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VERTRUE INC
Form 10-Q
May 10, 2006

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

FORM 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended March 31, 2006
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 No. 0-21527

VERTRUE INCORPORATED

(Exact name of registrant as specified in its charter)

DELAWARE

(State of Incorporation)

06-1276882

(IRS Employer Identification No.)

20 Glover Avenue
Norwalk, Connecticut

(Address of principal executive offices)

06850

(Zip Code)

(203) 324-7635

(Registrant's telephone number, including area code)

680 Washington Boulevard, Stamford, Connecticut 06901

(Former address, if changed since last report)

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 [X] No []

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

Large accelerated filer [] Accelerated filer [X] Non-accelerated filer []

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 9,827,000 shares of Common Stock, \$0.01 par value as of April 28, 2006.

VERTRUE INCORPORATED INDEX TO FORM 10-Q

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VERTRUE INCORPORATED ITEM 1. CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

CONSOLIDATED BALANCE SHEETS (in thousands, except per share amounts)

| March 31, 2006 | June 30, 2005 |
|-------------------|------------------|
|-------------------|------------------|

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| | | ----- | ----- |
|---|------------|------------|-------|
| Assets | | | |
| Current assets: | | | |
| Cash and cash equivalents | \$ 54,704 | \$ 64,356 | |
| Restricted cash | 3,506 | 3,411 | |
| Short-term investments | 32,727 | 16,223 | |
| Accounts receivable | 16,034 | 12,559 | |
| Prepaid membership materials | 3,362 | 2,557 | |
| Prepaid expenses and other current assets | 15,445 | 8,695 | |
| Deferred marketing costs | 30,314 | 39,226 | |
| | ----- | ----- | |
| Total current assets | 156,092 | 147,027 | |
| Fixed assets, net | 41,353 | 39,062 | |
| Goodwill | 212,670 | 201,499 | |
| Intangible assets, net | 39,952 | 46,476 | |
| Other assets | 15,848 | 13,098 | |
| | ----- | ----- | |
| Total assets | \$ 465,915 | \$ 447,162 | |
| | ===== | ===== | |
| Liabilities and Shareholders' Deficit | | | |
| Current liabilities: | | | |
| Current maturities of long-term obligations | \$ 749 | \$ 686 | |
| Accounts payable | 41,049 | 42,077 | |
| Accrued liabilities | 86,960 | 82,157 | |
| Deferred revenues | 95,702 | 108,117 | |
| Deferred income taxes | 9,750 | 9,780 | |
| | ----- | ----- | |
| Total current liabilities | 234,210 | 242,817 | |
| Deferred income taxes | 9,509 | 9,702 | |
| Other long-term liabilities | 8,053 | 5,257 | |
| Long-term debt | 237,939 | 237,814 | |
| | ----- | ----- | |
| Total liabilities | 489,711 | 495,590 | |
| | ----- | ----- | |
| Commitments and contingencies | - | - | |
| Shareholders' deficit: | | | |
| Preferred stock, \$0.01 par value -- 1,000 shares authorized; no shares issued | - | - | |
| Common stock, \$0.01 par value -- 40,000 shares authorized; 20,112 shares issued (19,703 shares at June 30, 2005) | 201 | 197 | |
| Capital in excess of par value | 183,958 | 169,463 | |
| Retained earnings | 56,126 | 35,680 | |
| Accumulated other comprehensive income (loss) | 202 | (148) | |
| Treasury stock, 10,295 shares at cost (10,020 shares at June 30, 2005) | (264,283) | (253,620) | |
| | ----- | ----- | |
| Total shareholders' deficit | (23,796) | (48,428) | |
| | ----- | ----- | |
| Total liabilities and shareholders' deficit | \$ 465,915 | \$ 447,162 | |
| | ===== | ===== | |

The accompanying notes are an integral part of these consolidated financial statements.

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VERTRUE INCORPORATED ITEM 1. CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

CONSOLIDATED STATEMENTS OF OPERATIONS (in thousands, except per share amounts)

| | Three months ended March 31, | | Nine months ended March 31, | |
|---|---------------------------------|------------|--------------------------------|------------|
| | 2006 | 2005 | 2006 | 2005 |
| Revenues | \$ 163,841 | \$ 148,995 | \$ 481,499 | \$ 421,097 |
| Expenses: | | | | |
| Marketing | 81,626 | 75,968 | 231,795 | 213,189 |
| Operating | 38,038 | 31,107 | 108,379 | 81,269 |
| General and administrative | 31,337 | 27,914 | 89,318 | 78,821 |
| Amortization of intangibles | 1,878 | 2,467 | 6,511 | 5,764 |
| Operating income | 10,962 | 11,539 | 45,496 | 42,054 |
| Interest expense, net | (4,140) | (4,993) | (12,984) | (14,247) |
| Other income (expense), net | 13 | 13 | (148) | 306 |
| Income before income taxes | 6,835 | 6,559 | 32,364 | 28,113 |
| Provision for income taxes | 2,694 | 2,206 | 11,918 | 10,281 |
| Net income | \$ 4,141 | \$ 4,353 | \$ 20,446 | \$ 17,832 |
| Earnings per share: | | | | |
| Basic | \$ 0.43 | \$ 0.44 | \$ 2.11 | \$ 1.77 |
| Diluted | \$ 0.38 | \$ 0.40 | \$ 1.78 | \$ 1.55 |
| Weighted average common shares used in earnings per share calculations: | | | | |
| Basic | 9,728 | 9,915 | 9,713 | 10,072 |
| Diluted | 12,848 | 13,005 | 12,820 | 13,014 |

The accompanying notes are an integral part of these consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS (In thousands)

| | Nine months ended March 31, | |
|---|--------------------------------|-----------|
| | 2006 | 2005 |
| Operating activities | | |
| Net income | \$ 20,446 | \$ 17,832 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Change in deferred revenues | (12,641) | (24,309) |
| Change in deferred marketing costs | 9,008 | 10,830 |
| Depreciation and amortization | 19,781 | 16,879 |
| Stock-based compensation | 3,362 | - |
| Deferred income taxes | (206) | 3,516 |
| Excess tax benefit from stock-based compensation | (1,457) | 1,545 |
| Other | (639) | 174 |
| Change in assets and liabilities: | | |
| Restricted cash | (95) | (155) |
| Accounts receivable | (3,475) | (2,894) |
| Prepaid membership materials | (805) | 256 |
| Prepaid expenses | (1,397) | (1,424) |
| Other assets | (8,904) | (1,158) |
| Accounts payable | (798) | 1,457 |
| Accrued and other liabilities | 15,383 | 2,007 |
| Net cash provided by operating activities | 37,563 | 24,556 |
| Investing activities | | |
| Acquisition of fixed assets | (14,862) | (7,407) |
| Purchases of short-term investments | (121,875) | (397,462) |
| Sales of short-term investments | 106,383 | 491,548 |
| Acquisitions of businesses, net of cash acquired | (14,942) | (65,687) |
| Net cash (used in) provided by investing activities | (45,296) | 20,992 |
| Financing activities | | |
| Net proceeds from issuance of stock | 7,400 | 9,795 |
| Excess tax benefit from stock-based compensation | 1,457 | - |
| Treasury stock purchases | (10,663) | (33,817) |
| Debt issuance costs | (125) | (803) |
| Payments of long-term obligations | (519) | (373) |
| Net cash used in financing activities | (2,450) | (25,198) |
| Effect of exchange rate changes on cash and cash equivalents | 531 | 212 |
| Net (decrease) increase in cash and cash equivalents | (9,652) | 20,562 |
| Cash and cash equivalents at beginning of year | 64,356 | 47,166 |
| Cash and cash equivalents at end of period | \$ 54,704 | \$ 67,728 |

The accompanying notes are an integral part of these consolidated financial statements.

VERTRUE INCORPORATED
ITEM 1. CONDENSED FINANCIAL STATEMENTS (UNAUDITED)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - NATURE OF BUSINESS

Vertrue Incorporated ("Vertrue" or the "Company") is a leading internet marketing services company. The Company gives consumers access to services that offer substantial discounts and convenience for important decisions in their everyday lives. The Company's services span healthcare, personal property, security/insurance, discounts and personals and are all offered online through an array of marketing channels. Vertrue is a premier marketing partner to corporate clients and its services enable partners to enhance market presence, strengthen customer affinity and generate additional value.

NOTE 2 - 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 for interim financial information and include the accounts of the Company, its wholly owned subsidiaries and variable interest entities required to be consolidated. All significant intercompany accounts and transactions have been eliminated. Such statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair statement have been included. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements in conformity with generally accepted accounting principles requires management of the Company to make estimates, judgments and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Operating results for the three and nine months ended March 31, 2006 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2006. For further information, refer to the financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2005.

The Company acquired Bargain Network, Inc. ("Bargain") on November 30, 2004 and My Choice Medical Holdings, Inc. ("MCM") on January 1, 2005. Therefore, their results of operations have been included in the consolidated results of operations since their acquisition dates. The results of Bargain have been included in the Marketing Services segment and the results of MCM have been included in the Management Services segment.

NOTE 3 - STOCK-BASED COMPENSATION

The Company adopted Financial Accounting Standards Board Statement ("SFAS") No. 123(R), "Share-Based Payment" ("SFAS 123R") on July 1, 2005. SFAS 123R established the accounting for share-based compensation and requires companies to measure and recognize compensation expense for all share-based payments at fair value. Accordingly, share-based compensation cost is measured at grant date based on the fair value of the award and is recognized as expense over the requisite service period. The Company adopted the modified prospective application method as permitted by SFAS 123R.

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 ITEM 1. CONDENSED FINANCIAL STATEMENTS (UNAUDITED)
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Prior to the adoption of SFAS 123R, the Company accounted for its share-based employee compensation plans under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and the related interpretations. If compensation cost for the Company's stock-based compensation plans had been determined based on the fair value method (estimated using the Black-Scholes option pricing model) at the grant dates in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation," ("SFAS 123"), the Company's pro forma net income and earnings per share would have been as follows for the three and nine months ended March 31, 2005 (in thousands, except per share data):

| | Three months ended March 31, 2005 | Nine months ended March 31, 2005 |
|---|--------------------------------------|-------------------------------------|
| | ----- | ----- |
| Net income reported | \$ 4,353 | \$ 17,832 |
| Add: Stock-based employee compensation expense under the intrinsic value method, net of related tax effects | - | - |
| Deduct: Stock-based employee compensation expense under the fair value method, net of related tax effects (1) | 986 | 2,926 |
| | ----- | ----- |
| Pro forma net income | \$ 3,367 | \$ 14,906 |
| | ===== | ===== |
| Earnings per share: | | |
| As reported | | |
| Basic | \$ 0.44 | \$ 1.77 |
| Diluted | \$ 0.40 | \$ 1.55 |
| Pro forma | | |
| Basic | \$ 0.34 | \$ 1.48 |
| Diluted | \$ 0.32 | \$ 1.31 |

(1) Compensation expense was reduced for forfeitures as they occurred.

The Company evaluated its valuation method and assumptions in connection with SFAS 123R. The Company determined that the use of the Black-Scholes option-pricing model was appropriate and is consistent with the Company's pro forma disclosures under the fair value recognition provisions of SFAS 123. The Company believes it has used appropriate assumptions in accordance with SFAS 123R to estimate the fair value of its stock options and its employee stock purchase plan during the three and nine months ended March 31, 2006. The following weighted average assumptions were used to estimate the fair value of options granted:

| | Three months ended March 31, | | Nine months ended March 31, | |
|--|---------------------------------|-------|--------------------------------|-------|
| | ----- | ----- | ----- | ----- |
| Black-Scholes Option Valuation Assumptions | 2006 | 2005 | 2006 | 2005 |
| | ----- | ----- | ----- | ----- |
| Dividend yield | 0.0% | 0.0% | 0.0% | 0.0% |
| Expected volatility (1) | 57% | 61% | 64% | 66% |
| Risk free interest rate (2) | 4.6% | 3.7% | 3.9% | 3.7% |
| Expected lives (in years) (3) | 5.0 | 5.0 | 5.6 | 5.0 |

(1) Estimated based on the historical volatility of the Company's stock.

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- (2) Based on the U.S. Treasury yield curve in effect at the time of grant with a term consistent with the expected life of the options granted.
- (3) Estimated based on historical exercise experience and expected future results of similar grants.

The weighted average fair values of options granted during the three and nine months ended March 31, 2006 estimated on the grant date using the Black-Scholes option-pricing model with the assumptions listed above were \$22.94 and \$21.23, respectively. The weighted average fair values of options granted during the three and nine months ended March 31, 2005 estimated on the grant date using the Black-Scholes option-pricing model with the assumptions listed above were \$22.07 and \$18.24, respectively.

For the three and nine months ended March 31, 2006, the Company recognized \$1,112,000 (\$674,000 net of tax, or \$0.05 per diluted share) and \$3,362,000 (\$2,125,000 net of tax, or \$0.17 per diluted share), respectively, in general and administrative expenses related to stock option compensation. As of March 31, 2006, unrecognized stock compensation expense related to unvested options was \$8,379,000, which is expected to be recognized over a weighted average period of 2.6 years.

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VERTRUE INCORPORATED
ITEM 1. CONDENSED FINANCIAL STATEMENTS (UNAUDITED)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The total intrinsic value of options exercised during the three and nine months ended March 31, 2006 was \$7,045,000 and \$9,164,000, respectively, and \$5,864,000 and \$10,411,000 during the three and nine months ended March 31, 2005, respectively. The total cash received as a result of employee stock option exercises for the three and nine months ended March 31, 2006 was \$4,671,000 and \$7,400,000, respectively, and \$3,558,000 and \$9,795,000 during the three and nine months ended March 31, 2005, respectively. The tax benefits realized in connection with these exercises were \$897,000 and \$1,457,000 during the three and nine months ended March 31, 2006, respectively, and \$606,000 and \$1,545,000 during the three and nine months ended March 31, 2005, respectively.

As of March 31, 2006, the Company had the following stock-based compensation plans which are described below.

Under the 1996 Stock Option Plan, the Board of Directors can determine the date on which options vest and become exercisable as well as the term of the options granted. The 1996 Stock Option Plan is authorized to grant options to acquire 5,524,000 shares of Common Stock.

Under the 1995 Executive Officers' Stock Option Plan and the 1995 Non-Employee Directors' Stock Option Plan, the Board is authorized to grant 360,000 and 180,000 options, respectively, to acquire shares of Common Stock at a price per share equal to or greater than fair market value at the grant date. Under the Executive Officers' Stock Option Plan, the Board can determine the date on which options vest and become exercisable.

Under the stock option plans described above, options generally become exercisable over a four to five year period and expire at the earlier of termination of employment or ten years from the grant date.

In addition, the 2005 Equity Incentive Plan has 1,000,000 shares authorized, reserved and available for issuance. Awards granted may be in the form of stock

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options, restricted stock, restricted stock units, stock appreciation rights, performance stock and performance stock units. As of March 31, 2006, no awards have been made under this plan. The Board of Directors has the authority to determine the form, terms and conditions of awards at the time of grant, including vesting, exercisability, payment, and the effect, if any, that a participant's termination of service will have on an award.

As of March 31, 2006, 4,074,000 shares of common stock were reserved for issuance under these stock incentive plans, of which 1,477,000 shares were available for future grant.

Information with respect to options to purchase shares issued under the above plans is as follows (shares in thousands):

| | Shares | Weighted Average Exercise Price |
|-------------------------------|--------|--|
| Outstanding at July 1, 2005 | 2,872 | \$ 22.16 |
| Granted | 235 | 38.43 |
| Exercised | (404) | 18.00 |
| Forfeited or expired | (106) | 32.60 |
| | 2,597 | 23.85 |
| Outstanding at March 31, 2006 | 2,597 | 23.85 |
| | 2,597 | 23.85 |

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VERTRUE INCORPORATED
ITEM 1. CONDENSED FINANCIAL STATEMENTS (UNAUDITED)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes the Company's stock options outstanding and exercisable as of March 31, 2006 (shares in thousands):

| | Options Outstanding | | | | Options Exercisable | | |
|---------------------|---------------------|--------|---|---|--------------------------------------|--------|---|
| | Exercise Price | Shares | Weighted Average Remaining Contractual Term (Yrs) | Weighted Average Exercise Price (\$) | Aggregate Intrinsic Value (\$) | Shares | Weighted Average Exercise Price (\$) |
| \$7.98 - \$13.05 | 441 | 6.03 | 12.42 | 12,952 | 314 | 12.16 | 9,307 |
| \$13.05 - \$19.375 | 376 | 3.85 | 16.43 | 9,554 | 342 | 16.40 | 8,674 |
| \$19.375 - \$25.563 | 557 | 5.68 | 20.69 | 11,765 | 496 | 20.66 | 10,488 |
| \$25.563 - \$29.875 | 852 | 4.86 | 29.47 | 10,502 | 699 | 29.43 | 8,638 |
| \$29.875 - \$43.00 | 371 | 9.07 | 36.87 | 1,838 | 23 | 33.12 | 203 |
| | 2,597 | 5.69 | 23.85 | 46,611 | 1,874 | 21.89 | 37,310 |
| | 2,597 | 5.69 | 23.85 | 46,611 | 1,874 | 21.89 | 37,310 |

The weighted average remaining contractual term of stock options exercisable as of March 31, 2006 was 4.73 years. Of the options outstanding, the Company expects 2,525,000 options to vest. Options expected to vest have a weighted

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average exercise price of \$23.57, a weighted average remaining contractual term of 5.5 years and an intrinsic value of \$46,042,000.

NOTE 4 - GOODWILL AND OTHER INTANGIBLE ASSETS

The gross carrying value and accumulated amortization of goodwill and other intangibles are as follows (in thousands):

| | March 31, 2006 | | June 30, | |
|---|-----------------------------|-----------------------------|-----------------------------|----------|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Ac Am |
| Amortizable intangible assets: | | | | |
| Membership and client relationships | \$ 40,215 | \$ 20,419 | \$ 40,215 | \$ |
| Trade names | 21,859 | 2,751 | 21,859 | |
| Other | 1,505 | 1,424 | 1,518 | |
| Total amortizable intangible assets | \$ 63,579 | \$ 24,594 | \$ 63,592 | \$ |
| Amortizable intangible assets, net | \$ 38,985 | | \$ 45,509 | |
| Indefinite-lived intangible assets: | | | | |
| Goodwill | \$ 212,670 | | \$ 201,499 | |
| Intangible asset related to minimum pension liability | \$ 967 | | \$ 967 | |

Changes in the carrying amount of goodwill by segment during the nine months ended were as follows (in thousands):

| | March 31, 2006 | | | |
|--------------------------------|-----------------------|-----------|------------------------|------------|
| | Marketing Services | Personals | Management Services | Total |
| Balance at beginning of period | \$ 95,917 | \$ 82,215 | \$ 23,367 | \$ 201,499 |
| Purchase adjustments and other | 515 | (189) | 10,845 | 11,171 |
| Balance at end of period | \$ 96,432 | \$ 82,026 | \$ 34,212 | \$ 212,670 |

As required by SFAS 142, goodwill was tested for impairment during the quarters ended September 30, 2005 and 2004 using a July 1 measurement date. The Company concluded that none of its goodwill was impaired. Fair value was estimated using discounted cash flow methodologies. In addition, the Company reassessed the estimated useful lives of its definite lived intangible assets and determined that the lives were appropriate. The Company will continue to test the goodwill of each of its reporting units annually or more frequently if impairment indicators exist.

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The Company uses purchase option contracts and forward contracts to minimize its exposure to changes in future cash flows caused by movements in foreign currency exchange rates between the U.S. dollar and the Canadian dollar. Derivatives are held only for the purpose of hedging such risks and are not used for speculative purposes. Derivatives used to hedge forecasted cash flows associated with Canadian dollar denominated forecasted transactions that meet the criteria for hedge accounting are designated as cash flow hedges. The effective portion of derivative gains and losses for cash flow hedges is deferred as a component of accumulated other comprehensive income and is recognized when the underlying hedged item is recognized in earnings.

The fair value of these contracts is included in prepaid expenses and other current assets. As of March 31, 2006 and June 30, 2005, the fair value of these instruments was \$243,000 (asset) and \$559,000 (asset), respectively. Derivative gains recognized in earnings were recorded in operating expenses and general and administrative expenses and amounted to \$265,000 and \$678,000 for the three and nine months ended March 31, 2006, respectively, and \$416,000 and \$1,027,000 for the three and nine months ended March 31, 2005, respectively. All forecasted transactions currently being hedged are expected to occur over the remaining fiscal year.

NOTE 6 - ALLOWANCE FOR MEMBERSHIP CANCELLATIONS

Accrued liabilities reported in the accompanying unaudited condensed consolidated balance sheets as of March 31, 2006 and June 30, 2005 include an allowance for membership cancellations of \$9,308,000 and \$11,232,000, respectively.

NOTE 7 - COMMITMENTS AND CONTINGENCIES

The Company operates in leased facilities. Management expects that leases currently in effect will be renewed or replaced by other leases of a similar nature and term.

The Company has an amended and restated senior secured credit facility dated as of March 17, 2006, which allows borrowings of up to \$50,000,000. Borrowings under this senior secured credit facility accrue interest at the Eurodollar rate plus an applicable margin or the Prime rate plus an applicable margin. There were no borrowings outstanding under this senior secured credit facility as of March 31, 2006. This credit facility matures on March 31, 2009.

Contingent payments related to the acquisition of MCM of up to \$56,000,000 may be paid if certain performance targets, including increasing levels of revenues and earnings, are achieved during the three calendar years ending December 31, 2007. As of March 31, 2006, the Company has recorded \$10,726,000 in accrued liabilities related to contingent payments paid during the fourth quarter of fiscal 2006.

As of March 31, 2006, the Company had outstanding purchase obligations of \$11,846,000 primarily related to marketing agreements and contracts for the Company's software, equipment and other services. In addition, as of March 31, 2006, the Company had commitments of \$57,365,000 related to existing operating leases.

During the quarter ended March 31, 2006, the Company recovered certain expenses related to litigation settled during the current period. As a result, the Company recognized a benefit of \$1,585,000 and \$967,000 in general and administrative expenses during the three and nine months ended March 31, 2006, respectively.

Legal proceedings

Except as set forth below, in management's opinion, there are no significant legal proceedings to which the Company or any of its subsidiaries is a party or to which any of their properties is subject. The Company or its subsidiaries are

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involved in other lawsuits and claims generally incidental to their respective businesses including, but not limited to, various suits, including previously disclosed suits, brought by individual consumers seeking monetary and/or injunctive relief relating to the marketing of the Company's services. In addition, from time to time in the regular course of its business, the Company or a subsidiary may receive inquiries from various federal and/or state regulatory authorities.

On October 17, 2005, the U.S. Supreme Court declined to review the Connecticut Supreme Court's May 10, 2005 decision to uphold an arbitration panel's award of \$5,458,000 in punitive damages and costs to MedValUSA Health Programs, Inc. Accordingly, the full amount of the award was paid in the quarter ending December 31, 2005. The Company recorded a one-time \$5,458,000 charge in the quarter ended June 30, 2005 related to this award.

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VERTRUE INCORPORATED
 ITEM 1. CONDENSED FINANCIAL STATEMENTS (UNAUDITED)
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 - INCOME TAX EXPENSE

Income tax expense as a percent of pre-tax income was 39.4% and 36.8% for the three and nine months ended March 31, 2006, respectively, and 33.6% and 36.6% for the three and nine months ended March 31, 2005, respectively. The effective tax rate was higher than the U.S. statutory rate for the three and nine months ended March 31, 2006 primarily due to state taxes and other non-deductible items offset by the favorable impact of foreign operations. The effective tax rate was higher than the U.S. statutory rate for the nine months ended March 31, 2005 primarily due to state taxes and other non-deductible items offset by the favorable impact of foreign operations.

The Company has open tax years in the U.S., Canada and other jurisdictions. The Company is currently under examination by the Internal Revenue Service for the fiscal year ended June 30, 2004. The audit is in the intermediate stages. No assessments have been issued.

In addition, there are certain tax years that are not currently under examination by the applicable tax authorities but may be subject to examination in the future. The results of audits are inherently uncertain. The Company periodically evaluates the adequacy of its related tax reserves, taking into account its open tax return positions and tax law changes. The Company believes that its tax reserves are appropriate. However, the final determination of tax audits could impact the Company's assessment of tax requirements.

NOTE 9 - EARNINGS PER SHARE

Basic and diluted earnings per share amounts are determined in accordance with the provisions of SFAS 128. The following table reconciles the numerators and denominators used in the computations of basic and diluted earnings per share (in thousands, except per share data):

| | Three months ended March 31, | | Ni |
|--|---------------------------------|----------|------|
| | 2006 | 2005 | 2 |
| Numerator: | | | |
| Income available to common shareholders used in basic earnings per share | \$ 4,141 | \$ 4,353 | \$ 2 |

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| | | | |
|---|----------|----------|------|
| Add back interest expense on convertible securities, net of tax | 750 | 821 | |
| | | | |
| Income available to common shareholders after assumed conversion of dilutive securities | \$ 4,891 | \$ 5,174 | \$ 2 |
| | | | |
| Denominator: | | | |
| Weighted average number of common shares outstanding - basic | 9,728 | 9,915 | |
| Effect of dilutive securities: | | | |
| Convertible securities | 2,230 | 2,230 | |
| Stock options | 890 | 860 | |
| | | | |
| Weighted average number of common shares outstanding - diluted | 12,848 | 13,005 | 1 |
| | | | |
| Basic earnings per share | \$ 0.43 | \$ 0.44 | \$ |
| | | | |
| Diluted earnings per share | \$ 0.38 | \$ 0.40 | \$ |
| | | | |

The diluted earnings per common share calculations exclude the effect of potentially dilutive shares when their effect is antidilutive. Excluded from the diluted share calculation above for the three and nine months ended March 31, 2006 are incremental weighted average stock options of approximately 342,000 and 377,000, respectively, and 25,000 and 54,000, respectively, for the three and nine months ended March 31, 2005.

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VERTRUE INCORPORATED
ITEM 1. CONDENSED FINANCIAL STATEMENTS (UNAUDITED)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10 - COMPREHENSIVE INCOME

The components of comprehensive income are as follows (in thousands):

| | Three months ended | | Nine months ended | |
|---|--------------------|----------|-------------------|-----------|
| | March 31, | | March 31, | |
| | 2006 | 2005 | 2006 | 2005 |
| Net income | \$ 4,141 | \$ 4,353 | \$ 20,446 | \$ 17,832 |
| Unrealized (loss) gain on derivative assets | (250) | (680) | (136) | 523 |
| Foreign currency translation gain (loss) | 75 | (16) | 486 | 77 |
| | | | | |
| Comprehensive income | \$ 3,966 | \$ 3,657 | \$ 20,796 | \$ 18,432 |
| | | | | |

NOTE 11 - BUSINESS SEGMENTS

The operating business segments reported below are the reportable business segments of the Company for which separate financial information is available and for which operating results are evaluated regularly by executive management in assessing performance and deciding how to allocate capital and other resources. The Company has three reportable business segments: Marketing Services, Personals and Management Services. The Marketing Services business segment primarily provides discounted products and services to consumers. The Personals business segment provides both web-based and phone-based personals services to its customers. During the quarter ended December 31, 2005, the Management Services business segment became reportable due to the increase in

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its assets and all prior periods have been restated to reflect this change. The Management Services business segment provides management services to healthcare professionals throughout the United States. The Corporate business unit includes unallocated general corporate expenses.

Management evaluates the operating results of each reportable business segment based on revenue and Adjusted EBITDA. The following is a summary of revenues, Adjusted EBITDA, capital expenditures, depreciation and amortization and assets by business segment (in thousands):

| | Three months ended March 31, | | Nine months ended March 31, | |
|---------------------------------|------------------------------|------------|-----------------------------|------------|
| | 2006 | 2005 | 2006 | 2005 |
| Revenues | | | | |
| Marketing Services | \$ 132,453 | \$ 123,949 | \$ 398,780 | \$ 359,941 |
| Personals | 18,384 | 17,998 | 55,617 | 54,244 |
| Management Services | 13,049 | 7,144 | 27,287 | 7,144 |
| Intersegment | (45) | (96) | (185) | (232) |
| Total | \$ 163,841 | \$ 148,995 | \$ 481,499 | \$ 421,097 |
| Adjusted EBITDA (1) | | | | |
| Marketing Services | \$ 19,545 | \$ 16,555 | \$ 69,450 | \$ 52,746 |
| Personals | 3,721 | 882 | 7,643 | 4,418 |
| Management Services | 2,950 | 2,057 | 3,933 | 2,057 |
| Corporate | (7,777) | (4,712) | (20,233) | (15,022) |
| Total | \$ 18,439 | \$ 14,782 | \$ 60,793 | \$ 44,199 |
| Capital Expenditures (2) | | | | |
| Marketing Services | \$ 8,033 | \$ 2,583 | \$ 14,013 | \$ 6,531 |
| Personals | 247 | 469 | 729 | 860 |
| Management Services | 64 | 16 | 120 | 16 |
| Total | \$ 8,344 | \$ 3,068 | \$ 14,862 | \$ 7,407 |

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VERTRUE INCORPORATED
 ITEM 1. CONDENSED FINANCIAL STATEMENTS (UNAUDITED)
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

| | Three months ended March 31, | | Nine months ended March 31, | |
|--------------------------------------|------------------------------|----------|-----------------------------|-----------|
| | 2006 | 2005 | 2006 | 2005 |
| Depreciation and Amortization | | | | |
| Marketing Services | \$ 2,929 | \$ 3,191 | \$ 9,277 | \$ 7,880 |
| Personals | 2,860 | 2,345 | 7,611 | 7,041 |
| Management Services | 409 | 399 | 1,214 | 399 |
| Corporate | 272 | 103 | 828 | 304 |
| Total | \$ 6,470 | \$ 6,038 | \$ 18,930 | \$ 15,624 |

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| | March 31, 2006 | June 30, 2005 |
|---------------------|-------------------|------------------|
| | ----- | ----- |
| Assets | | |
| Marketing Services | \$ 238,120 | \$ 245,635 |
| Personals | 128,884 | 132,992 |
| Management Services | 55,641 | 41,053 |
| Corporate (3) | 43,270 | 27,482 |
| | ----- | ----- |
| Total | \$ 465,915 | \$ 447,162 |
| | ===== | ===== |

- (1) Defined as net income excluding interest and other expense, net, provision for income taxes, depreciation and amortization and the changes in deferred revenue and deferred marketing costs. See reconciliation below.
- (2) Management does not allocate certain capital expenditures to the Corporate business unit. However, the associated depreciation expense has been allocated for purposes of evaluating performance.
- (3) Includes unallocated non-operating assets including short-term investments, debt issuance costs and other.

The following tables reconcile Adjusted EBITDA to income before income taxes (in thousands):

| | Three months ended March 31, 2006 | | | | |
|-------------------------------------|-----------------------------------|-----------|------------------------|------------|-----------|
| | Marketing Services | Personals | Management Services | Corporate | Total |
| | ----- | ----- | ----- | ----- | ----- |
| Income before income taxes | | | | | \$ 6,835 |
| Interest and other expense, net (1) | | | | | 4,127 |
| | | | | | ----- |
| Operating income (expense) | \$ 16,461 | \$ 821 | \$ 1,729 | \$ (8,049) | \$ 10,962 |
| Depreciation and amortization | 2,929 | 2,860 | 409 | 272 | 6,470 |
| Change in deferred revenues | (2,882) | 40 | 812 | - | (2,030) |
| Change in deferred marketing costs | 3,037 | - | - | - | 3,037 |
| | ----- | ----- | ----- | ----- | ----- |
| Adjusted EBITDA | \$ 19,545 | \$ 3,721 | \$ 2,950 | \$ (7,777) | \$ 18,439 |
| | ===== | ===== | ===== | ===== | ===== |

| | Three months ended March 31, 2005 | | | | |
|-------------------------------------|-----------------------------------|------------|------------------------|------------|-----------|
| | Marketing Services | Personals | Management Services | Corporate | Total |
| | ----- | ----- | ----- | ----- | ----- |
| Income before income taxes | | | | | \$ 6,559 |
| Interest and other expense, net (1) | | | | | 4,980 |
| | | | | | ----- |
| Operating income (expense) | \$ 17,546 | \$ (1,458) | \$ 266 | \$ (4,815) | \$ 11,539 |
| Depreciation and amortization | 3,191 | 2,345 | 399 | 103 | 6,038 |
| Change in deferred revenues | (6,327) | (5) | 1,392 | - | (4,940) |
| Change in deferred marketing costs | 2,145 | - | - | - | 2,145 |
| | ----- | ----- | ----- | ----- | ----- |
| Adjusted EBITDA | \$ 16,555 | \$ 882 | \$ 2,057 | \$ (4,712) | \$ 14,782 |
| | ===== | ===== | ===== | ===== | ===== |

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VERTRUE INCORPORATED
 ITEM 1. CONDENSED FINANCIAL STATEMENTS (UNAUDITED)
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Nine months ended March 31, 2006

| | Marketing Services | Personals | Management Services | Corporate | Total |
|-------------------------------------|-----------------------|-----------|------------------------|-------------|-----------|
| Income before income taxes | | | | | \$ 32,364 |
| Interest and other expense, net (1) | | | | | 13,132 |
| Operating income (expense) | \$ 64,231 | \$ 77 | \$ 2,249 | \$ (21,061) | \$ 45,496 |
| Depreciation and amortization | 9,277 | 7,611 | 1,214 | 828 | 18,930 |
| Change in deferred revenues | (13,066) | (45) | 470 | - | (12,641) |
| Change in deferred marketing costs | 9,008 | - | - | - | 9,008 |
| Adjusted EBITDA | \$ 69,450 | \$ 7,643 | \$ 3,933 | \$ (20,233) | \$ 60,793 |

Nine months ended March 31, 2005

| | Marketing Services | Personals | Management Services | Corporate | Total |
|-------------------------------------|-----------------------|------------|------------------------|-------------|-----------|
| Income before income taxes | | | | | \$ 28,113 |
| Interest and other expense, net (1) | | | | | 13,941 |
| Operating income (expense) | \$ 59,856 | \$ (2,742) | \$ 266 | \$ (15,326) | \$ 42,054 |
| Depreciation and amortization | 7,880 | 7,041 | 399 | 304 | 15,624 |
| Change in deferred revenues | (25,820) | 119 | 1,392 | - | (24,309) |
| Change in deferred marketing costs | 10,830 | - | - | - | 10,830 |
| Adjusted EBITDA | \$ 52,746 | \$ 4,418 | \$ 2,057 | \$ (15,022) | \$ 44,199 |

(1) Management does not allocate interest and other expense, net to the individual segments.

NOTE 12 - GUARANTOR AND NONGUARANTOR FINANCIAL INFORMATION

In April 2004, the Company issued \$150,000,000 aggregate principal amount of 9.25% Senior Notes due 2014. The Senior Notes are unsecured obligations and rank pari passu in right of payment to all of the Company's existing and future senior unsecured indebtedness and senior in right of payment to all of the Company's existing and future subordinated indebtedness that expressly provides for its subordination to the Senior Notes. The Senior Notes are fully and unconditionally guaranteed by all of the Company's existing and future domestic subsidiaries that guarantee the Company's Credit Facility (as defined in the Indenture governing the Senior Notes) and certain of the Company's existing and future foreign subsidiaries.

The following consolidating condensed financial information presents the consolidating balance sheets as of March 31, 2006 and June 30, 2005 and the related statements of operations for the three and nine months ended March 31, 2006 and 2005 and the cash flows for the nine months ended March 31, 2006 and 2005. The information includes the elimination entries necessary to consolidate

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the Company ("Parent") with the guarantor and nonguarantor entities.

Investments in subsidiaries are accounted for by the Parent using the equity method of accounting. The guarantor and nonguarantor subsidiaries are presented on a combined basis. The principal elimination entries eliminate investments in subsidiaries and intercompany balances and transactions.

Subsequent event

The Company entered into a First Supplemental Indenture dated as of April 28, 2006 that made substantially all of the Company's subsidiaries guarantors of the Company's payments under the Senior Notes. Since this occurred after March 31, 2006, the subsidiaries that became guarantors as a result of the First Supplemental Indenture are presented as nonguarantor subsidiaries in the following financial information. They will be presented as guarantor subsidiaries beginning in the quarter ending June 30, 2006 and all prior periods will be restated to conform to this presentation.

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VERTRUE INCORPORATED
ITEM 1. CONDENSED FINANCIAL STATEMENTS (UNAUDITED)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS
(In thousands)

| | March 31, 2006 | | |
|---|----------------|---------------------------|------------------------------|
| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries |
| Assets | | | |
| Current assets | \$ 92,390 | \$ 75,774 | \$ 32,483 |
| Fixed assets, net | 23,053 | 10,508 | 7,792 |
| Goodwill | - | 117,560 | 95,110 |
| Intangible assets, net | 989 | 27,293 | 11,670 |
| Other assets | 10,443 | 313 | 5,092 |
| Investment in subsidiaries | 300,238 | - | - |
| | \$ 427,113 | \$ 231,448 | \$ 152,147 |
| | \$ 427,113 | \$ 231,448 | \$ 152,147 |
| Liabilities and Shareholders' (Deficit) Equity | | | |
| Current liabilities | \$ 204,775 | \$ 45,918 | \$ 28,072 |
| Deferred income taxes | 1,629 | 7,510 | 370 |
| Other long-term liabilities | 6,566 | - | 1,487 |
| Long-term debt | 237,939 | - | - |
| | 450,909 | 53,428 | 29,929 |
| | 450,909 | 53,428 | 29,929 |
| Shareholders' (deficit) equity: | | | |
| Preferred stock | - | - | - |
| Common stock | 201 | 6 | 3 |
| Capital in excess of par value | 183,958 | 165,285 | 113,431 |
| Accumulated earnings (deficit) | 56,126 | 12,564 | 8,686 |
| Accumulated other comprehensive income (loss) | 202 | 165 | 98 |
| Treasury stock | (264,283) | - | - |

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| | | | |
|--|------------|------------|------------|
| Total shareholders' (deficit) equity | (23,796) | 178,020 | 122,218 |
| Total liabilities and shareholders' (deficit) equity | \$ 427,113 | \$ 231,448 | \$ 152,147 |

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VERTRUE INCORPORATED
ITEM 1. CONDENSED FINANCIAL STATEMENTS (UNAUDITED)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS
(In thousands)

| | June 30, 2005 | | |
|---|-------------------|---------------------------|------------------------------|
| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries |
| Assets | | | |
| Current assets | \$ 80,036 | \$ 60,684 | \$ 23,509 |
| Fixed assets, net | 18,797 | 13,098 | 7,167 |
| Goodwill | - | 117,749 | 83,750 |
| Intangible assets, net | 1,097 | 31,789 | 13,590 |
| Other assets | 10,991 | 64 | 2,043 |
| Investment in subsidiaries | 275,213 | - | - |
| Total assets | \$ 386,134 | \$ 223,384 | \$ 130,059 |
| Liabilities and Shareholders' (Deficit) Equity | | | |
| Current liabilities | \$ 190,595 | \$ 46,890 | \$ 22,534 |
| Deferred income taxes | 2,588 | 7,265 | (151) |
| Other long-term liabilities | 3,565 | - | 1,692 |
| Long-term debt | 237,814 | - | - |
| Total liabilities | 434,562 | 54,155 | 24,075 |
| Shareholders' (deficit) equity: | | | |
| Preferred stock | - | - | - |
| Common stock | 197 | 6 | 3 |
| Capital in excess of par value | 169,463 | 165,285 | 102,484 |
| Accumulated earnings (deficit) | 35,680 | 3,884 | 3,667 |
| Accumulated other comprehensive (loss) income | (148) | 54 | (170) |
| Treasury stock | (253,620) | - | - |
| Total shareholders' (deficit) equity | (48,428) | 169,229 | 105,984 |
| Total liabilities and shareholders' (deficit) equity | \$ 386,134 | \$ 223,384 | \$ 130,059 |

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VERTRUE INCORPORATED
 ITEM 1. CONDENSED FINANCIAL STATEMENTS (UNAUDITED)
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF OPERATIONS
 (In thousands)

| | Three months ended March 31, 2006 | | | | |
|----------------------------------|-----------------------------------|---------------------------|------------------------------|--------------|----------------------|
| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Eliminations | Consolidate Total |
| Revenues | \$ 96,123 | \$ 39,305 | \$ 34,509 | \$ (6,096) | \$ 163,841 |
| Expenses: | | | | | |
| Marketing | 56,496 | 18,037 | 13,118 | (6,025) | 81,626 |
| Operating | 16,658 | 8,375 | 13,076 | (71) | 38,038 |
| General and administrative | 20,320 | 6,402 | 4,615 | - | 31,337 |
| Amortization of intangibles | 9 | 1,491 | 378 | - | 1,878 |
| Operating income | 2,640 | 5,000 | 3,322 | - | 10,962 |
| Equity in income of subsidiaries | 5,152 | - | - | (5,152) | - |
| Interest (expense) income, net | (4,614) | 201 | 273 | - | (4,140) |
| Other (expense) income, net | (21) | 92 | (58) | - | 13 |
| Income before income taxes | 3,157 | 5,293 | 3,537 | (5,152) | 6,835 |
| Provision for income taxes | (984) | 2,145 | 1,533 | - | 2,694 |
| Net income | \$ 4,141 | \$ 3,148 | \$ 2,004 | \$ (5,152) | \$ 4,141 |

CONSOLIDATED STATEMENTS OF OPERATIONS
 (In thousands)

| | Three months ended March 31, 2005 | | | | |
|----------------------------------|-----------------------------------|---------------------------|------------------------------|--------------|----------------------|
| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Eliminations | Consolidate Total |
| Revenues | \$ 91,512 | \$ 37,016 | \$ 26,286 | \$ (5,819) | \$ 148,995 |
| Expenses: | | | | | |
| Marketing | 52,273 | 17,435 | 11,380 | (5,120) | 75,968 |
| Operating | 15,563 | 7,476 | 8,767 | (699) | 31,107 |
| General and administrative | 15,186 | 8,571 | 4,157 | - | 27,914 |
| Amortization of intangibles | 76 | 1,522 | 869 | - | 2,467 |
| Operating income | 8,414 | 2,012 | 1,113 | - | 11,539 |
| Equity in income of subsidiaries | 2,065 | - | - | (2,065) | - |
| Interest (expense) income, net | (5,031) | 22 | 16 | - | (4,993) |
| Other (expense) income, net | 42 | (14) | (15) | - | 13 |
| Income before income taxes | 5,490 | 2,020 | 1,114 | (2,065) | 6,559 |
| Provision for income taxes | 1,137 | 560 | 509 | - | 2,206 |
| Net income | \$ 4,353 | \$ 1,460 | \$ 605 | \$ (2,065) | \$ 4,353 |

VERTRUE INCORPORATED
 ITEM 1. CONDENSED FINANCIAL STATEMENTS (UNAUDITED)
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF OPERATIONS
 (In thousands)

| | Nine months ended March 31, 2006 | | | | |
|----------------------------------|----------------------------------|---------------------------|------------------------------|--------------|---------------------|
| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Eliminations | Consolidat Total |
| Revenues | \$ 289,896 | \$ 118,479 | \$ 88,934 | \$ (15,810) | \$ 481,499 |
| Expenses: | | | | | |
| Marketing | 160,277 | 52,872 | 33,749 | (15,103) | 231,795 |
| Operating | 50,713 | 26,090 | 32,283 | (707) | 108,379 |
| General and administrative | 54,603 | 21,427 | 13,288 | - | 89,318 |
| Amortization of intangibles | 94 | 4,494 | 1,923 | - | 6,511 |
| Operating income | 24,209 | 13,596 | 7,691 | - | 45,496 |
| Equity in income of subsidiaries | 13,699 | - | - | (13,699) | - |
| Interest (expense) income, net | (14,120) | 500 | 636 | - | (12,984) |
| Other income (expense), net | (8) | (143) | 3 | - | (148) |
| Income before income taxes | 23,780 | 13,953 | 8,330 | (13,699) | 32,364 |
| Provision for income taxes | 3,334 | 5,273 | 3,311 | - | 11,918 |
| Net income | \$ 20,446 | \$ 8,680 | \$ 5,019 | \$ (13,699) | \$ 20,446 |

CONSOLIDATED STATEMENTS OF OPERATIONS
 (In thousands)

| | Nine months ended March 31, 2005 | | | | |
|----------------------------------|----------------------------------|---------------------------|------------------------------|--------------|---------------------|
| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Eliminations | Consolidat Total |
| Revenues | \$ 280,148 | \$ 106,838 | \$ 41,632 | \$ (7,521) | \$ 421,097 |
| Expenses: | | | | | |
| Marketing | 152,145 | 50,839 | 15,832 | (5,627) | 213,189 |
| Operating | 46,311 | 21,956 | 14,896 | (1,894) | 81,269 |
| General and administrative | 46,364 | 25,340 | 7,117 | - | 78,821 |
| Amortization of intangibles | 152 | 4,593 | 1,019 | - | 5,764 |
| Operating income | 35,176 | 4,110 | 2,768 | - | 42,054 |
| Equity in income of subsidiaries | 4,652 | - | - | (4,652) | - |
| Interest (expense) income, net | (14,380) | 113 | 20 | - | (14,247) |
| Other (expense) income, net | (56) | 341 | 21 | - | 306 |

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| | | | | | |
|----------------------------|-----------|----------|----------|------------|-----------|
| Income before income taxes | 25,392 | 4,564 | 2,809 | (4,652) | 28,111 |
| Provision for income taxes | 7,560 | 1,402 | 1,319 | - | 10,281 |
| Net income | \$ 17,832 | \$ 3,162 | \$ 1,490 | \$ (4,652) | \$ 17,830 |

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VERTRUE INCORPORATED
ITEM 1. CONDENSED FINANCIAL STATEMENTS (UNAUDITED)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

| | Nine months ended March 31, 2017 | | | |
|--|----------------------------------|------------------------|---------------------------|--------------|
| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Eliminations |
| Net cash provided by (used in) operating activities | \$ 58,302 | \$ (6,162) | \$ (878) | \$ (1,000) |
| Investing activities | | | | |
| Acquisition of fixed assets | (10,196) | (1,438) | (3,228) | |
| Purchases of short-term investments | (121,875) | - | - | |
| Sales of short-term investments | 105,764 | 619 | - | |
| Acquisitions of businesses, net of cash acquired | (14,717) | (224) | (1) | |
| Investment in subsidiaries | (13,699) | - | - | |
| Net cash (used in) provided by investing activities | (54,723) | (1,043) | (3,229) | |
| Financing activities | | | | |
| Net proceeds from issuance of stock | 7,400 | - | - | |
| Excess tax benefit from stock-based compensation | 1,457 | - | - | |
| Treasury stock purchases | (10,663) | - | - | |
| Debt issuance costs | (125) | - | - | |
| Payments of long-term obligations | (293) | - | (226) | |
| Net cash used in financing activities | (2,224) | - | (226) | |
| Effect of exchange rate changes on cash and cash equivalents | - | 217 | 314 | |
| Net increase (decrease) in cash and cash equivalents | 1,355 | (6,988) | (4,019) | |
| Cash and cash equivalents at beginning of year | 24,366 | 29,821 | 10,169 | |
| Cash and cash equivalents at end of period | \$ 25,721 | \$ 22,833 | \$ 6,150 | \$ 10,169 |

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VERTRUE INCORPORATED
 ITEM 1. CONDENSED FINANCIAL STATEMENTS (UNAUDITED)
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF CASH FLOWS
 (In thousands)

| | Nine months ended March 31, 2007 | | | |
|--|----------------------------------|---------------------------|------------------------------|-------------------|
| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries | Elimi- nations |
| Net cash provided by (used in) operating activities | \$ 112,759 | \$ (89,116) | \$ 5,565 | \$ - |
| Investing activities | | | | |
| Acquisition of fixed assets | (5,043) | (1,208) | (1,156) | - |
| Purchases of short-term investments | (397,218) | (244) | - | - |
| Sales of short-term investments | 490,735 | 813 | - | - |
| Acquisitions of businesses, net of cash acquired | (160,994) | 93,937 | 1,370 | - |
| Investment in subsidiaries | (4,652) | - | - | - |
| Net cash (used in) provided by investing activities | (77,172) | 93,298 | 214 | - |
| Financing activities | | | | |
| Net proceeds from issuance of stock | 9,795 | - | - | - |
| Treasury stock purchases | (33,817) | - | - | - |
| Debt issuance costs | (803) | - | - | - |
| Payments of long-term obligations | (242) | (14) | (117) | - |
| Net cash used in financing activities | (25,067) | (14) | (117) | - |
| Effect of exchange rate changes on cash and cash equivalents | - | (272) | 484 | - |
| Net increase in cash and cash equivalents | 10,520 | 3,896 | 6,146 | - |
| Cash and cash equivalents at beginning of year | 18,251 | 26,657 | 2,258 | - |
| Cash and cash equivalents at end of period | \$ 28,771 | \$ 30,553 | \$ 8,404 | \$ - |

NOTE 13 - NEW ACCOUNTING PRONOUNCEMENTS

In May 2005, the Financial Accounting Standards Board ("FASB") issued Statement No. 154, "Accounting Changes and Error Corrections - A replacement of APB Opinion No. 20 and FASB Statement No. 3" ("SFAS 154"). This statement requires retrospective application to prior periods' financial statements of changes in accounting principles unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This statement applies to all voluntary changes in accounting principles and changes required by an accounting pronouncement that does not include specific transition provisions. SFAS 154 is effective beginning in the Company's first quarter of fiscal 2007. The Company does not expect the adoption of SFAS 154 to have a material effect on its consolidated financial position, results of operations or cash flows.

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VERTRUE INCORPORATED ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

The following discussion should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report on Form 10-K for the year ended June 30, 2005, which describes, among other things, the Company's basic business model and critical accounting policies.

The Company has three reportable business segments: Marketing Services, Personals and Management Services. During the quarter ended December 31, 2005, the Management Services business segment became reportable due to the increase in its assets. The Management Services business segment provides management services to healthcare professionals throughout the United States. For additional information about these reportable business segments, see Note 11 to the condensed consolidated financial statements in this Quarterly Report on Form 10-Q.

The results of My Choice Medical Holdings, Inc. ("MCM") and Bargain Network, Inc. ("Bargain") (collectively the "Acquired Companies") have been included in the consolidated results since their acquisitions on January 1, 2005 and November 30, 2004, respectively.

Adjusted EBITDA and EBITDA are used by the Company's management to evaluate the performance of its business. A discussion of Adjusted EBITDA can be found in "Liquidity and Capital Resources" in this Quarterly Report on Form 10-Q. A description and reconciliation of net income to EBITDA and Adjusted EBITDA are disclosed in "Reconciliation of Non-GAAP Measures" in this Quarterly Report on Form 10-Q.

| | Three months ended March 31, | | Increase/ (Decrease) | Nine months ended March 31, | | Incre (Decre |
|-------------------------------------|---------------------------------|----------|-------------------------|--------------------------------|----------|-----------------|
| (Dollars in millions) | 2006 | 2005 | '06 vs. '05 | 2006 | 2005 | '06 vs |
| Revenues | \$ 163.8 | \$ 149.0 | 10% | \$ 481.5 | \$ 421.1 | 14 |
| Marketing expenses | 81.6 | 76.0 | 7% | 231.8 | 213.2 | 9 |
| Operating expenses | 38.0 | 31.1 | 22% | 108.4 | 81.3 | 33 |
| General and administrative expenses | 31.3 | 27.9 | 12% | 89.3 | 78.8 | 13 |
| Amortization of intangibles | 1.9 | 2.5 | (24)% | 6.5 | 5.8 | 12 |
| Operating income | 11.0 | 11.5 | (4)% | 45.5 | 42.0 | 8 |
| Interest expense, net | (4.2) | (4.9) | (14)% | (13.0) | (14.2) | (8) |
| Other (expense) income, net | - | - | 0% | (0.2) | 0.3 | (167) |
| Income before income taxes | 6.8 | 6.6 | 3% | 32.3 | 28.1 | 15 |
| Provision for income taxes | 2.7 | 2.2 | 23% | 11.9 | 10.3 | 16 |
| Net income | \$ 4.1 | \$ 4.4 | (7)% | \$ 20.4 | \$ 17.8 | 15 |
| EBITDA | \$ 17.4 | \$ 17.6 | (1)% | \$ 64.4 | \$ 57.7 | 12 |

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 ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS
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The following table sets forth revenue by payment plan and by segment (in millions):

| | Three months ended March 31, | | Increase/ (Decrease) '06 vs. '05 | Nine months ended March 31, | | Increase/ (Decrease) '06 vs. '05 |
|--------------------------|---------------------------------|----------|--|--------------------------------|----------|--|
| | 2006 | 2005 | | 2006 | 2005 | |
| Revenues | | | | | | |
| Monthly payment plans | \$ 89.0 | \$ 67.4 | 32% | \$ 258.7 | \$ 172.9 | 50% |
| Annual payment plans: | | | | | | |
| Initial year | 7.6 | 11.7 | (35)% | 25.5 | 45.7 | (44)% |
| Renewal year | 26.8 | 36.8 | (27)% | 87.6 | 118.7 | (26)% |
| Other | 9.1 | 8.1 | 12% | 27.0 | 22.7 | 19% |
| Total Marketing Services | 132.5 | 124.0 | 7% | 398.8 | 360.0 | 11% |
| Personals | 18.3 | 17.9 | 2% | 55.4 | 54.0 | 3% |
| Management Services | 13.0 | 7.1 | 83% | 27.3 | 7.1 | 285% |
| Total | \$ 163.8 | \$ 149.0 | 10% | \$ 481.5 | \$ 421.1 | 14% |

For the Three Months Ended March 31, 2006 and 2005

Revenues increased \$14.8 million, or 10%, in 2006 primarily due to growth in the Marketing Services Segment and the Management Services Segment, as discussed below. Net active retail members and customers increased 3% to 6.5 million at March 31, 2006 from 6.3 million at March 31, 2005.

Marketing Services revenues increased \$8.5 million, or 7%, in the 2006 fiscal third quarter due to a 32% increase in revenues from members enrolled in monthly payment plans partially offset by a 29% decrease in revenue from members enrolled in annual payment plans. The increase in revenues from monthly payment plans was due to a 23% increase in average monthly members billed and a 6% increase in the monthly member price point. Revenues from members enrolled in annual payment plans continue to decrease for both initial year members and renewal members due to the continued shift to enrolling new members in monthly payment programs as well as the attrition of the annual renewal base.

Personals revenues increased \$0.4 million, or 2%, in the 2006 fiscal third quarter primarily due to the incremental revenue generated from Lavalife's growing mobile service. Management Services revenues increased \$5.9 million, or 83%, in the 2006 fiscal third quarter primarily due to an increase in the number of transactions managed and the mix of transactions performed.

Marketing expenses increased \$5.6 million, or 7%, in the 2006 fiscal third quarter and as a percent of revenues, were 50% this year versus 51% last year. Operating expenses increased \$6.9 million, or 22%, in the 2006 fiscal third quarter and as a percent of revenues, were 23% this year versus 21% last year. The Acquired Companies have a higher proportion of their cost structure included

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as operating expenses offset by a lower proportion included as marketing expenses. On a combined basis Marketing and Operating expenses increased 12% in the 2006 fiscal third quarter and as a percent of revenues were 73% this year versus 72% last year. The 12% increase was primarily due to the inclusion of the costs incurred by the Acquired Companies. The overall increase as a percent of revenue is due to the increased cost of servicing the higher member and customer base. Marketing expenses as a percentage of revenues, excluding the impact of the Acquired Companies, would have been 54% this year versus 53% last year despite a decrease in marketing cost before deferral as a percent of revenue before deferral, excluding the impact of the Acquired Companies.

General and administrative expenses increased \$3.4 million, or 12%, in the 2006 fiscal third quarter and included a \$1.1 million charge related to the adoption of Financial Accounting Standards Board Statement No. 123(R), "Share-Based Payment" ("SFAS 123R") offset by a one time \$1.6 million benefit realized on the recovery of certain expenses related to litigation settled during the current quarter. The remaining increase in general and administrative expenses was due to increased employee related and occupancy related expenses.

Amortization of intangible assets decreased \$0.6 million, or 24%, in the 2006 fiscal third quarter due to certain intangibles reaching the end of their estimated useful lives.

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VERTRUE INCORPORATED ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Operating income decreased \$0.5 million, or 4%, in the 2006 fiscal third quarter and as a percent of revenues, was 7% this year and 8% last year. The decrease in operating income is primarily due to the increase in operating and marketing expenses as a percent of revenue discussed above.

Interest expense, net decreased \$0.7 million, or 14%, in the 2006 fiscal third quarter and included \$3.6 million of interest expense related to the 9.25% Senior Notes and \$1.2 million of interest expense related to the 5.5% Convertible Notes. Interest expense, net decreased due to increased interest income earned on increased short-term investment balances and rates of return.

The provision for income taxes increased \$0.5 million, or 23%, in the 2006 fiscal third quarter and was based on an effective tax rate of 39.4% this year versus 33.6% last year. For the nine months ended March 31, 2006, the effective tax rate was 36.8% versus 36.6% for the nine months ended March 31, 2005.

EBITDA decreased 1% to \$17.4 million in the 2006 fiscal third quarter from \$17.6 million in the 2005 fiscal third quarter and as a percent of revenues, EBITDA was 11% this year versus 12% last year due to the decrease in operating income discussed above. Marketing Services EBITDA decreased 6% to \$19.4 million in the 2006 fiscal third quarter from \$20.7 million in the 2005 fiscal third quarter due to an increase in employee related expenses. Personals EBITDA increased 311% to \$3.7 million in the 2006 fiscal third quarter from \$0.9 million in the 2005 fiscal third quarter due in part to the one time \$1.6 million benefit realized on the recovery of certain expenses related to litigation settled during the current quarter. The remaining increase is due to more efficient marketing and cost containment measures. Management Services EBITDA increased 200% to \$2.1 million in the 2006 fiscal third quarter from \$0.7 million in the 2005 fiscal third quarter due to the increase in the volume and mix of the transactions managed. Corporate EBITDA decreased 66% to \$(7.8) million in the 2006 fiscal

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third quarter from \$(4.7) million in the 2005 fiscal third quarter due to the adoption of SFAS 123R and an increase in employee related and occupancy related expenses.

For the Nine Months Ended March 31, 2006 and 2005

Revenues increased \$60.4 million, or 14%, in the nine months ended March 31, 2006 primarily due to the inclusion of revenues from the Acquired Companies. Excluding revenues from the Acquired Companies, revenues would have increased 6% due to an increase in Marketing Services' revenues, as discussed below. Net active retail members and customers increased 3% to 6.5 million at March 31, 2006 from 6.3 million at March 31, 2005.

Marketing Services revenues increased \$38.8 million, or 11%, in the nine months ended March 31, 2006. Excluding revenues from Bargain, total marketing services revenues would have increased 7%. Revenues from members enrolled in monthly payment plans increased 50% and were partially offset by a 31% decrease in revenues from members enrolled in annual payment plans. The increase in revenues from monthly payment plans was due to a 33% increase in the average monthly members billed and an 11% increase in the monthly weighted average member price point. Revenues from members enrolled in annual payment plans continue to decrease for both initial year members and renewal members due to the continued shift to enrolling new members in monthly payment programs as well as the attrition of the annual renewal base.

Personals revenues increased \$1.4 million, or 3%, in the nine months ended March 31, 2006 primarily due to the incremental revenue generated from Lavalife's growing mobile service. Management Services revenues increased \$20.2 million, or 285%, primarily due to inclusion of revenues from MCM for the full nine month period ended March 31, 2006.

Marketing expenses increased \$18.6 million, or 9%, in the nine months ended March 31, 2006 and as a percent of revenues, were 48% this year versus 51% last year. The increase in marketing expenses was due to the inclusion of costs incurred by the Acquired Companies as well as an increase in online marketing efforts which resulted in increased revenues, as discussed above. The decrease in marketing expenses as a percent of revenues was primarily due to increased price points and synergies realized from our Acquired Companies.

Operating expenses increased \$27.1 million, or 33%, in the nine months ended March 31, 2006 and as a percent of revenues, were 23% this year versus 19% last year. Approximately half of the increase in both the level of operating expenses and the operating expense ratio was due to the inclusion of expenses incurred by the Acquired Companies with the remaining increase due to increased costs of servicing the higher member and customer base.

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General and administrative expenses increased \$10.5 million, or 13%, in the nine months ended March 31, 2006 and included a \$3.4 million charge related to the adoption of SFAS 123R partially offset by the one-time \$1.0 million benefit realized on the recovery of certain expenses related to litigation settled during the current quarter. Excluding the impact of these two items from both periods, general and administrative expenses would have increased \$8.7 million and as a percent of revenues, would have been 18% this year versus 19% in the

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prior year. Approximately half of the increase in general and administrative expenses was due to the inclusion of expenses incurred by the Acquired Companies. The remaining increase was due to increased employee related expenses and occupancy related expenses. General and administrative expenses decreased as a percent of revenue due to leveraging expenses with the increased revenue.

Amortization of intangible assets increased \$0.7 million, or 12%, in the nine months ended March 31, 2006 due to amortization expense related to the Acquired Companies.

Operating income increased \$3.5 million, or 8%, in the nine months ended March 31, 2006. Excluding the expenses associated with the adoption of SFAS 123R and the one-time benefit realized related to the settlement of litigation from 2006 and the expenses associated with that same litigation in the nine months ended March 2005, operating income would have increased 12% to \$47.9 million from \$42.6 million due to the 14% increase in revenue.

Interest expense, net decreased \$1.2 million, or 8%, to \$13.0 million, in the nine months ended March 31, 2006 and included \$10.7 million interest expense related to the 9.25% Senior Notes and \$3.7 million of interest expense related to the 5.5% Convertible Notes. Interest expense, net decreased due to an increase in interest income earned on increased short-term investment balances and rates of return.

The provision for income taxes increased \$1.6 million, or 16%, in the nine months ended March 31, 2006 and was based on an effective tax rate of 36.8% this year versus 36.6% last year.

EBITDA increased 12% to \$64.4 million in the nine months ended March 31, 2006 from \$57.7 million in the nine months ended March 31, 2005. Excluding the expenses associated with the adoption of SFAS 123R and the one-time benefit realized related to the settlement of litigation from 2006 and the expenses associated with that same litigation in the nine months ended March 2005 EBITDA, would have increased 15% to \$66.8 million from \$58.3 million due to the 14% increase in revenue generated. Marketing Services EBITDA increased 9% to \$73.5 million in the nine months ended March 31, 2006 from \$67.7 million in the nine months ended March 31, 2005 due to increased price points and synergies realized from our Acquired Companies. Personals EBITDA increased 79% to \$7.7 million in the nine months ended March 31, 2006 from \$4.3 million in the nine months ended March 31, 2005. Approximately half of the increase was related to the benefit realized in 2006 and the related expenses recognized in 2005 in connection with the litigation settled in the March 2006 quarter. The remaining increase was due to Lavalife's growing mobile service business and cost containment efforts. Management Services EBITDA increased to \$3.4 million in the nine months ended March 31, 2006 from \$0.7 million in the nine months ended March 31, 2005. Corporate EBITDA decreased to \$(20.2) million in the nine months ended March 31, 2006 from \$(15.0) million in the nine months ended March 31, 2005 primarily due to the adoption of SFAS 123R and increased employee related and occupancy related expenses.

LIQUIDITY AND CAPITAL RESOURCES

Net cash flow provided by operating activities is an important measure used to understand the Company's liquidity. Net cash provided by operating activities increased to \$37.6 million in the nine months ended March 31, 2006 from \$24.6 million in the nine months ended March 31, 2005. The \$13.0 million increase in operating cash flow was primarily due to a \$16.6 million increase in Adjusted EBITDA offset by a \$3.0 million decrease in operating cash flow due to the change in the classification of excess tax benefit from stock-based compensation from operating activities to financing activities, as required by SFAS 123R. The increase in Adjusted EBITDA is discussed in more detail below. Management believes it is useful to analyze the components of net cash provided by

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operating activities as follows: Revenue before deferral, marketing costs before deferral, Adjusted EBITDA and changes in assets and liabilities. For definitions and reconciliations of revenue before deferral, marketing costs before deferral and Adjusted EBITDA, refer to the discussion in "Reconciliation of Non-GAAP Measures" in this Quarterly Report on Form 10-Q.

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The table below summarizes the components of revenues before deferral (in millions):

| | Nine months ended March 31, | | Increase/ (Decrease) |
|--------------------------|--------------------------------|----------|-------------------------|
| | 2006 | 2005 | '06 vs. '05 |
| Revenues before deferral | | | |
| Monthly payment plans | \$ 262.8 | \$ 177.4 | 48% |
| Annual payment plans: | | | |
| Initial year | 22.9 | 31.0 | (26)% |
| Renewal year | 73.2 | 103.2 | (29)% |
| Other | 26.8 | 22.6 | 19% |
| Total Marketing Services | 385.7 | 334.2 | 15% |
| Personals | 55.4 | 54.1 | 2% |
| Management Services | 27.8 | 8.5 | 227% |
| Total | \$ 468.9 | \$ 396.8 | 18% |

Revenues before deferral increased 18% to \$468.9 million in the nine months ended March 31, 2006 and excluding revenues before deferral from the Acquired Companies, revenue before deferral would have increased 10% in 2006. Revenues before deferral from monthly payment plans increased 48% due to a 33% increase in the average monthly members billed to 2.1 million in the nine months ended March 31, 2006 and an 11% increase in the monthly weighted average program price point which increased to \$13.67 for the nine months ended March 31, 2006. The average monthly members billed increased due to the increase in the mix of new members enrolled in monthly payment plan programs, which was 89% during the nine months ended March 31, 2006 and 83% during the nine months ended March 31, 2005. Revenues before deferral from annual payment plans declined due to the continued shift to enrolling new members in monthly payment programs as well as the attrition of the annual renewal base. The new annual weighted average program price points were \$107 and \$104 for the nine months ended March 31, 2006 and 2005, respectively. Personals revenues before deferral increased 2% from the prior year due to increased revenues before deferral generated from Lavalife's growing mobile services. Management Services revenues before deferral represent the revenues from MCM which was acquired on January 1, 2005.

Marketing costs before deferral were \$222.8 million and \$202.4 million for the nine months ended March 31, 2006 and 2005, respectively. As a percent of revenue before deferral, marketing costs before deferral were 48% and 51% in the fiscal 2006 and 2005 year to date periods, respectively. The improved ratio is due to

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increased price points, more efficient marketing spending and better retention in certain sectors of our business. Marketing costs before deferral increased 10% in the nine months ended March 31, 2006 primarily due to the inclusion of marketing costs before deferral from the Acquired Companies. The effect of the increase in marketing margin before deferral in the fiscal 2006 year to date period contributed to a \$16.6 million increase in Adjusted EBITDA to \$60.8 million for the nine months ended March 31, 2006 from \$44.2 million for the nine months ended March 31, 2005. The table below presents Adjusted EBITDA by segment (in millions).

| Adjusted EBITDA | Nine months ended March 31, | | Increase/ Decrease |
|---------------------|--------------------------------|---------|-----------------------|
| | 2006 | 2005 | '06 vs. '05 |
| Marketing Services | \$ 69.4 | \$ 52.7 | 32% |
| Personals | 7.7 | 4.4 | 75% |
| Management Services | 3.9 | 2.1 | 86% |
| Corporate | (20.2) | (15.0) | (35)% |
| Total | \$ 60.8 | \$ 44.2 | 38% |

Changes in assets and liabilities used \$0.1 million of cash in the nine months ended March 31, 2006 compared to \$1.9 million in the nine months ended March 31, 2005. The use of cash in fiscal 2006 primarily related to the timing of trade and tax payments during the period and the \$5.5 million arbitration award payment made during the December 2005 quarter.

Capital expenditures increased to \$14.9 million in 2006 from \$7.5 million in 2005 due to the costs associated with the relocation of the Company's corporate headquarters. As a result, free cash flow, defined as operating cash flow less capital expenditures, was \$22.7 million for the nine months ended March 31, 2006 compared to \$17.1 million for the prior year period.

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Net cash (used in) provided by investing activities was \$(45.3) million and \$21.0 million in the nine months ended March 31, 2006 and 2005, respectively. Net cash used in investing activities in the nine months ended March 31, 2006 primarily reflected \$15.5 million net purchases of short-term investments and \$14.9 million used in connection with the Company's recent acquisitions. Net cash provided by investing activities in the nine months ended March 31, 2005 primarily reflected \$94.1 million of net proceeds from sales of short-term investments and \$(65.7) million invested in acquiring businesses.

Net cash used in financing activities was \$2.5 million in the nine months ended March 31, 2006 and \$25.2 million in the nine months ended March 31, 2005. Net cash used in financing activities in 2006 principally reflected the use of \$10.7 million to repurchase the Company's stock, which was partially offset by \$7.4 million of proceeds from the exercise of stock options and \$1.5 million of excess tax benefit from stock-based compensation. Net cash used in financing

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activities in 2005 principally reflected the use of \$33.8 million to repurchase the Company's stock, which was partially offset by proceeds from the exercise of stock options of \$9.8 million.

Credit Facility

The Company has an amended and restated senior secured credit facility dated as of March 17, 2006, which allows borrowings of up to \$50.0 million. Borrowings under this senior secured credit facility accrue interest at the Eurodollar rate plus an applicable margin or the Prime rate plus an applicable margin. As of March 31, 2006, the base interest rate for borrowings under this credit facility was 8.00%. There were no borrowings outstanding under this credit facility as of March 31, 2006. The senior secured credit facility has certain financial covenants, including a maximum debt coverage ratio, potential restrictions on borrowings and potential restrictions on additional stock repurchases. As of March 31, 2006, the Company was in compliance with all such debt covenants. The senior secured credit facility matures on March 31, 2009.

Stock Repurchase Program

The Company purchased 275,500 shares of its common stock for \$10.7 million at an average price of \$38.70 per share during 2006 compared to 972,000 shares for \$33.8 million at an average price of \$34.43 per share in 2005. The Company utilized cash from operations, stock issuances and the issuance of the Convertible Notes and Senior Notes to repurchase shares in fiscal 2006 and 2005.

As of March 31, 2006, the Company had 550,000 shares available for repurchase under its stock repurchase program.

Other

As of March 31, 2006, the Company had cash, cash equivalents and short-term investments of \$90.9 million in addition to its senior secured credit facility. The Company believes that existing cash and short-term investment balances and funds available under its senior secured credit facility together with cash generated from operations will be sufficient to meet its funding requirements for the foreseeable future.

The Company expects to incur capital expenditures of \$17.5 million in fiscal 2006. In addition, contingent payments related to the acquisition of MCM of up to \$56.0 million may be paid if certain performance targets, including increasing levels of revenues and earnings, are achieved during the three calendar years ending December 31, 2007. During the quarter ended June 30, 2006, the Company paid \$10.7 million related to these contingent payments. The Company intends to utilize cash on hand, short-term investments and cash generated from operations to fulfill payment obligations during 2006.

RECONCILIATION OF NON-GAAP MEASURES

Management believes that revenues before deferral and marketing costs before deferral are important measures of liquidity and are significant factors in understanding the Company's operating cash flow trends. These non-GAAP measures are used by management and the Company's investors to understand the liquidity trends of the Company's marketing margins related to current period operations which are reflected within the operating cash flow section of the cash flow statement. GAAP revenues and marketing expenses are important measures used to understand the marketing margins earned during the period in the income statement. However, in order to understand the Company's operating cash flow, it is important to understand the primary current period drivers of that cash flow. Two of the primary indicators of operating liquidity for the period are revenues before deferral and marketing costs before deferral. Revenues before deferral are revenues before the application of SAB 104 and represent the revenues billed during the current reporting period less an allowance for membership cancellations. That is, revenues before deferral for a reporting period include membership fees received in the current reporting period that will be recorded

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as GAAP revenues in future reporting periods and exclude membership fees received in prior reporting periods that are recorded as GAAP revenues in the current reporting period. Marketing costs before deferral are marketing costs before the application of SAB 104 and SOP 93-7 and represent marketing costs paid or accrued during the current reporting period. That is, marketing costs before deferral for a reporting period include costs paid or accrued in the current reporting period that will be recorded as GAAP marketing expenses in future reporting periods and exclude marketing expenses paid or accrued in prior reporting periods that are recorded as GAAP marketing expenses in the current reporting period. Neither revenues before deferral nor marketing costs before deferral exclude charges or liabilities that will require future cash settlement. Additionally, these measures are not a substitute for or superior to revenues and marketing expenses determined in accordance with generally accepted accounting principles.

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Revenues before deferral are calculated as follows (in millions):

| | Nine months ended March 31, | |
|-----------------------------|--------------------------------|----------|
| | 2006 | 2005 |
| Revenues | \$ 481.5 | \$ 421.1 |
| Change in deferred revenues | (12.6) | (24.3) |
| Revenues before deferral | \$ 468.9 | \$ 396.8 |

Marketing costs before deferral are calculated as follows (in millions):

| | Nine months ended March 31, | |
|------------------------------------|--------------------------------|----------|
| | 2006 | 2005 |
| Marketing expenses | \$ 231.8 | \$ 213.2 |
| Change in deferred marketing costs | (9.0) | (10.8) |
| Marketing costs before deferral | \$ 222.8 | \$ 202.4 |

EBITDA is calculated as net income excluding interest and other expense, taxes, depreciation and amortization. Adjusted EBITDA is calculated as EBITDA before the deferral of revenues and the deferral of marketing costs.

EBITDA and Adjusted EBITDA are used by the Company's management to evaluate the overall performance of its business and to measure that performance compared with internal budgets. Additionally, Adjusted EBITDA is the primary measure used by management to allocate capital and other resources to its operating segments and assess the operating performance of those segments (See Note 11 to the condensed consolidated financial statements in this Quarterly Report on Form 10-Q). Adjusted EBITDA is also one of the measures used to determine compensation under the Company's management incentive plans.

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Adjusted EBITDA is useful to management and investors because it provides insight into the current period cash operating results. Adjusted EBITDA is reconciled to net cash provided by operating activities because the Company believes that it is the most directly comparable GAAP liquidity measure. Adjusted EBITDA is also used by the Company's management as the primary performance measure of the business both on an overall company basis as well as for its operating segments. Adjusted EBITDA is reconciled to net income because the Company believes it is the most directly comparable GAAP performance measure.

EBITDA is useful to management and investors because it eliminates the effects of interest and other expense, income taxes, non-cash depreciation of tangible assets and non-cash amortization of intangible assets and is calculated using revenues and marketing expenses. EBITDA is reconciled to net income because the Company believes that it is the most directly comparable GAAP measure.

The usefulness of Adjusted EBITDA and EBITDA is limited as compared to net cash provided by operating activities or net income in that Adjusted EBITDA and EBITDA do not reflect the periodic amortization of certain capitalized tangible and intangible assets used in generating revenues in the Company's businesses, they do not reflect net income earned for GAAP reporting purposes and they exclude the effects of interest and taxes.

Adjusted EBITDA and EBITDA should not be considered a substitute for or superior to, operating income, net income, net cash from operating activities or other measures of financial performance and liquidity determined in accordance with generally accepted accounting principles.

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The following table reconciles net cash provided by operating activities to Adjusted EBITDA (in millions):

| | Nine months ended March 31, | |
|--|--------------------------------|---------|
| | 2006 | 2005 |
| Net cash provided by operating activities | \$ 37.6 | \$ 24.6 |
| Changes in assets and liabilities (use of cash) | 0.1 | 1.9 |
| Interest and other expense, net (to be paid in cash) | 12.3 | 12.7 |
| Taxes | 13.6 | 5.2 |
| Stock compensation expense | (3.4) | - |
| Other | 0.6 | (0.2) |
| | ----- | ----- |
| Adjusted EBITDA | \$ 60.8 | \$ 44.2 |
| | ===== | ===== |

The following tables reconcile net income to EBITDA and Adjusted EBITDA (in millions):

Three months ended March 31, 2006

| | |
|-----------|------------|
| ----- | ----- |
| Marketing | Management |

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| | Services | Personals | Services | Corporate | Total |
|-------------------------------------|----------|-----------|----------|-----------|---------|
| | ----- | ----- | ----- | ----- | ----- |
| Net income | | | | | \$ 4.1 |
| Interest and other expense, net (1) | | | | | 4.2 |
| Provision for income taxes (1) | | | | | 2.7 |
| | | | | | ----- |
| Operating income (expense) | \$ 16.5 | \$ 0.8 | \$ 1.7 | \$ (8.0) | \$ 11.0 |
| Depreciation and amortization | 2.9 | 2.9 | 0.4 | 0.2 | 6.4 |
| | ----- | ----- | ----- | ----- | ----- |
| EBITDA | \$ 19.4 | \$ 3.7 | \$ 2.1 | \$ (7.8) | \$ 17.4 |
| | ===== | ===== | ===== | ===== | ===== |

Three months ended March 31, 2005

| | Marketing Services | Personals | Management Services | Corporate | Total |
|-------------------------------------|-----------------------|-----------|------------------------|-----------|---------|
| | ----- | ----- | ----- | ----- | ----- |
| Net income | | | | | \$ 4.4 |
| Interest and other expense, net (1) | | | | | 4.9 |
| Provision for income taxes (1) | | | | | 2.2 |
| | | | | | ----- |
| Operating income (expense) | \$ 17.5 | \$ (1.5) | \$ 0.3 | \$ (4.8) | \$ 11.5 |
| Depreciation and amortization | 3.2 | 2.4 | 0.4 | 0.1 | 6.1 |
| | ----- | ----- | ----- | ----- | ----- |
| EBITDA | \$ 20.7 | \$ 0.9 | \$ 0.7 | \$ (4.7) | \$ 17.6 |
| | ===== | ===== | ===== | ===== | ===== |

Nine months ended March 31, 2006

| | Marketing Services | Personals | Management Services | Corporate | Total |
|-------------------------------------|-----------------------|-----------|------------------------|-----------|---------|
| | ----- | ----- | ----- | ----- | ----- |
| Net income | | | | | \$ 20.4 |
| Interest and other expense, net (1) | | | | | 13.2 |
| Provision for income taxes (1) | | | | | 11.9 |
| | | | | | ----- |
| Operating income (expense) | \$ 64.3 | \$ 0.1 | \$ 2.2 | \$ (21.1) | \$ 45.5 |
| Depreciation and amortization | 9.2 | 7.6 | 1.2 | 0.9 | 18.9 |
| | ----- | ----- | ----- | ----- | ----- |
| EBITDA | 73.5 | 7.7 | 3.4 | (20.2) | 64.4 |
| Change in deferred revenues | (13.1) | - | 0.5 | - | (12.6) |
| Change in deferred marketing | 9.0 | - | - | - | 9.0 |
| | ----- | ----- | ----- | ----- | ----- |
| Adjusted EBITDA | \$ 69.4 | \$ 7.7 | \$ 3.9 | \$ (20.2) | \$ 60.8 |
| | ===== | ===== | ===== | ===== | ===== |

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Nine months ended March 31, 2005

| Marketing Services | Personals | Management Services | Corporate | Total |
|-----------------------|-----------|------------------------|-----------|-------|
| ----- | ----- | ----- | ----- | ----- |

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| | | | | | | |
|-------------------------------------|---------|----------|--------|-----------|---------|---------|
| Net income | | | | | | \$ 17.8 |
| Interest and other expense, net (1) | | | | | | 13.9 |
| Provision for income taxes (1) | | | | | | 10.3 |
| Operating income (expense) | \$ 59.8 | \$ (2.7) | \$ 0.2 | \$ (15.3) | \$ 42.0 | |
| Depreciation and amortization | 7.9 | 7.0 | 0.5 | 0.3 | 15.7 | |
| EBITDA | 67.7 | 4.3 | 0.7 | (15.0) | 57.7 | |
| Change in deferred revenues | (25.8) | 0.1 | 1.4 | - | (24.3) | |
| Change in deferred marketing | 10.8 | - | - | - | 10.8 | |
| Adjusted EBITDA | \$ 52.7 | \$ 4.4 | \$ 2.1 | \$ (15.0) | \$ 44.2 | |

1) Management does not allocate interest and other expense, net nor does it allocate provision for income taxes to the individual segments.

Free cash flow represents net cash provided by operating activities less capital expenditures. Free cash flow is important because it represents the cash that is available to a company to pursue opportunities that enhance shareholder value, such as make acquisitions, reduce debt and develop new products. The following table reconciles operating cash flow to free cash flow (in millions):

| | Nine months ended March 31, | |
|---|--------------------------------|---------|
| | 2006 | 2005 |
| Net cash provided by operating activities | \$ 37.6 | \$ 24.6 |
| Capital expenditures | (14.9) | (7.5) |
| Free cash flow | \$ 22.7 | \$ 17.1 |

COMMITMENTS

The Company is not aware of any factors that are reasonably likely to adversely affect liquidity trends, other than the risk factors presented in the Forward Looking Statements in this Quarterly Report on Form 10-Q. The Company does not have off-balance sheet arrangements, non-exchange traded contracts or material related party transactions.

Future minimum payments of contractual obligations as of March 31, 2006 are as follows (in millions):

| | Payments Due by Period | | | | |
|----------------------|------------------------|---------------------|-------------|-------------|------------------|
| | Total | Less than 1 year | 1 - 3 years | 3 - 5 years | After 5 years |
| Operating leases | \$ 57.4 | \$ 9.1 | \$ 17.3 | \$ 13.9 | \$ 17.1 |
| Capital leases | 1.5 | 0.8 | 0.7 | - | - |
| Long-term debt | 240.0 | - | - | 90.0 | 150.0 |
| Purchase obligations | 11.8 | 10.5 | 1.3 | - | - |
| Other (1) | 158.3 | 29.8 | 37.7 | 38.1 | 52.7 |
| Total payments due | \$ 469.0 | \$ 50.2 | \$ 57.0 | \$ 142.0 | \$ 219.8 |

(1) Includes interest payments on long-term debt, pension obligations, line of

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credit termination fee and expected contingent payments related to the MCM acquisition.

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VERTRUE INCORPORATED ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward looking statements that are based on current expectations, estimates, forecasts and projections about the industry in which the Company operates and management's beliefs and assumptions. These forward looking statements include statements that do not relate solely to historical or current facts and can be identified by the use of words such as "believe," "expect," "estimate," "project," "continue" or "anticipate." These 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, are intended to qualify for the safe harbor provisions from liability provided by the Private Securities Litigation Reform Act of 1995.

Forward looking statements are not guarantees of future performance and are based on many assumptions and estimates that are inherently subject to significant risks and uncertainties, many of which are beyond our control, cannot be foreseen and reflect future business decisions that may change. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward looking statements. Among the many factors that could cause actual results to differ materially from the forward looking statements are:

- o higher than expected membership cancellations or lower than expected membership renewal rates;
- o changes in the marketing techniques of credit card issuers;
- o increases in the level of commission rates and other compensation required by marketing partners to actively market with the Company;
- o potential reserve requirements by business partners, such as the Company's credit card processors;
- o unanticipated termination of marketing agreements;
- o the extent to which the Company can continue to successfully develop and market new products and services and introduce them in a timely manner;
- o the Company's ability to integrate acquired businesses into the Company's management and operations and operate successfully;
- o unanticipated changes in or termination of the Company's ability to process revenues through third parties, including credit card processors and bank card associations;
- o the Company's ability to develop and implement operational and financial systems to manage growing operations;
- o the Company's ability to recover from a complete or partial system failure or impairment, other hardware or software related malfunctions or programming errors;
- o the degree to which the Company is leveraged;
- o the Company's ability to obtain financing on acceptable terms to finance the Company's growth strategy and to operate within the limitations imposed by financing arrangements;
- o the Company's ability to obtain new financing or re-finance existing debt;
- o further changes in the already competitive environment for the Company's products or competitors' responses to the Company's

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- strategies;
- o changes in the growth rate of the overall U.S. economy or the international economy where the Company does business such that credit availability, interest rates, consumer spending, related consumer financing and related consumer debt are affected;
- o additional government regulations and changes to existing government regulations of the Company's industry;
- o the Company's ability to compete with other companies that have financial or other advantages;
- o adverse movements of foreign exchange rates;
- o the Company's ability to attract and retain active members and users;
- o adverse results of litigation or regulatory matters; and
- o new accounting pronouncements.

Many of these factors are beyond the Company's control and therefore its business, financial condition, results of operations and cash flows may be adversely affected by these factors.

The Company cautions that these factors are not exclusive. All forward looking statements made in this Quarterly Report on Form 10-Q are qualified by these cautionary statements and readers are cautioned not to place undue reliance on these forward looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. Except as otherwise required by federal securities law, the Company has no obligation and does not intend to publicly update or revise any forward looking statements to reflect subsequent events or circumstances.

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VERTRUE INCORPORATED

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate

The Company has an amended and restated senior secured credit facility which allows borrowings of up to \$50.0 million. Borrowings under this senior secured credit facility accrue interest at the Eurodollar rate plus an applicable margin or the Prime rate plus an applicable margin. There were no borrowings outstanding under this credit facility as of March 31, 2006. As of March 31, 2006, the effective interest rate for borrowings under this credit facility was 8.00%. Management believes that an increase in the Eurodollar rate or the Prime rate would not be material to the Company's financial position or its results of operations. This credit facility matures on March 31, 2009.

In addition, the Company has \$90.0 million aggregate principal amount of 5.5% Convertible Notes due 2010 and \$150.0 million aggregate principal amount of 9.25% Senior Notes due 2014. The Convertible Notes and the Senior Notes pay interest in cash semi-annually in arrears on April 1 and October 1. The fair value of the fixed interest instruments is affected by changes in interest rates and, with respect to the Convertible Notes, by changes in the Company's stock price and volatility. The Company does not currently hedge interest rates with respect to its outstanding debt. As of March 31, 2006, the carrying value of the Convertible Notes and the Senior Notes was \$90.0 million and \$147.9 million, respectively, and the fair value of the notes was \$105.3 million and \$156.0 million, respectively. Cash paid in connection with interest on the Convertible Notes and the Senior Notes in each of the next five years is expected to be \$18.8 million assuming none of the Convertible Notes is converted into equity.

Foreign Currency

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The Company conducts business in certain foreign markets, primarily Canada. The Company's primary exposure to foreign currency risk relates to investments in foreign subsidiaries that transact business in functional currencies other than the U.S. dollar, primarily the Canadian dollar. The Company's recent acquisitions, which are based in the United States, have reduced the proportion of its operations exposed to potentially volatile movements in currency exchange rates. The economic impact of currency exchange rate movements on the Company is often linked to variability in real growth, inflation, interest rates, governmental actions and other factors. These changes, if material, could cause the Company to adjust its financing and operating strategies. As currency exchange rates change, translation of the income statements of the Company's international businesses into U.S. dollars affects year-to-year comparisons of operating results.

The Company uses purchase option contracts and forward contracts to minimize its exposure to certain changes in future cash flows caused by movements in foreign currency exchange rates between the U.S. dollar and the Canadian dollar. However, there can be no assurance that the Company's foreign currency hedging activities will substantially offset the impact of all fluctuations in currency exchange rates on its results of operations, cash flows and financial position. The Company does not use derivatives for speculative purposes. Derivatives used to hedge forecasted transactions and specific cash flows associated with Canadian dollar denominated financial assets and liabilities that meet the criteria for hedge accounting are designated as cash flow hedges. The effective portion of gains and losses is deferred as a component of accumulated other comprehensive income and is recognized in earnings in the same line item as the underlying hedged item at the time the hedged item affects earnings.

Fair Value of Investments

The Company does not have material exposure to market risk with respect to investments since the Company's investments are short-term in nature (original maturities of less than one year).

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures

The Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined under Rules 13a-15(e) and 15d-15(e) of the Securities and Exchange Act of 1934) as of the end of the period covered by this report and have concluded that the Company's disclosure controls and procedures were effective at the reasonable assurance level. The Company's disclosure controls and procedures are designed to ensure that material information relating to the Company and its consolidated subsidiaries that is required to be disclosed in its reports under the Exchange Act is accumulated, communicated to the Chief Executive Officer and Chief Financial Officer and disclosed appropriately and timely in its reports under the Exchange Act.

Because a cost-effective control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met, misstatements due to error or fraud may occur and not be detected. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

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During the third quarter of 2006, there were no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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VERTRUE INCORPORATED PART II. OTHER INFORMATION

Item 1. Legal proceedings

Except as set forth below, in management's opinion, there are no significant legal proceedings to which the Company or any of its subsidiaries is a party or to which any of their properties is subject. The Company or its subsidiaries are involved in other lawsuits and claims generally incidental to their respective businesses including, but not limited to, various suits, including previously disclosed suits, brought by individual consumers seeking monetary and/or injunctive relief relating to the marketing of the Company's services. In addition, from time to time in the regular course of its business, the Company or a subsidiary may receive inquiries from various federal and/or state regulatory authorities.

On October 17, 2005, the U.S. Supreme Court declined to review the Connecticut Supreme Court's May 10, 2005 decision to uphold an arbitration panel's award of \$5.5 million in punitive damages and costs to MedValUSA Health Programs, Inc. Accordingly, the full amount of the award was paid in the quarter ending December 31, 2005. The Company recorded a one-time \$5.5 million charge in the quarter ended June 30, 2005 related to this award. For additional information about the MedValUSA Health Programs, Inc. arbitration, refer to Item 3 - "Legal Proceedings" in the Company's Annual Report on Form 10-K for the year ended June 30, 2005.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table summarizes the shares of the Company's equity securities purchased by or on behalf of the Company:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|---------------------------------------|---|------------------------------------|---|--|
| ----- | ----- | ----- | ----- | ----- |
| January 1, 2006 to January 31, 2006 | 11,600 | \$ 35.38 | 11,600 | 648,830 |
| February 1, 2006 to February 28, 2006 | 58,500 | 42.69 | 58,500 | 590,330 |
| March 1, 2006 to March 31, 2006 | 40,600 | 43.36 | 40,600 | 549,730 |
| Total | 110,700 | 42.17 | 110,700 | 549,730 |
| | ===== | | ===== | |

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- (1) In October 2004, the Board of Directors authorized an additional 1,000,000 shares, no expiration date, to be purchased under the Company's stock repurchase program originally authorized during fiscal 1997.

Item 5. Other Information

- (a) The Company entered into a Second Amended and Restated Credit Agreement dated March 17, 2006 with the Lenders and LaSalle Bank National Association, as Agent. The senior secured credit facility allows borrowings of up to \$50.0 million for working capital and general corporate purposes. Borrowings under the senior secured credit facility accrue interest at the Eurodollar rate plus an applicable margin or the Prime rate plus an applicable margin. The senior secured credit facility matures on March 31, 2009.

Item 6. Exhibits

- 10.1 Second Amended and Restated Credit Agreement dated March 17, 2006 among the Registrant, the Lenders Parties Hereto, and LaSalle Bank National Association, as Agent
- 31.1 Rule 13a-14(a) CEO Certification.
- 31.2 Rule 13a-14(a) CFO Certification.
- 32.1 CEO Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 CFO Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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VERTRUE INCORPORATED
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.

VERTRUE INCORPORATED
(Registrant)

Date: May 10, 2006

By: /s/ Gary A. Johnson

Gary A. Johnson, President, Chief
Executive Officer and Director

Date: May 10, 2006

By: /s/ James B. Duffy

James B. Duffy, Executive Vice President and
Chief Financial Officer (Principal Financial
and Accounting Officer)

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