

ONLINE RESOURCES CORP

Form 10-Q

November 09, 2005

**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, 2005**

**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.)

4795 MEADOW WOOD LANE, SUITE 300,  
CHANTILLY, VIRGINIA

20151

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(ZIP CODE)

(703) 653-3100

(REGISTRANT'S TELEPHONE NUMBER,  
INCLUDING AREA CODE)

Indicate by check mark whether the registrant (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

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 2, 2005 there were 25,095,094 shares of the issuer's common stock outstanding.

**ONLINE RESOURCES CORPORATION**  
**FORM 10-Q**  
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**PART I. FINANCIAL INFORMATION**  
**ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS.**  
**ONLINE RESOURCES CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**

	<b>SEPTEMBER</b>	<b>DECEMBER</b>
	<b>30,</b>	<b>31,</b>
	<b>2005</b>	<b>2004</b>
	(unaudited)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 51,528,949	\$ 3,341,678
Restricted cash	2,219,674	1,650,723
Investments		1,298,909
Accounts receivable (net of allowance of approximately \$154,000 and \$152,000 at September 30, 2005 and December 31, 2004, respectively)	7,290,758	8,433,113
Deferred implementation costs	562,544	460,600
Prepaid expenses and other current assets	1,205,235	2,634,961
Total current assets	62,807,160	17,819,984
Property and equipment, net	14,657,172	13,099,829
Deferred implementation costs, less current portion	524,700	420,035
Goodwill	16,368,602	11,272,463
Intangible assets	2,468,003	1,569,800
Other assets	587,007	351,157
Total assets	\$ 97,412,644	\$ 44,533,268
<b>Liabilities and stockholders equity</b>		
Current liabilities:		
Accounts payable	\$ 824,152	\$ 1,654,650
Accrued expenses and other current liabilities	3,906,246	3,159,743
Accrued compensation	2,023,209	1,808,233
Deferred revenues	2,419,058	972,890
Deferred rent obligations	158,237	158,237
Capital lease obligations	15,867	10,573
Total current liabilities	9,346,769	7,764,326
Deferred revenues, less current portion	1,035,136	379,036
Deferred rent obligations, less current portion	1,780,040	1,524,828
Other long term liabilities		94,422
Total liabilities	12,161,945	9,762,612
Commitments and contingencies		
Stockholders equity		
Series B junior participating preferred stock, \$0.01 par value; 297,500 shares authorized; none issued at September 30, 2005 and December 31, 2004		

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Common stock, \$0.0001 par value; 70,000,000 shares authorized; 25,127,737 issued and 25,052,212 outstanding at September 30, 2005; and 19,340,222 issued and 19,264,697 outstanding at December 31, 2004	2,505	1,926
Additional paid-in capital	158,992,432	114,647,954
Accumulated deficit	(73,516,438)	(79,651,309)
Treasury stock, 75,525 shares at September 30, 2005 and December 31, 2004, respectively	(227,800)	(227,800)
Accumulated other comprehensive loss		(115)
Total stockholders' equity	85,250,699	34,770,656
Total liabilities and stockholders' equity	\$ 97,412,644	\$ 44,533,268

See accompanying notes to consolidated unaudited financial statements.

**ONLINE RESOURCES CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

	<b>THREE MONTHS ENDED</b>		<b>NINE MONTHS ENDED</b>	
	<b>SEPTEMBER 30,</b>		<b>SEPTEMBER 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Revenues:				
Account presentation services	\$ 1,898,573	\$ 727,518	\$ 6,923,501	\$ 2,289,032
Payment services	8,972,203	7,349,478	26,110,389	20,476,526
Relationship management services	1,850,528	2,017,012	5,807,734	5,881,358
Professional services and other	2,571,188	952,646	5,891,855	2,235,563
<b>Total revenues</b>	<b>15,292,492</b>	<b>11,046,654</b>	<b>44,733,479</b>	<b>30,882,479</b>
Costs and expenses:				
Service costs	4,823,006	4,120,557	14,840,668	12,449,031
Implementation and other costs	1,249,710	275,731	3,235,802	943,875
<b>Costs of revenues</b>	<b>6,072,716</b>	<b>4,396,288</b>	<b>18,076,470</b>	<b>13,392,906</b>
<b>Gross profit</b>	<b>9,219,776</b>	<b>6,650,366</b>	<b>26,657,009</b>	<b>17,489,573</b>
General and administrative	3,412,671	2,083,215	9,960,199	6,280,917
Sales and marketing	2,599,896	1,748,500	7,566,778	5,399,069
Systems and development	1,195,556	1,024,816	3,493,657	2,838,962
<b>Total expenses</b>	<b>7,208,123</b>	<b>4,856,531</b>	<b>21,020,634</b>	<b>14,518,948</b>
<b>Income from operations</b>	<b>2,011,653</b>	<b>1,793,835</b>	<b>5,636,375</b>	<b>2,970,625</b>
Other income (expense):				
Interest income	429,932	30,635	780,896	83,426
Interest expense	(2,158)	6,069	(10,901)	2,029
Other income	1,576	33,118	1,382	33,118
<b>Total other income</b>	<b>429,350</b>	<b>69,822</b>	<b>771,377</b>	<b>118,573</b>
<b>Income before income tax provision</b>	<b>2,441,003</b>	<b>1,863,657</b>	<b>6,407,752</b>	<b>3,089,198</b>
Income tax provision	77,600	53,000	272,881	71,000
<b>Net income</b>	<b>\$ 2,363,403</b>	<b>\$ 1,810,657</b>	<b>\$ 6,134,871</b>	<b>\$ 3,018,198</b>
Net income per share:				
Basic net income per share	\$ 0.09	\$ 0.10	\$ 0.27	\$ 0.17
Diluted net income per share	\$ 0.09	\$ 0.09	\$ 0.24	\$ 0.15
Shares used in calculation of net income per share:				
Basic	25,017,690	18,128,023	22,864,363	18,006,793
Diluted	27,321,956	20,031,531	25,208,877	20,057,026

**See accompanying notes to consolidated unaudited financial statements.**



**ONLINE RESOURCES CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>NINE MONTHS ENDED</b>	
	<b>SEPTEMBER 30,</b>	
	<b>2005</b>	<b>2004</b>
<b>Operating activities</b>		
Net income	\$ 6,134,871	\$ 3,018,198
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,211,949	2,744,719
Loss on impairment of assets	103,967	38,014
Provision for losses on accounts receivable	2,091	14,275
Net realized gain on investments		(205)
Amortization of discount premium	(976)	(28,051)
Changes in assets and liabilities, net of acquisitions:		
Restricted cash	(568,951)	(763,189)
Accounts receivable	1,298,869	(650,037)
Prepaid expenses and other current assets	1,431,893	(725,911)
Deferred implementation costs	(206,609)	(3,682)
Other assets	(210,116)	8,230
Accounts payable	(874,861)	1,324,099
Accrued expenses	600,148	982,284
Deferred revenues	1,186,450	(38,491)
Deferred rent obligation	255,212	
Other long term liabilities	(94,422)	
Net cash provided by operating activities	13,269,515	5,920,253
<b>Investing activities</b>		
Purchases of property and equipment	(5,391,624)	(4,911,452)
Purchases of available-for-sale securities	(3,100,000)	(9,814,405)
Sales of available-for-sale securities	4,400,000	8,779,164
Acquisition of Integrated Data Systems, Inc., net of cash acquired	(3,316,653)	
Net cash used in investing activities	(7,408,277)	(5,946,693)
<b>Financing activities</b>		
Net proceeds from issuance of common stock (non-secondary related)	2,123,411	892,940
Net proceeds from issuance of common stock in secondary offering	40,221,834	
Repayment of capital lease obligations	(19,212)	(93,209)
Net cash provided by financing activities	42,326,033	799,731
Net increase in cash and cash equivalents	48,187,271	773,291
Cash and cash equivalents at beginning of period	3,341,678	7,054,537
Cash and cash equivalents at end of period	\$ 51,528,949	\$ 7,827,828

**Supplemental information to statement of cash flows:**

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Cash paid for interest	\$	10,744	\$	4,902
Income taxes paid		178,600		25,275
Net unrealized gain (loss) on investments		115		(10,521)
Common stock issued in connection with Integrated Data Systems, Inc. acquisition		1,999,791		

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

**1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION**

Online Resources Corporation (the Company) provides Internet technology services consisting of account presentation, payment, relationship management and professional services to financial services providers nationwide. The Company offers services, branded in the clients name, that integrate seamlessly into a single-vendor, end-to-end solution, supported by 24x7 customer care, targeted consumer marketing, training and other network and technical professional products and services. The Company currently operates in two business segments Banking and eCommerce ( banking ) and Card and Credit Services ( card ). The card segment is the result of the acquisition of Incurrent Solutions, Inc. ( Incurrent ) on December 22, 2004.

**INTERIM FINANCIAL INFORMATION**

The accompanying unaudited consolidated 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 consolidated financial statements include all adjustments necessary (which are of a normal and recurring nature) for the fair presentation of the results of the interim periods presented. These consolidated financial statements should be read in conjunction with our consolidated audited financial statements for the year ended December 31, 2004 included in the Annual Report on Form 10-K/A filed by the Company with the Securities and Exchange Commission on August 19, 2005. 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. RESTATEMENT**

On August 15, 2005, the Company concluded that the its financial statements for fiscal periods ending December 31, 2004 and 2003 and the first interim period of 2005 should be restated to reflect a change in its policy regarding unclaimed bill payment checks and correct its accounting treatment with regard to its prior policy.

In the third quarter of 2003, the Company adopted a policy to recognize stale bill payment checks as assets and began withdrawing funds related to certain stale unclaimed bill payment checks from an escrow account held for bill payments. The Company believed that there was a basis for making a claim of ownership of these funds for unclaimed bill payment checks after reviewing an appropriate legal analysis. Based on the length of time that the unclaimed checks were outstanding, the Company would withdraw the cash from the escrow accounts and record an asset with a corresponding liability. The Company then reduced the liability in accordance with FASB Statement No. 5, *Accounting for Contingencies*, based on an analysis of its payment history related to stale unclaimed bill payments with a corresponding reduction to payment processing costs. The amount by which payment processing costs were reduced from July 1, 2003 through March 31, 2005 totaled \$1.9 million. The Company has determined that under this policy, the liability for the unclaimed bill payments should not have been reduced as the liability was not legally extinguished under paragraph 16 of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

Under its revised policy, the Company will either return unclaimed funds to its financial institution clients or surrender the funds to the appropriate state escheat funds. The policy was revised to derive consistency with that of other bill payment providers, to take cognizance of changes occurring in the adoption of unclaimed property laws and to resolve issues regarding the manner in which the Company accounted for unclaimed bill payment funds following the adoption of its initial policy. As a result of this revised policy, the Company restated its financial statements, which resulted in a reduction to net income of \$1.0, \$0.7 and \$0.2 million and reduced earnings per share by \$0.05, \$0.04 and \$0.01 for the years ended December 31, 2004 and 2003 and the quarter ended March 31, 2005, respectively.

Unclaimed bill payment funds are now no longer reflected in the Company s statements of operations, nor do they contribute to its financial performance. Unclaimed bill payment funds no longer are used to reduce the Company s service costs, thereby resulting in a corresponding decrease in the Company s gross profits and net income. In addition,

the Company has accrued a liability equal to the cash it obtained subsequent to the adoption of its initial policy to reflect its obligation to either return funds to its clients or to surrender the funds in accordance with unclaimed property laws. This cash and the corresponding liability will remain on the Company's balance sheet until such funds have been disposed of in accordance with the new policy.

The following table sets forth the effects of the restatement on certain line items within the Company's consolidated statements of operations and comprehensive income for the three and nine months ended September 30, 2004:

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	<b>THREE MONTHS ENDED SEPTEMBER 30, 2004</b>		<b>NINE MONTHS ENDED SEPTEMBER 30, 2004</b>	
	<b>PREVIOUSLY</b>		<b>PREVIOUSLY</b>	
	<b>REPORTED</b>	<b>RESTATED</b>	<b>REPORTED</b>	<b>RESTATED</b>
Service costs	\$ 3,781,504	\$ 4,120,557	\$ 11,697,390	\$ 12,449,031
Gross profit	6,989,419	6,650,366	18,241,214	17,489,573
Income from operations	2,132,888	1,793,835	3,722,266	2,970,625
Net income	2,149,710	1,810,657	3,769,839	3,018,198
Net income per share:				
Basic	\$ 0.12	\$ 0.10	\$ 0.21	\$ 0.17
Diluted	\$ 0.11	\$ 0.09	\$ 0.19	\$ 0.15

### 3. RECLASSIFICATION

Certain amounts reported in prior periods have been reclassified to conform to the 2005 presentation.

### 4. ACQUISITIONS

#### *Incurrent*

On December 22, 2004, the Company completed the acquisition of Incurrent, a New Jersey corporation, pursuant to which Incurrent merged with and into the Company's wholly-owned subsidiary, Incurrent Acquisition LLC, a New Jersey limited liability company. The Company now operates the Incurrent business as its card division. Founded in 1997, Incurrent develops and operates advanced web-based products for financial institutions in the global payment card industry, including issuers of consumer, small business, purchasing, corporate and private label cards. Incurrent's products enhance the card issuers' relationship with their cardholders by allowing the issuers to achieve enhanced service and functionality on the Internet. Services provided by Incurrent include account, statement and transaction inquiry, account maintenance requests, payments, compliant statements and collections. The Company issued 1,000,014 shares of common stock to the Incurrent shareholders. The Company paid to, and for the benefit of, the Incurrent shareholders, approximately \$7.9 million in cash.

The Company's primary reasons for acquiring Incurrent were to allow the Company to enter a complementary vertical market, exploit potential product and customer synergies between the companies and acquire management for that business line. The value of this acquisition to the Company lay in what could be created by marketing new products to the card issuer community and through layering its technology onto the Incurrent platform.

The acquisition has been accounted for using the purchase method of accounting. The purchase price was allocated to the estimated fair value of the assets acquired and liabilities assumed. The estimated fair value of the tangible assets acquired and liabilities assumed approximated the historical basis. Incurrent lacked significant intangible assets other than its customer list, technology and employee base. Identified values were assigned for the customer list and technology and the identified value assigned to the employee base was included in goodwill. No other significant intangible assets were identified or included in goodwill. The Company engaged a qualified, independent valuation firm to identify and value any intangible assets acquired in the transaction.

The preliminary purchase price allocation to identifiable intangible assets was \$1.6 million and goodwill was \$11.6 million. The identifiable intangible assets will be amortized on a straight-line basis over the estimated useful life of five years.

**Integrated Data Systems, Inc. ( IDS )**

On June 27, 2005, the Company completed the acquisition of IDS, a California corporation, pursuant to which IDS merged with and into the Company's wholly-owned subsidiary, IDS LLC, a California limited liability company. The Company now operates the IDS business as part of its banking division. Founded in 1990, IDS is a privately held software development firm that develops and implements software applications for credit unions and other financial institutions. The acquisition adds approximately 30 employees and facilities in Woodland Hills, California and Pleasanton, California.

The Company's primary reasons for acquiring IDS were to acquire additional distribution and complimentary software products and to exploit the potential product synergies between the companies and to acquire management for that business line. The value of this acquisition to the Company lay in what could be created by exploiting the potential product synergies between the two companies.

The Company issued 181,108 shares of common stock to the IDS shareholders. The Company paid to, and for the benefit of, the IDS shareholders, approximately \$3.3 million in cash. The acquisition has been accounted for using the purchase method of accounting. The purchase price was allocated to the estimated fair value of the assets acquired and liabilities assumed. The estimated fair value of the tangible assets acquired and liabilities assumed approximated the historical basis. IDS lacked significant intangible assets other than its customer list, non-compete covenants, technology and employee base. Identified values were assigned for the customer list, non-compete covenants and technology, and the identified value assigned to the employee base was included in goodwill. No other significant intangible assets were identified or included in goodwill. The Company engaged a qualified, independent valuation firm to identify and value any intangible assets acquired in the transaction.

The preliminary purchase price allocation to identifiable intangible assets was \$1.2 million and goodwill was \$4.7 million. The identifiable assets will be amortized on a straight-line basis over the estimated useful life of five years.

The results of operations for IDS are included in the unaudited consolidated statements of operations beginning July 1, 2005. The financial information in the table below summarizes the results of operations of the Company and IDS on a pro forma basis, as though the companies had been combined as of the beginning of the periods being presented. This pro forma information is presented for informational purposes only and is not necessarily indicative of the results of operations that would have been achieved had the acquisition actually taken place as of the beginning of the period being presented.

	<b>Three Months Ended</b>	<b>Nine Months Ended September</b>	
	<b>September 30,</b>	<b>30,</b>	
	<b>2004</b>	<b>2005</b>	<b>2004</b>
Revenues	\$ 11,950,329	\$ 46,138,226	\$ 33,048,353
Net income	\$ 1,774,132	\$ 4,451,083	\$ 2,314,242
Net income per share:			
Basic	\$ 0.10	\$ 0.19	\$ 0.13
Diluted	\$ 0.09	\$ 0.18	\$ 0.11

**5. REPORTABLE SEGMENTS**

The Company manages its business through two reportable segments: banking and card. On January 1, 2005 the Company established the card segment with the acquisition of Incurrent. The operating results of the business segments exclude the allocation of intangible asset amortization.

The results of operations from these reportable segments were as follows for the three and nine months ended September 30, 2005 and 2004:



	<b>UNALLOCATED EXPENSES</b>			
	<b>BANKING</b>	<b>CARD</b>	<b>(1)</b>	<b>TOTAL</b>
Three months ended September 30, 2005:				
Revenues	\$ 13,540,790	\$ 1,751,702	\$	\$ 15,292,492
Costs of revenues	4,952,544	1,029,032	91,140	6,072,716
Gross profit	8,588,246	722,670	(91,140)	9,219,776
Operating expenses	6,514,441	646,665	47,017	7,208,123
Income from operations	\$ 2,073,805	\$ 76,005	\$ (138,157)	\$ 2,011,653
Three months ended September 30, 2004:				
Revenues	\$ 11,046,654	\$	\$	\$ 11,046,654
Costs of revenues	4,396,288			4,396,288
Gross profit	6,650,366			6,650,366
Operating expenses	4,856,531			4,856,531
Income from operations	\$ 1,793,835	\$	\$	\$ 1,793,835
Nine months ended September 30, 2005:				
Revenues	\$ 38,511,276	\$ 6,222,203	\$	\$ 44,733,479
Costs of revenues	14,719,281	3,166,049	191,140	18,076,470
Gross profit	23,791,995	3,056,154	(191,140)	26,657,009
Operating expenses	18,754,048	2,162,589	103,997	21,020,634
Income from operations	\$ 5,037,947	\$ 893,565	\$ (295,137)	\$ 5,636,375
Nine months ended September 30, 2004:				
Revenues	\$ 30,882,479	\$	\$	\$ 30,882,479
Costs of revenues	13,392,906			13,392,906
Gross profit	17,489,573			17,489,573
Operating expenses	14,518,948			14,518,948
Income from operations	\$ 2,970,625	\$	\$	\$ 2,970,625

(1) Unallocated expenses are comprised of intangible asset amortization that is not included in the measure of

segment profit  
or loss used  
internally to  
evaluate the  
segments.

## 6. SECONDARY OFFERING

The Company completed the placement of 4,400,000 shares of its common stock on April 4, 2005 at a public offering price of \$8.50. The underwriters subsequently exercised their option to purchase an aggregate of 720,734 additional shares on April 29, 2005. The Company generated net proceeds from the offering of approximately \$40 million, which it intends to use for acquisitions and accelerating development of products and services.

## 7. STOCK BASED COMPENSATION

The Company has accounted for stock option grants using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ( APB No. 25 ), for stock-based compensation and to furnish the pro forma disclosures required under Statement of Financial Accounting Standards ( SFAS ) No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* ( SFAS No. 148 ). In electing to continue to follow APB No. 25 for expense recognition purposes, the Company has provided below the expanded disclosures required under SFAS No. 148 for stock-based compensation granted, including, if materially different from reported results, disclosure of pro forma net earnings or losses and earnings or losses per share had compensation expense relating to grants been measured under the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation* ( SFAS No. 123 ).

The weighted-average fair values at date of grant for options granted during the three months ended September 30, 2005 and 2004 were \$6.67 and \$4.55, respectively, and during the nine months ended September 30, 2005 and 2004 were \$6.65 and \$4.69, respectively. The fair values were estimated using the Black-Scholes option valuation model with the following weighted-average assumptions:

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2005	2004	2005	2004
Dividend yield				
Expected volatility	79%	84%	80%	86%
Risk-free interest rate	3.88%	3.38%	3.73%	3.32%
Expected life in years	5.1	5.4	5.1	5.5

A reconciliation of the Company's net income to pro forma net income and the related basic and diluted pro forma net income per share amounts for the three and nine months ended September 30, 2005 and 2004 is provided below. For purposes of pro forma disclosure, stock-based compensation expense is recognized in accordance with the provisions of SFAS No. 123. Further, pro forma stock-based compensation expense is amortized to expense on a straight-line basis over the vesting

period.

	<b>THREE MONTHS ENDED</b>		<b>NINE MONTHS ENDED</b>	
	<b>SEPTEMBER 30,</b>		<b>SEPTEMBER 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Net income as reported	\$ 2,363,403	\$ 1,810,657	\$ 6,134,871	\$ 3,018,198
Adjustment to net income for:				
Pro forma stock-based compensation expense	(391,573)	(309,381)	(1,253,800)	(1,231,689)
Pro forma net income	\$ 1,971,830	\$ 1,501,276	\$ 4,881,071	\$ 1,786,509
 Basic net income per share				
As reported	\$ 0.09	\$ 0.10	\$ 0.27	\$ 0.17
Pro forma	\$ 0.08	\$ 0.08	\$ 0.21	\$ 0.10
 Diluted net income per share				
As reported	\$ 0.09	\$ 0.09	\$ 0.24	\$ 0.15
Pro forma	\$ 0.07	\$ 0.07	\$ 0.19	\$ 0.09

As permitted by SFAS No. 123, the Company currently accounts for share-based payments to employees using APB No. 25's intrinsic value method and, as such, generally recognizes no compensation expense for employee stock options. Accordingly, the adoption of SFAS No. 123(R)'s, *Share-Based Payment* (SFAS No. 123(R)), fair value method on January 1, 2006 will have a significant impact on our results of operations, although it will have no impact on our overall financial position. The impact of adoption of SFAS No. 123(R) cannot be predicted at this time because it will depend on levels of share-based payments granted in the future, however, had we adopted SFAS No. 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma net income and net income per share in Note 7 to our consolidated unaudited financial statements. SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. While the Company cannot estimate what those amounts will be in the future (because they depend on, among other things, when employees exercise stock options), there were no operating cash flows recognized in the three and nine months ended September 30, 2005 and 2004 for such excess tax deductions.

## 8. MAJOR CUSTOMER

One of the Company's card segment clients, Sears, accounted for approximately \$1.3 million, or 3% of the Company's revenues, for the nine months ended September 30, 2005. During 2004, Citigroup acquired the Sears credit card portfolio and converted the Sears customers to the Citigroup platform in the second quarter of 2005. The Company anticipated the loss of Sears as part of its acquisition of Incurrent.

## 9. NET INCOME PER SHARE

The following table sets forth the computation of basic and diluted net income per share:

	<b>THREE MONTHS ENDED</b>		<b>NINE MONTHS ENDED</b>	
	<b>SEPTEMBER 30,</b>		<b>SEPTEMBER 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Net income	\$ 2,363,403	\$ 1,810,657	\$ 6,134,871	\$ 3,018,198

Shares used in calculation  
of income per share:

Basic	25,017,690	18,128,023	22,864,363	18,006,793
In the money warrants		58,618		60,648
In the money options	2,304,266	1,844,890	2,344,514	1,989,585
Diluted	27,321,956	20,031,531	25,208,877	20,057,026

## Net income per share

Basic	\$ 0.09	\$ 0.10	\$ 0.27	\$ 0.17
Diluted	\$ 0.09	\$ 0.09	\$ 0.24	\$ 0.15

**10. COMPONENTS OF COMPREHENSIVE INCOME**

SFAS No. 130, *Reporting Comprehensive Income*, requires that items defined as comprehensive income or loss be separately classified in the financial statements and that the accumulated balance of other comprehensive income or loss be reported separately from accumulated deficit and additional paid-in capital in the equity section of the balance sheet.

The following table summarizes the Company's comprehensive income:

	<b>THREE MONTHS ENDED SEPTEMBER 30,</b>		<b>NINE MONTHS ENDED SEPTEMBER 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Net income	\$ 2,363,403	\$ 1,810,657	\$ 6,134,871	\$ 3,018,198
Unrealized gain (loss) on marketable securities		1,229	115	(10,521)
Total comprehensive income	\$ 2,363,403	\$ 1,811,886	\$ 6,134,986	\$ 3,007,677

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

### **CAUTIONARY NOTE**

The following management's discussion and analysis should be read in conjunction with the accompanying Consolidated Unaudited Financial Statements and Notes thereto. This Quarterly Report on Form 10-Q may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including, but not limited to:

Any statements in this document that are not statements of historical fact may be considered forward-looking;

Statements regarding trends in our revenues, expense levels, and liquidity and capital resources;

Statements about the sufficiency of the proceeds from the sale of securities and cash balances to meet currently planned working capital and capital expenditure requirements for at least the next twelve months; and

Other statements identified or qualified by words such as likely, will, suggest, may, would, could, should, anticipates, estimates, plans, projects, believes, seek, intend and other similar words that signify forward-looking statements.

These forward-looking statements represent our best judgment as of the date of the Quarterly Report on Form 10-Q, and we caution readers not to place undue reliance on such statements. Actual performance and results of operations may differ materially from those projected or suggested in the forward-looking statements due to certain risks and uncertainties, including but not limited to, the risks and uncertainties described or discussed in the section

Risk Factors in our Annual Report on Form 10-K/A filed with the Securities and Exchange Commission on August 19, 2005. These risks include, among others, the following:

our history of prior losses and lack of certainty as to our continuing profitability;

possible fluctuations of our quarterly financial results;

our failure to retain or increase our end-users;

our dependence on the marketing efforts of third parties;

our dependence on our clients to market our services;

the possibility that we may not be able to expand to meet increased demand for our services and related products;

the potential adverse impact that a loss of a material client may have on our financial results;

our inability to attract and retain qualified management and technical personnel and our dependence on our executive officers and key employees;

possible security breaches or system failures disrupting our business and the liability associated with these disruptions;

the failure to properly develop, market or sell new products;

reduction or elimination of the fees we charge for some services due to the consumer demand for low-cost or free online financial services;

the potential impact of the consolidation of the banking and financial services industry;

interference with our business from the adoption of government regulations;

our need to maintain satisfactory ratings from federal depository institution regulators;

the potential of litigation;

our volatile stock price; and

the trading of a substantial number of shares adversely impacting the price of our shares.

**OVERVIEW**

We provide Internet technology services consisting of account presentation, payment, relationship management and professional services to financial services providers nationwide. Our services, branded in the clients name, 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.

We manage our business through two reportable segments: banking and card. The operating results of the business segments exclude the allocation of intangible asset amortization.

Registered end-users using account presentation, bill payment or both, are the major drivers of our revenues. Since September 30, 2004, the number of users using our account presentation services increased 583%, and the number of users using our payment services increased 25%, for an overall 269% increase in users. Exclusive of the 2.6 million users added through the acquisition of Incurrent, account presentation services users increased 25% and overall users increased 26%.

	PERIOD ENDED		INCREASE/(DECREASE)	
	2005	2004	CHANGE	%
Account presentation users (000s):				
Banking segment	577	463	114	25%
Card segment	2,587		2,587	N/A
Enterprise	3,164	463	2,701	583%
Payment services users (000s):				
Banking segment	907	728	179	25%
Total users (000s):				
Banking segment	1,346	1,065	281	26%
Card segment	2,587		2,587	N/A
Enterprise	3,933	1,065	2,868	269%

We have long-term service contracts with most of our financial services provider clients. The majority of our revenues are recurring, though these contracts also provide for implementation, set-up and other non-recurring fees. Account presentation services revenues are based on either a monthly license fee, allowing our financial institution clients to register an unlimited number of customers, or a monthly fee for each registered customer. Payment services revenues are based on either a monthly fee for each customer enrolled, a fee per executed transaction, or a combination of both. Our clients pay nearly all of our fees and then determine if or how they want to pass these costs on to their users. They typically provide account presentation services to users free of charge, as they derive significant potential benefits including account retention, delivery and paper cost savings, account consolidation and cross-selling of other products. As of September 30, 2005 approximately 40% of our clients were charging their users for providing payment services.

As a network-based service provider, we have made substantial up-front investments in infrastructure, particularly for our proprietary systems. While we continue to incur ongoing development and maintenance costs, we believe the infrastructure we have built provides us with significant operating leverage. In 2003 we began an effort to upgrade and rewrite certain of our applications infrastructure that will continue into 2006. We expect that this effort will require incremental capital expenditures, primarily for additional development labor, of between \$3.0 million and \$5.0 million over that period.

We continue to automate processes and develop applications that allow us to make only small increases in labor and other operating costs relative to increases in customers and transactions. We believe our financial and operating performance will be based primarily on our ability to leverage additional end-users and transactions over this relatively fixed cost base.

#### **Financial Condition**

While we have achieved net income for the past seven quarters and expect our profitability to be sustainable, we have historically experienced operating losses and negative cash flow due to the initial costs of developing our infrastructure and the early revenues typical of an emerging market segment. As a result, at September 30, 2005 we had an accumulated deficit of \$73.5 million. We have funded our operations primarily through the issuance of equity and debt securities. Our ongoing working capital requirements consist primarily of personnel costs related to

providing our services and operating, enhancing and maintaining our systems.

Cash and cash equivalents were \$51.5 and \$3.3 million as of September 30, 2005 and December 31, 2004, respectively. The \$48.2 million increase in cash and cash equivalents results from \$13.3 and \$42.3 million in cash provided by operating and financing activities, respectively, \$1.3 million in net sales of available-for-sale securities, partially offset by \$5.4 million in capital expenditures and \$3.3 million used to acquire IDS.

**Results of Operations**

The following table presents the summarized results of operations for our two reportable segments, banking and card:

	<b>THREE MONTHS ENDED SEPTEMBER 30,</b>				<b>NINE MONTHS ENDED SEPTEMBER 30,</b>			
	<b>2005</b>		<b>2004</b>		<b>2005</b>		<b>2004</b>	
	<b>Dollars</b>	<b>%</b>	<b>Dollars</b>	<b>%</b>	<b>Dollars</b>	<b>%</b>	<b>Dollars</b>	<b>%</b>
Revenues:								
Banking	\$ 13,540,790	89%	\$ 11,046,654	100%	\$ 38,511,276	86%	\$ 30,882,479	100%
Card	1,751,702	11%		0%	6,222,203	14%		0%
Total	\$ 15,292,492	100%	\$ 11,046,654	100%	\$ 44,733,479	100%	\$ 30,882,479	100%
	<b>Dollars</b>	<b>Margin</b>	<b>Dollars</b>	<b>Margin</b>	<b>Dollars</b>	<b>Margin</b>	<b>Dollars</b>	<b>Margin</b>
Gross profit:								
Banking	\$ 8,588,246	63%	\$ 6,650,366	60%	\$ 23,791,995	62%	\$ 17,489,573	57%
Card	722,670	41%		0%	3,056,154	49%		0%
Unallocated	(91,140)				(191,140)			
Total	\$ 9,219,776	60%	\$ 6,650,366	60%	\$ 26,657,009	60%	\$ 17,489,573	57%
	<b>Dollars</b>	<b>%</b>	<b>Dollars</b>	<b>%</b>	<b>Dollars</b>	<b>%</b>	<b>Dollars</b>	<b>%</b>
Operating expenses:								
Banking	\$ 6,514,441	90%	\$ 4,856,531	100%	\$ 18,754,048	89%	\$ 14,518,948	100%
Card	646,665	9%		0%	2,162,589	10%		0%
Unallocated	47,017	1%		0%	103,997	1%		0%
Total	\$ 7,208,123	100%	\$ 4,856,531	100%	\$ 21,020,634	100%	\$ 14,518,948	100%
	<b>Dollars</b>	<b>Margin</b>	<b>Dollars</b>	<b>Margin</b>	<b>Dollars</b>	<b>Margin</b>	<b>Dollars</b>	<b>Margin</b>
Income from operations:								
Banking	\$ 2,073,805	15%	\$ 1,793,835	16%	\$ 5,037,947	13%	\$ 2,970,625	10%
Card	76,005	4%		0%	893,565	14%		0%
Unallocated	(138,157)				(295,137)			
Total	\$ 2,011,653	13%	\$ 1,793,835	16%	\$ 5,636,375	13%	\$ 2,970,625	10%

### **THREE MONTHS ENDED SEPTEMBER 30, 2005 COMPARED TO THE THREE MONTHS ENDED SEPTEMBER 30, 2004**

#### **Revenues**

We generate revenues from account presentation services, payment services, relationship management services and professional services and other revenues. Revenues increased \$4.3 million, or 38%, to \$15.3 million for the three months ended September 30, 2005, from \$11.0 million for the same period of 2004. This increase was attributable to a 23% increase in banking segment revenues and \$1.8 million in revenues contributed by the new card segment acquired on December 22, 2004.



	<b>THREE MONTHS ENDED</b>		<b>INCREASE/(DECREASE)</b>		
	<b>2005</b>	<b>2004</b>	<b>CHANGE</b>	<b>%</b>	
<b>Revenues (in millions):</b>					
Account presentation services	\$ 1.9	\$ 0.7	\$ 1.2	161%	
Payment services	9.0	7.3	1.7	22%	
Relationship management services	1.8	2.0	(0.2)	-8%	
Professional services and other	2.6	1.0	1.6	170%	
<b>Total revenues</b>	<b>\$ 15.3</b>	<b>\$ 11.0</b>	<b>\$ 4.3</b>	<b>38%</b>	
<b>Payment metrics:</b>					
Payment services clients	770	728	42	6%	
Payment transactions (000s)	11,563	9,571	1,992	21%	
<b>Adoption rates:</b>					
Account presentation services	Banking (1)	26.9%	21.1%	5.8%	27%
Account presentation services	Card (1)	16.4%	N/A	N/A	NA
Payment services (2)		9.1%	6.8%	2.3%	34%

**Notes:**

- (1) Represents the percentage of users subscribing to our account presentation services out of the total number of potential users enabled for account presentation services.
- (2) Represents the percentage of users subscribing to our payment services out of the total number of potential users enabled for payment services.

*Account Presentation Services.* Both the banking and card segments contribute to account presentation services revenues, which increased \$1.2 million compared to the same period of last year to \$1.9 million. The inclusion of the new card segment in 2005 is the reason for the increase, with account presentation services revenue generated by the banking segment decreasing by 2% compared to 2004. This is the result of the loss of one of our largest banking clients in the first quarter of 2005 and our decision to fix price the account presentation service to our banking segment clients in an effort to drive adoption of those services. This allows our financial services provider clients to register an unlimited number of account presentation services users (as evidenced by the 27% increase in banking account presentation services adoption since September 30, 2004) to whom we can then attempt to up-sell our higher margin bill pay products and other services.

*Payment Services.* Primarily composed of revenues from the banking segment, payment services revenues increased to \$9.0 million for the three months ended September 30, 2005 from \$7.3 million in the prior year. This was driven by a 25% increase in the number of period-end payment services users and a 21% increase in the number of payment transactions processed during the period. The increases in period-end payment services users and the number of payment transactions processed were driven by two factors: an increase in financial services provider clients using our payment services and an increase in payment services adoption. Compared to September 30, 2004, the number of financial services provider clients using our payment services increased from 728 clients to 770 clients. Additionally, we increased the adoption rate of our payment services from 6.8% at September 30, 2004 to 9.1% at September 30, 2005.

*Relationship Management Services.* Consisting entirely of revenues from the banking segment, relationship management services revenues decreased to \$1.8 million from \$2.0 in 2004. This is the result of the loss of one of our largest banking clients in the first quarter of 2005, partially offset by additional relationship management services revenues attributable to an increase of 26% in the number of period-end banking segment end-users utilizing either account presentation or payment services compared to 2004. We expect relationship management services revenues growth to be flat as more of our financial services provider clients move to a monthly license fee pricing model similar to the one we use for account presentation services.

*Professional Services and Other.* Both the banking and card segments contribute to professional services and other revenues, which increased \$1.6 million from \$1.0 million in 2004 to \$2.6 million in 2005. The increase was the result of the inclusion of the new card segment and custom solutions group (formerly IDS and part of the banking segment) in 2005 and increased professional services revenues in the banking segment in 2005 compared to 2004.

#### **Costs and Expenses**

	THREE MONTHS ENDED		INCREASE/(DECREASE)	
	2005(1)	2004(1)	CHANGE(1)	%
Revenues	\$ 15.3	\$ 11.0	\$ 4.3	38%
Costs of revenues	6.1	4.4	1.7	38%
Gross profit	9.2	6.6	2.6	39%
Gross margin	60%	60%	0%	0%
Operating expenses				
General & administrative	3.4	2.1	1.3	64%
Sales & marketing	2.6	1.7	0.9	49%
Systems & development	1.2	1.0	0.2	17%
Total operating expenses	7.2	4.8	2.4	48%
Income from operations	2.0	1.8	0.2	12%
Other income, net	0.4		0.4	0%
Net income	\$ 2.4	\$ 1.8	\$ 0.6	31%
Net income per share:				
Basic	\$ 0.09	\$ 0.10	\$ (0.01)	-10%
Diluted	\$ 0.09	\$ 0.09	\$ (0.00)	0%
Shares used in calculation of net income per share:				
Basic	25.0	18.1	6.9	38%
Diluted	27.3	20.0	7.3	36%

**Notes:**

(1) In millions except for net income per share.

*Costs of Revenues.* Costs of revenues encompass the direct expenses associated with providing our services. These expenses include telecommunications, payment processing, systems operations, customer service, implementation and professional services work. Costs of revenues increased by \$1.7 million to \$6.1 million for the three months ended September 30, 2005, from \$4.4 million for the same period in 2004. In addition to the inclusion of costs associated with the new card segment and custom solutions group (formerly IDS and part of the banking segment), the increase related to increases in volume-related payment processing and systems operations costs and increased amortization of software development costs capitalized in accordance with Statement of Position No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* ( SOP No. 98-1 ).

*Gross Profit.* Gross profit increased to \$9.2 million for the three months ended September 30, 2005 from \$6.6 million for the same period of 2004. Of the \$2.6 million increase, \$0.7 million, or 28%, related to the inclusion of the new card segment, and the remaining \$1.9 million, or 72%, related to growth in the banking segment and the addition of the new custom solutions group (formerly IDS and part of the banking segment). Gross margin stayed flat

at 60%.

*General and Administrative.* General and administrative expenses primarily consist of salaries for executive, administrative and financial personnel, consulting expenses and facilities costs such as office leases, insurance, and depreciation. General and administrative expenses increased \$1.3 million, or 64%, to \$3.4 million for the three months ended September 30, 2005, from \$2.1 million in the same period of 2004. The increase related to the inclusion of the new card segment and custom solutions group (formerly IDS and part of the banking segment), and to increased depreciation expense, rent expense, and salary and benefits costs as a result additional headcount.

*Sales and Marketing.* Sales and marketing expenses include salaries and commissions paid to sales and marketing personnel, consumer marketing costs, public relations costs, and other costs incurred in marketing our services and products. Sales and marketing expenses increased \$0.9 million, or 49%, to \$2.6 million for the three months ended September 30, 2005, from \$1.7 million in 2004. In addition to the costs related to the inclusion of the new card segment and custom solutions group (formerly IDS and part of the banking segment), the increase was the result of increased salary and benefits costs as a result of the expansion of our sales and client services groups, increased remuneration expenses to our reseller partners owing to higher user and transaction volumes, increased marketing costs resulting from running a higher number of client-sponsored marketing programs and increased sales commissions due to higher sales activity in 2005.

*Systems and Development.* Systems and development expenses include salaries, consulting fees and all other expenses incurred in supporting the research and development of new services and products and new technology to enhance existing products. Systems and development expenses increased \$0.2 million to \$1.2 million for the three months ended September 30, 2005. The increase was the result of the inclusion of the new card segment and custom solutions group (formerly IDS and part of the banking segment), respectively, in 2005. Even though systems and development costs in the banking segment increased relative to 2004 as a result of increased headcount, this increase was offset by an increase in the amount of costs capitalized in accordance with SOP No. 98-1. We capitalized \$1.3 million of development costs associated with software developed or obtained for internal use during the three months ended September 30, 2005, compared to \$0.7 million in 2004.

*Income from Operations.* Income from operations increased \$0.2 million, or 12%, to \$2.0 million for the three months ended September 30, 2005. The increase was due to an increase in service fee revenues leveraged over relatively fixed costs and \$0.1 million in additional operating income for the new card segment.

*Other Income, Net.* Other income increased \$0.4 million due to a \$0.4 million increase in interest income resulting from interest earned on the proceeds from the secondary offering completed in April 2005.

*Net Income.* Net income was \$2.4 million for the three months ended September 30, 2005, compared to \$1.8 million for the same period of 2004. Basic net income per share was \$0.09 and \$0.10 for the three months ended September 30, 2005 and 2004, respectively. Diluted net income per share was \$0.09 for the three months ended September 30, 2005 and 2004. Basic and diluted shares outstanding increased by 38% and 36%, respectively, compared to 2004 as a result of shares issued as part of the secondary offering in April 2005 and shares issued related to the Incurrent and IDS acquisitions. Diluted shares outstanding also increased as a result of the impact of our rising share price on the fully diluted share calculation.

**NINE MONTHS ENDED SEPTEMBER 30, 2005 COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 2004.**

	<b>NINE MONTHS ENDED</b>		<b>INCREASE/(DECREASE)</b>		
	<b>2005</b>	<b>2004</b>	<b>CHANGE</b>	<b>%</b>	
<b>Revenues (in millions):</b>					
Account presentation services	\$ 6.9	\$ 2.3	\$ 4.6	202%	
Payment services	26.1	20.5	5.6	28%	
Relationship management services	5.8	5.9	(0.1)	-1%	
Professional services and other	5.9	2.2	3.7	164%	
<b>Total revenues</b>	<b>\$ 44.7</b>	<b>\$ 30.9</b>	<b>\$ 13.8</b>	<b>45%</b>	
<b>Payment metrics:</b>					
Payment services clients	770	728	42	6%	
Payment transactions (000s)	33,790	26,906	6,884	26%	
<b>Adoption rates:</b>					
Account presentation services	Banking (1)	26.9%	21.1%	5.8%	27%
Account presentation services	Card (1)	16.4%	N/A	N/A	N/A
Payment services (2)		9.1%	6.8%	2.3%	34%

**Notes:**

- (1) Represents the percentage of users subscribing to our account presentation services out of the total number of potential users enabled for account presentation services.

- (2) Represents the percentage of users subscribing to our payment services out of the total number of potential users enabled for payment services.

We generate revenues from account presentation services, payment services, relationship management services and professional services and other revenues. Revenues increased \$13.8 million, or 45%, to \$44.7 million for the nine months ended September 30, 2005, from \$30.9 million for the same period of 2004. This increase was attributable to a 25% increase in banking segment revenues and \$6.2 million in revenues contributed by the new card segment acquired on December 22, 2004.

*Account Presentation Services.* Both the banking and card segments contribute to account presentation services revenues, which increased \$4.6 million compared to the same period of last year to \$6.9 million. The inclusion of the new card segment in 2005 is the reason for the increase, with account presentation services revenue generated by the banking segment decreasing by 2% compared to 2004. This is the result of the loss of one of our largest banking clients in the first quarter of 2005 and our decision to fix price the account presentation service to our banking segment clients in an effort to drive adoption of those services. This allows our financial services provider clients to register an unlimited number of account presentation services users (as evidenced by the 27% increase in banking account presentation services adoption since September 30, 2005) to whom we can then attempt to up-sell our higher margin bill pay products and other services.

*Payment Services.* Primarily composed of revenues from the banking segment, payment services revenues increased to \$26.1 million for the nine months ended September 30, 2005 compared to \$20.5 million in the prior year. This was driven by a 25% increase in the number of period-end payment services users and a 26% increase in the number of payment transactions processed during the period. The increases in period-end payment services users and the number of payment transactions processed were driven by two factors: an increase in financial services provider clients using our payment services and an increase in payment services adoption. Compared to September 30, 2004, the number of financial services provider clients using our payment services increased from 728 clients to 770 clients. Additionally, we increased the adoption rate of our payment services from 6.8% at September 30, 2004 to 9.1% at September 30, 2005.

*Relationship Management Services.* Consisting entirely of revenues from the banking segment, relationship management services revenues decreased to \$5.8 million from \$5.9 million. This is the result of the loss of one of our largest banking clients in the first quarter of 2005, partially offset by additional relationship management services revenues attributable to an increase of 26% in the number of period-end banking segment end-users utilizing either account presentation or payment services compared to 2004. We expect relationship management services revenues growth to be flat as more of our financial services provider clients move to a monthly license fee pricing model similar to the one we use for account presentation services.

*Professional Services and Other.* Both the banking and card segments contribute to professional services and other revenues, which increased \$3.7 million from \$2.2

million in 2004 to \$5.9 million in 2005. The increase was the result of the inclusion of the new card segment and custom solutions group (formerly IDS and part of the banking segment) in 2005 and increased termination fees and professional services work in the banking segment in 2005 compared to 2004.

### Costs and Expenses

	NINE MONTHS ENDED SEPTEMBER 30,		INCREASE/(DECREASE)	
	2005(1)	2004(1)	CHANGE(1)	%
Revenues	\$ 44.7	\$ 30.9	\$ 13.8	45%
Costs of revenues	18.1	13.4	4.7	35%
Gross profit	26.6	17.5	9.1	52%
Gross margin	60%	57%	3%	5%
Operating expenses				
General & administrative	9.9	6.3	3.6	59%
Sales & marketing	7.6	5.4	2.2	40%
Systems & development	3.5	2.8	0.7	23%
Total operating expenses	21.0	14.5	6.5	45%
Income from operations	5.6	3.0	2.6	90%
Other income, net	0.5		0.5	
Net income	\$ 6.1	\$ 3.0	\$ 3.1	103%
Net income per share:				
Basic	\$ 0.27	\$ 0.17	\$ 0.10	59%
Diluted	\$ 0.24	\$ 0.15	\$ 0.09	60%
Shares used in calculation of net income per share:				
Basic	22.9	18.0	4.9	27%
Diluted	25.2	20.1	5.1	26%

### Notes:

- (1) In millions  
except for net  
income per  
share.

*Costs of Revenues.* Costs of revenues encompass the direct expenses associated with providing our services. These expenses include telecommunications, payment processing, systems operations, customer service, implementation and professional services work. Costs of revenues increased by \$4.7 million to \$18.1 million for the nine months ended September 30, 2005, from \$13.4 million for the same period in 2004. In addition to the inclusion of costs associated with the new card segment and custom solutions group (formerly IDS and part of the banking segment), the increase related to increases in volume-related payment processing and systems operations costs and increased amortization of software development costs capitalized in accordance with Statement of Position No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* ( SOP No. 98-1 ).

*Gross Profit.* Gross profit increased to \$26.6 million for the nine months ended September 30, 2005 from \$17.5 million for the same period of 2004. Of the \$9.1 million increase, \$3.1 million, or 33%, related to the inclusion of the new card segment, and the remaining \$6.0 million, or 67%, related to growth in the banking segment and the addition of the new custom solutions group (formerly IDS and part of the banking segment). Gross margin increased to 60% from 57% due to increased service fees leveraged over our relatively fixed costs of revenues.

*General and Administrative.* General and administrative expenses primarily consist of salaries for executive, administrative and financial personnel, consulting expenses and facilities costs such as office leases, insurance, and depreciation. General and administrative expenses increased \$3.6 million, or 59%, to \$9.9 million for the nine months ended September 30, 2005, from \$6.3 million in the same period of 2004. The increase related to the inclusion of the new card segment and custom solutions group (formerly IDS and part of the banking segment), and to increased depreciation expense, rent expense and salary and benefits costs as a result additional headcount.

*Sales and Marketing.* Sales and marketing expenses include salaries and commissions paid to sales and marketing personnel, consumer marketing costs, public relations costs, and other costs incurred in marketing our services and products. Sales and marketing expenses increased \$2.2 million, or 40%, to \$7.6 million for the nine months ended September 30, 2005, from \$5.4 million in 2004. In addition to the costs related to the inclusion of the new card segment and custom solutions group (formerly IDS and part of the banking segment), the increase was the result of increased salary and benefits costs as a result of the expansion of our sales and client services groups, increased remuneration expenses to our reseller partners owing to higher user and transaction volumes, increased marketing costs resulting from running a higher number of client-sponsored marketing programs and increased sales commissions due to higher sales activity in 2005.

*Systems and Development.* Systems and development expenses include salaries, consulting fees and all other expenses incurred in supporting the research and development of new services and products and new technology to enhance existing products. Systems and development expenses increased \$0.7 million to \$3.5 million for the nine months ended September 30, 2005. The increase was the result of the inclusion of the new card segment and custom solutions group (formerly IDS and part of the banking segment), respectively, in 2005. Even though systems and development costs in the banking segment increased relative to 2004 as a result of increased headcount, this increase was offset by an increase in the amount of costs capitalized in accordance with SOP No. 98-1. We capitalized \$3.2 million of development costs associated with software developed or obtained for internal use during the nine months ended September 30, 2005, compared to \$2.0 million in 2004.

*Income from Operations.* Income from operations increased \$2.6 million, or 90%, to \$5.6 million for the nine months ended September 30, 2005. The increase was due to an increase in service fee revenues leveraged over relatively fixed costs, \$0.9 million in additional operating income for the new card segment and additional one-time termination fees received in 2005 compared to 2004.

*Other Income, Net.* Other income increased \$0.5 million due to a \$0.7 million increase in interest income resulting from interest earned on the proceeds from the secondary offering completed in April 2005, partially offset by a \$0.2 million increase in income tax expense.

*Net Income.* Net income was \$6.1 million for the nine months ended September 30, 2005, compared to \$3.0 million for the same period of 2004. Basic net income per share was \$0.27 and \$0.17 for the nine months ended September 30, 2005 and 2004, respectively, while diluted net income per share was \$0.24 and \$0.15 for the nine months ended September 30, 2005 and 2004, respectively. Basic and diluted shares outstanding increased by 27% and 26%, respectively, compared to 2004 as a result of shares issued as part of the secondary offering in April 2005 and shares issued related to the Incurrent and IDS acquisitions. Diluted shares outstanding also increased as a result of the impact of our rising share price on the fully diluted share calculation.

#### **LIQUIDITY AND CAPITAL RESOURCES**

Since inception, we have primarily financed our operations through private placements and public offerings of our common and preferred stock and the issuance of debt. We have also entered into various capital lease financing agreements. Cash and cash equivalents were \$51.5 and \$3.3 million as of September 30, 2005 and December 31, 2004, respectively. The \$48.2 million increase in cash and cash equivalents results from \$13.3 and \$42.3 million in cash provided by operating and financing activities, respectively, \$1.3 million in net sales of available-for-sale securities, partially offset by \$5.4 million in capital expenditures and \$3.3 million used to acquire IDS.

Net cash provided by operating activities was \$13.3 million for the nine months ended September 30, 2005 as compared to \$5.9 million during the nine months ended September 30, 2004. Approximately 90% of the cash generated by operating activities in 2005 was recurring in nature, while approximately 91% of the cash generated by operating activities in 2004 was recurring in nature.

Net cash used in investing activities for the nine months ended September 30, 2005 was \$7.4 million, which was the result of \$5.4 million in capital expenditures, \$3.3 million used to acquire IDS, partially offset by \$1.3 million in net sales of securities available-for-sale. Net cash used in investing activities for the nine months ended September 30, 2004 was \$5.9 million, which was the result of net purchases of \$1.0 million in available-for-sale securities and \$4.9 million in capital expenditures.

Net cash provided by financing activities was \$42.3 million for the nine months ended September 30, 2005 compared to \$0.8 million for the nine months ended September 30, 2004. During the nine months ended September 30, 2005, we generated \$2.1 million in cash through the exercise of company-issued stock options and our employees' participation in our employee stock purchase plan compared to \$0.9 million during the nine months ended September 30, 2004. We also generated \$40.2 million in cash through the issuance of common stock in connection with a secondary offering in April 2005. We issued 5.1 million primary shares of our common stock at an offering price of \$8.50, which we intend to use for acquisitions and accelerating development of products and services.

Our material commitments under operating and capital leases and purchase obligations are as follows:

	<b>TOTAL</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>THEREAFTER</b>
Capital lease obligations	\$ 15,867	\$ 8,169	\$ 7,698	\$	\$
Operating lease	19,893,514	658,515	2,747,749	2,257,216	14,230,034
Purchase obligations	490,000	65,000	305,000	120,000	
Total obligations	\$ 20,399,381	\$ 731,684	\$ 3,060,447	\$ 2,377,216	\$ 14,230,034

Future capital requirements will depend upon many factors, including the timing of research and product development efforts and the expansion of our marketing effort. We expect to continue to expend significant amounts on expansion of facility infrastructure, ongoing research and development, computer and related equipment, and

personnel.

We currently believe that cash on hand, investments and the cash we expect to generate from operations will be sufficient to meet our current anticipated cash requirements for at least the next twelve months. We expect to have additional cash requirements over the next two to three years because of efforts we are undertaking to upgrade and rewrite certain of our infrastructure applications. We forecast that all incremental expenses related to this undertaking can be financed out of cash provided by operating activities.

There can be no assurance that additional capital beyond the amounts currently forecasted by us will not be required or that any such required additional capital will be available on reasonable terms, if at all, at such time as required. We intend to invest our cash in excess of current operating requirements in marketable government, corporate and mortgage-backed securities.

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

We invest primarily in short-term, investment grade, marketable government, corporate, and mortgage-backed debt securities. Our interest income is most sensitive to changes in the general level of U.S. interest rates and given the short-term nature of our investments, our exposure to interest rate risk is not material. We do not have operations subject to risks of foreign currency fluctuations, nor do we use derivative financial instruments in our operations or investment portfolio.

**ITEM 4. CONTROLS AND PROCEDURES.**

Restatement

On August 15, 2005, we concluded that the our financial statements for the fiscal periods ending December 31, 2004 and 2003 and the first interim period of 2005 should be restated to reflect an amendment to the accounting treatment of unclaimed bill payment checks.

In the third quarter of 2003, we had adopted a policy to recognize as assets the amounts underlying bill payment checks drawn upon our escrow accounts that have been outstanding for at least a year. Our policy was to recognize checks that were more than a year outstanding and less than \$200 after one year as an offset to payment processing costs after taking a 5% reserve on the assets. Checks greater than \$200 were recognized as assets after they were outstanding for two years with no reserve on the assets. We adopted this policy after obtaining a legal analysis from outside counsel and conferring with our independent auditors as to the accounting treatment that should apply to this policy. We determined to retroactively change this policy so that we would no longer recognize the amounts underlying aged bill payment checks as assets. Instead, we determined to either return aged bill payment funds to our financial institution clients or surrender the funds underlying the checks in accordance with state unclaimed property laws.

After management's decision to amend our accounting treatment of unclaimed bill payment checks on August 15, 2005, management recommended to the Audit Committee that, upon completion of our analysis of the impact of the items described above, our previously filed financial statements be restated to reflect the correction of this item. The Audit Committee agreed with this recommendation. On August 15, 2005, upon completion of our analysis, the Audit Committee approved our restated financial statements included in this Amendment.

#### Evaluation of Disclosure Controls and Procedures

In connection with the restatements, we re-evaluated our disclosure controls and procedures. We concluded that with respect to our prior policy, we failed to properly account for the treatment of unclaimed bill payment checks under SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities* ( SFAS No. 140 ). This failure constituted a material weakness in our internal control over financial reporting. Solely as a result of this material weakness, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of December 31, 2004.

#### Remediation of Material Weakness in Internal Control

SFAS No. 140 no longer applies to our aged bill payment check policy because we no longer withdraw cash from the escrow account. Accordingly, there are no new or modified internal control procedures required to remediate the issue caused by the material weakness we identified.

### **PART II. OTHER INFORMATION**

#### **ITEM 1. LEGAL PROCEEDINGS.**

We are not a party to any pending material litigation nor are we aware of any pending or threatened litigation that would have a material adverse effect on the Company, our business or results of operation.

#### **ITEM 2. UNREGISTERED SALES OF SECURITIES AND USE OF PROCEEDS.**

None

#### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

None

#### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

None

#### **ITEM 5. OTHER INFORMATION.**

None

#### **ITEM 6. EXHIBITS.**

Exhibit 31.1 Rule 13a-14a Certification of Chief Executive Officer

Exhibit 31.2 Rule 13a-14a Certification of Chief Financial Officer

Exhibit 32 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code)

**SIGNATURES**

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.

ONLINE RESOURCES CORPORATION

Date: November 9, 2005

By: /s/ Matthew P. Lawlor

Matthew P. Lawlor  
Chairman and Chief Executive Officer  
(Principal Executive Officer)

ONLINE RESOURCES CORPORATION

Date: November 9, 2005

By: /s/ Catherine A. Graham

Catherine A. Graham  
Executive Vice President and Chief Financial  
Officer  
(Principal Financial Officer)