RENTRAK CORP
Form 10-Q
February 07, 2006

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended December 31, 2005**

**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: 0-15159**

# RENTRAK CORPORATION

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Oregon**<br>(State or other jurisdiction of incorporation or organization) | **93-0780536**<br>(I.R.S. Employer Identification No.) |
| **7700 NE Ambassador Place, Portland, Oregon**<br>(Address of principal executive offices) | **97220**<br>(Zip Code) |

Registrant s telephone number, including area code: **503-284-7581**

**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** ý 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 ý Non-accelerated filer o

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

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

| | |
|---|---|
| **Common stock $0.001 par value**<br>(Class) | **10,576,819**<br>(Outstanding at January 31, 2006) |

**RENTRAK CORPORATION**

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**Rentrak Corporation and Subsidiaries**
**Condensed Consolidated Balance Sheets**
**(in thousands, except per share amounts)**

| | December 31, 2005 (Unaudited) | March 31, 2005 (1) |
|---|---|---|
| **Assets** | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 12,681 | $ 21,983 |
| Marketable securities | 14,848 | |
| Accounts receivable, net of allowances for doubtful accounts of $430 and $654 | 16,521 | 14,428 |
| Advances to program suppliers, net of program supplier reserves of $2,921 and $3,246 | 269 | 1,185 |
| Income tax receivable and prepaid taxes | 67 | 580 |
| Deferred income tax assets | 169 | 944 |
| Notes receivable - related party | | 753 |
| Other current assets | 925 | 1,028 |
| Total Current Assets | 45,480 | 40,901 |
| | | |
| Property and Equipment, net of accumulated depreciation of $5,517 and $4,317 | 3,463 | 3,216 |
| Deferred Income Tax Assets | 77 | 115 |
| Other Assets | 627 | 851 |
| Total Assets | $ 49,647 | $ 45,083 |
| | | |
| **Liabilities and Stockholders Equity** | | |
| Current Liabilities: | | |
| Accounts payable | $ 14,150 | $ 12,470 |
| Accrued liabilities | 1,078 | 711 |
| Accrued compensation | 966 | 1,539 |
| Deferred revenue | 474 | 379 |
| Total Current Liabilities | 16,668 | 15,099 |
| | | |
| Long-Term Obligations: | | |
| Lease obligations and deferred gain | | 52 |
| | | |
| Commitments and Contingencies | | |
| | | |
| Stockholders Equity: | | |
| Preferred stock, $0.001 par value; 10,000 shares authorized; none issued | | |
| Common stock, $0.001 par value; 30,000 shares authorized; shares issued and outstanding: | | |
| 10,572 and 10,545 | 11 | 10 |
| Capital in excess of par value | 47,148 | 46,988 |
| Accumulated other comprehensive income | 181 | 181 |
| Accumulated deficit | (14,361) | (17,247) |
| Total Stockholders Equity | 32,979 | 29,932 |
| Total Liabilities and Stockholders Equity | $ 49,647 | $ 45,083 |

(1) Derived from our March 31, 2005 audited consolidated financial statements.

See accompanying Notes to Condensed Consolidated Financial Statements.

**Rentrak Corporation and Subsidiaries**
**Condensed Consolidated Income Statements (Unaudited)**
**(in thousands, except per share amounts)**

| | For the Three Months Ended December 31, | | For the Nine Months Ended December 31, | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| Revenue | $ 23,957 | $ 22,821 | $ 65,003 | $ 75,152 |
| Operating expenses: | | | | |
| Cost of sales | 17,014 | 15,411 | 45,364 | 53,953 |
| Selling and administrative | 5,454 | 5,222 | 15,787 | 14,087 |
| | 22,468 | 20,633 | 61,151 | 68,040 |
| Income from operations | 1,489 | 2,188 | 3,852 | 7,112 |
| Other income (expense): | | | | |
| Interest income | 283 | 92 | 693 | 203 |
| Interest expense | | (2) | (2) | (5) |
| | 283 | 90 | 691 | 198 |
| Income before income taxes | 1,772 | 2,278 | 4,543 | 7,310 |
| Provision for income taxes | 646 | 991 | 1,657 | 2,827 |
| Net income | $ 1,126 | $ 1,287 | $ 2,886 | $ 4,483 |
| Basic net income per share | $ 0.11 | $ 0.13 | $ 0.27 | $ 0.46 |
| Diluted net income per share | $ 0.10 | $ 0.12 | $ 0.26 | $ 0.43 |
| Shares used in per share calculations: | | | | |
| Basic | 10,567 | 9,932 | 10,556 | 9,851 |
| Diluted | 11,054 | 10,606 | 11,071 | 10,465 |

See accompanying Notes to Condensed Consolidated Financial Statements.

**Rentrak Corporation and Subsidiaries**
**Condensed Consolidated Statements of Cash Flows**
**(Unaudited)**
**(in thousands)**

| | For the Nine Months Ended December 31, 2005 | 2004 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income | $ 2,886 | $ 4,483 |
| Adjustments to reconcile net income to net cash flows provided by operating activities: | | |
| Gain on sale of assets | | (2) |
| Tax benefit from stock option exercises | 55 | 256 |
| Depreciation and amortization | 1,222 | 819 |
| Adjustment to allowance for doubtful accounts | (224) | 96 |
| Deferred income taxes | 813 | 1,381 |
| (Increase) decrease in: | | |
| Accounts receivable | (1,869) | (557) |
| Advances to program suppliers | 916 | 2,479 |
| Income taxes receivable and prepaid taxes | 513 | (19) |
| Other current assets | (67) | 107 |
| Increase (decrease) in: | | |
| Accounts payable | 1,715 | (3,051) |
| Accrued liabilities and compensation | (206) | 1,038 |
| Deferred revenue and other liabilities | 45 | 103 |
| Net cash provided by operating activities | 5,799 | 7,133 |
| | | |
| **Cash flows from investing activities:** | | |
| Purchases of marketable seucrities | (14,848) | |
| Purchase of property and equipment | (1,447) | (1,353) |
| Purchase of common stock | | (475) |
| Proceeds from sale of assets | | 2 |
| Note receivable payments received | 372 | 300 |
| Net cash used in investing activities | (15,923) | (1,526) |
| | | |
| **Cash flows from financing activities:** | | |
| Payments on capital lease obligation | (36) | (28) |
| Issuance of common stock | 105 | 3,896 |
| Collection of note receivable, related party | 753 | |
| Net cash provided by financing activities | 822 | 3,868 |
| | | |
| Increase (decrease) in cash and cash equivalents | (9,302) | 9,475 |
| | | |
| **Cash and cash equivalents:** | | |
| Beginning of year | 21,983 | 8,736 |
| End of period | $ 12,681 | $ 18,211 |
| | | |
| **Supplemental cash flow information:** | | |
| Cash paid during the period for interest | $ 3 | $ 5 |
| Cash paid (refunds received) during the period for income taxes, net | (37) | 259 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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**RENTRAK CORPORATION**

# NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**Note 1. Basis of Presentation**

The accompanying unaudited Condensed Consolidated Financial Statements of Rentrak Corporation have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with the accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. The results of operations for the three and nine-month periods ended December 31, 2005, are not necessarily indicative of the results to be expected for the entire fiscal year ending March 31, 2006. The Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and footnotes thereto included in our 2005 Annual Report to Shareholders.

The Condensed Consolidated Financial Statements reflect, in the opinion of management, all material adjustments (which include only normal recurring adjustments) necessary to present fairly our financial position, results of operations and cash flows.

**Note 2. Net Income Per Share**

Basic net income per share (EPS) and diluted EPS are computed using the methods prescribed by Statement of Financial Accounting Standards ( SFAS ) No. 128, Earnings per Share. Following is a reconciliation of the shares used for the basic EPS and diluted EPS calculations (in thousands):

| | Three Months Ended Dec. 31, | | Nine Months Ended Dec. 31, | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| **Basic EPS:** | | | | |
| Weighted average number of shares of common stock outstanding | 10,567 | 9,932 | 10,556 | 9,851 |
| **Diluted EPS:** | | | | |
| Effect of dilutive stock options and warrants | 487 | 674 | 515 | 614 |
| | 11,054 | 10,606 | 11,071 | 10,465 |
| | | | | |
| Options not included in diluted EPS because the exercise price of the options was greater than the average market price of the common shares for the period | 400 | 4 | 302 | 29 |

**Note 3. Business Segments, Significant Suppliers and Major Customers**

During fiscal 2005, we operated in one business segment, Entertainment. Effective April 1, 2005, we implemented a new corporate structure, which includes separate Pay-Per-Transaction ( PPT ) and Advanced Media and Information ( AMI ) operating divisions and, accordingly, we are

now reporting certain financial information by individual segment under this new structure. The PPT Division focuses on managing our business operations that facilitate the delivery of home entertainment products and related rental and sales information to our Participating Retailers on a revenue sharing basis. The AMI Division concentrates on the management and growth of our Essentials Suite of business intelligence services offered on a recurring subscription basis which are no longer in the development stage, as well as operating our direct revenue sharing ( DRS ) services.

Certain information by segment for the three and nine-month periods ended December 31, 2005 and 2004 was as follows (in thousands):

| | PPT | AMI | Other(1) | Total |
|---|---|---|---|---|
| **Three months ended December 31, 2005(2)** | | | | |
| Sales to external customers | $ 20,851 | $ 2,681 | $ 425 | $ 23,957 |
| Depreciation and amortization | 8 | 266 | 133 | 407 |
| Income (loss) from operations | 2,819 | 1,193 | (2,523) | 1,489 |
| | | | | |
| **Three months ended December 31, 2004(2) (3)** | | | | |
| Sales to external customers | $ 19,736 | $ 2,930 | $ 155 | $ 22,821 |
| | | | | |
| **Nine months ended December 31, 2005(2)** | | | | |
| Sales to external customers | $ 56,492 | $ 7,608 | $ 903 | $ 65,003 |
| Depreciation and amortization | 28 | 683 | 511 | 1,222 |
| Income (loss) from operations | 8,421 | 3,296 | (7,865) | 3,852 |
| | | | | |
| **Nine months ended December 31, 2004(2) (3)** | | | | |
| Sales to external customers | $ 66,778 | $ 7,951 | $ 423 | $ 75,152 |

(1) Includes revenue and expenses relating to products and/or services which are still in the development stage, as well as corporate expenses and other expenses which are not allocated to a specific segment.

(2) Assets are not specifically identified by segment as the information is not used by the chief operating decision maker to measure the segments performance.

(3) The depreciation and amortization and operating income (loss) segment information for the three and nine-month periods ended December 31, 2004 is not included as it would be impracticable to do so.

During the three and nine-month periods ended December 31, 2005 and 2004, we had Program Suppliers that supplied product which generated in excess of 10% of our total revenues as follows:

| | Three Months Ended Dec. 31, | | Nine Months Ended Dec. 31, | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| Program Supplier 1 | 25% | 26% | 26% | 46% |
| Program Supplier 2 | 16% | 16% | 15% | 10% |
| Program Supplier 3 | 15% | 10% | 16% | 5% |
| Program Supplier 4 | 6% | 13% | 8% | 8% |

There were no other Program Suppliers who provided product that accounted for 10% or more of our total revenues for the three or nine-month periods ended December 31, 2005 or 2004. A loss of any of these suppliers could have a material adverse effect on our financial condition, results of operations and liquidity.

We had one customer that accounted for 25% of our total revenue in the nine-month period ended December 31, 2004. The agreement with this customer expired in September 2004. There were no other customers that accounted for 10% or more of our total revenue in the three or nine-month periods ended December 31, 2005 or 2004.

**Note 4. Stock-Based Compensation**

We account for stock-based compensation utilizing the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, as interpreted by FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation. Pursuant to SFAS No. 148 Accounting for Stock-Based Compensation Transition and Disclosure, we have computed, for pro forma disclosure purposes, the impact on net income and net income per share as if we had accounted for our stock-based compensation plans in accordance with the fair value method prescribed by SFAS No. 123 Accounting for Stock-Based Compensation as follows:

(in thousands, except per share amounts)

| | Three Months Ended Dec. 31, | | Nine Months Ended Dec. 31, | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| Net income, as reported | $ 1,126 | $ 1,287 | $ 2,886 | $ 4,483 |
| Deduct total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects | (215) | (198) | (611) | (640) |
| Net income, pro forma | $ 911 | $ 1,089 | $ 2,275 | $ 3,843 |
| Net income per share basic, as reported | $ 0.11 | $ 0.13 | $ 0.27 | $ 0.46 |
| Net income per share basic, pro forma | $ 0.09 | $ 0.11 | $ 0.22 | $ 0.39 |
| Net income per share diluted, as reported | $ 0.10 | $ 0.12 | $ 0.26 | $ 0.43 |
| Net income per share diluted, pro forma | $ 0.08 | $ 0.10 | $ 0.21 | $ 0.37 |

To determine the fair value of stock-based awards granted during the periods shown above, we used the Black-Scholes option pricing model and the following weighted average assumptions:

| Three and Nine Months Ended December 31, | 2005 | 2004 |
|---|---|---|
| Risk-free interest rate | 4.16% - 4.49% | 4.17% - 4.58% |
| Expected dividend yield | | |
| Expected lives | 6.39 - 8.58 years | 6.36 - 7.24 years |
| Expected volatility | 64.87% - 70.08% | 72.05% - 74.98% |

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123R, Share-Based Payment, which requires companies to recognize in their statement of operations the grant-date fair value of stock options and other equity-based compensation issued to employees. SFAS No. 123R is effective for annual periods beginning after June 15, 2005. Accordingly, we will adopt SFAS No. 123R in the first quarter of fiscal 2007. We are in the process of evaluating how the adoption of SFAS 123R will affect our results of operations, financial position and cash flows.

**Note 5. Marketable Securities**

In the first nine months of fiscal 2006, we purchased $12.3 million of fixed-rate corporate bonds and $2.5 million of fixed-rate government bonds, all of which mature March 31, 2006 and are included as short-term marketable securities on our balance sheet as of December 31, 2005. We have classified these marketable securities as held-to-maturity, and, accordingly, they are reported at amortized cost with earnings included as a component of interest income.

**Note 6. Line of Credit**

On December 21, 2005, we entered into a renewal of our secured revolving line of credit with Wells Fargo Bank, National Association (the Line of Credit ). The expiration date for the Line of Credit was extended to December 1, 2006 from December 1, 2005. In addition, the Line of Credit was increased from $6.0 million to $15.0 million. The interest rate on the Line of Credit continues to be calculated at our choice of (a) the bank s prime interest rate minus 0.5 percent or (b) LIBOR plus 2 percent. Certain financial covenants continue to apply as follows: (1) consolidated pre-tax income must be at least $1.00 for each fiscal quarter, and consolidated after-tax income must be at least $1.00 on an annual basis, determined at fiscal year end; (2) our current ratio must be at least 1.5:1.0, measured quarterly; and (3) our debt-to-tangible net worth ratio must not exceed 1.5:1.0, measured quarterly. As of December 31, 2005, we were in compliance with these covenants and no amounts were outstanding under the Line of Credit.

**Note 7. Related Party Transactions**

In February 2005, pursuant to his separation agreement, we loaned Mr. F. Kim Cox, our former President and Secretary, $0.8 million to assist him with exercising a portion of his vested options to purchase shares of our common stock. The loan bore interest at 2.78% per annum and was repaid in full, including accrued interest, in May 2005.

In addition, we entered into a consulting agreement with Mr. Cox on January 25, 2005 whereby he is assisting us with strategic planning and product development issues. Pursuant to the agreement, we will pay Mr. Cox $25,000 per month from February 2005 through March 2007. We paid Mr. Cox a total of $75,000 and $225,000, respectively, in the three and nine-month periods ended December 31, 2005 under this contract.

**Note 8. Shareholder Rights Plan**

In May 2005, we entered into a new rights plan to replace our previously existing rights plan, which expired on May 18, 2005. The terms of the new rights plan are similar to those of the previous rights plan. The new rights plan expires May 18, 2015.

**Note 9. Approval of 2005 Stock Incentive Plan**

At our annual meeting of shareholders, which was held on August 25, 2005, our shareholders approved the Rentrak Corporation 2005 Stock Incentive Plan (the 2005 Plan ). The 2005 Plan replaces the 1997 Non-Officer Employee Stock Option Plan and the 1997 Equity Participation Plan (the Prior Plans ).

Under the 2005 Plan, we may grant incentive or nonqualified stock options, stock appreciation rights, restricted stock or units with time-based vesting, performance shares with vesting tied to performance goals and other equity-based awards to eligible participants, including our officers, other key employees, our non-employee directors and certain consultants. Up to a total of 1.0 million shares of our common stock may be issued pursuant to awards granted under the 2005 Plan, subject to adjustment for changes in capitalization. In addition, shares covered by outstanding stock options under the Prior Plans that are cancelled, terminate or otherwise expire without being exercised will become available for grants of new awards under the 2005 Plan.

As of August 25, 2005, there were approximately 1.6 million shares subject to outstanding options under the Prior Plans. No further awards will be made under the Prior Plans.

**Note 10. Customer Bankruptcy**

On November 3, 2005, one of our customers, who filed a voluntary petition for relief under Chapter 11 in the U.S. Bankruptcy Court on August 2, 2005, converted that petition to a revised petition for relief under Chapter 7 in the U.S. Bankruptcy Court. The balance this customer owed us on its account was approximately $588,000 at December 31, 2005 and has been written off. This had no material impact on net income in the current period.

**Note 11. Reclassifications**

Certain reclassifications have been made to the prior year statements to conform to the current year presentation.

**Note 12. Subsequent Event Share Repurchase Program**

In January 2006, our board of directors adopted a share repurchase program authorizing the purchase of up to 1,000,000 shares of our common stock. Shares may be repurchased from time to time in both open market and privately negotiated purchases in such amounts as our authorized officer, Paul Rosenbaum, Chairman, President and Chief Executive Officer, deems appropriate. The timing and actual number of shares repurchased will depend on a variety of factors, including price, corporate and regulatory requirements and other market conditions. As of December 31, 2005, we had 10,571,680 shares outstanding and, as of the date of filing this Form 10-Q, no shares have been repurchased.

**ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Forward Looking Statements**

Certain information included in this Quarterly Report on Form 10-Q (including Management s Discussion and Analysis of Financial Condition and Results of Operations regarding revenue growth, gross profit margin and liquidity) constitute forward looking statements that involve a number of risks and uncertainties. Forward looking statements may be identified by the use of forward looking words such as may, will, expects, intends, anticipates, estimates or continues or the negative thereof or variations thereon or comparable terminology. The following factors are among the factors that could cause actual results to differ materially from the forward looking statements: our ability to retain and grow our customer base of retailers participating in the Pay-Per-Transaction system (the PPT System ) ( Participating Retailers ) and customers for our business intelligence software and services; the financial stability of the Participating Retailers and their performance of their obligations under our PPT System; business conditions and growth in the video industry and general economic conditions, both domestic and international; customer demand for movies in various media formats subject to company guarantees; competitive factors, including increased competition, expansion of revenue sharing programs other than the PPT System by motion picture studios or other licensees or owners of the rights to certain video programming or video game publishers ( Program Suppliers ) and new technology; the continued availability of digital videodiscs ( DVDs ), video games and videocassettes ( Cassettes ) (collectively Units ) leased/licensed to home video specialty stores and other retailers from Program Suppliers; the loss of significant Program Suppliers; our ability to successfully develop and market new services, including our business intelligence services, to create new revenue streams; and non-renewal of our line of credit. This Quarterly Report on Form 10-Q further describes some of these factors.

**Business Trends**

Our financial results continue to be affected by the changing dynamics in the home video and game rental market, as they impact our PPT business. We continue to experience the impact of the migration from higher historical rentals of Cassettes to greater rentals of DVDs by our Participating Retailers. We have successfully implemented new agreements with Program Suppliers to incorporate the availability of DVDs, and we are continuing our efforts in fiscal 2006 to secure more DVD arrangements to address this impact. In addition, our PPT segment continues to be affected by a shift to output programs. Previously, the terms of these programs resulted in lower order processing and transaction fees with Program Suppliers in exchange for the Participating Retailers commitment to order a greater number of Units of all the Program Supplier s titles. The result was an increased number of Units leased by the Participating Retailers, but a reduced amount of fees per Unit earned by the Program Supplier and us. Recently, we have seen a shift in upfront fees associated with newer output agreements. This shift generally resulted in higher order processing and transaction fees and lower sell-through fees, as we experienced both in the three and nine-month periods ended December 31, 2005. These output programs are, in part, an economic response to the changing dynamics of the home video rental market, and have become more prevalent since the migration from Cassette format to the DVD format. We expect the growth of these output programs to continue, and believe that they will be financially beneficial for the Participating Retailers, Program Suppliers and us.

Our base of Participating Retailers continues to be strong. We had one Participating Retailer that accounted for $18.4 million, or 25%, of total revenues in the nine-month period ended December 31, 2004. Our agreement with this Participating Retailer expired in September 2004 and we have not received, nor do we expect to receive, any appreciable revenue from this Participating Retailer in fiscal 2006 or future periods. We are implementing strategies to obtain new Participating Retailers and Program Suppliers in an effort to further stabilize and grow our overall PPT revenue and earnings streams.

We continue to be in good standing with all of our Program Suppliers and we make on-going efforts to enhance those business relationships through improvement of current services offered and the development of new service offerings. We are also continually seeking to develop business relationships with new Program Suppliers. In September 2003, we entered into a combined VHS/DVD revenue sharing program

with one of the world s largest studios that has resulted in their becoming our largest Program Supplier representing 26% and 46% of our total revenues in the nine months ended December 31, 2005 and 2004, respectively. The percentage decrease in total revenues related to this Program Supplier was primarily due to the loss of the major Participating Retailer noted above. Also, in November, 2005, based on our successful involvement with another major studio in Canada, we entered into a revenue sharing agreement which extends product offerings to Participating Retailers in the United States. This agreement is effective for titles which are released in January, 2006. This will allow our U.S. Participating Retailers access to the large volume of high quality entertainment that this major studio continues to deliver year after year. Additional Program Suppliers represented 16%, 15% and 8% of our total revenues in the nine months ended December 31, 2005. As is typical of our agreements with Program Suppliers, our relationships with these Program Suppliers may be terminated without cause upon thirty days written notice by either party.

We are also allocating significant resources towards our business intelligence service offerings, both those services that are currently operational as well as those that are in various stages of development. Our suite of business intelligence services has been well received in the various targeted markets to date, as our offerings fit well with the needs identified by those market participants. Our Box Office Essentials™ and Home Video Essentials™ business intelligence service offerings, which are fully operational and no longer in significant stages of development, saw revenue increases of 9.1% and 9.6%, respectively, during the three and nine-month periods ended December 31, 2005 compared to the same periods of the prior fiscal year. We intend to continue to invest in our existing, as well as new, business intelligence services in the near-term as we expand the markets we serve and our service lines, which likely will lower our earnings. Longer-term, we believe these services will provide significant future revenue and earnings streams and ultimately be the cornerstone of our success.

As an example, included in the Other segment is OnDemand Essentials™, which is one of our lines of business which is currently in development. This is a system created for measuring and reporting anonymous video on demand ( VOD ) usage data. Participating distributors in the service represent 53% of VOD enabled homes. Data is collected from the following operators, with whom we have agreements in place: Comcast, Insight, Cablevision, Charter and Bresnan Communications. We have begun testing data sources from a sixth distributor.

Our OnDemand Essentials™ Content Provider site is a transactional tracking and reporting system that enables users to view and analyze on-demand content. As of January 2006, we had a total of 19 clients for the service: Music Choice, Paramount Studios, CBS, MTV, Nickelodeon, Noggin, The N, Comedy Central, VH1, Expo TV, NFL Network, Ripe TV, National Geographic Channel, Logo, Country Music Television, Warner Home Video, Hallmark Channel, Playboy TV and TV Guide Spot.

**Sources of Revenue**

Effective April 1, 2005, we implemented a new corporate structure, which includes separate Pay-Per-Transaction ( PPT ) and Advanced Media and Information ( AMI ) operating divisions and, accordingly, we are now reporting certain financial information by individual segment under this new structure. The PPT Division focuses on managing our business operations that facilitate the delivery of home entertainment products and related rental and sales information to our Participating Retailers on a revenue sharing basis. The AMI Division concentrates on the management and growth of our Essentials Suite of business intelligence services offered on a recurring subscription basis, as well as operating our direct revenue sharing ( DRS ) services.

Revenue by segment includes the following:

*PPT Segment*

order processing fees generated when DVDs, video games and Cassettes ( Units ) are ordered by and distributed to retailers;

transaction fees generated when retailers rent Units to consumers; additionally, certain arrangements include guaranteed minimum revenues from our customers. We recognize the guaranteed minimum revenue on the street date in accordance with Statement of Position 00-2,

Accounting by Producers or Distributors of Films, ( SOP 00-2 ) provided all other revenue recognition criteria are met;

sell-through fees generated when retailers sell Units to consumers;

buy-out fees generated when retailers purchase Units at the end of the lease term;

communication fees when retailers point-of-sale systems are connected to our information system; and

charges for Internet services provided by our subsidiary, Formovies.com.

*AMI Segment*

direct revenue sharing fees from data tracking and reporting services provided to Program Suppliers ( DRS );

revenues from Box Office Essentials™ and

revenues from Home Video Essentials™.

*Other*

revenue relating to products and/or services which are still in the development stage;

OnDemand Essentials™;

Supply Chain Essentials™; and

Retail Essentials™.

**Results of Operations**

| | Three Months Ended December 31, (1) | | | |
|---|---|---|---|---|
| | 2005 | | 2004 | |
| (Dollars in Thousands) | Dollars | % of revenues | Dollars | % of revenues |
| Revenues: | | | | |
| PPT | $ 20,851 | 87.0% | $ 19,736 | 86.5% |
| AMI | 2,681 | 11.2 | 2,930 | 12.8 |
| Other | 425 | 1.8 | 155 | 0.7 |
| | 23,957 | 100.0 | 22,821 | 100.0 |
| Operating expenses: | | | | |
| Cost of sales | 17,014 | 71.0 | 15,411 | 67.5 |
| Selling and administrative | 5,454 | 22.8 | 5,222 | 22.9 |
| | 22,468 | 93.8 | 20,633 | 90.4 |
| Income from operations | 1,489 | 6.2 | 2,188 | 9.6 |

| | | | | |
|---|---|---|---|---|
| Other income (expense): | | | | |
| Interest income | 283 | 1.2 | 92 | 0.4 |
| Interest expense | | | (2) | |
| | 283 | 1.2 | 90 | 0.4 |
| Income before income tax provision | 1,772 | 7.4 | 2,278 | 10.0 |
| Income tax provision | 646 | 2.7 | 991 | 4.3 |
| Net income | $ 1,126 | 4.7% | $ 1,287 | 5.6% |

| | Nine Months Ended December 31, (1) | | | |
|---|---|---|---|---|
| | 2005 | | 2004 | |
| (Dollars in Thousands) | Dollars | % of revenues | Dollars | % of revenues |
| Revenues: | | | | |
| PPT | $ 56,492 | 86.9% | $ 66,778 | 88.9% |
| AMI | 7,608 | 11.7 | 7,951 | 10.6 |
| Other | 903 | 1.4 | 423 | 0.6 |
| | 65,003 | 100.0 | 75,152 | 100.0 |
| Operating expenses: | | | | |
| Cost of sales | 45,364 | 69.8 | 53,953 | 71.8 |
| Selling and administrative | 15,787 | 24.3 | 14,087 | 18.7 |
| | 61,151 | 94.1 | 68,040 | 90.5 |
| Income from operations | 3,852 | 5.9 | 7,112 | 9.5 |
| Other income (expense): | | | | |
| Interest income | 693 | 1.1 | 203 | 0.3 |
| Interest expense | (2) | | (5) | |
| | 691 | 1.1 | 198 | 0.3 |
| Income before income tax provision | 4,543 | 7.0 | 7,310 | 9.7 |
| Income tax provision | 1,657 | 2.5 | 2,827 | 3.8 |
| Net income | $ 2,886 | 4.4% | $ 4,483 | 6.0% |

(1) Percentages may not add due to rounding.

Certain results of operations information by segment was as follows:

| | Three Months Ended December 31, (1) | | | |
|---|---|---|---|---|
| | 2005 | | 2004 | |
| (Dollars in Thousands) | Dollars | % of segment revenues | Dollars | % of segment revenues |
| **PPT** | | | | |
| Revenues | $ 20,851 | 100.0% | $ 19,736 | 100.0% |
| Cost of sales | 16,602 | 79.6 | 15,136 | 76.7 |
| Gross margin | $ 4,249 | 20.4% | $ 4,600 | 23.3% |
| | | | | |
| **AMI** | | | | |
| Revenues | $ 2,681 | 100.0% | $ 2,930 | 100.0% |
| Cost of sales | 278 | 10.4 | 263 | 9.0 |
| Gross margin | $ 2,403 | 89.6% | $ 2,667 | 91.0% |
| | | | | |
| **Other** | | | | |
| Revenues | $ 425 | 100.0% | $ 155 | 100.0% |
| Cost of sales | 134 | 31.5 | 12 | 7.7 |
| Gross margin | $ 291 | 68.5% | $ 143 | 92.3% |

| | Nine Months Ended December 31, (1) | | | |
|---|---|---|---|---|
| | 2005 | | 2004 | |
| (Dollars in Thousands) | Dollars | % of segment revenues | Dollars | % of segment revenues |
| **PPT** | | | | |
| Revenues | $ 56,492 | 100.0% | $ 66,778 | 100.0% |
| Cost of sales | 44,158 | 78.2 | 53,150 | 79.6 |
| Gross margin | $ 12,334 | 21.8% | $ 13,628 | 20.4% |
| | | | | |
| **AMI** | | | | |
| Revenues | $ 7,608 | 100.0% | $ 7,951 | 100.0% |
| Cost of sales | 855 | 11.2 | 768 | 9.7 |
| Gross margin | $ 6,753 | 88.8% | $ 7,183 | 90.3% |
| | | | | |
| **Other** | | | | |
| Revenues | $ 903 | 100.0% | $ 423 | 100.0% |
| Cost of sales | 351 | 38.9 | 35 | 8.3 |
| Gross margin | $ 552 | 61.1% | $ 388 | 91.7% |

(1) Percentages may not add due to rounding.

***Revenue***

Revenue increased $1.2 million, or 5.0%, to $24.0 million in the three months ended December 31, 2005 (the third quarter of fiscal 2006) compared to $22.8 million in the third quarter of fiscal 2005 and decreased $10.2 million, or 13.5%, to $65.0 million in the nine-month period ended December 31, 2005 compared to $75.2 million in the nine-month period ended December 31, 2004.

The increase in revenue in the third quarter of fiscal 2006 compared to the third quarter of fiscal 2005 was primarily due to increases in order processing and transaction fee revenue from the PPT segment, as well as increases in revenue from operating lines of Essentials™ business intelligence service offerings, offset by lower sell-through fees.

The decrease in revenue in the nine-month period was due primarily due to decreases in transaction fees and sell-through fees, partially offset by small increases in order processing fees and our Essentials Suite™ of business intelligence services as described more fully below.

*PPT Segment*

PPT revenues increased $1.1 million, or 5.7%, and decreased $10.3 million, or 15.4%, respectively, in the three and nine-month periods ended December 31, 2005 compared to the same periods of the prior fiscal year. The increase in the three-month period was primarily due to changes in terms of output agreements which include minimum rental guarantees, which are recognized immediately as a component of revenue

and cost of sales upon the street date per SOP 00-2. These minimum rental guarantees resulted in higher transaction fees. Additionally, new terms this period resulted in higher order processing fees and lower sell-through fees. The decrease in the nine-month period was primarily a result of decreases in transaction and sell-through fees, partially offset by increases in order processing fees as described below.

Order processing fees increased $0.7 million, or 49.0%, and $1.5 million, or 40.5%, respectively, in the three and nine-month periods ended December 31, 2005 compared to the same periods of the prior fiscal year due to a new output program with a major supplier, which was effective April 1, 2005. The terms of this new agreement, and its utilization by our Participating Retailers during the current periods, resulted in higher order processing fees per unit compared with the prior year periods.

Transaction fees increased $2.4 million, or 18.3%, and decreased $8.1 million, or 16.6%, respectively, in the three and nine-month periods ended December 31, 2005 compared to the same periods of the prior fiscal year. The increase in the three-month period ended December 31, 2005 compared to the three-month period ended December 31, 2004 was primarily due to the April 1, 2005 output agreement mentioned above, as well as a new output program with an existing Program Supplier, which was effective at the end of September 2005, and their utilization by our Participating Retailers during the current period. These agreements include minimum rental guarantees, which are recognized immediately as a component of revenue and cost of sales upon the street date in accordance with SOP 00-2. The decrease in transaction fees in the nine-month period was primarily due to the loss of a significant customer whose contract expired in September 2004, partially offset by increased fees related to the new output programs discussed above.

Sell-through fees decreased $1.9 million, or 37.3%, and $3.5 million, or 26.6%, respectively, in the three and nine-month periods ended December 31, 2005 compared to the same periods of the prior fiscal year. The decreases in sell-through fees were primarily due to the loss of the significant customer mentioned above, as well as changes in terms with our new output programs.

*AMI Segment*

Revenues from our AMI segment decreased $0.2 million, or 8.5%, and $0.3 million, or 4.3%, respectively, in the three and nine-month periods ended December 31, 2005 compared to the same periods of the prior fiscal year. Our Essentials™ business intelligence service offerings, which include those services that management considers fully operational and no longer in significant stages of development, saw revenue increases of $0.1 million, or 9.1%, and $0.3 million, or 9.6%, respectively, during the three and nine-month periods ended December 31, 2005 compared to the same periods of the prior fiscal year. These increases were offset by a $0.3 million, or 19.0%, and a $0.6 million, or a 13.6%, decrease, respectively, in DRS revenue in the same periods due to a decrease in the total number of DRS rental transactions processed. This decrease resulted from a decline in the number of DRS rental transactions processed for one of our major studios in the first nine months of fiscal 2006 compared to the first nine months of fiscal 2005 due to a change in the relationship between the studio and one of its direct revenue sharing customers.

*Other Segment*

Revenues from our Other segment increased $0.3 million, or 174%, and $0.5 million, or 114%, respectively, in the three and nine-month periods ended December 31, 2005 compared to the same periods of the prior fiscal year. These increases related primarily to revenue from OnDemand

Essentials™, which is finalizing its development stage and is expected to be part of our AMI segment in the first quarter of fiscal 2007.

***Cost of Sales***

Cost of sales consists of order processing costs, transaction costs, sell-through costs, handling and freight costs, and costs associated with certain Essentials™ business intelligence service offerings. These expenditures represent the direct costs to produce revenues. Order processing costs, transaction costs and sell through costs represent the amounts due to the Program Suppliers that hold the distribution rights to the Units. Freight costs represent the cost to pick, pack and ship orders of Units to the Participating

Retailers. A portion of the Essentials™ business intelligence service offerings costs represent costs associated with the operation of a call center.

Cost of sales increased $1.6 million, or 10.4%, to $17.0 million in the third quarter of fiscal 2006 compared to $15.4 million in the third quarter of fiscal 2005 and decreased $8.6 million, or 15.9%, to $45.4 million in the nine-month period ended December 31, 2005 compared to $54.0 million in the nine-month period ended December 31, 2004. Cost of sales as a percentage of revenue was 71.0% and 69.8%, respectively, in the three and nine-month periods ended December 31, 2005 compared to 67.5% and 71.8%, respectively, in the same periods of the prior year.

The increase in cost of sales in the third quarter of fiscal 2006 compared to the third quarter of fiscal 2005 was primarily due to the increase in revenues and guarantees related to our new output programs discussed above. The increase in cost of sales as a percentage of revenue in the third quarter of fiscal 2006 compared to the third quarter of fiscal 2005 was primarily due to increased costs from the PPT segment related to the guarantees to major Program Suppliers mentioned in the Revenue section above. We expect that the margins on titles released in the third quarter of fiscal 2006 will improve in the fourth quarter of fiscal 2006 when and if those titles exceed the guaranteed minimums. However, any new titles released during the fourth quarter of fiscal 2006 under these programs may also have guaranteed minimum rentals, in which case margins may not expand to any significant degree during that three-month period. Since these factors are highly dependent upon the quality, timing and release dates of new products, it is difficult to predict the ultimate impact this will have on future results of operations in any reporting period.

The decrease in cost of sales in the nine-month period was primarily due to the decrease in revenues discussed above. The decrease in cost of sales as a percentage of revenue was primarily due to lower costs for the PPT segment, offset by higher costs in the AMI segment, as well as costs associated with revenues from services which are still in the development stage and included in Other. The PPT segment experienced lower cost of sales as a percentage of revenue as a result of the higher order processing fees related to the new output programs mentioned above. The higher order processing fees per unit from most of these new output programs generate no corresponding costs, which resulted in improved margins. The higher costs for the AMI segment primarily related to increased costs associated with the operation of our call center.

***Selling and Administrative***

Selling and administrative expenses consist primarily of compensation and benefits, development, marketing and advertising costs, legal and professional fees, communications costs, depreciation and amortization of tangible fixed assets and software, real and personal property leases, as well as other general corporate expenses.

Selling and administrative expenses increased $0.3 million, or 4.4%, to $5.5 million in the third quarter of fiscal 2006 compared to $5.2 million in the third quarter of fiscal 2005 and increased $1.7 million, or 12.1%, to $15.8 million in the nine-month period ended December 31, 2005 compared to $14.1 million in the nine-month period ended December 31, 2004.

The increase in selling and administrative expenses in the three-month period ended December 31, 2005 compared to the same period of the prior fiscal year was primarily due to a $0.3 million increase in expenditures related to our continued investment in the development and marketing of our Essentials™ business service offerings, offset by a net reduction of $0.3 million in professional and audit fees relating primarily to our compliance with Section 404 of the Sarbanes-Oxley Act. Additionally, the prior year amounts include recoveries, net of expenses, related to an embezzlement, which was discovered in March 2004,

totaling $0.2 million.

The increase in selling and administrative expenses in the nine-month period ended December 31, 2005 compared to the same period of the prior fiscal year was primarily due to a $1.1 million increase in expenditures related to our continued investment in the development and marketing of our Essentials™ business service offerings. This increase was offset by lower legal costs and improvements in trends relating to the collection of accounts receivable, which had a positive impact on the provision for bad debts.

Additionally, the prior year amount includes recoveries, net of expenses, related to an embezzlement, which was discovered in March 2004, totaling $0.3 million, as well as $0.3 million in higher advertising credits.

As a percentage of revenues, selling and administrative expenses were 22.8% and 24.3%, respectively, for the three and nine-month periods ended December 31, 2005 compared to 22.9% and 18.7%, respectively, for the same periods of the prior fiscal year, due to a combination of the change in expenses in both periods as discussed above and lower revenues over which to spread these costs in the nine-month period.

***Interest Income***

Interest income was $0.3 million and $0.7 million, respectively, for the three and nine-month periods ended December 31, 2005 compared to $0.1 million and $0.2 million, respectively, for the same periods of the prior fiscal year. The increases in interest income primarily relate to higher interest rates and higher average cash balances in the current periods compared to the same periods of the prior fiscal year. Our average cash, cash equivalents and short-term marketable securities balance was $24.0 million and $11.7 million for the nine-month periods ended December 31, 2005 and 2004, respectively. We also purchased $14.8 million of low-risk marketable securities during the first nine months of fiscal 2006, which contributed to higher yields on our invested cash. These securities mature March 31, 2006.

***Income Taxes***

Our effective tax rate was 36.5% and 38.7%, respectively, in the nine-month periods ended December 31, 2005 and 2004. Our effective tax rate differs from the federal statutory tax rate primarily due to state income taxes.

**Liquidity and Capital Resources**

Our sources of liquidity include our cash, cash equivalents and marketable securities, cash expected to be generated from future operations and our $15.0 million line of credit. Based on our current financial projections and projected cash needs, we believe that our available sources of liquidity will be sufficient to fund our current operations, the continued current development of our business intelligence services and other cash requirements through at least December 31, 2006.

Cash and cash equivalents decreased $9.3 million to $12.7 million at December 31, 2005 compared to $22.0 million at March 31, 2005. This decrease resulted primarily from $14.8 million used for the purchase of marketable securities and $1.4 million invested in property and equipment and internally developed software for our business intelligence service offerings, which were partially offset by $5.8 million provided by operations, $0.3 million received on a note receivable, $0.8 million received on a related party note receivable and $0.1 million received from the issuance of common stock. Our current ratio was 2.7:1.0 at both December 31, 2005 and March 31, 2005.

Accounts receivable, net of allowances, increased $2.1 million to $16.5 million at December 31, 2005 compared to $14.4 million at March 31, 2005, due primarily to increased revenues in the third quarter of fiscal 2006 compared to the fourth quarter of fiscal 2005 and increased minimum rental guarantees discussed in the Revenue section.

Advances to Program Suppliers decreased $0.9 million to $0.3 million at December 31, 2005 compared to $1.2 million at March 31, 2005. These amounts represent the unearned portion of guarantees with certain Program Suppliers, offset by reserves for estimated shortages under the guarantees. Advances to Program Suppliers increase and decrease over time based on changes in business volume, as well as on the timing of payments.

Deferred tax assets, short and long-term, were $0.2 million at December 31, 2005 compared to $1.1 million at March 31, 2005. The reduction of $0.9 million primarily relates to utilizing net operating loss carryforwards ( NOLs ) at December 31, 2005 to reduce taxes payable in fiscal 2006. The remaining deferred tax asset balance primarily relates to net operating loss carryforwards and various reserves not currently deductible for tax purposes.

Note receivable from related party of $0.8 million at March 31, 2005 represented a note receivable from our former president plus accrued interest pursuant to his January 2005 separation agreement. This amount was paid in full on May 4, 2005.

During the first three quarters of fiscal 2006, we spent $1.4 million on property and equipment, including $1.0 million for the capitalization of internally developed software for our business intelligence service offerings. We anticipate spending a total of approximately $1.9 million on property and equipment in fiscal 2006, including approximately $1.3 million for the capitalization of internally developed software, primarily for our business intelligence service offerings.

Accounts payable increased $1.7 million to $14.2 million at December 31, 2005 compared to $12.5 million at March 31, 2005 primarily due to the timing of Program Supplier and other vendor payments.

Accrued compensation decreased $0.5 million to $1.0 million at December 31, 2005 compared to $1.5 million at March 31, 2005 primarily due to payments of bonuses relating to the fiscal year ended March 31, 2005 and accrued withholding taxes related the exercise of stock options.

We currently have a secured revolving line of credit for $15.0 million, with a maturity of December 1, 2006. Interest on the line of credit is at our choice of either the bank s prime interest rate minus 0.5 percent or LIBOR plus 2 percent. The credit line is secured by substantially all of our assets. The line of credit includes certain financial covenants requiring: (1) a consolidated pre-tax income to be achieved each fiscal quarter of a minimum of $1.00, and consolidated after-tax income not less than $1.00 on an annual basis, determined at fiscal year end; (2) a minimum current ratio of 1.5:1.0, measured quarterly; and (3) a maximum debt-to-tangible net worth ratio of 1.5:1.0, measured quarterly. Based upon the financial results reported as of, and for the quarter ended, December 31, 2005, we determined that we were in compliance with the financial covenants at December 31, 2005. At December 31, 2005, we had no outstanding borrowings under this agreement.

**Critical Accounting Policies and Estimates**

We reaffirm the critical accounting policies and estimates as reported in our Form 10-K for the fiscal year ended March 31, 2005, which was filed with the Securities and Exchange Commission on June 13, 2005.

**Additionally, please refer to Note 5 of Notes to Condensed Consolidated Financial Statements for a discussion of our policy regarding marketable securities.**

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.**

As of December 31, 2005, we had additional exposure to interest rate risk related to our marketable securities. We utilized sensitivity analyses to assess the potential effect of this risk and concluded that near-term changes in interest rates should not materially adversely affect our financial position, results of operations or cash flows.

There have been no other material changes in our reported market risks since the filing of our fiscal 2005 Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on June 13, 2005.

**ITEM 4. CONTROLS AND PROCEDURES**

***Disclosure Controls and Procedures***

**Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended (Exchange Act). Based on that evaluation our Chief Executive Officer and our Chief Financial Officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective in ensuring that material information required to be disclosed in our Exchange Act reports is (1) recorded, processed, summarized and reported in a timely manner, and (2) accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.**

***Changes in Internal Control Over Financial Reporting***

There has been no change in our internal control over financial reporting that occurred during our last fiscal quarter that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

**PART II OTHER INFORMATION**

**ITEM 6. EXHIBITS**

The following exhibits are filed herewith and this list is intended to constitute the exhibit index:

| | |
|---|---|
| 10.1 | Fifth Amendment to Credit Agreement, dated December 1, 2005, to Credit Agreement with Wells Fargo Bank, dated July 15, 2002. |
| 10.2 | Revolving Line of Credit Note, dated December 1, 2005. |
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934. |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934. |
| 32.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350. |
| 32.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350. |

**SIGNATURE**

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.

Date: February 7, 2006

RENTRAK CORPORATION

By: /s/ Mark L. Thoenes
Mark L. Thoenes
Senior Vice President and Chief Financial Officer