INTERCEPT INC
Form 10-Q
November 14, 2003
Table of Contents

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2003.

OR

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

For the transition period from ________to ________, 19__.

Commission file number: 01-14213

InterCept, Inc.

(Exact name of registrant as specified in its charter)

Georgia	**58 2237359**
(State or other jurisdiction of	**(I.R.S. Employer**

incorporation or organization)	**Identification No.)**

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

(Address of principal executive offices)

(770) 248-9600

(Registrant s telephone number including area code)

N/A

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

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

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

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

Class	Outstanding at November 10, 2003
Common Stock, no par value	20,210,350

INTERCEPT, INC.

INDEX TO FORM 10-Q

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

InterCept, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands, except share amounts)

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

Retained earnings	16,396	14,255
Accumulated other comprehensive loss	(352)	(348)
Total shareholders equity	328,070	315,059
Total liabilities and shareholders equity	$ 433,421	$ 472,614

The accompanying notes are an integral part of these condensed consolidated balance sheets.

1

Table of Contents

InterCept, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

(in thousands, except per share data)

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

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

Table of Contents

InterCept, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in thousands)

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

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

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

3

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Basis of Presentation

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

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

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

Table of Contents

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

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

2. Business Segment Reporting

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

InterCept. Inc and Subsidiaries

Segment information

(in thousands)

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

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

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

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

Table of Contents

3. Net Income Per Share

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

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

	Nine Months Ended September 30, 2003			Nine Months Ended September 30, 2002		
	Income	**Shares**	**EPS**	**Income**	**Shares**	**EPS**
Basic EPS	$ 2,138	19,805	$ 0.11	$ 10,850	18,539	$ 0.59
Dilutives:						
Stock options		197			547	
Shares held in escrow to satisfy contingencies					265	
Preferred	21	117				
Contingently issuable shares subject to earnout provisions		270			51	
Diluted EPS	$ 2,159	20,389	$ 0.11	$ 10,850	19,402	$ 0.56

4. Comprehensive Income

Comprehensive income is the total of net income and all other unrealized gains (losses) on securities, net of tax. The following table sets forth the calculation of InterCept s comprehensive income for the periods indicated below (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Net income, as reported	$ 39	$ 2,777	$ 2,159	$ 10,850
Unrealized loss on securities, net of tax:	4	(11)	(4)	2
Comprehensive income	$ 43	$ 2,766	$ 2,155	$ 10,852

Table of Contents

5. Acquisitions

Effective April 8, 2002, InterCept acquired substantially all of the assets of Internet Billing Company, Ltd., a Florida limited partnership that provided transaction processing for internet merchants. These assets included shares of several subsidiaries and affiliated companies of Internet Billing Company, Ltd. InterCept paid cash of $104.3 million, net of cash received of $7.7 million. Costs associated with the acquisition totaled approximately $2.7 million. In February 2003, InterCept amended the iBill asset purchase agreement to settle outstanding issues related to escrow and earnout provisions. At the closing of the original agreement on April 8, 2002, InterCept placed a portion of the purchase price in escrow to secure representations and warranties of the former owners. Under the amendment, InterCept received $8.0 million from the escrow, and the former owners received the remaining $2.5 million. Of the $8.0 million received by InterCept, $1.7 million was applied to InterCept s claim against the former owners of iBill for indemnification related to iBill s working capital deficit as of the closing date. The remainder of the $8.0 million was credited to goodwill from the iBill acquisition during the first quarter of 2003. In the February 2003 amendment, the former owners also agreed to eliminate the earnout provisions in the purchase agreement. InterCept agreed to indemnify the former owners for any claims resulting from processing-related activities that occurred before April 8, 2002.

On May 24, 2002, InterCept acquired all of the outstanding stock of Electronic Payment Exchange, Inc. (EPX, which is now named InterCept Payment Solutions, Inc.), a provider of transaction processing services based in New Castle, Delaware. Under the merger agreement, InterCept issued 1,349,877 shares of its common stock to the stockholders of EPX. In accordance with Statement of Financial Accounting Standard No. 141, Business Combinations, InterCept recorded the purchase price at $37.71 per share, representing the average closing price for the three trading days before and after the announcement of the acquisition.

In June 2002, InterCept acquired certain item and remittance processing and statement rendering assets from Affiliated Computer Services, Inc. (ACS). The assets include two locations in Woodbury and Utica, New York. Consideration for this purchase was approximately $7.5 million plus certain prepaid items.

6. Goodwill and Intangibles

InterCept adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, as of January 1, 2002. Under this statement, InterCept no longer amortizes goodwill but assesses it annually or whenever events or changes in circumstances occur for impairment. Additionally, InterCept no longer recognizes assembled workforce apart from goodwill in accordance with the Statement of Financial Accounting Standards No. 141, Business Combinations, (SFAS No. 141) and has reclassified the cost previously allocated to workforce of $800,000, less accumulated amortization of $300,000 to goodwill. InterCept has also adopted the provisions of SFAS No. 141 and will perform its annual impairment analysis on December 31, 2003 or if circumstances change that would more likely than not reduce the fair value of InterCept s reporting units below the carrying amounts.

As it has implemented these new accounting rules, InterCept has completed the initial goodwill impairment test. To accomplish this, InterCept identified its reporting units and determined the carrying value of each reporting unit by assigning the assets and liabilities, including existing goodwill and intangible assets, to those reporting units as of the date of adoption, January 1, 2002. InterCept then determined the fair value of each reporting unit and compared it to the reporting unit s carrying amount. Based on this comparison, InterCept concluded that goodwill was not impaired as of December 31, 2002. InterCept will continue to test for impairment on an annual basis or on an interim basis if circumstances change that would more likely than not reduce the fair value of InterCept s reporting units below the carrying amounts.

InterCept reviews its long-lived assets, including intangible assets subject to amortization, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment is recognized when the undiscounted future cash flows estimated to be generated by the asset are not sufficient to recover the unamortized balance of the asset. An impairment loss would be recognized based on the difference between the carrying values and estimated fair value. The estimated fair value will be determined based on either the discounted future cash flows or other appropriate fair value methods with the amount of any such deficiency charged to income in the current

Table of Contents

year. Estimates of future cash flows are based on many factors, including current operating results, management s plans with respect to operations, expected market trends and competitive influences. InterCept also evaluates the amortization periods assigned to its intangible assets to determine whether events or changes in circumstances warrant revised estimates of useful lives. In the fourth quarter of 2002, InterCept recorded an impairment loss of $20.0 million related to its intangibles.

Intangible assets as of September 30, 2003 and December 31, 2002 were as follows (in thousands):

	September 30, 2003			December 31, 2002		
	Gross Assets	**Accumulated Amortization**	**Net Assets**	**Gross Assets**	**Accumulated Amortization**	**Net Assets**
Amortized intangible assets:						
Product technology	$ 12,010	$ (3,863)	$ 8,147	$ 10,544	$ (2,628)	$ 7,916
Customer relationships	60,453	(12,217)	48,236	60,453	(8,495)	51,958
Marketing agreement	825	(141)	684	825	(110)	715
Patented technology	18,782	(2,770)	16,012	18,745	(1,424)	17,321
Non-compete agreements	1,091	(515)	576	1,091	(335)	756
Domain Names	88	(13)	75	88	(6)	82
	93,249	(19,519)	73,730	91,746	(12,998)	78,748
Nonamortized intangible assets:						
Trade names and trademarks	4,693	(23)	4,670	4,693	(23)	4,670
Total intangible assets	$ 97,942	$ (19,542)	$ 78,400	$ 96,439	$ (13,021)	$ 83,418

Amortization expense of intangible assets was $2.2 million and $2.5 million for the three months ended September 30, 2003 and 2002, respectively, and $6.6 million and $5.8 million for the nine months ended September 30, 2003 and 2002, respectively. As of September 30, 2003, estimated future annual amortization expense for the next five years of other intangible assets is as follows:

2004	$ 8,960
2005	$ 8,781
2006	$ 8,572
2007	$ 8,179
2008	$ 7,816

Goodwill for each segment is as follows:

	Financial Institutions	**Merchant Processing**	**Total**
Goodwill	93,999	124,178	218,177
Accum Depreciation	(5,980)		(5,980)

Net Goodwill	88,019	124,178	212,197

7. Long-Term Debt and Capital Lease Obligations

On September 19, 2003, InterCept entered into a three-year $50.0 million credit facility with Bank of America, N.A., which replaced InterCept s previous credit facility with Wachovia Bank, National Association. In connection with the syndication of the Bank of America facility in early November, the credit facility was amended to increase the amount InterCept can borrow to $60.0 million. Bank of America is the administrative agent for the syndicated facility. Banc of America Securities LLC was the lead arranger and book manager for the syndication. InterCept has paid a total of approximately $1.5 million in fees and expenses related to the facility. InterCept will amortize these fees and expenses over the three year life of the facility. Amounts InterCept borrows under the facility bear interest at LIBOR plus a tiered scale ranging from 225 to 275 basis points, depending on InterCept s consolidated leverage ratio, as defined in the credit agreement. InterCept is currently paying interest at a rate of 3.87% per annum. InterCept also has the option to pay interest at an alternate rate based on the higher of the Federal Funds rate plus ½% or Bank of America s published prime rate. InterCept must comply with the financial and other covenants of the credit facility to be able to draw on it, including borrowings to fund its acquisitions. The total amount InterCept may borrow under the facility decreases by $1,250,000 per quarter beginning on December 31, 2003. The amount we may borrow under the facility will also be reduced, beginning with the delivery of financial statements for the fiscal year ending December 31, 2004, by an amount equal to 50% of Excess Cash Flow for each fiscal year, up to a maximum reduction of $2,500,000 per year. The reductions described in the preceding two sentences will not, however, decrease the amount we may borrow to less than $35,000,000. This paragraph is only a summary of some the terms of the credit facility, and you should refer to the copy of the credit agreement InterCept has filed with the SEC for more detailed information.

Long-term debt and capital lease obligations at September 30, 2003 and December 31, 2002 consisted of the following (in thousands):

	September 30, 2003	December 31, 2002
$60.0 million line of credit with Bank of America, interest payable at the LIBOR rate plus applicable margins or at the Prime Rate plus applicable margins as defined (the effective LIBOR rate was approximately 3.8% and the Prime Rate was approximately 5.25% as of September 30, 2003); payable September 19, 2006.	$ 33,100	$
$ 50.0 million line of credit with Wachovia Bank, National Association (formerly First Union National Bank), as amended, interest payable at the LIBOR rate plus 2.0% as defined paid in full September 19, 2003.		39,350
Note with The Peoples Bank of Winder, interest payable monthly at prime minus .375 paid in full during January 2003.		18,221
Note with Wachovia Bank, National Association, interest payable monthly at the LIBOR rate plus applicable margins paid in full January 16, 2003.		5,000
Equipment under capital lease with rates ranging from 7.86% to 20.4% with maturity dates ranging from September 2003 to May 2004.	253	588
Other		6
	33,353	63,165
	(5,253)	(23,740)
Less current maturities	$ 28,100	$ 39,425

8. Advances to SLM

On December 3, 2001, InterCept entered into a loan agreement with SLMsoft.com Inc., an Ontario corporation (SLM Canada), and SLMsoft.com Inc., a Kansas corporation, (SLM Kansas, and together with SLM Canada, SLM). Under the loan agreement, InterCept loaned SLM $7.0 million in exchange for cash and settlement of indemnification obligations that SLM owed to InterCept. The loan was secured by the pledge of shares of InterCept stock. The SLM loan agreement was amended on September 30, 2002. Under the amended loan agreement, borrowings bear interest at prime plus 2%. Interest was payable on January 2, 2003 for all interest accrued through that date, and SLM sold 30,000 of the pledged shares in January 2003, which generated $551,000 used to pay off the accrued interest and a small portion of the principal. During the second quarter of 2003, SLM Kansas filed in Kansas for protection under the U.S. bankruptcy laws, and SLM Canada became the subject of bankruptcy proceedings in Ontario, Canada. The loan matured on June 30, 2003, has not been repaid, and is secured by 371,636 shares of InterCept common stock.

In light of the market value of the pledged shares and the uncertainties inherent in the two bankruptcy proceedings, InterCept determined that a loss on the SLM loan was probable as of June 30, 2003. Based on the facts known to InterCept, it estimated that loss at $3,500,000. InterCept also determined that it was unlikely to collect approximately $250,000 in indemnification obligations and accounts receivable from SLM. Accordingly, InterCept charged a total of $3,750,000 in the statements of operations for the quarter ended June 30, 2003 in the line item Other (expense) income, net. There is a reasonable possibility that InterCept may incur additional losses on the SLM loan in the future as the bankruptcy proceedings progress, and it is also possible that the loss may ultimately prove to be less than the second quarter charge. Because the collateral that secures the loan consists of shares of InterCept stock, there may also be additional expense or income due to the fluctuation of InterCept s stock price until the SLM situation is resolved. InterCept cannot now estimate whether any further charges will be necessary, and if so, the amount of these charges. Accordingly, in future periods as this situation becomes more certain, InterCept may incur additional charges or receive additional income. As of September 30, 2003, the balance of the note receivable on the balance sheet was $3.7 million.

9. MCI (formerly WorldCom)

MCI, which is currently subject to federal bankruptcy proceedings, provides various services to InterCept, including frame relay circuits, network and internet backbone, and billing and collection for iBill s WEB 900 billing service. WEB 900 allows a consumer to make a purchase by dialing a 900 telephone number. The charge for the purchase appears on the consumer s telephone bill. iBill sends amounts for the purchase to its internet merchant, as it would for any other internet purchase. MCI collects for the charges when the consumer pays its telephone bill, and then remits the amounts collected to ICN Ltd., iBill s WEB 900 service provider, which then forwards the monies to iBill. During the third quarter of 2002, MCI failed to remit to ICN certain amounts collected from consumers before MCI s bankruptcy filing, and accordingly ICN was unable to remit those amounts to iBill. As of September 30, 2002, ICN owed iBill approximately $2.1 million for WEB900 services, net of fees owed to ICN of $300,000. Of this $2.1 million, iBill had remitted to its customers approximately $700,000 and had recognized gross profit of approximately $300,000 related to its WEB900 service offering. In addition, iBill deposited $1.4 million with ICN as a reserve against charge-backs. ICN deposited these amounts with MCI for reserves. MCI has notified ICN that it will not refund reserve amounts held on behalf of ICN, and ICN has notified iBill that it will not return iBill s $1.4 million cash reserve to iBill. As of September 30, 2002, InterCept had reserved a total of $2.4 million against the $1.4 million deposit, the $700,000 that iBill has paid to its merchants, and the $300,000 of gross profits. During the three months ended December 31, 2002, ICN sold the MCI receivable, ICN paid iBill approximately $0.3 million for amounts due from MCI related to May 2002 and InterCept reduced the $2.4 million reserve and expense by this amount. During the three months ended June 30, 2003, ICN paid iBill for additional amounts due from MCI. InterCept s net recovery was approximately $0.4 million, and as of June 30, 2003, InterCept reduced the reserve to $1.7 million from the $2.1 million reserved as of March 31, 2003. As of September 30, 2003, the balance on the reserve is $1.7 million. InterCept previously provided statement and printing services for MCI. As of September 30, 2003, InterCept has reserved $70,000 for MCI s failure to pay for these services and is seeking to collect that amount.

Table of Contents

10. Recent Accounting Pronouncements

In July 2002, the FASB issued SFAS No. 146 Accounting for Costs Associated with Exit or Disposal Activities, which replaces Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity. SFAS No. 146 requires that liabilities associated with exit or disposal activities be recognized when they are incurred. Under EITF Issue No. 94-3, a liability for exit costs is recognized at the date of a commitment to an exit plan. SFAS No. 146 also requires that the liability be measured and recorded at fair value. Accordingly, the adoption of this standard may affect the timing of recognizing future restructuring costs as well as the amounts recognized. InterCept has adopted the provisions of SFAS No. 146 for restructuring activities initiated after December 31, 2002.

In December 2002, the FASB issued Statement No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure an amendment of FASB Statement No. 123, (SFAS 148). SFAS 148 amends FASB Statement No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation and to require prominent disclosures about the effects on reported net income of an entity s accounting policy decisions with respect to stock-based employee compensation. SFAS 148 also amends APB Opinion No. 28, Interim Financial Reporting, to require disclosures about those effects in interim financial information. InterCept currently accounts for its stock-based compensation awards to employees and directors under the accounting prescribed by Accounting Principles Board Opinion No. 25 and provides the disclosures required by SFAS No. 123. InterCept currently intends to continue to account for its stock-based compensation awards to employees and directors under the accounting prescribed by Accounting Principles Board Opinion No. 25 and has adopted the disclosure provisions of SFAS 148 as of December 31, 2002**.**

In November 2002, the FASB issued Interpretation No. 45 Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45). FIN 45 requires that a liability be recognized at fair value at the inception of certain guarantees for the obligations undertaken by the guarantor. FIN 45 also requires additional disclosures for certain guarantee contracts. The disclosure provisions of FIN 45 are effective for financial statements ending after December 15, 2002, while the recognition and initial measurement provisions are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The impact of the recognition and measurement provisions of FIN 45 on its financial statements was not material to the company s results of operations or financial condition.

In January 2003, the FASB issued Interpretation No. 46 Consolidation of Variable Interest Entities (FIN 46). FIN 46 provides guidance on the identification of variable interest entities, and the assessment of a company s interests in a variable interest entity to determine whether consolidation is appropriate. FIN 46 requires the consolidation of a variable interest entity by the primary beneficiary if the entity does not effectively disperse risks among the parties involved. FIN 46 applies immediately to variable interest entities created after January 31, 2003, and is effective for periods beginning after June 15, 2003 for existing variable interest entities. Because InterCept has no material exposures to special purpose entities or other off-balance sheet arrangements, the effects of adopting FIN 46 have not been material to InterCept s results of operations or financial condition.

In April 2003, the FASB issued Statement of Financial Accounting Standards No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities (SFAS 149). SFAS 149 amends and clarifies the accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS 149 is generally effective for contracts entered into or modified after September 30, 2003 and for hedging relationships designated after September 30, 2003. The adoption of SFAS 149 did not have a material effect on InterCept s financial position, results of operations and cash flows.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (SFAS 150). SFAS 150 requires that certain financial instruments, which under previous guidance were accounted for as equity, must now be accounted for as liabilities. The financial instruments affected include mandatorily redeemable stock, certain financial instruments that require or may require the issuer to buy back some of its shares in exchange for cash or other assets and certain obligations that can be settled with shares of stock. This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except as it relates to consolidated limited-life subsidiaries. The FASB indefinitely deferred the effective date of this statement as it relates to consolidated limited-life subsidiaries. The adoption of the effective provisions of SFAS No. 150 did not have a material impact on InterCept s results of operations or financial position.

In November 2002, the Financial Accounting Standards Board reached a consensus regarding Emerging Issues Task Force (EITF) Issue No. 00-21, Revenue Arrangements with Multiple Deliverables. EITF Issue No. 00-21 addresses accounting for arrangements that may involve the delivery or performance of multiple products, services, and/or rights to use assets. The guidance provided by EITF Issue No. 00-21 is effective for contracts entered into on or after July 1, 2003. The adoption of this statement did not have a material effect on our consolidated financial statements.

11. Commitments and Contingencies

In September 2003, we entered into a $12.0 million leasing arrangement with GE Capital under which we have leased $10.7 million of equipment to be used in our item processing operations for Sovereign Bank. We have used and will continue to use this financing to obtain equipment for the second phase of the Sovereign Bank conversion.

Litigation

Other than as described below, InterCept is not a party to, and none of its material properties is subject to, any material litigation other than routine litigation incidental to its business.

(1) InterCept brought an action on March 15, 2002 against Midwest Payment Systems, Inc. (MPS) in the U.S. District Court in the Eastern District of Tennessee seeking a declaration as to the rights and legal relations of InterCept, MPS and the customer banks under the contracts that InterCept and the banks have with MPS and asserting a claim for tortious interference with contractual relations. On April 3, 2002, InterCept and MPS agreed to a consent order pursuant to which MPS agreed to continue to provide services on a month-to-month basis so that InterCept can continue to service its customers who use MPS for ATM/EFT services. Both InterCept and MPS agreed not to solicit the ATM/EFT business of the customer banks until final resolution of the lawsuit, and both companies agreed to limited communications with the customers regarding the lawsuit. MPS has answered InterCept s complaint and has brought its own claims against InterCept, including tortious interference with contract, breach of contract and breach of fiduciary duty. InterCept believes that MPS s claims are without merit and intends to defend them vigorously if the lawsuit is not settled. InterCept is presently engaged in settlement discussions with MPS. If settlement efforts are unsuccessful, the case is scheduled to go to trial in March 2004. InterCept cannot evaluate the probability of a favorable or unfavorable outcome, or the amount of any potential loss that InterCept would suffer in the event of an unfavorable outcome.

(2) On September 30, 2002, Perfect10, Inc. filed a lawsuit in the Central District of California against iBill; CCBill, LLC; Paycom Billing Services, Inc; IMA Enterprises, Inc.; Cybertech Communications NV; Network Authentication Systems Corporation; Cavecreek Wholesale

Internet Exchange; Netpass Systems, Inc; Internet Key, Inc; and other defendants asserting causes of action for copyright infringement, trademark infringement, violations of privacy rights, RICO, false advertising, unfair competition and related claims. The complaint seeks a broad range of remedies, including actual damages, treble damages, an accounting of profits attributable to the allegedly infringing conduct, injunctive relief and other remedies. The plaintiff contends that iBill, which rendered billing services in connection with certain websites, is liable under theories of secondary liability and conspiracy for the alleged wrongdoing.

Discovery in the suit has begun. InterCept believes the claims are without merit and will vigorously defend the lawsuit and assert applicable defenses. It is too early in the proceeding to evaluate the probability of a favorable or unfavorable outcome, or the amount of any potential loss that InterCept would suffer in the event of an unfavorable outcome.

(3) InterCept, three of its officers John W. Collins, G. Lynn Boggs, and Scott R. Meyerhoff

and a former officer, Garrett M. Bender, were named as defendants in a shareholder class action lawsuit filed in the U.S. District Court for the Northern District of Georgia (Civil Action No. 03-CV0567). The plaintiff sought to represent a class of individuals who purchased InterCept common stock between September 16, 2002 and January 9, 2003. The plaintiff alleged that InterCept and the individual defendants made material misrepresentations and/or omitted to make material disclosures throughout the class period due to their false assurances that the adult entertainment portion of the company s merchant services business was insignificant and their failure to disclose the impact of the implementation of new Visa regulations in November 2002. The plaintiff alleged violations of Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 promulgated under Section 10(b), and Section 20(a) of the Exchange Act. Similar actions were filed by multiple plaintiffs, and on May 2, 2003, the plaintiffs filed a motion to consolidate the claims. On June 23, 2003, the court denied the plaintiffs motion to consolidate. On July 11, 2003, the plaintiffs filed a new motion for consolidation.

On August 7, 2003, InterCept, Collins, Boggs and Meyerhoff filed motions to dismiss all of the actions, and on August 12, 2003, they filed answers to each of the complaints denying liability and stating affirmative defenses. InterCept believes the claims are without merit and will continue to vigorously defend the lawsuits.

Due to the inherent uncertainties of the litigation process and the judicial system, the company is unable to predict the outcome of such litigation matters. If the outcome of this matter is adverse to the company, it could have a material adverse effect on the company s business, financial condition and results of operations.

(4) Internet Billing Company (iBill) has received notice from the Federal Trade Commission that the FTC is conducting an inquiry to determine whether iBill s activities comply with the FTC Act. The FTC has requested information since January 1, 1997. InterCept acquired substantially all of the assets of Internet Billing Company, Ltd. on April 8, 2002. iBill is cooperating fully with the FTC in its inquiry. At this early stage, iBill cannot predict the likely outcome of the inquiry or how that outcome may affect its business.

(5) On or about July 17, 2003, a former customer of Internet Billing Company, Trade News Corporation, NV (Tradenews) served a demand on iBill for arbitration claiming negligence, intentional misrepresentation, breach of contract, violation of Florida s Deceptive and Unfair Trade Practices Act, breach of implied covenant, and breach of oral contract. The demand claimed damages in excess of $20,000,000. We believe that the claims made in the demand were totally without merit. We engaged in supervised mediation and settlement discussions with Tradenews, but were not able to settle the case prior to arbitration. The arbitration was held October 21-24, 2003, and we are currently awaiting the decision of the arbitrator. We cannot now determine the probability of a favorable or unfavorable outcome or estimate the amount or range of any potential loss in the event of an unfavorable outcome.

Other Contingencies

(1) Because InterCept is not a bank, it cannot belong to or directly access the Visa and MasterCard credit card associations or the ACH payment network. To provide transaction processing services, InterCept must be designated a certified processor by, and be a member service provider of, MasterCard and be designated as an internet payment services provider of Visa. In cases of fraud or disputes between cardholders and merchants, InterCept faces charge-backs when cardholders dispute items for which they have been billed. Charge-backs may arise from the unauthorized use of the cardholder s name or bank account information or from a cardholder s claim that a merchant failed to perform. If a billing dispute between a credit card holder and a merchant is not resolved in favor of the merchant, the transaction is normally charged back to the merchant, and the purchase price is refunded to the cardholder. If InterCept s charge-back rate becomes excessive, credit card associations can fine InterCept or terminate InterCept s ability to accept credit cards for payment. InterCept retains a portion of merchant payouts for a period of six months to cover its potential liability for merchant processing card activities including potential charge-back penalties. InterCept acquired the iBill assets from Internet Billing Company, Ltd. (Old iBill) in April 2002. On February 11, 2003, InterCept amended the iBill asset purchase agreement to settle outstanding issues related to the $10.5 million remaining in the purchase price escrow that secured representations and

warranties of the former owners, including those related to potential Visa and MasterCard fines for excessive charge-backs. Under the amendment, InterCept received $8.0 million from the escrow, and the former owners of Old iBill received the $2.5 million then remaining in the escrow. In the amendment, the former owners also agreed to eliminate the earnout provisions in the purchase agreement. InterCept agreed to indemnify the former owners for any claims resulting from processing-related activities that occurred before April 8, 2002.

Table of Contents

InterCept processes MasterCard and Visa transactions through First Financial Bank and its affiliate, First Data Merchant Services Corporation (together referred to as First Data). On March 14, 2003, First Data was notified by MasterCard of an estimated assessment with respect to iBill s noncompliance with MasterCard s charge-back rules. First Data notified InterCept that MasterCard has reviewed the historical charge-back percentages for InterCept and Old iBill for the period from January 1, 2001 through February 28, 2003 and has determined that those percentages exceeded MasterCard s limits. On March 31, 2003, First Data notified InterCept that MasterCard had determined the final amount of the assessment to be $5.85 million. Of the $5.85 million, $3.5 million was recorded as an adjustment of the iBill purchase price, $1.9 million was recorded as an expense for the quarter ended December 31, 2002, and $450,000 was recorded during the first quarter of 2003. For the quarters ended March 31, 2003 and June 30, 2003, InterCept reserved $330,000 and $237,000, respectively, for potential fines. As of March 31, 2003, First Data was holding a reserve of approximately $11.0 million owed to InterCept to cover InterCept s potential liability for merchant processing card activities, including potential charge-back penalties. During the quarters ended June 30, 2003 and September 30, 2003, First Data deducted from the reserve $5.5 million and $330,000, respectively, of the $5.85 million assessment. The balance in the reserve of $5.3 million as of September 30, 2003 is included in the line item Other noncurrent assets in the balance sheet contained in the condensed consolidated financial statements included in this report.

InterCept also faces the possibility of fines from Visa for similar charge-back violations. Before InterCept acquired Old iBill in April 2002, Visa fined Old iBill for excessive charge-backs in the months of August and September of 2001 and January and February of 2002 in the aggregate amount of approximately $4.5 million. Old iBill also exceeded the Visa charge-back allowed rate in March 2002, and iBill exceeded the allowed charge-back rate in November 2002. In addition, Visa may deem iBill to have exceeded its charge-back levels in other months, but Visa has imposed no fines on iBill for excess charge-backs to date. Visa also tracks transactions that issuers report as fraudulent. Visa began imposing penalties for merchants with excessive fraud levels in July 2003. These penalties escalate from $5,000 in the first month to $100,000 in the sixth and subsequent months. Visa notified First Data that iBill had exceeded the fraud parameters for August 2003; however, Visa waived this $5,000 fine based on iBill s business plan to come into compliance. InterCept has concluded that Visa fines in excess of amounts withheld by InterCept from merchant payouts are not probable, and accordingly, InterCept has not recorded a liability under Statement of Financial Accounting Standard No. 5, Accounting for Contingencies (SFAS 5) issued by the FASB. InterCept also faces the possibility of fines from Visa and MasterCard for any future charge-back violations if Visa and/or MasterCard decide to impose fines.

(2) In March 2002, MasterCard implemented a rule that requires all banks that submit transactions on behalf of a merchant to have a valid merchant agreement with that merchant. This rule applies whether the card is presented directly to the merchant or to a third-party payment facilitator, such as iBill. As a result, MasterCard has notified iBill s former and current acquiring banks for MasterCard transactions that iBill has acquired transactions from merchants without the required merchant agreements. Because of this determination, MasterCard has stated that it will impose assessments on the acquiring banks of $2,500 per day, retroactive to the day that the first noncompliant transaction was acquired through iBill. For the quarters ended March 31, 2003 and June 30, 2003, InterCept incurred $225,000 and $10,000, respectively, of expense related to these potential assessments. On April 4, 2003, MasterCard notified iBill s acquiring bank that MasterCard had accepted iBill s plan to achieve compliance with MasterCard s rules and that MasterCard had granted a suspension of the $2,500 per day assessments through August 22, 2003 to give iBill time to achieve full compliance. MasterCard has informed iBill that iBill was in compliance as of August 22.

(3) In June 2003, iBill became aware, and subsequently informed Visa, that it had processed certain transactions for merchants who were not registered with Visa. Visa has assessed iBill $300,000 for these violations. Although iBill recognized it as expense in the second quarter of 2003, iBill may appeal the assessment because it self-reported the violation. Visa retained an independent party to review iBill s processes to ensure that iBill has procedures in place to prevent additional processing of unregistered merchants in the future. The audit was conducted in October 2003, and iBill is waiting to hear from Visa regarding the results of the audit. If the results are unsatisfactory, Visa could assess additional fines for improper processing.

Table of Contents

InterCept cannot predict with certainty whether Visa and MasterCard will fine it for excess charge-backs, merchant violations or other violations of card association rules, and if so, the amounts of those fines. Any fines could materially adversely affect InterCept s financial condition and result of operations.

Visa has established a monitoring program for its acquiring banks in which Visa compares the number of fraudulent transactions processed through a bank against unpublished thresholds for a given industry. During the third quarter of 2003, Visa notified our acquiring bank that because we had exceeded Visa s threshold for fraudulent transactions, Visa had imposed fines of $400,000. Because Visa does not publish these industry rates or our rates, we cannot estimate whether a fine will be imposed, or if so, its amount, until Visa notifies us of the fine. We face the possibility of future fines from Visa if we continue to exceed these alert thresholds.

(4) On August 13, 2003, iBill s acquiring bank for Visa transactions in Europe threatened to close iBill s account, allegedly due to transactions placed into the Visa system by unauthorized merchants sponsored by iBill. Although iBill has explained to its acquiring bank and to Visa that iBill is not responsible for the transactions and has taken action to terminate the accounts of the merchants in question, the acquiring bank may still suspend iBill s account, which may effectively terminate iBill s ability to process Visa transactions in Europe. Those transactions contribute approximately 4-6% of InterCept s aggregate merchant processing revenues. Although iBill is continuing discussions with the bank and with Visa and intends to pursue all available legal remedies to address this problem, iBill could lose a majority, if not all, of the revenues from its Visa transactions in Europe if its account is suspended.

(5) Under InterCept s amended and restated articles of incorporation, it has agreed to indemnify its directors for any breach of a duty of care or other duty, to the fullest extent allowed for under the Georgia Business Corporation Code (the GBCA). The GBCA also permits a corporation to indemnify officers to the same extent as directors, and, under InterCept s amended and restated bylaws, InterCept has agreed to indemnify both InterCept s directors and officers to the fullest extent allowed under the GBCA. In addition, InterCept s bylaws provide broad indemnification rights to its directors and the officers, employees and agents designated by its directors, with respect to various civil and criminal liabilities and losses which may be incurred by the director, officer, agent or employee under any pending or threatened litigation or other proceedings, except those situations to which indemnification is prohibited under the GBCA. InterCept is also obligated to reimburse directors and other parties for expenses, including legal fees, court costs and expert witness fees, incurred by the person in defending against any liabilities and losses, as long as the person in good faith believes that he or she acted in accordance with the applicable standard of conduct with respect to the underlying accusations giving rise to such liabilities or losses and agrees to repay to InterCept any advances made if it is ultimately determined that the person is not entitled to indemnification by InterCept. InterCept has separate indemnification agreements with each of its directors and certain of its officers, whereby InterCept agrees, among other things, to provide for indemnification and advancement of expenses in a manner and subject to terms and conditions similar to those provided in the articles of incorporation and the bylaws. These agreements may not be invalidated by action of the shareholders. The maximum potential amount of future payments InterCept could be required to make under these indemnification agreements is unlimited. InterCept currently has, however, a directors and officers liability insurance policy that may limit InterCept s exposure and enable it to recover a portion of any future amounts paid. Because InterCept is not able to estimate the amount of any indemnification obligation and because the insurance policy may cover a portion of any indemnification obligation, InterCept believes the estimated fair value of these indemnification agreements is minimal. Therefore, InterCept has recorded no liabilities for these agreements as of September 30, 2003.

(6) During the third quarter of 2003, InterCept accrued $800,000 in connection with an oral agreement to settle a contract dispute with a customer of our merchant services division. We expect to complete a written agreement memorializing the settlement during the fourth quarter of 2003.

Table of Contents

12. Stock Based Compensation

Stock based compensation to employees is accounted for based on the intrinsic value method under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). Under APB 25, if the exercise price of employee stock options equals the market price of the underlying stock on the grant date, no compensation expense is recorded. InterCept has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123).

Because InterCept has adopted the disclosure-only provisions of SFAS 123, no compensation cost has been recognized for the stock option plans. Had compensation cost for InterCept s stock option plans been determined based on the fair value at the grant date for awards for the three and nine months ended September 30, 2003 and 2002 consistent with the provisions of SFAS 123, InterCept s pro forma net income would have been as follows (diluted net income per share is not presented as the equivalents are antidilutive):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Net Income				
Net income before preferred dividends	$ 39	$ 2,777	$ 2,159	$ 10,850
Preferred dividends	(21)		(21)	
Net income attributable to common shareholders	18	2,777	2,138	10,850
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	$ (2,494)	$ (4,171)	$ (7,392)	$ (12,513)
Pro-forma	(2,476)	(1,394)	(5,254)	(1,663)
Number of Basic Shares	19,903	19,132	19,805	18,539
Basic (loss) Income Per Share				
Net income attributable to common shareholders	0.00	0.15	0.11	0.59
Pro-forma	(0.12)	(0.07)	(0.27)	(0.09)

13. Preferred Stock

On September 16, 2003, InterCept completed the sale of 100,000 shares of Series A preferred stock to the Sprout Group and related entities for $10,000,000. The Series A preferred stock is convertible into InterCept common stock at a fixed price of $13.97 per share at the holder s option at any time after the earliest of:

- the date as of which the closing bid price of InterCept s common stock shall have been equal to or greater than $25 per share for at least 10 consecutive trading days;
- the fifth anniversary of the issuance date; and

five business days prior to a liquidation of the company or the closing of

- n any merger, consolidation, combination, reorganization or other similar transaction, approved by the majority of the board, in which InterCept is not the surviving entity or in which securities of InterCept constituting in excess of 50% of the voting power of InterCept are exchanged for, or changed into, cash, property or securities of another person, or

- n the sale of all or substantially all of InterCept s assets in a transaction approved by the majority of the board.

Dividends on the Series A preferred stock will accrue and be payable in kind at the rates of 5% per annum through March 31, 2004, 4% per annum from April 1, 2004 through March 31, 2005 and 3% per annum thereafter. Additionally, a majority of the holders of Series A preferred stock must consent to certain actions by InterCept, including but not limited to, an amendment to InterCept s articles of incorporation, a sale or liquidation of the company, or an issuance of additional shares of InterCept s capital stock, other than under existing employee benefit plans.

14. Subsequent Event

InterCept s Chairman and CEO, John W. Collins, has informed InterCept s board of directors that he intends to submit an offer to take the company private and has engaged in preliminary discussions with financing sources for this transaction. As a result, the board has established a committee of independent directors, consisting of Jon R. Burke, Boone A. Knox and John D. Schneider, which has retained its own legal counsel and financial advisors.

Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

This section of this report is composed of five subsections:

Overview, where we explain our business segments, how we make money, and how we account for our revenue, among other things;

Recent Developments, where we address the following developments and events:

- n our sale of $10 million of Series A preferred stock in September 2003;
- n our new $60 million three-year Bank of America credit facility and $12.0 million in lease financing from GE Capital;
- n our revised guidance for 2003;
- n a possible going private transaction led by our Chairman and Chief Executive Officer, John W. Collins;
- n our agreement with Sovereign Bank to provide item processing and check imaging services and our progress in transitioning those services to us;
- n the default by SLMsoft.com Inc. in paying the $7.2 million owed to us;
- n fines from card associations and assessments levied on us by an acquiring bank; and
- n a threat by iBill s international acquiring bank to cease processing Visa transactions;

Disclosure Regarding Forward-Looking Statements, where we discuss various risks that we face;

Results of Operations;

Liquidity and Capital Resources; and

Critical Accounting Policies and Estimates.

Overview

Our operations are comprised of two business segments: financial institution services and merchant services. In our financial institution services segment, we derive revenues primarily by providing software systems, data processing services and related equipment and services to financial institutions. In our merchant services division, we provide credit card and other merchant processing services to financial institutions and merchants. This Overview section explains how we generate and recognize revenues and also summarizes certain other information that we believe is useful in evaluating our financial statements and performance. Please see the following sections in this Item 2: Recent Developments, for information about recent events and trends in our business and financial condition; and Disclosure Regarding Forward-Looking Statements, for cautions regarding the forward-looking statements we make in this report and an explanation of various risks we face.

Financial Institution Services

The products and services included in our financial institution services segment include:

- Core data processing and check imaging systems, support, maintenance and related services and software sales,
- EFT processing services,
- Data communications management and
- Equipment and product sales, services and other, including:
  - sales of banking-related equipment and complementary products and
  - equipment maintenance and technical support services.

In our service bureau operations, we generate core data processing revenues from service and processing fees based primarily on the number of accounts we service for our financial institution customers and the number of transactions we process. We recognize these revenues as we perform the services. We also generate revenues from the licensing of our core data processing systems. We recognize revenues for licensing these systems in accordance with Statement of Position 97-2 on Software Revenue Recognition, using the residual method prescribed in SOP 98-9 issued by the American Institute of Certified Public Accountants. We recognize software license fees and

Table of Contents

hardware and installation revenue when we have signed a non-cancelable license agreement, installed the product and satisfied all significant obligations to the customer. We recognize maintenance fees over the term of the maintenance period. We sell some of our software and hardware products through five-year, sales-type lease agreements under which customers make annual installment payments. These annual payments include the initial installation and an ongoing license fee. We recognize revenue attributable to installation fees and the sale of equipment upon installation. License fees are deferred and recognized ratably over the period of the lease.

We license Renaissance Imaging® check imaging software on an in-house basis, and we generate revenues from up-front license fees and recurring annual maintenance fees charged for this system. We recognize revenues primarily from the licensing of Renaissance Imaging in accordance with Statement of Position 97-2, as discussed above. We also provide check processing and imaging in a service bureau environment under which we generate recurring revenues. On a service bureau basis, we generate revenues primarily based on the volume of items processed. We recognize this revenue as we provide the service.

We derive EFT revenues principally from processing ATM and debit card transactions. We receive a base fee for providing our ATM processing services and an additional fee for each additional ATM and network serviced. Once the number of transactions by a financial institution exceeds established levels for that customer, we charge additional fees for these transactions. For some debit card transactions, we receive a portion of the interchange fees generated by our financial institution customers, and we charge a monthly fee if our customers transactions do not meet a specified minimum dollar amount of transactions for a particular month. Most charges under our EFT service agreements are due and paid monthly. During the second quarter of 2002, we began implementation of a new debit card pricing structure, under which we receive a flat fee for each transaction processed. Under the new pricing, we do not receive a portion of the interchange fee for processing debit card transactions. The change to our pricing structure has reduced our per-transaction earnings from debit card processing by approximately $50,000 per month, but it has also materially reduced our exposure to the changes in interchange fees that have been or may be implemented by Visa and MasterCard. See Risk Factors Risks Related to Financial Institution Services Industry Our revenues may decrease as a result of legal actions against Visa and MasterCard.

We generate our data communications management service revenues principally from network management and from equipment configuration services and installation. We charge a regular monthly fee on an ongoing basis for providing telecommunications connectivity and network management. We recognize revenues from data communications management as we perform the services.

We recognize revenues from sales of equipment and complementary products at the time of shipment or, if we are responsible for installation, upon installation of the product. We recognize maintenance and technical support service ratably over the period during which we perform the services.

Merchant Services

In our merchant services segment, we provide payment processing services and merchant portfolio management services. We recognize revenues from merchant processing services as we perform services. Our service offerings allow merchants to accept and process real-time payments for goods and services purchased over the internet using our merchant account in which event revenue recognized is equal to the service fees that we charge to the merchant. This fee is generally based on a percentage of the total transaction amount. Merchants can also establish their own merchant account with our acquiring bank partners and utilize our end-to-end processing solution, which eliminates the need for the merchant to establish multiple relationships with banks, front-end system providers, gateways, and back-end processors. We recognize revenues related to this service offering net of certain costs that we do not control primarily interchange and other fees charged by credit card associations.

For merchants using our merchant account, we retain a portion of our merchant payouts for a period of six months to cover potential merchant credit losses that can arise as a result of, among other things, disputes between cardholders and merchants or association fines related to charge-back activity. The aggregate withheld amount is sometimes referred to as the holdback, and our aggregate liability to refund the holdback is included in the line item Client payouts in the balance sheet contained in the condensed consolidated financial statements included in

17

this report. If disputes are not resolved in the merchant s favor, the transaction is charged back to us and the purchase price is refunded to the merchant s customer. If we are unable to collect from the merchant, we bear the credit risk for the full amount of the transaction. Our acquiring bank partners also establish and hold reserves for merchant credit losses for merchants using our solution. If transactions are charged back to our banks and our banks are unable to collect from the merchants, we bear the credit risk for amounts in excess of reserves held by the banks. The holdback provides us with funds to address these credit risks. After the six month holdback period expires, we refund the holdback to the merchant. For merchants who continue to use our services, we withhold and refund holdbacks in a rolling process so that as new transactions are processed we withhold a portion as the holdback, while at the same time refunding the holdbacks for which the six month period has expired.

Recurring Revenues and Customer Reimbursements

For the three and nine months ended September 30, 2003, approximately 93% respectively, of our total revenues were recurring revenues. Recurring revenues result from regular monthly, quarterly or annual payments by our customers for ongoing services they use in connection with their businesses and for transaction processing of debit, ATM, credit and ACH transactions that occur under long-term agreements. These revenues do not include conversion or de-conversion fees, initial software license fees, installation fees, hardware sales or similar activities. Because most of our customer contracts require the payment of monthly charges and have original terms of three to five years, we have a high percentage of recurring revenues. Customer reimbursements reflect pass-through items, primarily postage, that we bill to our customers.

Netzee, Inc.

Until December 31, 2002, we offered internet banking and voice response products through Netzee, Inc., and we owned approximately 28% of Netzee s outstanding common stock. We accounted for our investment in Netzee under the equity method, which required us to record Netzee s results of operations in a single line item in our statement of operations titled equity in loss of affiliate.

On December 31, 2002, Certegy, Inc. acquired substantially all of the assets of Netzee for approximately $10.4 million. In January 2003, we received approximately $2.3 million in payment on the line of credit that we jointly provided with John H. Harland Company to Netzee and $473,000 for the purchase of the common stock of Netzee that we owned. As of December 31, 2002, we recorded a one-time charge of $5.4 million related to the sale of Netzee. We received approximately $400,000 during the second quarter of 2003, which is included in Other Income (expense) net in the financial statements, from escrow accounts established at the time of closing, and we may receive a significantly smaller additional payout.

2002 Acquisitions

As of April 8, 2002, we acquired substantially all of the assets of Internet Billing Company, Ltd., a Ft. Lauderdale-based provider of transaction processing for Web merchants. We paid cash of $104.3 million, net of cash received of $7.7 million. Costs associated with the acquisition totaled approximately $2.7 million. In February 2003, the iBill asset purchase agreement was amended to settle outstanding issues related to escrow and earnout provisions. At the closing of the original agreement on April 8, 2002, we placed a portion of the purchase price in escrow to secure representations and warranties of the former owners. Under the amendment, we received $8.0 million from the escrow, and the former owners received the remaining $2.5 million. Of the $8.0 million we received, we applied $1.7 million to our claim against the former owners of iBill for indemnification related to iBill s working capital deficit as of the closing date. We credited the remainder of the $8.0 million to goodwill from the iBill acquisition during the first quarter of 2003. In the February 2003 amendment, the former owners also agreed to eliminate the earnout provisions in the purchase agreement. We agreed to indemnify the former owners for any claims resulting from processing-related activities that occurred beforeApril 8, 2002.

On May 24, 2002, we acquired all of the outstanding stock of Electronic Payment Exchange, Inc. (EPX, which is now named InterCept Payment Solutions, Inc.), a provider of transaction processing services based in New Castle, Delaware. Under the merger agreement, we issued 1,349,877 shares of our common stock to the

18

Table of Contents

stockholders of EPX. In accordance with Statement of Financial Accounting Standard No. 141, Business Combinations, we recorded the purchase price at $37.71 per share, representing the average closing price for the three trading days before and after the announcement of the acquisition.

In June 2002, we acquired certain item and remittance processing and statement rendering assets from Affiliated Computer Services, Inc. (ACS). The assets include two locations in Woodbury and Utica, New York. Consideration for this purchase was approximately $7.5 million plus certain prepaid items.

Recent Developments

Sale of $10 Million of Series A Preferred Stock

On September 16, 2003, InterCept completed the sale of 100,000 shares of Series A preferred stock to the Sprout Group and related entities for $10,000,000. The Series A preferred stock is convertible into InterCept common stock at a fixed price of $13.97 per share at the holder s option at any time after the earliest of:

- the date as of which the closing bid price of our common stock shall have been equal to or greater than $25 per share for at least 10 consecutive trading days;
- the fifth anniversary of the issuance date; and
- five business days prior to a liquidation of the company or the closing of
  - n any merger, consolidation, combination, reorganization or other similar transaction, approved by the majority of the board, in which InterCept is not the surviving entity or in which securities of InterCept constituting in excess of 50% of the voting power of InterCept are exchanged for, or changed into, cash, property or securities of another person, or
  - n the sale of all or substantially all of InterCept s assets in a transaction approved by the majority of the board.

Dividends on the Series A preferred stock will accrue and be payable in kind at the rates of 5% per annum through March 31, 2004, 4% per annum from April 1, 2004 through March 31, 2005 and 3% per annum thereafter. Additionally, a majority of the holders of Series A preferred stock must consent to certain actions by InterCept, including but not limited to, an amendment to InterCept s articles of incorporation, a sale or liquidation of the company, or an issuance of additional shares of InterCept s capital stock, other than under existing employee benefit plans. This is only a summary of the terms of the Series A preferred stock, and you should refer to the exhibits related to the transaction that we have filed with the SEC for more detailed information.

Bob Finzi, a general partner of Sprout Group, was to be installed as a director at a board meeting in late October. Mr. Finzi has deferred any decision to become a member of our board. He will continue to attend board meetings as an observer and may become a director at a later date.

New Three-year Credit Facility and Lease Financing

On September 19, 2003, we entered into a three-year $50.0 million credit facility with Bank of America, N.A., which replaced our previous credit facility with Wachovia Bank, National Association. In connection with the syndication of the Bank of America facility in early November, the credit facility was amended to increase the amount we can borrow to $60.0 million. Bank of America is the administrative agent for the syndicated facility. Banc of America Securities LLC was the lead arranger and book manager for the syndication. We have paid a total of approximately $1.5 million in fees and expenses related to the facility. We will amortize these fees and expenses over the three year life of the facility. Amounts we borrow under the facility bear interest at LIBOR plus a tiered scale ranging from 225 to 275 basis points, depending on our consolidated leverage ratio, as defined in the credit agreement. We are currently paying interest at a rate of 3.87% per annum. We also have the option to pay interest at an alternate rate based on the higher of the Federal Funds rate plus ½% or Bank of America s published prime rate. We must comply with the financial and other covenants of the credit facility to be able to draw on it, including

Table of Contents

borrowings to fund our acquisitions. The total amount we may borrow under the facility decreases by $1,250,000 per quarter beginning on December 31, 2003. The amount we may borrow under the facility will also be reduced, beginning with the delivery of financial statements for the fiscal year ending December 31, 2004, by an amount equal to 50% of Excess Cash Flow for each fiscal year, up to a maximum reduction of $2,500,000 per year. The reductions described in the preceding two sentences will not, however, decrease the amount we may borrow to less than $35,000,000. This paragraph is only a summary of some the terms of the credit facility, and you should refer to the copy of the credit agreement we have filed with the SEC for more detailed information.

Separately, also in September 2003, we entered into a $12.0 million leasing arrangement with GE Capital under which we have leased $10.7 million of equipment to be used in our item processing operations for Sovereign Bank. Our monthly payments under this lease are approximately $250,000. We have used and may continue to use this financing to obtain equipment for the second phase of the Sovereign Bank conversion.

Revised Guidance for 2003

We previously announced in August 2003 that we expected our 2003 earnings per share to be in the range of $0.63 to $0.68, excluding $3.8 million of non- recurring items related to SLM, a $780,000 assessment for non-compliance with association charge-back guidelines and $685,000 in severance payments related to our merchant processing unit. On a GAAP basis, the expected 2003 earnings per share were in the range of $0.46 to $0.51. On October 30, 2003, we announced that we now expect that our 2003 earnings per share will be in the range of $0.34 to $0.42, excluding the items noted above. On a GAAP basis, we now expect that our 2003 earnings per share will be in the range of $0.17 to $0.25. We believe that presentation of non-GAAP financial measures in the press release and in this report provides useful information to investors regarding our financial condition and results of operations because it permits investors to better understand our core business without the effects of (a) unusual items and (b) a cash payment that is covered by escrow proceeds we received in February and by merchant processing reserves established for that purpose.

The expected earnings shortfall is due to operational cost overruns and conversion delays in our financial institutions division. The shortfall is also due to customer attrition, contract settlement costs and association charges in our merchant processing division.

In our financial institution division, we experienced greater than expected conversion costs in Sovereign Bank s item processing in the third quarter and anticipate additional conversion delays in the fourth quarter. We continue to expect that the Sovereign operations will be fully converted before the end of 2003, but the conversion costs and additional delays will have resulted in a shortfall of $0.6 million.

We experienced difficulties in combining two of our item processing centers, which resulted in expense overruns and a loss of expected savings from the combination of these two centers. These issues caused a shortfall in earnings expectations of approximately $1.2 million in the third quarter, and we expect an additional shortfall of $0.6 million in the fourth quarter.

Merchant services results were below expectations due to an $0.8 million charge arising from a contract dispute, $0.4 million related to association charges and a $1.0 million shortfall due to customer attrition. Because of our efforts to bring our iBill operations into compliance with card association rules, we have terminated a number of adult entertainment merchants. Although we have made steady progress in growing the mainstream segment of the iBill portion of our merchant services division, the overall loss of customers has resulted in a decline in merchant service revenues from $17.4 million in the first quarter of 2003 to $14.6 million in the third quarter of 2003. Our merchant services revenues have increased slightly since September 2003, but we may not be able to sustain this trend. We may continue to suffer customer attrition as we discontinue providing services to problem merchants in our efforts to comply with existing and new card association rules.

Table of Contents

The revised guidance given above and the related expectations for the fourth quarter of 2003 and 2004 are forward-looking statements within the meaning of the securities laws that are based on current expectations, assumptions, estimates, and projections about InterCept and our industry. This forward-looking statements are not a guarantee of future performance and are subject to risks and uncertainties, many of which are outside of our control, that may cause actual earnings per share for 2003 to differ materially from the guidance provided. These risks and uncertainties include:

- whether we can convert Sovereign Bank to our item processing and check imaging centers in the time frames we expect;
- the effects of the recent MasterCard and Visa settlement;
- how and when the SLM loan situation will ultimately be resolved and the timing and amount of any charges related to that loan;
- the possible inaccuracy of our estimates of the costs to defend and pursue litigation; and
- whether we can:
  - meet our budget goals;
  - continue to sustain our current internal growth rate or our total growth rate;
  - successfully integrate acquisitions of assets and businesses and other operations we may acquire;
  - continue to provide enhanced and new products and services that appeal to our financial institution and merchant customers;
  - continue to have access to the debt and equity capital we need to sustain our growth; and
  - achieve our sales objectives.

Other risks related to our merchant services division include:

- whether we can make changes to iBill s business without suffering a further decline in its operating performance;
- the possibility that, notwithstanding these changes, credit card companies may fine us again for excessive credit card charge-backs or other issues arising out of our merchant services operations;
- the possibility that the termination of customers or other changes in our merchant services business could affect its value and result in the impairment of that asset or other intangible assets, which would require us to record an impairment charge in our statement of operations; and

- n the possibility that we may have to sell all or a portion of the division, further restructure the division, or suspend the operations of all or a portion of the division.

For a more detailed analysis of these and other risks and uncertainties that we face, please see Disclosure Regarding Forward-Looking Statements below.

Possible Going Private Transaction Announced by John Collins, Our CEO

Our Chairman and CEO, John W. Collins, has informed our board of directors that he intends to submit an offer to take the company private and has engaged in preliminary discussions with financing sources for this transaction. As a result, the board has established a committee of independent directors, consisting of Jon R. Burke, Boone A. Knox and John D. Schneider, which has retained its own legal counsel and financial advisors.

Table of Contents

Sovereign Bank Update

In January 2003, we executed a definitive agreement with Sovereign Bank for item processing and check imaging services. Sovereign is a $41 billion financial institution headquartered in Pennsylvania with approximately 530 community banking offices in New England and the Mid-Atlantic states. To accommodate Sovereign s item and check processing needs, we have opened all four of our previously announced four new check image processing centers and significantly expanded two other centers, and to date have hired 225 new employees with plans to hire approximately 30 more employees by year-end. We began transitioning Sovereign Bank s item and check processing services to us on July 25, 2003 and have completed the transition of 255 of Sovereign s community banking offices located in the New England area. Sovereign is now our largest customer. We anticipate that we will recognize more than $120 million in total revenue over the 6 year term of the agreement with Sovereign. We issued 375,000 shares of our common stock to Sovereign upon execution of the letter of intent in October 2002 for us to provide Sovereign with item processing and check imaging services, and the value of the shares will be amortized over the term of the processing agreement.

As noted above, we experienced greater than expected conversion costs in Sovereign Bank s item processing in the third quarter and anticipate additional conversion delays in the fourth quarter. We continue to expect that the conversion of the Sovereign operations community banking offices to our check image processing services will be completed before the end of 2003. We expect most of the quarter-over-quarter revenue increase from the Sovereign contract to occur in the fourth quarter of 2003.

Default by SLMsoft.com Inc.

On December 3, 2001, we entered into a loan agreement with SLMSoft.com Inc., an Ontario corporation (SLM Canada), and SLMSoft.com Inc., a Kansas corporation, (SLM Kansas, and together with SLM Canada, SLM). Under the loan agreement, we loaned SLM $7.0 million in exchange for cash and settlement of indemnification obligations that SLM owed to us. The loan was secured by the pledge of shares of InterCept stock. The SLM loan agreement was amended on September 30, 2002. Under the amended loan agreement, borrowings bear interest at prime plus 2%. Interest was payable on January 2, 2003 for all interest accrued through that date, and SLM sold 30,000 of the pledged shares in January 2003, which generated $551,000 used to pay off the accrued interest and a small portion of the principal. During the second quarter of 2003, SLM Kansas filed in Kansas for protection under the U.S. bankruptcy laws, and SLM Canada became the subject of bankruptcy proceedings in Ontario, Canada. The loan matured on June 30, 2003, has not been repaid, and is secured by 371,636 shares of InterCept common stock. As of September 30, 2003, the balance on the balance sheet was $3.7 million.

In light of the current market value of the pledged shares and the uncertainties inherent in the two bankruptcy proceedings, we determined that a loss on the SLM loan was probable as of June 30, 2003. Based on the facts now known to us, we estimated that loss at $3,500,000. We also determined that we are unlikely to collect approximately $250,000 in indemnification obligations and accounts receivable from SLM. Accordingly, we charged a total of $3,750,000 in the statements of operations for the quarter ended June 30, 2003 in the line item Other (expense) income (loss), net. There is a reasonable possibility that we may incur additional losses on the SLM loan in the future as the bankruptcy proceedings progress, and it is also possible that the loss may ultimately prove to be less than our second quarter charge. Because the collateral that secures the loan consists of shares of InterCept stock, there may also be additional expense or income due to the fluctuation of InterCept s stock price until the SLM situation is resolved. We cannot now estimate whether any further charges will be necessary, and if so, its amount. Accordingly, in future periods as this situation becomes more certain, we may incur additional charges or receive additional income. We did not incur additional charges or receive additional income during the quarter ended September 30, 2003.

Fines from Card Associations

Because we are not a bank, we cannot belong to or directly access the Visa and MasterCard credit card associations or the ACH payment network. To provide transaction services, we must be designated a certified

Table of Contents

processor by, and be a member service provider of, MasterCard and be designated as an internet payment services provider of Visa. In cases of fraud or disputes between cardholders and merchants, we face charge-backs when cardholders dispute items for which they have been billed. Charge-backs may arise from the unauthorized use of the cardholder s name or bank account information or from a cardholder s claim that a merchant failed to perform. If a billing dispute between a card holder and a merchant is not resolved in favor of the merchant, the transaction is normally charged back to the merchant, and the purchase price is refunded to the cardholder. If our charge-back rate becomes excessive, credit card associations can fine us or terminate our ability to accept credit cards for payment. We delay a portion of merchant payouts to cover our potential liability for merchant processing card activities including potential charge-back penalties.

As noted above we acquired the iBill assets from Internet Billing Company, Ltd. (Old iBill) in April 2002. On February 11, 2003, we amended the iBill asset purchase agreement to settle outstanding issues related to the $10.5 million remaining in the purchase price escrow that secured representations and warranties of the former owners, including those related to potential Visa and MasterCard fines for excessive charge-backs. Under the amendment, we received $8.0 million from the escrow, and the former owners of Old iBill received the $2.5 million then remaining in the escrow. In the amendment, the former owners also agreed to eliminate the earnout provisions in the purchase agreement. We agreed to indemnify the former owners for any claims resulting from processing-related activities that occurred before April 8, 2002.

We process MasterCard and Visa transactions through First Data. On March 14, 2003, MasterCard notified First Data of an estimated assessment with respect to iBill s noncompliance with MasterCard s charge-back rules. First Data notified us that MasterCard has reviewed the historical charge-back percentages for InterCept and Old iBill for the period from January 1, 2001 through February 28, 2003 and has determined that those percentages exceeded MasterCard s limits. On March 31, 2003, First Data notified us that MasterCard had determined the final amount of the assessment to be $5.85 million. Of the $5.85 million, $3.5 million was recorded as an adjustment of the iBill purchase price, $1.9 million was recorded as an expense for the quarter ended December 31, 2002 and $450,000 was recorded during the first quarter of 2003. For the quarters ended March 31, 2003 and June 30, 2003 we reserved $330,000 and $237,000, respectively, for potential fines. As of March 31, 2003, First Data was holding a reserve of approximately $11.0 million owed to us to cover our potential liability for merchant processing card activities, including potential charge-back penalties. During the quarters ended June 30, 2003 and September 30, 2003, First Data deducted from the reserve $5.5 million and $330,000 respectively, of the $5.85 million assessment. The balance in the First Data reserve of $5.3 million as of September 30, 2003 is included in the line item Other noncurrent assets and the remaining $300,000 is included in the line item Inventory and other in the balance sheet contained in the condensed consolidated financial statements included in this report.

We also face the possibility of fines from Visa for similar charge-back violations. Before our April 2002 acquisition of the iBill assets, Visa fined Old iBill for excessive charge-backs in the months of August and September of 2001 and January and February of 2002 in the aggregate amount of approximately $4.5 million. Old iBill also exceeded the Visa charge-back allowed rate in March 2002, and iBill exceeded the allowed charge-back rate in November 2002. In addition, Visa may deem us to have exceeded its charge-back levels in other months, but no fines have been assessed by Visa to date. We have concluded that Visa fines in excess of amounts withheld by us from merchant payouts are not probable, and accordingly, we have not recorded a liability under SFAS 5. We also face the possibility of fines from Visa and MasterCard for similar charge-back violations if we fail to comply with MasterCard and Visa charge-back rules in the future and if Visa and/or MasterCard decide to impose fines.

In March 2002, MasterCard implemented a rule that requires all banks that submit transactions on behalf of a merchant to have a valid merchant agreement with that merchant. This rule applies whether the card is presented directly to the merchant or to a third-party payment facilitator, such as iBill. MasterCard has notified iBill s former and current acquiring banks for MasterCard transactions that iBill has acquired transactions from merchants without the required merchant agreements. Because of this determination, MasterCard has stated that it will impose assessments on the acquiring banks of $2,500 per day, retroactive to the day that the first noncompliant transaction was acquired through iBill. For the quarters ended March 31, 2003 and June 30, 2003, InterCept incurred $225,000 and $10,000, respectively, of expense related to these potential assessments. On April 4, 2003, MasterCard notified iBill s acquiring bank that MasterCard had accepted iBill s plan to achieve compliance with MasterCard s rules and

Table of Contents

that MasterCard had granted a suspension of the $2,500 per day assessments through August 22, 2003 to give iBill time to achieve full compliance. MasterCard has informed iBill that iBill was in compliance as of August 22.

In June 2003, iBill became aware, and subsequently informed Visa, that it had processed certain transactions for merchants who were not registered with Visa. Visa has assessed iBill $300,000 for these violations. iBill paid the assessment and we recognized it as an expense in the second quarter of 2003, but iBill may appeal the assessment because it self-reported the violation. Visa retained an independent party to review iBill s processes to ensure that iBill has procedures in place to prevent additional processing of unregistered merchants in the future. The audit was conducted in October, and iBill is waiting to hear from Visa regarding the results of the audit. If the results are unsatisfactory, Visa could assess additional fines for improper processing.

We cannot predict with certainty whether Visa and MasterCard will fine us and if so, the amounts of those fines. Any fines could materially adversely affect our financial condition and result of operations.

Association Charges from an Acquiring Bank

Visa has established a monitoring program for its acquiring banks in which Visa compares the number of fraudulent transactions processed through a bank against unpublished thresholds for a given industry. During the third quarter of 2003, Visa notified our acquiring bank that because the bin in which we process merchant transactions had exceeded Visa s threshold for fraudulent transactions, Visa had imposed fines of $400,000. The bank in turn assessed us that amount. Because Visa does not publish these industry rates or our rates, we cannot estimate whether a fine will be imposed, or if so, its amount, until Visa notifies us of the fine. We face the possibility of future fines from Visa if we continue to exceed these alert thresholds.

Threat by International Acquiring Bank to Cease Processing Visa Transactions for iBill

On August 13, 2003, our acquiring bank for Visa transactions in Europe threatened to close our account, allegedly due to transactions placed into the Visa system by unauthorized merchants sponsored by iBill. Although we have explained to our acquiring bank and to Visa that iBill is not responsible for the transactions and have taken action to terminate the accounts of the merchants in question, our acquiring bank may still suspend our account, which may effectively terminate our ability to process Visa transactions in Europe. Those transactions contribute approximately 4-6% of our aggregate merchant processing revenues. Although we are continuing discussions with the bank and with Visa and intend to pursue all available legal remedies to address this problem, we could lose a majority, if not all, of the revenues from our Visa transactions in Europe if our account is suspended.

Contract Settlement

During the third quarter of 2003, we accrued $800,000 in connection with an oral agreement to settle a contract dispute with a customer of our merchant services division. We expect to complete a written agreement memorializing the settlement during the fourth quarter of 2003.

Disclosure Regarding Forward-Looking Statements

We make forward-looking statements throughout this Item 2 and elsewhere in this report. These statements are subject to risks and uncertainties, and we can provide no assurances that they will prove to be correct. Forward-looking statements include assumptions as to how we may perform in the future. When we use words like believe, expect, anticipate, predict, project, potential, seek, continue, will, may, could forma, estimate, goal, strive and similar expressions, we are making forward-looking statements. Forward-looking statements include the matters discussed in Recent Developments above and our expectations regarding our liquidity and capital resources and our critical accounting policies and estimates as explained below. We believe that the expectations reflected in our forward-looking statements are reasonable, but we cannot be sure that we will actually achieve these expectations. Projections or estimates of our future performance are necessarily subject to a high degree of uncertainty and may vary materially from actual results. In evaluating forward-looking statements, please carefully consider the various factors discussed below.

Table of Contents

Risks Related to Our Operations

Our growth could strain our managerial, operational and financial resources, and our failure to manage our growth could cause our business to suffer.

Our internal growth and acquisitions since our initial public offering in June 1998 have placed great demands on our business, particularly our managerial, operational and financial personnel and systems. For example, we have grown from approximately 170 employees on March 31, 1998 to approximately 2,000 employees on September 30, 2003. Additional internal growth and acquisitions may further strain our resources. We can provide no assurances that our systems, procedures, controls and existing facilities will be adequate to support the expansion of our operations, while maintaining adequate levels of customer service and satisfaction. Our future operating results will depend substantially on the ability of our officers and key employees to manage changing business conditions and to implement and improve our technical, administrative, financial control and reporting systems. Our failure to respond to and manage changing business conditions as we expand could diminish the quality of our products and services, result in the loss of customers and weaken our operating results.

The failure to sustain our current growth rates or to achieve expected growth rates could adversely affect the price of our common stock.

We have experienced significant growth since our inception. Our revenues have increased from $33.3 million in 1998 to $226.7 million for 2002. This revenue growth has resulted from both internal growth of our business and through acquisitions we have completed. Our overall growth rate declined in the fourth quarter of 2002, and we failed to achieve growth rates expected by stock market analysts. In addition, our revenues in our merchant services division have been contracting since the fourth quarter of 2002. As a result of these and other factors, our stock price has declined substantially. Either our internal growth rate or our total growth rate, or both, may again decline in the future due to factors within or beyond our control. Revenues in our merchant services division may continue to decline. Our failure to sustain our growth rates, or achieve growth rates expected by stock market analysts, could again have a material adverse impact on the trading price of our common stock.

Our acquisitions have resulted and could again result in integration difficulties, unexpected expenses, diversion of management s attention and other negative consequences.

As part of our growth strategy, we have made numerous acquisitions since our initial public offering in June 1998. Assuming we have access to adequate levels of debt and equity capital, we plan to continue to acquire complementary businesses, products and services as a key element of our growth strategy. We must integrate the technology, products and services, operations, systems and personnel of acquired businesses with our own and attempt to grow the acquired businesses as part of our company. The integration of other businesses is a complex process and places significant demands on our management, financial, technical and other resources. The successful integration of businesses we have acquired in the past and may acquire in the future is critical to our future success. If we are unsuccessful in integrating these businesses, our financial and operating performance could suffer. The risks and challenges associated with the acquisition and integration of acquired businesses include:

- we may be unable to centralize and consolidate our financial, operational and administrative functions with those of the businesses we acquire;

- our management s attention may be diverted from other business concerns;

we may be unable to retain and motivate key employees of an acquired company;

we may enter markets in which we have little or no prior direct experience;

litigation, indemnification claims and other unforeseen claims and liabilities may arise from the acquisition or operation of acquired businesses;

the costs necessary to complete integration may exceed our expectations or outweigh some of the intended benefits of the transactions we complete;

we may be unable to maintain the customers or goodwill of an acquired business; and

the costs necessary to improve or replace the operating systems, products and services of acquired businesses may exceed our expectations.

Table of Contents

We may be unable to integrate our acquisitions successfully with our operations on schedule or at all. We have been forced to deal with many of the risks listed above in connection with our acquisitions of iBill and EPX, which we acquired in 2002. We can provide no assurances that we will not incur large accounting charges or other expenses in connection with business units we acquire, divest, or close. We have in fact incurred a large impairment charge in connection with our acquisitions of iBill and EPX, and we can provide no assurances that we can avoid incurring similar charges in the future if these businesses do not perform as we expect or our plans with respect to such businesses change. Further, we can provide no assurances that acquisitions will result in cost savings or sufficient revenues or earnings to justify our investment in, or our expenses related to, these acquisitions.

We may suffer further losses in seeking to collect the SLM note receivable.

SLM Kansas and SLM Canada together owe us approximately $7.2 million, secured by 371,636 shares of InterCept common stock. Both of the SLM entities are the subject of bankruptcy proceedings. The loan matured on June 30, 2003 and has not been repaid. We have also determined that we are unlikely to collect approximately $250,000 in indemnification obligations and accounts receivable from SLM. In light of the market value of the pledged shares and the uncertainties inherent in the two bankruptcy proceedings, we determined that a loss on the SLM loan and other SLM obligations was probable as of June 30, 2003, and based on the facts known to us, we estimated that loss at $3,750,000 and incurred a charge of that amount in the statements of operations for the quarter ended June 30, 2003. There is a reasonable possibility that we may incur additional losses on the SLM loan in the future as the bankruptcy proceedings progress.

The slower economy in the United States may continue to affect our operations adversely.

We continue to see sluggishness in item volumes in our financial institution services segment, and we believe that the economy continues to affect this part of our business. We believe that the economy and the unsettled international situation will continue to influence transaction volumes negatively. This problem may be exacerbated if additional events of terrorism occur within the United States or elsewhere.

If we do not continue to expand our sales force and our marketing relationships, we may be unable to continue our growth.

Our ability to expand our business will depend significantly upon our ability to expand our sales and marketing force and our strategic marketing relationships. Competition for experienced sales and marketing personnel is intense, and we may not be able to retain our existing personnel or locate and attract additional qualified personnel in the future. In addition, if we lose any of the relationships with various banking-related organizations for the marketing and endorsement of our products and services or are unable to enter into new ones, growth in our customer base and revenues could be impaired.

Competition may impede our ability to acquire other businesses and may inhibit our growth.

Acquisitions have generated a significant part of our historic growth. We anticipate that a portion of our future growth may be accomplished through acquisitions, although we expect to focus on improving our current operations until we have access to the debt and equity capital we need to finance acquisitions. The success of our acquisition strategy depends upon our ability to identify suitable acquisition candidates, reach agreements to acquire these companies and obtain necessary financing on acceptable terms. In pursuing acquisition and investment opportunities, we may compete with other companies that have similar growth strategies. Some of these competitors may be larger and have greater financial and other resources than we have. This competition may render us unable to acquire businesses that could improve our growth or expand our operations. This competition will be particularly strong, given our current stock price and limited access to capital.

Table of Contents

The decline in our stock price may impair our ability to acquire other businesses.

We have financed the acquisitions we have completed since our initial public offering with a combination of our common stock, cash from common stock offerings, cash from our operations and borrowings made under our line of credit. Because our stock price has declined substantially from its historical high in early 2002, the shareholders of businesses that we seek to acquire may be unwilling to accept our common stock in exchange for their businesses. As a result, we will be required to use larger portions of our line of credit (which may already be fully drawn or reserved for other purposes) or cash from operations to continue to complete acquisitions, which would decrease our working capital and increase our interest expense. The unavailability of capital to finance future acquisitions could have a material negative effect on our financial performance and results of operations.

Our credit facility with Bank of America restricts our ability to complete acquisitions without the bank s consent.

We must comply with the financial and other covenants of the credit facility with Bank of America to be able to draw on our credit facility to fund our acquisitions. If we are unable to borrow funds under our credit line, we may be unable to make acquisitions that could be helpful to our business.

The loss of our chief executive officer or other key employees could have a material adverse effect on our business.

John W. Collins, our chief executive officer, has substantial experience with our operations and our industry and has contributed significantly to our growth. Although we maintain key man life insurance on Mr. Collins and we have an employment agreement with him, our customer and marketing relationships would likely be impaired and our business would likely suffer if we lost the services of Mr. Collins for any reason.

In addition, in our merchant services operations, we rely on several key employees for software programming and other information technology issues. In the event that any of these employees leave the company for any reason or otherwise refuse to perform their duties, we could experience problems in our merchant services operations, which may result in a loss of revenue or customers.

If our processing centers or communications network suffers a systems failure or interruption, we may face customer service issues and be liable for damage suffered by our customers.

Our operations depend upon our ability to protect our processing centers, network infrastructure and equipment. Damage to our systems or equipment or those of third parties that we use may be caused by natural disasters, human error, power and telecommunications failures, intentional acts of vandalism and similar events. Although we do have data and item processing centers in several locations that serve as back-ups for each other. Interruption in our processing or communications services could delay transfers of our customers data, or damage or destroy the data. Sudden increases in ATM usage or debit card activity could result in slow response times in our network. Any of these occurrences could result in lawsuits or loss of customers and may also harm our reputation.

We depend on other providers for products and services necessary to our business, and if we cannot obtain satisfactory products and services on favorable terms, or at all, our business could suffer.

We rely on other providers for internet and telephone banking products and services, ATM and debit card manufacturing, fiber optic communications and other products and services that are essential to our business. If any of these providers is permanently or temporarily unable to provide its products and services to us as the result of natural disasters, technical difficulties or otherwise, we may be unable to provide our products and services to our customers. If the performance of these third party products and services does not meet our customers expectations, it may damage our current customer relationships, harm our reputation and inhibit our ability to obtain new customers.

Table of Contents

We depend on MCI for various services, and its bankruptcy could negatively affect our business.

MCI, Inc. provides various services to us, including frame relay circuits, network and internet backbone and collection for WEB 900 billing. If MCI s services are interrupted for any reason, including its bankruptcy, we could experience a disruption in the services that we provide to our customers. Any interruption of services by MCI could force us to seek other vendors to provide these services, which could increase our costs, result in delays or disruptions in our own services or make it difficult or impossible to provide the services if we cannot engage another vendor. During the third quarter of 2002, iBill s WEB 900 service provider, ICN Ltd., withheld certain amounts from iBill because MCI did not send the monies to ICN. InterCept reserved $2.4 million, which represents deposits held for WEB 900 billing, amounts that iBill has paid to its merchants but not received from ICN, and related gross profits. During the fourth quarter of 2002, ICN sold its receivables to a third party and paid us $288,000 related to May 2002. During the second quarter of 2003, we received an additional $0.4 million, and as of September 30, 2003, the reserve balance is $1.7 million. We have fully reserved for the account receivable and are seeking to recover the remaining $1.7 million owed as of September 30, 2003, but we can offer no assurances that these efforts will be successful.

If our products and services contain errors, we may lose customers and revenues and be subject to claims for damages.

Our new products and services, and enhancements to our existing products and services, may have undetected errors or failures, or could fail to achieve market acceptance, despite testing by our current and potential customers and by us. If we discover errors after we have introduced a new or updated product to the marketplace, we could experience, among other things:

- delayed or lost revenues while we correct the errors;
- a loss of customers or delay in market acceptance; and
- additional and unexpected expenses to fund further product development.

Our agreements with our customers generally contain provisions designed to limit our exposure to potential product liability claims, such as disclaimers of warranties and limitations on liability for special, consequential and incidental damages. These provisions may not be effective because of existing or future federal, state or local laws or ordinances, or unfavorable judicial decisions. If our products and services fail to function properly, we could be subject to product liability claims, which could result in increased litigation expense, damage awards and harm to our business reputation.

Because our business involves the electronic storage and transmission of data, security breaches and computer viruses could adversely affect us.

Our online transaction processing systems electronically store and transmit sensitive business information of our customers. The difficulty of securely storing confidential information electronically has been a significant issue in conducting electronic transactions. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by breaches or viruses. To the extent that our activities or the activities of our customers involve the storage and transmission of confidential information, such as banking records or credit information, security breaches and viruses could expose us to claims, litigation and other possible liabilities. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in our systems and terminate their agreements with us, and could inhibit our ability to attract new customers.

Technological changes may reduce the demand for our products and services or render them obsolete.

The introduction of new technologies and financial products and services can render existing technology products and services obsolete. We expect other vendors to introduce new products and services, as well as enhancements to their existing products and services, that will compete with our products and services. To be successful, we must anticipate evolving industry trends, continue to apply advances in technology, enhance our existing products and services and develop or acquire new products and services to meet the demands of our customers. We may not be successful in developing, acquiring or marketing new or enhanced products or services that respond to technological change or evolving customer needs. We may also incur substantial costs in developing and employing new technologies. If we fail to adapt to changes in technologies, we could lose customers and revenues, and fail to attract new customers or otherwise realize the benefits of costs we incur.

We may not be able to protect our intellectual property rights.

We attempt to protect our software, documentation and other written materials under trade secret and copyright laws, confidentiality procedures and contractual provisions, which afford only limited protection. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or obtain and use information that we regard as proprietary. We cannot be sure that our means of protecting our proprietary rights will be adequate or that our competitors will not independently develop similar technology.

If others claim that we have infringed their intellectual property rights, we could be liable for significant damages.

We do not believe that any of our products infringe the proprietary rights of third parties. We cannot be sure, however, that others will not make infringement claims, and we have agreed to indemnify many of our customers against those claims. We anticipate that the number of infringement claims will increase as the number of products and services increases and the functionality of products in different industry segments overlaps. Any of those claims, whether with or without merit, could be time-consuming, result in costly litigation and may not be resolved on terms favorable to us.

Fluctuations in our operating results have negatively affected the trading price of our common stock and may do so again.

Our operating results have varied in the past and may fluctuate significantly in the future because of many factors. These factors include:

- the possible negative impact of implementing our growth and acquisition strategies, including accounting charges and other expenses associated with our acquisitions;
- the loss of customers or strategic relationships;
- competition and pricing pressures;
- a reduction in recurring revenues as a percentage of total revenues;
- increases in operating expenses due to launches of new products and services and sales and marketing efforts;

- unanticipated increases in operating expenses due to obtaining new customers and transitioning them to our services;

- our inability to accurately forecast legal expenses;

- changes in interchange and transaction fees of MasterCard and Visa; and

- fines from non-compliance with MasterCard and Visa regulations.

Many factors that affect our operating results are outside of our control. Because of these factors, it is likely that in some future period our financial results will again fall below the expectations of securities analysts or investors. In that event, the trading price of our common stock would likely decline, perhaps significantly.

If we fail to comply with privacy regulations imposed on providers of services to financial institutions, our business could be harmed.

As a provider of services to financial institutions, we are required to comply with privacy regulations. We are bound by the same limitations on disclosure of the information received from our customers as apply to the financial institutions themselves. If we fail to comply with these regulations, we could damage our customer relationships, harm our reputation and inhibit our ability to obtain new customers.

A former employee owes us $2.7 million under a defaulted promissory note, and we may not collect part or all of the amount owed.

In connection with our acquisition of EPX, we made a loan of $2.5 million to an officer and shareholder of EPX who became our employee and shareholder. The loan accrues interest monthly at prime plus 1%. At September 30, 2003, the balance on the note was $2.7 million, including accrued interest of $200,000. The note matured on December 31, 2002 and is now in default. Although the employee owns 968,878 shares of our common stock worth approximately $10.8 million at the November 13 closing price of $11.15 per share, those shares are not pledged to secure the note. We face the risk that we will be unable to collect all or part of the amount owed under the note.

We may become engaged in litigation with former EPX stockholders.

Former stockholders of EPX have threatened to file a lawsuit against us alleging a breach of the May 2002 merger agreement and misrepresentation. We deny those allegations and believe that we have significant counterclaims against the stockholders, with whom we are in settlement discussions. If those discussions do not result in a settlement, we will vigorously defend any lawsuit that the stockholders may file, and we will pursue our own claims against the stockholders. At present, we do not know if the settlement discussions will be successful, and we are unable to predict the outcome of any litigation that may occur.

Our limited combined operating history makes it difficult to evaluate our business.

Since our incorporation in May 1996, we have completed numerous acquisitions, including several large acquisitions in 2002. We have a limited combined operating history, and our historical results of operations and our other financial information may not be an accurate indication of our future results of operations or prospects.

Risks Related to Our Merchant Services Operations

The failure of our merchant services operations to perform as we expect could result in a loss of revenue, damage to customer relationships, and additional financial losses.

Our management has developed a business plan for our merchant services division, and we have significantly restructured that division. If our business plan for that division does not prove to be successful, we may have to pursue other alternatives for it. Those alternatives may include the sale of all or a portion of the division, the further restructuring of the division, or the suspension of all or a portion of the operations of the division. The occurrence of any of these events could result in a loss of substantial revenue and customers, and we may be required to incur a significant impairment charge to write down the value of the assets used in the division. In addition, any event of that nature could harm our business reputation and relationships with our financial institution customers and prospects.

Our business depends upon our continued Visa and MasterCard certification and financial institution sponsorship, and loss or suspension of this certification and sponsorship could adversely affect our business.

Because we are not a bank, we cannot belong to or directly access the Visa and MasterCard credit card associations or the ACH payment network. To provide our transaction processing services, we must be designated a certified processor by, and be a member service provider of, MasterCard and be designated as an internet payment services provider of Visa. These designations depend on our being sponsored by member clearing banks of both organizations and our continuing adherence to the standards of the Visa and MasterCard associations. The member financial institutions of Visa and MasterCard, some of which are our competitors, set the standards with which we must comply. If we fail to comply with these standards, our designation as a certified processor, a member service provider or an internet payment services provider could be suspended or terminated. The termination of our member service provider status or our status as a certified processor, or any changes in the Visa and MasterCard rules that prevent our registration, or otherwise limit our ability to provide transaction processing and marketing services for the Visa or MasterCard organizations:

- may increase our costs of compliance with those rules;
- could result in the loss of business from Visa or MasterCard customers; and
- could lead to a severe reduction in our transactions and an increase in our charge-back percentages.

If member banks were to decline to sponsor us, we would be unable to process transactions for our customers, which could cause our revenues to decline significantly. We cannot guarantee that our current sponsor banks will not terminate their sponsorship of us in the future.

If we are unable to maintain a relationship with a foreign bank to sponsor our international transactions, we could lose all revenues from our Visa transactions in Europe

iBill is not able to acquire Visa transactions on behalf of foreign sponsored merchants unless the transactions are from an acquiring bank within the sponsored merchant s region. On August 13, 2003, iBill s foreign acquiring bank for Visa transactions in Europe threatened to close iBill s account, allegedly due to transactions placed into the Visa system by unauthorized merchants sponsored by iBill. Although iBill has explained to its acquiring bank and to Visa that iBill is not responsible for the transactions and has taken action to terminate the accounts of the merchants in question, the acquiring bank may still suspend iBill s account, which may effectively terminate iBill s ability to process Visa transactions in Europe. Those transactions contribute approximately 4-6% of iBill s aggregate merchant processing revenues. Although iBill is continuing

Table of Contents

discussions with the bank and with Visa and intends to pursue all available legal remedies to address this problem, iBill could lose a majority, if not all, of the revenues from its Visa transactions in Europe if its account is suspended.

If our charge-back rate is excessive, credit card associations can fine us or terminate our ability to accept credit cards for payment.

In cases of fraud or disputes between cardholders and merchants, we face charge-backs when cardholders dispute items for which they have been billed. Charge-backs may arise from the unauthorized use of the cardholder s name or bank account information or from a cardholder s claim that a merchant failed to perform. If a billing dispute between a card holder and a merchant is not resolved in favor of the merchant, the transaction is normally charged back to the merchant, and the purchase price is refunded to the cardholder. If our charge-back rate becomes excessive, credit card associations can fine us or terminate our ability to accept credit cards for payment. If we are prohibited from accepting credit cards for payment, our ability to compete could be impaired and our business would suffer.

In March 2003, MasterCard imposed a fine of approximately $5.85 million on us. Continued fines of this magnitude would materially adversely affect our financial condition and results of operations. We also face the possibility of fines from Visa for similar charge-back violations. We cannot predict with certainty, however, whether or when MasterCard or Visa will fine us, and if so, the amounts of those fines. In addition to the risk of possible fines, either or both MasterCard or Visa could terminate our ability to accept their credit cards for payment, which would materially adversely affect our financial condition and results of operations.

Visa recently announced revisions to its charge-back monitoring program that are designed to reduce the impact of charge-backs on the Visa payment system. The new rules heighten the scrutiny on problematic merchants and place greater responsibility on acquirers like iBill to deal appropriately with merchants that have excessive levels of charge-backs. Effective October 1, 2003, Visa reduced the charge-back threshold from 2.5% to 1.0% for Visa USA transactions, and effective January 1, 2004, the charge-back threshold will drop from 2.5% to 2.0% for Visa International transactions. Merchants that exceed a these charge-back thresholds become subject to Visa s charge-back monitoring program. This monitoring program results in greater scrutiny of transactions, potential fines and possible suspension from the Visa payments system. In addition, Visa has issued a detailed program that specifies the responsibilities of the acquirer and the fees and actions required when a merchant is placed into the charge-back monitoring program. We have taken measures to reduce the charge-backs of the merchants we sponsor, including the termination of some problematic merchants. However, implementation of the new rules by Visa will require us to further reduce the charge-back activity of our sponsored merchants. If any of our merchants do not meet the new Visa thresholds, Visa could impose fees and take further action, including termination of the merchant. Any such fines or termination could negatively affect our results of operations.

We face significant charge-back liability if our merchants refuse or cannot reimburse charge-backs resolved in favor of their customers, and we face potential liability for merchant or customer fraud.

In addition to the possible consequences from the card associations as described in the previous risk factor, we face potential liabilities for charge-backs associated with the transactions we process. If we, or our processing banks, are unable to collect a charge-back from the merchant s account, or if the merchant refuses, or is financially unable due to bankruptcy or other reasons, to reimburse the merchant s bank for the charge-back, we bear the loss for the amount of the refund paid to the cardholder s bank.

Merchant fraud occurs when a merchant, rather than a customer, knowingly uses a stolen or counterfeit card or card number to record a false sales transaction, or intentionally fails to deliver the merchandise or services sold in an otherwise valid transaction. When a merchant is unable to satisfy a charge-back, we are responsible for that charge-back. Our charge-back liability will increase if we fail to manage this risk effectively.

We also have potential liability for losses caused by fraudulent credit card transactions by customers. Card fraud occurs when a merchant s customer uses a stolen card, or a stolen card number in a card-not-present transaction, to purchase merchandise or services. In a traditional card-present transaction, if the merchant swipes the

31

Table of Contents

card, receives authorization for the transaction from the card issuing bank and verifies the signature on the back of the card against the paper receipt signed by the customer, the card issuing bank remains liable for any loss. In most cases, in a fraudulent card-not-present transaction, even if the merchant receives authorization for the transaction, the merchant is liable for any loss arising from the transaction. Many of the merchants that we serve transact all or a substantial percentage of their sales over the internet. Because their sales are card-not-present transactions, these merchants are more vulnerable to customer fraud than traditional brick and mortar merchants, which in turn exposes us to greater risks to this type of fraud.

Changes in card association fees, products or practices could increase our costs or otherwise limit our operations.

In March 2002, MasterCard implemented a rule that requires all banks that submit transactions on behalf of a merchant to have a valid merchant agreement with that merchant. This rule applies whether the card is presented directly to the merchant or to a third-party payment facilitator, such as iBill. MasterCard has notified iBill s former and current acquiring banks for MasterCard transactions that iBill has acquired transactions from merchants without the required merchant agreements. Because of this determination, MasterCard has stated that it will impose assessments on the acquiring banks of $2,500 per day, retroactive to the day that the first noncompliant transaction was acquired through iBill. The total amount of this fine through April 4, 2003 is approximately $540,000, which we have recorded in the financial statements included in this report. On April 4, 2003, MasterCard notified iBill s acquiring bank that MasterCard had accepted iBill s plan to achieve compliance with MasterCard s rules and that MasterCard had granted a suspension of the $2,500 per day assessments through August 22, 2003 to give iBill time to achieve full compliance. MasterCard has informed iBill that iBill was in compliance as of August 22.

From time to time, the card associations increase the interchange fees that they charge processors and the sponsoring banks. For example, Visa increased its interchange fees by 0.19% in April 2003. At their sole discretion, our sponsoring banks may seek to increase their Visa and MasterCard sponsorship fees to us, all of which are based upon the dollar amount of the payment transactions we process. Competitive pressures might force us to absorb a portion of those increases in the future, which would increase our operating costs and reduce our margins. Furthermore, the rules and regulations of the various card associations and networks prescribe certain capital requirements for settlement banks. Any increase in that capital requirement may adversely affect a bank s ability to serve as our settlement bank.

Online payment processing systems might be used for illegal or improper purposes, which could expose us to additional liability and harm our business.

Despite our efforts to review and monitor the types of transactions we process, all online payment processing systems remain susceptible to potentially illegal or improper uses. These may include illegal online gaming, fraudulent sales of goods and services, software and other intellectual property piracy, child pornography trafficking, prohibited sales of alcoholic beverages and tobacco products and online securities fraud. Our business could suffer if customers use our system for illegal or improper purposes.

Unauthorized disclosure of merchant and cardholder data, whether through breach of our computer systems or otherwise, could expose us to protracted and costly litigation.

We collect and store sensitive data about merchants and cardholders, including names, addresses, social security numbers, drivers license numbers, checking and savings account numbers and payment history records, such as account closures and returned checks. In addition, we maintain a database of cardholder data relating to specific transactions, including payment card numbers and cardholder addresses, to process the transactions and for fraud prevention and other internal processes. If a person penetrates our network security or otherwise misappropriates sensitive merchant or cardholder data, we could be subject to liability or business interruption.

Hackers have in the past penetrated computer systems of payment processors. If we suffer such an attack, we may be subject to liability, including claims for unauthorized purchases with misappropriated card information, impersonation or other similar fraud claims. We could also be subject to liability for claims relating to misuse of

32

Table of Contents

personal information, such as unauthorized marketing purposes. These claims also could result in protracted and costly litigation.

Unless and until Congress renews a moratorium that expired on November 1, 2003, state and local governments will be permitted to levy additional taxes on internet access and electronic commerce transactions, which could adversely affect our business.

In 1998, the federal government imposed a three-year moratorium on state and local governments from imposing new taxes on internet access or electronic commerce transactions. This moratorium expired on November 1, 2003, and Congress is currently considering whether to renew it. If the moratorium is not renewed, state and local governments may levy additional taxes on internet access and electronic commerce transactions. An increase in applicable taxes may make electronic commerce transactions less attractive for merchants and businesses, which could result in a decrease in the volume of transactions we process and reduce our revenues. Additionally, if a tax is levied against the merchants or service providers we serve, they may attempt to pass this additional cost along to us, thereby decreasing our revenues.

Our product features may infringe the patents of others, which could affect our business and profitability.

We could be sued for patent infringement. If all or any portion of our service were found to infringe a patent and we are unable to obtain a license, or if a preliminary injunction were issued, we could be required to restructure our payment system, stop offering our payment product altogether, or pay substantial damages, which could have a material adverse effect on our business, prospects, results of operations and financial condition. Even if we prevail in a lawsuit, litigation can be expensive and can consume substantial amounts of management s time and attention.

Because some of the transactions we process are for the adult entertainment industry, our reputation with our customers and in the investment community may be harmed and the price of our common stock may decline.

We process transactions for merchants in many different industries, including the adult entertainment industry. Certain current and potential customers as well as investors, lenders, and others may be reluctant or refuse to do business with us, participate in the market for our common stock, provide financing, or offer related services because we process transactions for the adult entertainment industry. This may negatively affect our business, financial results, the price of our common stock or limit our ability to raise capital in the future.

Our customers may not adopt our online payment methods as soon as we intend, which would limit our growth and may cause our stock price to decline.

Our future profitability will depend, in part, on our ability to implement our strategy to increase adoption of our online payment methods. We can provide no assurances that the relatively new market for online payment mechanisms will remain viable. We expect to invest substantial amounts:

- to drive merchant awareness of electronic payments;

to encourage merchants to sign up for and use our electronic payment products;

to enhance our infrastructure to handle seamless processing of transactions;

to continue to develop our technology;

to diversify our customer base; and

to establish international relationships.

We may fail to increase the adoption of our electronic payment methods as we intend, which would adversely affect revenues and cause our business to suffer.

We face strong competition in the merchant processing and online processing businesses.

In our online processing business, we compete with other online processing companies. In our merchant processing business, we compete with large merchant processors like Chase Merchant Services, National Processing Company, Paymentech, U.S. Bancorp/NOVA, First Data Corporation, Concord EFS and others. In each of these areas, many of our competitors have longer operating histories, greater name recognition and substantially greater resources than we do. We can provide no assurances that we will be able to compete successfully with these and other existing or new competitors.

Risks Related to Our Financial Institution Services Operations

Because many of our competitors have significantly greater resources than we do, we may be unable to gain market share.

Because our business includes a variety of products and services, we generally face different competitors within each area of our business. In our core banking and data processing business, we compete with numerous companies that have national operations and significant assets. Our principal EFT competitors include regional ATM networks, regional and local banks that perform processing functions, non-bank processors and other independent technology and data communications organizations. In each of these areas, many of our competitors have longer operating histories, greater name recognition and substantially greater resources than we do. If we compete with them for the same geographic market, their financial strength could prevent us from capturing market share in those areas. In addition, the competitive pricing pressures that would result from an increase in competition from these companies could have a material adverse effect on our business, financial condition and results of operations. Some of our competitors have established cooperative relationships among themselves or with third parties to increase their ability to address customer needs. Accordingly, new competitors or alliances among competitors may emerge and rapidly acquire significant market share.

We can provide no assurances that we will be able to compete successfully with existing or new competitors. If we fail to adapt to emerging market demands or to compete successfully with existing and new competitors, our business, financial condition and results of operations would be materially adversely affected.

Our revenues may decrease as a result of legal actions against Visa and MasterCard.

We generate revenue from interchange fees, which are the interbank fees paid by merchants when they accept credit and debit cards. Visa and MasterCard set the interchange rates. Visa and MasterCard have been sued by the Department of Justice, or DOJ, for alleged violation of the Federal antitrust laws arising out of their respective functionally identical policies of (a) not allowing members in the respective organization to issue cards participating in the other organization s system, and (b) prohibiting their members from issuing cards in competing systems other than Visa or MasterCard, the largest owner/member of Visa and MasterCard. The potential impact of this litigation on us depends upon whether or not the DOJ is successful, and if it is successful, the relief ordered by the court.

As a result of the settlement of a class action case brought by Wal-Mart and other merchants, Visa and MasterCard have announced new interchange rates for debit transactions that are approximately 33% lower than previous interchange rates. We have converted 85% of our customers to a new pricing structure, under which we receive a flat fee for each transaction. Until all of our customers are converted to flat fee pricing the revenues that we continue to derive from interchange fees may be reduced by changes in interchange rates for debit transactions.

Financial institutions are subject to industry consolidation, and we may lose customers with little notice.

The banking industry is prone to consolidations that result from mergers and acquisitions. Other financial institutions that do not use our products and services may acquire our existing customers and then convert them to competing products and services. Although we have included in most of our contracts a charge for early termination of the contract without cause, these charges would be insufficient to replace the recurring revenues that we would have received if the financial institution had continued as a customer.

Table of Contents

We face risks in connection with our contract with Sovereign Bank.

In January 2003, we executed a definitive agreement with Sovereign Bank to provide Sovereign with item processing and check imaging services. Sovereign is now our largest customer. To accommodate the Sovereign business, we have incurred and will continue to incur substantial costs to open four new item processing centers, expand two existing centers and add approximately 250 new employees. We experienced greater than expected conversion costs in Sovereign Bank s item processing in the third quarter of 2003 and anticipate additional conversion delays in the fourth quarter.

Sovereign can terminate the agreement at any time, including upon its acquisition or for convenience and in that event would be required to pay us liquidated damages. Although the amount of those damages would be significant, they may not compensate us adequately for the loss of the business. Sovereign is currently the subject of speculation in the financial press regarding its acquisition by a larger financial institution. Sovereign also has the ability to terminate the agreement without paying liquidated damages for various events of default that include Sovereign s reasonable belief that its prospects of receiving services from us are materially impaired due to the occurrence of a material adverse change, as defined in the agreement. Depending on when a termination of the Sovereign agreement occurred, it could have a material adverse effect on our business, prospects, results of operations and financial condition.

The banking industry is highly regulated, and changes in banking regulations could negatively affect our business.

Our banking customers are subject to the supervision of several state and federal government regulatory agencies. If bank regulations change, or if new regulations are adopted to regulate the products and services offered or used by community financial institutions, we could suffer an increase in the costs of providing our products and services. Moreover, if any new or revised regulations diminish the need for our services, we could lose customers and suffer a decline in revenues.

We are subject to government and private regulation, and an increase in regulatory requirements or tax burdens could place a strain on our business.

Various federal and state regulatory agencies examine our operations from time to time. These agencies can make findings or recommendations regarding various aspects of our operations, and we generally must follow those recommendations to continue our operations. If we fail to comply with these regulations, our operations and processing revenues could be negatively affected.

Our ATM network operations are subject to federal regulations governing consumers rights. Fees charged by ATM owners are currently regulated in several states, and legislation regulating ATM fees has been proposed in several other states. Additional legislation may be proposed and enacted in the future, or existing consumer protection laws may be expanded to apply to ATM fees. If the number of ATMs decreases as a result of such legislation, our EFT revenues may decline. Furthermore, we are subject to the regulations and policies of various ATM and debit card associations and networks. If we lost our privileges to provide transaction processing services across these networks, our revenues from ATM and debit card transaction processing would decrease significantly.

As a transaction processing company, we may be subject to state taxation of certain portions of the fees charged for our services. Application of this tax is an emerging issue in the industry, and the states have not yet adopted uniform guidelines implementing these regulations. If we are required to bear all or a portion of these costs and are unable to pass these costs through to our customers, our financial condition and results of operations would be adversely affected.

Table of Contents

Other Risks of Owning Our Stock

If our stock price remains depressed for an extended period of time, we may be required to incur a significant impairment charge to reduce the carrying value of our intangible assets.

Our stock price has declined significantly, although it has rebounded somewhat, from its low in March 2003. As a result, our market value is substantially lower than the carrying value of our intangible assets on our balance sheet. If the price of our stock does not increase significantly, we may be required to incur an impairment charge to reduce the carrying value of our intangible assets to correspond to the market value of our stock. Any impairment charge of that nature may result in a large net loss for the period in which the impairment charge is incurred, which could result in the loss of customers or prospects, adversely affect the trading price of our common stock and otherwise negatively affect our business.

Future sales of shares of our common stock may negatively affect our stock price.

To carry out our growth strategies, we may acquire other businesses and products using a combination of our stock and cash, and we may also sell additional shares of our stock to raise money for expanding our operations. Sales of substantial amounts of common stock in the public market or the prospect of such sales could adversely affect the market for our common stock. These sales also might make it more difficult for us to sell equity securities in the future at a time and price that we deem appropriate. As of September 30, 2003, we had 20,210,434 outstanding shares of common stock, outstanding options to acquire an additional 4,181,039 shares of common stock, and outstanding shares of Series A preferred stock convertible into 715,820 shares of common stock upon the satisfaction of certain terms. Additionally, approximately 500,000 shares of common stock may be issued under our employee stock purchase plan, and approximately 1.0 million shares may be granted in the future under our stock option plans. If any of these issuances occur, it would dilute our existing shareholders ownership interest in the company.

Georgia law, our articles of incorporation and bylaws and some of our employment agreements contain provisions that could discourage a third party from attempting to acquire our outstanding shares at a premium to the market price.

Some provisions of our articles of incorporation, our bylaws and Georgia law make it more difficult for a third party to acquire control of our company, even if a change in control would be beneficial to our shareholders. Some of our executive officers have entered into employment agreements with us that contain change in control provisions. These provisions may discourage or prevent a tender offer, proxy contest or other attempted takeover. In addition, we have in the past and may in the future create and issue new classes of preferred stock that have greater rights than our common stock. These superior rights may include greater voting rights, entitlement to dividends and preferential treatment in the event of a change in control, liquidation, consolidation or other circumstances. Any shares of preferred stock that we issue may discourage a third party from attempting to acquire our shares of common stock at a premium price.

We cannot predict every event and circumstance that may adversely affect our business and, therefore, the risks and uncertainties discussed above may not be the only ones we face. The risks and uncertainties discussed above are in addition to those that apply to most businesses generally. In addition, as we continue to grow our business, we may encounter other risks of which we are currently unaware. These additional risks may cause serious damage to our business in the future, the impact of which we cannot estimate at this time.

Table of Contents

Results of Operations

The following table provides the percentage of revenues represented by certain line items in our condensed consolidated statements of operations for the periods indicated.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Revenues	100.0%	100.0%	100.0%	100.0%
Costs of services	51.8	51.0	51.4	48.9
Selling, general, and administrative expenses	39.3	32.0	37.1	31.9
Depreciation and amortization	8.0	7.0	7.7	6.8
Total operating expenses	99.1	90.0	96.2	87.6
Operating income	0.9	10.0	3.8	12.4
Other income, net	(0.8)	0.0	(2.0)	1.1
Income before provision for income taxes, equity in loss of affiliates and minority interest	0.1	10.0	1.8	13.5
Provision for income taxes	0.1	3.7	0.7	5.0
Equity in loss of affiliates	0.0	(2.1)	0.0	(1.8)
Minority interest	0.0	0.0	0.0	0.0
Net income	0.0%	4.2%	1.1%	6.7%

Three Months Ended September 30, 2003 Compared to Three Months Ended September 30, 2002

Revenues. Revenues decreased 3.4% to $64.1 million for the three months ended September 30, 2003 from $66.3 million for the three months ended September 30, 2002. The $2.2 million decrease was comprised of:

(a) a $5.8 million decrease in merchant processing service fee income,

(b) a $4.9 million increase in financial institution service income and

(c) a $1.3 million decrease in customer reimbursements.

The decrease in merchant processing service fee income is due to customer attrition resulting from our efforts to remain in compliance with charge-back thresholds and other rules of credit card associations.

The $4.9 million increase in financial institution service income is comprised of a $5.1 million increase in service fee income and a $230,000 increase in data communications management income, offset by a $370,000 decrease in hardware sales. The increases are attributable to internal growth and not to any significant increases in prices.

Costs of Services. Costs of services decreased 1.9% to $33.2 million for the three months ended September 30, 2003 from $33.9 million for the three months ended September 30, 2002. The $620,000 decrease was comprised of:

(a) a $4.3 million decrease in costs associated with merchant processing services,

(b) a $4.9 million increase in costs related to financial institution service income and

(c) a $1.3 million decrease in customer reimbursements.

The decrease in merchant processing costs of services is due to customer attrition resulting from our efforts to remain in compliance with credit card associations charge-back thresholds and other rules.

The $4.9 million increase in financial institution service costs was due primarily to a $4.6 million increase in service fee costs associated with the increase in service fee revenues. The increase in financial institution service costs also reflects a $450,000 increase in data communications management costs, offset by a $190,000 decrease in hardware sales costs. Gross margins decreased to 45.2% for the three months ended September 30, 2003 from 48.9% for the three months ended September 30, 2002. This decrease is partially due to the requirement of EITF 01-14 to include customer reimbursements, which have no gross margin, as revenue and partially due to pricing pressure associated with InterCept s EFT offering. Customer reimbursements decreased to $3.1 million for the three months ended September 30, 2003 from $4.4 million for the three months ended September 30, 2002.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased 18.8% to $25.2 million for the three months ended September 30, 2003 from $21.2 million for the three months ended September 30, 2002. The $4.0 million increase was comprised of (a) $4.1 million related to financial institution service expenses offset by a (b) $90,000 decrease of merchant processing service expenses. The increase in financial institution service expenses was primarily due to personnel added from acquisitions, additional personnel to support our growth and other miscellaneous expenses. The decrease in merchant processing service expenses was primarily due to the restructuring of operations resulting from the customer attrition offset by an $800,000 contract settlement fee. Selling, general and administrative expenses as a percentage of revenues

Table of Contents

increased to 39.3% for the three months ended September 30, 2003 from 32.0% for the three months ended September 30, 2002.

Depreciation and Amortization. Depreciation and amortization increased $450,000 to $5.1 million for the three months ended September 30, 2003 from $4.6 million for the three months ended September 30, 2002. The increase was primarily attributable to purchases of property and equipment for the Sovereign conversion and other financial institution division purchases.

Other Income, Net. Other income, net decreased to expense of $490,000 for the three months ended September 30, 2003 from income of $10,000 for the three months ended September 30, 2002. The decrease resulted from lower interest income in 2003 due to the repayment of debt incurred for our acquisitions, compared with higher interest income in 2002 resulting from the investment of proceeds from our August 2001 public offering. The decrease was partially offset by lower interest expense due to the repayment of debt with proceeds from the maturity of several certificates of deposit.

Provision (benefit) for Income Taxes. The effective tax rate for the three months ended September 30, 2003 was 48.5% as compared to 37.2% for the three months ended September 30, 2002. The increase in the effective rate is mainly due to generating profits in states that impose higher tax rates.

Equity in Loss of Affiliate. For the three months ended September 30, 2002, equity in loss of affiliate was $1.4 million, and primarily represented our 28% ownership in Netzee. There was no equity in loss of affiliate for the three months ended September 30, 2003.

Minority Interest. Minority interest increased to a charge of $13,000 for the three months ended September 30, 2003 from a charge of $10,000 for the three months ended September 30, 2002.

Nine Months Ended September 30, 2003 Compared to Nine Months Ended September 30, 2002

Revenues. Revenues increased 19.7% to $193.4 million for the nine months ended September 30, 2003 from $161.6 million for the nine months ended September 30, 2002. The $31.9 million increase was comprised of:

(a) $12.3 million of merchant processing service fee income primarily related to the April and May 2002 acquisitions of iBill and EPX, respectively,

(b) an $18.1 million increase in financial institution service income and

(c) a $1.5 million increase in customer reimbursements.

The $18.1 million increase in financial institution service income is comprised of a $16.2 million increase in service fee income, a $960,000 increase in hardware sales and a $950,000 increase in data communications management income. The increases are attributable to both internal growth and acquisitions and not to any significant increases in prices.

Costs of Services. Costs of services increased 25.7% to $99.4 million for the nine months ended September 30, 2003 from $79.1 million for the nine months ended September 30, 2002. The $20.3 million increase was comprised of:

(a) $4.3 million in costs associated with merchant processing services resulting from the 2002 acquisitions of iBill and EPX, Income before provision for income taxes, equity in

(b) $14.5 million in costs related to financial institution service income and

(c) a $1.5 million increase in customer reimbursements.

Table of Contents

The $14.5 million increase in financial institution service costs was due primarily to a $12.2 million increase in service fee costs associated with the increase in revenue. The increase in financial institution service costs also reflects a $840,000 increase in hardware sales costs and a $1.5 million increase in data communications management costs. The increases are attributable to both internal growth and acquisitions. Gross margins decreased to 48.6% for the nine months ended September 30, 2003 from 51.1% for the nine months ended September 30, 2002. This decrease is partially due to the requirement of EITF 01-14 to include customer reimbursements, which have no gross margin, as revenue. Customer reimbursements increased to $11.1 million for the nine months ended September 30, 2003 from $10.0 million for the nine months ended September 30, 2002.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased 39.2% to $71.7 million for the nine months ended September 30, 2003 from $51.5 million for the nine months ended September 30, 2002. The $20.2 million increase was comprised of (a) $11.7 million related to financial institution service expenses and (b) $8.5 million of merchant processing service expenses. The increase in financial institution service expenses was primarily due to personnel added from acquisitions, additional personnel to support our growth and other miscellaneous expenses. The increase in merchant processing service expenses was primarily due to the operations of iBill and EPX being included for the full nine-month period in 2003 compared with only a portion of the same period in 2002. Selling, general and administrative expenses as a percentage of revenues increased to 37.1% for the nine months ended September 30, 2003 from 31.9% for the nine months ended September 30, 2002.

Depreciation and Amortization. Depreciation and amortization increased $4.0 million to $14.9 million for the nine months ended September 30, 2003 from $10.9 million for the nine months ended September 30, 2002. The increase was primarily attributable to depreciation and amortization resulting from the acquisitions of iBill and EPX and additional property and equipment depreciation.

Other Income, Net. Other income, net decreased to expense of $3.8 million for the nine months ended September 30, 2003 from income of $1.8 million for the nine months ended September 30, 2002. The decrease resulted primarily from a $3.7 million impairment to the SLM note receivable and other SLM obligations, partially offset by $400,000 received from the remaining escrow from the sale of Netzee to Certegy as of December 31, 2002.

Provision (benefit) for Income Taxes. The effective tax rate for the nine months ended September 30, 2003 was 39.2% as compared to 37.0% for the nine months ended September 30, 2002. The increase in the effective rate is due to generating profits in states that impose higher tax rates and lower operating income which caused greater impact from non-deductible items.

Equity in Loss of Affiliate. For the nine months ended September 30, 2002, equity in loss of affiliate was $2.9 million due to the recording of equity losses in Netzee. Equity in loss of affiliate for the nine months ended September 30, 2003 was $4,000 and represented our 50% ownership in Interactive Payments, LLC through our wholly owned subsidiary, Internet Billing Company, LLC.

Minority Interest. Minority interest increased to a charge of $42,000 for the nine months ended September 30, 2003 from a charge of $26,000 for the nine months ended September 30, 2002.

Liquidity and Capital Resources

Since our incorporation, we have financed our operations and capital expenditures through cash from operations, borrowings from banks and sales of our common and preferred stock. As explained in more detail in Recent Developments above, we have recently enhanced our liquidity and capital resources by:

- obtaining a $60 million three-year credit facility from Bank of America,
- issuing shares of Series A preferred stock for $10 million, and
- obtaining $12 million in lease financing from GE Capital.

As of November 5, 2003, the outstanding balance on our credit facility was $26.0 million.

Table of Contents

We have no off-balance sheet arrangements. We believe that borrowings under our Bank of America facility, funds provided by operations and our GE Capital lease financing will be sufficient to meet our anticipated capital expenditures and liquidity requirements for at least the next 12 months as well as the longer term. We are unlikely to have repaid the credit facility in full by its maturity in September 2006 out of our cash from operations, so we face the prospect of refinancing that facility at that time if we have not repaid it from sales of assets or proceeds of additional equity offerings.

Cash and cash equivalents were $11.7 million at September 30, 2003 and $24.1 million at December 31, 2002. Short-term investments with a maturity of one year or less were $10,000 at September 30, 2003. Net cash used in operating activities was $794,000 for the nine months ended September 30, 2003 and net cash provided by operating activities was $27.2 million for the nine months ended September 30, 2002. The decrease in the net cash provided by operating activities was primarily attributable to decreased client payouts and reserves due to the customer attrition in the merchant services segment.

Net cash used in investing activities was $7.6 million for the nine months ended September 30, 2003 and net cash used in investing activities was $103.6 million for the nine months ended September 30, 2002. The net cash used in investing activities primarily relates to the acquisition of iBill in April 2002 and the amendment of the iBill purchase agreement in February 2003.

Net cash used in financing activities was $19.2 million for the nine months ended September 30, 2003 and net cash provided by financing activities was $67.2 million for the nine months ended September 30, 2002. The increase in net cash used in financing activities was primarily due to the repayment of debt with the proceeds from the maturity of several certificates of deposit.

During 2002, we borrowed $30.0 million from The Peoples Bank of Winder, Georgia and $6.7 million from The Bankers Bank. Interest was payable monthly at prime minus .375% under both notes. The notes were secured by certificates of deposit pledged by us and were payable in full on December 31, 2002. We repaid the $200,000 loan from The Bankers Bank on December 30, 2002, when the final certificate of deposit that secured that loan matured. During 2002, we repaid approximately $11.8 million of the loan from The Peoples Bank. On January 6, 2003, we borrowed $18.2 million from The Bankers Bank to repay the loan to The Peoples Bank. The second Bankers Bank loan was fully secured by certificates of deposit that were previously pledged to the Peoples Bank. During February 2003, we repaid $1.4 million we owed under The Bankers Bank note when a certificate of deposit that secured that note matured. We repaid the $16.9 million balance of the Bankers Bank loan on August 31, 2003 when the certificates of deposits matured. We have used the remaining $1.5 million proceeds of the certificates of deposit for working capital.

The following paragraphs address possible events and factors that may reduce or increase our liquidity and capital resources in the future.

SLMsoft.com Inc.

On December 3, 2001, we entered into a loan agreement with SLMsoft.com Inc., an Ontario corporation (SLM Canada), and SLMsoft.com Inc., a Kansas corporation, (SLM Kansas, and together with SLM Canada, SLM). Under the loan agreement, we loaned SLM $7.0 million in exchange for cash and settlement of indemnification obligations that SLM owed to us. The loan was secured by the pledge of shares of InterCept stock. The SLM loan agreement was amended on September 30, 2002. Under the amended loan agreement, borrowings bear interest at prime plus 2%. Interest was payable on January 2, 2003 for all interest accrued through that date, and SLM sold 30,000 of the pledged shares in January 2003, which generated $551,000 used to pay off the accrued interest and a small portion of the principal. During the second quarter of 2003, SLM Kansas filed in Kansas for protection under the U.S. bankruptcy laws, and SLM Canada became the subject of bankruptcy proceedings in Ontario, Canada. The loan matured on June 30, 2003, has not been repaid, and is secured by 371,636 shares of InterCept common stock. As of September 30, 2003, the balance on the loan was $7.2 million.

Table of Contents

In light of the market value of the pledged shares and the uncertainties inherent in the two bankruptcy proceedings, we determined that a loss on the SLM loan was probable as of June 30, 2003. Based on the facts known to us, we estimated that loss at $3,500,000. We also determined that we are unlikely to collect approximately $250,000 in indemnification obligations and accounts receivable from SLM. Accordingly, we charged a total of $3,750,000 in the statements of operations for the quarter ended June 30, 2003 in the line item Other (expense) income (loss), net. There is a reasonable possibility that we may incur additional losses on the SLM loan in the future as the bankruptcy proceedings progress, and it is also possible that the loss may ultimately prove to be less than our second quarter charge. Because the collateral that secures the loan consists of shares of InterCept stock, there may also be additional expense or income due to the fluctuation of InterCept s stock price until the SLM situation is resolved. We cannot now estimate whether any further charges will be necessary, and if so, its amount. Accordingly, in future periods as this situation becomes more certain, we may incur additional charges or receive additional income.

Sovereign Bank

In January 2003, we executed a definitive agreement with Sovereign Bank for item processing and check imaging services. To accommodate Sovereign s item and check processing needs, we have opened all four of our previously announced four new check image processing centers and significantly expanded two other centers, and to date have hired 225 new employees with plans to hire approximately 30 more employees by year-end. Sovereign is now our largest customer. We have used approximately $6.5 million of our working capital to fund the capital improvements and other expenses necessary for us to prepare to provide services to Sovereign.

Possible Visa and MasterCard Fines

Because InterCept is not a bank, it cannot belong to or directly access the Visa and MasterCard credit card associations or the ACH payment network. To provide transaction processing services, InterCept must be designated a certified processor by, and be a member service provider of, MasterCard and be designated as an internet payment services provider of Visa. In cases of fraud or disputes between cardholders and merchants, InterCept faces charge-backs when cardholders dispute items for which they have been billed. Charge-backs may arise from the unauthorized use of the cardholder s name or bank account information or from a cardholder s claim that a merchant failed to perform. If a billing dispute between a card holder and a merchant is not resolved in favor of the merchant, the transaction is normally charged back to the merchant, and the purchase price is refunded to the cardholder. If InterCept s charge-back rate becomes excessive, credit card associations can fine InterCept or terminate InterCept s ability to accept credit cards for payment. InterCept withholds certain merchant payouts for a period of six months to cover its potential liability for merchant processing card activities including potential charge-back penalties.

As noted above, we acquired the iBill assets from Internet Billing Company, Ltd. (Old iBill) in April 2002. On February 11, 2003, we amended the iBill asset purchase agreement to settle outstanding issues related to the $10.5 million remaining in the purchase price escrow that secured representations and warranties of the former owners, including those related to potential Visa and MasterCard fines for excessive charge-backs. Under the amendment, we received $8.0 million from the escrow, and the former owners of Old iBill received the $2.5 million then remaining in the escrow. In the amendment, the former owners also agreed to eliminate the earnout provisions in the purchase agreement. We agreed to indemnify the former owners for any claims resulting from processing-related activities that occurred before April 8, 2002.

We process MasterCard and Visa transactions through First Financial Bank and its affiliate, First Data Merchant Services Corporation (together referred to as First Data). On March 14, 2003, First Data was notified by MasterCard of an estimated assessment with respect to iBill s noncompliance with MasterCard s charge-back rules. First Data notified us that MasterCard had reviewed the historical charge-back percentages for InterCept and Old iBill for the period from January 1, 2001 through February 28, 2003 and had determined that those percentages exceeded MasterCard s limits. On March 31, 2003, First Data notified us that MasterCard had determined the final amount of the assessment to be $5.85 million. Of the $5.85 million, $3.5 million was recorded as an adjustment of the iBill purchase price, $1.9 million was recorded as an expense for the quarter ended December 31, 2002 and $450,000 was recorded during the first quarter of 2003. As of September 30, 2003, First Data was holding a reserve of approximately $5.3 million of money owed to us to cover our potential liability for merchant processing card activities, including potential charge-back penalties. This $5.3 million amount is included in Other Noncurrent Assets in the balance sheet contained in our consolidated financial statements. The MasterCard fine was deducted from that reserve.

We also face the possibility of fines from Visa for similar charge-back violations. Before our April 2002 acquisition of the iBill assets, Visa fined Old iBill for excessive charge-backs in the months of August and September of 2001 and January and February of 2002 in the aggregate amount of approximately $4.5 million. Old iBill also exceeded the Visa charge-back allowed rate in March 2002, and iBill exceeded the allowed charge-back rate in November 2002. In addition, Visa may deem us to have exceeded its charge-back levels in other months, but no fines have been assessed by Visa to date. We have concluded that Visa fines in excess of amounts withheld by us from merchant payouts are not probable, and accordingly, we have not recorded a liability under SFAS 5. Any fines could materially adversely affect our financial condition or results of operations.

In June 2003, iBill became aware, and subsequently informed Visa, that it had processed certain transactions for merchants who were not registered with Visa. Visa has assessed iBill $300,000 for these violations. iBill paid the assessment and we recognized it as an expense in the second quarter of 2003, but iBill may appeal the assessment because it self-reported the violation. Visa retained an independent party to review iBill s processes to ensure that iBill has procedures in place to prevent additional processing of unregistered merchants in the future. The audit was conducted in October, and iBill is waiting to hear from Visa regarding the results of the audit. If the results are unsatisfactory, Visa could assess additional fines for improper processing.

We also face the possibility of fines from Visa and MasterCard for similar charge-back violations if we fail to comply with MasterCard and Visa charge-back rules in the future and if Visa and/or MasterCard decide to impose fines. We cannot predict with certainty whether Visa and MasterCard will fine us, and if so, the amounts of those fines. Any fines could materially adversely affect our financial condition and result of operations.

Use of Capital Resources for Acquisitions

Historically, we have grown, in part, through strategic acquisitions. Now that we have replaced our Wachovia credit facility with the new, larger Bank of America facility we expect to make additional expenditures to make acquisitions and integrate the acquired companies. However, we must comply, however, with the financial and other covenants of the credit facility with Bank of America to be able to draw on it to fund our acquisitions. We can give no assurances with respect to the timing of the acquisitions we may make. In addition, we can give no assurance that we will complete any acquisitions on terms favorable to us, if at all, or that sources of financing in addition to the Bank of America credit facility will be available to us.

Critical Accounting Policies and Estimates

Management s discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. Actual results may differ materially from these estimates under different assumptions or conditions.

Table of Contents

We believe the following critical accounting policies involve the most complex or subjective decisions or assessments and affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

a) Revenue recognition

Revenues include service fees; debit and credit card processing fees; data communication management fees; revenues from equipment sales, installation and maintenance; software license fees; and software maintenance fees. We recognize service fee income and data communication management fees as services are performed. We recognize revenue from equipment sales and installations upon installation of the product, and we recognize any related maintenance revenue ratably over the period during which the services are performed. We also generate revenues from the licensing of our core data processing systems. We recognize revenue for licensing these systems in accordance with Statement of Position 97-2, Software Revenue Recognition, using the residual method prescribed in SOP 98-9 issued by the American Institute of Certified Public Accountants. We recognize software license, hardware and installation revenue after we have a signed non-cancelable license agreement, have installed the products and have fulfilled all significant obligations to the customer. We recognize maintenance fees over the term of the maintenance period. We sell some of our software and hardware products under five-year, sales-type lease agreements under which customers make annual installment payments. These annual payments include the initial installation and an ongoing license fee. Revenue attributable to installation fees and the sale of equipment is recognized upon installation. License fees are deferred and recognized ratably over the period of the lease.

Merchant processing services revenues are recognized as services are performed. Our service offerings allow merchants to accept and process real-time payments for goods and services purchased over the internet using our merchant account, in which event revenue recognized is equal to service fees that we charge to the merchant. This fee is generally based on a percentage of the total transaction amount. Merchants can also establish their own merchant account with our acquiring bank partners and utilize our end-to-end processing solution, which eliminates the need for the merchant to establish multiple relationships with banks, front-end system providers, gateways, and back-end processors. We recognize revenues related to this service offering net of certain costs that we do not control primarily interchange and other fees charged by credit card associations. For merchants using our merchant account, we delay a portion of our merchant payouts for a period of six months to cover for merchant credit losses that arise as a result of, among other things, disputes between cardholders and merchants or association fines related to charge-back activity. If disputes are not resolved in the merchant s favor, the transaction is charged back to us and the purchase price is refunded to the merchant s customer. If we are unable to collect from the merchant, we bear the credit risk for the full amount of the transaction. Our acquiring bank partners also establish and hold reserves for merchant credit losses for merchants using our end-to-end solution. If transactions are charged back to our banks and our banks are unable to collect from the merchants, we bear the credit risk for amounts in excess of reserves held by the banks.

b) Commitments and Contingencies

We record commitments and contingencies in accordance with SFAS 5. SFAS 5 requires that when a loss contingency exists, the likelihood that the contingency will result in the impairment of an asset or the incurrence of a liability be identified as remote, reasonably possible or probable. The identification as remote, reasonably possible or probable and whether the amount can be reasonably estimated determines whether the potential loss is recorded in the financial statements or disclosed in the notes to the financial statements or both.

As described in detail above in Liquidity and Capital Resources, we have been fined by MasterCard and may be fined by Visa. On March 14, 2003, First Data was notified by MasterCard of an estimated assessment with respect to iBill s noncompliance with MasterCard s charge-back rules. First Data notified us that MasterCard has reviewed the historical charge-back percentages for InterCept and Old iBill for the period from January 1, 2001 through February 28, 2003 and had determined that those percentages have exceeded MasterCard s limits. On March 31, 2003, First Data notified InterCept that MasterCard had determined the final amount of the assessment to be $5.85 million. Of the $5.85 million, $3.5 million was recorded as an adjustment of the iBill purchase price, $1.9 million was recorded as an expense for the quarter ended December 31, 2002 and $450,000 was recorded during the

43

Table of Contents

first quarter of 2003. As of September 30, 2003, First Data was holding a reserve of approximately $5.3 million owed to us to cover our potential liability for merchant processing card activities, including potential charge-back penalties. This $5.3 million amount is included in Other Noncurrent Assets in the balance sheet contained in our consolidated financial statements.

We have concluded that the probability of Visa fines in excess of amounts withheld from merchant payouts is reasonably possible, but not probable, and accordingly, we have not recorded a liability under SFAS 5. We cannot predict with certainty whether or when Visa will fine us, and if so, the amounts of those fines.

In June 2003, iBill became aware, and subsequently informed Visa, that it had processed certain transactions for merchants who were not registered with Visa. Visa has assessed iBill $300,000 for these violations. iBill paid the assessment and we recognized it as an expense in the second quarter of 2003, but iBill may appeal the assessment because it self-reported the violation. Visa retained an independent party to review iBill s processes to ensure that iBill has procedures in place to prevent additional processing of unregistered merchants in the future. The audit was conducted in October, and iBill is waiting to hear from Visa regarding the results of the audit. If the results are unsatisfactory, Visa could assess additional fines for improper processing.

c) Allowance for doubtful accounts

We record an allowance for doubtful accounts based on estimates of losses related to customer receivables balances. We develop estimates by evaluating specific customer accounts for risk of loss as well as historical credit memo data and other known factors for billing disputes that arise in the normal course of business.

d) Fair value of assets acquired and liabilities assumed in purchase combinations

Our purchase combinations require us to estimate the fair value of the assets acquired and liabilities assumed in our business. In general, we determine the fair value based upon information supplied by the management of the acquired entities and valuations by independent appraisal experts. The valuations have been based primarily upon future cash flow projections for the acquired assets, discounted to present value using a risk-adjusted discount rate. In connection with our acquisitions, we have recorded a significant amount of intangible assets. These assets are being amortized over the expected economic lives of the assets, generally ranging from five to 20 years. We are required to evaluate the remaining useful lives of our intangible assets that are being amortized each reporting period to determine whether events and circumstances warrant a revision to the remaining period of amortization. We are also required to test the carrying amount of these assets for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

During the fourth quarter of 2002, our revenues and earnings for our merchant services segment fell below original estimates due to several factors, including the implementation of new credit card association rules in November 2002, the termination of certain merchants due to noncompliance with credit card association rules and the transfer of iBill s transaction processing from EPX to a third party processor. As a result, we determined that the carrying amounts of intangible assets in the merchant services segment may not be recoverable. We estimated the undiscounted future cash flows associated with the assets and compared the amounts to the carrying values of the assets. Based on this comparison, we determined that certain assets were impaired. In order to quantify the impairment loss, we estimated the fair value of the assets based on the discounted future cash flows associated with the assets and recorded an impairment loss of $20.0 million equal to the difference in the fair value and carrying amount of the assets. We also evaluated the remaining useful lives of our intangible assets subject to amortization. Based on changes in merchant attrition rates in the EPX reporting unit, we have shortened the useful life of EPX customer relationships from 20 years to 10 years. We will amortize the revised carrying amount after the impairment loss above based on a 10-year life. We concluded that the remaining useful lives of all other intangible

Table of Contents

assets were appropriate as of December 31, 2002. We will continue to evaluate these lives on an annual basis, and if we determine that we have over-estimated the economic life of these assets, we will begin to amortize the remaining unamortized carrying value of the assets over the newly estimated life. Accordingly, depreciation and amortization expense could be increased, and the amount of any increase could be material to our results of operations.

We also recorded a significant amount of goodwill in connection with our acquisitions. Through the end of 2001, we evaluated goodwill for impairment whenever indicators of impairment existed based on undiscounted projected future cash flows. If the carrying value of the goodwill were less than the undiscounted projected future cash flows, no impairment was recognized. Beginning in 2002, we have been required to evaluate our goodwill for impairment on an annual basis or whenever indicators of impairment exist. The evaluation will be based upon a comparison of the estimated fair value of the unit of our business to which the goodwill has been assigned to the sum of the carrying value of the assets and liabilities of that unit. The fair values used in this evaluation will be estimated based upon discounted future cash flow projections for the unit as well as comparable industry revenue and earnings multiples. These cash flow projections will be based on a number of assumptions as discussed above.

e) Investment in and Advances to Netzee

Until December 31, 2002, we owned approximately 28% of Netzee s common stock. We accounted for our investment in Netzee using the equity method of accounting, under which the operations of Netzee were recorded on a single line item in our statements of operations, equity in loss of affiliate. We did not consolidate Netzee s results of operations with our results of operations.

We reviewed our investment in Netzee in accordance with Accounting Principles Board (APB) Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock. APB Opinion No. 18 provides that a loss in value of an investment which is other than a temporary decline should be recognized. We compared our carrying value of the investment to the fair market value of the stock over time in order to determine when a loss in value that is other than temporary has occurred. For the three months ended March 31, 2002, we continued to record equity method losses in Netzee, resulting in the reduction of our investment in common stock of Netzee to zero.

Beginning in the second quarter of 2002, we then applied EITF 99-10, Percentage Used to Determine the Amount of Equity Method Losses, which addresses the percentage of ownership that an investor should use to compute equity method losses when the investment in a company s common stock has been reduced to zero and the investor holds other securities of the company such as preferred stock or loans to the company. Netzee had preferred stock outstanding; we owned none of that preferred stock. Netzee also had an $18.0 million line of credit, of which we loaned or were obligated to loan approximately 78%. Under EITF 99-10, we did not record any additional equity method losses until the preferred stockholders had reduced their investments to zero by absorbing $7.8 million of losses. During the three months ended September 30, 2002, we used our relative ownership percentage in the next most senior level of capital the line of credit to record our share of Netzee s losses. On December 31, 2002, Certegy, Inc. acquired substantially all of the assets of Netzee. We received approximately $2.3 million in payment on our line of credit and $473,000 for our Netzee stock which resulted in a loss of $5.4 million. This loss is included in equity in loss of affiliate. In 2003, we have received approximately $400,000 from escrow accounts established at the time of closing and may receive additional payouts.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We do not use derivative financial instruments in our operations or investments and do not have significant operations subject to fluctuations in foreign currency exchange rates. Borrowings under our Bank of America credit facility accrue interest at LIBOR plus a tiered scale ranging from 225 to 275 basis points, depending on our consolidated leverage ratio, as defined in the credit agreement. We are currently paying interest at a rate of 3.875% per annum. As of September 30, 2003, $33.1 million was outstanding under this facility. Changes in interest rates that increase the interest rate on the credit facility would make it more costly to borrow under that facility and may impede our acquisition and growth strategies if we determine that the costs associated with borrowing funds are too high to implement these strategies. Changes in interest rates that increase the interest rate by 1.0% would increase our interest expense by approximately $331,000 per year.

Table of Contents

Item 4. Controls and Procedures

As of September 30, 2003, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Exchange Act Rule 13a-14(c). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our current disclosure controls and procedures are effective as of September 30, 2003.

The design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of future events. There can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Other than as described below, we are not a party to, and none of our material properties is subject to, any material litigation other than routine litigation incidental to our business.

(1) We brought an action on March 15, 2002 against Midwest Payment Systems, Inc. (MPS) in the U.S. District Court in the Eastern District of Tennessee seeking a declaration as to the rights and legal relations of InterCept, MPS and the customer banks under the contracts that we and the banks have with MPS and asserting a claim for tortious interference with contractual relations. On April 3, 2002, InterCept and MPS agreed to a consent order pursuant to which MPS agreed to continue to provide services on a month-to-month basis so that InterCept can continue to service its customers who use MPS for ATM/EFT services. Both InterCept and MPS agreed not to solicit the ATM/EFT business of the customer banks until final resolution of the lawsuit, and both companies agreed to limited communications with the customers regarding the lawsuit. MPS has answered our complaint and has brought its own claims against us, including tortious interference with contract, breach of contract and breach of fiduciary duty. InterCept believes that MPS s claims are without merit and intends to defend them vigorously if the lawsuit is not settled. We are presently engaged in settlement discussions with MPS. If settlement efforts are unsuccessful, the case is scheduled to go to trial in March 2004. InterCept cannot evaluate the probability of a favorable or unfavorable outcome, or the amount of any potential loss that InterCept would suffer in the event of an unfavorable outcome.

(2) On September 30, 2002, Perfect10, Inc. filed a lawsuit in the Central District of California against iBill; CCBill, LLC; Paycom Billing Services, Inc; IMA Enterprises, Inc.; Cybertech Communications NV; Network Authentication Systems Corporation; Cavecreek Wholesale Internet Exchange; Netpass Systems, Inc; Internet Key, Inc; and other defendants asserting causes of action for copyright infringement, trademark infringement, violations of privacy rights, RICO, false advertising, unfair competition and related claims. The complaint seeks a broad range of remedies, including actual damages, treble damages, an accounting of profits attributable to the allegedly infringing conduct, injunctive relief and other remedies. The plaintiff contends that iBill, which rendered billing services in connection with certain websites, is liable under theories of secondary liability and conspiracy for the alleged wrongdoing.

Discovery in the suit has begun. We believe the claims are without merit and will vigorously defend the lawsuit and assert applicable defenses. It is too early in the proceeding to evaluate the probability of a favorable or unfavorable outcome, or the amount of any potential loss that we would suffer in the event of an unfavorable outcome.

(3) InterCept, three of its officers John W. Collins, G. Lynn Boggs, and Scott R. Meyerhoff and its former officer, Garrett M. Bender, were named as defendants in a shareholder class action lawsuit filed in the U.S. District Court for the Northern District of Georgia (Civil Action No. 03-CV0567). The plaintiff

Table of Contents

sought to represent a class of individuals who purchased InterCept common stock between September 16, 2002 and January 9, 2003. The plaintiff alleged that InterCept and the individual defendants made material misrepresentations and/or omitted to make material disclosures throughout the class period due to their false assurances that the adult entertainment portion of the company s merchant services business was insignificant and their failure to disclose the impact of the implementation of new Visa regulations in November 2002. The plaintiff alleged violations of Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 promulgated under Section 10(b), and Section 20(a) of the Exchange Act. Similar actions were filed by multiple plaintiffs, and on May 2, 2003, the plaintiffs filed a motion to consolidate claims. On June 23, 2003, the court denied the plaintiffs motions to consolidate. On July 11, 2003, the plaintiffs filed a new motion for consolidation.

On August 7, 2003, InterCept, Collins, Boggs and Meyerhoff filed motions to dismiss all of the actions, and on August 12, 2003, they filed answers to each of the complaints denying liability and stating affirmative defenses. InterCept believes the claims are without merit and will continue to vigorously defend the lawsuits.

Due to the inherent uncertainties of the litigation process and the judicial system, the company is unable to predict the outcome of such litigation matters. If the outcome of this matter is adverse to the company, it could have a material adverse effect on the company s business, financial condition and results of operations.

(4) Internet Billing Company (iBill) has received notice from the Federal Trade Commission that the FTC is conducting an inquiry to determine whether iBill s activities comply with the FTC Act. The FTC has requested information since January 1, 1997. InterCept acquired substantially all of the assets of Internet Billing Company, Ltd. on April 8, 2002. iBill is cooperating fully with the FTC in its inquiry. At this early stage, iBill cannot predict the likely outcome of the inquiry or how that outcome may affect its business.

(5) On or about July 17, 2003, a former customer of Internet Billing Company, Trade News Corporation, NV (Tradenews) served a demand on iBill for arbitration claiming negligence, intentional misrepresentation, breach of contract, violation of Florida s Deceptive and Unfair Trade Practices Act, breach of implied covenant, and breach of oral contract. The demand claimed damages in excess of $20,000,000. We believe that the claims made in the demand were totally without merit. We engaged in supervised mediation and settlement discussions with Tradenews, but were not able to settle the case prior to arbitration. The arbitration was held October 21-24, 2003, and we are currently awaiting the decision of the arbitrator. We cannot now determine the probability of a favorable or unfavorable outcome or estimate the amount or range of any potential loss in the event of an unfavorable outcome.

Item 2. Changes in Securities and Use of Proceeds

We did not modify, limit, or qualify the rights of the holders of common stock during the three or nine months ended September 30, 2003.

On September 16, 2003, InterCept completed the sale of 100,000 shares of Series A preferred stock to the Sprout Group and related entities for $10,000,000. The Series A preferred stock is convertible into InterCept common stock at a fixed price of $13.97 per share at the holder s option at any time after the earliest of:

- the date as of which the closing bid price of our common stock shall have been equal to or greater than $25 per share for at least 10 consecutive trading days;
- the fifth anniversary of the issuance date; and
- five business days prior to a liquidation of the company or the closing of

- any merger, consolidation, combination, reorganization or other similar transaction, approved by the majority of the board, in which InterCept is not the surviving entity or in which securities of InterCept constituting in excess of 50% of the voting power of InterCept are exchanged for, or changed into, cash, property or securities of another person, or
- the sale of all or substantially all of InterCept s assets in a transaction approved by the majority of the board.

Table of Contents

Dividends on the Series A preferred stock will accrue and be payable in kind at the rates of 5% per annum through March 31, 2004, 4% per annum from April 1, 2004 through March 31, 2005 and 3% per annum thereafter. Additionally, a majority of the holders of Series A preferred stock must consent to certain actions by InterCept, including but not limited to, an amendment to InterCept s articles of incorporation, a sale or liquidation of the company, or an issuance of additional shares of InterCept s capital stock, other than under existing employee benefit plans. This is only a summary of the terms of the Series A preferred stock, and you should refer to the exhibits related to the transaction that InterCept has filed with the SEC for more detailed information.

The issuance of the Series A preferred stock was exempt from registration as a private placement under section 4(2) of the Securities Act of 1933, and these securities are deemed to be restricted securities for purposes of the Act. We affixed appropriate legends to the share certificates we issued in these transactions. The recipients of these securities are institutional investors who were represented by counsel and had adequate access to information about us through their relationship with us.

Item 3. Defaults Upon Senior Securities

Until September 19, 2003, our principal credit facility was with Wachovia Bank. On that date, we obtained a new $50 million credit facility from Bank of America and repaid the amount outstanding under the Wachovia facility in full. We owed $31.3 million under the Wachovia facility as of June 30, 2003. During all periods that the Wachovia facility was outstanding, we made all required payments of principal and interest to Wachovia. One of the financial covenants in the Wachovia facility, however, required us to have a minimum amount of EBITDA for each quarter. Because of the $3,750,000 in charges related to SLM described in Note 8 to the condensed consolidated financial statements included in this report, we fell below the minimum required EBITDA amount as of June 30, 2003, which caused us not to comply with the financial covenant. Wachovia waived this non-compliance until September 30, 2003 to give us the opportunity to refinance the facility with another lender, which we did.

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

None

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits required by Item 601 of Regulation S-K.

Exhibit No.	Description
3	Articles of Amendment to Amended and Restated Articles of Incorporation of InterCept, Inc., as amended. (Pursuant to Item 601(b)(3)(i) of Regulation S-K, this exhibit includes a complete copy of InterCept s Amended and Restated Articles of

Incorporation, as currently in effect.) [Incorporated by reference to Exhibit 3 from our current report on Form 8-K dated September 16, 2003 and filed on September 18, 2003.]

10.1 Stock Purchase Agreement dated September 16, 2003 among InterCept and the purchasers named therein. [Incorporated by reference to Exhibit 10.1 from our current report on Form 8-K dated September 16, 2003 and filed on September 18, 2003.]

10.2 Registration Rights Agreement dated September 16, 2003 among InterCept and the purchasers named therein. [Incorporated by reference to Exhibit 10.2 from our current report on Form 8-K dated September 16, 2003 and filed on September 18, 2003.]

10.3 Credit Agreement dated as of September 19, 2003 by and between InterCept and Bank of America, N.A.

10.4 Amendment No. 1 to Credit Agreement dated as of November 7, 2003 by and among InterCept, Bank of America, N.A., each of the Lenders signatory thereto, and each of the Guarantors signatory thereto.

10.5 Master Lease Agreement dated September 19, 2003 between InterCept and General Electric Capital Corporation, and related equipment schedules.

31 Certifications of John W. Collins and Scott R. Meyerhoff pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32 Certifications of John W. Collins and Scott R. Meyerhoff pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. This exhibit is not filed for purposes of Section 18 of the Securities Exchange Act of 1934 but is instead furnished as provided by applicable rules of the SEC.

Confidential treatment has been requested for certain portions of this exhibit pursuant to Rule 24(b)(2), and accordingly, those portions have been omitted from the exhibit and filed separately with the Commission.

(b) Reports on Form 8-K filed during the three months ended September 30, 2003

Form 8-K dated August 11, 2003, filed on August 18, 2003, reporting under Item 12 the press release announcing InterCept s earnings for the three months ended June 30, 2003 and that InterCept held a meeting with analysts to discuss the operations and earnings. The full text of the slideshow presentation from the meeting as well as the transcript is included as an exhibit.

Form 8-K dated September 16, 2003, filed on September 19, 2003, reporting under Item 5 the press release announcing that Sprout Group and related entities have invested $10.0 million in InterCept, Inc.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	INTERCEPT, INC.
November 14, 2003	/s/ John W. Collins
Date	John W. Collins Chairman of the Board and Chief Executive Officer (principal executive officer)
November 14, 2003	/s/ Scott R. Meyerhoff
Date	Scott R. Meyerhoff Chief Financial Officer (principal financial and accounting officer)

Table of Contents

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