ONLINE RESOURCES CORP
Form 10-Q
August 09, 2006

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, 2006

OR

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 0-26123

ONLINE RESOURCES CORPORATION

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	52-1623052
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)
4795 MEADOW WOOD LANE, SUITE 300, CHANTILLY, VIRGINIA	20151
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	(ZIP CODE)

(703) 653-3100

(REGISTRANT S TELEPHONE NUMBER, INCLUDING AREA CODE)

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

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 þ No o

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

Large Accelerated Filer o Accelerated Filer þ Non-accelerated filer o

As of August 4, 2006 there were 25,610,305 shares of the issuer s common stock outstanding.

ONLINE RESOURCES CORPORATION
FORM 10-Q
TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS.

ONLINE RESOURCES CORPORATION

CONSOLIDATED CONDENSED BALANCE SHEETS

(in thousands, except share data)

	June 30, 2006 (unaudited)	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 58,130	$ 55,864
Restricted cash	1,627	2,220
Accounts receivable	9,995	7,262
Deferred implementation costs	854	609
Deferred tax asset, current portion	557	2,030
Prepaid expenses and other current assets	1,553	1,034
Total current assets	72,716	69,019
Property and equipment, net	17,256	15,242
Deferred tax asset, less current portion	11,635	11,635
Deferred implementation costs, less current portion	580	521
Goodwill	16,290	16,322
Intangible assets	2,054	2,330
Other assets	595	527
Total assets	$ 121,126	$ 115,596
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 615	$ 1,134
Accrued expenses and other current liabilities	1,338	1,324
Accrued compensation	1,725	2,065
Deferred revenues, current portion	3,035	2,638
Deferred rent obligations, current portion	172	162
Capital lease obligations		8
Total current liabilities	6,885	7,331
Deferred revenues, less current portion	1,824	1,213
Deferred rent obligations, less current portion	1,825	1,796
Other long term liabilities	1,627	2,220
Total liabilities	12,161	12,560
Commitments and contingencies		
Series A redeemable convertible preferred stock, $0.01 par value; 75,000 shares authorized and none issued and outstanding		
Stockholders equity		

Series B junior participating preferred stock, $0.01 par value; 297,500 shares authorized and none issued and outstanding		
Common stock, $0.0001 par value; 70,000,000 shares authorized; 25,665,584 issued and 25,590,059 outstanding at June 30, 2006; 25,288,886 issued and 25,213,361 outstanding at December 31, 2005	3	3
Additional paid-in capital	164,024	160,249
Accumulated deficit	(54,834)	(56,988)
Treasury stock, 75,525 shares	(228)	(228)
Total stockholders equity	108,965	103,036
Total liabilities and stockholders equity	$ 121,126	$ 115,596

See accompanying notes to consolidated condensed unaudited financial statements.

ONLINE RESOURCES CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Revenues:				
Account presentation services	$ 1,956	$ 2,198	$ 3,884	$ 5,025
Payment services	10,849	8,695	21,244	17,138
Relationship management services	2,058	1,912	4,155	3,957
Professional services and other	2,496	1,524	4,793	3,321
Total revenues	17,359	14,329	34,076	29,441
Costs and expenses:				
Service costs	5,953	5,395	11,929	10,713
Implementation and other costs	1,638	1,068	3,324	1,986
Costs of revenues	7,591	6,463	15,253	12,699
Gross profit	9,768	7,866	18,823	16,742
General and administrative	4,284	3,506	8,708	6,869
Sales and marketing	2,850	2,109	5,558	4,254
Systems and development	1,064	869	2,207	1,994
Total expenses	8,198	6,484	16,473	13,117
Income from operations	1,570	1,382	2,350	3,625
Other income (expense):				
Interest income	682	322	1,280	350
Interest expense		(5)	(1)	(9)
Total other income	682	317	1,279	341
Income before income tax provision	2,252	1,699	3,629	3,966
Income tax provision	855	135	1,475	195
Net income	$ 1,397	$ 1,564	$ 2,154	$ 3,771
Net income per share:				
Basic	$ 0.05	$ 0.06	$ 0.08	$ 0.17
Diluted	$ 0.05	$ 0.06	$ 0.08	$ 0.16
Shares used in calculation of net income per share:				
Basic	25,523	24,155	25,410	21,770
Diluted	27,527	26,509	27,553	24,124

See accompanying notes to consolidated condensed unaudited financial statements.

ONLINE RESOURCES CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(in thousands)

	Six Months Ended June 30, 2006 (unaudited)	Six Months Ended June 30, 2005 (unaudited)
Operating activities		
Net income	$ 2,154	$ 3,771
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,657	2,796
Equity compensation expense	1,232	
Loss on disposal of assets		104
Deferred tax asset	1,473	
Other		1
Changes in operating assets and liabilities, net of acquisitions:		
Restricted cash	593	(501)
Accounts receivable	(2,733)	1,164
Deferred implementation costs	(304)	(161)
Prepaid expenses and other current assets	(519)	1,717
Other assets	(68)	(149)
Accounts payable	(519)	(720)
Accrued expenses and other current liabilities	46	265
Accrued compensation	(340)	(7)
Deferred revenues	1,008	(44)
Deferred rent obligations	39	204
Other long term liabilities	(593)	(94)
Net cash provided by operating activities	5,126	8,346
Investing activities		
Purchases of property and equipment	(5,395)	(3,119)
Purchases of available-for-sale securities		(3,100)
Sales of available-for-sale securities		1,300
Acquisition of Integrated Data Systems, Inc. (IDS), net of cash acquired		(3,317)
Net cash used in investing activities	(5,395)	(8,236)
Financing activities		
Net proceeds from issuance of common stock (non-secondary related)	2,543	1,901
Net proceeds from issuance of common stock in secondary offering		40,298
Repayment of capital lease obligations	(8)	(7)
Net cash provided by financing activities	2,535	42,192
Net increase in cash and cash equivalents	2,266	42,302
Cash and cash equivalents at beginning of period	55,864	3,342
Cash and cash equivalents at end of period	$ 58,130	$ 45,644

Supplemental information to statement of cash flows:				
Income taxes paid	$	76	$	155
Common stock issued in connection with IDS acquisition				2,000

See accompanying notes to consolidated condensed unaudited financial statements.

ONLINE RESOURCES CORPORATION
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Online Resources Corporation (the Company) provides Internet technology services consisting of account presentation, payment, relationship management and professional services to financial services providers nationwide. The Company offers services, branded in the clients name, that integrate seamlessly into a single-vendor, end-to-end solution, supported by 24x7 customer care, targeted consumer marketing, training and other network and technical professional products and services. The Company currently operates in two business segments banking and card. The operating results of the business segments exclude general corporate overhead expenses and intangible asset amortization.

INTERIM FINANCIAL INFORMATION

The accompanying consolidated condensed unaudited financial statements have been prepared in conformity with generally accepted accounting principles (GAAP) for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, the consolidated condensed unaudited financial statements include all adjustments necessary (which are of a normal and recurring nature) for the fair presentation of the results of the interim periods presented. These consolidated condensed unaudited financial statements should be read in conjunction with our consolidated audited financial statements for the year ended December 31, 2005 included in the Annual Report on Form 10-K filed by the Company with the Securities and Exchange Commission on March 16, 2006. The results of operations for any interim period are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year.

2. RECLASSIFICATION

Certain amounts reported in prior periods have been reclassified to conform to the 2006 presentation.

3. REPORTABLE SEGMENTS

The Company manages its business through two reportable segments: banking and card. Factors used to identify the Company s reportable segments include the organizational structure of the Company and the financial information available for evaluation by the chief operating decision-maker in making decisions about how to allocate resources and assess performance. The Company s operating segments have been broken out based on similar economic and other qualitative criteria. The Company operates both reporting segments in one geographical area, the United States. The Company s management assesses the performance of its assets in the aggregate, and accordingly, they are not presented on a segment basis. The operating results of the business segments exclude general corporate overhead expenses and intangible asset amortization.

The results of operations from these reportable segments were as follows for the three and six months ended June 30, 2006 and 2005 (in thousands):

	Banking	Card	Unallocated Expenses (1)	Total
Three months ended June 30, 2006:				
Revenues	$ 15,404	$ 1,955	$	$ 17,359
Costs of revenues	6,208	1,292	91	7,591
Gross profit	9,196	663	(91)	9,768
Operating expenses	5,258	874	2,066	8,198
Income (loss) from operations	$ 3,938	$ (211)	$ (2,157)	$ 1,570
Three months ended June 30, 2005:				
Revenues	$ 12,414	$ 1,915	$	$ 14,329
Costs of revenues	5,303	1,110	50	6,463
Gross profit	7,111	805	(50)	7,866
Operating expenses	4,220	694	1,570	6,484
Income (loss) from operations	$ 2,891	$ 111	$ (1,620)	$ 1,382
Six months ended June 30, 2006:				
Revenues	$ 30,101	$ 3,975	$	$ 34,076
Costs of revenues	12,414	2,657	182	15,253
Gross profit	17,687	1,318	(182)	18,823
Operating expenses	10,481	1,737	4,255	16,473
Income (loss) from operations	$ 7,206	$ (419)	$ (4,437)	$ 2,350
Six months ended June 30, 2005:				
Revenues	$ 24,970	$ 4,471	$	$ 29,441
Costs of revenues	10,461	2,138	100	12,699
Gross profit	14,509	2,333	(100)	16,742
Operating expenses	8,371	1,516	3,230	13,117

Income (loss) from operations	$ 6,138	$ 817	$ (3,330)	$ 3,625

(1) Unallocated expenses are comprised of general corporate overhead expenses and intangible asset amortization that are not included in the measure of segment profit or loss used internally to evaluate the segments.

4. STOCK BASED COMPENSATION

At June 30, 2006, the Company had three stock-based employee compensation plans, which are described more fully below. Prior to January 1, 2006, the Company accounted for those plans under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB No. 25), and related interpretations, as permitted by Statements of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123). No stock-based employee compensation cost was recognized in the Statement of Operations for the three and six months ended June 30, 2005, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment* (SFAS No. 123(R)), using the modified-prospective transition method. Under that transition method, compensation cost recognized in the three and six months ended June 30, 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all share-based payments granted on or subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). Results for prior periods have not been restated.

As a result of adopting SFAS No. 123(R) on January 1, 2006, the Company s income before income taxes for the three and six months ended June 30, 2006 is approximately $0.6 and $1.2 million lower, respectively, than if it had continued to account for share-based compensation under APB No. 25. Basic and diluted net income per share for the three months ended June 30, 2006 would have been $0.08 and $0.07, respectively, compared to reported basic and diluted net income per share of $0.05. Basic and diluted net income per share for the for the six months ended June 30, 2006 would have been $0.13 and $0.12, respectively, compared to reported basic and diluted net income per share of $0.08. Compensation cost capitalized as part of software development costs capitalized in accordance with Statement of Position No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (SOP No. 98-1) for the three and six months ended June 30, 2006 was approximately $54,000 and $111,000, respectively, and no income tax benefit was recognized in the Statement of Operations for share-based compensation arrangements since the Company currently recognizes a full valuation allowance against that benefit.

Prior to the adoption of SFAS No. 123(R), if the Company had not recognized a full valuation allowance against its deferred tax asset, it would have presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the Statement of Cash Flows. SFAS No. 123(R) requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows.

The following table illustrates the effect on net income and net income per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to options granted under the Company s stock option plans for the three and six months ended June 30, 2005. For purposes of this pro forma disclosure, the value of the options is estimated using a Black-Scholes-Merton option-pricing formula and amortized to expense over the options vesting periods.

(in thousands, except per share data)	Three Months Ended June 30, 2005		Six Months Ended June 30, 2005	
Net income as reported	$	1,564	$	3,771
Adjustment to net income for:				
Pro forma stock-based compensation expense		(314)		(862)
Pro forma net income	$	1,250	$	2,909
Basic net income per share				
As reported	$	0.06	$	0.17
Pro forma	$	0.05	$	0.13
Diluted net income per share				
As reported	$	0.06	$	0.16
Pro forma	$	0.05	$	0.12

Share Option Plans

During 1989, the Company adopted an Incentive Stock Option Plan (the 1989 Plan), which has since been amended to allow for the issuance of up to 2,316,730 shares of common stock. The option price under the 1989 Plan cannot be less than fair market value of the Company s common stock on the date of grant. The vesting period of the options is determined by the Board of Directors and is generally four years. Outstanding options expire after ten years.

During 1999, the Company adopted the 1999 Stock Option Plan (the 1999 Plan), which permits the granting of both incentive stock options and nonqualified stock options to employees, directors and consultants. The aggregate number of shares that can be granted under the 1999 Plan is 5,858,331. The option exercise price under the 1999 Plan cannot be less than the fair market value of the Company s common stock on the date of grant. The vesting period of the options is determined by the Board of Directors and is generally four years. Outstanding options expire after seven to ten years.

In May 2005, the stockholders approved the 2005 Restricted Stock and Option Plan (the 2005 Plan), which permits the granting of restricted stock units and awards, stock appreciation rights, incentive stock options and non-statutory stock options to employees, directors and consultants. The aggregate number of shares that can be granted under the 2005 Plan is 1.7 million. The vesting period of the options and restricted stock is determined by the Board of Directors and is generally three years. Outstanding options expire after seven years.

The fair value of each option award is estimated on the date of grant using a Black-Scholes-Merton option-pricing formula that uses the assumptions noted in the table and discussion that follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Dividend yield				
Expected volatility	75%	75%	71%	76%
Risk-free interest rate	4.87%	3.63%	4.37%	3.70%
Expected life in years	6.4	5.1	5.4	5.1

Dividend Yield. The Company has never declared or paid dividends and has no plans to do so in the foreseeable future.

Expected Volatility. Volatility is a measure of the amount by which a financial variable such as a share price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. The Company uses the historical volatility over the average expected term of the options granted.

Risk-Free Interest Rate. This is the U.S. Treasury rate for the week of each option grant during the quarter having a term that most closely resembles the expected term of the option.

Expected Life of Option Term. Expected life of option term is the period of time that the options granted are expected to remain unexercised. Options granted during the quarter have a maximum term of seven years. The Company used historical expected terms with further consideration given to the class of employees to whom the equity awards were granted to estimate the expected life of the option term.

Forfeiture Rate. Forfeiture rate is the estimated percentage of equity awards granted that are expected to be forfeited or canceled on an annual basis before becoming fully vested. The Company estimates forfeiture rate based on past turnover data ranging anywhere from one to five years with further consideration given to the class of employees to whom the equity awards were granted.

A summary of option activity under the 1989, 1999 and 2005 Plans as of June 30, 2006, and changes in the period then ended is presented below (in thousands, except exercise price and remaining contract term data):

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contract Term	Aggregate Intrinsic Value
Outstanding at January 1, 2006	4,796	$ 6.04		
Granted	89	$ 11.47		
Exercised	(362)	$ 6.77		
Forfeited or expired	(369)	$ 12.46		
Outstanding at June 30, 2006	4,154	$ 5.52	4.66	$ 13,120
Vested or expected to vest at June 30, 2006	4,022	$ 5.46	4.63	$ 12,489
Exercisable at June 30, 2006	2,984	$ 5.20	4.22	$ 8,226

The weighted-average grant-date fair value of options granted during the three months ended June 30, 2006 and 2005 was $9.35 and $6.56, respectively, and $7.31 and $6.38 for the six months ended June 30, 2006 and 2005, respectively. The total intrinsic value of options exercised during the three months ended June 30, 2006 and 2005 was $0.8 and $0.5 million, respectively, and $1.7 and $0.9 million for the six months ended June 20, 2006 and 2005, respectively. As of June 30, 2006, there was $3.6 million of total unrecognized compensation cost related to stock options granted under the 1999 and 2005 Plans. That cost is expected to be recognized over a weighted average period of 2.6 years.

A summary of the status of the Company s non-vested restricted shares issued as of June 30, 2006, and changes in the period then ended, is presented below (in thousands, except grant-date fair value data):

	Shares	Weighted-Average Grant-Date Fair Value
Non-vested at January 1, 2006		$
Granted	62	$ 11.10
Vested		$