

ONLINE RESOURCES CORP

Form 10-Q

August 14, 2003

Edgar Filing: ONLINE RESOURCES CORP - Form 10-Q

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

FORM 10-Q

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2003

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER 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.)

7600 COLSHIRE DRIVE, McLEAN, VIRGINIA

22102

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(ZIP CODE)

(703) 394-5100

(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.

YES NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

YES NO

As of July 25, 2003 there were 15,354,377 shares of the issuer's common stock outstanding.

ONLINE RESOURCES CORPORATION

FORM 10-Q

TABLE OF CONTENTS

	<u>Page</u>	
Part I	FINANCIAL INFORMATION	
Item 1:	Financial Statements	
	Unaudited Balance Sheets at June 30, 2003 and December 31, 2002	1
	Unaudited Statements of Operations for the three and six months ended June 30, 2003 and 2002	2
	Unaudited Statements of Cash Flows for the six months ended June 30, 2003 and 2002	3
	Notes to Financial Statements (unaudited)	4
Item 2:	Management's Discussion and Analysis of Financial Condition and Results of Operations	7
Item 3:	Quantitative and Qualitative Disclosures about Market Risk	13
Item 4:	Controls and Procedures	13
PART II	OTHER INFORMATION	
Item 1	Legal Proceedings	13
Item 2, 3 and 4:	Not Applicable	13
Item 5:	Other Information	13
Item 6:	Exhibits and Reports on Form 8-K	13

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

ONLINE RESOURCES CORPORATION
UNAUDITED BALANCE SHEETS

	JUNE 30, 2003	DECEMBER 31, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 6,754,645	\$ 2,290,950
Investments	2,416,717	4,494,877
Accounts receivable (net of allowance of approximately \$67,000 and \$77,000 at June 30, 2003 and December 31, 2002, respectively)	4,319,547	3,825,801
Deferred implementation costs	571,973	631,087
Prepaid expenses and other current assets	1,156,662	771,986
	<u>15,219,544</u>	<u>12,014,701</u>
Total current assets	15,219,544	12,014,701
Property and equipment, net	7,453,288	7,804,229
Deferred implementation costs, less current portion	457,693	401,051
Debt issuance costs	364,523	659,879
Other assets	562,602	450,080
	<u>24,057,650</u>	<u>21,329,940</u>
Total assets	\$ 24,057,650	\$ 21,329,940
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 653,014	\$ 891,313
Accrued expenses and other current liabilities	884,843	984,535
Accrued compensation	929,559	743,107
Deferred revenues	576,453	531,789
Current portion of capital lease obligations	193,203	213,913
	<u>3,237,072</u>	<u>3,364,657</u>
Total current liabilities	3,237,072	3,364,657
Capital lease obligation, less current maturities	23,379	111,491
Deferred revenues, less current portion	305,549	355,662
Notes payable	8,100,000	12,000,000
	<u>11,666,000</u>	<u>15,831,810</u>
Total liabilities	11,666,000	15,831,810
Commitments and contingencies		
Stockholders' equity:		
Series A convertible preferred stock, \$.01 par value; 1,000,000 shares authorized, none issued at June 30, 2003 and December 31, 2002		
Series B junior participating preferred stock, \$.01 par value; 297,500 shares authorized, none issued at June 30, 2003 and December 31, 2002		
Common stock, \$.0001 par value; 35,000,000 shares authorized, 15,369,067 issued and 15,293,542 outstanding at June 30, 2003; and 13,781,946 issued and 13,706,421 outstanding at December 31, 2002, respectively	1,529	1,370
Additional paid-in capital	96,339,438	91,410,356
Accumulated deficit	(83,725,491)	(85,700,448)
Treasury stock, 75,525 shares at June 30, 2003 and December 31, 2002	(227,800)	(227,800)
Accumulated other comprehensive income	3,974	14,652

Edgar Filing: ONLINE RESOURCES CORP - Form 10-Q

Total stockholders' equity	12,391,650	5,498,130
Total liabilities and stockholders' equity	<u>\$ 24,057,650</u>	<u>\$ 21,329,940</u>

See accompanying notes to unaudited financial statements.

ONLINE RESOURCES CORPORATION
UNAUDITED STATEMENTS OF OPERATIONS

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2003	2002	2003	2002
Revenues:				
Banking services	\$ 943,312	\$ 1,329,385	\$ 2,251,223	\$ 2,630,002
Payment services	4,888,242	3,603,397	9,463,035	6,995,011
Consumer contact services	1,977,316	2,226,039	4,392,812	4,338,682
Professional services and other	608,540	720,156	3,320,338	1,742,661
Total revenues	8,417,410	7,878,977	19,427,408	15,706,356
Costs and expenses:				
Service costs	3,306,272	3,156,909	6,855,765	6,500,170
Implementation and other costs	454,153	516,815	755,149	1,107,306
Costs of revenues	3,760,425	3,673,724	7,610,914	7,607,476
Gross profit	4,656,985	4,205,253	11,816,494	8,098,880
General and administrative	1,900,645	1,680,522	4,212,291	3,386,084
Sales and marketing	1,480,936	1,309,175	3,025,589	2,572,690
Systems and development	955,750	1,068,531	1,846,404	2,269,778
Total expenses	4,337,331	4,058,228	9,084,284	8,228,552
Income (loss) from operations	319,654	147,025	2,732,210	(129,672)
Other (expenses) income:				
Interest income	13,857	33,266	36,581	80,282
Interest expense	(273,047)	(312,942)	(585,155)	(664,382)
Other		(417)		(34,211)
Debt repurchase/conversion expense	(181,179)		(181,179)	(191,807)
Total other expense	(440,369)	(280,093)	(729,753)	(810,118)
Income (loss) before income taxes	(120,715)	(133,068)	2,002,457	(939,790)
Income tax provision	27,500		27,500	
Net income (loss)	\$ (148,215)	\$ (133,068)	\$ 1,974,957	\$ (939,790)
Net income (loss) per share:				
Basic	\$ (0.01)	\$ (0.01)	\$ 0.14	\$ (0.07)
Diluted	\$ (0.01)	\$ (0.01)	\$ 0.13	\$ (0.07)
Shares used in calculation of net income (loss) per share:				
Basic	14,108,920	13,557,195	13,909,443	13,418,599
Diluted	14,108,920	13,557,195	14,846,817	13,418,599

See accompanying notes to unaudited financial statements.

ONLINE RESOURCES CORPORATION
UNAUDITED STATEMENTS OF CASH FLOWS

	SIX MONTHS ENDED JUNE 30,	
	2003	2002
OPERATING ACTIVITIES		
Net income (loss)	\$ 1,974,957	\$ (939,790)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Debt repurchase/conversion expense	181,179	191,807
Depreciation	1,463,493	1,193,186
Amortization of debt issuance costs	114,177	126,579
Stock compensation		58,246
Provision for losses on accounts receivable	(10,000)	113,000
Net realized gain on investments	(6,631)	(6,775)
Amortization of bond premium	5,040	249
Changes in assets and liabilities:		
Accounts receivable	(483,746)	(700,059)
Prepaid expenses and other current assets	(384,676)	27,573
Deferred implementation costs	2,472	398,894
Other assets	(112,522)	458,203
Accounts payable	(238,299)	(431,038)
Accrued expenses	86,760	269,390
Deferred revenues	(5,449)	(317,812)
Net cash provided by operating activities	2,586,755	441,653
INVESTING ACTIVITIES		
Purchase of available for sale securities	(7,015,442)	(2,303,226)
Sales of available for sale securities	9,084,515	3,914,323
Purchases of property and equipment	(1,112,552)	(1,735,293)
Net cash provided by (used in) investing activities	956,521	(124,196)
FINANCING ACTIVITIES		
Net proceeds from issuance of common stock	4,929,241	112,427
Principal payments of capital lease obligations	(108,822)	(118,173)
Purchase of notes payable	(3,900,000)	
Net cash provided by (used in) financing activities	920,419	(5,746)
Net increase in cash and cash equivalents	4,463,695	311,711
Cash and cash equivalents at beginning of period	2,290,950	2,120,252
Cash and cash equivalents at end of period	\$ 6,754,645	\$ 2,431,963
Supplemental information to statement of cash flows:		
Cash paid for interest	492,968	519,580
Conversion of notes payable		1,000,000
Unrealized loss on investments	(10,678)	(15,339)

See accompanying notes to unaudited financial statements.

**ONLINE RESOURCES CORPORATION
NOTES TO FINANCIAL STATEMENTS
(UNAUDITED)**

1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Online Resources Corporation (the Company) is a leading outsourcer of Internet banking, payment and consumer contact services to financial institution clients 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.

INTERIM FINANCIAL INFORMATION

The accompanying unaudited financial statements have been prepared in conformity with generally accepted accounting principles 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 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 financial statements should be read in conjunction with our audited financial statements for the year ended December 31, 2002, included in the Annual Report on Form 10-K filed by the Company with the Securities and Exchange Commission on March 31, 2003 and the amended Form 10-K filed as part of an 8-K on June 27, 2003. 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. REVENUE RECOGNITION

The Company generates revenues from service fees, professional services, and other revenues. Revenues from service fees are reported in the statements of operations based on three business lines, banking services, payment services and consumer contact services. In prior years, revenues from these business lines were reported as service fees. Revenue amounts reported in prior periods have been reclassified to conform to the 2003 presentation. Service fee revenue from these three business lines includes account access fees, transaction fees, customer service, new user setup, communications and other services. Revenue from banking services, payment services and consumer contact services are recognized over the term of the contract as the services are provided. Professional services and other revenues are generated from the linking of the Company's financial institution clients to the Company's Quotien e-financial suite through various networks and the Company's gateways and the sale of software used to access the e-financial suite. Other revenue also includes termination fees, which are recognized at the date of termination of a contract. Implementation revenue and direct implementation costs are recognized on a straight-line basis over the contract term. In prior years, professional services and other fees were included as implementation and other revenues. Although the Company separately reports its revenues from its three business lines, it does not track costs and expenses at the business line level.

3. MAJOR CUSTOMER

For the quarter ended June 30, 2002, one of the Company's financial institution clients, California Federal Bank (Cal Fed), accounted for approximately \$1.2 million, or 15% of the Company's revenue, but no revenue was generated from Cal Fed for the quarter ended June 30, 2003. For the six months ended June 30, 2003 and 2002, Cal Fed accounted for approximately \$3.3 million and \$2.3 million, or 17% and 14% of the Company's revenue, respectively. In 2002 Citigroup acquired Cal Fed and during the first quarter of 2003 converted the Cal Fed customers to the Citigroup banking and bill payment platform, thereby causing a cessation of the Company's relationship with Cal Fed. Of the \$3.3 million in revenue earned from Cal Fed during the first six months of 2003, \$2.2 million represented a one-time fee resulting from the conversion of Cal Fed customers to the Citigroup platform.

4. NET INCOME (LOSS) PER SHARE

Basic and diluted net (loss) income per share is calculated by dividing the net income (loss) by the weighted average number of common shares outstanding. The Convertible Notes are antidilutive for all periods presented.

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2003 (1)	2002 (1)	2003	2002 (1)
Net (loss) income	\$ (148,215)	\$ (133,068)	\$ 1,974,957	\$ (939,790)
Shares used in calculation of net (loss)/income per share:				
Basic	14,108,920	13,557,195	13,909,443	13,418,599
In the money options			937,374	
Diluted	14,108,920	13,557,195	14,846,817	13,418,599
Net (loss) income per share:				
Basic	(0.01)	(0.01)	0.14	(0.07)
Diluted	\$ (0.01)	\$ (0.01)	\$ 0.13	\$ (0.07)

(1) Stock options are antidilutive due to the Company's net loss position.

5. NOTES PAYABLE

On September 28, 2000, the Company completed the private placement of \$20 million in Convertible Notes to a group of accredited investors and received proceeds of \$18.7 million net of expenses. The Convertible Notes carry an 8% coupon and interest payment dates are April 1 and October 1 of each year. The Convertible Notes were initially convertible at a price of \$4.75 per share but are subject to an annual reset under certain circumstances. In no event can the conversion price under the terms of the Convertible Notes be reset to a price of less than \$4.00 per share. Subject to certain conditions, the Company may redeem all or part of the Convertible Notes prior to maturity.

During 2001, the Company paid \$2.2 million to repurchase \$3.5 million of the Convertible Notes in privately negotiated transactions and converted \$3.5 million of the Convertible Notes, under separately negotiated agreements with several holders of the Convertible Notes. On March 27, 2002, \$1.0 million of the Convertible Notes were converted at \$3.39 per common share, instead of the \$4.00 conversion price that otherwise existed under the Convertible Notes. The induced conversion which occurred on March 27, 2002 resulted in the issuance of 295,031 shares, or 45,031 additional shares had the Convertible Notes been converted at the \$4.00 per common share conversion price. For the quarter ending March 31, 2002, the Company recognized a \$141,848 non-cash debt conversion expense and wrote off \$49,959 of related debt issuance costs in connection with the transaction.

On May 30, 2003 and June 9, 2003, the Company repurchased \$1.9 million and \$2.0 million, respectively, of the Convertible Notes at par. This removed 975,000 shares from possible future issuance in conjunction with conversion of the repurchased Convertible Notes. For the quarter ended June 30, 2003, the Company wrote off \$181,179 of related debt issuance costs in connection with the transaction. Accordingly, as of June 30, 2003, \$8.1 million of the Convertible Notes remains outstanding and matures on September 30, 2005. Based on the established \$4.00 conversion price, the outstanding Convertible Notes are convertible into 2,025,000 shares of the Company's common stock at June 30, 2003. The remaining \$8.1 million in Convertible Notes are callable by the Company after October 1, 2003 at a 2 percent premium over par.

Interest expense and amortization of the debt issuance costs related to the Convertible Notes for the three months ended June 30, 2003 and 2002 were \$268,045 and \$302,799. Interest expense and amortization of the debt issuance costs related to the Convertible Notes for the six months ended June 30, 2003 and 2002 were \$571,733 and \$625,690, respectively. As of June 30, 2003 and 2002, accrued interest on the Convertible Notes totaled \$161,556 and \$240,000, respectively.

6. EQUITY

During the six months ended June 30, 2003, employees purchased 12,365 shares of common stock under the Company's employee stock purchase plan and exercised 238,756 shares of common stock under the Company's stock option plan with net proceeds to the Company of

Edgar Filing: ONLINE RESOURCES CORP - Form 10-Q

approximately \$563,293. On June 9, 2003, the Company increased its stockholders' equity by \$4.4 million through a private placement of 1,336,000 newly issued common shares to a group of institutional investors. This transaction was priced at a discount to the Online Resources volume weighted average closing share price for the 10 trading days prior to the seventh trading day before closing.

7. COMPONENTS OF COMPREHENSIVE INCOME