

VALASSIS COMMUNICATIONS INC

Form 10-Q

November 08, 2011

[Table of Contents](#)

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 September 30, 2011
- ☐ **Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission File Number: 1-10991

VALASSIS COMMUNICATIONS, INC.

(Exact Name of Registrant as Specified in its Charter)

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Delaware
(State or Other Jurisdiction of

38-2760940
(IRS Employer Identification Number)

Incorporation or Organization)

19975 Victor Parkway

Livonia, Michigan 48152

(Address of Principal Executive Offices)

Registrant's Telephone Number: (734) 591-3000

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files): Yes ☒ No ☐

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☐

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

As of November 1, 2011, there were 44,754,756 shares of the Registrant's Common Stock outstanding.

Table of Contents

VALASSIS COMMUNICATIONS, INC.

Index to Quarterly Report on Form 10-Q

Quarter Ended September 30, 2011

| | Page |
|--|------|
| <u>PART I FINANCIAL INFORMATION</u> | |
| Item 1. <u>Financial Statements (Unaudited)</u> | |
| <u>Condensed Consolidated Balance Sheets at September 30, 2011 and December 31, 2010</u> | 1 |
| <u>Condensed Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2011 and 2010</u> | 2 |
| <u>Condensed Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2011 and 2010</u> | 3 |
| <u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2011 and 2010</u> | 4 |
| <u>Notes to Condensed Consolidated Financial Statements</u> | 5 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 23 |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 34 |
| Item 4. <u>Controls and Procedures</u> | 35 |
| <u>PART II OTHER INFORMATION</u> | |
| Item 1. <u>Legal Proceedings</u> | 35 |
| Item 1A. <u>Risk Factors</u> | 35 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 36 |
| Item 3. <u>Defaults Upon Senior Securities</u> | 36 |
| Item 4. <u>Removed and Reserved</u> | 36 |
| Item 5. <u>Other Information</u> | 36 |
| Item 6. <u>Exhibits</u> | 37 |
| <u>Signature</u> | 38 |

Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****VALASSIS COMMUNICATIONS, INC.****Condensed Consolidated Balance Sheets****(U.S. dollars in thousands)****(unaudited)**

| | September 30, 2011 | December 31, 2010 |
|---|-----------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 91,034 | \$ 245,935 |
| Accounts receivable, net (Note 1) | 407,286 | 459,952 |
| Inventories (Note 1) | 36,135 | 41,987 |
| Prepaid expenses and other | 63,408 | 38,657 |
| Total current assets | 597,863 | 786,531 |
| Property, plant and equipment, net (Note 1) | 157,000 | 175,567 |
| Goodwill (Note 2) | 636,471 | 636,471 |
| Other intangible assets, net (Note 2) | 224,350 | 233,817 |
| Other assets | 16,764 | 13,272 |
| Total assets | \$ 1,632,448 | \$ 1,845,658 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Current portion long-term debt (Note 3) | \$ 15,000 | \$ 7,058 |
| Accounts payable | 295,112 | 329,602 |
| Progress billings | 52,608 | 53,001 |
| Accrued expenses (Note 4) | 93,591 | 99,612 |
| Total current liabilities | 456,311 | 489,273 |
| Long-term debt (Note 3) | 591,310 | 699,169 |
| Deferred income taxes | 78,258 | 78,764 |
| Other non-current liabilities | 39,738 | 49,568 |
| Total liabilities | 1,165,617 | 1,316,774 |
| Commitments and contingencies (Note 5) | | |
| Stockholders' equity: | | |
| Preferred stock (\$0.01 par value; 25,000,000 shares authorized; no shares issued or outstanding at September 30, 2011 and December 31, 2010) | | |
| Common stock (\$0.01 par value; 100,000,000 shares authorized; 65,389,749 and 65,283,749 shares issued at September 30, 2011 and December 31, 2010, respectively; 45,058,606 and 50,361,749 shares outstanding at September 30, 2011 and December 31, 2010, respectively) | 654 | 653 |
| Additional paid-in capital | 125,507 | 124,988 |
| Retained earnings | 987,293 | 908,136 |
| Accumulated other comprehensive income | 2,784 | 3,299 |

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| | | |
|--|---------------------|---------------------|
| Treasury stock, at cost (20,331,143 and 14,922,000 shares at September 30, 2011 and December 31, 2010, respectively) | (649,407) | (508,192) |
| Total stockholders' equity | 466,831 | 528,884 |
| Total liabilities and stockholders' equity | \$ 1,632,448 | \$ 1,845,658 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**VALASSIS COMMUNICATIONS, INC.****Condensed Consolidated Statements of Income**

(U.S. dollars in thousands, except per share data)

(unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-------------------|------------------------------------|---------------------|
| | 2011 | 2010 | 2011 | 2010 |
| Revenues | \$ 528,391 | \$ 572,406 | \$ 1,640,622 | \$ 1,702,358 |
| Costs and expenses: | | | | |
| Cost of sales | 395,728 | 421,510 | 1,222,345 | 1,248,664 |
| Selling, general and administrative | 80,520 | 91,800 | 239,778 | 275,421 |
| Amortization expense | 3,156 | 3,156 | 9,467 | 9,467 |
| Total costs and expenses | 479,404 | 516,466 | 1,471,590 | 1,533,552 |
| Gain from litigation settlement, net (Note 6) | | | | 490,085 |
| Earnings from operations | 48,987 | 55,940 | 169,032 | 658,891 |
| Other expenses and income: | | | | |
| Interest expense | 8,148 | 14,091 | 29,649 | 52,084 |
| Interest income | (54) | (116) | (315) | (510) |
| Loss on extinguishment of debt (Note 3) | | | 16,318 | 23,873 |
| Other income, net | (3,856) | (2,120) | (6,168) | (4,471) |
| Total other expenses, net | 4,238 | 11,855 | 39,484 | 70,976 |
| Earnings before income taxes | 44,749 | 44,085 | 129,548 | 587,915 |
| Income tax expense (Note 1) | 17,255 | 17,106 | 50,391 | 227,303 |
| Net earnings | \$ 27,494 | \$ 26,979 | \$ 79,157 | \$ 360,612 |
| Net earnings per common share, basic (Note 7) | \$ 0.60 | \$ 0.55 | \$ 1.65 | \$ 7.33 |
| Net earnings per common share, diluted (Note 7) | \$ 0.58 | \$ 0.52 | \$ 1.58 | \$ 6.93 |
| Weighted-average common shares outstanding, basic (Note 7) | 45,689 | 49,138 | 47,831 | 49,216 |
| Weighted-average common shares outstanding, diluted (Note 7) | 47,766 | 51,995 | 50,089 | 52,033 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**VALASSIS COMMUNICATIONS, INC.****Condensed Consolidated Statements of Comprehensive Income****(U.S. dollars in thousands)****(unaudited)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|------------------|--|-------------------|
| | 2011 | 2010 | 2011 | 2010 |
| Net earnings | \$ 27,494 | \$ 26,979 | \$ 79,157 | \$ 360,612 |
| Other comprehensive income, net of tax: | | | | |
| Unrealized changes in fair value of cash flow hedges and available-for-sale securities | (2,738) | (789) | (3,108) | (3,159) |
| Realized losses on cash flow hedges reclassified from AOCI into earnings | | | 3,040 | |
| Amortization of realized losses and unrealized changes in fair value of discontinued cash flow hedges | | 2,659 | | 8,197 |
| Foreign currency translation adjustment | (1,254) | 1,221 | (447) | (195) |
| Total other comprehensive income (loss) | (3,992) | 3,091 | (515) | 4,843 |
| Comprehensive income | \$ 23,502 | \$ 30,070 | \$ 78,642 | \$ 365,455 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**VALASSIS COMMUNICATIONS, INC.****Condensed Consolidated Statements of Cash Flows**

(U.S. dollars in thousands)

(unaudited)

| | Nine Months Ended September 30, | |
|---|--|------------------|
| | 2011 | 2010 |
| Cash flows from operating activities: | | |
| Net earnings | \$ 79,157 | \$ 360,612 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization | 45,487 | 45,919 |
| Amortization of debt issuance costs | 1,785 | 1,855 |
| Provision for losses on accounts receivable | 2,515 | 3,577 |
| Loss on extinguishment of debt | 5,748 | 3,429 |
| Loss on derivatives, net | 6,952 | 14,586 |
| Loss on sale of property, plant and equipment | 13 | 62 |
| Earnings on equity investments | (3,228) | (3,963) |
| Stock-based compensation expense | 6,564 | 22,371 |
| Deferred income taxes | 2,356 | 10,749 |
| Changes in assets and liabilities: | | |
| Accounts receivable, net | 50,151 | 6,000 |
| Inventories | 5,852 | (3,289) |
| Prepaid expenses and other | (24,333) | 697 |
| Other assets | 2,834 | 1,484 |
| Accounts payable | (34,490) | (44,606) |
| Progress billings | (393) | 10,921 |
| Accrued expenses | (10,253) | (22,374) |
| Other non-current liabilities | (13,519) | 14,177 |
| Total adjustments | 44,041 | 61,595 |
| Net cash provided by operating activities | 123,198 | 422,207 |
| Cash flows from investing activities: | | |
| Additions to property, plant and equipment | (18,127) | (16,447) |
| Additions to intangible assets | | (7,581) |
| Proceeds from sale of property, plant and equipment | 46 | 59 |
| Proceeds from sale of available-for-sale securities | 1,494 | |
| Net cash used in investing activities | (16,587) | (23,969) |
| Cash flows from financing activities: | | |
| Borrowings of long-term debt | 610,000 | |
| Repayments of long-term debt | (709,919) | (303,079) |
| Debt issuance costs | (11,580) | |
| Repurchases of common stock | (155,817) | (58,225) |
| Proceeds from issuance of common stock | 5,646 | 41,603 |
| Net cash used in financing activities | (261,670) | (319,701) |

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| | | |
|--|-----------|---------|
| Effect of exchange rate changes on cash and cash equivalents | 158 | 137 |
| Net increase (decrease) in cash and cash equivalents | (154,901) | 78,674 |
| Cash and cash equivalents at beginning of period | 245,935 | 129,846 |

| | | |
|---|------------------|-------------------|
| Cash and cash equivalents at end of period | \$ 91,034 | \$ 208,520 |
|---|------------------|-------------------|

Supplemental disclosure of cash flow information:

| | | |
|---|-----------|------------|
| Cash paid during the period for interest | \$ 28,567 | \$ 63,894 |
| Cash paid during the period for income taxes | \$ 72,026 | \$ 188,804 |
| Non-cash financing activities: | | |
| Stock issued under stock-based compensation plans | \$ 3,184 | \$ 1,592 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents

VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP principles for complete financial statements. In the opinion of management, the information contained herein reflects all adjustments necessary for a fair presentation of the information presented. All such adjustments are of a normal recurring nature. The results of operations for the interim periods are not necessarily indicative of results to be expected for the fiscal year. For further information, refer to the consolidated financial statements and footnotes thereto included in the Valassis Communications, Inc. (Valassis, we, and our) Annual Report on Form 10-K for the year ended December 31, 2010 (the 2010 Form 10-K).

Significant Accounting Policies

Accounts Receivable

The allowance for doubtful accounts was \$5.9 million and \$12.1 million as of September 30, 2011 and December 31, 2010, respectively.

Income Taxes

We are required to adjust our effective tax rate each quarter to be consistent with our estimated annual effective tax rate. We are also required to record the tax impact of certain unusual or infrequently occurring items, including the effects of changes in tax laws or rates, in the interim period in which they occur. The effective tax rate during a particular quarter may be higher or lower as a result of the timing of actual earnings versus annual projections.

Inventories

Inventories are accounted for at the lower of cost, determined on a first in, first out (FIFO) basis, or market. Inventories included on the condensed consolidated balance sheets consisted of:

| (in thousands of U.S. dollars) | September 30, 2011 | December 31, 2010 |
|--------------------------------|-----------------------|----------------------|
| Raw materials | \$ 23,771 | \$ 27,035 |
| Work in progress | 12,364 | 14,952 |
| Inventories | \$ 36,135 | \$ 41,987 |

Table of Contents**VALASSIS COMMUNICATIONS, INC.****Notes to Condensed Consolidated Financial Statements****(unaudited)*****Property, Plant and Equipment***

The following table summarizes the costs and ranges of useful lives of the major classes of property, plant and equipment and the total accumulated depreciation related to Property, plant and equipment, net included on the condensed consolidated balance sheets:

| | Useful Lives (in years) | September 30, 2011 (in thousands of U.S. dollars) | December 31, 2010 (in thousands of U.S. dollars) |
|---|----------------------------|---|--|
| Land, at cost | N/A | \$ 7,168 | \$ 7,195 |
| Buildings, at cost | 10 - 30 | 37,516 | 37,657 |
| Machinery and equipment, at cost | 3 - 20 | 229,345 | 225,762 |
| Office furniture and equipment, at cost | 3 - 10 | 234,662 | 221,804 |
| Leasehold improvements, at cost | 5 - 10 | 28,247 | 28,174 |
| | | 536,938 | 520,592 |
| Less accumulated depreciation | | (379,938) | (345,025) |
| Property, plant and equipment, net | | \$ 157,000 | \$ 175,567 |

New Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*, which eliminates the option to present the components of other comprehensive income as a part of the statement of stockholders' equity. Instead, ASU 2011-05 requires all non-owner transactions that affect an entity's equity be presented either in a single continuous statement of comprehensive income or in two separate, but consecutive, statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present the components of other comprehensive income, total other comprehensive income and the total of comprehensive income. We have adopted the provisions of ASU 2011-05 and retrospectively applied herein the two-statement approach described above.

In October 2009, the FASB issued ASU 2009-13, *Multiple-Deliverable Revenue Arrangements*, which addresses the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. The adoption of ASU 2009-13, applied prospectively for revenue arrangements entered into or materially modified beginning on or after January 1, 2011, did not have a material impact on our financial position or results of operations.

2. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill included on the condensed consolidated balance sheets consisted of:

| (in thousands of U.S. dollars) | September 30, 2011 | December 31, 2010 |
|--------------------------------|-----------------------|----------------------|
| Shared Mail | \$ 534,184 | \$ 534,184 |
| Neighborhood Targeted | 5,325 | 5,325 |
| Free-standing Inserts | 22,357 | 22,357 |

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| | | |
|---|--------|--------|
| International, Digital Media & Services | 74,605 | 74,605 |
|---|--------|--------|

| | | |
|-----------------|-------------------|-------------------|
| Goodwill | \$ 636,471 | \$ 636,471 |
|-----------------|-------------------|-------------------|

Table of Contents

VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

The components of other intangible assets, net included on the condensed consolidated balance sheets consisted of:

| | September 30, 2011 | | | | December 31, 2010 | | | |
|---|--------------------|--------------|-------------------|--|-------------------|--------------|-------------------|--|
| | Gross | Accumulated | Net | Weighted | Gross | Accumulated | Net | Weighted |
| (in thousands of U.S. dollars) | Amount | Amortization | Amount | Average Remaining Useful Life (in years) | Amount | Amortization | Amount | Average Remaining Useful Life (in years) |
| Finite-lived intangible assets: | | | | | | | | |
| Mailing lists, non compete agreements and other | \$ 48,037 | \$ (9,387) | \$ 38,650 | 14.3 | \$ 48,037 | \$ (7,871) | \$ 40,166 | 15.0 |
| Customer relationships | 140,000 | (41,941) | 98,059 | 9.2 | 140,000 | (33,990) | 106,010 | 10.0 |
| Total | 188,037 | (51,328) | 136,709 | | 188,037 | (41,861) | 146,176 | |
| Indefinite-lived intangible assets: | | | | | | | | |
| Valassis name, tradenames, trademarks and other | 87,641 | | 87,641 | | 87,641 | | 87,641 | |
| Other intangible assets, net | \$ 275,678 | | \$ 224,350 | | \$ 275,678 | | \$ 233,817 | |

3. LONG-TERM DEBT

Long-term debt included on the condensed consolidated balance sheets consisted of:

| (in thousands of U.S. dollars) | September 30, 2011 | December 31, 2010 |
|--|--------------------|-------------------|
| New Senior Secured Revolving Credit Facility | \$ 50,000 | \$ |
| Prior Senior Secured Revolving Credit Facility | | |
| Senior Secured Term Loan A | 296,250 | |
| Senior Secured Convertible Notes due 2033, net of discount | 60 | 58 |
| 8 1/4% Senior Notes due 2015 | | 242,224 |
| 6 5/8% Senior Notes due 2021 | 260,000 | |
| Senior Secured Term Loan B | | 347,723 |
| Senior Secured Delayed Draw Term Loan | | 116,222 |
| Total debt | 606,310 | 706,227 |
| Current portion long-term debt | 15,000 | 7,058 |
| Long-term debt | \$ 591,310 | \$ 699,169 |

Senior Secured Credit Facility

General

On June 27, 2011, we entered into a new senior secured credit facility with JPMorgan Chase Bank, N.A., as administrative agent, and a syndicate of lenders jointly arranged by J.P. Morgan Securities LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated and RBS Securities Inc. (the new senior secured credit facility). The new senior secured credit facility and related loan documents replaced and terminated our prior credit agreement, dated as of March 2, 2007, as amended (the prior senior secured credit facility), by and among Valassis, Bear Stearns Corporate Lending Inc., as Administrative Agent, and a syndicate of lenders jointly arranged by Bear, Stearns & Co. Inc. and Banc of America Securities LLC. In connection with the termination of the prior senior secured credit facility, all obligations and rights under the related guarantee, security and collateral agency agreement, dated as of March 2, 2007, as amended (the Prior Security Agreement), by Valassis and certain of its domestic subsidiaries signatory thereto, as grantors, in favor of Bear Stearns Corporate Lending Inc., in its capacity as collateral agent for the benefit of the Secured Parties (as defined in the Prior Security Agreement), were also simultaneously terminated.

Table of Contents

VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

The new senior secured credit facility consists of:

a five-year term loan A in an aggregate principal amount equal to \$300.0 million, with principal repayable in quarterly installments at a rate of 5.0% during each of the first two years, 10% during the third year, 15% during the fourth year and 11.25% during the fifth year, with the remaining 53.75% due at maturity (the Term Loan A);

a five-year revolving credit facility in an aggregate principal amount of \$100 million (the revolving line of credit), including \$15.0 million available in Euros, Pounds Sterling or Canadian Dollars, \$50.0 million available for letters of credit and a \$20.0 million swingline loan subfacility, of which \$50.0 million was drawn at closing and remains outstanding as of September 30, 2011 (exclusive of outstanding letters of credit described below); and

an incremental facility pursuant to which, prior to the maturity of the new senior secured credit facility, we may incur additional indebtedness in an amount up to \$150.0 million under the revolving line of credit or the term loan A or a combination thereof, subject to certain conditions, including receipt of additional lending commitments for such additional indebtedness. The terms of the incremental facility will be substantially similar to the terms of the new senior secured credit facility, except with respect to the pricing of the incremental facility, the interest rate for which could be higher than that for the revolving line of credit and the Term Loan A.

We used the initial borrowing under the revolving line of credit, the proceeds from the Term Loan A and existing cash of \$120.0 million to repay the \$462.2 million outstanding under the Term Loan B and Delayed Draw Term Loan portions of our prior senior secured credit facility (reflecting all outstanding borrowings thereunder), to pay accrued interest with respect to such loans and to pay the fees and expenses related to the new senior secured credit facility. We recognized a pre-tax loss on extinguishment of debt of \$3.0 million during the nine months ended September 30, 2011, which represents the write-off of related capitalized debt issuance costs. In addition, as further discussed in Note 8, *Derivative Financial Instruments and Fair Value Measurements*, we recorded in interest expense a pre-tax loss of \$2.6 million related to the discontinuation of hedge accounting on the related interest rate swap. We capitalized related debt issuance costs of approximately \$6.5 million, which will be amortized over the term of the new senior secured credit facility.

All borrowings under our new senior secured credit facility, including, without limitation, amounts drawn under the revolving line of credit, are subject to the satisfaction of customary conditions, including absence of a default and accuracy of representations and warranties. As of September 30, 2011, we had approximately \$41.1 million available under the revolving line of credit portion of our senior secured credit facility (after giving effect to the reductions in availability pursuant to \$8.9 million in standby letters of credit outstanding as of September 30, 2011).

Interest and Fees

Borrowings under our new senior secured credit facility bear interest, at our option, at either the alternate base rate (defined as the higher of the prime rate announced by the Administrative Agent, the federal funds effective rate plus 0.5% or one-month LIBOR plus 1%) (the Base Rate) or at an Adjusted LIBO Rate (as defined in the credit agreement governing the new senior secured credit facility) (the Eurodollar Rate), except for borrowings made in alternate currencies which may not accrue interest based upon the alternate base rate, in each case, plus an applicable interest rate margin. The applicable margins are initially 0.75% per annum for Base Rate loans and 1.75% per annum for Eurodollar Rate loans. The margins applicable to the borrowings under our new senior secured credit facility may be adjusted based on our consolidated leverage ratio, with 1.00% being the maximum Base Rate margin and 2.00% being the maximum Eurodollar Rate. See Note 8, *Derivative Financial Instruments and Fair Value Measurements*, for discussion regarding our various interest rate swap agreements.

Guarantees and Security

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Our new senior secured credit facility is guaranteed by certain of our existing and future domestic restricted subsidiaries pursuant to a Guarantee and Collateral Agreement. In addition, our obligations under our senior secured credit facility and the guarantee obligations of the subsidiary guarantors are secured by first priority liens on substantially all of our and our subsidiary guarantors' present and future assets and by a pledge of all of the equity interests in our domestic subsidiary guarantors and 65% of the capital stock of certain of our existing and future foreign subsidiaries.

Table of Contents

VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

The Guarantee and Collateral Agreement also secures our Senior Secured Convertible Notes due 2033 on an equal and ratable basis with the indebtedness under our new senior secured credit facility to the extent required by the indenture governing such notes.

Prepayments

The new senior secured credit facility also contains a requirement that we make mandatory principal prepayments on the Term Loan A and revolving line of credit in certain circumstances, including, without limitation, with 100% of the aggregate net cash proceeds from certain asset sales, casualty events or condemnation recoveries (in each case, to the extent not otherwise used for reinvestment in our business or related business and subject to certain other exceptions). The new senior secured credit facility further provides that, subject to customary notice and minimum amount conditions, we may make voluntary prepayments without payment of premium or penalty.

Covenants

Subject to customary and otherwise agreed upon exceptions, our new senior secured credit facility contains affirmative and negative covenants, including, but not limited to:

the payment of other obligations;

the maintenance of organizational existences, including, but not limited to, maintaining our property and insurance;

compliance with all material contractual obligations and requirements of law;

limitations on the incurrence of indebtedness;

limitations on creation and existence of liens;

limitations on certain fundamental changes to our corporate structure and nature of our business, including mergers;

limitations on asset sales;

limitations on restricted payments, including certain dividends and stock repurchases and redemptions;

limitations on capital expenditures;

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limitations on any investments, provided that certain permitted acquisitions and strategic investments are allowed;

limitations on optional prepayments and modifications of certain debt instruments;

limitations on modifications to organizational documents;

limitations on transactions with affiliates;

limitations on entering into certain swap agreements;

limitations on negative pledge clauses or clauses restricting subsidiary distributions;

limitations on sale-leaseback and other lease transactions; and

limitations on changes to our fiscal year.

Our new senior secured credit facility also requires us to comply with:

a maximum consolidated leverage ratio, as defined in our senior secured credit facility (generally, the ratio of our consolidated total debt to consolidated earnings before interest, taxes, depreciation and amortization, or EBITDA, for the most recent four quarters), of 3.50:1.00; and

a minimum consolidated interest coverage ratio, as defined in our new senior secured credit facility (generally, the ratio of our consolidated EBITDA to consolidated interest expense for the most recent four quarters), of 3.00:1.00.

The following table shows the required and actual financial ratios under our new senior secured credit facility as of September 30, 2011:

| | Required Ratio | Actual Ratio |
|---|---------------------------|--------------|
| Maximum consolidated leverage ratio | No greater than 3.50:1.00 | 1.95:1.00 |
| Minimum consolidated interest coverage ratio | No less than 3.00:1.00 | 7.94:1.00 |

Table of Contents

VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

In addition, we are required to give notice to the administrative agent and the lenders under our new senior secured credit facility of defaults under the facility documentation and other material events, make any new wholly-owned domestic subsidiary (other than an immaterial subsidiary) a subsidiary guarantor and pledge substantially all after-acquired property as collateral to secure our and our subsidiary guarantors obligations in respect of the facility.

Events of Default

Our new senior secured credit facility contains customary events of default, including upon a change in control. If such an event of default occurs, the lenders under our new senior secured credit facility would be entitled to take various actions, including in certain circumstances increasing the effective interest rate and accelerating the amounts due under our new senior secured credit facility.

8 1/4% Senior Notes due 2015

On January 13, 2011, we commenced a cash tender offer and consent solicitation to purchase any and all of our outstanding 8 1/4% Senior Notes due 2015 (the 2015 Notes) and to amend the indenture governing the 2015 Notes, which we refer to as the 2015 Indenture, to eliminate substantially all of the restrictive covenants and certain events of default. We used the net proceeds from the 2021 Notes (described below) to fund the purchase of the 2015 Notes, the related consent payments pursuant to the tender offer and consent solicitation, and the subsequent redemption of the 2015 Notes that were not tendered and remained outstanding after the expiration of the tender offer and consent solicitation. We recognized a pre-tax loss on extinguishment of debt of \$13.3 million during the nine months ended September 30, 2011, which represents the difference between the aggregate purchase price and the aggregate principal amount of the 2015 Notes purchased and the write-off of related capitalized debt issuance costs.

During the nine months ended September 30, 2010, we purchased \$297.8 million aggregate principal amount of the 2015 Notes pursuant to a cash tender offer and open market repurchases. We recognized a pre-tax loss on extinguishment of debt of \$23.9 million during the nine months ended September 30, 2010, which represents the difference between the aggregate purchase price and the aggregate principal amount of the 2015 Notes purchased and the proportionate write-off of related capitalized debt issuance costs.

6 5/8% Senior Notes due 2021

On January 28, 2011, we issued in a private placement \$260.0 million aggregate principal amount of our 6 5/8% Senior Notes due 2021 (the 2021 Notes). The net proceeds were used to fund the purchase of the outstanding 2015 Notes and the related consent payments in a concurrent tender offer and consent solicitation as described above and the redemption of the remaining outstanding 2015 Notes. We capitalized related debt issuance costs of approximately \$5.1 million, which will be amortized over the term of the 2021 Notes.

Interest on the 2021 Notes is payable every six months on February 1 and August 1. The 2021 Notes are fully and unconditionally guaranteed, jointly and severally, by substantially all of our existing and future domestic restricted subsidiaries on a senior unsecured basis.

In July 2011, in accordance with the terms of the registration rights agreement between us and the initial purchasers of the 2021 Notes, we completed an exchange offer to exchange the original notes issued in the private placement for a like principal amount of exchange notes registered under the Securities Act of 1933, as amended. An aggregate principal amount of \$260.0 million, or 100%, of the original notes were exchanged for exchange notes in the exchange offer. The exchange notes are substantially identical to the original notes, except that the exchange notes are not subject to certain transfer restrictions.

The 2021 Notes were issued under an indenture with Wells Fargo Bank, National Association, as trustee (the 2021 Indenture). Subject to a number of exceptions, the 2021 Indenture restricts our ability and the ability of our restricted subsidiaries (as defined in the 2021 Indenture) to incur or guarantee additional indebtedness, transfer or sell assets, make certain investments, pay dividends or make distributions or other restricted payments, create certain liens, merge or consolidate, repurchase stock, create or permit restrictions on the ability of our restricted

subsidiaries to pay dividends or make other distributions to us and enter into transactions with affiliates.

Table of Contents**VALASSIS COMMUNICATIONS, INC.****Notes to Condensed Consolidated Financial Statements****(unaudited)**

We may redeem all or a portion of the 2021 Notes at our option at any time prior to February 1, 2016, at a redemption price equal to 100% of the principal amount of 2021 Notes to be redeemed, plus a make-whole premium as described in the 2021 Indenture, plus accrued and unpaid interest to the redemption date, if any. At any time on or after February 1, 2016, we may redeem all or a portion of the 2021 Notes at our option at the following redemption prices (expressed as percentages of the principal amount thereof) if redeemed during the twelve-month period commencing on February 1 of the years set forth below:

| Year | Percentage |
|---------------------|-------------------|
| 2016 | 103.313% |
| 2017 | 102.208% |
| 2018 | 101.104% |
| 2019 and thereafter | 100.000% |

In addition, we must pay accrued and unpaid interest to the redemption date, if any. On or prior to February 1, 2014, we may also redeem at our option up to 35% of the principal amount of the outstanding 2021 Notes with the proceeds of certain equity offerings at the redemption price specified in the 2021 Indenture, plus accrued and unpaid interest to the date of redemption, if any. Upon the occurrence of a change of control, as defined in the 2021 Indenture, we must make a written offer to purchase all of the 2021 Notes for cash at a purchase price equal to 101% of the principal amount of the 2021 Notes, plus accrued and unpaid interest to the date of repurchase, if any.

Covenant Compliance

As of September 30, 2011, we were in compliance with all of our indenture and new senior secured credit facility covenants.

4. ACCRUED EXPENSES

Accrued expenses included on the condensed consolidated balance sheets consisted of:

| (in thousands of U.S. dollars) | September 30, 2011 | December 31, 2010 |
|---------------------------------------|-------------------------------|------------------------------|
| Accrued interest | \$ 4,414 | \$ 6,710 |
| Accrued compensation and benefits | 41,316 | 57,781 |
| Other accrued expenses | 47,861 | 35,121 |
| Accrued expenses | \$ 93,591 | \$ 99,612 |

5. COMMITMENTS AND CONTINGENCIES

The application and interpretation of applicable state sales tax laws to certain of our products is uncertain. Accordingly, we may be exposed to additional sales tax liability to the extent various state jurisdictions determine that certain of our products are subject to such jurisdictions' sales tax. As of September 30, 2011, we have recorded a liability of \$9.9 million, reflecting our best estimate of our potential sales tax liability.

In addition to the above matter, we are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material effect on our financial position, results of operations or liquidity.

6. GAIN FROM LITIGATION SETTLEMENT

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On January 30, 2010, we announced that we had reached an agreement to settle our outstanding lawsuits against News America Incorporated, a/k/a News America Marketing Group, News America Marketing, FSI, Inc. a/k/a News America Marketing FSI, LLC and News America Marketing In-Store Services, Inc. a/k/a News America Marketing In-Store Services, LLC (collectively News). The operative complaint alleged violations of the Sherman Act and various state competitive statutes and the commission of torts by News in connection with the marketing and sale of FSI space and in-store promotion and advertising services.

Table of Contents**VALASSIS COMMUNICATIONS, INC.****Notes to Condensed Consolidated Financial Statements****(unaudited)**

On February 4, 2010, we executed a settlement agreement and release (the **Settlement Agreement**) with News, and pursuant to the terms of the Settlement Agreement, News paid us \$500.0 million. News America, Inc. also entered into a 10-year shared mail distribution agreement with our subsidiary, Valassis Direct Mail, Inc., which provides for our sale of certain shared mail services to News on specified terms.

In connection with the settlement, the parties worked with the United States District Court for the Eastern District of Michigan (the **Court**), under the Honorable Arthur J. Tarnow, on a set of procedures to handle future disputes among the parties with respect to conduct at issue in the litigation. The Court issued the order on this matter on June 15, 2011.

The settlement resolves all outstanding claims between us and News as of February 4, 2010. As a result, the parties agreed to dismiss all outstanding litigation between them and release all existing and potential claims against each other that were or could have been asserted in the litigation as of the date of the Settlement Agreement.

During the nine months ended September 30, 2010, in connection with the successful settlement of these lawsuits, we made \$9.9 million in related payments, including special bonuses to certain of our employees (including our named executive officers in our proxy statement) in an aggregate amount of \$8.1 million. These expenses were netted against the \$500.0 million of proceeds received, and the net proceeds of \$490.1 million were recorded as a separate line item **Gain from litigation settlement, net** in our condensed consolidated statement of income for the nine months ended September 30, 2010.

7. EARNINGS PER SHARE

Earnings per common share data were as follows:

| (in thousands, except per share data) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|----------------|------------------------------------|----------------|
| | 2011 | 2010 | 2011 | 2010 |
| Net earnings | \$ 27,494 | \$ 26,979 | \$ 79,157 | \$ 360,612 |
| Weighted-average common shares outstanding, basic | 45,689 | 49,138 | 47,831 | 49,216 |
| Shares issued on exercise of dilutive options | 4,981 | 8,368 | 5,756 | 8,303 |
| Shares purchased with assumed proceeds of options and unearned restricted shares | (2,908) | (5,520) | (3,502) | (5,495) |
| Shares contingently issuable | 4 | 9 | 4 | 9 |
| Weighted-average common shares outstanding, diluted | 47,766 | 51,995 | 50,089 | 52,033 |
| Net earnings per common share, diluted | \$ 0.58 | \$ 0.52 | \$ 1.58 | \$ 6.93 |
| Anti-dilutive options excluded from calculation of weighted-average common shares outstanding, diluted | 3,681 | 1,409 | 3,170 | 2,069 |

Table of Contents**VALASSIS COMMUNICATIONS, INC.****Notes to Condensed Consolidated Financial Statements****(unaudited)****8. DERIVATIVE FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS**

We are exposed to market risks arising from adverse changes in foreign exchange rates and interest rates. We manage these risks through a variety of strategies which include the use of derivatives. Certain derivatives are designated as cash flow hedges and qualify for hedge accounting treatment, while others do not qualify or have not been designated as hedges and are marked to market through earnings. The notional amounts of derivative financial instruments and related fair values measured on a recurring basis and included in the condensed consolidated balance sheets were as follows:

| (in millions of U.S. Dollars) | Notional Amounts | | Fair Values | | Balance Sheet Location |
|---|-----------------------|----------------------|-----------------------|----------------------|---|
| | September 30, 2011 | December 31, 2010 | September 30, 2011 | December 31, 2010 | |
| <i>Derivatives designated as cash flow hedging instruments:</i> | | | | | |
| Interest rate swap contract | \$ 186.3 | \$ 300.0 | \$ (4.5) | \$ (4.6) | Other non-current liabilities |
| <i>Derivatives not receiving hedge accounting treatment:</i> | | | | | |
| Interest rate swap contract | 180.0 | | (1.6) | | Accrued expenses |
| Foreign exchange contracts | 12.6 | 11.4 | (1.3) | 0.7 | Accrued expenses/Prepaid expenses and other |
| Total derivative financial instruments | \$ 378.9 | \$ 311.4 | \$ (7.4) | \$ (3.9) | |

The fair values of our interest rate swap contracts and foreign exchange contracts are determined based on third-party valuation models and observable foreign exchange forward contract rates, respectively, both of which represent Level 2 fair value inputs.

The following tables summarize the impact of derivative financial instruments on the condensed consolidated financial statements for the indicated periods:

| (in millions of U.S. Dollars) | Three Months Ended September 30, | | | | 2010 |
|---|----------------------------------|----------|------------------------|----------|---------------------------------------|
| | 2011 | 2010 | 2011 | 2010 | |
| | Amount of Pre-tax Gain (Loss) | | Amount of Pre-tax Loss | | Amount of Pre-tax Loss |
| | Recognized in Earnings* | | Recognized in OCI | | Reclassified from AOCI into Earnings* |
| <i>Derivatives designated as cash flow hedging instruments:</i> | | | | | |
| Interest rate swap contract | \$ | \$ | \$ (4.5) | \$ (1.5) | \$ |
| <i>Derivatives not receiving hedge accounting treatment:</i> | | | | | |
| Interest rate swap contracts | \$ 0.1 | \$ (0.4) | \$ | \$ | \$ (4.3) |
| Foreign exchange contracts | (2.0) | 0.2 | | | |
| | \$ (1.9) | \$ (0.2) | \$ (4.5) | \$ (1.5) | \$ (4.3) |

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* Amount recognized in earnings related to interest rate swap contracts included in Interest expense and amounts recognized in earnings related to foreign exchange contracts included in Cost of sales.

| | Nine Months Ended September 30, | | | | | |
|---|--|----------|---|----------|--|-----------|
| | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 |
| (in millions of U.S. Dollars) | Amount of Pre-tax Gain (Loss) Recognized in Earnings* | | Amount of Pre-tax Loss Recognized in OCI | | Amount of Pre-tax Loss Reclassified from AOCI into Earnings* | |
| <i>Derivatives designated as cash flow hedging instruments:</i> | | | | | | |
| Interest rate swap contract | \$ | \$ | \$ (4.9) | \$ (5.3) | \$ (5.0) | \$ |
| <i>Derivatives not receiving hedge accounting treatment:</i> | | | | | | |
| Interest rate swap contracts | \$ | \$ (1.4) | \$ | \$ | \$ | \$ (13.2) |
| Foreign exchange contracts | (2.0) | | | | | |
| | \$ (2.0) | \$ (1.4) | \$ (4.9) | \$ (5.3) | \$ (5.0) | \$ (13.2) |

* Amount recognized in earnings related to interest rate swap contracts included in Interest expense and amounts recognized in earnings related to foreign exchange contracts included in Cost of sales.

Table of Contents

VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

Interest Rate Swaps

During the second quarter of 2007, we entered into two interest rate swap agreements with an aggregate notional principal amount of \$480.0 million. These interest rate swaps effectively fixed three-month LIBOR at 5.045%, for a then-effective interest rate of 6.795%, including the applicable margin, for \$480.0 million of our variable rate debt under our senior secured credit facility. In February 2009, we reduced the notional principal amount of the interest rate swaps by \$32.8 million and paid termination fees of approximately \$2.6 million. The termination fees, or deferred losses, related to the terminated portion of the swaps were amortized to interest expense over the original life of the interest rate swaps, through December 31, 2010. As a result of the reduced notional amount of the swaps, three-month LIBOR was effectively fixed at 5.026%, for a then-effective interest rate of 6.776%, including the applicable margin. We initially designated the swaps as hedging instruments and recorded changes in the fair value of these interest rate swaps as a component of accumulated other comprehensive income. We discontinued cash flow hedge accounting treatment for the interest rate swap agreements effective April 1, 2009. The deferred losses on the interest rate swaps previously charged to accumulated other comprehensive income were amortized to interest expense and subsequent changes in the fair value of the swaps were recognized in earnings as a component of interest expense until the swaps expired on December 31, 2010.

On December 17, 2009, we entered into an interest rate swap agreement with an initial notional amount of \$300.0 million to fix three-month LIBOR at 2.005%, for an effective rate of 4.255%, including the applicable margin, for \$300.0 million of our variable rate debt under our prior senior secured credit facility. The effective date of this agreement was December 31, 2010. The notional amount of \$300.0 million amortizes by \$40.0 million at the end of every quarter until it reaches \$100.0 million for the quarter ended June 30, 2012, the expiration date. The swap was designated as, and qualified as, a cash flow hedge through the termination of the prior senior secured credit facility on June 27, 2011. During the nine months ended September 30, 2011, as a result of the termination of the prior senior secured credit facility, pre-tax losses of \$2.6 million were reclassified from accumulated other comprehensive income to earnings as a component of interest expense. This interest rate swap remains in effect and subsequent changes in the fair value of this swap will be recognized in earnings as a component of interest expense until the swap expires.

On July 6, 2011, we entered into an interest rate swap agreement with an initial notional amount of \$186.3 million. The effective date of this agreement is June 30, 2012, the expiration date of our existing interest rate swap. Under the swap agreement, we are required to make quarterly payments at a fixed interest rate of 1.8695% per annum to the counterparty on an amortizing notional amount in exchange for receiving variable payments based on the three-month LIBOR interest rate for the same notional amount. After giving effect to the swap agreement, our effective interest rate for the notional amount, based on the current applicable margin under the new senior secured credit facility of 1.75% per annum, will be 3.6195% per annum. The initial notional amount of \$186.3 million amortizes quarterly by (i) \$2,812,500 from the effective date through the quarter ended September 30, 2013, (ii) \$5,625,000 from September 30, 2013 through the quarter ended September 30, 2014, and (iii) \$8,437,500 from September 30, 2014 until June 30, 2015, the expiration date of the agreement. The swap is designated as and qualifies as a cash flow hedge.

Foreign Currency

Currencies to which we have exposure are the Mexican peso, Canadian dollar, British pound, Polish zloty and Euro. Currency restrictions are not expected to have a significant effect on our cash flows, liquidity, or capital resources. We purchase the Mexican peso and Polish zloty under two to twelve-month forward foreign exchange contracts to stabilize the cost of production. As of September 30, 2011, we had a commitment to purchase \$11.7 million in Mexican pesos and \$0.9 million in Polish zlotys over the next 12 months.

Long-Term Debt

The estimated fair market value of our long-term debt was \$26.2 million below carrying value and \$10.6 million above carrying value as of September 30, 2011 and December 31, 2010, respectively. Our 2021 Notes are traded in an active market with the fair value determined based on quoted active market prices. Borrowings under our new senior secured credit facility are not traded in an active market and are valued based on an implied price derived from industry averages and relative loan performance.

Table of Contents**VALASSIS COMMUNICATIONS, INC.****Notes to Condensed Consolidated Financial Statements****(unaudited)****Cash and Cash Equivalents**

The carrying amounts of cash and cash equivalents and accruals approximate fair value due to the near-term maturity of these instruments.

9. REPURCHASES OF COMMON STOCK

The following table summarizes our repurchases of common stock during the three and nine months ended September 30, 2011 and 2010:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------------------|---|--------------|--|---------------|
| | 2011 | 2010 | 2011 | 2010 |
| Shares repurchased | 2,094,028 | 114,072 | 5,860,880 | 1,733,672 |
| Aggregate repurchase price | \$ 49,960,683 | \$ 3,601,798 | \$ 155,817,128 | \$ 58,224,769 |
| Average price paid per share | \$ 23.86 | \$ 31.57 | \$ 26.59 | \$ 33.58 |

As of September 30, 2011, we had authorization to repurchase an additional 4,496,273 shares of our common stock under the share repurchase program approved by our Board of Directors.

10. SEGMENT REPORTING

Our segments meeting the quantitative thresholds to be considered reportable are Shared Mail, Neighborhood Targeted and Free-standing Inserts (FSI). All other lines of business fall below a materiality threshold and are, therefore, combined together in an other segment named International, Digital Media & Services. These business lines include NCH Marketing Services, Inc., direct mail, software analytics, security services, digital and in-store. Our reportable segments are strategic business units that offer different products and services and are subject to regular review by our chief operating decision-maker. They are managed separately because each business requires different executional strategies and caters to different client marketing needs.

The accounting policies of the segments are the same as those described in the 2010 Form 10-K and Note 1, *Basis of Presentation and Significant Accounting Policies*. We evaluate reportable segment performance based on segment profit, which we define as earnings from operations excluding unusual or infrequently occurring items. Assets are not allocated in all cases to reportable segments and are not used to assess the performance of a segment.

Table of Contents

VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

The following table sets forth, by segment, revenues, depreciation/amortization and segment profit for the indicated periods:

| (in millions of U.S. dollars) | Three Months Ended September 30, | | | | Total |
|----------------------------------|----------------------------------|-----------------------|----------|---|----------|
| | Shared Mail | Neighborhood Targeted | FSI | International, Digital Media & Services | |
| 2011 | | | | | |
| Revenues from external customers | \$ 330.5 | \$ 76.9 | \$ 73.5 | \$ 47.5 | \$ 528.4 |
| Intersegment revenues | \$ 4.4 | \$ 13.8 | \$ 9.6 | \$ 0.1 | \$ 27.9 |
| Depreciation/amortization | \$ 8.9 | \$ 1.2 | \$ 3.6 | \$ 0.7 | \$ 14.4 |
| Segment profit (loss) | \$ 46.2 | \$ 0.4 | \$ (0.8) | \$ 3.2 | \$ 49.0 |

| | | | | | |
|----------------------------------|----------|----------|---------|---------|----------|
| 2010 | | | | | |
| Revenues from external customers | \$ 326.1 | \$ 114.0 | \$ 89.2 | \$ 43.1 | \$ 572.4 |
| Intersegment revenues | \$ 4.4 | \$ 6.8 | \$ 10.9 | \$ 0.3 | \$ 22.4 |
| Depreciation/amortization | \$ 10.1 | \$ 1.1 | \$ 3.3 | \$ 0.7 | \$ 15.2 |
| Segment profit | \$ 39.3 | \$ 7.2 | \$ 4.9 | \$ 4.5 | \$ 55.9 |

| (in millions of U.S. dollars) | Nine Months Ended September 30, | | | | Total |
|----------------------------------|---------------------------------|-----------------------|----------|---|------------|
| | Shared Mail | Neighborhood Targeted | FSI | International, Digital Media & Services | |
| 2011 | | | | | |
| Revenues from external customers | \$ 990.3 | \$ 255.8 | \$ 251.9 | \$ 142.6 | \$ 1,640.6 |
| Intersegment revenues | \$ 13.0 | \$ 36.0 | \$ 29.2 | \$ 0.3 | \$ 78.5 |
| Depreciation/amortization | \$ 28.4 | \$ 3.2 | \$ 9.6 | \$ 4.3 | \$ 45.5 |
| Segment profit | \$ 136.0 | \$ 3.1 | \$ 14.9 | \$ 15.0 | \$ 169.0 |

| | | | | | |
|----------------------------------|----------|----------|----------|----------|------------|
| 2010 | | | | | |
| Revenues from external customers | \$ 965.3 | \$ 330.1 | \$ 281.3 | \$ 125.7 | \$ 1,702.4 |
| Intersegment revenues | \$ 11.8 | \$ 19.2 | \$ 29.8 | \$ 0.5 | \$ 61.3 |
| Depreciation/amortization | \$ 31.0 | \$ 3.1 | \$ 9.5 | \$ 2.3 | \$ 45.9 |
| Segment profit | \$ 111.5 | \$ 19.6 | \$ 24.6 | \$ 13.1 | \$ 168.8 |

The following table provides reconciliations of total segment profit to earnings from operations for the indicated periods:

| (in millions of U.S. dollars) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---------------------------------|----------------------------------|----------------|---------------------------------|-----------------|
| | 2011 | 2010 | 2011 | 2010 |
| Total segment profit | \$ 49.0 | \$ 55.9 | \$ 169.0 | \$ 168.8 |
| Unallocated amounts: | | | | |
| Gain from litigation settlement | | | | 490.1 |
| Earnings from operations | \$ 49.0 | \$ 55.9 | \$ 169.0 | \$ 658.9 |

Table of Contents**VALASSIS COMMUNICATIONS, INC.****Notes to Condensed Consolidated Financial Statements****(unaudited)**

Domestic and foreign revenues were as follows:

| (in millions of U.S. dollars) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------------|-------------------------------------|-----------------|------------------------------------|-------------------|
| | 2011 | 2010 | 2011 | 2010 |
| United States | \$ 516.4 | \$ 562.3 | \$ 1,601.6 | \$ 1,665.2 |
| Foreign | 12.0 | 10.1 | 39.0 | 37.2 |
| Revenues | \$ 528.4 | \$ 572.4 | \$ 1,640.6 | \$ 1,702.4 |

Domestic and foreign long-lived assets (property, plant and equipment, net) were as follows:

| (in millions of U.S. dollars) | September 30, 2011 | December 31, 2010 |
|---|-----------------------|----------------------|
| United States | \$ 148.7 | \$ 166.8 |
| Foreign | 8.3 | 8.8 |
| Property, plant and equipment, net | \$ 157.0 | \$ 175.6 |

11. GUARANTOR AND NON-GUARANTOR CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

The following information is presented in accordance with Rule 3-10 of Regulation S-X. The operating and investing activities of the separate legal entities included in the consolidated financial statements are fully interdependent and integrated. Revenues and operating expenses of the separate legal entities include intercompany charges for management and other services. The 2021 Notes issued by Valassis (referred to for purposes of this note only as the Parent Company) are guaranteed by substantially all of the Parent Company's domestic wholly-owned subsidiaries (collectively, the Guarantor Subsidiaries) on a senior unsecured basis. Each of the Guarantor Subsidiaries is 100% owned, directly or indirectly, by the Parent Company and has guaranteed the 2021 Notes on a joint and several, full and unconditional basis. Non-wholly-owned subsidiaries, joint ventures, partnerships and foreign subsidiaries (collectively, the Non-Guarantor Subsidiaries) are not guarantors of these obligations. Substantially all of the Guarantor Subsidiaries also guarantee the Parent Company's senior secured credit facility.

The following tables present the condensed consolidating balance sheets as of September 30, 2011 and December 31, 2010, the condensed consolidating statements of income for the three and nine months ended September 30, 2011 and 2010, and the condensed consolidating statements of cash flows for the nine months ended September 30, 2011 and 2010. As a result of combining our general ledgers of record into an existing, single general ledger module within our enterprise resource planning system on July 1, 2010, the condensed consolidating statement of income for the nine months ended September 30, 2011 below reflects certain revenues and costs and expenses between the Parent Company and the Guarantor Subsidiaries differently than the condensed consolidating statement of income for the nine months ended September 30, 2010. Although it is not practicable to reclassify the amounts presented for the nine months ended September 30, 2010 to reflect these changes in presentation, if such reclassifications could be made they would have no effect on any of the Consolidated Total amounts included below and would have no effect on the net income of the Parent Company or the Non-Guarantor Subsidiaries.

Table of Contents**VALASSIS COMMUNICATIONS, INC.****Notes to Condensed Consolidated Financial Statements****(unaudited)****Condensed Consolidating Balance Sheet****September 30, 2011****(in thousands of U.S. dollars)**

| | Parent Company | Guarantor Subsidiaries | Non- Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Total |
|---|---------------------------|-----------------------------------|--|--------------------------------------|-------------------------------|
| Assets | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | \$ 65,249 | \$ 1,759 | \$ 24,026 | \$ | \$ 91,034 |
| Accounts receivable, net | 107,605 | 274,747 | 24,934 | | 407,286 |
| Inventories | 25,331 | 10,801 | 3 | | 36,135 |
| Prepaid expenses and other (including intercompany) | 1,067,181 | 1,244,125 | 1,710 | (2,249,608) | 63,408 |
| Total current assets | 1,265,366 | 1,531,432 | 50,673 | (2,249,608) | 597,863 |
| Property, plant and equipment, net | 26,373 | 129,000 | 1,627 | | 157,000 |
| Goodwill | 23,584 | 605,898 | 6,989 | | 636,471 |
| Other intangible assets, net | 19,145 | 205,205 | | | 224,350 |
| Investments | 434,949 | 20,587 | | (452,466) | 3,070 |
| Intercompany note receivable (payable) | (92,419) | 104,867 | (12,448) | | |
| Other assets | 10,225 | (187) | 3,656 | | 13,694 |
| Total assets | \$ 1,687,223 | \$ 2,596,802 | \$ 50,497 | \$ (2,702,074) | \$ 1,632,448 |

| | Parent Company | Guarantor Subsidiaries | Non- Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Total |
|---|---------------------------|-----------------------------------|--|--------------------------------------|-------------------------------|
| Liabilities and Stockholders' Equity | | | | | |
| Current liabilities: | | | | | |
| Current portion, long-term debt | \$ 15,000 | \$ | \$ | \$ | \$ 15,000 |
| Accounts payable and intercompany payable | 523,939 | 2,008,714 | 12,067 | (2,249,608) | 295,112 |
| Progress billings | 25,354 | 13,310 | 13,944 | | 52,608 |
| Accrued expenses | 50,793 | 35,875 | 6,923 | | 93,591 |
| Total current liabilities | 615,086 | 2,057,899 | 32,934 | (2,249,608) | 456,311 |
| Long-term debt | 591,310 | | | | 591,310 |
| Deferred income taxes | (5,403) | 87,657 | (3,996) | | 78,258 |
| Other non-current liabilities | 19,399 | 18,320 | 2,019 | | 39,738 |
| Total liabilities | 1,220,392 | 2,163,876 | 30,957 | (2,249,608) | 1,165,617 |
| Stockholders' equity | 466,831 | 432,926 | 19,540 | (452,466) | 466,831 |

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| | | | | | |
|--|--------------|--------------|-----------|----------------|--------------|
| Total liabilities and stockholders' equity | \$ 1,687,223 | \$ 2,596,802 | \$ 50,497 | \$ (2,702,074) | \$ 1,632,448 |
|--|--------------|--------------|-----------|----------------|--------------|

Table of Contents**VALASSIS COMMUNICATIONS, INC.****Notes to Condensed Consolidated Financial Statements****(unaudited)****Condensed Consolidating Balance Sheet****December 31, 2010****(in thousands of U.S. dollars)**

| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Total |
|---|---------------------------|-----------------------------------|---------------------------------------|--------------------------------------|-------------------------------|
| Assets | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | \$ 211,933 | \$ 8,026 | \$ 25,976 | \$ | \$ 245,935 |
| Accounts receivable, net | 175,115 | 259,001 | 25,836 | | 459,952 |
| Inventories | 33,305 | 8,679 | 3 | | 41,987 |
| Prepaid expenses and other (including intercompany) | 278,489 | 630,972 | 2,083 | (872,887) | 38,657 |
| Total current assets | 698,842 | 906,678 | 53,898 | (872,887) | 786,531 |
| Property, plant and equipment, net | 31,475 | 142,006 | 2,086 | | 175,567 |
| Goodwill | 23,584 | 605,898 | 6,989 | | 636,471 |
| Other intangible assets, net | 19,161 | 214,656 | | | 233,817 |
| Investments | 400,404 | 12,486 | | (409,744) | 3,146 |
| Intercompany note receivable (payable) | 479,365 | (460,369) | (18,996) | | |
| Other assets | 6,982 | 3,130 | 14 | | 10,126 |
| Total assets | \$ 1,659,813 | \$ 1,424,485 | \$ 43,991 | \$ (1,282,631) | \$ 1,845,658 |
| Liabilities and Stockholders' Equity | | | | | |
| Current liabilities: | | | | | |
| Current portion, long-term debt | \$ 7,058 | \$ | \$ | \$ | \$ 7,058 |
| Accounts payable and intercompany payable | 323,277 | 866,614 | 12,598 | (872,887) | 329,602 |
| Progress billings | 26,353 | 11,751 | 14,897 | | 53,001 |
| Accrued expenses | 51,035 | 41,300 | 7,277 | | 99,612 |
| Total current liabilities | 407,723 | 919,665 | 34,772 | (872,887) | 489,273 |
| Long-term debt | 699,169 | | | | 699,169 |
| Deferred income taxes | (4,044) | 86,804 | (3,996) | | 78,764 |
| Other non-current liabilities | 28,081 | 19,575 | 1,912 | | 49,568 |
| Total liabilities | 1,130,929 | 1,026,044 | 32,688 | (872,887) | 1,316,774 |
| Stockholders' equity | 528,884 | 398,441 | 11,303 | (409,744) | 528,884 |
| Total liabilities and stockholders' equity | \$ 1,659,813 | \$ 1,424,485 | \$ 43,991 | \$ (1,282,631) | \$ 1,845,658 |

Table of Contents

VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

Condensed Consolidating Statement of Income

Three Months Ended September 30, 2011

(in thousands of U.S. dollars)

| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Total |
|--|-------------------|---------------------------|-------------------------------|------------------------------|-----------------------|
| Revenues | \$ 173,543 | \$ 443,671 | \$ 17,008 | \$ (105,831) | \$ 528,391 |
| Cost and expenses: | | | | | |
| Cost of sales | 148,817 | 287,173 | 12,368 | (52,630) | 395,728 |
| Selling, general and administrative | 30,065 | 100,223 | 3,433 | (53,201) | 80,520 |
| Amortization expense | 5 | 3,151 | | | 3,156 |
| Total costs and expenses | 178,887 | 390,547 | 15,801 | (105,831) | 479,404 |
| Earnings (loss) from operations | (5,344) | 53,124 | 1,207 | | 48,987 |
| Other expenses and income: | | | | | |
| Interest expense | 8,148 | | | | 8,148 |
| Interest income | (28) | | (26) | | (54) |
| Intercompany interest | (1,179) | 1,179 | | | |
| Other income, net | (2,877) | (972) | (7) | | (3,856) |
| Total other expenses (income), net | 4,064 | 207 | (33) | | 4,238 |
| Earnings (loss) before income taxes | (9,408) | 52,917 | 1,240 | | 44,749 |
| Income tax (benefit) expense | (10) | 16,891 | 374 | | 17,255 |
| Equity in net earnings of subsidiaries | 36,892 | 866 | | (37,758) | |
| Net earnings | \$ 27,494 | \$ 36,892 | \$ 866 | \$ (37,758) | \$ 27,494 |

Condensed Consolidating Statement of Income

Three Months Ended September 30, 2010

(in thousands of U.S. dollars)

| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Total |
|-----------------|-------------------|---------------------------|-------------------------------|------------------------------|-----------------------|
| Revenues | \$ 273,629 | \$ 421,906 | \$ 15,003 | \$ (138,132) | \$ 572,406 |

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| | | | | | |
|---|------------------|------------------|-----------------|--------------------|------------------|
| Cost and expenses: | | | | | |
| Cost of sales | 225,822 | 275,137 | 11,231 | (90,680) | 421,510 |
| Selling, general and administrative | 38,596 | 96,825 | 3,830 | (47,451) | 91,800 |
| Amortization expense | 6 | 3,151 | | (1) | 3,156 |
| Total costs and expenses | 264,424 | 375,113 | 15,061 | (138,132) | 516,466 |
| Earnings (loss) from operations | 9,205 | 46,793 | (58) | | 55,940 |
| Other expenses and income: | | | | | |
| Interest expense | 14,091 | | | | 14,091 |
| Interest income | (98) | | (18) | | (116) |
| Intercompany interest | (16,355) | 16,356 | (1) | | |
| Other income, net | (1,240) | (799) | (81) | | (2,120) |
| Total other expenses (income), net | (3,602) | 15,557 | (100) | | 11,855 |
| Earnings before income taxes | 12,807 | 31,236 | 42 | | 44,085 |
| Income tax expense | 6,133 | 10,788 | 185 | | 17,106 |
| Equity in net earnings (loss) of subsidiaries | 20,305 | (143) | | (20,162) | |
| Net earnings (loss) | \$ 26,979 | \$ 20,305 | \$ (143) | \$ (20,162) | \$ 26,979 |

Table of Contents

VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

Condensed Consolidating Statement of Income

Nine Months Ended September 30, 2011

(in thousands of U.S. dollars)

| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Total |
|--|-------------------|---------------------------|-------------------------------|------------------------------|-----------------------|
| Revenues | \$ 572,298 | \$ 1,317,568 | \$ 54,658 | \$ (303,902) | \$ 1,640,622 |
| Cost and expenses: | | | | | |
| Cost of sales | 483,751 | 851,885 | 38,660 | (151,951) | 1,222,345 |
| Selling, general and administrative | 76,040 | 305,162 | 10,527 | (151,951) | 239,778 |
| Amortization expense | 16 | 9,451 | | | 9,467 |
| Total costs and expenses | 559,807 | 1,166,498 | 49,187 | (303,902) | 1,471,590 |
| Earnings from operations | 12,491 | 151,070 | 5,471 | | 169,032 |
| Other expenses and income: | | | | | |
| Interest expense | 29,649 | | | | 29,649 |
| Interest income | (242) | | (73) | | (315) |
| Intercompany interest | (15,533) | 15,371 | 162 | | |
| Loss on extinguishment of debt | 16,318 | | | | 16,318 |
| Other income, net | (3,095) | (3,242) | 169 | | (6,168) |
| Total other expenses, net | 27,097 | 12,129 | 258 | | 39,484 |
| Earnings (loss) before income taxes | (14,606) | 138,941 | 5,213 | | 129,548 |
| Income tax expense | 556 | 48,199 | 1,636 | | 50,391 |
| Equity in net earnings of subsidiaries | 94,319 | 3,577 | | (97,896) | |
| Net earnings | \$ 79,157 | \$ 94,319 | \$ 3,577 | \$ (97,896) | \$ 79,157 |

Condensed Consolidating Statement of Income

Nine Months Ended September 30, 2010

(in thousands of U.S. dollars)

| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated Total |
|-----------------|-------------------|---------------------------|-------------------------------|------------------------------|-----------------------|
| Revenues | \$ 678,002 | \$ 1,158,915 | \$ 51,959 | \$ (186,518) | \$ 1,702,358 |

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Cost and expenses:

| | | | | | |
|-------------------------------------|---------|---------|--------|-----------|-----------|
| Cost of sales | 538,485 | 813,050 | 36,195 | (139,066) | 1,248,664 |
| Selling, general and administrative | 110,790 | 201,115 | 10,967 | (47,451) | 275,421 |
| Amortization expense | 17 | 9,451 | | (1) | 9,467 |

| | | | | | |
|--------------------------|---------|-----------|--------|-----------|-----------|
| Total costs and expenses | 649,292 | 1,023,616 | 47,162 | (186,518) | 1,533,552 |
|--------------------------|---------|-----------|--------|-----------|-----------|

| | | | | | |
|--------------------------------------|---------|--|--|--|---------|
| Gain from litigation settlement, net | 490,085 | | | | 490,085 |
|--------------------------------------|---------|--|--|--|---------|

| | | | | | |
|---------------------------------|----------------|----------------|--------------|--|----------------|
| Earnings from operations | 518,795 | 135,299 | 4,797 | | 658,891 |
|---------------------------------|----------------|----------------|--------------|--|----------------|

Other expenses and income:

| | | | | | |
|--------------------------------|----------|---------|-------|--|---------|
| Interest expense | 52,084 | | | | 52,084 |
| Interest income | (471) | 3 | (42) | | (510) |
| Intercompany interest | (49,899) | 49,788 | 111 | | |
| Loss on extinguishment of debt | 23,873 | | | | 23,873 |
| Other income, net | (2,053) | (2,215) | (203) | | (4,471) |

| | | | | | |
|------------------------------------|--------|--------|-------|--|--------|
| Total other expenses (income), net | 23,534 | 47,576 | (134) | | 70,976 |
|------------------------------------|--------|--------|-------|--|--------|

| | | | | | |
|-------------------------------------|----------------|---------------|--------------|--|----------------|
| Earnings before income taxes | 495,261 | 87,723 | 4,931 | | 587,915 |
|-------------------------------------|----------------|---------------|--------------|--|----------------|

| | | | | | |
|--------------------|---------|--------|-------|--|---------|
| Income tax expense | 194,876 | 30,966 | 1,461 | | 227,303 |
|--------------------|---------|--------|-------|--|---------|

| | | | | | |
|--|--------|-------|--|----------|--|
| Equity in net earnings of subsidiaries | 60,227 | 3,470 | | (63,697) | |
|--|--------|-------|--|----------|--|

| | | | | | |
|---------------------|-------------------|------------------|-----------------|--------------------|-------------------|
| Net earnings | \$ 360,612 | \$ 60,227 | \$ 3,470 | \$ (63,697) | \$ 360,612 |
|---------------------|-------------------|------------------|-----------------|--------------------|-------------------|

Table of Contents**VALASSIS COMMUNICATIONS, INC.****Notes to Condensed Consolidated Financial Statements****(unaudited)****Condensed Consolidating Statement of Cash Flows****Nine Months Ended September 30, 2011****(in thousands of U.S. dollars)**

| | 000000 Parent Company | 000000 Guarantor Subsidiaries | 000000 Non-Guarantor Subsidiaries | 000000 Consolidating Adjustments | 000000 Consolidated Total |
|--|--|--|--|---|--|
| Net cash provided by (used in) operating activities | \$ 246,069 | \$ (120,960) | \$ (1,911) | \$ | \$ 123,198 |
| Cash flows from investing activities: | | | | | |
| Additions to property, plant and equipment | (11,101) | (6,829) | (197) | | (18,127) |
| Proceeds from sale of property, plant and equipment | 46 | | | | 46 |
| Proceeds from sale of available-for-sale securities | 1,494 | | | | 1,494 |
| Net cash used in investing activities | (9,561) | (6,829) | (197) | | (16,587) |
| Cash flows from financing activities: | | | | | |
| Cash provided by (used in) intercompany activity | (121,522) | 121,522 | | | |
| Borrowings of long-term debt | 610,000 | | | | 610,000 |
| Repayments of long-term debt | (709,919) | | | | |