ONLINE RESOURCES CORP
Form 10-Q
November 04, 2010

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2010
OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE TRANSITION PERIOD FROM _________ TO _________
COMMISSION FILE NUMBER 0-26123
ONLINE RESOURCES CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Delaware	**52-1623052**
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	*(I.R.S. EMPLOYER IDENTIFICATION NO.)*
4795 Meadow Wood Lane Chantilly, Virginia	**20151**
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	*(ZIP CODE)*

(703) 653-3100
(REGISTRANT S TELEPHONE NUMBER, INCLUDING AREA CODE)

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

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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

As of October 29, 2010 there were 31,248,647 shares of the issuer s common stock outstanding.

ONLINE RESOURCES CORPORATION
FORM 10-Q
TABLE OF CONTENTS

	Page
PART I FINANCIAL INFORMATION	
Item 1: Condensed Consolidated Financial Statements	
Condensed Consolidated Balance Sheets (unaudited) at September 30, 2010 and December 31, 2009	3
Condensed Consolidated Statements of Operations (unaudited) Three and nine months ended September 30, 2010 and 2009	4
Condensed Consolidated Statements of Cash Flows (unaudited) Nine months ended September 30, 2010 and 2009	5
Notes to Condensed Consolidated Financial Statements (unaudited)	6
Item 2: Management s Discussion and Analysis of Financial Condition and Results of Operations	15
Item 3: Quantitative and Qualitative Disclosures About Market Risk	24
Item 4: Controls and Procedures	24
PART II OTHER INFORMATION	
Item 1: Legal Proceedings	25
Item 1A: Risk Factors	25
Item 2: Unregistered Sales of Equity Securities and Use of Proceeds	26
Item 3: Defaults Upon Senior Securities	26
Item 4: Submission of Matters to a Vote of Security Holders	26
Item 5: Other Information	26
Item 6: Exhibits	26
EX-31.1	
EX-31.2	
EX-32	

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. ***CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.***

ONLINE RESOURCES CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par values)

	September 30, 2010	December 31, 2009
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 27,042	$ 22,907
Accounts receivable (net of allowance of $216 and $100, respectively)	18,834	17,457
Deferred tax asset, current portion	7,477	7,477
Deferred implementation costs, current portion	2,993	1,941
Prepaid expenses and other current assets	2,829	2,102
Total current assets	59,175	51,884
Property and equipment, net	26,950	25,561
Deferred tax asset, less current portion	18,591	22,490
Goodwill	181,516	181,516
Intangible assets, net	15,468	19,972
Deferred implementation costs, less current portion, and other assets	9,175	7,067
Total assets	$ 310,875	$ 308,490
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 2,344	$ 2,008
Accrued expenses	5,143	3,739
Notes payable, senior secured debt, current portion	21,625	8,250
Interest payable	3	27
Deferred revenues, current portion and other current liabilities	7,496	6,793
Total current liabilities	36,611	20,817
Notes payable, senior secured debt, less current portion	19,125	40,500
Deferred revenues, less current portion and other long-term liabilities	6,699	6,888
Total liabilities	62,435	68,205
Commitments and contingencies		
Redeemable convertible preferred stock:		

Series A-1 convertible preferred stock, $0.01 par value; 75 shares authorized and issued at September 30, 2010 and December 31, 2009 (redeemable on July 3, 2013 at $135,815)	107,747		100,623
Stockholders equity:			
Series B junior participating preferred stock, $0.01 par value; 297.5 shares authorized; none issued			
Common stock, $0.0001 par value; 70,000 shares authorized; 31,619 issued and 31,192 outstanding at September 30, 2010 and 30,439 and 30,112 outstanding at December 31, 2009	3		3
Additional paid-in capital	216,795		213,096
Accumulated deficit	(73,182)		(70,776)
Treasury stock, 427 shares at September 30, 2010 and 327 shares at December 31, 2009	(2,923)		(2,661)
Total stockholders equity	140,693		139,662
Total liabilities and stockholders equity	$ 310,875	$	308,490

See accompanying notes to condensed consolidated unaudited financial statements.

3

Table of Contents

ONLINE RESOURCES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Unaudited)		(Unaudited)	
Revenues:				
Account presentation services	$ 2,237	$ 2,083	$ 6,676	$ 5,877
Payment services	27,699	28,971	85,576	90,126
Relationship management services	2,358	2,015	6,498	6,055
Professional services and other	4,501	3,525	12,986	11,559
Total revenues	36,795	36,594	111,736	113,617
Costs and expenses:				
Service costs	18,334	17,856	55,045	55,268
Implementation and other costs	1,060	960	3,361	3,228
Costs of revenues	19,394	18,816	58,406	58,496
Gross profit	17,401	17,778	53,330	55,121
General and administrative	7,399	6,955	23,427	23,564
Sales and marketing	4,900	4,624	14,657	15,952
Systems and development	2,277	2,247	7,403	6,630
Total expenses	14,576	13,826	45,487	46,146
Income from operations	2,825	3,952	7,843	8,975
Other income (expense):				
Interest income	18	22	39	104
Interest expense	286	(357)	450	(3,300)
Other (expense) income		14	(99)	91
Total other income (expense)	304	(321)	390	(3,105)
Income before income tax provision	3,129	3,631	8,233	5,870
Income tax provision	1,427	918	3,282	1,950
Net income	1,702	2,713	4,951	3,920
Preferred stock accretion	2,413	2,325	7,124	6,861

Net (loss) income available to common stockholders	$ (711)	$ 388	$ (2,173)	$ (2,941)
Net (loss) income available to common stockholders per share:				
Basic	$ (0.02)	$ 0.01	$ (0.07)	$ (0.10)
Diluted	$ (0.02)	$ 0.01	$ (0.07)	$ (0.10)
Shares used in calculation of net loss available to common stockholders per share:				
Basic	31,148	30,048	30,850	29,898
Diluted	31,148	31,546	30,850	29,898

See accompanying notes to condensed consolidated unaudited financial statements.

Table of Contents

ONLINE RESOURCES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Nine Months Ended September 30,	
	2010	2009
	(Unaudited)	
Operating activities		
Net income	$ 4,951	$ 3,920
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred tax benefit	3,899	2,008
Depreciation and amortization	13,983	15,209
Equity compensation expense	2,095	3,307
Write off and amortization of debt issuance costs	250	250
Loss on disposal of assets		37
Provision for losses on accounts receivable	169	16
Gain on investments		(91)
Change in fair value of theoretical swap derivative	(1,676)	8
Changes in certain other assets and liabilities	(1,501)	(958)
Net cash provided by operating activities	22,170	23,706
Investing activities		
Purchases of property and equipment	(10,793)	(6,744)
Sale of short-term investments		2,100
Net cash used in investing activities	(10,793)	(4,644)
Financing activities		
Net proceeds from issuance of common stock	777	425
Repayment of 2007 Notes	(8,000)	(11,687)
Repayment of capital lease obligations	(19)	(26)
Net cash used in financing activities	(7,242)	(11,288)
Net increase in cash and cash equivalents	4,135	7,774
Cash and cash equivalents at beginning of year	22,907	22,969
Cash and cash equivalents at end of period	$ 27,042	$ 30,743

See accompanying notes to condensed consolidated unaudited financial statements.

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

1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Online Resources Corporation (the Company) provides outsourced, web- and phone-based financial technology services to financial institution, biller, card issuer and creditor clients and their millions of consumer end-users. End-users may access and view their accounts online and perform various self-service functions. They may also make electronic bill payments and funds transfers, utilizing the Company s unique, real-time debit architecture, ACH and other payment methods. The Company s value-added relationship management services reinforce a favorable user experience and drive a profitable and competitive online channel for its clients. Further, the Company provides professional services, including software solutions, which enable various deployment options, a broad range of customization and other value-added services. The Company currently operates in two business segments Banking and eCommerce.

INTERIM FINANCIAL INFORMATION

The accompanying condensed consolidated unaudited financial statements have been prepared in conformity with generally accepted accounting principles (GAAP) for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted, pursuant to the rules and regulations of the Securities and Exchange Commission. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. In the opinion of management, the condensed consolidated unaudited financial statements include all adjustments necessary (which are of a normal and recurring nature) for the fair presentation of the results of the interim periods presented. These condensed consolidated unaudited financial statements should be read in conjunction with the consolidated audited financial statements for the year ended December 31, 2009, included in the Annual Report on Form 10-K filed by the Company with the Securities and Exchange Commission (SEC) on March 10, 2010. The results of operations for any interim period are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year. Certain amounts from prior periods have been reclassified to conform to current period presentation. The Company has evaluated all subsequent events through the date the financial statements were issued.

NEW ACCOUNTING STANDARDS

In September 2010, the FASB amended its guidance for reporting loans to participants by defined contribution plans. The revised guidance says that participant loans are to be valued at principal plus accrued interest rather than at fair value by adjusting for observable and non-observable inputs. The guidance also changed the reporting requirements for participant loans and instead of classifying these loans as plan investments, they should be reported separately as notes receivable from plan participants. These changes become effective, retrospectively to all prior periods presented, for the Company on January 1, 2011 and early adoption is permitted. The Company has determined that adoption will not have a material impact on the Company s consolidated financial statements.

In February of 2010, the FASB amended its guidance for disclosing subsequent events. The revised guidance removes the requirement of disclosing the date through which subsequent events are evaluated and requires evaluation of subsequent events through the date that the financial statements are issued. Adoption of this guidance in the first quarter of 2010 did not impact the Company s consolidated financial statements.

In January of 2010, the FASB improved its disclosures for fair value measurements, requiring separate disclosures of transfers in and out of Level 1 and Level 2 fair value measurements along with the reason for the transfer. The new guidance also requires separately presenting the reconciliation for Level 3 fair value measurements purchases, sales, issuances and settlements and clarifies the disclosure regarding the level of disaggregation and input and valuation techniques. The guidance related to the Level 3 reconciliation will be effective January 1, 2011. The remaining guidance was adopted during the first quarter of 2010. Adoption of this guidance in the first quarter of 2010 did not materially impact the Company s consolidated financial statements and financial disclosures.

In October 2009, the FASB changed its guidance for the accounting of certain revenue arrangements that include software elements. This authoritative guidance amends the scope of pre-existing software revenue guidance by removing from the guidance non-software components of tangible products and certain software components of tangible products. The Company has adopted this authoritative guidance prospectively in the first quarter of 2010. The implementation currently has no impact on the Company s consolidated financial statements. This guidance will be assessed on an ongoing basis to determine if any new contracts are subject to these new rules.

In October 2009, the FASB changed its guidance for the accounting of multiple-deliverable revenue arrangements with customers. Current GAAP requires a vendor to use vendor-specific objective evidence or third-party evidence of selling price to separate deliverables in a multiple-deliverable arrangement. Multiple-deliverable arrangements will be separated in more circumstances with the updated guidance. The change in guidance establishes a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific nor third-party evidence is available. The best estimate to use in determining a selling price is the price as if the item were sold on a stand alone basis. Changes also include eliminating the residual method of allocation and requiring that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price

method, which allocates discounts in the arrangement proportionally to each deliverable based on each selling price. These changes become effective, prospectively, for the Company on January 1, 2011 and early adoption is permitted. The Company has not determined the impact, if any; implementation of this guidance will have on the Company s consolidated financial statements.

In April 2009, the FASB issued guidance for determining fair value when the volume and level of activity for the asset or liability have significantly decreased and identifying transactions that are not orderly. Additionally, entities are required to disclose in interim and annual periods the inputs and valuation techniques used to measure fair value. This guidance became effective for the Company and was adopted on July 1, 2009. As the requirements under this guidance are consistent with our current practice, adoption did not have a material impact on the Company s consolidated financial statements or financial disclosures.

2. SENIOR SECURED NOTES

The Company has an agreement with Bank of America which finances its senior secured notes (2007 Notes). The agreement also provides a $15 million revolver (Revolver) under which the Company can secure up to $5 million in letters of credit. Currently, there are no amounts outstanding under the Revolver, but available credit under the Revolver has been reduced by approximately $1.6 million as a result of letters of credit the bank has issued. The Company has made voluntary payments of $8.0 million on the 2007 Notes during the nine months ended September 30, 2010, reducing the outstanding principal from $48.8 million to $40.8 million. The Company expensed less than $0.1 million of deferred credit facility costs related to these voluntary payments. The Company will make periodic principal payments until the 2007 Notes are due in 2012 as noted in the table below. On October 29, 2010, the Company made a voluntary payment of $4 million on the 2007 Notes.

The interest rate on both the Revolver and the 2007 Notes is the one-month London Interbank Offered Rate (LIBOR) plus 225 to 275 basis points based upon the ratio of the Company s funded indebtedness to its earnings before interest, taxes, depreciation and amortization (EBITDA, as defined in the 2007 Notes), and it is payable monthly. During the first quarter of 2010 the margin decreased from 250 basis points to 225 basis points and the average interest rate was 2.63%. The 2007 Notes and the Revolver are secured by the assets of the Company.

Maturities of long-term debt over the remaining period of the 2007 Notes are as follows (in thousands):

Year	Maturing Amounts
2010 (October 1, 2010-December 31, 2010)	$ 3,000
2011	$ 28,188
2012	$ 9,562

3. DERIVATIVE INSTRUMENTS

Theoretical Swap Derivative

The Company bifurcated the fair market value of the embedded derivative associated with the Series A-1 Redeemable Convertible Preferred Stock (Series A-1 Preferred Stock) issued in conjunction with the Princeton eCom acquisition on July 3, 2006 as required by GAAP. The Company determined that the embedded derivative is defined as the right to receive a fixed rate of return on the accrued, but unpaid dividends and the variable negotiated rate, which creates a theoretical swap between the fixed rate of return on the accrued, but unpaid dividends and the variable rate actually accrued on the unpaid dividends. This embedded derivative is marked to market at the end of each reporting period through earnings and an adjustment to other assets as required by the *Derivative and Hedging* Topic. There is no active market quote available for the fair value of the embedded derivative. Thus, management measures fair value of the derivative by estimating future cash flows related to the asset using a forecasted iMoney Net First Tier rate based on the one-month LIBOR rate adjusted for the historical spread for the estimated period in which the Series A-1 Preferred Stock will be outstanding.

The following table presents the fair value of the theoretical swap derivative instrument included within the condensed consolidated balance sheet at September 30, 2010 and December 31, 2009 (in thousands):

	September 30, 2010	December 31, 2009	Balance Sheet Location
Asset Derivatives:			
Theoretical swap (1)	$ 6,344	$ 4,668	Other assets

(1) See Note 12, Fair Value Measurements, for a description of how the derivatives shown above are valued.

Table of Contents

The following table presents the amounts affecting the condensed consolidated statement of operations for the three and nine months ended September 30, 2010 and September 30, 2009 (in thousands):

	Theoretical Swap (1)			
	Three Months Ended September 30,		Nine Months Ended September 30,	
Derivative Not Designated as Hedging Instrument:	2010	2009	2010	2009
Amount of gain (loss) recognized in income on derivative, pre tax	$ 649	$ 694	$ 1,676	$ (8)

	Interest Rate Swap (2)			
	Three Months Ended September 30,		Nine Months Ended September 30,	
Derivative Cash Flow Hedging Relationships:	2010	2009	2010	2009
Amount of loss recognized in OCI on derivative, after tax	$	$ 201	$	$ 715
Amount of loss reclassified from OCI into income, pre tax	$	$ 451	$	$ 1,358

(1) See Note 12, Fair Value Measurements, for additional information. The gain (loss) recognized in income is included in interest expense.

(2) See Note 11, Components of Comprehensive Loss for additional information. The loss reclassified from OCI to income is included in interest expense.

4. REDEEMABLE CONVERTIBLE PREFERRED STOCK

Series A-1 Redeemable Convertible Preferred Stock

Pursuant to the restated certificate of incorporation, the Board of Directors has the authority, without further action by the stockholders, to issue up to 3,000,000 shares of preferred stock in one or more series. Of these 3,000,000 shares of preferred stock, 75,000 shares have been designated Series A-1. The Series A-1 Preferred Stock has a redemption value of 115% of the face value of the stock, on or after seven years from the date of issuance, or July 3, 2013. The Company recognized $0.4 million for the three months ended September 30, 2010 and 2009 and $1.2 million for the nine months ended September 30, 2010 and 2009, to adjust for the redemption value at maturity.

Additionally, the Series A-1 Preferred Stock has a feature that grants holders the right to receive interest-like returns on accrued, but unpaid, dividends that accumulate at 8% per annum. For the three months ended

September 30, 2010 and 2009, $1.5 million of preferred stock accretion was recognized and for the nine months ended September 30, 2010 and 2009, $4.5 million of preferred stock accretion was recognized in the condensed consolidated statements of operations, for the 8% per annum cumulative dividends. The right to receive the accrued, but unpaid dividends is based on a variable interest rate, and as such the difference between the fixed and variable rate of returns is a theoretical swap derivative. The Company bifurcates this feature and accretes it to the Series A-1 Preferred Stock over the life of the security. For the three months ended September 30, 2010 and 2009, $0.3 million and $0.2 million, of preferred stock accretion expense were recognized and for the nine months ended September 30, 2010 and 2009, $0.9 million and $0.6 million of preferred stock accretion expense were recognized for the theoretical swap derivative in the condensed consolidated statement of operations.

Finally, the cost to issue the Series A-1 Preferred Stock of $5.1 million is being accreted back to the redemption value of the Series A-1 Preferred Stock through July 2013, and generated an additional $0.2 million and $0.5 million of preferred stock accretion for each of the three months and nine months ended September 30, 2010 and 2009 in the condensed consolidated statements of operations.

5. REPORTABLE SEGMENTS

The Company manages its business through two reportable segments: Banking and eCommerce. The Banking segment s market consists primarily of banks, credit unions and other depository financial institutions in the United States. The segment s fully integrated suite of account presentation, bill payment, relationship management and professional services are delivered through the Internet. The eCommerce segment s market consists of billers, card issuers, processors, and other creditors such as payment acquirers and very large online billers. The segment s account presentation, payment, relationship management and professional services are distributed to these clients through the Internet.

Factors used to identify the Company s reportable segments include the organizational structure of the Company and the financial information available for evaluation by the chief operating decision-maker in making decisions about how to allocate resources and assess performance. The Company s operating segments have been broken out based on similar economic and other qualitative criteria. The Company operates both reporting segments in one geographical area, the United States. The Company s management assesses the performance of its assets in the aggregate, and accordingly, they are not presented on a segment basis.

Table of Contents

The results of operations from these reportable segments were as follows for the three and nine months ended September 30, 2010 and 2009 (in thousands):

	Banking	eCommerce	Corporate(1)	Total
Three months ended September 30, 2010:				
Revenues	$ 22,319	$ 14,476	$	$ 36,795
Costs of revenues	11,322	8,072		19,394
Gross profit	10,997	6,404		17,401
Operating expenses	5,943	4,595	4,038	14,576
Income (loss) from operations	$ 5,054	$ 1,809	$ (4,038)	$ 2,825
Three months ended September 30, 2009:				
Revenues	$ 22,793	$ 13,801	$	$ 36,594
Costs of revenues	11,220	7,596		18,816
Gross profit	11,573	6,205		17,778
Operating expenses	5,458	4,594	3,774	13,826
Income (loss) from operations	$ 6,115	$ 1,611	$ (3,774)	$ 3,952
Nine months ended September 30, 2010:				
Revenues	$ 67,835	$ 43,901	$	$ 111,736
Costs of revenues	34,053	24,353		58,406
Gross profit	33,782	19,548		53,330
Operating expenses	18,416	14,019	13,052	45,487
Income (loss) from operations	$ 15,366	$ 5,529	$ (13,052)	$ 7,843
Nine months ended September 30, 2009:				
Revenues	$ 68,723	$ 44,894	$	$ 113,617
Costs of revenues	33,701	24,795		58,496
Gross profit	35,022	20,099		55,121
Operating expenses	17,874	15,023	13,249	46,146

Income (loss) from operations	$	17,148	$	5,076	$	(13,249)	$	8,975

(1) Corporate expenses are primarily comprised of corporate general and administrative expenses that are not considered in the measure of segment profit or loss used to evaluate the segments.

6. INVESTMENTS

The Company s investment in the Columbia Strategic Cash Portfolio was liquidated in September 2009. During the nine months ended September 30, 2009, the Company received $2.1 million in liquidation payments from the Fund administrator and recognized a gain of $0.1 million for the nine months ended September 30, 2009.

7. GOODWILL

Goodwill is not amortized and is tested at the reporting unit level at least annually or whenever events or circumstances indicate that goodwill might be impaired. The fair value of the Company s reporting units are measured under the income method by utilizing discounted cash flows. The estimates the Company uses in evaluating goodwill are consistent with the plans and estimates that the Company uses to manage its operations.

The Company did not experience any impairment of goodwill or other intangible assets for the nine months ended September 30, 2010 or 2009. The Company s stock price declined from $5.26 as of December 31, 2009 to $4.44 as of September 30, 2010. The Company considered whether or not the decline in stock price indicated an impairment requiring reevaluation of the goodwill. Factors evaluated include consideration of the 2010 financial performance as well as other Company specific matters. The Company s financial performance exceeded

the financial projections included in the annual impairment testing and there was no indication that other assumptions used in the annual impairment testing were no longer appropriate. As a result, the Company concluded that there was no indication of impairment. The Company will continue to monitor its financial performance, stock price and other factors in order to determine if there are any indicators of impairment prior to its annual impairment evaluation date.

We have presented a strategic direction to the Board of Directors and are now developing the supporting operating plan for their approval in December 2010. While we expect that the plan will improve our business outlook over multiple periods, it could result in a change in the relative focus on, and results of, our Banking and eCommerce segments including investment decisions in products and services. These decisions could result in impairment of assets including intangible assets, capitalized software costs and/or goodwill.

8. STOCK BASED COMPENSATION

At September 30, 2010, the Company had two stock-based employee compensation plans. The Company used the modified-prospective transition method, as required, to recognize compensation costs; which include (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the estimated grant date fair value, and (b) compensation cost for all share-based payments granted on or subsequent to January 1, 2006, based on the estimated grant-date fair value. The compensation expense for stock-based compensation was $0.5 million and $1.1 million for the three months and $2.1 million and $3.3 million for the nine months ended September 30, 2010 and 2009, respectively. A portion of the stock based compensation cost has been capitalized as part of software development costs and deferred costs. For each of the three months ended September 30, 2010 and 2009, less than $0.1 million was capitalized as part of software development costs and deferred costs. For each of the nine months ended September 30, 2010 and 2009, approximately $0.1 million was capitalized as part of software development costs and deferred costs.

Stock Options

The fair value of each option award is estimated on the date of grant using a Black-Scholes-Merton option-pricing formula that uses the assumptions noted in the table and discussion that follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Dividend yield				
Expected volatility		64%	62%	62%
Risk-free interest rate		2.63%	2.75%	1.90%
Expected life in years		5.1	6.4	5.8

Dividend Yield. The Company has never declared or paid dividends and has no plans to do so in the foreseeable future.

Expected Volatility. Volatility is a measure of the amount by which a financial variable, such as a share price, has fluctuated (historical daily volatility) or is expected to fluctuate (expected volatility) during a period. The Company uses the historical average daily volatility over the average expected term of the options granted to estimate expected volatility.

Risk-Free Interest Rate. The risk-free interest rate is the average U.S. Treasury rate for the week of each option grant during the period having a term that most closely resembles the expected term of the option.

Expected Life of Option Term. Expected life of option term is the period of time that the options granted are expected to remain unexercised. Options granted during the period have a maximum term of seven to ten years. The Company uses historical expected terms, with further consideration given to the class of employees to whom the equity awards were granted, to estimate the expected life of the option term.

Forfeiture Rate. Forfeiture rate is the estimated percentage of equity awards granted that are expected to be forfeited or canceled on an annual basis before becoming fully vested. The Company estimates forfeiture rate based on past turnover data ranging anywhere from one to five years with further consideration given to the class of employees to whom the equity awards were granted.

A summary of stock option activity as of September 30, 2010, and changes in the period then ended is presented below (in thousands, except exercise price and remaining contract term data):

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contract Term	Aggregate Intrinsic Value
Outstanding at January 1, 2010	3,254	$ 5.52		
Granted	281	$ 4.64		
Exercised	(384)	$ 3.05		
Forfeited or expired	(536)	$ 7.69		
Outstanding at September 30, 2010	2,615	$ 5.34	3.29	$ 2,043
Vested or expected to vest at September 30, 2010	2,604	$ 5.34	3.28	$ 2,039
Exercisable at September 30, 2010	2,005	$ 5.54	2.50	$ 1,779

At September 30, 2010, approximately 2,349,000 shares of stock options were outstanding under the 1999 or 2005 Plans. Additionally, approximately 266,000 stock options were granted outside the Company s plans during the second quarter of 2010 to the Company s CEO as an inducement to join the Company.

The weighted-average grant-date fair value of options granted was $3.58 per share during the three months ended September 30, 2009. There were no options granted during the third quarter of 2010. The weighted-average grant-date fair value of options granted was $2.80 and $2.01 per share during the nine months ended September 30, 2010 and 2009, respectively. In the table above, the total intrinsic value is calculated as the difference between the market price of the Company s stock on the last trading day of the quarter and the exercise price of the options. For options exercised, intrinsic value is calculated as the difference between the market price on the date of exercise and the grant price. The intrinsic value of options exercised in each of the three months ended September 30, 2010 and 2009 was $0.1 million. The intrinsic value of options exercised in the nine months ended September 30, 2010 and 2009 were $0.5 million, and $0.4 million, respectively.

As of September 30, 2010, there was $1.2 million of total unrecognized compensation cost related to stock options. This cost is expected to be recognized over a weighted average period of 2.7 years.

Cash received from option exercises under all share-based payment arrangements for the three months ended September 30, 2010 and 2009 was $0.3 million and $0.1 million, respectively, and $1.2 million and $0.7 million for the nine months ended September 30, 2010 and 2009, respectively, net of shares repurchased to cover the cost of certain exercises and taxes. The tax benefits related to the deductions from option exercises of the share-based payment arrangements will be recognized when those deductions, currently being carried forward as net operating losses, reduce taxes payable.

Restricted Stock Units

A summary of the Company s non-vested restricted stock units as of the nine months ended September 30, 2010, and changes for the period then ended, is presented below (in thousands, except grant-date fair value data):

	Shares	Weighted-Average Grant-Date Fair Value
Non-vested at January 1, 2010	1,523	$ 5.07
Granted	979	$ 4.70
Vested	(771)	$ 4.55
Forfeited	(607)	$ 5.49
Non-vested at September 30, 2010	1,124	$ 4.87

At September 30, 2010, there were approximately 803,000 shares of non-vested restricted stock units under the 1999 or 2005 Plans. Additionally, approximately 321,000 restricted stock units were granted outside the Company s plans during the second quarter of 2010 to the Company s CEO as an inducement to join the Company.

The fair value of non-vested units is determined based on the opening trading price of the Company s shares on the grant date. As of September 30, 2010, there was $4.0 million of total unrecognized compensation cost related to non-vested restricted stock units. This cost is expected to be recognized over a weighted average period of 2.3 years.

9. INCOME TAXES

The Company recorded income tax expense based on the estimated effective tax rate for the full year, adjusted for non-forecastable items recorded during the first nine months of 2010.

The Company s effective tax rate was 45.6% and 25.3% for the three months ended September 30, 2010 and 2009, respectively and 39.9% and 33.2% for the nine months ended September 30, 2010 and 2009, respectively. The year over year change in the effective tax rate relates to permanent differences, state taxes, a $0.4 million increase to the New Jersey net operating loss carryforwards valuation allowance, a return to provision adjustment of $0.1 million, and

a stock based compensation adjustment of approximately $0.3 million relating to the difference between the expected deduction from stock based compensation which is based upon the fair value of the award at the date of issuance and the actual deduction taken which is based upon the fair value of the award at the time the award is exercised or vests.

The Company has determined that there have been no material changes in tax positions taken in the prior periods, tax positions taken in the current period, settlements with taxing authorities resulting from lapses in the statute of limitations and unrecognized tax benefits that if recognized would affect the effective tax rate and amount of interest and penalties recognized in the condensed consolidated statement of operations and the condensed consolidated balance sheets.

The tax return years since 2000 in the Company s major tax jurisdictions, both federal and various states, have not been audited and are not currently under audit. The Company does not have reason to expect any changes in the next twelve months regarding uncertain tax positions.

Table of Contents

10. NET (LOSS) INCOME AVAILABLE TO COMMON STOCKHOLDERS PER SHARE

The following table sets forth the computation of basic and diluted net loss available to common stockholders per share (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net income	$ 1,702	$ 2,713	$ 4,951	$ 3,920
Preferred stock accretion	2,413	2,325	7,124	6,861
Net (loss) income available to common shareholders	$ (711)	$ 388	$ (2,173)	$ (2,941)
Weighted average shares outstanding used in calculation of net loss available to common stockholders per share:				
Basic	31,148	30,048	30,850	29,898
Dilutive stock options		1,498		
Diluted	31,148	31,546	30,850	29,898
Net (loss) income available to common stockholders per share:				
Basic	$ (0.02)	$ 0.01	$ (0.07)	$ (0.10)
Diluted	$ (0.02)	$ 0.01	$ (0.07)	$ (0.10)

Approximately 8,309,485 and 8,443,768 shares of common stock equivalents for the three months ended September 30, 2010 and 2009, respectively, and approximately 8,146,659 and 8,541,372 shares of common stock equivalents for the nine months ended September 30, 2010 and 2009, respectively were excluded from the calculation of diluted earnings per share because of their anti-dilutive effect.

11. COMPONENTS OF COMPREHENSIVE (LOSS) INCOME

Shown below are items defined as comprehensive (loss) income that are separately classified in the financial statements. The following table reconciles the Company s net (loss) income available to common stockholders and its total comprehensive net (loss) income for the three and nine months ended September 30, 2010 and 2009 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net (loss) income available to common stockholders	$ (711)	$ 388	$ (2,173)	$ (2,941)
Other comprehensive (loss) income:				
Realized loss on hedging activity		451		1,358
Net unrealized loss on hedging activity		(201)		(715)
Comprehensive net (loss) income	$ (711)	$ 638	$ (2,173)	$ (2,298)

12. FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In addition, the standard specifies that the fair value should be the exit price, or price received to sell the asset or liability as opposed to the entry price, or price paid to acquire an asset or assume a liability.

The standard provides valuation techniques and a fair value hierarchy used to measure fair value. The hierarchy prioritizes inputs for valuation techniques used to measure fair value into three categories:

(1) Level 1 inputs, which are considered the most reliable, are quoted prices in active markets for identical assets or liabilities.

Table of Contents

(2) Level 2 inputs are those that are observable in the market place, either directly or indirectly for the asset or liability.

(3) Level 3 inputs are unobservable due to unavailability and as such the entity s own assumptions are used.

The tables below show how the Company categorizes certain financial assets and liabilities based on the types of inputs used in valuation techniques for measuring fair value:

	Fair Value Measurements at September 30, 2010			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Financial assets (in thousands):				
Merrill Lynch Institutional Fund	$ 14,149	$	$	$ 14,149
Theoretical swap derivative(1)			6,344	6,344
	$ 14,149	$	$ 6,344	$ 20,493

	Fair Value Measurements at December 31, 2009		
	Quoted Prices in Active Markets for Identical	Significant Other Observable	Significant Unobservable

	Assets (Level 1)	Inputs (Level 2)	Inputs (Level 3)	Total
Financial assets (in thousands):				
Merrill Lynch Institutional Fund	$ 7,623	$	$	$ 7,623
Theoretical swap derivative(1)			4,668	4,668
	$ 7,623	$	$ 4,668	$ 12,291

(1) Represents the fair market value of the embedded derivative associated with the Series A-1 Redeemable Convertible Preferred Stock issued in conjunction with the Princeton eCom acquisition on July 3, 2006. Management measures fair value of the derivative by estimating future cash flows related to the asset using a forecasted iMoney Net First Tier rate based on the one-month LIBOR rate adjusted for the historical spread for the estimated period in which the Series A-1 Preferred Stock will be outstanding.

The following tables are summaries of the Company s financial assets that use Level 3 inputs to measure fair value (in thousands):

	Theoretical Swap Derivative
Balance as of January 1, 2010	$ 4,668
Unrealized gain(1)	1,676
Balance as of September 30, 2010	$ 6,344

	Strategic Cash Fund Investment	Theoretical Swap Derivative
Balance as of January 1, 2009	$ 2,009	$ 4,562
Realized and unrealized gain(1)	91	(8)
Redemptions(2)	(2,100)	
Balance as of September 30, 2009	$	$ 4,554

(1) The unrealized gains are included as interest expense in the condensed consolidated statements of operations for the nine months ended September 30, 2010 and September 30, 2009.

(2) Redemptions are payments received by the Company for partial liquidation of the Columbia Strategic Cash Fund. The Company s investment in the

Columbia Strategic Cash Fund was liquidated in September 2009.

Table of Contents

13. COMMITMENTS & CONTINGENCIES

On April 16, 2010, Mr. Lawlor, former Chairman and Chief Executive Officer of the Company, commenced an action in the Circuit Court of Fairfax County, Virginia, captioned *Lawlor v. Online Resources Corporation*, Case No. 2010-5601. The action asserts employment claims for breach of contract under two stock option plans, breach of an implied employment agreement, unjust enrichment, wrongful termination and a declaratory judgment claim that a change in control occurred under the Company s stock option plan, and requests damages of $14 million. The Company disputes all the claims raised by Mr. Lawlor and has determined the lawsuit is without merit; as a result, the Company has not recorded a provision for this legal action.

On May 19, 2010, Mr. Lawlor filed a complaint with the U.S. Department of Labor alleging that the Company wrongfully terminated him in contravention of Section 806 of the Sarbanes-Oxley Act. Mr. Lawlor contends that he was terminated as CEO in retaliation for raising concerns of alleged insider trading violations to the Company. The Company denies the allegations. In a letter dated September 17, 2010, the U.S. Department of Labor notified Mr. Lawlor that his claim has been dismissed because it was not timely filed.

Table of Contents

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

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

- Any statements that are not statements of historical fact;
- Statements regarding trends in our revenues, expense levels, and liquidity and capital resources;
- Statements about the sufficiency of the proceeds from the sale of securities and cash balances to meet currently planned working capital and capital expenditure requirements for at least the next twelve months; and
- Other statements identified or qualified by words such as likely , will , suggest , may , would , could , sh expects , anticipates , estimates , plans , projects , believes , seeks , intends and other similar words t forward-looking statements.

These forward-looking statements represent our best judgment as of the date of the Quarterly Report on Form 10-Q, and we caution readers not to place undue reliance on such statements. Actual performance and results of operations may differ materially from those projected or suggested in the forward-looking statements due to certain risks and uncertainties, including but not limited to, the risks and uncertainties described or discussed in the section Risk Factors in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 10, 2010. These risks include, among others, the following:

- our history of prior losses and the lack of certainty of maintaining consistent profitability;
- our dependence on the marketing assistance of third parties to market our services;
- the possibility that we may not be able to expand to meet increased demand for our services and related products;
- the potential adverse impact that client departures may have on our financial results;
- our inability to attract and retain qualified management and technical personnel and our dependence on our executive officers and key employees;
- potential security breaches or system failures disrupting our business and the liability associated with these disruptions;
- the failure to properly develop, market or sell new products;
- the potential impact of the consolidation of the banking and financial services industry;
- the effect of adoption of government regulations on our business may be problematic;
- our need to maintain satisfactory ratings from federal depository institution regulators;
- the liquidation preference rights and redemption rights associated with our outstanding shares of preferred stock;
- the voting rights of our preferred stock restricting our right to take certain actions;
- the potential losses we may incur from the impairment of the goodwill we have obtained from our acquisitions;
- our inability to obtain additional financing to grow our business;
- the concentration of our clients in a small number of industries, including the financial services industry, and changes within those industries reducing demand for our products and services;
- the failure to retain existing end-users or changes in their continued use of our services adversely affecting our operating results;

Table of Contents

demand for low-cost or free online financial services and competition placing significant pressure on our pricing structure and revenues;
exposure to greater than anticipated tax liabilities;
our quarterly financial results being subject to fluctuations and having a material adverse effect on the price of our stock;
our limited ability to protect our proprietary technology and other rights;
the need to redesign our products, pay royalties or enter into license agreements with third parties as a result of our infringing the proprietary rights of third parties;
the potential obsolescence of our technology or the offering of new, more efficient means of conducting account presentation and payments services negatively impacting our business;
errors and bugs existing in our internally developed software and systems as well as third-party products;
the disruption of our business and the diversion of management s attention resulting from breach of contract or product liability suits;
difficulties in integrating acquired businesses;
our having limited knowledge of, or experience with, the industries served and products provided by our acquired businesses;
the liabilities or obligations that were not or will not be adequately disclosed from acquisitions we have made and may make;
the claims that may arise from acquired companies giving us limited warranties and indemnities in connection with their businesses;
the effect on the trading price of our stock from the sale of the substantial number of shares of common and convertible preferred stock outstanding, including shares issued in connection with certain acquisitions and shares that may be issued upon exercise of grants under our equity compensation plans;
the significant amount of debt which will have to repay;
the adverse effect to the market price of our common stock from future offerings of debt and preferred stock which would be senior to our common stock upon liquidation; and
the acceleration of repayment of borrowed funds if a default under the terms of our credit agreement arises.

OVERVIEW

We provide outsourced web- and phone- based financial technology services branded to financial institution, biller, card issuer and creditor clients and their millions of consumer end-users. We currently derive approximately 80% of our revenues from payments and 20% from other services including account presentation, relationship management, professional services, and custom software solutions. End-users may access and view their accounts online and perform various self-service functions. They may also make electronic bill payments and funds transfers utilizing our unique, real-time debit architecture, ACH and other payment methods. Our value-added relationship management services reinforce a favorable user experience and drive a profitable and competitive online channel for our clients. Further, we provide professional services, including software solutions, which enable various deployment options, a broad range of customization and other value-added services.

We currently operate in two business segments Banking and eCommerce. The operating results of these business segments exclude general corporate overhead expenses. Within each business segment, we face differing opportunities, challenges and risks. In our Banking segment we have the opportunity to deploy the new and enhanced products we have developed to deepen the relationships we have with our existing clients. Our differentiated account presentation and payments products, as well as our ability to deliver a full suite of remote delivery financial services, provide the opportunity for us to increase market share particularly among mid-sized financial institutions. In the bank market, a very large percentage of financial institutions now offer internet banking and bill payment to their customers. We therefore face competition in our efforts to obtain new clients from other established providers of these services. The end-user base within these clients is not highly penetrated, however, so we benefit from continuing adoption increases.

Additionally, financial service providers have recently been adversely affected by significant illiquidity and credit tightening trends in the financial markets in which they operate. Unfavorable economic conditions adversely impacting those types of business could have a material adverse effect on our business.

In our eCommerce segment, there are still a significant number of potential clients who do not offer services such as those we are in a position to provide to their customer base. Further, the competition to provide these services is more fragmented than it is in the banking market. These factors provide us with the opportunity to expand our client base. We also provide an innovative debt collection product that is attractive to a number of large and mid-sized potential clients. For a portion of our eCommerce business, our revenue is tied to the value of the payment being made which exposes us to the impact of economic factors on these payments. We also continuously monitor the potential risks that we face due to the interfaces we have with, and our reliance on, various payments networks.

Across our markets, we are exposed to interest rate risk as we earn float interest in clearing accounts that hold funds collected from end-users until they are disbursed to receiving merchants or financial institutions. We also closely monitor covenant and other compliance requirements under our debt and preferred stock agreements, as well as other potential risks associated with our capital structure.

In the past we have experienced, and expect to return to, significant user and transaction growth. Growth places significant demands on our personnel, management and other resources. We may need to expand and adapt our infrastructure, services and related products to accommodate additional clients and their end-users, increased transaction volumes and changing end-user requirements.

We have long-term service contracts with most of our clients. The majority of our revenues are recurring, though these contracts also provide for implementation, set-up and other non-recurring fees. Account presentation services revenues are based on either a monthly license fee, allowing our clients to register an unlimited number of customers, or a monthly fee for each registered customer. Payment services revenues are either based on a monthly fee for each customer enrolled, a fee per executed transaction, or a combination of both. Our clients typically provide account presentation services to users free of charge, as they derive significant potential benefits including account retention, delivery and paper cost savings, account consolidation and cross-selling of other products. Payment is either paid by our client or through service fees paid by their end users.

As a network-based service provider, we have made substantial up-front investments in infrastructure, particularly for our proprietary systems. We invested approximately $10.8 million for the nine months ended September 30, 2010, and $6.2 million and $7.4 million for the years ended December 31, 2009 and 2008, respectively. These investments were made to create new products, enhance the functionality of existing products and improve our infrastructure.

Product enhancements allow us to remain competitive, retain existing clients and attract new clients. New products allow us to increase revenue and attract new clients. Infrastructure investments allow us to leverage ongoing advances in technology to improve our operating efficiency and capture cost savings. Our investments increased significantly in 2010 due to investments made in periodic expansions of our data storage and processing capacity and the investment in client specific infrastructure.

While we continue to incur ongoing development and maintenance costs, we believe the infrastructure we have built provides us with operating leverage. We continue to automate processes, develop applications and change product mix that allow us to make smaller increases in labor and other operating costs relative to increases in customers and transactions. We believe our financial and operating performance will be based primarily on our ability to leverage additional end-users and transactions over this relatively fixed cost base.

End-users using account presentation, payment services, bill payment or any combination thereof, and the payment transactions executed by those end-users are the major drivers of our revenues. Since December 31, 2009, the number of users of our account presentation services increased 7% and the number of users of our payment services decreased 1%. Overall, the number of users in the current period approximated the number of users at the previous year end. Since September 30, 2009, the number of account presentation services users increased by 16%,

Table of Contents

and the number of payment services users increased 10%, for an overall 10% increase in users. The increase in account presentation services users is due to new clients as well as increased users with existing clients.

We have presented a strategic direction to the Board of Directors and are now developing the supporting operating plan for their approval in December 2010. While we expect that the plan will improve our business outlook over multiple periods, it could result in a change in the relative focus on, and results of, our Banking and eCommerce segments including investment decisions in products and services. These decisions could result in impairment of assets including intangible assets, capitalized software costs and/or goodwill.

Results of Operations

The following table presents the summarized results of operations for our two reportable segments, Banking and eCommerce (dollars in thousands):

	Three Months Ended September 30,				**Nine Months Ended September 30,**			
	2010		**2009**		**2010**		**2009**	
	Dollars	**%**	**Dollars**	**%**	**Dollars**	**%**	**Dollars**	**%**
Revenues:								
Banking	$ 22,319	61%	$ 22,793	62%	$ 67,835	61%	$ 68,723	60%
eCommerce	14,476	39%	13,801	38%	43,901	39%	44,894	40%
Total	$ 36,795	100%	$ 36,594	100%	$ 111,736	100%	$ 113,617	100%
	Dollars	**Margin**	**Dollars**	**Dollars**	**Margin**	**Margin**	**Dollars**	**Margin**
Gross profit:								
Banking	$ 10,997	49%	$ 11,573	51%	$ 33,782	50%	$ 35,022	51%
eCommerce	6,404	44%	6,205	45%	19,548	45%	20,099	45%
Total	$ 17,401	47%	$ 17,778	49%	$ 53,330	48%	$ 55,121	49%
	Dollars	**%**	**Dollars**	**%**	**Dollars**	**%**	**Dollars**	**%**
Operating expenses:								
Banking	$ 5,943	41%	$ 5,458	40%	$ 18,416	40%	$ 17,874	39%
eCommerce	4,595	31%	4,594	33%	14,019	31%	15,023	32%
Corporate(1)	4,038	28%	3,774	27%	13,052	29%	13,249	29%
Total	$ 14,576	100%	$ 13,826	100%	$ 45,487	100%	$ 46,146	100%
	Dollars	**Margin**	**Dollars**	**Margin**	**Dollars**	**Margin**	**Dollars**	**Margin**
Income from operations:								
Banking	$ 5,054	23%	$ 6,115	27%	$ 15,366	23%	$ 17,148	25%
eCommerce	1,809	12%	1,611	12%	5,529	13%	5,076	11%
Corporate(1)	(4,038)		(3,774)		(13,052)		(13,249)	

Total	$ 2,825	8%	$ 3,952	11%	$ 7,843	7%	$ 8,975	8%

(1) Corporate expenses are primarily comprised of corporate general and administrative expenses that are not considered in the measure of segment profit or loss used to evaluate the segments.

Table of Contents

THREE MONTHS ENDED SEPTEMBER 30, 2010 COMPARED TO THE THREE MONTHS ENDED SEPTEMBER 30, 2009

Revenues

We generate revenues from account presentation, payment, relationship management and professional services and other revenues.

	Three Months Ended September 30,		Change	
	2010(1)	2009(1)	Difference(1)	%
Revenues:				
Account presentation services	$ 2,237	$ 2,083	$ 154	7%
Payment services	27,699	28,971	(1,272)	(4)%
Relationship management services	2,358	2,015	343	17%
Professional services and other	4,501	3,525	976	28%
Total revenues	$ 36,795	$ 36,594	$ 201	1%
Payment metrics:				
Banking payment transactions	36,754	38,524	(1,770)	(5)%
Biller payment transactions	18,014	15,123	2,891	19%

(1) In thousands

Account Presentation Services. Both the Banking and eCommerce segments contribute to account presentation services revenues, which increased 7%, or $0.2 million, to $2.2 million. The increase is primarily due to a $0.2 million increase in user fees from a new large client in the current period.

Payment Services. Both the Banking and eCommerce segments contribute to payment services revenues, which decreased to $27.7 million for the three months ended September 30, 2010 from $29.0 million in the prior year quarter. The decrease is primarily due to declines of $1.1 million in user fees and $0.2 million in electronic transaction fees related to client losses and reduced fees per transaction, partially offset by increased transactions.

Relationship Management Services. Primarily composed of revenues from the Banking segment, relationship management services revenues increased 17% to $2.4 million. The increase was primarily due to an increase of $0.3 million in user fees.

Professional Services and Other. Both the Banking and eCommerce segments contribute to professional services and other revenues, which increased $1.0 million, or 28%. The increase is primarily due to a $0.2 million increase in implementation fees, a $0.4 million increase in professional services provided to existing clients and a $0.3 million increase in ancillary service fees.

Table of Contents

Costs and Expenses

	Three Months Ended September 30,		Change	
	2010(1)	2009(1)	Difference(1)	%
Revenues	$ 36,795	$ 36,594	$ 201	1%
Costs of revenues	19,394	18,816	578	3%
Gross profit	17,401	17,778	(377)	(2)%
Gross margin	47%	49%		
Operating expenses				
General and administrative	7,399	6,955	444	6%
Sales and marketing	4,900	4,624	276	6%
Systems and development	2,277	2,247	30	1%
Total operating expenses	14,576	13,826	750	5%
Income from operations	2,825	3,952	(1,127)	(29)%
Other income (expense)				
Interest income	18	22	(4)	(18)%
Interest and other expense	286	(343)	629	(183)%
Total other income (expense)	304	(321)	625	(195)%
Income before tax provision	3,129	3,631	(502)	(14)%
Income tax provision	1,427	918	509	55%
Net income	1,702	2,713	(1,011)	(37)%
Preferred stock accretion	2,413	2,325	88	4%
Net (loss) income available to common stockholders	$ (711)	$ 388	$ (1,099)	(283)%
Net (loss) income available to common stockholders per share:				
Basic	$ (0.02)	$ 0.01	$ (0.03)	(300)%
Diluted	$ (0.02)	$ 0.01	$ (0.03)	(300)%
Shares used in calculation of net loss available to common stockholders per share:				
Basic	31,148	30,048	1,100	4%
Diluted	31,148	31,546	(398)	(1)%

(1) In thousands except for per share amounts.

Costs of Revenues. Costs of revenues encompass the direct expenses associated with providing our services. These expenses include telecommunications, payment processing, systems operations, customer service, implementation and professional services work. Costs of revenues increased 3%, or $0.6 million, primarily due to an increase in system operations expenses of $0.3 million, an increase in amortization of capitalized software of $0.1 million and an increase in implementation compensation of $0.1 million.

Gross Profit. Gross profit decreased $0.4 million for the three months ended September 30, 2010 and gross margin as a percentage of revenues decreased 2% to 47% primarily due to higher system operations expenses of $0.3 million.

General and Administrative. General and administrative expenses primarily consist of salaries for executive, administrative and financial personnel, consulting expenses and facilities costs such as office leases, insurance and depreciation. General and administrative expenses increased $0.4 million, or 6%, to $7.4 million for the three months ended September 30, 2010 due to an increase of approximately $0.6 million in consulting and legal services, $0.1 million higher depreciation expense, offset by a decrease of $0.3 million in repair and maintenance costs.

Sales and Marketing. Sales and marketing expenses include salaries and commissions paid to sales and client services personnel and other costs incurred in selling our services and products. Sales and marketing expenses increased $0.3 million, or 6%, to $4.9 million for the three months ended September 30, 2010. The primary reason for the increase is higher commissions of $0.6 million, an increase of $0.1 million to our bad debt allowance and reduced amortization expense of approximately $0.3 million related to our customer lists.

Systems and Development. Systems and development expenses include salaries, consulting fees and all other expenses incurred in supporting the development of new services and products and new technology to enhance existing products. Systems and development expenses remained constant compared to the prior year period.

Income from Operations. Income from operations decreased $1.1 million, or 29%, to $2.8 million for the three months ended September 30, 2010. The decrease is due to lower gross profit and increased operating expenses.

Interest Income. Interest income remained constant for the three months ended September 30, 2010 compared to the same period in the prior year.

Interest and Other Expense. Interest and other expense decreased by $0.6 million for the three months ended September 30, 2010 compared to the same period in the prior year due to reduced interest payments on the 2007 Notes of approximately $0.7 million.

Income Tax Provision. We recognized tax expense for the three months ended September 30, 2010, as a result of $3.1 million of income before income taxes generated during the third quarter of 2010. Our effective tax rate for the period was 45.6%. The difference between our effective tax rate and the federal statutory rate is primarily due to permanent differences, state taxes, a $0.3 million increase to the New Jersey net operating loss carryforwards valuation allowance, and a return to provision adjustment of $0.1 million.

Preferred Stock Accretion. The accretion related to the Series A-1 Preferred Stock issued on July 3, 2006 increased 4% due to compounding of dividends.

Net (Loss) Income Available to Common Stockholders. Net (loss) income available to common stockholders decreased $1.1 million to a net loss of $0.7 million for the three months ended September 30, 2010, compared to net income of $0.4 million for the three months ended September 30, 2009. Basic and diluted net loss available to common stockholders per share was $0.02 for the three months ended September 30, 2010, compared to a basic and diluted net income available to common stockholders of $0.01 for the three months ended September 30, 2009. Basic shares outstanding increased by 4% primarily as a result of shares issued in connection with the exercise of stock options, issuance of restricted stock units and our employees participation in the employee stock purchase plan.

NINE MONTHS ENDED SEPTEMBER 30, 2010 COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 2009

Revenues

Revenues decreased $1.9 million, or 2%, to $111.7 million for the nine months ended September 30, 2010.

	Nine Months Ended September 30,		**Change**	
	2010(1)	**2009(1)**	**Difference(1)**	**%**
Revenues:				
Account presentation services	$ 6,676	$ 5,877	$ 799	14%
Payment services	85,576	90,126	(4,550)	(5)%
Relationship management services	6,498	6,055	443	7%
Professional services and other	12,986	11,559	1,427	12%
Total revenues	$ 111,736	$ 113,617	$ (1,881)	(2)%
Payment metrics:				
Banking transactions	109,204	114,870	(5,666)	(5)%
Biller payment transactions	52,012	44,680	7,332	16%

(1) In thousands

Account Presentation Services. Both the Banking and eCommerce segments contribute to account presentation services revenues, which increased 14%, or $0.8 million, to $6.7 million. The increase is primarily due to approximately $0.8 million increase in user fees, $0.3 million in hosting and license fees, $0.2 million increase in account maintenance fees offset by a decrease of approximately $0.5 million in card usage fees.

Payment Services. Both the Banking and eCommerce segments contribute to payment services revenues, which decreased to $85.6 million for the nine months ended September 30, 2010 from $90.1 million in the same period of the prior year. The decrease is due to declines of $2.2 million in user fees, a decrease of $0.5 million in float interest revenue and a $1.9 million decrease in electronic transaction fees related to client losses, partially offset by increased transactions.

Relationship Management Services. Primarily composed of revenues from the Banking segment, relationship management services revenues increased by $0.4 million as a result of an increase in user fees.

Professional Services and Other. Both the Banking and eCommerce segments contribute to professional services and other revenues, which increased $1.4 million, or 12%. The increase is primarily due to a $1.0 million increase in ancillary service fees, a $0.9 million increase in professional service fees, offset by a $0.4 million decrease in cancellation fees.

Table of Contents

Costs and Expenses

	Nine Months Ended September 30,		Change	
	2010(1)	2009(1)	Difference(1)	%
Revenues	$ 111,736	$ 113,617	$ (1,881)	(2)%
Costs of revenues	58,406	58,496	(90)	0%
Gross profit	53,330	55,121	(1,791)	(3)%
Gross margin	48%	49%		
Operating expenses				
General and administrative	23,427	23,564	(137)	(1)%
Sales and marketing	14,657	15,952	(1,295)	(8)%
Systems and development	7,403	6,630	773	12%
Total operating expenses	45,487	46,146	(659)	(1)%
Income from operations	7,843	8,975	(1,132)	(13)%
Other income (expense)				
Interest income	39	104	(65)	(63)%
Interest and other expense	351	(3,209)	3,560	(111)%
Total other income (expense)	390	(3,105)	3,495	(113)%
Income before tax provision	8,233	5,870	2,363	40%
Income tax provision	3,282	1,950	1,332	68%
Net income	4,951	3,920	1,031	26%
Preferred stock accretion	7,124	6,861	263	4%
Net loss available to common stockholders	$ (2,173)	$ (2,941)	$ 768	(26)%
Net loss available to common stockholders per share:				
Basic	$ (0.07)	$ (0.10)	$ 0.03	(30)%
Diluted	$ (0.07)	$ (0.10)	$ 0.03	(30)%
Shares used in calculation of net loss available to common stockholders per share:				
Basic	30,850	29,898	952	3%
Diluted	30,850	29,898	952	3%

(1)

In thousands
except for per
share amounts.

Costs of Revenues. Costs of revenues encompass the direct expenses associated with providing our services. These expenses include telecommunications, payment processing, systems operations, customer service, implementation and professional services work. Costs of revenues did not change compared to the same prior year period primarily due to an insignificant change in revenue compared to the same prior year period.

Gross Profit. Gross profit decreased $1.8 million for the nine months ended September 30, 2010 and gross margin as a percentage of revenues decreased 1% to 48%. The decrease in gross profit is primarily due to lower revenues.

General and Administrative. General and administrative expenses primarily consist of salaries for executive, administrative and financial personnel, consulting expenses and facilities costs such as office leases, insurance and depreciation. General and administrative expenses decreased $0.1 million, or 1%, to $23.4 million for the nine months ended September 30, 2010 due a decrease in repair and maintenance of $0.8 million and a reduction of trade show costs of $0.2 million, offset by an increase in consulting fees of $0.6 million and professional fees of $0.3 million.

Sales and Marketing. Sales and marketing expenses include salaries and commissions paid to sales and client services personnel and other costs incurred in selling our services and products. Sales and marketing expenses decreased $1.3 million, or 8%, to $14.7 million for the nine months ended September 30, 2010. The primary reason for the decrease is reduced amortization expense of approximately $1.1 million related to our customer lists, reduced partnership commissions of $0.7 million and reduced equity compensation costs of $0.3 million, offset by higher commissions of $0.6 million and additional bad debt expense of $0.1 million.

Systems and Development. Systems and development expenses include salaries, consulting fees and all other expenses incurred in supporting the research and development of new services and products and new technology to enhance existing products. Systems and development expenses increased by $0.8 million, or 12%, to $7.4 million for the nine months ended September 30, 2010. The increase is due to

an increase in consulting fees of $0.8 million, higher employee compensation costs of $0.4 million, an increase of capitalized software costs of $0.5 million, offset by an increase in deferred implementation costs $1.0 million.

Income from Operations. Income from operations decreased $1.1 million to $7.8 million, compared to the prior year period, primarily due to lower gross profit of $1.8 million, partially offset by lower operating expenses of $0.7 million.

Interest Income. Interest income remained constant for the nine months ended September 30, 2010 compared to the same period in the prior year.

Interest and Other Expense. Interest and other expense decreased by $3.6 million for the nine months ended September 30, 2010 due to reduced interest payments on the 2007 Notes of approximately $2.1 million and an increase in the fair value of the theoretical swap derivative which reduced other expense by approximately $1.7 million, partially offset by a decrease in unrealized gains of approximately $0.2 million.

Income Tax Provision. We recognized tax expense for the nine months ended September 30, 2010, as a result of $8.2 million of income before income taxes generated during the nine months of 2010. Our effective tax rate for the period was 39.9%. The difference between our effective tax rate and the federal statutory rate is primarily due to permanent differences, state taxes, a $0.4 million increase to the New Jersey net operating loss carryforwards valuation allowance, a return to provision adjustment of $0.1 million, and a stock based compensation adjustment of approximately $0.3 million relating to the difference between the expected deduction from stock based compensation which is based upon the fair value of the award at the date of issuance and the actual deduction taken which is based upon the fair value of the award at the time the award is exercised or vests.

Preferred Stock Accretion. The accretion related to the Series A-1 Preferred Stock issued on July 3, 2006 increased 4% due to compounding of dividends.

Net Loss Available to Common Stockholders. Net loss available to common stockholders decreased $0.8 million to net loss of $2.2 million for the nine months ended September 30, 2010, compared to net loss of $2.9 million for the nine months ended September 30, 2009. Basic and diluted net loss available to common stockholders per share was $0.07 for the nine months ended September 30, 2010, compared to a net loss available to common stockholders of $0.10 for the nine months ended September 30, 2009. Basic and diluted shares outstanding increased by 3% primarily as a result of shares issued in connection with the exercise of stock options, issuance of restricted stock units and our employees participation in the employee stock purchase plan.

LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities was $22.2 million for the nine months ended September 30, 2010. This represented a $1.5 million decrease in cash provided by operating activities compared to the same period in the prior year, which was primarily the result of an increase in net income of $1.0 million and an increase to deferred tax benefits of $1.9 million offset by a decrease in depreciation and amortization of $1.2 million, a decrease in equity compensation expense of $1.2 million, a change in the fair value of the theoretical swap derivative of $1.7 million, and changes in certain other assets and liabilities of $0.3 million.

Net cash used by investing activities for the nine months ended September 30, 2010 was $10.8 million, which was the result of capital expenditures.

Net cash used by financing activities was $7.2 million for the nine months ended September 30, 2010, which was primarily the result of $8.0 million of payments on our 2007 Notes offset by $0.8 million in net proceeds from the issuance of common stock. On October 29, 2010, we made a voluntary payment of $4 million on the 2007 Notes.

Given continuing economic uncertainty and interest rate volatility, we could experience unforeseeable impacts on our results of operations, cash flows, ability to meet debt and other contractual requirements, and other items in future periods. While there can be no guarantees as to outcome, we have developed a contingent plan to address the negative effects of these uncertainties, if they occur.

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

We currently believe that cash on hand, investments and the cash we expect to generate from operations will be sufficient to meet our current anticipated cash requirements for at least the next twelve months and to service our existing debt. There can be no assurance that additional capital beyond the amounts currently forecasted by us will not be required or that any such required additional capital will be available on reasonable terms, if at all, at such time as required.

Table of Contents

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

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

We are exposed to the impact of interest rate changes as they affect our outstanding senior secured notes, or 2007 Notes. The interest rate on our 2007 Notes varies based on LIBOR and, consequently, our interest expense could fluctuate with changes in the LIBOR rate through the maturity date of the senior secured note.

We earn float interest in clearing accounts that hold funds collected from end-users until they are disbursed to receiving merchants or financial institutions. The float interest we earn on these clearing accounts is considered in our determination of the fee structure for clients and represents a portion of the payment for our services. As such, the float interest earned is classified as payment services revenue in our condensed consolidated statements of operations. This float interest revenue is exposed to changes in the general level of U.S. interest rates as it relates to the balances of these clearing accounts. The float interest totaled $0.1 million for each of the three months ended September 30, 2010 and 2009 and $0.2 million and $0.7 million for the nine months ended September 30, 2010 and 2009, respectively. If there was a change in interest rates of one percent as of September 30, 2010, revenues associated with float interest would have increased by approximately $1.4 million for the nine months ended September 30, 2010.

ITEM 4. ***CONTROLS AND PROCEDURES***

Our management is responsible for establishing and maintaining disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, and for internal controls over financial reporting.

(a) As of the end of the period covered by this Quarterly Report on Form 10-Q, an evaluation was performed under the supervision and with the participation of our management, including the President and Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based on that evaluation, the CEO and CFO have concluded that our disclosure controls and procedures were effective as of September 30, 2010 to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission s rules and forms and is accumulated and communicated to our management including our CEO and CFO as appropriate to allow timely decisions regarding disclosures.

(b) There have been no changes in our internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) identified in connection with the evaluation of such internal control that occurred during our last fiscal quarter (as required by Exchange Act Rules 13a-15(d) and 15d-15(d)) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. ***LEGAL PROCEEDINGS***

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

ITEM 1A. ***RISK FACTORS***

There have been no material changes to risk factors as previously disclosed in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 10, 2010 except for the following:

Our risk factor entitled ***The failure to attract or retain our officers and skilled employees could have a material adverse effect on our business*** has been modified to reflect recent developments. The modified risk factor reads as follows:

The failure to attract or retain our officers and skilled employees could have a material adverse effect on our business.

If we fail to attract, assimilate or retain highly qualified managerial and technical personnel, our business could be materially adversely affected. Our performance is substantially dependent on the performance of our executive officers and key employees who must be knowledgeable and experienced in both financial services and technology. We are also dependent on our ability to retain and motivate high quality personnel, especially management and highly skilled technical teams. The loss of the services of any executive officers or key employees could have a material adverse effect on our business. Our future success also depends on the continuing ability to identify, hire, train and retain other highly qualified managerial and technical personnel. If our managerial and key personnel fail to effectively manage our business, our results of operations and reputation could be harmed.

In June, 2010, our board of directors appointed Joseph L. Cowan as President and Chief Executive Officer. The transition to Mr. Cowan s leadership of the Company could distract our existing management team and may ultimately lead to changes in corporate strategy. These changes may negatively impact our ability to meet key corporate and financial objectives, which could adversely affect our business, results of operations and financial condition. Our Chief Executive Officer is in the process of an evaluation and may propose changes to the Company s operations.

Our risk factor entitled ***Our recent change of chief executive officer may be viewed negatively and have an adverse impact on our business*** was modified in our Quarterly Report on Form 10-Q flied with the Securities and Exchange Commission on May 6, 2010, and has been further modified to reflect recent developments. The modified risk factor reads as follows:

Our recent changes of chief executive officer may be viewed negatively and have an adverse impact on our business.

Our board of directors recently appointed Joseph L. Cowan as President, Chief Executive Officer and a member of the Board of Directors. Mr. Cowan replaces John C. Dorman, who previously served as interim chief executive officer, and who now serves as Chairman of the Board of Directors. Investors, employees, customers, suppliers, and others could react negatively to the appointment of Mr. Cowan as our President and Chief Executive Officer or the appointment of Mr. Dorman as our Chairman. Matthew P. Lawlor, who had served as chief executive officer for the preceding twenty years, retired on December 14, 2009. Our relationship with Mr. Lawlor is currently adversarial, and Mr. Lawlor is pursuing litigation against the Company related to the financial arrangements associated with his retirement. In addition, we believe Mr. Lawlor owns a significant number of shares of our common stock and could pursue a proxy fight or otherwise attempt to influence the affairs of the company. The potential negative reactions related to the recent change in our chief executive officer position and any litigation or proxy challenge initiated by Mr. Lawlor could adversely impact our revenue, capital needs, ability to retain employees, relations with customers, suppliers, investors, and others and our business in general.

The following risk factor was added to the Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 6, 2010. This additional risk factor reads as follows:

Certain payment funding methods expose us to the credit and/or operating risk of our clients.

When we process an automated clearing house or automated teller machine network payment transaction for a client, we initiate a transaction to withdraw funds from the designated source account and deposit them into our off-balance sheet settlement account, which is a trust account maintained for the benefit of our clients. We then

initiate a simultaneous transaction to transfer funds from our settlement account to the intended destination account. These back to back transactions are designed to settle at the same time, usually overnight, such that we receive the funds from the source at the same time as we send the funds to their destination. It is possible, however, that the source account may not have sufficient funds for the transaction, the institution controlling the account may commit an operational error causing insufficient funds to be sent or the account may be subject to legal or other constraints that prevent the withdrawal of the funds. The vast majority of these occurrences are resolved quickly though normal processes. However, if they are not resolved and we are then unable to reverse the transaction that sent funds to the intended destination, a shortfall in our settlement account will be created. We have legal and contractual recourse against our clients for the amount of the shortfall, but timing of recovery may be delayed by litigation or other legal processes. Additionally, the amount of recovery may be diminished if our clients creditworthiness is not then sufficient to cover the shortfall. If we are unable to recover the funds through any of these methods, we may have to fund the shortfall in our settlement account from our corporate funds.

Table of Contents

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

Information regarding unregistered sales of securities and use of proceeds are contained in a Form 8-K filed with the Securities and Exchange Commission on June 21, 2010.

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

None

ITEM 4. ***SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDER***

Information regarding submission of matters to a vote of security holders is contained in a Form 8-K filed with the Securities and Exchange Commission on July 7, 2010.

ITEM 5. ***OTHER INFORMATION***

None

ITEM 6. ***EXHIBITS***

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

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

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

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	ONLINE RESOURCES CORPORATION
Date: November 4, 2010	By: /s/ Joseph L. Cowan Joseph L. Cowan President and Chief Executive Officer (Principal Executive Officer)
	ONLINE RESOURCES CORPORATION
Date: November 4, 2010	By: /s/ Catherine A. Graham Catherine A. Graham Executive Vice President and Chief Financial Officer (Principal Financial Officer)