ONLINE RESOURCES & COMMUNICATIONS CORP
Form 10-Q
August 14, 2001

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

FORM 10-Q

(MARK ONE)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2001

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM ________________ TO __________________

COMMISSION FILE NUMBER 0-26123

ONLINE RESOURCES CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)

52-1623052
(I.R.S. EMPLOYER IDENTIFICATION NO.)

7600 COLSHIRE DRIVE, McLEAN, VIRGINIA 22102
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) (ZIP CODE)

(703) 394-5100
(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 __

As of August 10, 2001 there were 11,708,881 shares of the issuer s common stock outstanding.

ONLINE RESOURCES CORPORATION

FORM 10-Q

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

ONLINE RESOURCES CORPORATION

BALANCE SHEETS

	JUNE 30, 2001	DECEMBER 31, 2000
ASSETS	(UNAUDITED)	
Current assets:		
Cash and cash equivalents	$1,010,195	$1,771,477
Investments	10,872,130	19,688,454
Accounts receivable (net of allowance of approximately $148,000and $117,000 at June 30, 2001 and December 31, 2000,respectively)	3,287,033	3,026,010
Deferred implementation costs	892,835	809,901
Prepaid expenses and other current assets	680,957	540,780
Total current assets	16,743,150	25,836,622
Property and equipment, net	6,789,502	6,524,904
Deferred implementation costs, less current portion	711,151	712,828
Debt issuance costs	1,332,481	1,750,096
Other assets	357,778	303,978
Total assets	$25,934,062	$35,128,428
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$951,773	$858,980
Accrued expenses and other current liabilities	915,472	1,309,211
Accrued compensation expenses	818,162	947,136
Deferred revenues	1,065,785	1,103,964
Current portion of capital lease obligations	181,575	278,638

Total current liabilities3,932,7674,497,929 Capital lease obligation, less current maturities151,596232,125Deferred revenues, less current portion841,7251,193,404Notes payable16,500,00020,000,000

Total liabilities21,426,08825,923,458 CommitmentsSeries B redeemable convertible preferred stock; 100,000 sharesauthorized, no shares issued and outstanding Series C redeemable convertible preferred stock; 287,000 sharesauthorized, no shares issued and outstanding Stockholders equity:Series A convertible preferred stock, $.01 par value; 1,000,000 sharesauthorized, no shares issued and outstanding Common stock, $.0001 par value; 35,000,000 shares authorized,11,680,377 and 11,616,649 issued and outstanding at June 30,2001 and December 31, 2000, respectively1,1681,162Additional paid-in capital85,480,81485,238,538Accumulated deficit(80,453,478)(75,482,307)Deferred stock compensation(166,579)(185,894)Receivable from the sale of common stock(422,604)(422,604)Accumulated other comprehensive income68,65356,075

Total stockholders equity4,507,9749,204,970

Total liabilities and stockholders equity$25,934,062$35,128,428

See accompanying notes to unaudited financial statements.

ONLINE RESOURCES CORPORATION
UNAUDITED STATEMENTS OF OPERATIONS

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2001	**2000**	**2001**	**2000**

Revenues:
Service
fees$5,228,172$2,865,471$10,158,122$5,182,286Implementation
and other revenues780,031613,7941,413,5711,295,815

Total
revenues6,008,2033,479,26511,571,6936,478,101Costs and
expenses:Service
costs3,197,8922,868,7646,408,9405,558,278Implementation
and other costs361,616287,299798,347592,970

Costs of revenues3,559,5083,156,0637,207,2876,151,248

Gross profit2,448,695323,2024,364,406326,853

General &
administrative1,852,1441,501,3913,597,5763,163,708Selling
and
marketing1,549,7542,162,0273,060,9074,428,841Systems
and
development1,468,3891,684,7622,970,7313,111,715Non-recurring
charges 209,434

Total expenses4,870,2875,348,1809,838,64810,704,264

Loss from
operations(2,421,592)(5,024,978)(5,474,242)(10,377,411)Other

(expense) income:Interest
income194,892237,547399,742538,551Interest
expense(465,659)(20,808)(979,824)(49,508)

Total other
(expense) income(270,767)216,739(580,082)489,043

Loss before extraordinary itemand cumulative effect of
changein accounting
principle(2,692,359)(4,808,239)(6,054,324)(9,888,368)Extraordinary
item- gain fromrepurchase of
debt1,083,153 1,083,153 Cumulative effect of change
inaccounting principle (216,818)

Net loss$(1,609,206)$(4,808,239)$(4,971,171)$(10,105,186)

Loss per share:Loss from
operations(0.21)(0.44)(0.47)(0.92)Loss before
extraordinary item andcumulative effect of change
inaccounting principle(0.23)(0.42)(0.52)(0.87)Extraordinary
item0.09 0.09 Cumulative effect of change inaccounting
principle (0.02)Net loss(0.14)(0.42)(0.43)(0.89)Pro
forma amounts assuming theaccounting change is
appliedretroactively:Net loss$(9,888,368)Net loss per
share$(0.87)Shares used in calculation ofloss per
share:Basic and
diluted11,680,37711,541,13111,663,70311,338,162

See accompanying notes to unaudited financial statements.

ONLINE RESOURCES CORPORATION

UNAUDITED STATEMENTS OF CASH FLOWS

	SIX MONTHS ENDED JUNE 30,	
	2001	**2000**

OPERATING ACTIVITIES
Net
loss$(4,971,171)$(10,105,186)Adjustments
to reconcile net loss to netcash used
in operating
activities:Extraordinary item-gain
on repurchase of
debts(1,083,153) Depreciation1,041,252814,234Amortization180,093 Stock
compensation
expenses39,619128,350Cumulative
effect of change in accounting
principle 216,818Provision for
losses on accounts
receivable31,119(44,000)Realized
gain on
investments(54,488) Amortization
of bond discount(27,917) Changes
in assets and liabilities:Accounts
receivable(223,489)(399,880)Prepaid
expenses and other current
assets(140,177)20,286Deferred
implementation
costs(81,257)(176,485)Other
assets(53,800)86,096Accounts
payable92,793(492,354)Accrued
expenses(482,824)557,490Deferred
revenues(389,858)437,218

Net cash used in operating
activities(6,123,258)(8,957,413) INVESTING
ACTIVITIESPurchases of
available for sale
securities(16,380,394)(15,106,538)Sales
of available for sale
securities25,223,04824,065,290Purchases
of property and
equipment(1,305,850)(1,616,815)

Net cash provided by investing
activities7,536,8047,341,937 FINANCING
ACTIVITIESNet proceeds from
issuance of common
stock221,9781,353,633Net
repayment of stock
subscription 314,636Repayment of
capital lease
obligations(177,592)(332,282)Repurchase
of notes
payable(2,167,389) Payment of
financing costs(51,825)

Net cash (used in) provided by
financing
activities(2,174,828)1,335,987

Net decrease in cash and cash equivalents(761,282)(279,489)Cash and cash equivalents at beginning of period1,771,4771,588,187

Cash and cash equivalents at end of period$1,010,195$1,308,698

Supplemental information to statement of cash flows:Cash paid for interest873,02049,508Unrealized loss on investment(12,578)(28,680)

See accompanying notes to unaudited financial statements.

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ONLINE RESOURCES CORPORATION
NOTES TO FINANCIAL STATEMENTS
(UNAUDITED)

1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Online Resources Corporation (the Company) is a leading Internet banking, bill payment and e-financial service provider to financial institutions. The Company provides its clients, primarily regional and community banks, thrifts and credit unions, with an end-to-end outsourced service, that is branded in the client s name. This enables cost-effective delivery of Internet-based financial services to consumer, small business and other retail customers of the Company s clients. By packaging transaction services with call center, database and support services, the Company offers an integrated financial hub and a single-source solution for its clients and their retail customers.

INTERIM FINANCIAL INFORMATION

The accompanying unaudited financial statements have been prepared in conformity with generally accepted accounting principles for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed, or omitted, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, the statements include all adjustments necessary (which are of a normal and recurring nature) for the fair presentation of the results of the interim periods presented. These financial statements should be read in conjunction with our audited financial statements for the year ended December 31, 2000, included in the Annual Report on Form 10-K filed by the Company with the Securities and Exchange Commission on March 30, 2001. The results of operations for any interim period are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year.

RECENT PRONOUNCEMENTS

In July 2001, the Securities and Exchange Commission issued staff announcement, D-98, Classification and Measurement of Redeemable Securities. The announcement is required to be adopted in years beginning after December 15, 2001. The Company believes the announcement will not have a significant effect on the earnings or the financial position of the Company upon adoption.

RECLASSIFICATION

Certain 2000 amounts have been reclassified to conform to the 2001 presentation.

2. CHANGE IN REVENUE RECOGNITION FOR IMPLEMENTATION REVENUE

The Company generates revenues from service fees, implementation fees, and other revenues. Revenues from service fees are derived from recurring monthly fees by providing services which include banking and bill payment, customer service, consumer marketing, information reporting, and administrative services, to financial institution clients, typically based on the number of enrolled retail customers. These services are priced on a monthly per retail customer basis, and in some cases, on a transaction basis. Implementation and other related revenues are generated from the linking of the Company s financial institution clients to the Company s Quotien(TM) e-financial suite through various networks and the Company s gateways and the sale of PC software and customer service software used to access the e-financial suite. Effective January 1, 2001, we discontinued support of our proprietary PC software and screen-based telephone products which have not been a significant source of revenue.

The Company previously recognized nonrefundable implementation fees as revenue under the percentage of completion method as certain milestone output measures were completed. During the year ended December 31, 2000, the Company adopted SEC Staff Accounting Bulletin No. 101 Revenue Recognition in Financial Statements (SAB 101), effective January 1, 2000, and changed its method of accounting for nonrefundable implementation fees for all contracts to recognize such fees and the related incremental direct costs of implementation activities over the contract term as the services are provided, which typically range from one to five years (generally three years). The Company believes the change in accounting principle was preferable based on guidance provided in SAB 101. The cumulative effect of the accounting change as of January 1, 2000 was $217,000 ($1,371,000 of revenue less direct incremental costs of $1,154,000) and was recognized in the statement of operations for the three months ended March 31, 2000. The effect of the accounting change was to increase the net loss before the cumulative effect of the accounting change by $119,000 and $163,000 for the three months and six months ended June 30, 2000, respectively. Due to the adoption of SAB 101, $1,371,000 of revenue that was previously recognized under the Company s prior revenue recognition policy will be recognized under the

Company s revised revenue recognition policy through periods up to 2004 because some contract periods extend through 2004. During the three months and six months ended June 30, 2001, the Company recognized revenue of approximately $153,000 and $316,000, respectively, and related direct incremental costs that were included in the cumulative effect adjustment at January 1, 2000.

3. NON-RECURRING CHARGES

The Company paid a one-time charge of $209,434 including severance and benefit payments during the six months ended June 30, 2001 as a result of the staff reduction of 23 employees, approximately 9% of the total employees, on January 3, 2001.

4. NET LOSS PER COMMON SHARE

Basic and diluted net loss per common share is calculated by dividing the net loss by the weighted average number of common shares outstanding.

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2001	**2000**	**2001**	**2000**
Loss before extraordinary item and cumulative effect of change in accounting principle	$(2,692,359)	$(4,808,239)	$(6,054,324)	$(9,888,368)
Extraordinary item	1,083,153		1,083,153	
Cumulative effect of change in accounting principle				(216,818)
Net loss	$(1,609,206)	$(4,808,239)	$(4,971,171)	$(10,105,186)
Weighted average number of common shares	11,680,377	11,541,131	11,663,703	11,338,162
Loss per share: Basic and diluted	$(0.14)	$(0.42)	$(0.43)	$(0.89)
Proforma amounts assuming the accounting change is applied retroactively: Net loss				$(9,888,368)
Net loss per share				$(0.87)

Due to their antidulitive effects, shares underlying outstanding stock options, warrants and convertible subordinated notes to purchase shares of common stock were excluded from the computation of diluted earnings per share for all periods presented.

5. EQUITY

During the six months ended June 30, 2001, employees purchased 42,343 shares of common stock under the Company's employee stock purchase plan and individuals exercised warrants to purchase 21,385 shares of common stock with net proceeds to the Company of approximately $222,000.

6. NOTES PAYABLE

On September 28, 2000, the Company completed the private placement of $20 million in convertible subordinated notes (the Convertible Notes) to a group of accredited investors and received proceeds of $18.7 million net of debt issuance costs of $1.3 million including commission of $917,200. The proceeds have been and will continue to be used for working capital. On May 22, 2001 and May 24, 2001, the Company repurchased $3,000,000 and $500,000, respectively, of the Convertible Notes in privately negotiated transactions. Accordingly, as of June 30, 2001, $16.5 million of the Convertible Notes remains outstanding and matures on September 30, 2005. The Convertible Notes carry an 8% coupon and interest payment dates are April 1 and October 1, commencing April 1, 2001. The Convertible Notes are convertible at a price of $4.75 per share subject to an annual reset under certain circumstances but in no event will the price be less than $4.00 per share. Subject to certain conditions, the Company may redeem all or part of the Convertible Notes prior to maturity. As of June 30, 2001, 4,210,526 shares were authorized and issuable upon conversion of the Convertible Notes. Jefferies & Company, Inc., one of the underwriters of the placement, also obtained 200,000 warrants that expire on September 30, 2005 that are exercisable at the same price as the conversion price under the Convertible Notes.

Interest expense related to the Convertible Notes for the three months and six months ended June 30, 2001, was $370,000 and $780,000, respectively. As of June 30, 2001, accrued interest on notes payable totaled approximately $330,000. As of June 30, 2000, we had no accrued interest on notes payable as no notes were outstanding.

7. EXTRAORDINARY ITEM

The extraordinary item represents a gain of $1,083,153 from the repurchase of $3.5 million of the Convertible Notes pursuant to privately negotiated transactions in May 2001. The funds used to repurchase the Convertible Notes represent a portion of the proceeds from the issuance of the Convertible Notes.

8. COMPONENTS OF COMPREHENSIVE INCOME

Comprehensive income includes the Company s net loss adjusted for changes, net of tax, of unrealized losses on investments in marketable securities. Comprehensive income for the three months and six months ended June 30, 2001 and 2000 is as follows:

	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2001	2000	2001	2000
Comprehensive income:				
Net loss	$(1,609,206)	$(4,808,239)	$(4,971,171)	$(10,105,186)
Unrealized (loss) gain on investments in marketable securities	(22,348)	13,813	12,578	(28,680)
Total comprehensive loss:	$(1,631,554)	$(4,794,426)	$(4,958,593)	$(10,133,866)

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

CAUTIONARY NOTE

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

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

Forecasts of growth in business-to-business electronic commerce, and growth in the number of consumers using online banking and billpaying services;

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

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

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

These forward-looking statements represent our best judgment as of the date of the Quarterly Report on Form 10-Q, and we caution readers not to place undue reliance on such statements. Actual performance and results of operations may differ materially from those projected or suggested in the forward-looking statements due to certain risks and uncertainties, including but not limited to, the risks and uncertainties described or discussed in the section Risk Factors in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 30, 2001. These risks include, among others, the following:

our history of losses and anticipation of future losses;

significant fluctuations of our quarterly financial results;

our dependence on the marketing efforts of third parties;

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our dependence on our financial institution clients to market our services;

the potential uncertainty of our co-marketing efforts and the risk that such efforts may not be successful;

the potential fluctuations in our operating results;

our potential need for additional capital;

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

our potential ability to compete with larger, more established businesses offering similar products or services;

our need to attract and retain skilled personnel due to our complex business;

our reliance on our patents and other intellectual property rights;

our ability to promote our services to be broadly used and accepted by consumers;

the potential obsolescence of our technology or the offering of new, more efficient means of conducting Internet banking and bill payment;

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

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

our failure to successfully implement a system upgrade or conversion may adversely affect our reputation and our business;

government regulation could interfere with our business;

our certificate of incorporation and bylaw provisions may prevent or delay third parties from buying your stock;

control of our management and affairs by our management and directors;

our volatile stock price;

a substantial number of shares of common stock may be sold, which could affect the trading prices of our common stock and the convertible notes;

the possibility that we fail to meet listing standards for continued listing on The Nasdaq National Market;

security breaches or system failures could disrupt our business and we could be liable for some types of failure; and

if we lose a material client, our business may be adversely impacted.

OVERVIEW

We are a leading service provider for Internet banking, bill payment and e-financial services to financial institutions. We provide our clients a cost-effective outsourced service, branded in their name, by seamlessly integrating Internet banking, electronic bill payment, and other e-financial services into a single-vendor, end-to-end solution. As part of our services, we provide customer support through our call center, marketing services, web site design, implementation and other services.

We primarily derive revenue from long-term service contracts with our financial institution clients, who pay us recurring fees based primarily on the number of their retail customers enrolled and transaction volumes, as well as an up-front implementation fee. Our financial institution clients typically subsidize some or all of our fees when reselling our services to their retail customers, as they derive significant potential benefits including account retention, delivery and paper cost savings, account consolidation and cross-selling of other products. As a network-based service provider, we have made substantial up-front investments in infrastructure. We believe our financial performance and operating leverage will be based primarily on increasing retail customer subscriptions and transaction volumes over a relatively fixed cost base.

Our current sources of revenue are from service fees, implementation and other revenues. We expect that our revenue growth will principally come from service fees as a result of continued growth of retail customers.

Service fees. Our service fee revenues are derived from recurring monthly fees by providing services which include banking and bill payment, customer service, consumer marketing, information reporting, and administrative services, to financial institution clients, typically based on the number of enrolled retail customers. These services are priced on a monthly per retail customer basis, and in some cases, on a transaction basis. We recognize these revenues as services are provided.

Implementation and other revenues. We generate revenue from implementation of our fully integrated services to our financial institution clients. Implementation fees are paid on a one-time basis at signing. We previously recognized nonrefundable implementation fees as revenue under the percentage of completion method as certain milestone output measures were completed. During the year ended December 31, 2000, effective January 1, 2000, we adopted SEC Staff Accounting Bulletin No. 101 Revenue Recognition in Financial Statements (SAB 101) and changed our method of accounting for nonrefundable implementation fees for all contracts to recognize such fees over the contract term as the services are provided, which typically range from one to five years. We also derive revenue from sales of related enabling products and software at fixed prices, including our PC software and customer service software. These have not been a significant source of revenue and continue to decline as retail customers migrate to the web service. Effective January 1, 2001, we discontinued support of our proprietary PC software and screen-based telephone.

Historically, the majority of our resources have been directed to creating our proprietary system. Our proprietary system enables us to provide a broad range of services to our financial institution clients including Internet banking, bill paying, and access to complementary financial services supported by our customer call center, marketing services and other support services. While investment to date has been significant, we believe the infrastructure we have built will enable us to support our anticipated growth over the next several years with only modest cost increases associated with adding retail customers.

FINANCIAL CONDITION

Since our founding, we have incurred high costs to create and upgrade our infrastructure, while generating low revenues. As a result, we have historically experienced large operating losses and negative cash flow. At June 30, 2001, we had an accumulated deficit of $80.5 million and net property and equipment of $6.8 million. We have funded our operations primarily through the issuance of equity and debt securities. Ongoing working capital requirements will primarily consist of personnel costs related to enhancing and maintaining our system. We expect to continue to incur losses in the near future.

As of June 30, 2001, we had $1.0 million in cash and cash equivalents and $10.9 million in investments as compared to $1.8 million in cash and cash equivalents and $19.7 million in investments as of December 31, 2000. The decrease in cash and investments results from cash used for operating purposes and the repurchase of $3.5 million of 8% convertible subordinated notes. Total liabilities decreased from $25.9 million as of December 31, 2000 to $21.4 million as of June 30, 2001 primarily as a result of the repurchase of $3.5 million of 8% convertible subordinated notes, decreases in deferred revenues and capital lease obligations.

Our limited operating history makes it difficult to evaluate our prospects for success and our revenue and profitability potential is unproven.

RESULTS OF OPERATIONS

The following table presents certain items derived from our statements of operations expressed as a percentage of revenue.

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2001	**2000**	**2001**	**2000**
Statement of Operations Data:				
Revenues:				
Service fees	87.0%	82.4%	87.8%	80.0%
Implementation and other revenues	13.0	17.6	12.2	20.0
Total revenues	100.0	100.0	100.0	100.0
Expenses:				
Cost of revenues	59.2	90.7	62.3	95.0
Gross margin	40.8	9.3	37.7	5.0
General and administrative	30.8	43.2	31.1	48.8
Sales and marketing	25.8	62.1	26.5	68.4
Systems and development	24.5	48.4	25.7	48.0
Non-recurring charges			1.8	
Total expenses	81.1	153.7	85.1	165.2
Loss from operations	(40.3)	(144.4)	(47.4)	(160.2)
Other (expense) income	(4.5)	6.2	(5.0)	7.5
Extraordinary item	18.0		9.4	
Cumulative effect of change in accounting principle				(3.3)
Net loss	(26.8)%	(138.2)%	(43.0)%	(156.0)%

THREE MONTHS ENDED JUNE 30, 2001 COMPARED TO THE THREE MONTHS ENDED JUNE 30, 2000.

Revenues. We derive revenues from service fees, implementation and other revenues. Revenues increased $2.5 million, or 72.7%, to $6.0 million for the three months ended June 30, 2001 as compared to $3.5 million for the same period in 2000. This increase was primarily attributable to a 82.5% increase in service fees which were largely recurring and driven by an increase of 93.1% in the number of retail customers and an increase of 101.2% in the number of transactions offset by lower service fees per user measured at June 30, 2001 and June 30, 2000. Additionally, implementation and other revenues increased $166,000, or 27.1%, to $780,000 as a result of the cancellation fees from a client acquired by another financial institution and an increase in demand of professional services.

Cost of Revenues. Cost of revenues primarily includes telecommunications, payment processing, systems operations, customer service, implementation and related products. Cost of revenues increased $403,000, or 12.8%, to $3.6 million for the three months ended June 30, 2001 as compared to $3.2 million for the same period in 2000. This increase was primarily attributable to a $358,000 increase in bill payment processing and customer service costs. These increases resulted from increases in the number of retail customers, transactions, banking expenses and staff to support the growth of our operations.

Gross Profit. Gross profit increased to $2.4 million from $323,000 for the three months ended June 30, 2001 and 2000, respectively. Gross margin for the same periods improved to 41% from 9% primarily due to increased service fees leveraged over our relatively fixed costs of revenue as a result of improved efficiency from technology development and cost control initiative. Gross margin for service fees improved as a result of increased end user growth without a corresponding incremental increase in costs.

General and Administrative. General and administrative expenses are comprised primarily of salaries for executive, administrative and financial control personnel, consulting expenses and facilities costs such as office leases, insurance, and depreciation. General and administrative expenses increased $351,000, or 23.4%, to $1,852,000 as compared to $1,501,000 for the three months ended June 30, 2001 and 2000, respectively. The increase was primarily attributed to higher depreciation expense as a result of capital expenditures of approximately $3.2 million between June 30, 2000 and June 30, 2001 and an increase in other overhead expenses necessary to support the growing business operations.

Sales and Marketing. Sales and marketing expenses consist of salaries and commissions paid to sales and marketing personnel, consumer marketing costs, public relations costs, and other costs incurred in marketing our services and products. Sales and marketing expenses decreased $612,000, or 28.3%, to $1.5 million for the three months ended June 30, 2001 as compared to $2.2 million for the same period in 2000. The principal reason for the decrease in sales and marketing expenses was a decline in advertising and commission expenses and a reduction in staffs as a result of consolidating certain client service responsibilities.

Systems and Development. Systems and development expenses include salaries of personnel in the systems and development department, consulting fees and all other expenses incurred in supporting the research and development of new services and products, and new technology to enhance existing products. Systems and development expenses decreased $216,000, or 12.8%, to $1.5 million for the three months ended June 30, 2001 as compared to $1.7 million for the same period in 2000. The decrease in our systems and development expenses was primarily due to the reduction in consulting fees associated with our efforts to control costs.

Loss from Operations. Loss from operations decreased $2.6 million, or 51.8%, to $2.4 million as compared to $5.0 million for the three months ended June 30, 2001 and 2000, respectively. Loss from operations significantly decreased between the two periods, primarily as a result of increases in service fees and gross profit driven by growth in our customer base, decreases in various expenditures and costs derived from our cost-cutting initiatives, as well as other factors described above.

Other Income and Expense. Interest income decreased $43,000, or 18.0%, to $195,000 for the three months ended June 30, 2001 as compared to $238,000 for the same period in 2000, primarily due to lower interest rates. Interest expenses increased $445,000, or 2137.9%, to $466,000 for the three months ended June 30, 2001 as compared to $20,808 for the same period in 2000 as the result of the interest expense incurred in connection with the issuance of 8% convertible subordinated notes on September 28, 2000. Going forward, until at least September 2005, unless the convertible notes are earlier converted, we will continue to incur interest expenses due to the convertible subordinated notes.

Net Loss and Loss Per Share. Net loss was $1.6 million compared to a loss of $4.8 million for the three months ended June 30, 2001 and 2000, respectively. For the three months ended June 30, 2001 and 2000 the basic and diluted loss per share were $(0.14) and $(0.42), respectively. Excluding gain from repurchase of debt, we would have reported loss per share of $(0.23) and $(0.42), for the three months ended June 30, 2001 and 2000, respectively, as a result of the various factors noted above.

SIX MONTHS ENDED JUNE 30, 2001 COMPARED TO THE SIX MONTHS ENDED JUNE 30, 2000.

Revenues. Revenues increased $5.1 million, or 78.6%, to $11.6 million for the six months ended June 30, 2001 as compared to $6.5 million for the same period in 2000. This increase was primarily attributable to a 96.0% increase in service fees which were largely recurring and driven by an increase of 93.1% in the number of retail customers and an increase of 111.0% in the number of transactions. Additionally, implementation and other revenues increased $118,000, or 9.1%, to $1.4 million as a result of an increase in professional service revenue offset by discontinued screen phone and proprietary PC software revenues.

Cost of Revenues. Cost of revenues increased $1.1 million, or 17.2%, to $7.2 million for the six months ended June 30, 2001 as compared to $6.2 million for the same period in 2000. This increase was primarily attributable to a $462,000 increase in bill payment processing costs and a $417,000 increase in customer service costs. These increases resulted from expansion in the number of retail customers, transactions, banking expenses and staff to support the growth of operations.

Gross Profit. Gross profit increased to $4.4 million from $327,000 for the six months ended June 30, 2001 and 2000, respectively. Gross margin for the same periods improved to 37.7% from 5.0% primarily due to increased service fees leveraged over our relatively fixed costs of revenue as a result of the continued efforts to improve efficiency and our cost control initiatives. Gross margin for service fees positively affected by increased end user growth without a corresponding incremental increase in costs.

General and Administrative. General and administrative expenses increased $434,000, or 13.7%, to $3.6 million as compared to $3.2 million for the six months ended June 30, 2001 and 2000, respectively. The increase was primarily attributed to higher depreciation expense as a result of capital expenditures of approximately $3.2 million, increased personnel expenses and other overhead expenses necessary to support the growing business operations.

Sales and Marketing. Sales and marketing expenses decreased $1.4 million, or 30.9%, to $3.1 million for the six months ended June 30, 2001 as compared to $4.4 million for the same period in 2000. The principal reason for the decrease in sales and marketing expenses was a decline in advertising and commission expenses and a reduction in staffs as a result of consolidating certain client service responsibilities.

Systems and Development. Systems and development expenses decreased $141,000, or 4.5%, to $3.0 million for the six months ended June 30, 2001 as compared to $3.1 million for the same period in 2000. The decrease in our systems and development expenses was primarily due to the reduction in consulting fees associated with our efforts to control costs.

Non-Recurring Charges. As a result of the reduction in staffs by approximately 9% on January 3, 2001, we paid a one-time charge of $209,000 including severance costs and benefit payments during the six months ended June 30, 2001.

Loss from Operations. Loss from operations decreased $4.9 million, or 47.2%, to $5.5 million as compared to $10.4 million for the six months ended June 30, 2001 and 2000, respectively. Excluding one-time charges related to the staff reduction, loss from operations decreased $5.1 million, or 49.3%, between the two periods, primarily as a result of increases in service fees and gross profit driven by growth in our customer base, decreases in various expenditures and costs derived from our cost-cutting initiatives, as well as other factors describved above.

Other Income and Expense. Interest income decreased $139,000, or 25.8%, to $400,000 for the six months ended June 30, 2001 as compared to $539,000 for the same period in 2000, primarily due to lower interest rates. Interest expenses increased $930,000, or 1879.1%, to $980,000 for the six months ended June 30, 2001 as compared to $49,508 for the same period in 2000 as the result of the interest expense in connection with the issuance of 8% convertible subordinated notes on September 28, 2000. Going forward, until at least September 2005, unless the convertible notes are earlier converted, we will continue to incur interest expenses due to the convertible subordinated notes.

Net Loss and Loss Per Share. Net loss was $5.0 million compared to a loss of $10.1 million for the six months ended June 30, 2001 and 2000, respectively. For the six months ended June 30, 2001 and 2000 the basic and diluted loss per share were $(0.43) and $(0.89), respectively. Excluding gain from repurchase of debt, non-recurring charges and cumulative effect of change in accounting principle, we would have reported loss per share of $(0.50) and $(0.87), for the six months ended June 30, 2001 and 2000,

respectively, as a result of the various factors noted above.

LIQUIDITY AND CAPITAL RESOURCES

Cash and investments in available for sale securities decreased $9.6 million to $11.9 million from $21.5 million as of June 30, 2001 and December 31, 2000, respectively.

Net cash used in operating activities was $6.1 million for the six months ended June 30, 2001. The decrease resulted primarily from a net loss of $5.0 million and $1.1 million of gain from repurchase of debts.

Net cash provided from investing activities for the six months ended June 30, 2001 was $7.5 million, which primarily resulted from the net reduction of $8.8 million in available for sale securities. In addition, capital expenditures were $1.3 million for the six months ended June 30, 2001.

Net cash used in financing activities was $2.2 million for the six months ended June 30, 2001 relating primarily to $2.2 million in net payments made to repurchase $3.5 million of 8% convertible subordinated notes. At June 30, 2001, we had cash and cash equivalents of $1.0 million, investments in available for sale securities of $10.9 million, working capital of $12.8 million, long-term obligations of $17.5 million and stockholder equity of $4.5 million.

We currently believe that cash, cash equivalents and investment balances will be sufficient to meet our current anticipated cash requirements for at least the next twelve months. However, there can be no assurance that additional capital beyond the amounts currently forecasted by us will not be required or that any such required additional capital will be available on reasonable terms, if at all, at such time as required. We intend to invest our cash in excess of current operating requirements in marketable government, Corporate and mortgage-backed securities.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We invest primarily in marketable government, corporate, and mortgage-backed debt securities. We do not have operations subject to risks of foreign currency fluctuations, nor do we use derivative financial instruments in our operations or investment portfolio. We have classified all of our investments as available-for-sale financial instruments. The following table provides information about our available-for-sale investments that are sensitive to changes in interest rates.

	JUNE 30, 2001		
	BOOK VALUE	FAIR VALUE	INTEREST RATE
U.S. government treasury obligations	$907,383	$907,452	4.18%
Commercial bonds	9,964,747	10,033,331	4.31%
Total investments	$10,872,130	$10,940,783	

The long-term debts on June 30, 2001 are comprised of convertible subordinated notes with an 8% interest rate and capital lease obligations with interest rates ranging from 8% to 13%. The cost of the convertible subordinated notes is approximately fair market value at June 30, 2001. We do not believe a fluctuation of 100 basis points in the prime rate would have a material adverse effect on us.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

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

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None

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

On June 6, 2001, the Company held its annual meeting of shareholders (the Annual Meeting). There were three proposals submitted to a vote of the shareholders at the Annual Meeting: (i) to elect three Directors; (ii) to approve the amendment to the 1999 Stock Option Plan to increase the number of shares of Common Stock reserved for issuance thereunder by 600,000 shares; and (iii) to ratify the appointment of the independent auditors for the fiscal year ending December 31, 2001.

At the Annual Meeting each of the following persons were elected to serve as directors of the Company until the 2004 annual meeting: Matthew P. Lawlor was elected with 9,343,515 votes cast in favor of election and 42,945 cast against election and Ervin R. Shames and Barry D. Wessler were each elected with 9,343,586 votes cast in favor of election and 42,874 cast against election. The directors whose terms continued after the Annual Meeting are Michael H. Heath, Thomas S. Johnson, George M. Middlemas, David A. O Connor and Joseph S. Spalluto. Next, the shareholders approved the amendment to the 1999 Stock Option Plan with 7,971,530 votes cast in favor, 1,228,064 votes cast against, 186,865 votes abstaining and one broker non-vote. Finally, the shareholders ratified the appointment of Ernst & Young LLP as the Company s independent auditors, with 9,381,310 votes cast in favor of this proposal, 4,975 votes cast against, 175 votes abstaining and no broker non-votes.

No other matters were submitted to the shareholders for a vote.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(A) Exhibits
None. (B) Reports on Form 8-K

Online Resources Corporation did not file any Form 8-K reports during the quarter ended June 30, 2001.

SIGNATURES

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

ONLINE RESOURCES CORPORATION

Date: August 14, 2001
By: /s/ Matthew P. Lawlor

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

Date: August 14, 2001
By: /s/ Carl D. Blandino

Carl D. Blandino
Chief Financial Officer and Executive Vice President
(Principal Financial Officer)