of the forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements except as required by the federal securities laws.

Investors should refer to the Company s Form 10-K for the year ended December 31, 2013 (the 2013 Form 10-K) for a discussion of factors that could cause events to differ from those suggested by the forward-looking statements, including factors set forth in the sections entitled Risk Factors and Management s Discussion and Analysis of Financial

Condition and Results of Operations .

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EVERTEC, Inc. (Unaudited) Consolidated Balance Sheets

(Dollar amounts in thousands, except for share information)

	September 30, 2014		December 31, 2013	
Assets				
Current Assets:				
Cash	$	29,226	$	22,485
Restricted cash		6,126		5,433
Accounts receivable, net		68,969		68,434
Deferred tax asset		3,378		2,537
Prepaid expenses and other assets		21,880		17,524
Total current assets		129,579		116,413
Investment in equity investee		11,492		10,639
Property and equipment, net		29,482		33,240
Goodwill		369,304		373,119
Other intangible assets, net		338,248		367,780
Other long-term assets		12,335		18,162
Total assets	$	890,440	$	919,353
Liabilities and stockholders equity				
Current Liabilities:				
Accrued liabilities	$	26,023	$	26,571
Accounts payable		14,748		18,630
Unearned income		8,866		5,595
Income tax payable		1,945		259
Current portion of long-term debt		19,000		19,000
Short-term borrowings		8,000		51,200
Deferred tax liability, net		350		543
Total current liabilities		78,932		121,798
Long-term debt		652,102		665,680
Long-term deferred tax liability, net		20,308		20,212
Other long-term liabilities		238		333
Total liabilities		751,580		808,023
Commitments and contingencies (Note 10)				
Stockholders equity				
Preferred stock, par value $0.01; 2,000,000 shares authorized; none issued				
		787		783

Common stock, par value $0.01; 206,000,000 shares authorized; 78,672,101 shares issued and outstanding at September 30, 2014 (December 31, 2013- 78,286,465)				
Additional paid-in capital		83,296		80,718
Accumulated earnings		60,924		29,403
Accumulated other comprehensive (loss) income, net of tax		(6,147)		426
Total stockholders equity		138,860		111,330
Total liabilities and stockholders equity	$	890,440	$	919,353

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 information)

	Three months ended September 30,		Nine months ended September 30,	
	2014	**2013**	**2014**	**2013**
Revenues				
Merchant Acquiring, net	$ 19,227	$ 18,211	$ 58,345	$ 53,835
Payment Processing (from affiliates: $7,192, $7,338, $21,599 and $21,846)	25,611	24,731	77,019	73,128
Business Solutions (from affiliates: $33,688, $33,500, $101,289 and $102,996)	43,804	44,472	131,609	136,965
Total revenues	88,642	87,414	266,973	263,928
Operating costs and expenses				
Cost of revenues, exclusive of depreciation and amortization shown below	38,625	38,903	115,109	121,176
Selling, general and administrative expenses	7,104	8,990	25,629	30,477
Depreciation and amortization	16,453	17,657	49,457	53,074
Total operating costs and expenses	62,182	65,550	190,195	204,727
Income from operations	26,460	21,864	76,778	59,201
Non-operating (expenses) income				
Interest income	91	54	245	147
Interest expense	(6,370)	(6,403)	(19,780)	(31,414)
Earnings of equity method investment	241	198	905	823
Other income (expenses):				
Loss on extinguishment of debt				(58,464)
Termination of consulting agreements				(16,718)
Other income (expenses)	(249)	448	2,127	(1,838)
Total other income (expenses)	(249)	448	2,127	(77,020)
Total non-operating (expenses) income	(6,287)	(5,703)	(16,503)	(107,464)
Income (loss) before income taxes	20,173	16,161	60,275	(48,263)
Income tax expense (benefit)	1,082	1,358	5,205	(3,603)
Net income (loss)	19,091	14,803	55,070	(44,660)

Other comprehensive income (loss), net of tax of $4, $11, $57 and $29 Foreign currency translation adjustments	378	(210)	(6,573)	1,750
Total comprehensive income (loss)	$ 19,469	$ 14,593	$ 48,497	$ (42,910)
Net income (loss) per common share - basic	$ 0.24	$ 0.18	$ 0.70	$ (0.57)
Net income (loss) per common share - diluted	$ 0.24	$ 0.18	$ 0.70	$ (0.57)

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 share information)

	Number of Shares of Common Stock	Common Stock	Additional Paid-in Capital	Accumulated Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at December 31, 2013	78,286,465	$ 783	$ 80,718	$ 29,403	$ 426	$ 111,330
Share-based compensation recognized			1,314			1,314
Tax windfall benefit on exercises of stock options			1,937			1,937
Stock options exercised, net of cashless exercise	385,636	4	(694)			(690)
Dividend (1)			21			21
Net income				55,070		55,070
Cash dividends declared on common stock				(23,549)		(23,549)
Other comprehensive loss					(6,573)	(6,573)
Balance at September 30, 2014	78,672,101	$ 787	$ 83,296	$ 60,924	$ (6,147)	$ 138,860

(1) Related to dividend declared in 2012 and accrued upon vesting of stock options. Such options were forfeited during the nine months ended September 30, 2014.

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, 2014	2013
Cash flows from operating activities		
Net income (loss)	$ 55,070	$ (44,660)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	49,457	53,074
Amortization of debt issue costs and premium and accretion of discount	2,315	3,136
Write-off of debt issue costs, premium and discount accounted as loss on extinguishment		16,555
Provision for doubtful accounts and sundry losses	1,102	954
Deferred tax benefit	(1,486)	(6,723)
Share-based compensation	1,314	5,719
Unrealized loss (gain) of indemnification assets	459	(21)
Loss on disposition of property and equipment and other intangibles	23	30
Earnings of equity method investment	(905)	(823)
Dividend received from equity method investment	326	500
Decrease (increase) in assets:		
Accounts receivable, net	309	9,035
Prepaid expenses and other assets	(4,283)	(2,591)
Other long-term assets	2,497	(1,928)
(Decrease) increase in liabilities:		
Accounts payable and accrued liabilities	(7,357)	(18,485)
Income tax payable	1,686	(2,713)
Unearned income	3,271	2,625
Total adjustments	48,728	58,344
Net cash provided by operating activities	103,798	13,684
Cash flows from investing activities		
Net increase in restricted cash	(693)	(157)
Intangible assets acquired	(9,100)	(9,591)
Property and equipment acquired	(7,463)	(7,380)
Proceeds from sales of property and equipment	44	16
Net cash used in investing activities	(17,212)	(17,112)
Cash flows from financing activities		
Proceeds from initial public offering, net of offering costs of $12,567		112,369
Proceeds from issuance of long-term debt		700,000
	(1,004)	(16,704)

Statutory minimum withholding taxes paid on cashless exercises of stock options				
Debt issuance costs				(12,077)
Net decrease in short-term borrowing		(42,000)		(22,663)
Proceeds from short-term borrowing for purchase of equipment				1,800
Repayment of short-term borrowing for purchase of equipment		(1,200)		
Dividends paid		(23,547)		(8,192)
Tax windfall benefits on exercises of stock options		1,937		1,627
Issuance of common stock, net		314		91
Repayment of other financing agreement		(95)		(224)
Repayment of long-term debt		(14,250)		(750,273)
Net cash (used in) provided by financing activities		(79,845)		5,754
Net increase in cash		6,741		2,326
Cash at beginning of the period		22,485		25,634
Cash at end of the period	$	29,226	$	27,960
Supplemental disclosure of non-cash activities:				
Dividend declared not received from equity method investment	$	326	$	500
Foreign currency translation adjustments		(6,573)		1,750
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 Basis of Presentation

The Company

EVERTEC, Inc. (formerly known as Carib Latam Holdings, Inc.) and its subsidiaries (collectively the Company, or EVERTEC) is the leading full-service transaction processing business in Latin America and the Caribbean. The Company is based in Puerto Rico and provides a broad range of merchant acquiring, payment processing and business process management services across 19 countries in the region. EVERTEC owns and operates the ATH network, one of the leading automated teller machine (ATM) and personal identification number (PIN) debit networks in Latin America. In addition, EVERTEC provides a comprehensive suite of services for core bank processing, cash processing and technology outsourcing in the regions the Company serves. EVERTEC serves 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. Management believes that the Company s business is well-positioned to continue to expand across the fast-growing Latin American region.

On April 13, 2012, EVERTEC was formed in order to act as the new parent company of EVERTEC Intermediate Holdings, LLC (formerly known as Carib Holdings, LLC and Carib Holdings, Inc., hereinafter Holdings) and its subsidiaries, including EVERTEC Group, LLC (formerly known as EVERTEC, LLC and EVERTEC, Inc., hereinafter EVERTEC Group). The Company s subsidiaries include Holdings, EVERTEC Group, EVERTEC Dominicana SAS, EVERTEC Panamá, S.A., EVERTEC Costa Rica, S.A. (EVERTEC CR), EVERTEC Guatemala, S.A. and EVERTEC México Servicios de Procesamiento, S.A. de C.V.

Basis of Presentation

The unaudited consolidated financial statements of EVERTEC have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The preparation of the accompanying unaudited consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the unaudited consolidated financial statements. Actual results could differ from these estimates.

Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted from these statements pursuant to the rules and regulations of the SEC and, accordingly, these financial statements should be read in conjunction with the Audited Consolidated Financial Statements of the Company for the year ended December 31, 2013, included in the Company s 2013 Form 10-K. In the opinion of management, the accompanying 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. All significant intercompany accounts and transactions have been eliminated in consolidation.

Certain reclassifications have been made to the September 30, 2013 unaudited consolidated financial statements and related notes to conform with the presentation in 2014.

Stock Repurchase Plan

On September 24, 2014, the Company announced that the Board of Directors (the Board) had approved a stock repurchase program authorizing the purchase of up to $75 million of the Company s common stock over the next 12 months. Under the stock repurchase program, the Company may repurchase its common stock from time to time, in amounts, at prices, and at such times as the Company deems appropriate, subject to market conditions and other considerations. The Company s repurchases may be executed using open market purchases, privately negotiated transactions, accelerated share repurchase programs or other transactions, any of which may be enacted immediately following the Board s approval of the stock repurchase program. The Company intends to fund repurchases under the stock repurchase program from cash on hand and available borrowings under its existing credit facility, as necessary. The stock repurchase program does not obligate the Company to repurchase any specific number of shares and may be suspended or terminated at any time without prior notice. For the period ended September 30, 2014, the Company did not repurchase any shares under this program.

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EVERTEC, Inc. Notes to Unaudited Consolidated Financial Statements

Note 2 Recent Accounting Pronouncements

The Financial Accounting Standards Board (FASB) has issued the following accounting pronouncements and guidance relevant to the Company s operations:

In August 2014, the FASB issued updated guidance relating to disclosures for uncertainties about an entity s ability to continue as a going concern. The amendments require management to assess an entity s ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. Specifically, the amendments (1) provide a definition of the term *substantial doubt,* (2) require an evaluation every reporting period including interim periods, (3) provide principles for considering the mitigating effect of management s plans, (4) require certain disclosures when substantial doubt is alleviated as a result of consideration of management s plans, (5) require an express statement and other disclosures when substantial doubt is not alleviated, and (6) require an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). The amendments in this Update are effective for annual reporting periods ending after December 15, 2016, and for annual and interim periods thereafter. Early application is permitted. The Company does not expect this guidance to have an impact on the financial statements when adopted.

Note 3 Property and Equipment, net

Property and equipment, net consists of the following:

(Dollar amounts in thousands)	**Useful life in years**	**September 30, 2014**	**December 31, 2013**
Buildings	30	$ 1,600	$ 1,726
Data processing equipment	3 - 5	73,199	68,273
Furniture and equipment	3 - 20	8,200	6,385
Leasehold improvements	5 - 10	2,896	2,880
		85,895	79,264
Less - accumulated depreciation and amortization		(57,832)	(47,555)
Depreciable assets, net		28,063	31,709
Land		1,419	1,531
Property and equipment, net		$ 29,482	$ 33,240

Depreciation and amortization expense related to property and equipment for the three and nine months ended September 30, 2014 amounted to $3.8 million and $11.5 million, respectively, compared to $4.1 million and $12.2 million, respectively, for the same periods in 2013.

Note 4 Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill, allocated by reportable segments, were as follows (See Note 12):

(Dollar amounts in thousands)	**Merchant Acquiring, net**	**Payment Processing**	**Business Solutions**	**Total**
Balance at December 31, 2013	$ 138,121	$ 187,622	$ 47,376	$ 373,119
Foreign currency translation adjustments		(2,906)	(909)	(3,815)
Balance at September 30, 2014	$ 138,121	$ 184,716	$ 46,467	$ 369,304

Goodwill is tested for impairment at least annually, or more often if events or circumstances indicate there may be impairment, 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.

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EVERTEC, Inc. Notes to Unaudited Consolidated Financial Statements

During the third quarter of 2014, the Company completed the qualitative assessment described above and determined that there were no impairment losses to be recognized during the period. There were no triggering events or changes in circumstances that subsequent to the impairment test would have required an additional impairment evaluation. As part of the Company s qualitative assessment, EVERTEC considered the results for the 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 the Company s reporting units that occurred subsequent to the 2011 impairment test.

The carrying amount of other intangible assets at September 30, 2014 and December 31, 2013 consisted of the following:

(Dollar amounts in thousands)	September 30, 2014			
	Useful life in years	**Gross amount**	**Accumulated amortization**	**Net carrying amount**
Customer relationships	14	$ 312,811	$ (89,909)	$ 222,902
Trademark	10 - 15	39,950	(13,856)	26,094
Software packages	3 - 10	129,249	(81,459)	47,790
Non-compete agreement	15	56,539	(15,077)	41,462
Other intangible assets, net		$ 538,549	$ (200,301)	$ 338,248

(Dollar amounts in thousands)	December 31, 2013			
	Useful life in years	**Gross amount**	**Accumulated amortization**	**Net carrying amount**
Customer relationships	14	$ 314,036	$ (73,180)	$ 240,856
Trademark	10 - 15	39,950	(11,258)	28,692
Software packages	3 - 10	119,598	(65,655)	53,943
Non-compete agreement	15	56,539	(12,250)	44,289
Other intangible assets, net		$ 530,123	$ (162,343)	$ 367,780

For the three and nine months ended September 30, 2014, the Company recorded amortization expense related to other intangibles of $12.7 million and $37.9 million, respectively, compared to $13.6 million and $40.9 million for the corresponding 2013 periods.

The estimated amortization expense of the balances outstanding at September 30, 2014 for the next five years is as follows:

(Dollar amounts in thousands)	
Remaining 2014	$ 12,358
2015	46,588
2016	36,228
2017	33,237
2018	31,377
2019	30,609

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EVERTEC, Inc. Notes to Unaudited Consolidated Financial Statements

Note 5 Debt and Short-Term Borrowings

Total debt as of September 30, 2014 and December 31, 2013 was as follows:

(Dollar amounts in thousands)	**September 30, 2014**	**December 31, 2013**
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)(3))	$ 280,968	$ 292,153
Senior Secured Credit Facility (Term B) due on April 17, 2020 paying interest at a variable interest rate (LIBOR plus applicable margin(2)(3))	390,134	392,527
Senior Secured Revolving Credit Facility expiring on April 17, 2018 paying interest at a variable interest rate	8,000	50,000
Other short-term borrowing		1,200
Total debt	$ 679,102	$ 735,880

(1) Applicable margin of 2.50% at September 30, 2014 and December 31, 2013.
(2) Subject to a minimum rate (LIBOR floor) of 0.75% plus applicable margin of 2.75% at September 30, 2014 and December 31, 2013.
(3) Includes unamortized discount.

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.

Term A Loan

As of September 30, 2014, the unpaid principal balance of the Term A Loan was $281.3 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 plus an applicable margin ranging from 2.00% to 2.50%, or (b) Base Rate, as defined in the 2013 Credit Agreement, plus an applicable margin ranging from 1.00% to 1.50%. Term A Loan has no LIBOR or Base Rate minimum or floor.

Term B Loan

As of September 30, 2014, the unpaid principal balance of the Term B Loan was $395.0 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 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 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.

The 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,

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EVERTEC, Inc. Notes to Unaudited Consolidated Financial Statements

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 limit 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, 2014, the Company was in compliance with the applicable restrictive covenants under the 2013 Credit Agreement.

Note 6 Financial Instruments and Fair Value Measurements

Recurring Fair Value Measurements

Fair value measurement provisions establish a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. These provisions describe 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, that 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 mostly 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, 2014 and December 31, 2013 for assets measured at fair value on a recurring basis:

(Dollar amounts in thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**

September 30, 2014				
Financial assets:				
Indemnification assets:				
Software cost reimbursement	$	$	$ 1,632	$ 1,632
December 31, 2013				
Financial assets:				
Indemnification assets:				
Software cost reimbursement	$	$	$ 3,586	$ 3,586

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.

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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 transaction completed on September 30, 2010 (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, 2014, therefore resulting in a net unrealized loss of approximately $0.3 million and $0.5 million for the three and nine months ended September 30, 2014, respectively, and a net unrealized gain of approximately $2,000 and $21,000 for the three and nine months ended September 30, 2013, respectively, which are reflected within the other 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.

The unobservable inputs related to the Company s indemnification assets as of September 30, 2014 using the discounted cash flow model include the discount rate of 5.53% and the projected cash flows of $1.6 million.

For indemnification assets a significant increase or decrease in market rates or cash flows could result in a significant change to the fair value. Also, the credit rating and/or the non-performance credit risk of Popular, which is subjective in nature, also could 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, 2014 and December 31, 2013:

	September 30, 2014		**December 31, 2013**	
(Dollar amounts in thousands)	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Financial assets:				
Indemnification assets:				
Software cost reimbursement	$ 1,632	$ 1,632	$ 3,586	$ 3,586
Financial liabilities:				
Senior secured term loan A	$ 280,968	$ 276,913	$ 292,153	$ 284,091
Senior secured term loan B	390,134	387,922	392,527	387,055

The fair value of the senior secured term loans at September 30, 2014 and December 31, 2013 were obtained using prices supplied 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. The pricing inputs also may include the use of an algorithm that could take into account movement in the general high-yield market, among other variants.

The senior secured term loans, which are not measured at fair value in the balance sheets, if measured, could 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:

(Dollar amounts in thousands)	**Three months ended September 30,**		**Nine months ended September 30,**	
	2014	**2013**	**2014**	**2013**
Indemnification assets:				
Beginning balance	$ 2,114	$ 4,540	$ 3,586	$ 6,099
Payments received	(196)	(369)	(1,495)	(1,947)
Unrealized gain (loss) recognized in other expenses	(286)	2	(459)	21
Ending balance	$ 1,632	$ 4,173	$ 1,632	$ 4,173

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Note 7 Share-based Compensation

The following table summarizes stock options activity for the nine months ended September 30, 2014:

	Shares	Weighted-average exercise prices
Outstanding at December 31, 2013	1,285,536	$ 4.77
Granted	100,000	24.01
Forfeited	31,164	1.30
Exercised	452,999	2.09
Outstanding at September 30, 2014	901,373	$ 8.36
Exercisable at September 30, 2014	23,374	$ 1.30

Management uses the fair value method of recording stock-based compensation as described in the guidance for stock compensation in ASC topic 718.

The following table summarizes nonvested restricted shares activity for the nine months ended September 30, 2014:

Nonvested restricted shares	Shares	Weighted-average grant date fair value
Nonvested at December 31, 2013	9,133	$ 24.64
Vested	9,133	24.64
Granted	11,942	23.03