DELUXE CORP
Form 10-Q
August 07, 2008

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008

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

For the transition period from __________ to __________

Commission file number: 1-7945
DELUXE CORPORATION
(Exact name of registrant as specified in its charter)

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

(651) 483-7111
(Registrant s telephone number, including area code)

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

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

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

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

The number of shares outstanding of registrant s common stock, par value $1.00 per share, at July 25, 2008 was 51,522,195.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

DELUXE CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands, except share par value)
(Unaudited)

	June 30, 2008	December 31, 2007
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 17,780	$ 21,615
Trade accounts receivable (net of allowances for uncollectible accounts of $6,529 and $7,194, respectively)	74,350	85,687
Inventories and supplies	32,055	32,279
Deferred income taxes	14,359	14,901
Cash held for customers	26,283	23,285
Other current assets	11,072	14,178

See Condensed Notes to Unaudited Consolidated Financial Statements

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

	Quarter Ended June 30, 2008	Quarter Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Revenue	$ 367,749	$ 399,871	$ 748,962	$ 803,705
Cost of goods sold	139,816	142,794	285,694	292,112
Gross Profit	227,933	257,077	463,268	511,593
Selling, general and administrative expense	166,632	189,595	347,137	378,910
Net gain on sale of product line				(3,773)
Operating Income	61,301	67,482	116,131	136,456
Interest expense	(12,380)	(13,909)	(25,133)	(26,709)
Other income	379	876	874	1,864
Income Before Income Taxes	49,300	54,449	91,872	111,611
Income tax provision	16,683	18,474	31,938	40,408
Net Income	$ 32,617	$ 35,975	$ 59,934	$ 71,203
Earnings per share:				
Basic	$ 0.64	$ 0.70	$ 1.17	$ 1.39
Diluted	0.63	0.69	1.16	1.37
Cash Dividends per Share	$ 0.25	$ 0.25	$ 0.50	$ 0.50
Total Comprehensive Income	$ 33,905	$ 39,235	$ 61,817	$ 76,257

See Condensed Notes to Unaudited Consolidated Financial Statements

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

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Cash Flows from Operating Activities:		
Net income	$ 59,934	$ 71,203
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	10,703	11,031
Amortization of intangibles	20,389	23,597
Amortization of contract acquisition costs	12,442	15,001
Employee share-based compensation expense	4,873	6,050
Deferred income taxes	971	1,665
Gain on sale of product line		(3,773)
Other non-cash items, net	9,088	9,721
Changes in assets and liabilities, net of effect of acquisitions and product line disposition:		
Trade accounts receivable	7,358	4,507
Inventories and supplies	(735)	(1,120)
Other current assets	(1,181)	1,736
Non-current assets	4,009	(2,461)
Accounts payable	(4,354)	(3,324)
Contract acquisition payments	(4,571)	(9,700)
Other accrued and non-current liabilities	(52,183)	(19,439)
Net cash provided by operating activities	66,743	104,694
Cash Flows from Investing Activities:		
Purchases of capital assets	(15,214)	(12,026)
Payments for acquisitions, net of cash acquired	(1,675)	(2,316)
Purchases of marketable securities		(280,252)
Proceeds from sales of marketable securities		102,972
Proceeds from sale of product line		19,214
Other	109	3,933
Net cash used by investing activities	(16,780)	(168,475)
Cash Flows from Financing Activities:		
Net payments on short-term debt	(6,870)	(112,660)
Proceeds from long-term debt, net of debt issuance costs		196,507
Payments on long-term debt	(855)	(771)
Change in book overdrafts	(7,876)	(5,225)
Proceeds from issuing shares under employee plans	1,635	13,787

Excess tax benefit from share-based employee awards	92	521
Payments for common shares repurchased	(13,943)	
Cash dividends paid to shareholders	(25,779)	(25,971)
Net cash (used) provided by financing activities	(53,596)	66,188
Effect of Exchange Rate Change on Cash	(202)	579
Net Change in Cash and Cash Equivalents	(3,835)	2,986
Cash and Cash Equivalents: Beginning of Period	21,615	11,599
End of Period	$ 17,780	$ 14,585

See Condensed Notes to Unaudited Consolidated Financial Statements

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DELUXE CORPORATION
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1: Consolidated financial statements

The consolidated balance sheet as of June 30, 2008, the consolidated statements of income for the quarters and six months ended June 30, 2008 and 2007 and the consolidated statements of cash flows for the six months ended June 30, 2008 and 2007 are unaudited. The consolidated balance sheet as of December 31, 2007 was derived from audited consolidated financial statements, but does not include all disclosures required by generally accepted accounting principles (GAAP) in the United States of America. In the opinion of management, all adjustments necessary for a fair statement of the consolidated financial statements are included. Adjustments consist only of normal recurring items, except for any discussed in the notes below. Interim results are not necessarily indicative of results for a full year. The consolidated financial statements and notes are presented in accordance with instructions for Form 10-Q, and do not contain certain information included in our consolidated annual financial statements and notes. The consolidated financial statements and notes appearing in this report should be read in conjunction with the consolidated audited financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2007 (the 2007 Form 10-K).

Note 2: New accounting pronouncements

Recently adopted accounting pronouncements In December 2007, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 110. This guidance allows companies, in certain circumstances, to utilize a simplified method in determining the expected term of stock option grants when calculating the compensation expense to be recorded under Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment*. The simplified method can be used after December 31, 2007 only if a company s stock option exercise experience does not provide a reasonable basis upon which to estimate the expected option term. Through 2007, we utilized the simplified method to determine the expected option term, based upon the vesting and original contractual terms of the option. On January 1, 2008, we began calculating the expected option term based on our historical option exercise data. This change did not have a significant impact on the compensation expense recognized for stock options granted in 2008.

Accounting pronouncements not yet adopted In December 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 141(R), *Business Combinations,* which modifies the required accounting for business combinations. This guidance applies to all transactions or other events in which an entity (the acquirer) obtains control of one or more businesses (the acquiree), including those sometimes referred to as true mergers or mergers of equals. SFAS No. 141(R) changes the accounting for business acquisitions and will impact financial statements at the acquisition date and in subsequent periods. We are required to apply the new guidance to business combinations completed after December 31, 2008.

In April 2008, the FASB issued FASB Staff Position (FSP) No. FAS 142-3, *Determination of the Useful Life of Intangible Assets*. This guidance addresses the determination of the useful life of intangible assets which have legal, regulatory or contractual provisions that potentially limit a company s use of an asset. Under the new guidance, a company should consider its own historical experience in renewing or extending similar arrangements. We are required to apply the new guidance to intangible assets acquired after December 31, 2008.

In June 2008, the FASB issued FSP No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. This guidance states that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are participating securities and should be included in the computation of earnings per share using the two-class method outlined in SFAS No. 128, *Earnings per Share*. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared and participation rights in undistributed earnings. The terms of our restricted stock unit and restricted stock awards do provide a nonforfeitable right to receive dividend equivalent payments on unvested awards. As such, these awards are considered participating securities under the new guidance. Effective January 1, 2009, we will begin reporting earnings per share under the two-class method and will restate all historical earnings per share data. We are currently evaluating the impact of this new guidance on our reported earnings per share.

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Note 3: Supplemental balance sheet and cash flow information

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

(in thousands)	June 30, 2008	December 31, 2007
Raw materials	$ 6,426	$ 6,803
Semi-finished goods	11,116	10,886
Finished goods	8,055	8,499
Total inventories	25,597	26,188
Supplies, primarily production	6,458	6,091
Inventories and supplies	$ 32,055	$ 32,279

Fair value measurements During the quarter and six months ended June 30, 2008 and 2007, we measured a long-term mutual fund investment at fair value based on quoted prices in active markets for identical assets. This is considered a Level 1 fair value measurement under SFAS No. 157, *Fair Value Measurements*. We account for this investment at fair value in accordance with SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. This investment corresponds to our liability under an officers deferred compensation plan. This deferred compensation plan is not available to new participants and is fully funded by the mutual fund investment. The liability under the plan equals the fair value of the mutual fund investment. Under SFAS No. 159, changes in the value of both the plan asset and the liability are netted in the consolidated statements of income within selling, general and administrative (SG&A) expense. Dividends earned by the mutual fund investment, as reported by the fund, are also netted within SG&A expense in the consolidated statements of income. The fair value of this investment was $2.8 million as of June 30, 2008 and $3.0 million as of December 31, 2007 and is included in long-term investments in the consolidated balance sheets. The long-term investment caption on our consolidated balance sheets also includes life insurance policies which are recorded at their cash surrender values. We recognized a net unrealized gain on the mutual fund investment of $0.2 million during the quarters ended June 30, 2008 and 2007. During the six months ended June 30, 2008 and 2007, we recognized a net unrealized loss of $0.3 million and $37,000, respectively.

Intangibles Intangibles were comprised of the following:

	June 30, 2008			December 31, 2007		
(in thousands)	Gross carrying amount	Accumulated amortization	Net carrying amount	Gross carrying amount	Accumulated amortization	Net carrying amount
Indefinite-lived:						
Trade names	$ 59,400	$	$ 59,400	$ 59,400	$	$ 59,400
Amortizable intangibles:						
Internal-use software	285,673	(250,123)	35,550	278,802	(243,483)	35,319
Customer lists	110,280	(93,185)	17,095	110,165	(85,199)	24,966
Distributor contracts	30,900	(21,076)	9,824	30,900	(19,016)	11,884
Trade names	30,449	(19,239)	11,210	30,369	(16,708)	13,661
Other	7,658	(4,835)	2,823	7,667	(4,410)	3,257
Amortizable intangibles	464,960	(388,458)	76,502	457,903	(368,816)	89,087

Intangibles	$ 524,360	$ (388,458)	$ 135,902	$ 517,303	$ (368,816)	$ 148,487

Total amortization of intangibles was $10.1 million for the quarter ended June 30, 2008 and $11.7 million for the quarter ended June 30, 2007. Amortization of intangibles was $20.4 million for the six months ended June 30, 2008 and $23.6 million for the six months ended June 30, 2007. Based on the intangibles in service as of June 30, 2008, estimated future amortization expense is as follows:

(in thousands)	
Remainder of 2008	$17,099
2009	25,163
2010	11,006
2011	5,710
2012	2,683

Goodwill Changes in goodwill during the six months ended June 30, 2008 were as follows:

(in thousands)	**Small Business Services**	**Direct Checks**	**Total**
Balance, December 31, 2007	$ 503,057	$ 82,237	$ 585,294
Adjustment to New England Business Service, Inc. (NEBS) acquisition uncertain tax position	(435)		(435)
Acquisition of Logo Design Mojo, Inc. (see Note 5)	1,359		1,359
Currency translation adjustment	(41)		(41)
Balance, June 30, 2008	$ 503,940	$ 82,237	$ 586,177

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

(in thousands)	**June 30, 2008**	**December 31, 2007**
Contract acquisition costs (net of accumulated amortization of $92,493 and $82,976, respectively)	$ 47,650	$ 55,516
Deferred advertising costs	22,241	26,009
Other	26,089	28,246
Other non-current assets	$ 95,980	$ 109,771

Changes in contract acquisition costs during the first six months of 2008 and 2007 were as follows:

(in thousands)	**Six Months Ended June 30, 2008**	**2007**
Balance, beginning of year	$ 55,516	$ 71,721
Additions[(1)]	4,576	9,138
Amortization	(12,442)	(15,001)
Balance, end of period	$ 47,650	$ 65,858

(1) Contract acquisition costs are accrued upon contract execution. Cash payments made for contract acquisition costs were $4,571 for the six months ended June 30, 2008 and $9,700 for the six months ended June 30, 2007.

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Accrued liabilities Accrued liabilities were comprised of the following:

(in thousands)	June 30, 2008	December 31, 2007
Cash held for customers	$ 26,283	$ 23,285
Customer rebates	20,389	20,397
Wages, including vacation	20,233	17,275
Employee profit sharing and pension	10,155	40,294
Interest	5,414	5,414
Restructuring (see Note 6)	3,415	5,050
Other	28,888	38,048
Accrued liabilities	$ 114,777	$ 149,763

Supplemental cash flow disclosure As of June 30, 2008, we had accounts payable of $2.2 million related to capital asset purchases. These amounts were reflected in property, plant and equipment and intangibles in our consolidated balance sheet as of June 30, 2008, as we received the assets as of that date. As these liabilities are paid, the payments will be included in purchases of capital assets on the consolidated statements of cash flows. As of December 31, 2007, we had accounts payable of $3.9 million related to capital asset purchases.

Marketable securities purchased and sold during the six months ended June 30, 2007 consisted of auction rate securities and investments in tax-exempt mutual funds. The mutual funds were comprised of variable rate demand notes, municipal bonds and notes, and commercial paper. The cost of these investments equaled their fair value due to their short-term duration. Proceeds from sales of marketable securities were $103.0 million during the six months ended June 30, 2007. No gains or losses were realized on these sales.

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Note 4: Earnings per share

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

	Quarter Ended June 30,		Six Months Ended June 30,	
(in thousands, except per share amounts)	2008	2007	2008	2007
Earnings per share basic:				
Net income	$ 32,617	$ 35,975	$ 59,934	$ 71,203
Weighted-average shares outstanding	51,005	51,449	51,047	51,342
Earnings per share basic	$ 0.64	$ 0.70	$ 1.17	$ 1.39
Earnings per share diluted:				
Net income	$ 32,617	$ 35,975	$ 59,934	$ 71,203
Re-measurement of share-based awards classified as liabilities	(48)		(272)	(7)
Income available to common shareholders	$ 32,569	$ 35,975	$ 59,662	$ 71,196
Weighted-average shares outstanding	51,005	51,449	51,047	51,342
Dilutive impact of options, restricted stock units, unvested restricted stock and employee stock purchase plan	387	575	435	452
Weighted-average shares and potential dilutive shares outstanding	51,392	52,024	51,482	51,794
Earnings per share diluted	$ 0.63	$ 0.69	$ 1.16	$ 1.37
Antidilutive options excluded from calculation (weighted-average amount for six month periods)	3,645	1,001	3,677	2,011

Note 5: Acquisitions and disposition

Acquisitions In July 2008, we acquired the assets of PartnerUp, Inc. (PartnerUp) for cash of approximately $3.8 million plus contingent payments based on the revenue and operating margin generated by the business, provided the principals remain with the company. PartnerUp is an online community that is designed to connect small businesses and entrepreneurs with people, resources and contacts to build their businesses. Its results of operations will be included in our Small Business Services segment.

In June 2008, we entered into a definitive agreement to acquire all of the common shares of Hostopia.com Inc. (Hostopia) in a cash transaction of approximately $100 million, net of cash acquired. The merger agreement was approved by Hostopia stockholders on July 30, 2008, and the transaction became effective on August 6, 2008, in accordance with the rules of the Toronto Stock Exchange. We utilized availability on our existing lines of credit to fund the acquisition. Hostopia is a leading provider of web services that enable small and medium-sized businesses to establish and maintain an internet presence. It also provides email marketing, fax-to-email, mobility synchronization and other services. Its results of operations will be included in our Small Business Services segment.

In April 2008, we acquired the assets of Logo Design Mojo, Inc. (Logo Mojo) for cash of $1.5 million. Of this amount, $1.4 million was paid as of June 30, 2008. Logo Mojo is a Canadian-based online logo design firm and is included in our Small Business Services segment. Logo Mojo s operating results are included in our consolidated results of operations from the acquisition date. The allocation of the purchase price based upon the fair values of the assets acquired and liabilities assumed resulted in goodwill of $1.4 million and a trade name intangible asset of $0.1 million. We believe this acquisition resulted in goodwill primarily due to Logo Mojo s web-based workflow which we can incorporate into our processes and which we expect will increase our product offerings for small businesses.

In March 2008, we acquired certain assets of Yoffi Digital Press (Yoffi) for cash of $0.3 million. Yoffi is a commercial digital printer specializing in one-to-one marketing strategies and is included in our Small Business Services segment. Yoffi s operating results are included in our consolidated results of operations from the acquisition date. The assets acquired consisted primarily of a customer list.

In February 2007, we acquired all of the common stock of All Trade Computer Forms, Inc. (All Trade) for cash of $2.3 million, net of cash acquired. All Trade is a custom form printer based in Canada and is included in our Small Business Services segment. All Trade s operating results are included in our consolidated results of operations from the acquisition date. The allocation of the purchase price based upon the fair values of the assets acquired and liabilities assumed resulted in goodwill of $0.7 million. We believe this acquisition resulted in goodwill due to All Trade s expertise in custom printing which we expect will help us expand our core printing capabilities and product offerings for small businesses.

Disposition In January 2007, we completed the sale of the assets of our Small Business Services industrial packaging product line for $19.2 million, realizing a pre-tax gain of $3.8 million. This sale had an insignificant impact on diluted earnings per share as the effective tax rate specifically attributable to the gain was higher because the goodwill written-off is not deductible for tax purposes. This product line generated approximately $51 million of revenue in 2006. The disposition of this product line did not qualify to be reported as discontinued operations in our consolidated financial statements.

Note 6: Restructuring accruals

During the quarter ended June 30, 2008, we recorded restructuring accruals of $2.3 million for employee severance related to the planned closing of our customer service call center located in Flagstaff, Arizona, as well as employee reductions in various functional areas, including sales, marketing and fulfillment. These reductions are a result of our cost savings initiatives. The restructuring accruals included severance benefits for 163 employees. We expect to close the Flagstaff facility during the third quarter of 2008 and we expect the other employee reductions to be completed by mid-2009, with the majority of severance payments completed by the end of 2009 utilizing cash from operations. Also during the quarter ended June 30, 2008, we reversed $0.1 million of restructuring accruals due to fewer employees receiving severance benefits than originally estimated. These restructuring charges, net of reversals, were reflected as cost of goods sold of $0.4 million and SG&A expense of $1.8 million in our consolidated statement of income for the quarter ended June 30, 2008. During the six months ended June 30, 2008, we recorded restructuring accruals of $2.6 million related to our cost savings initiatives, and we reversed $0.9 million of restructuring accruals as fewer employees received severance benefits than originally estimated. These restructuring charges, net of reversals, were reflected as cost of goods sold of $0.5 million and SG&A expense of $1.2 million in our consolidated statement of income for the six months ended June 30, 2008.

Restructuring accruals of $3.4 million as of June 30, 2008 and $5.1 million as of December 31, 2007 are reflected in accrued liabilities in the consolidated balance sheets. The accruals consist of employee severance benefits and payments due under operating lease obligations for facilities that we have vacated. The remaining payments due under the operating lease obligations will be paid through early 2009. Further information regarding our restructuring accruals can be found under the caption Note 6: Restructuring accruals in the Notes to Consolidated Financial Statements appearing in the 2007 Form 10-K.

As of June 30, 2008, our restructuring accruals, by company initiative, were as follows:

(in thousands)	NEBS acquisition related	2006 initiatives	2007 initiatives	2008 initiatives	Total
Balance, December 31, 2007	$ 36	$ 325	$ 4,689	$	$ 5,050
Restructuring charges			12	2,552	2,564
Restructuring reversals		(27)	(838)	(21)	(886)
Payments	(11)	(108)	(2,867)	(327)	(3,313)

Balance, June 30, 2008	$ 25	$ 190	$ 996	$ 2,204	$ 3,415
Cumulative amounts:					
Restructuring accruals	$ 30,243	$ 10,859	$ 6,940	$ 2,552	$ 50,594
Restructuring reversals	(839)	(1,671)	(1,400)	(21)	(3,931)
Payments	(29,379)	(8,998)	(4,544)	(327)	(43,248)
Balance, June 30, 2008	$ 25	$ 190	$ 996	$ 2,204	$ 3,415

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As of June 30, 2008, the components of our restructuring accruals, by segment, were as follows:

	Employee severance benefits				Operating lease obligations	
(in thousands)	Small Business Services	Financial Services	Direct Checks	Corporate	Small Business Services	Total
Balance, December 31, 2007	$ 2,001	$ 953	$	$ 2,060	$ 36	$ 5,050
Restructuring charges	1,508	75	150	831		2,564
Restructuring reversals	(380)	(405)		(101)		(886)
Inter-segment transfer	763	354		(1,117)		
Payments	(1,886)	(538)	(39)	(839)	(11)	(3,313)
Balance, June 30, 2008	$ 2,006	$ 439	$ 111	$ 834	$ 25	$ 3,415
Cumulative amounts for current initiatives[1]:						
Restructuring accruals	$ 33,821	$ 4,385	$ 278	$ 9,192	$ 2,918	$ 50,594
Restructuring reversals	(800)	(1,041)	(142)	(1,397)	(551)	(3,931)
Inter-segment transfer	1,396	732	32	(2,160)		
Payments	(32,411)	(3,637)	(57)	(4,801)	(2,342)	(43,248)
Balance, June 30, 2008	$ 2,006	$ 439	$ 111	$ 834	$ 25	$ 3,415

(1) Includes accruals related to our 2008, 2007 and 2006 cost reduction initiatives and the NEBS acquisition in June 2004.

Note 7: Pension and other postretirement benefits

We have historically provided certain health care benefits for a large number of retired employees. In addition to our retiree health care plan, we also have supplemental executive retirement plans (SERP s) in the United States and Canada and a pension plan which covers certain Canadian employees. These pension plans were acquired as part of the NEBS acquisition in 2004. Further information regarding our postretirement benefit plans can be found under the caption Note 12: Pension and other postretirement benefits in the Notes to Consolidated Financial Statements appearing in the 2007 Form 10-K.

Pension and postretirement benefit expense for the quarters ended June 30, 2008 and 2007 consisted of the following components:

	Postretirement benefit plan	Pension plans

(in thousands)	2008	2007	2008	2007
Service cost	$ 24	$ 39	$	$ 54
Interest cost	1,989	1,753	128	126
Expected return on plan assets	(2,183)	(2,066)	(70)	(64)
Amortization of prior service credit	(990)	(990)		
Amortization of net actuarial losses	2,369	2,464	3	2
Total periodic benefit expense	$ 1,209	$ 1,200	$ 61	$ 118

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Pension and postretirement benefit expense for the six months ended June 30, 2008 and 2007 consisted of the following components:

	Postretirement benefit plan		Pension plans	
(in thousands)	2008	2007	2008	2007
Service cost	$ 47	$ 78	$	$ 104
Interest cost	3,977	3,506	257	248
Expected return on plan assets	(4,367)	(4,132)	(141)	(123)
Amortization of prior service credit	(1,979)	(1,980)		
Amortization of net actuarial losses	4,739	4,928	5	3
Settlement loss			111	
Total periodic benefit expense	$ 2,417	$ 2,400	$ 232	$ 232

In March 2008, we used $0.5 million of plan assets to settle approximately one-half of the benefits due under our Canadian SERP plan. We anticipate that final settlement of this plan will occur by the end of 2008.

Note 8: Provision for income taxes

Our effective tax rate for the six months ended June 30, 2008 was 34.8%, compared to our 2007 annual effective tax rate of 34.1%. Our 2008 effective tax rate included favorable discrete adjustments related primarily to uncertain tax positions, which lowered our effective tax rate 1.3 percentage points. Our 2007 effective tax rate included favorable adjustments which lowered our effective tax rate 2.1 percentage points related to receivables for prior year tax returns and the reconciliation of our 2006 federal income tax return to our 2006 estimated provision for income taxes. Additionally, our 2007 effective tax rate was favorably impacted by tax-exempt interest income. These favorable amounts in 2007 were partially offset by the non-deductible write-off of goodwill related to the sale of our industrial packaging product line in January 2007.

As of June 30, 2008, our unrecognized tax benefits, excluding interest and penalties, were $12.8 million compared to $14.4 million as of December 31, 2007. The majority of the change related to reductions for tax positions of prior years of $2.3 million, partially offset by additions for tax positions of prior years of $1.5 million. These adjustments were the result of changes in judgment arising from new information. The remainder of the change related to minor settlements, statute expirations and additions for tax positions of the current year.

Note 9: Debt

Total debt outstanding was comprised of the following:

(in thousands)	June 30, 2008	December 31, 2007
5.0% senior, unsecured notes due December 15, 2012, net of discount	$ 299,156	$ 299,062
5.125% senior, unsecured notes due October 1, 2014, net of discount	274,615	274,584
7.375% senior, unsecured notes due June 1, 2015	200,000	200,000
Long-term portion of capital lease obligation	493	1,440
Long-term portion of debt	774,264	775,086
Amounts drawn on credit facilities	$ 60,330	$ 67,200
Capital lease obligation due within one year	1,847	1,754

Short-term portion of debt	62,177	68,954
Total debt	$ 836,441	$ 844,040

Our senior, unsecured notes include covenants that place restrictions on the issuance of additional debt, the execution of certain sale-leaseback agreements and limitations on certain liens. Discounts from par value are being amortized ratably as increases to interest expense over the term of the related debt.

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In May 2007, we issued $200.0 million of 7.375% senior, unsecured notes maturing on June 1, 2015. The notes were issued via a private placement under Rule 144A of the Securities Act of 1933. These notes were subsequently registered with the SEC via a registration statement which became effective on June 29, 2007. Interest payments are due each June and December. The notes place a limitation on restricted payments, including increases in dividend levels and share repurchases. This limitation does not apply if the notes are upgraded to an investment-grade credit rating. Principal redemptions may be made at our election at any time on or after June 1, 2011 at redemption prices ranging from 100% to 103.688% of the principal amount. We may also redeem up to 35% of the notes at a price equal to 107.375% of the principal amount plus accrued and unpaid interest using the proceeds of certain equity offerings completed before June 1, 2010. In addition, at any time prior to June 1, 2011, we may redeem some or all of the notes at a price equal to 100% of the principal amount plus accrued and unpaid interest and a make-whole premium. If we sell certain of our assets or experience specific types of changes in control, we must offer to purchase the notes at 101% of the principal amount. Proceeds from the offering, net of offering costs, were $196.3 million. These proceeds were used to repay amounts drawn on our credit facility and to invest in marketable securities. On October 1, 2007, we used proceeds from liquidating all of our marketable securities and certain cash equivalents, together with a $120.0 million advance on our credit facilities, primarily to repay $325.0 million of 3.5% unsecured notes plus accrued interest. The fair value of the notes issued in May 2007 was $176.0 million as of June 30, 2008, based on quoted market prices.

In October 2004, we issued $275.0 million of 5.125% senior, unsecured notes maturing on October 1, 2014. The notes were issued via a private placement under Rule 144A of the Securities Act of 1933 and were subsequently registered with the SEC via a registration statement which became effective on November 23, 2004. Interest payments are due each April and October. Principal redemptions may be made at our election prior to their stated maturity. Proceeds from the offering, net of offering costs, were $272.3 million. These proceeds were used to repay commercial paper borrowings used for the acquisition of NEBS in 2004. The fair value of these notes was $207.7 million as of June 30, 2008, based on quoted market prices.

In December 2002, we issued $300.0 million of 5.0% senior, unsecured notes maturing on December 15, 2012. These notes were issued under our shelf registration statement covering up to $300.0 million in medium-term notes, thereby exhausting that registration statement. Interest payments are due each June and December. Principal redemptions may be made at our election prior to the stated maturity. Proceeds from the offering, net of offering costs, were $295.7 million. These proceeds were used for general corporate purposes, including funding share repurchases, capital asset purchases and working capital. The fair value of these notes was $246.0 million as of June 30, 2008, based on quoted market prices.

As of June 30, 2008, we had a $500.0 million commercial paper program in place. Given our current credit ratings, the commercial paper market is not available to us. We also have committed lines of credit which are available for borrowing and to support our commercial paper program. The credit agreements governing the lines of credit contain customary covenants requiring a ratio of earnings before interest and taxes to interest expense of 3.0 times, as well as limits on the level of subsidiary indebtedness. No commercial paper was outstanding during the six months ended June 30, 2008 or during 2007. The daily average amount outstanding under our lines of credit during the six months ended June 30, 2008 was $64.7 million at a weighted-average interest rate of 3.58%. As of June 30, 2008, $60.3 million was outstanding at a weighted-average interest rate of 3.15%. During 2007, the daily average amount outstanding under our lines of credit was $45.5 million at a weighted-average interest rate of 5.57%. As of December 31, 2007, $67.2 million was outstanding at a weighted-average interest rate of 5.62%. As of June 30, 2008, amounts were available under our committed lines of credit for borrowing or for support of commercial paper, as follows:

(in thousands)	**Total available**	**Expiration Date**	**Commitment Fee**
Five year line of credit	$ 275,000	July 2010	.175%
Five year line of credit	225,000	July 2009	.225%

Total committed lines of credit	500,000
Amounts drawn on lines of credit	(60,330)
Outstanding letters of credit	(10,835)
Net available for borrowing as of June 30, 2008	$ 428,835

Absent certain defined events of default under our debt instruments, and as long as our ratio of earnings before interest, taxes, depreciation and amortization to interest expense is in excess of two to one, our debt covenants do not restrict our ability to pay cash dividends at our current rate.

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Note 10: Other commitments and contingencies

Information regarding indemnifications, environmental matters, self-insurance and litigation can be found under the caption Note 14: Other commitments and contingencies in the Notes to Consolidated Financial Statements appearing in the 2007 Form 10-K. Based on information available as of June 30, 2008, the liability for workers compensation decreased to $7.6 million as of June 30, 2008 from $9.9 million as of December 31, 2007, and the liability for self-insured medical and dental benefits decreased to $6.1 million as of June 30, 2008 from $8.5 million as of December 31, 2007.

Note 11: Shareholders equity

We have an outstanding authorization from our board of directors to purchase up to 10 million shares of our common stock. This authorization has no expiration date, and 7.0 million shares remain available for purchase under this authorization. Share repurchases are reflected as reductions of shareholders equity in the consolidated balance sheets. Under the laws of Minnesota, our state of incorporation, shares which we repurchase are considered to be authorized and unissued shares. Thus, share repurchases are not presented as a separate treasury stock caption in our consolidated balance sheets, but are recorded as direct reductions of common shares and additional paid-in capital and increases in accumulated deficit.

Changes in shareholders equity during the six months ended June 30, 2008 were as follows:

(in thousands)	Common shares Number of shares	Common shares Par value	Additional paid-in capital	Accumulated deficit	Accumulated other comprehensive loss	Total shareholders equity
Balance, December 31, 2007	51,887	$51,887	$ 65,796	$(37,530)	$(39,046)	$ 41,107
Net income				59,934		59,934
Cash dividends				(25,779)		(25,779)
Common shares issued(1)	283	283	1,364			1,647
Tax impact of share-based awards			(1,446)			(1,446)
Common shares repurchased	(580)	(580)	(13,363)			(13,943)
Other common shares retired	(67)	(67)	(1,457)			(1,524)
Fair value of share-based compensation			5,815			5,815
Amortization of postretirement prior service credit, net of tax					(1,237)	(1,237)
Amortization of postretirement net actuarial losses, net of tax					3,007	3,007
Amortization of loss on derivatives, net of tax					692	692
Currency translation adjustment					(579)	(579)
Balance, June 30, 2008	51,523	$51,523	$ 56,709	$ (3,375)	$(37,163)	$ 67,694

(1) Includes shares issued to employees for cash payments of $1,635, as well as the vesting of share-based awards previously classified as accrued liabilities in our consolidated balance sheet of $12.

Accumulated other comprehensive loss was comprised of the following:

(in thousands)	June 30, 2008	December 31, 2007
Postretirement and defined benefit pension plans:		
Unrealized prior service credit	$ 24,068	$ 25,305
Unrealized net actuarial losses	(58,415)	(61,422)
Postretirement and defined benefit pension plans, net of tax	(34,347)	(36,117)
Loss on derivatives, net of tax	(8,189)	(8,881)
Currency translation adjustment	5,373	5,952
Accumulated other comprehensive loss	$ (37,163)	$ (39,046)

Note 12: Business segment information

We operate three business segments: Small Business Services, Financial Services and Direct Checks. Small Business Services sells business checks, printed forms, promotional products, marketing materials and related services and products to small businesses and home offices through direct response marketing, financial institution referrals, independent distributors, the internet and sales representatives. Financial Services sells personal and business checks, check-related products and services, stored value gift cards, and customer loyalty, retention and fraud monitoring and protection services to financial institutions. Direct Checks sells personal and business checks and related products and services directly to consumers through direct response marketing and the internet. All three segments operate primarily in the United States. Small Business Services also has operations in Canada.

The accounting policies of the segments are the same as those described in the Notes to Consolidated Financial Statements included in the 2007 Form 10-K. We allocate corporate costs to our business segments, including costs of our executive management, human resources, supply chain, finance, information technology and legal functions. Generally, where costs incurred are directly attributable to a business segment, primarily within the areas of information technology, supply chain and finance, those costs are reported in that segment s results. Due to our corporate shared services approach to many of our functions, certain costs are not directly attributable to a business segment. These costs are allocated to our business segments based on segment revenue, as revenue is a measure of the relative size and magnitude of each segment and indicates the level of corporate shared services consumed by each segment. Corporate assets are not allocated to the segments and consist of property, plant and equipment, internal-use software, inventories and supplies related to our corporate shared services functions of manufacturing, information technology and real estate, as well as long-term investments and deferred income taxes.

We are an integrated enterprise, characterized by substantial intersegment cooperation, cost allocations and the sharing of assets. Therefore, we do not represent that these segments, if operated independently, would report the operating income and other financial information shown.

The following is our segment information as of and for the quarters ended June 30, 2008 and 2007:

		Reportable Business Segments				
(in thousands)		Small Business Services	Financial Services	Direct Checks	Corporate	Consolidated
Revenue from external customers:	2008	$ 211,490	$ 110,064	$ 46,195	$	$ 367,749

	2007	230,082	117,933	51,856		399,871
Operating income:	2008	29,107	18,779	13,415		61,301
	2007	29,989	23,168	14,325		67,482
Depreciation and amortization expense:	2008	12,117	2,377	1,079		15,573
	2007	13,935	2,232	1,126		17,293
Total assets:	2008	725,263	61,284	99,921	276,744	1,163,212
	2007	758,315	82,972	102,465	465,792	1,409,544
Capital asset purchases:	2008				9,412	9,412
	2007				7,670	7,670

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The following is our segment information as of and for the six months ended June 30, 2008 and 2007:

(in thousands)		Reportable Business Segments: Small Business Services	Financial Services	Direct Checks	Corporate	Consolidated
Revenue from external customers:	2008	$ 427,339	$ 223,995	$ 97,628	$	$ 748,962
	2007	461,885	231,420	110,400		803,705
Operating income:	2008	50,271	37,749	28,111		116,131
	2007	63,165	38,894	34,397		136,456
Depreciation and amortization expense:	2008	24,147	4,767	2,178		31,092
	2007	27,662	4,559	2,407		34,628
Total assets:	2008	725,263	61,284	99,921	276,744	1,163,212
	2007	758,315	82,972	102,465	465,792	1,409,544
Capital asset purchases:	2008				15,214	15,214
	2007				12,026	12,026

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

EXECUTIVE OVERVIEW

Our business is organized into three segments: Small Business Services, Financial Services and Direct Checks. Our Small Business Services segment generated 57.1% of our consolidated revenue for the first half of 2008. This segment has sold business checks, printed forms, promotional products, marketing materials and related services and products to more than six million small businesses and home offices in the past five years through direct response marketing, financial institution referrals, independent distributors, the internet and sales representatives. Of the more than six million customers we have served in the past five years, approximately four million have ordered our products or services in the last 24 months. Our Financial Services segment generated 29.9% of our consolidated revenue for the first half of 2008. This segment sells personal and business checks, check-related products and services, stored value gift cards, and customer loyalty, retention and fraud monitoring and protection services to approximately 7,000 financial institution clients nationwide, including banks, credit unions and financial services companies. Our Direct Checks segment generated 13.0% of our consolidated revenue for the first half of 2008. This segment is the nation s leading direct-to-consumer check supplier, selling under the Checks Unlimited®, Designer® Checks and Checks.com brand names. Through these brands, we sell personal and business checks and related products and services directly to consumers using direct response marketing and the internet. We operate primarily in the United States. Small Business Services also has operations in Canada.

Our net income for the first half of 2008, as compared to 2007, benefited from the following:

- A significant reduction in performance-based employee compensation;
- Various cost reductions from previously announced management initiatives to reduce our cost structure, primarily within sales and marketing, information technology and manufacturing;
- Reduced employee benefit costs related to lower workers compensation and medical claims activity;
- The first quarter year-over-year benefit of a February 2007 price increase in Financial Services; and

Lower amortization of acquired intangible assets within Small Business Services, as certain of the assets are amortized using accelerated methods.

These benefits were more than offset by the following:
Lower volume driven by unfavorable economic conditions, primarily affecting Small Business Services;

Lower order volume for Direct Checks due to the continuing decline in check usage and advertising response rates;

Lower revenue per order in Financial Services;

Higher delivery-related costs due to a mid-2007 postal rate increase and fuel surcharges in 2008;

Lower volume in Financial Services due to non-recurring financial institution conversion activity in 2007 and the continuing decline in check usage;

Additional revenue in the first quarter of 2007 for Direct Checks due to a weather-related backlog from the last week of 2006; and

Investments made to drive revenue growth opportunities, primarily within Small Business Services e-commerce and marketing.

Our Strategies and Business Challenges

Details concerning our strategies and business challenges were provided in the *Management s Discussion and Analysis of Financial Condition and Results of Operation* section of our Annual Report on Form 10-K for the year ended December 31, 2007 (the 2007 Form 10-K). There were no significant changes in our strategies or business challenges during the first half of 2008, although the impact of economic conditions on our Small Business Services segment was greater than anticipated. Additionally, we have completed four acquisitions this year. We expect that these acquisitions will expand revenue from higher growth business services.

In July 2008, we acquired the assets of PartnerUp, Inc. (PartnerUp) for cash of approximately $3.8 million plus contingent payments based on the revenue and operating margin generated by the business, provided the principals remain with the company. PartnerUp is an online community that is designed to connect small businesses and entrepreneurs with people, resources and contacts to build their businesses. Its results of operations will be included in our Small Business Services segment.

In June 2008, we entered into a definitive agreement to acquire all of the common shares of Hostopia.com Inc. (Hostopia) in a cash transaction of approximately $100 million, net of cash acquired. The merger agreement was approved by Hostopia stockholders on July 30, 2008, and the transaction became effective on August 6, 2008, in accordance with rules of the Toronto Stock Exchange. We utilized availability on our existing lines of credit to fund the acquisition. Hostopia is a leading provider of web services that enable small and medium-sized businesses to establish and maintain an internet presence. It also provides email marketing, fax-to-email, mobility synchronization and other services. Its results of operations will be included in our Small Business Services segment. Hostopia s revenue for its fiscal year ended March 31, 2008 was $27.8 million.

In April 2008, we acquired the assets of Logo Design Mojo, Inc. (Logo Mojo) for cash of $1.5 million. Of this amount, $1.4 million was paid as of June 30, 2008. Logo Mojo is a Canadian-based online logo design firm. Its results of operations are included in our Small Business Services segment.

In March 2008, we acquired certain assets of Yoffi Digital Press (Yoffi) for cash of $0.3 million. Yoffi is a commercial digital printer specializing in one-to-one marketing strategies. Its results of operations are included in our Small Business Services segment.

Update on Cost Reduction Initiatives

As discussed in the *Management s Discussion and Analysis of Financial Condition and Results of Operation* section of the 2007 Form 10-K, we are pursuing aggressive cost reduction and business simplification initiatives which we expect to collectively reduce our annual cost structure by at least $225 million, net of required investments, by the end of 2009. The baseline for these anticipated savings is the estimated cost structure for 2006, which was reflected in the earnings guidance reported in our press release on July 27, 2006 regarding second quarter 2006 results. We expect to realize approximately $70 million of the $225 million target in 2008. We realized $105 million of this target through the end of 2007, and we expect the remaining $50 million to be realized in 2009. To date, most of our savings are from sales and marketing, information technology and fulfillment, including manufacturing and supply chain.

Outlook for 2008

We anticipate that consolidated revenue will be between $1.515 billion and $1.535 billion for 2008, as compared to $1.61 billion for 2007. We expect that current economic conditions will continue to adversely affect volumes in Small Business Services and drive a mid-single digit decline in revenue despite modest contributions from our e-commerce initiatives and approximately $15 million of revenue from the Hostopia and PartnerUp acquisitions. In Financial Services, we expect check usage to continue to decline 4% to 5% per year, with the related revenue pressure being partially offset by a previously planned price increase in the fourth quarter, as well as a modest contribution from several new loyalty, retention, monitoring and protection offers. We expect the revenue decline in

Direct Checks to be in the high single digits driven by the decline in check usage, the year-over-year lapping of several new feature and accessory initiatives and the $3 million revenue benefit in 2007 attributable to the weather-related backlog at the end of 2006.

We expect that 2008 diluted earnings per share will be between $2.52 and $2.62, compared to $2.76 for 2007. We expect the revenue decline to be partially offset by continued progress with our cost reduction initiatives. Our outlook includes an

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expected decrease in diluted earnings per share of approximately $0.08 from the Hostopia and PartnerUp acquisitions due to the estimated amortization associated with acquired intangible assets and interest expense. We estimate that our annual effective tax rate for 2008 will be approximately 35%, compared to 34.1% for 2007, although the third quarter 2008 tax rate will be lower due to the settlement of tax contingencie