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VERTRUE INC
Form 10-Q
February 09, 2005

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

FORM 10-Q

X Quarterly report pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934 for the quarterly period ended December 31, 2004
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.)

680 Washington Boulevard
Stamford, Connecticut

(Address of principal executive offices)

06901

(Zip Code)

(203) 324-7635

(Registrant's telephone number,
including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No []

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). [X] Yes [] No

Indicate the number of shares outstanding of each of the registrant's class of common stock as of the latest practicable date: 9,256,000 shares of Common Stock, \$0.01 par value as of January 31, 2005.

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INDEX TO FORM 10-Q

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VERTRUE INCORPORATED
CONSOLIDATED BALANCE SHEETS (UNAUDITED)
(In thousands, except per share amounts)

| | | December 2004 |
|--------------------------------------------------------------------------------------------------------------------------------------|----|------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ | 15 |
| Restricted cash | | |
| Short-term investments | | |
| Accounts receivable (net of allowance for doubtful accounts of \$238 and \$235 at December 31, 2004 and June 30, 2004, respectively) | | 1 |
| Prepaid membership materials | | |
| Prepaid expenses and other current assets | | |
| Membership solicitation and other deferred costs | | 4 |
| | | |

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| | | |
|----------------------------------------------------------------------------------------------------------------------|----|-------|
| Total current assets | | 23 |
| Fixed assets, net | | 4 |
| Goodwill | | 16 |
| Intangible assets, net | | 3 |
| Other assets | | 1 |
| | | ----- |
| Total assets | \$ | 48 |
| | | ===== |
| Liabilities and Shareholders' Deficit | | |
| Current liabilities: | | |
| Current maturities of long-term obligations | \$ | |
| Accounts payable | | 3 |
| Accrued liabilities | | 9 |
| Deferred revenues | | 12 |
| Deferred income taxes | | 1 |
| | | ----- |
| Total current liabilities | | 26 |
| Deferred income taxes | | 1 |
| Other long-term liabilities | | |
| Long-term debt | | 23 |
| | | ----- |
| Total liabilities | | 51 |
| | | ----- |
| Commitments and contingencies (Note 10) | | |
| 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; 19,415 shares issued (19,089 shares at June 30, 2004) | | |
| Capital in excess of par value | | 16 |
| Accumulated earnings | | 2 |
| Accumulated other comprehensive loss | | |
| Treasury stock, 9,167 shares at cost (8,852 shares at June 30, 2004) | | (22) |
| | | ----- |
| Total shareholders' deficit | | (3) |
| | | ----- |
| Total liabilities and shareholders' deficit | \$ | 48 |
| | | ===== |

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

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VERTRUE INCORPORATED
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(In thousands, except per share amounts)

| Three months ended December 31, | | S |
|------------------------------------|------|-------|
| 2004 | 2003 | 200 |
| ----- | | ----- |

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| | | | | | | |
|-------------------------------------------------------------------------|----|---------|----|---------|----|-------|
| Revenues | \$ | 136,479 | \$ | 123,164 | \$ | 27 |
| Expenses: | | | | | | |
| Marketing | | 68,689 | | 66,745 | | 13 |
| Operating | | 25,952 | | 23,042 | | 5 |
| General and administrative | | 26,302 | | 19,195 | | 5 |
| Amortization of intangibles | | 1,753 | | 271 | | |
| | | ----- | | ----- | | ----- |
| Operating income | | 13,783 | | 13,911 | | 3 |
| Interest expense, net | | (4,611) | | (1,084) | | (|
| Other income (expense), net | | 428 | | (52) | | |
| | | ----- | | ----- | | ----- |
| Income before income taxes | | 9,600 | | 12,775 | | 2 |
| Provision for income taxes | | 3,717 | | 5,110 | | |
| | | ----- | | ----- | | ----- |
| Net income | \$ | 5,883 | \$ | 7,665 | \$ | 1 |
| | | ===== | | ===== | | ===== |
| Basic earnings per share | \$ | 0.58 | \$ | 0.71 | \$ | 1 |
| | | ===== | | ===== | | ===== |
| Diluted earnings per share | \$ | 0.51 | \$ | 0.60 | \$ | 1 |
| | | ===== | | ===== | | ===== |
| Weighted average common shares used in earnings per share calculations: | | | | | | |
| Basic | | 10,128 | | 10,756 | | 1 |
| | | ===== | | ===== | | ===== |
| Diluted | | 13,063 | | 14,074 | | 1 |
| | | ===== | | ===== | | ===== |

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

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VERTRUE INCORPORATED
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In thousands)

| | | Six Months End | |
|-----------------------------------------------------------------------------------|----|----------------|-------|
| | | December 31, | |
| | | ----- | ----- |
| | | 2004 | ----- |
| Operating activities | | | |
| Net income | \$ | 13,479 | \$ |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Change in deferred revenues | | (19,369) | |
| Change in membership solicitation and other deferred costs | | 8,685 | |
| Depreciation and amortization | | 10,422 | |
| Deferred and other income taxes | | 3,197 | |

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| | | |
|--------------------------------------------------------------|------------|-------|
| Tax benefit from employee stock plans | 939 | |
| Other | 422 | |
| Change in assets and liabilities: | | |
| Restricted cash | 283 | |
| Accounts receivable | (3,939) | |
| Prepaid membership materials | (1,150) | |
| Prepaid expenses | (2,247) | |
| Other assets | (19) | |
| Accounts payable | 834 | |
| Accrued and other liabilities | 3,089 | |
| | ----- | ----- |
| Net cash provided by operating activities | 14,626 | |
| | ----- | ----- |
| Investing activities | | |
| Acquisition of fixed assets | (4,339) | |
| Net settlement of short-term investments | 264 | |
| Acquisition of business and other investing activities | (16,097) | |
| | ----- | ----- |
| Net cash used in investing activities | (20,172) | |
| | ----- | ----- |
| Financing activities | | |
| Net proceeds from exercise of stock options | 6,237 | |
| Treasury stock purchases | (8,396) | |
| (Debt issuance costs) net proceeds from issuance of debt | (750) | |
| Payments of long-term obligations | (204) | |
| | ----- | ----- |
| Net cash (used in) provided by financing activities | (3,113) | |
| | ----- | ----- |
| Effect of exchange rate changes on cash and cash equivalents | 235 | |
| | ----- | ----- |
| Net (decrease) increase in cash and cash equivalents | (8,424) | |
| Cash and cash equivalents at beginning of period | 159,496 | |
| | ----- | ----- |
| Cash and cash equivalents at end of period | \$ 151,072 | \$ |
| | ===== | ===== |

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

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VERTRUE INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 - NATURE OF BUSINESS

Vertrue Incorporated (the "Company"), a Delaware Corporation, began doing business as Cardmember Publishing Corporation in 1986 and was organized as MemberWorks Incorporated in 1996. On October 13, 2004, the Company began doing business as Vertrue Incorporated. On November 18, 2004, the Company's shareholders approved an amendment to the Company's charter formally changing its name to Vertrue Incorporated. The name change was intended to reflect the ever-broadening base of membership services that the Company offers to its customers. The Company is a category leader in both membership and loyalty programs. The Company's membership programs are both subscription and transaction based offerings focused on meeting consumer needs in large spending categories - healthcare, discounts, security and personals. The Company's programs offer everyday savings, event-oriented discounts, peace of mind and

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unique consumer benefits. Programs are available in English, French and Spanish and are increasingly customized for specific client customer segments or consumer communities. The Company's loyalty programs provide clients with a wide range of benefits to offer or market to their customers and include stand-alone benefits, reward point accumulation and management, gift certificate, merchandise and travel reward redemption. The Company's versatility in designing loyalty strategies and providing turnkey execution is essential in supporting and promoting the client's brand.

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. Accordingly, 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 presentation have been included. 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 six months ended December 31, 2004 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2005. For further information, refer to the financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K with respect to the fiscal year ended June 30, 2004.

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

The Company acquired Lavalife Inc. on April 1, 2004 and Bargain Network, Inc. on November 30, 2004. Therefore, the results of operations of Lavalife Inc. and Bargain Network, Inc. have been included in the consolidated results of operations since the dates of acquisition and are not included in the results of operations for the three and six months ended December 31, 2003. The results of Bargain Network, Inc. are included in the Membership segment and the results of Lavalife Inc. are included in the Personals segment.

NOTE 3 - RECLASSIFICATIONS

Certain prior year amounts have been reclassified to conform to the current year presentation.

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VERTRUE INCORPORATED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 4 - STOCK-BASED COMPENSATION

In accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), the Company applies the intrinsic value method in accounting for employee stock options. Accordingly, the Company generally does not recognize compensation expense with respect to stock-based awards to employees. If compensation cost for the Company's stock-based compensation plans had been determined based on the fair value (estimated using the Black-Scholes option-pricing model) at the grant dates for awards under those plans consistent with the method of Financial Accounting Standards Board Statement ("SFAS") No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), and SFAS No. 148, "Accounting for Stock-Based Compensation Transition and

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Disclosure" ("SFAS 148"), the Company's pro forma net income and earnings per share would have been as follows:

| | Three months ended December 31, | | |
|---------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------|----------|----|
| | 2004 | 2003 | |
| Net income reported | \$ 5,883 | \$ 7,665 | \$ |
| Add: Stock-based employee compensation expense determined under the intrinsic value based method for all awards, net of related tax effects | - | - | |
| Deduct: Stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects | 961 | 1,262 | |
| Pro forma net income | \$ 4,922 | \$ 6,403 | \$ |
| Earnings per share: | | | |
| As reported: | | | |
| Basic | \$ 0.58 | \$ 0.71 | \$ |
| Diluted | \$ 0.51 | \$ 0.60 | \$ |
| Pro forma: | | | |
| Basic | \$ 0.49 | \$ 0.60 | \$ |
| Diluted | \$ 0.43 | \$ 0.51 | \$ |

NOTE 5 - BUSINESS COMBINATIONS

On November 30, 2004, the Company completed the acquisition of certain of the assets of Bargain Network, Inc., a privately held provider of premier pricing services for homes, vehicles and consumer durables. The Company acquired certain of the assets of Bargain Network, Inc. in order to expand its direct to consumer marketing presence. The purchase price, which excludes fees and expenses and is subject to certain purchase price adjustments, amounted to \$27,771,000, of which \$16,000,000 was paid subsequent to December 31, 2004. In addition, the Company assumed certain liabilities amounting to \$4,729,000. The Company estimates that contingent payments of up to \$31,883,000 may be paid if certain performance targets, including increasing levels of earnings, are achieved through June 30, 2005. Any additional payments under the contingency arrangement would be considered additional purchase price and allocated to the net assets acquired. The Company identified \$3,200,000 of intangible assets other than goodwill in conjunction with the acquisition of certain of the assets of Bargain Network, Inc. The \$36,945,000 of unallocated excess merger consideration over the net assets acquired was allocated to goodwill and the entire amount is deductible for tax purposes. See Note 6 for a detailed description of the identified intangible assets and goodwill identified in connection with this business combination. The fair values of the acquired assets and liabilities assumed at the date of acquisition are as follows (in thousands):

| | |
|-------------------------------------|----------|
| Current assets | \$ 2,238 |
| Fixed assets | 6,066 |
| Goodwill arising in the acquisition | 36,945 |
| Intangible assets | 3,200 |
| Other assets | 995 |
| Current liabilities | (3,904) |
| Other long-term obligations | (769) |
| | ----- |

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Net assets acquired \$ 44,771
=====

On April 1, 2004, the Company completed the acquisition of all of the assets and outstanding capital stock of Lavalife Inc. ("Lavalife"), a leading provider of online and IVR-based interactive personals services. The purchase price, excluding fees and expenses, was Cdn\$152,500,000, or \$116,300,000, and is subject to certain purchase price adjustments. The acquisition was funded with cash on hand and borrowings under the Company's \$45,000,000 senior secured credit facility.

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VERTRUE INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Pro Forma Results

The following unaudited pro forma results of operations for the three and six months ended December 31, 2004 and 2003 have been prepared assuming the Lavalife acquisition had occurred on July 1, 2003. These pro forma results are not necessarily indicative of the results of future operations or results that would have occurred had the acquisition been consummated as of that date (in thousands, except per share data).

| | Three Months Ended December 31, | | Six Months |
|----------------------------|---------------------------------|------------|------------|
| | 2004 | 2003 | 2004 |
| Revenues | \$ 136,479 | \$ 140,401 | \$ 272,102 |
| Net income | 5,883 | 7,168 | 13,479 |
| Basic earnings per share | \$ 0.58 | \$ 0.64 | \$ 1.33 |
| Diluted earnings per share | 0.51 | 0.54 | 1.16 |

NOTE 6 - GOODWILL AND OTHER INTANGIBLE ASSETS

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

| | As of December 31, 2004 | | As of Ju |
|-------------------------------------|-------------------------|--------------------------|-----------------------|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount |
| Amortizable intangible assets: | | | |
| Membership and client relationships | \$ 29,695 | \$ (11,218) | \$ 27,999 |
| Trade names | 20,118 | (935) | 18,543 |
| Other | 1,520 | (1,026) | 1,162 |
| Total amortizable intangible assets | 51,333 | (13,179) | 47,704 |
| Amortizable intangible assets, net | \$ 38,154 | | \$ 37,822 |
| Unamortizable intangible assets: | | | |
| Goodwill | \$ 161,636 | | \$ 125,675 |

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| | | | | |
|-------------------------------------------------------|----|-------|----|-------|
| Intangible asset related to minimum pension liability | \$ | 1,050 | \$ | 1,050 |
|-------------------------------------------------------|----|-------|----|-------|

The future intangible amortization expense for the next five years is estimated to be as follows (in thousands):

| Fiscal Year | | | | |
|-------------|----|-------|--|--|
| 2005 | \$ | 7,381 | | |
| 2006 | | 6,870 | | |
| 2007 | | 5,295 | | |
| 2008 | | 3,275 | | |
| 2009 | | 2,854 | | |

The changes in the carrying amount of goodwill by segment for the six months ended December 31, 2004 are as follows (in thousands):

| | | Membership ----- | | Personals ----- | | |
|----------------------------------------------------|----|---------------------|----|--------------------|----|---------|
| Balance at June 30, 2004 | \$ | 42,040 | \$ | 83,635 | \$ | 123,675 |
| Arising from the Bargain Network, Inc. acquisition | | 36,945 | | - | | 36,945 |
| Arising from purchase adjustments | | - | | (984) | | (984) |
| Balance at December 31, 2004 | \$ | 78,985 | \$ | 82,651 | \$ | 161,636 |
| | | ===== | | ===== | | ===== |

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VERTRUE INCORPORATED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Goodwill was tested for impairment during the quarters ended September 30, 2004 and 2003 as required by SFAS 142. The Company concluded that none of its goodwill was impaired. Fair value was estimated using a discounted cash flow method. 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.

As part of the acquisition of certain of the assets of Bargain Network, Inc. on November 30, 2004, the Company acquired intangible assets of \$40,145,000. Of that amount, \$1,700,000 was assigned to membership and client relationships and \$1,500,000 was assigned to trade names. These identified intangible assets are subject to periodic amortization over the estimated useful lives ranging from 2 to 4 years. Goodwill of \$36,945,000, which is not subject to amortization, also arose in connection with the acquisition.

NOTE 7 - FOREIGN CURRENCY INSTRUMENTS

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 is deferred as a component of accumulated other comprehensive income and is recognized concurrent with the recognition in earnings of the underlying hedged item.

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The fair value of these contracts is included in prepaid and other current assets. As of December 31, 2004, the fair value of these instruments was \$1,220,000 (asset). Derivative gains and losses recognized in earnings were recorded in operating expenses and general administrative expenses and amounted to a gain of \$567,000 and \$611,000 for three and six months ended December 31, 2004, respectively. All forecasted transactions currently being hedged are expected to occur over the next six months. There were no such derivative instruments utilized during the three or six months ended December 31, 2003.

NOTE 8 - ALLOWANCE FOR MEMBERSHIP CANCELLATIONS

Accrued liabilities set forth in the accompanying unaudited condensed consolidated balance sheets as of December 31, 2004 and June 30, 2004 include an allowance for membership cancellations of \$14,465,000 and \$14,156,000, respectively. Recording an allowance for membership cancellations has the effect of reducing the amount of deferred membership fees recorded.

NOTE 9 - RESTRUCTURING CHARGES

The restructuring reserve balance, which is recorded in accrued liabilities and other long-term liabilities, amounted to \$1,575,000 and \$1,644,000 as of December 31, 2004 and June 30, 2004, respectively. Cash payments for the three and six months ended December 31, 2004 were \$21,000 and \$69,000, respectively, and relate to lease obligations.

NOTE 10 - 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.

On March 25, 2004, the Company entered into an amended and restated senior secured credit facility that allows borrowings of up to \$45,000,000. Borrowings under the senior secured credit facility accrue interest at either the Eurodollar rate, or the higher of the Prime rate or the Federal Funds rate, plus an applicable margin. The availability under the senior secured credit facility is reduced by outstanding letters of credit of \$19,859,000, of which \$14,400,000 expired on January 5, 2005, and by one year's worth of interest on the Senior Notes. There were no borrowings outstanding under this bank credit facility as of December 31, 2004. As of December 31, 2004, the availability under the senior secured credit facility was \$11,266,000.

On November 30, 2004, the Company completed the acquisition of certain of the assets of Bargain Network, Inc. Contingent payments of up to \$31,883,000 may be paid if certain performance targets, including increasing levels of earnings, are achieved through June 30, 2005. See Note 5 for details.

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VERTRUE INCORPORATED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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 are subject. The Company is involved in other lawsuits and claims generally incidental to its business including, but not limited to, various suits, including previously disclosed suits, brought against the Company by individual consumers seeking monetary and/or injunctive relief relating to the marketing of the Company's programs. In addition, from time to time, and in the regular course of its business, the Company receives inquiries from various federal and/or state regulatory authorities.

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On January 24, 2003, the Company filed a motion with the Superior Court for the Judicial District of Hartford, Connecticut to vacate and oppose the confirmation of an arbitration award issued in December 2002. The arbitration, filed against the Company by MedValUSA Health Programs, Inc. ("MedVal") in September 2000, involved claims of breach of contract, breach of the duty of good faith and fair dealing, and violation of the Connecticut Unfair Trade Practices Act ("CUTPA"). Even though the arbitrators found that the Company was not liable to MedVal for any compensatory damages, they awarded \$5,459,000 in punitive damages and costs against the Company solely under CUTPA. The Company believes that this arbitration award is unjustified and not based on any existing legal precedent. Specifically, the Company is challenging the award on a number of grounds, including that it violates a well defined public policy against excessive punitive damage awards, raises constitutional issues and disregards certain legal requirements for a valid award under CUTPA. The hearing on the Company's motion was held on February 10, 2003. On June 22, 2003, the Superior Court denied the Company's motion to vacate the award, and the Company filed an appeal of that decision. While the Company intends to take action to prevent the enforcement of the award by, among other things, vigorously pursuing an appeal, there can be no assurance that the Company will be successful in its efforts. The Company has made no provision in its financial statements for this contingency because it believes that a loss is not probable. If the Company was ultimately unsuccessful in this or other available appeals, and a final non-appealable court order confirming the arbitration award is rendered, the payment of the award could have a material adverse effect on the Company's results of operations in the period in which the final order is entered.

In March 2001, an action was instituted by plaintiff Teresa McClain against Coverdell & Company ("Coverdell"), a wholly-owned subsidiary of the Company, Monumental Life Insurance Company and other defendants in the United States District Court for the Eastern District of Michigan, Southern Division. The suit, which seeks unspecified monetary damages, alleges that Coverdell and the other defendants violated the Michigan Consumer Protection Act and other applicable Michigan laws in connection with the marketing of Monumental Life Insurance Company insurance products. The Court certified a class of Michigan residents. The Court has now signed an Order granting preliminary approval of a settlement agreement that has been signed by all parties. The Court approved the settlement at a Fairness/Approval hearing on November 22, 2004. The settlement agreement will have no financial or other material impact on the Company's business.

NOTE 11 - DUTCH AUCTION SELF-TENDER OFFER

On November 8, 2004, the Board of Directors authorized a modified Dutch Auction self-tender offer for up to 500,000 shares of its common stock. Under the terms of the self-tender offer and as approved by the Board of Directors, the Company's stockholders were given the opportunity to tender part or all of their shares to the Company at a price of not less than \$33.50 per share and not more than \$38.50 per share. The self-tender offer closed on January 7, 2005 (See Note 19).

NOTE 12 - INCOME TAX EXPENSE

Income tax expense as a percentage of pre-tax income was 38.7% and 40% for the three months ended December 31, 2004 and 2003, respectively, and 37.5% and 40% for the six months ended December 31, 2004 and 2003, respectively. The effective tax rate was higher than the U.S. statutory rate for the three and six months ended December 31, 2004 and 2003 primarily due to state tax expense. The estimated effective tax rate for the three and six months ended December 31, 2004 decreased from the same periods in the prior year due to certain tax planning strategies implemented. The Company expects to report an effective tax rate of approximately 37% for fiscal 2005. Tax benefits resulting from the exercise of nonqualified stock options and the disqualifying dispositions of shares issued under the Company's stock based compensation plans reduced taxes payable by \$810,000 and \$38,000 for the three months ended December 31, 2004 and

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2003, respectively, and by \$939,000 and \$1,553,000 for the six months ended December 31, 2004 and 2003, respectively. Such benefits are credited to capital in excess of par value.

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VERTRUE INCORPORATED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The Company has open tax years in the U.S., Canada and other jurisdictions that are currently not under examination by the applicable tax authorities and may be subject to examination in the future. 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 13 - EARNINGS PER SHARE

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

| | Three Months Ended December 31, | |
|-----------------------------------------------------------------------------------------------------------------------|------------------------------------|----------|
| | 2004 | 2003 |
| Numerator: | | |
| Income available to common shareholders used in basic earnings per share | \$ 5,883 | \$ 7,665 |
| Add Back: Interest expense on convertible securities, net of tax | 761 | 743 |
| Income available to common shareholders after assumed conversion of dilutive securities for diluted earning per share | \$ 6,644 | \$ 8,408 |
| Denominator : | | |
| Weighted average number of common shares outstanding- basic | 10,128 | 10,756 |
| Effect of dilutive securities: | | |
| Convertible securities | 2,230 | 2,230 |
| Stock options | 705 | 1,088 |
| Weighted average number of common shares outstanding- diluted | 13,063 | 14,074 |
| Basic earnings per share | \$ 0.58 | \$ 0.71 |
| Diluted earnings per share | \$ 0.51 | \$ 0.60 |

The diluted earnings per common share calculation excludes the effect of potentially dilutive shares when their effect is antidilutive. For the three months ended December 31, 2004 and 2003, the Company had 44,000 and 996,000 shares, respectively, of potentially dilutive stock options outstanding that are not included in the calculation as they are antidilutive. For the six months

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ended December 31, 2004 and 2003, the Company had 917,000 and 765,000 shares, respectively, of potentially dilutive stock options that are not included in the calculations as they are antidilutive.

NOTE 14 - COMPREHENSIVE INCOME

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

| | Three Months Ended December 31, | |
|------------------------------------------|------------------------------------|-----------------|
| | 2004 | 2003 |
| Net income | \$ 5,883 | \$ 7,665 |
| Unrealized gain on derivative assets | 454 | - |
| Foreign currency translation (loss) gain | (5) | 14 |
| Comprehensive income | \$ 6,332 | \$ 7,679 |

NOTE 15 - BUSINESS SEGMENTS

The operating business segments reported below are the business segments of the Company for which separate financial information is available and for which operating results are evaluated regularly by executive management in deciding how to allocate resources and in assessing performance. Prior to the acquisition of Lavalife in April 2004, the Company operated as one reportable business segment. Subsequent to the acquisition of Lavalife, the Company operates as two reportable business segments: Membership and Personals. The Membership business segment is primarily involved in the marketing of membership programs to consumers. The Personals business segment is primarily involved in providing both web-based and IVR-based personals services to its customers. The results of Bargain Network, Inc. have been included in the Membership segment.

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VERTRUE INCORPORATED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Management evaluates the operating results of each of its reportable business segments based upon revenue and operating income. The following is a summary of revenues, operating income, and assets by business segment (in thousands):

| | Three Months Ended December 31, | |
|------------------|------------------------------------|-------------------|
| | 2004 | 2003 |
| Revenues: | | |
| Membership | \$ 118,714 | \$ 123,164 |
| Personals | 17,901 | - |
| Intersegment | (136) | - |
| Total | \$ 136,479 | \$ 123,164 |

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| | | | | |
|-----------------------|----|---------|----|--------|
| Operating Income (1): | | | | |
| Membership | \$ | 15,015 | \$ | 13,911 |
| Personals | | (1,232) | | - |
| | | ----- | | ----- |
| Total | \$ | 13,783 | \$ | 13,911 |
| | | ===== | | ===== |

| | | | | |
|-------------------------|----|--------------|----------|---------|
| | | December 31, | June 30, | |
| | | 2004 | 2004 | |
| | | ----- | ----- | |
| Assets: | | | | |
| Membership | \$ | 236,306 | \$ | 178,723 |
| Personals | | 136,452 | | 136,874 |
| Corporate and other (2) | | 113,686 | | 137,565 |
| | | ----- | | ----- |
| Total | \$ | 486,444 | \$ | 453,162 |
| | | ===== | | ===== |

(1) Operating income includes amortization of intangible assets of:

| | | | | |
|------------|----|--------------------|-------|-------|
| | | Three Months Ended | | |
| | | December 31, | | |
| | | ----- | ----- | |
| | | 2004 | 2003 | |
| | | ----- | ----- | |
| Membership | \$ | 452 | \$ | 271 |
| Personals | | 1,301 | | - |
| | | ----- | | ----- |
| Total | \$ | 1,753 | \$ | 271 |
| | | ===== | | ===== |

(2) Represents unallocated non-operating assets including non-operating cash, short-term investments, debt issuance costs and other.

NOTE 16 - GUARANTOR AND NONGUARANTOR FINANCIAL INFORMATION

In April 2004, the Company issued \$150,000,000 aggregate principal amount of 9.25% Senior Notes in a private placement pursuant to Rule 144A. 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 our 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 financial information presents the consolidating balance sheets as of December 31, 2004 and June 30, 2004, the related statements of operations for the three and six months ended December 31, 2004 and 2003 and the related statements of cash flows for the six months ended December 31, 2004 and 2003. The information includes the elimination entries

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

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VERTRUE INCORPORATED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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.

CONSOLIDATED BALANCE SHEETS

| | As of December | | |
|------------------------------------------------------|----------------|---------------------------|------------------------------|
| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries |
| Assets | (in thousands) | | |
| Current assets | \$ 170,979 | \$ 55,192 | \$ 15,37 |
| Fixed assets, net | 19,567 | 12,913 | 8,13 |
| Goodwill | - | 117,972 | 43,66 |
| Intangible assets, net | 1,332 | 34,822 | 3,05 |
| Other assets | 10,667 | 54 | 98 |
| Intercompany notes receivable | 2,052 | - | |
| Investment in subsidiaries | 219,089 | - | |
| Total assets | \$ 423,686 | \$ 220,953 | \$ 71,20 |
| | | | |
| Liabilities and Shareholders' (Deficit) Equity | | | |
| Current liabilities | \$ 213,344 | \$ 43,894 | \$ 15,10 |
| Deferred income taxes | 1,495 | 10,107 | (5) |
| Other long-term liabilities | 3,640 | - | 1,96 |
| Intercompany notes payable | - | 2,052 | |
| Long-term debt | 237,735 | - | |
| Total liabilities | 456,214 | 56,053 | 17,01 |
| | | | |
| Shareholders' (deficit) equity: | | | |
| Preferred stock | - | - | |
| Common stock | 194 | 6 | |
| Capital in excess of par value | 163,630 | 165,070 | 54,33 |
| Accumulated (deficit) earnings | 23,610 | (1,012) | (4) |
| Accumulated other comprehensive loss | 923 | 836 | (10) |
| Treasury stock | (220,885) | - | |
| Total shareholders' (deficit) equity | (32,528) | 164,900 | 54,18 |
| | | | |
| Total liabilities and shareholders' (deficit) equity | \$ 423,686 | \$ 220,953 | \$ 71,20 |

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VERTRUE INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

CONSOLIDATED BALANCE SHEETS

| | As of June 30 | | |
|------------------------------------------------------|---------------|---------------------------|------------------------------|
| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries |
| Assets | | | (in thousand) |
| Current assets | \$ 194,227 | \$ 42,955 | \$ 10,76 |
| Fixed assets, net | 19,675 | 14,823 | 2,04 |
| Goodwill | - | 118,956 | 6,71 |
| Intangible assets, net | 1,050 | 37,822 | |
| Other assets | 10,666 | 39 | |
| Intercompany notes receivable | 95,543 | - | |
| Investment in subsidiaries | 78,633 | - | |
| Total assets | \$ 399,794 | \$ 214,595 | \$ 19,52 |
| Liabilities and Shareholders' (Deficit) Equity | | | |
| Current liabilities | \$ 206,915 | \$ 40,549 | \$ 11,41 |
| Deferred income taxes | (2,402) | 6,647 | 10 |
| Other long-term liabilities | 3,705 | - | 1,22 |
| Intercompany notes payable | - | 95,543 | |
| Long-term debt | 237,659 | - | |
| Total liabilities | 445,877 | 142,739 | 12,74 |
| Shareholders' (deficit) equity: | | | |
| Preferred stock | - | - | |
| Common stock | 191 | 6 | |
| Capital in excess of par value | 156,457 | 71,744 | 9,56 |
| Accumulated (deficit) earnings | 10,131 | (15) | (2,30) |
| Accumulated other comprehensive loss | (373) | 121 | (48) |
| Treasury stock | (212,489) | - | |
| Total shareholders' (deficit) equity | (46,083) | 71,856 | 6,77 |
| Total liabilities and shareholders' (deficit) equity | \$ 399,794 | \$ 214,595 | \$ 19,52 |

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VERTRUE INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

CONSOLIDATED STATEMENTS OF OPERATIONS

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| | For the Three Months Ended Dec | | |
|-----------------------------------|--------------------------------|---------------------------|------------------------------|
| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries |
| | | | (in thousands) |
| Revenues | \$ 92,351 | \$ 35,316 | \$ 10,026 |
| Expenses: | | | |
| Marketing | 49,373 | 16,839 | 2,984 |
| Operating | 15,616 | 7,291 | 3,752 |
| General and administrative | 15,664 | 8,588 | 2,050 |
| Amortization of intangible assets | 76 | 1,527 | 150 |
| Operating income | 11,622 | 1,071 | 1,090 |
| Equity in income of subsidiary | 1,767 | - | - |
| Interest (expense) income, net | (4,649) | 37 | 1 |
| Other income (expense), net | (5) | 419 | 14 |
| Income before income taxes | 8,735 | 1,527 | 1,105 |
| Provision for income taxes | 2,852 | 321 | 544 |
| Net income | \$ 5,883 | \$ 1,206 | \$ 561 |

CONSOLIDATED STATEMENTS OF OPERATIONS

| | For the Three Months Ended Dec | | |
|-----------------------------------|--------------------------------|---------------------------|------------------------------|
| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries |
| | | | (in thousands) |
| Revenues | \$ 103,006 | \$ 15,128 | \$ 5,451 |
| Expenses: | | | |
| Marketing | 58,013 | 7,532 | 1,200 |
| Operating | 17,762 | 3,156 | 2,545 |
| General and administrative | 15,631 | 2,583 | 981 |
| Amortization of intangible assets | - | 271 | - |
| Operating income | 11,600 | 1,586 | 725 |
| Equity in income of subsidiaries | 1,423 | - | - |
| Interest (expense) income, net | (1,139) | 30 | 25 |
| Other income (expense), net | (57) | 31 | (26) |
| Income before income taxes | 11,827 | 1,647 | 724 |
| Provision for income taxes | 4,162 | 659 | 289 |
| Net income | \$ 7,665 | \$ 988 | \$ 435 |

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CONSOLIDATED STATEMENTS OF OPERATIONS

| | For the Six Months Ended Dec | | |
|-----------------------------------|------------------------------|---------------------------|------------------------------|
| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries |
| | (in thousands) | | |
| Revenues | \$ 188,636 | \$ 69,822 | \$ 15,346 |
| Expenses: | | | |
| Marketing | 99,872 | 33,404 | 4,452 |
| Operating | 30,748 | 14,480 | 6,129 |
| General and administrative | 31,178 | 16,769 | 2,960 |
| Amortization of intangible assets | 76 | 3,071 | 150 |
| Operating income | 26,762 | 2,098 | 1,655 |
| Equity in income of subsidiary | 2,587 | - | - |
| Interest (expense) income, net | (9,349) | 91 | 4 |
| Other income (expense), net | (98) | 355 | 36 |
| Income before income taxes | 19,902 | 2,544 | 1,695 |
| Provision for income taxes | 6,423 | 842 | 810 |
| Net income | \$ 13,479 | \$ 1,702 | \$ 885 |

CONSOLIDATED STATEMENTS OF OPERATIONS

| | For the Six Months Ended Dec | | |
|-----------------------------------|------------------------------|---------------------------|------------------------------|
| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries |
| | (in thousands) | | |
| Revenues | \$ 201,176 | \$ 27,998 | \$ 8,598 |
| Expenses: | | | |
| Marketing | 117,124 | 14,039 | 2,238 |
| Operating | 35,144 | 6,358 | 3,787 |
| General and administrative | 31,016 | 5,089 | 1,857 |
| Amortization of intangible assets | - | 589 | - |
| Operating income | 17,892 | 1,923 | 716 |
| Equity in income of subsidiaries | 1,632 | - | - |
| Interest (expense) income, net | (1,162) | 58 | 53 |
| Other income (expense), net | (184) | 31 | (61) |
| Income before income taxes | 18,178 | 2,012 | 708 |
| Provision for income taxes | 6,618 | 805 | 283 |
| Net income | \$ 11,560 | \$ 1,207 | \$ 425 |

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VERTRUE INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

CONSOLIDATED STATEMENTS OF CASH FLOWS

| | For the Six Months Ended D | | |
|--------------------------------------------------------------|----------------------------|---------------------------|------------------------------|
| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries |
| | | | (in thousands) |
| Net cash provided by (used in) operating activities | \$ 101,300 | \$ (82,693) | \$ (1,394) |
| Investing activities | | | |
| Acquisition of fixed assets | (3,495) | (538) | (306) |
| Net settlement of short-term investments | 43 | 221 | -- |
| Acquisition of business and other investing activities | (111,322) | 93,937 | 1,288 |
| Investment in subsidiaries | (2,587) | -- | -- |
| Net cash (used in) provided by investing activities | (117,361) | 93,620 | 982 |
| Financing activities | | | |
| Net proceeds from exercise of stock options | 6,237 | - | - |
| Treasury stock purchases | (8,396) | - | - |
| Debt issuance costs | (750) | - | - |
| Payments of long-term obligations | (161) | (13) | (30) |
| Net cash used in financing activities | (3,070) | (13) | (30) |
| Effect of exchange rate changes on cash and cash equivalents | - | (291) | 526 |
| Net (decrease) increase in cash and cash equivalents | (19,131) | 10,623 | 84 |
| Cash and cash equivalents at beginning of period | 130,581 | 26,657 | 2,258 |
| Cash and cash equivalents at end of period | \$ 111,450 | \$ 37,280 | \$ 2,342 |

CONSOLIDATED STATEMENTS OF CASH FLOWS

| | For the Six Months Ended De | | |
|-----------------------------------------------------|-----------------------------|---------------------------|------------------------------|
| | Parent | Guarantor Subsidiaries | Nonguarantor Subsidiaries |
| | | | (in thousands) |
| Net cash provided by (used in) operating activities | \$ 21,296 | \$ 104 | \$ 673 |
| Investing activities | | | |
| Acquisition of fixed assets | (2,082) | (201) | (255) |
| Investment in subsidiaries | (1,632) | - | - |

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| | | | |
|--------------------------------------------------------------|-----------|-----------|----------|
| Net cash (used in) provided by investing activities | (3,714) | (201) | (255) |
| | ----- | ----- | ----- |
| Financing activities | | | |
| Net proceeds from exercise of stock options | 22,551 | - | - |
| Treasury stock purchases | (79,078) | - | - |
| Net proceeds from the issuance of debt | 86,568 | - | - |
| Payments of long-term obligations | - | (250) | - |
| | ----- | ----- | ----- |
| Net cash provided by (used in) financing activities | 30,041 | (250) | - |
| | ----- | ----- | ----- |
| Effect of exchange rate changes on cash and cash equivalents | - | - | 41 |
| | ----- | ----- | ----- |
| Net increase (decrease) in cash and cash equivalents | 47,623 | (347) | 459 |
| Cash and cash equivalents at beginning of period | 51,895 | 18,716 | 1,649 |
| | ----- | ----- | ----- |
| Cash and cash equivalents at end of period | \$ 99,518 | \$ 18,369 | \$ 2,108 |
| | ===== | ===== | ===== |

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VERTRUE INCORPORATED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 17 - SUPPLEMENTAL CASH FLOW DISCLOSURE

During the quarter ended December 31, 2004, the Company accrued \$27,133,000 of purchase costs related to the acquisition of certain of the assets of Bargain Network, Inc., which will be settled in cash during the quarter ending March 31, 2005.

NOTE 18 - NEW ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board issued Statement No. 123 (Revised 2004), "Share-Based Payment," ("SFAS 123R"). This statement is a revision of SFAS 123 and supersedes ABP 25. SFAS 123R will require the Company to measure all employee stock-based compensation awards using a fair value method and record such expense in its consolidated financial statements. In addition, the adoption of SFAS 123R will require additional accounting related to the income tax effects and additional disclosure regarding the cash flow effects resulting from share-based payment arrangements. SFAS 123R is effective beginning in the Company's first quarter of fiscal 2006. The adoption of SFAS 123R will have a material impact on the Company's consolidated financial position, results of operations, cash flows and related disclosures.

NOTE 19 - SUBSEQUENT EVENTS

On January 6, 2005, the Company completed the acquisition of certain of the assets of My Choice Medical Holdings, Inc., a privately held advertising and practice management company serving cosmetic surgeons throughout the United States. The purchase price, excluding fees and expenses, amounted to \$33,000,000 and was paid in cash on January 6, 2005. In addition, contingent payments of up to \$56,000,000 may be paid if certain performance targets, including increasing levels of revenues and earnings, are achieved over the next three calendar years. Any additional payments under the contingency arrangement will be considered additional purchase price and allocated to the net assets acquired. The Company is in the process of completing its assessment of the fair value of assets acquired and liabilities assumed.

On January 7, 2005, the Company completed the Dutch Auction self-tender offer for up to 500,000 shares of its Common Stock as discussed in Note 11. Shareholders tendered a total of 605,000 shares. The Company exercised its right

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to purchase the additional 105,000 shares in addition to the 500,000 shares for which it originally solicited tenders. In total, the Company repurchased 605,000 shares for \$38.50 per share and paid \$23,293,000 to repurchase these shares. Subsequent to the completion of the self-tender offer, the Company had 1,074,000 shares available for repurchase under its stock repurchase program.

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

OVERVIEW

On October 13, 2004, MemberWorks Incorporated began doing business as Vertrue Incorporated (the "Company"). On November 18, 2004, the Company's shareholders approved an amendment to the Company's charter formally changing its name to Vertrue Incorporated. The name change was intended to reflect the ever-broadening base of membership services that the Company offers to its customers. The Company is a category leader in both membership and loyalty programs. The Company's membership programs are both subscription and transaction based offerings focused on meeting consumer needs in large spending categories - healthcare, discounts, security and personals. The Company's programs offer everyday savings, event-oriented discounts, peace of mind and unique consumer benefits. Programs are available in English, French and Spanish and are increasingly customized for specific client customer segments or consumer communities. The Company's loyalty programs provide clients with a wide range of benefits to offer or market to their customers and include stand-alone benefits, reward point accumulation and management, gift certificate, merchandise and travel reward redemption. The Company's versatility in designing loyalty strategies and providing turnkey execution is essential in supporting and promoting the client's brand.

The Company operates in two business segments: Membership and Personals. For additional financial information about these business segments, see Note 15 to the condensed consolidated financial statements.

Membership service programs offer consumers a variety of products and services from selected vendors for an annual or monthly fee. Revenues are derived principally from recurring fees which are billed to the member either on an annual or monthly basis. In the case of annually billed membership fees, the Company receives full payment at or near the beginning of the membership period, but recognizes the revenues as the member's refund privilege expires. Membership fees that are billed monthly are recognized when earned. Profitability and cash flow generated from renewal memberships exceed that of new memberships due to the absence of solicitation costs associated with new member procurement.

The Personals business segment employs a transactional business model, in which users buy non-refundable credits up front and spend those credits only when they want to interact with other users. Personals revenues are generally recognized when the services are used.

CRITICAL ACCOUNTING POLICIES

Critical accounting policies are those policies that are important to the Company's financial condition and results of operations and involve subjective or complex judgments on the part of management, often as a result of the need to make estimates. The following areas require the use of judgments and estimates: membership cancellation rates, deferred marketing costs, valuation of goodwill and other intangible assets, estimation of remaining useful lives of intangible assets and valuation of deferred tax assets. Estimates in each of these areas are based on historical experience and various assumptions that the Company

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believes are appropriate. Actual results may differ from these estimates. The Company believes the areas listed above represent the critical accounting policies of the Company as contemplated by Financial Reporting Release No. 60, "Cautionary Advice Regarding Disclosure about Critical Accounting Policies." The Company's critical accounting policies are disclosed in 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, 2004. Since the date of the Annual Report on Form 10-K, there have been no material changes to the Company's critical accounting policies. For a summary of all of the Company's significant accounting policies, see Note 2 to the consolidated financial statements located in the Company's 2004 Annual Report on Form 10-K.

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

RESULTS OF OPERATIONS

For the Three Months Ended December 31, 2004 and December 31, 2003

Revenues

| | Three Months Ended December 31, | | Percent Increase/ (Decrease) |
|------------|------------------------------------|------------|------------------------------------|
| | 2004 | 2003 | '04 vs. '03 |
| Membership | \$ 118,714 | \$ 123,164 | (4)% |
| Personals | 17,765 | - | NM |
| | \$ 136,479 | \$ 123,164 | 11% |
| | \$ 136,479 | \$ 123,164 | 11% |

NM = Not Meaningful

Membership

Revenues decreased 4% in 2004 primarily due to a decrease in the net active retail members. The net active retail members decreased 11% to 5.6 million as of December 31, 2004 primarily due to the decrease in members enrolled through the outbound telemarketing channel which was not completely offset by an increase in members enrolled through the Company's online and MemberLink channels. The decline in net active retail members may impact future revenues and profitability. The mix of new members enrolled in a monthly payment plan program was 82% and 66% in 2004 and 2003, respectively.

Revenues from members enrolled in different payment programs are summarized below:

| | Three Months Ended December 31, 2004 | | Percent Increase/ (Decrease) |
|--|-----------------------------------------|------|------------------------------------|
| | 2004 | 2003 | '04 vs. '03 |

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| | ----- | ----- | ----- |
|-----------------------|------------|------------|-------|
| Monthly payment plans | \$ 56,037 | \$ 41,405 | 35% |
| Annual payment plans: | | | |
| Initial year | 14,866 | 31,732 | (53)% |
| Renewal year | 47,811 | 50,027 | (4)% |
| Total | \$ 118,714 | \$ 123,164 | (4)% |
| | ===== | ===== | ===== |

Personals

Revenues were \$17.8 million and represent the revenues of Lavalife, which was acquired by the Company on April 1, 2004. There were approximately 0.6 million active customers as of December 31, 2004.

Operating income

| | Three Months Ended December 31, 2004 | | Percent Increase/ (Decrease) |
|------------|-----------------------------------------|-----------|------------------------------------|
| | 2004 | 2003 | '04 vs. '03 |
| | ----- | ----- | ----- |
| Membership | \$ 15,015 | \$ 13,911 | 8% |
| Personals | (1,232) | - | NM |
| Total | \$ 13,783 | \$ 13,911 | (1)% |
| | ===== | ===== | ===== |

NM = Not Meaningful

Membership

Operating income increased 8% due to a decrease in marketing expenses of 9%. Marketing expenses were \$60.8 million in 2004 versus \$66.7 million in 2003 and, as a percentage of revenues, marketing expenses were 51% in 2004 versus 54% in 2003. These decreases were primarily due to the decrease in the level and mix of members enrolled through the higher cost outbound telemarketing channel.

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

Personals

Operating loss was \$1.2 million in 2004 and represented the results of Lavalife. Operating loss reported for 2004 reflected \$1.3 million of expense for the amortization of intangible assets.

Corporate

| | Three Months Ended December 31, 2004 | | Percent Decrease |
|--|-----------------------------------------|-------|---------------------|
| | 2004 | 2003 | '04 vs. '03 |
| | ----- | ----- | ----- |

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| | ----- | ----- | ----- |
|-----------------------------|------------|------------|-------|
| Interest expense, net | \$ (4,611) | \$ (1,084) | NM |
| Other income (expense), net | 428 | (52) | NM |
| Provision for income taxes | 3,717 | 5,110 | (27)% |

NM = Not Meaningful

Interest expense, net. The increase in interest expense, net in 2004 was due to \$3.6 million of interest expense related to the 9.25% Senior Notes issued in April 2004 ("Senior Notes"). For additional information on this debt issuance, refer to the related discussion located in the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" of this Quarterly Report on Form 10-Q.

Other income (expense), net. The increase in other income (expense), net is due to gains recognized on foreign currency transactions.

Provision for income taxes. The Company recorded a provision for income taxes of \$3.7 million and \$5.1 million based on an effective tax rate of 38.7% and 40% in 2004 and 2003, respectively. The effective tax rate was higher than the U.S. federal statutory rate due to state tax expense. The estimated effective tax rate in 2004 decreased from the prior year due to certain tax planning strategies implemented. The Company expects to report an effective tax rate of approximately 37% for fiscal 2005.

For the Six Months Ended December 31, 2004 and December 31, 2003

Revenues

| | Six Months Ended December 31, | | Percent Increase |
|------------|----------------------------------|------------|---------------------|
| | 2004 | 2003 | '04 vs. '03 |
| | ----- | ----- | ----- |
| Membership | \$ 235,992 | \$ 236,988 | - |
| Personals | 36,110 | - | NM |
| | ----- | ----- | ----- |
| Total | \$ 272,102 | \$ 236,988 | 15% |
| | ===== | ===== | ===== |

NM = Not Meaningful

Membership

Revenues decreased 0.4% in 2004 primarily due to a decrease in the net active retail members. The net active retail members decreased 11% to 5.6 million as of December 31, 2004 primarily due to the decrease in members enrolled through the outbound telemarketing channel which was not completely offset by an increase in members enrolled through the Company's online and MemberLink channels. The decline in net active retail members may impact future revenues and profitability. The mix of new members enrolled in a monthly payment plan program was 83% and 65% in 2004 and 2003, respectively.

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Revenues from members enrolled in different payment programs are summarized below:

| | Six Months Ended December 31, | | Percent Increase (Decrease) |
|-----------------------|----------------------------------|-------------------|-----------------------------------|
| | 2004 | 2003 | '04 vs. '03 |
| Monthly payment plans | \$ 105,494 | \$ 67,753 | 56% |
| Annual payment plans: | | | |
| Initial year | 33,916 | 72,787 | (53)% |
| Renewal year | 96,582 | 96,448 | 1% |
| Total | \$ 235,992 | \$ 236,988 | - |

Personals

Revenues were \$36.1 million and represent the revenues of Lavalife. There were approximately 0.6 million active customers as of December 31, 2004.

Operating income

| | Six Months Ended December 31, | | Percent Increase |
|--------------|----------------------------------|------------------|---------------------|
| | 2004 | 2003 | '04 vs. '03 |
| Membership | \$ 31,798 | \$ 20,531 | 55% |
| Personals | (1,283) | - | NM |
| Total | \$ 30,515 | \$ 20,531 | 49% |

NM = Not Meaningful

Membership

Operating income increased 55% primarily due to a decrease in marketing expenses of 9%. Marketing expenses were \$121.7 million in 2004 versus \$133.4 million in 2003 and, as a percentage of revenues, marketing expenses were 52% in 2004 versus 56% in 2003. These decreases were primarily due to the decrease in the level and mix of members enrolled through the higher cost outbound telemarketing channel.

Personals

Operating loss was \$1.3 million in 2004 and represented the results of Lavalife. Operating loss reported for 2004 reflected \$2.6 million of expense for the amortization of intangible assets.

Corporate

| | Six Months Ended December 31, | Percent Increase |
|--|----------------------------------|---------------------|
|--|----------------------------------|---------------------|

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| | 2004 | 2003 | '04 vs. '03 |
|----------------------------|------------|------------|-------------|
| Interest expense, net | \$ (9,254) | \$ (1,051) | NM |
| Other income, net | 293 | (214) | NM |
| Provision for income taxes | 8,075 | 7,706 | 5% |

NM = Not Meaningful

Interest expense, net. The increase in interest expense, net in 2004 was due to interest expense related to the 5.5% Convertible Senior Subordinated Notes issued in September 2003 and interest expense related to the 9.25% Senior Notes issued in April 2004. For additional information on these debt issuances, refer to the section titles "Management's Discussion and Analysis of Financial Condition - Liquidity and Capital Resources" of this Quarterly Report on Form 10-Q.

Other income (expense), net. The increase in other income (expense), net is due to gains recognized on foreign currency transactions.

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

Provision for income taxes. The Company recorded a provision for income taxes of \$8.1 million and \$7.7 million based on an effective tax rate of 37.5% and 40% in 2004 and 2003, respectively. The effective tax rate was higher than the U.S. federal statutory rate due to state tax expense. The estimated effective tax rate in 2004 decreased from the prior year due to certain tax planning strategies implemented. The Company expects to report an effective tax rate of approximately 37% for fiscal 2005.

LIQUIDITY AND CAPITAL RESOURCES

Net cash flow provided by operating activities is an important measure used to understand the Company's liquidity. Management believes it is useful to analyze the components of net cash provided by operating activities as follows: Revenue before deferral, marketing costs before deferral, operating expenses, general and administrative expenses and changes in assets and liabilities. For definitions and reconciliations of revenue before deferral and marketing costs before deferral, refer to the related discussion located in the Reconciliation of Non-GAAP Measures section in this Quarterly Report on Form 10-Q.

Net cash provided by operating activities was \$14.6 million and \$20.4 million for the six months ended December 31, 2004 and 2003, respectively.

Revenues before deferral increased 15% to \$252.7 million for the six months ended December 31, 2004 from \$219.3 million for the six months ended December 31, 2003 primarily due to revenues before deferral generated by Lavalife. The new annual weighted average program price points per retail member were \$106 and \$106 for the six months ended December 31, 2004 and 2003, respectively. Monthly weighted average program price points per retail member were \$11.98 and \$11.18 for the six months ended December 31, 2004 and 2003, respectively.

The table below summarizes the components of revenues before deferral for the six months ended December 31:

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| | 2004 |
|-----------------------|------------|
| Monthly payment plans | \$ 108,243 |
| Annual payment plans: | |
| Initial year | 20,290 |
| Renewal year | 87,967 |
| Personals | 36,233 |
| Total | \$ 252,733 |

Marketing costs before deferral were \$128.5 million and \$118.0 million for the six months ended December 31, 2004 and 2003, respectively. For the six months ended December 31, 2004, marketing costs before deferral increased 9% primarily due to marketing costs incurred by Lavalife, which were partially offset by a decrease in the level of marketing through the outbound telemarketing channel. As a percent of revenue before deferral, marketing costs before deferral were 51% for the six months ended December 31, 2004 versus 54% for the six months ended December 31, 2003 due to the effect of the Lavalife acquisition, the maturing base of members enrolled in a monthly payment plan program and the reduced level and mix of the higher cost outbound telemarketing. As a result, marketing margin before deferral was \$124.2 million and \$101.2 million for the six months ended December 31, 2004 and 2003, respectively. The effect of the increase in marketing margin before deferral on net cash provided by operating activities was more than offset by increased general and administrative and operating expenses primarily due to the Lavalife acquisition and increased interest costs associated with the Convertible Notes and Senior Notes.

Net cash provided by operating activities was also impacted by changes in assets and liabilities, which used \$3.1 million of cash for the six months ended December 31, 2004 and \$1.6 million of cash for the six months ended December 31, 2003 primarily due to the timing of accounts receivable collections.

Net cash used in investing activities was \$20.2 million for the six months ended December 31, 2004 and primarily reflected the acquisition of certain of the assets of Bargain Network, Inc. Capital expenditures were \$4.3 million and \$2.5 million for the six months ended December 31, 2004 and 2003, respectively.

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

Net cash used in financing activities was \$3.1 million for the six months ended December 31, 2004 compared to net cash provided by financing activities of \$29.8 million for the six months ended December 31, 2003. Net cash used in financing activities for the six months ended December 31, 2004 principally reflected the use of \$8.4 million in cash to repurchase the Company's stock, which was partially offset by proceeds from the issuance of stock of \$6.2 million. Net cash provided by financing activities for the six months ended December 31, 2003 principally reflected the issuance of \$86.6 million in debt, net of issuance costs, and proceeds from the exercise of employee stock options of \$22.6 million. These sources of cash were partially offset by the use of \$79.1 million in cash to repurchase the Company's stock.

Debt Issuances

As of December 31, 2004, the Company had \$237.7 million of debt outstanding. In September 2003, the Company issued \$90.0 million aggregate

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principal amount 5.5% convertible senior subordinated notes ("Convertible Notes") due September 2010. The Convertible Notes bear interest at the rate of 5.5% per year, which is payable in cash semi-annually in arrears on April 1 and October 1 of each year. Upon the occurrence of a change in control, holders of the Convertible Notes may require the Company to repurchase all or part of the Convertible Notes for cash.

In April 2004, the Company issued \$150.0 million aggregate principal amount of 9.25% Senior Notes due 2014. The Senior Notes were sold at 98.418% of the principal amount which resulted in an effective yield of 9.5%. Interest on the Senior Notes is payable in cash semi-annually in arrears on April 1 and October 1 of each year. A portion of the proceeds from the offering of the Senior Notes was used to repay amounts borrowed under the senior secured credit facility to fund a portion of the Lavalife acquisition. The Company intends to use the remaining proceeds for general corporate purposes, including working capital, future acquisitions and repurchases of the Company's common stock under the Company's stock buyback program to the extent permitted under the indenture governing the Senior Notes and the senior secured credit facility. The Senior Notes offering was made solely by means of a private placement to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended, and to certain persons in offshore transactions pursuant to Regulation S under the Securities Act. All Senior Notes were exchanged for registered notes on December 10, 2004.

Credit Facility

The Company has an amended and restated senior secured credit facility that allows borrowings of up to \$45.0 million. Borrowings under the senior secured credit facility accrue interest at either the Eurodollar rate, or the higher of the Prime rate or the Federal Funds rate, plus an applicable margin. As of December 31, 2004, the availability under the senior secured credit facility was reduced by outstanding letters of credit of \$19.9 million, of which \$14.4 million expired on January 5, 2005, and one year's worth of interest on the Senior Notes. As of December 31, 2004, the availability under the senior secured credit facility is approximately \$11.3 million. As of December 31, 2004, the effective interest rate for borrowings under the senior secured credit facility was 5.25%. The senior secured credit facility has certain financial covenants, including a maximum debt coverage ratio, potential restrictions on additional borrowings and potential restrictions on additional stock repurchases. As of December 31, 2004, the Company was in compliance with all such debt covenants.

Stock Repurchase Program

The Company purchased 315,000 shares for \$8.2 million at an average price of \$26.05 for the six months ended December 31, 2004 compared to 2.5 million shares for \$79.1 million at an average price of \$31.91 for the six months ended December 31, 2003. During the six months ended December 31, 2004, the Company's Board of Directors authorized the repurchase of 1.0 million shares of its common stock under its ongoing stock repurchase program

On November 8, 2004, the Board of Directors authorized a modified Dutch Auction self-tender offer for up to 500,000 shares of its common stock. Under the terms of the self-tender offer and as approved by the Board of Directors, the Company's stockholders were given the opportunity to tender part or all of their shares to the Company at a price of not less than \$33.50 per share and not more than \$38.50 per share. The self-tender offer closed on January 7, 2005 and a total of 605,000 shares were tendered by shareholders. The Company exercised its right to purchase the additional 105,000 shares in addition to the 500,000 shares for which it originally solicited tenders. In total, the Company repurchased 605,000 shares for \$38.50 per share and paid \$23.3 million to repurchase these shares. Subsequent to the completion of the self-tender offer, the Company had 1,074,000 shares available for repurchase under its stock repurchase program.

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

Acquisitions

On November 30, 2004, the Company completed the acquisition of certain of the assets of Bargain Network, Inc., a privately held provider of premier pricing services for homes, vehicles and consumer durables. The purchase price, which excludes fees and expenses and is subject to certain purchase price adjustments, amounted to \$27.8 million, of which \$16.0 million was paid subsequent to December 31, 2004. In addition, the Company assumed certain liabilities amounting to \$4.7 million. The Company estimates that contingent payments of up to \$31.9 million may be paid if certain performance targets, including increasing levels earnings, are achieved through June 30, 2005.

On January 6, 2005, the Company completed the acquisition of certain of the assets of My Choice Medical Holdings, Inc., a privately held advertising and practice management company serving cosmetic surgeons throughout the United States. The purchase price, excluding fees and expenses, amounted to \$33.0 million and was paid in cash on the closing date. In addition, contingent payments of up to \$56.0 million may be paid if certain performance targets, including increasing levels of revenues and earnings, are achieved over the next three calendar years.

As of December 31, 2004, the Company had cash, cash equivalents and short-term investments of \$161.6 million in addition to its senior secured credit facility. The Company believes that existing cash and short term investment balances, together with funds available under its senior secured credit facility, will be sufficient to meet its funding requirements for the foreseeable future.

The Company did not have any material commitments for capital expenditures as of December 31, 2004. The Company intends to utilize cash on hand and cash generated from operations to fulfill any capital expenditure requirements during 2005.

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 the 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 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 for or accrued for during the current reporting period. That is, marketing costs before deferral for a reporting period include costs

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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 cash settlement. Additionally, these measures are not a substitute for, or superior to, Revenues and Marketing Expenses prepared in accordance with generally accepted accounting principles. In light of the difference between revenues before deferral, marketing expenses before deferral and their most directly comparable GAAP measures, the Company solely uses these measures as liquidity measures and not as performance measures.

Revenues before deferral for the six months ended December 31, 2004 and 2003 are calculated as follows:

| | 2004 | |
|-----------------------------------------------------------------------|------------|----|
| | | |
| Revenues | \$ 272,102 | \$ |
| Change in deferred revenues, net of deferred membership fees acquired | (19,369) | |
| | | |
| Revenues before deferral | \$ 252,733 | \$ |
| | | |

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

Marketing cost before deferral for the six months ended December 31, 2004 and 2003 is calculated as follows:

| | 2004 | |
|------------------------------------------------------------|------------|----|
| | | |
| Marketing expenses | \$ 137,221 | \$ |
| Change in membership solicitation and other deferred costs | (8,685) | |
| | | |
| Marketing costs before deferral | \$ 128,536 | \$ |
| | | |

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 Form 10-Q filing. 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 December 31, 2004 are as follows (amounts in thousands):

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| | Payments Due by Period | | | |
|---------------------------|------------------------|---------------------|------------------|----------------|
| | Total | Less than 1 year | 1-3 years | 4-5 years |
| Operating leases | \$ 28,439 | \$ 8,883 | \$ 10,678 | \$ 7,54 |
| Capital leases | 2,137 | 705 | 1,250 | 18 |
| Long term debt | 240,000 | - | - | |
| Purchase obligations | 96,193 | 36,460 | 59,733 | |
| Total payments due | \$ 366,769 | \$ 46,048 | \$ 71,661 | \$ 7,72 |

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.

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 the Company's 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 are made pursuant to safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements are not guarantees of future performance and are based on a number of 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 are subject to 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 basis;
- 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

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processors and bank card associations;

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

- 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 further changes in the already competitive environment for the Company's products or competitors' responses to the Company's 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 and related consumer debt are impacted;
- 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 movement 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 such factors are not exclusive. All of the 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 required by law, the Company does not have any intention or obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate

The Company has a senior secured credit facility that allows borrowings of up to \$45.0 million. Borrowings under the senior secured credit facility accrue interest at either the Eurodollar rate or the higher of the Prime rate or the Federal Funds rate plus an applicable margin. There were no borrowings outstanding under this senior secured credit facility as of December 31, 2004. As of December 31, 2004, availability under the senior secured credit facility was reduced by outstanding letters of credit of \$19.9 million, of which \$14.4 million expired on January 5, 2005, and one year's worth of interest on the Senior Notes. As of December 31, 2004, the availability under the senior secured credit facility is approximately \$11.3 million. Management believes that an increase in the Eurodollar rate, the Prime rate or the Federal Funds rate would not be material to the Company's financial position or its results of operations. If the Company is not able to renew its existing credit facility agreement, which matures on March 25, 2005, it is possible that any replacement lending facility obtained by the Company may be more sensitive to interest rate changes. 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 of each year. The fair value of the fixed interest instruments are affected by changes in interest rates, and with respect to the Convertible Notes, are also affected 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 December 31, 2004, the carrying value of the Convertible Notes and the Senior Notes was \$90.0 million and \$147.7 million, respectively, and the fair value of the notes was \$105.8 million and \$159.0 million, respectively.

Foreign Currency

The Company conducts business in certain foreign markets, primarily in 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. As the Company increases its operations in international markets, it becomes increasingly exposed to potentially volatile movements in currency exchange rates. The economic impact of currency exchange rate movements on the Company are 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 business into U.S. dollars affects year-over-year comparability of operating results.

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. However, there can be no assurance that the Company's foreign currency hedging activities will substantially offset the impact of fluctuations in currency exchange rates on its results of operations 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

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investments, as 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 have evaluated the effectiveness of the Company's disclosure controls and procedures (as defined under Rules 13a-15(e) and 15d-15(e)) 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 and communicated to the Chief Executive Officer and Chief Financial Officer. In addition, there were no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, these internal controls over financial reporting.

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Notwithstanding the foregoing, although there can be no assurance that the Company's disclosure controls and procedures will detect or uncover all failures of persons within the Company and its consolidated subsidiaries to disclose material information otherwise required to be set forth in the Company's periodic reports, the Chief Executive Officer's and Chief Financial Officer's evaluation concluded that they are reasonably effective to do so.

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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 are subject. The Company is involved in other lawsuits and claims generally incidental to its business including, but not limited to, various suits, including previously disclosed suits, brought against the Company by individual consumers seeking monetary and/or injunctive relief relating to the marketing of the Company's programs. In addition, from time to time, and in the regular course of its business, the Company receives inquiries from various federal and/or state regulatory authorities.

On January 24, 2003, the Company filed a motion with the Superior Court for the Judicial District of Hartford, Connecticut to vacate and oppose the confirmation of an arbitration award issued in December 2002. The arbitration, filed against the Company by MedValUSA Health Programs, Inc. ("MedVal") in September 2000, involved claims of breach of contract, breach of the duty of good faith and fair dealing, and violation of the Connecticut Unfair Trade Practices Act ("CUTPA"). Even though the arbitrators found that the Company was not liable to MedVal for any compensatory damages, they awarded \$5.5 million in punitive damages and costs against the Company solely under CUTPA. The Company believes that this arbitration award is unjustified and not based on any existing legal precedent. Specifically, the Company is challenging the award on a number of grounds, including that it violates a well defined public policy against excessive punitive damage awards, raises constitutional issues and

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disregards certain legal requirements for a valid award under CUTPA. The hearing on the Company's motion was held on February 10, 2003. On June 22, 2003, the Superior Court denied the Company's motion to vacate the award, and the Company filed an appeal of that decision. While the Company intends to take action to prevent the enforcement of the award by, among other things, vigorously pursuing an appeal, there can be no assurance that the Company will be successful in its efforts. The Company has made no provision in its financial statements for this contingency because it believes that a loss is not probable. If the Company was ultimately unsuccessful in this or other available appeals, and a final non-appealable court order confirming the arbitration award is rendered, the payment of the award could have a material adverse effect on the Company's results of operations in the period in which the final order is entered.

In March 2001, an action was instituted by plaintiff Teresa McClain against Coverdell & Company ("Coverdell"), a wholly-owned subsidiary of the Company, Monumental Life Insurance Company and other defendants in the United States District Court for the Eastern District of Michigan, Southern Division. The suit, which seeks unspecified monetary damages, alleges that Coverdell and the other defendants violated the Michigan Consumer Protection Act and other applicable Michigan laws in connection with the marketing of Monumental Life Insurance Company insurance products. The Court certified a class of Michigan residents. The Court has now signed an Order granting preliminary approval of a settlement agreement that has been signed by all parties. The Court approved the settlement at a Fairness/Approval hearing on November 22, 2004. The settlement agreement will have no financial or other material impact on the Company's business.

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VERTRUE INCORPORATED PART II. OTHER INFORMATION

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 Shares Purchased as Part of Publicly Announced Plan or Programs (1) |
|---------------------------------------|----------------------------------------|---------------------------------|-------------------------------------------------------------------------------------------------|
| October 1, 2004 to October 31, 2004 | 36,000 | \$ 26.17 | 36,000 |
| November 1, 2004 to November 30, 2004 | - | \$ - | - |
| December 1, 2004 to December 31, 2004 | - | \$ - | - |
| Total | 36,000 | \$ 26.17 | 36,000 |

- (1) During 2004, the Board of Directors authorized the following share amounts to be purchased under the Company's stock buyback program originally authorized during fiscal 1997:
- January 2004 - authorized an additional 1,000,000 shares, no expiration.

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October 2004 - authorized an additional 1,000,000 shares, no expiration.

- (2) On November 8, 2004, the Board of Directors authorized a modified Dutch Auction self-tender offer for up to 500,000 shares of its common stock. Under the terms of the self-tender offer and as approved by the Board of Directors, the Company's stockholders were given the opportunity to tender part or all of their shares to the Company at a price of not less than \$33.50 per share and not more than \$38.50 per share. The self-tender offer closed on January 7, 2005 and a total of 605,000 shares were tendered by shareholders. The Company exercised its right to purchase the additional 105,000 shares in addition to the 500,000 shares for which it originally solicited tenders. In total, the Company repurchased 605,000 shares for \$38.50 per share and paid \$23.3 million to repurchase these shares. Subsequent to the completion of the self-tender offer, the Company had 1,074,000 shares available for repurchase under its stock repurchase program.

Item 4. Submission of Matters to a Vote of Security Holders

The Company's 2004 Annual Meeting of Stockholders was held on November 18, 2004.

At the annual meeting, the following Directors were elected to the Board of Directors for a term of one year:

| Name ---- | For --- | Withheld ----- | Nonvotes ----- |
|---------------------|------------|-------------------|-------------------|
| Scott N. Flanders | 9,075,903 | 82,534 | 919,004 |
| Michael T. McClorey | 9,141,087 | 17,350 | 919,004 |
| Edward M. Stern | 9,144,513 | 13,924 | 919,004 |
| Alec L. Ellison | 7,018,676 | 2,139,761 | 919,004 |
| Marc S. Tesler | 9,141,240 | 17,197 | 919,004 |
| Gary A. Johnson | 9,144,679 | 13,758 | 919,004 |
| Robert Kamerschen | 9,106,000 | 52,437 | 919,004 |

At the annual meeting, the following proposals were approved:

To change the Company's name to Vertrue Incorporated:

| | |
|------------|-----------|
| For - | 9,115,201 |
| Against - | 43,036 |
| Abstain - | 200 |
| Nonvotes - | 919,004 |

To elect all directors annually:

| | |
|------------|-----------|
| For - | 9,130,687 |
| Against - | 27,150 |
| Abstain - | 600 |
| Nonvotes - | 919,004 |

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VERTRUE INCORPORATED PART II. OTHER INFORMATION

To adopt the 2004 Long Term Incentive Plan:

| | |
|------------|-----------|
| For - | 6,903,619 |
| Against - | 291,589 |
| Abstain - | 1,762 |
| Nonvotes - | 2,880,471 |

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To ratify PricewaterhouseCoopers LLP as the independent auditors:

| | |
|------------|-----------|
| For - | 9,148,517 |
| Against - | 9,458 |
| Abstain - | 462 |
| Nonvotes - | 919,004 |

Item 5. Other Information

1.01 Entry into a Material Definitive Agreement

The Board adopted the Long-Term Incentive Plan ("LTIP") on January 22, 2004, subject to stockholder approval. On November 18, 2004, the shareholders of the Company approved the LTIP filed as Annex C to the Definitive Proxy Statement on Schedule 14A on October 28, 2004.

The LTIP provides incentive to certain officers and employees of the Company and its subsidiaries with competitive incentive compensation opportunities based on the achievement of specified performance goals. The Executive Officer Development and Compensation Committee of the Board of Directors (the "Committee") has the sole authority and discretion to designate the employees who are eligible for a LTIP award, subject to the terms of the Plan. In determining the amount and form of an award, consideration will be given to the functions and responsibilities of the employee, his or her potential contributions to the success of the Company and other factors deemed relevant by the Committee.

The LTIP expires on the fifth anniversary of the date of stockholder approval, unless terminated earlier by the Board.

The Committee may grant long-term incentive performance awards payable in cash or stock at the end of a 3-year performance period. A separate 3-year performance period begins each fiscal year and, accordingly, the fiscal years included in a 3-year performance period will overlap. Payment will be contingent upon the achievement of pre-established performance goals by the end of the 3-year performance period. The Committee has the sole authority to determine the range of the payment values of an award and the performance goals required before payment will be made. In general, a participant will not be entitled to payment of a long-term incentive performance award unless the participant is continuously employed by the Company until the end of the 3-year performance period, except in cases of the participant's death or total disability. If the Committee determines that a participant's employment has terminated during the 3-year performance period due to retirement or an involuntary termination without cause, the participant will receive a pro-rata portion of the award payable for that performance period. A maximum of \$3 million for each three-year performance period may be awarded to any one participant.

Item 6. Exhibits

Exhibits

- 3.1 Amended and Restated Certificate of Incorporation of the Registrant.
- 10.1 Long-Term Incentive Plan (filed as Annex C to the Company's Definitive Proxy Statement on Schedule 14A, File No. 000-21527, filed on October 28, 2004).
- 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: February 9, 2005

By: /s/ Gary A. Johnson

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

February 9, 2005

By: /s/ James B. Duffy

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

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