ONLINE RESOURCES CORP
Form 10-Q
May 15, 2002

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 MARCH 31, 2002

OR

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

FOR THE TRANSITION PERIOD FROM _________________ TO ___________________

COMMISSION FILE NUMBER 0-26123

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

DELAWARE	52-1623052
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)
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 April 30, 2002 there were 13,549,500 shares of the issuer's common stock outstanding.

ONLINE RESOURCES CORPORATION

FORM 10-Q

TABLE OF CONTENTS

		PAGE
Part I.	FINANCIAL INFORMATION	
Item 1:	Financial Statements	
	Unaudited Balance Sheets at March 31, 2002 and December 31, 2001	1
	Unaudited Statements of Operations for the three months ended March 31, 2002 and 2001	2
	Unaudited Statements of Cash Flows for the three months ended March 31, 2002 and 2001	3
	Notes to Financial Statements (unaudited)	4
Item 2:	Management's Discussion and Analysis of Financial Condition and Results of Operations	6
Item 3:	Quantitative and Qualitative Disclosures about Market Risk	11
PART II	OTHER INFORMATION	
Item 1:	Legal Proceedings	11
Item 2, 3 and 4:	Not Applicable	11
Item 5:	Other Information	11
Item 6:	Exhibits and Reports on Form 8-K	11

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

ONLINE RESOURCES CORPORATION

UNAUDITED BALANCE SHEETS

	MARCH 31, 2002	DECEMB 200
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,381,242	$ 2,12
Investments	4,344,743	5,58
Accounts receivable (net of allowance of approximately $105,000 and $35,000 at March 31, 2002 and December 31, 2001, respectively)	3,305,507	2,63
Deferred implementation costs	772,697	91
Prepaid expenses and other current assets	944,908	79
Total current assets	11,749,097	12,05
Property and equipment, net	7,393,696	6,81
Deferred implementation costs, less current portion	587,210	70
Debt issuance costs	870,398	98
Other assets	564,233	96
Total assets	$ 21,164,634	$ 21,52
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 590,219	$ 72
Accrued expenses and other current liabilities	1,604,364	73
Accrued compensation expenses	292,692	61
Deferred revenues	793,495	88
Current portion of capital lease obligations	254,009	31
Total current liabilities	3,534,779	3,26
Capital lease obligation, less current maturities	339,924	34
Deferred revenues, less current portion	499,438	56
Notes payable	12,000,000	13,00
Total liabilities	16,374,141	17,18
Commitments		
Series B redeemable convertible preferred stock; 100,000 shares designated, none issued at March 31, 2002 and December 31, 2001	--	
Series C redeemable convertible preferred stock; 287,000 shares designated, none issued at March 31, 2002 and December 31, 2001	--	
Stockholders' equity:		
Series A convertible preferred stock, $.01 par value; 1,000,000 shares authorized, none issued at March 31, 2002 and December 31, 2001	--	
Common stock, $.0001 par value; 35,000,000 shares authorized, 13,621,177 issued and 13,545,652 outstanding at March 31, 2002; and 13,293,238 issued and 13,248,390 outstanding at December 31, 2001, respectively	1,355	
Additional paid-in capital	91,163,516	89,93
Accumulated deficit	(86,101,587)	(85,29
Deferred stock compensation	(43,807)	(6
Treasury stock, 75,525 shares and 44,848 shares at March 31, 2002 and December 31, 2001, respectively	(227,800)	(14
Receivable from the sale of common stock	--	(12
Accumulated other comprehensive (loss) income	(1,184)	2

Total stockholders' equity	4,790,493	4,33
Total liabilities and stockholders' equity	$ 21,164,634	$ 21,52

SEE ACCOMPANYING NOTES TO UNAUDITED FINANCIAL STATEMENTS.

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ONLINE RESOURCES CORPORATION
UNAUDITED STATEMENTS OF OPERATIONS

	THREE MONTHS ENDED MARCH 31, 2002	2001
Revenues:		
Service fees	$ 6,858,261	$ 4,929,950
Implementation and other revenues	969,118	633,540
Total revenues	7,827,379	5,563,490
Costs and expenses:		
Service costs	3,343,261	3,211,048
Implementation and other costs	590,491	436,731
Costs of revenues	3,933,752	3,647,779
Gross profit	3,893,627	1,915,711
General & administrative	1,705,562	1,745,432
Sales and marketing	1,263,515	1,511,153
Systems and development	1,201,247	1,502,342
Non-recurring charges	--	209,434
Total expenses	4,170,324	4,968,361
Loss from operations	(276,697)	(3,052,650)
Other (expenses) income:		
Interest income	47,016	204,850
Interest expense	(351,440)	(514,165)
Other	(33,794)	--
Debt conversion expense	(191,807)	--
Total other expense	(530,025)	(309,315)
Net loss	$ (806,722)	$ (3,361,965)

Loss per share:

Net loss	$ (0.06)	$ (0.29)
Shares used in calculation of loss per share:		
Basic and diluted net loss per share	13,278,464	11,646,321

SEE ACCOMPANYING NOTES TO UNAUDITED FINANCIAL STATEMENTS.

ONLINE RESOURCES CORPORATION

UNAUDITED STATEMENTS OF CASH FLOWS

	THREE MONTHS ENDED 2002	
OPERATING ACTIVITIES		
Net loss	$ (806,722)	$ (3
Adjustments to reconcile net loss to net cash used in operating activities:		
Debt conversion expense	191,807	
Depreciation	562,540	
Amortization of debt issuance costs	62,891	
Stock compensation expense	58,246	
Provision for losses on accounts receivable	24,000	
Realized gain on investments	(4,190)	
Amortization of bond premium (discount) on investment	3,232	
Changes in assets and liabilities:		
Accounts receivable	(693,769)	
Prepaid expenses and other current assets	(149,044)	
Deferred implementation costs	266,938	
Other assets	398,941	
Accounts payable	(134,465)	
Accrued expenses	543,850	
Deferred revenues	(153,986)	
Net cash provided by (used in) operating activities	170,269	(3
INVESTING ACTIVITIES		
Purchase of available for sale securities	(1,634,401)	(12
Sales of available for sale securities	2,847,432	17
Purchases of property and equipment	(1,143,113)	
Net cash provided by investing activities	69,918	4
FINANCING ACTIVITIES		
Net proceeds from issuance of common stock	86,060	
Repayment of capital lease obligations	(65,257)	
Payment of long-term debt costs	--	
Net cash provided by financing activities	20,803	
Net increase in cash and cash equivalents	260,990	1

Cash and cash equivalents at beginning of period	2,120,252	1
Cash and cash equivalents at end of period	$ 2,381,242	$ 3
Supplemental information to statement of cash flows:		
Cash paid for interest	28,548	
Conversion of notes payable	1,000,000	
Unrealized (loss) gain on investment	(26,554)	

SEE ACCOMPANYING NOTES TO UNAUDITED FINANCIAL STATEMENTS.

ONLINE RESOURCES CORPORATION
NOTES TO FINANCIAL STATEMENTS
(UNAUDITED)

1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Online Resources Corporation (the "Company") is a leading outsourcer of e-financial services with over 500 bank and credit union clients. The Company's comprehensive Quotien SM suite of services provides Internet banking, electronic bill presentment and payment, commercial cash management and other consumer and business e-financial applications. The Company supports its products with 24x7 customer care and targeted consumer marketing services, training services and other network and technical professional services, giving clients the benefit of a single, integrated solution with real-time banking transaction capabilities.

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, 2001, included in the Annual Report on Form 10-K filed by the Company with the Securities and Exchange Commission on March 29, 2002. 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 Company adopted the announcement on January 1, 2002 and the adoption of this announcement does not have a significant effect on the earnings or the financial position of the Company.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement replaces SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of". This statement applies to all long-lived assets, including discontinued operations, and replaces the provisions of APB Opinion No. 30, Reporting Results of Operations-Reporting the Effects of Disposal of a segment of a Business, for the disposal of segments of a business. This statement requires that those long-lived assets be measured at the lower of carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. The Company adopted this statement on January 1, 2002 and the adoption of this statement does not have a significant impact on its results of operations, financial position and cash flows.

The FASB issued Statement No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("SFAS No. 145"). SFAS No. 145 revisits the accounting for gains and losses from the extinguishment of debt. SFAS No. 145 rescinds Statement 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. As a result, the criteria in Opinion 30 will now be used to classify those gains and losses. SFAS No. 145 is effective for fiscal years beginning after May 15, 2002. Provisions related to FASB Statement No. 13 are effective for transactions occurring after May 15, 2002 and all other provisions are effective for financial statements issued on or after May 15, 2002. The Company expects that the impact of adopting SFAS No. 145 will result in restating prior year extraordinary losses from extinguishment of debt so that they are reflected as part of ordinary income. The Company is currently assessing the impact of this pronouncement.

2. NON-RECURRING CHARGES

The Company incurred and paid a one-time charge of $209,434 including severance and benefit payments during the three months ended March 31, 2001 as a result of the staff reduction of 23 employees, approximately 9% of the total employees, on January 3, 2001.

3. 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 MARCH 31,	
	2002	2001
Net loss	$ (806,722)	$ (3,361,965)
Weighted average number of common shares	13,278,464	11,646,321

Loss per share:		
Basic and diluted	$ (0.06)	$ (0.29)

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.

4. EQUITY

During the three months ended March 31, 2002, employees purchased 14,160 shares of common stock under the Company's employee stock purchase plan and exercised 44,422 shares of common stock under the Company's stock option plan with net proceeds to the Company of approximately $86,000. On March 27, 2002, $1.0 million of the 8% convertible subordinated notes (the "Convertible Notes") was converted at $3.3895 per share of common stock (Note 5). This conversion resulted in an issuance of 295,031 shares of common stock. No cash proceeds were obtained from the conversion.

5. NOTES PAYABLE

On September 28, 2000, the Company completed the private placement of $20 million in 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. The Convertible Notes carry an 8% coupon and interest payment dates are April 1 and October 1, commencing April 1, 2001. The Convertible Notes were initially convertible at a price of $4.75 per share but are subject to an annual reset under certain circumstances. In no event can the conversion 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. There were 4,210,526 shares authorized and issuable upon conversion of the Convertible Notes. Jefferies & Company, Inc., one of the underwriters of the private 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.

On May 22, 2001 and May 24, 2001, the Company paid $2.2 million to repurchase $3,000,000 and $500,000, respectively, of the Convertible Notes in privately negotiated transactions. After $289,000 of debt issuance costs was written off, the Company recognized an extraordinary gain of $1.1 million as a result of the transaction.

On September 28, 2001, November 2, 2001 and March 27, 2002, $2.5 million, $1.0 million and $1.0 million of the Convertible Notes were converted at $2.00, $3.05 and $3.3895 per common share, respectively, instead of the $4.00 conversion price that otherwise existed under the Convertible Notes. These induced conversions resulted in the issuance of 1,250,000, 327,869 and 295,031 shares or 625,000, 77,869 and 45,031 additional shares, respectively, had the Convertible Notes been converted at the $4.00 per common share conversion price. The Company recognized $731,250, $175,205 and $141,848 non-cash debt conversion expense and wrote off $157,157, $51,970 and $49,959 of related debt issuance costs in September 2001, November 2001 and March 2002, respectively, in connection with the transactions. Accordingly, as of March 31, 2002, $12.0 million of the Convertible Notes remains outstanding and matures on September 30, 2005.

Interest expense related to the Convertible Notes for the three months ended March 31, 2002 and 2001 was $260,000 and $400,000, respectively. As of March 31, 2002 and 2001, accrued interest on notes payable totaled $480,000 and $813,000, respectively.

6. 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 ended March 31, 2002 and 2001 is as follows:

	THREE MONTHS ENDED MARCH 31, 2002	2001
Comprehensive income:		
Net loss	$ (806,722)	$(3,361,965)
Unrealized (loss) gain on investments in marketable securities	(26,554)	34,926
Total comprehensive loss:	$ (833,276)	$(3,327,039)

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", "should", "expects", "anticipates", "estimates", "plans", "projects", "believes", "seek", "intend" and other similar words that signify forward-looking statements.

These forward-looking statements represent our best judgment as of the date of the Quarterly Report on Form 10-Q, and we caution readers not to place undue reliance on such statements. Actual performance and results of operations may differ materially from those projected or suggested in the forward-looking statements due to certain risks and uncertainties, including but not limited to, the risks and uncertainties described or discussed in the section "Risk Factors" in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 29, 2002. These risks include, among others, the following:

- our history of losses and anticipation of future losses;

- significant fluctuations of our quarterly financial results;

- our potential need for additional capital to stay in business;

- our dependence on the marketing efforts of third parties;

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

- the potential adverse impact as a result of loss of a material client or restructure of our agreement with a material customer;

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

- the possibility of a failure to successfully implement a system upgrade or conversion;

- our inability to attract and retain skilled personnel;

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

- the lack of success in promoting our services for broad use and acceptance by consumers and the possibility of the development of defective new products ;

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

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

- the potential impact of the consolidation of the banking and financial services industry;
- interference with our business from the adoption of government regulations;
- the potential litigation and liability claims;
- control of the management and affairs of the Company by our executives and directors;
- our volatile stock price;
- the trading of a substantial number of shares adversely impacting the price of our shares;

- the possibility that we fail to meet listing standards for continued listing on The NASDAQ National Market;
- the possibility of discouraging a takeover as a result of the adoption of a Stockholder Rights Plan; and
- the possibility of terrorism and further acts of violence.

OVERVIEW

Online Resources Corporation is a leading outsourcer of e-financial services with over 500 bank and credit union clients. Our comprehensive Quotien SM suite provides Internet banking, electronic bill presentment and payment, commercial cash management, and other consumer and business e-financial applications. We support our services with 24x7 customer care and targeted consumer marketing services, training services and other network and technical professional services giving clients the benefit of a single, integrated solution and real-time banking transaction capabilities. We back our services with an end to end service guaranty that we believe is unique to our industry. We process approximately 80 million transactions annually, including $3.8 billion in consumer bill payments.

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 billable customers enrolled and transaction volumes, as well as an up-front implementation fees. Our financial institution clients typically subsidize some or all of our fees when reselling our services to their customers, as they derive significant potential benefits including account retention, delivery and paper cost savings, account consolidation and cross-selling of other products through the use of our services. 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 fees and other revenues.

- Service fees. Our primary source of revenues is 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 billable customers. These services are priced on a monthly per billable 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 recognize nonrefundable implementation fees for all contracts 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, including cash management, Quicken and customer service software.

We expect that our primary source of revenue growth will come from service fees as a result of continued growth of billable customers.

Historically, the majority of our resources have been directed to creating and upgrading 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, targeted consumer 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 nominal incremental cost for additional retail customers.

FINANCIAL CONDITION

Since our founding, we have incurred high costs to create our infrastructure, while generating low revenues that have been increasing in amount over the past several years. As a result, we have historically experienced large operating losses and negative cash flow. At March 31, 2002, we had an accumulated deficit of $86.1 million and net property and equipment of $7.4 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 foreseeable future although as a result of our improving revenues and

gross margins the amount of our losses has been decreasing.

As of March 31, 2002, we had $2.4 million in cash and cash equivalents and $4.3 million in investments as compared to $2.1 million in cash and cash equivalents and $5.6 million in investments as of December 31, 2001. The decrease in cash and investments results primarily from cash used for capital expenditures in the amount of $1.1 million. Total liabilities decreased from $17.2 million as of December 31, 2001 to $16.4 million as of March 31, 2002 primarily as a result of the conversion of $1.0 million of the 8% convertible subordinated notes (the "Convertible Notes"). Accordingly, as of March 31, 2002, $12.0 million of the Convertible Notes remains outstanding and matures on

September 30, 2005.

Even though our financial trends have been favorable and indicate the potential for our operations becoming profitable, we have not yet attained profitable operations. Therefore, until we reach and sustain profitability our prospects for success remain 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 MARCH 31, 2002	THREE MONTHS ENDED MARCH 31, 2001
Statement of Operations Data:		
Revenues:		
Service fees	87.6%	88.6%
Implementation and other revenues	12.4	11.4
Total revenues	100.0	100.0
Expenses:		
Cost of revenues	50.3	65.6
Gross margin	49.7	34.4
General and administrative	21.8	31.4
Sales and marketing	16.1	27.2
Systems and development	15.3	27.0
Non-recurring charges	--	3.7
Total expenses	53.2	89.3
Loss from operations	(3.5)	(54.9)
Other (expenses)	(4.3)	(5.5)
Debt conversion expense	(2.5)	--
Net loss	(10.3)%	(60.4)%

THREE MONTHS ENDED MARCH 31, 2002 COMPARED TO THE THREE MONTHS ENDED MARCH 31, 2001.

Revenues. We derive revenues from service fees, implementation fees and other revenues. Revenues grew $2.2 million, or 40.7%, to $7.8 million for the three months ended March 31, 2002 as compared to $5.6 million for the same period in 2001. This growth was primarily attributable to a 39.3% increase in service fees which were largely recurring and driven by an increase of 50.7% in the number of billable customers and an increase of 75.6% in the number of transactions partially offset by lower service fees per user measured for the periods ended March 31, 2002 and 2001. Additionally, implementation and other revenues increased $335,000, or 52.8%, to $969,000 for the three months ended March 31, 2002 as compared to $634,000 for the same period in 2001 mainly as a result of an increase of $442,000 in non-recurring cancellation fees offset in part by a decrease of $107,000 in professional service and other revenues.

Cost of Revenues. Cost of revenues primarily includes telecommunications, payment processing, systems operations, customer service, implementation and related products. Cost of revenues increased $286,000, or 7.9%, to $3.9 million for the three months ended March 31, 2002 as compared to $3.6 million for the same period in 2001. This increase primarily reflected an increase in telecommunication charges and higher implementation expenses.

Gross Profit. Gross profit increased to $3.9 million from $1.9 million for the three months ended March 31, 2002 and 2001, respectively. Gross margin for the same periods improved to 50% from 34% mainly due to increased service fees from billable customer growth that was leveraged over our relatively fixed costs of revenue. Gross margin for services fees also improved as a result of improved efficiency from technology development and cost control initiatives.

General and Administrative. General and administrative expenses are comprised primarily of salaries for executive, administrative and financial personnel, consulting expenses and facilities costs such as office leases, insurance, and depreciation. General and administrative expenses decreased $40,000, or 2.3%, to $1.7 million as compared to $1.7 million for the three months ended March 31, 2002 and 2001, respectively. General and administrative expenses as a percentage of revenue decreased to 21.8% as compared to 31.4% for the three months ended March 31, 2002 and 2001, respectively. This decrease was a result of improved operational efficiencies and cost control initiatives.

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 $248,000, or 16.4%, to $1.3 million for the three months ended March 31, 2002 as compared to $1.5 million for the same period in 2001. The principal reason for the decrease in sales and marketing expenses was 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 $301,000, or 20.0%, to $1.2 million for the three months ended March 31, 2002 as compared to $1.5 million for the same period in 2001. The decrease in our systems and development expenses was mainly due to the capitalization of payroll related costs for projects that qualified for computer software developed for internal use. The payroll-related costs incurred for the quarter ended March 31, 2001 for certain projects that otherwise qualify for capitalization were immaterial and, therefore no such costs in such quarter were capitalized.

Loss from Operations. Loss from operations decreased $2.8 million, or 90.3%, to $277,000 as compared to $3.1 million for the three months ended March 31, 2002 and 2001, respectively. Loss from operations significantly decreased between the two periods, primarily as a result of increases in services fees and gross profit driven by growth in our customer base, decreases in various expenditures and savings derived from our cost-cutting initiatives and our leveraging of technology.

Other Income and Expenses. Interest income decreased $158,000, or 77.1%, to $47,000 for the three months ended March 31, 2002 as compared to $205,000 for the same period in 2001, primarily due to a decrease in average cash and investment balances and lower interest rates. Interest and other expenses decreased $129,000, or 25.1%, to $385,000 for the three months ended March 31, 2002 as compared to $514,000 for the same period in 2001 as the result of a decrease in Convertible Notes outstanding in connection with the repurchases and conversions of Convertible Notes. The induced conversion of $1.0 million Convertible Notes on March 27, 2002 resulted in a non-cash debt conversion expense of $192,000 that was attributable to the issuance of 45,031 incremental shares of common stock issued to holders in conformance with accounting rules for induced conversions of convertible debt.

Net Loss and Loss Per Share. Net loss was $807,000 compared to a loss of $3.4 million for the three months ended March 31, 2002 and 2001, respectively. For the three months ended March 31, 2002 and 2001 the basic and diluted loss per share were $(0.06) and $(0.29), respectively. Excluding debt conversion expense, we would have reported loss per share of $(0.05) and $(0.29), for the three months ended March 31, 2002 and 2001, respectively, as a result of the various factors noted above.

Significant Event. We have previously announced and reported that in January 2002 we restructured our service agreement with California Federal Bank, our major client. The restructured agreement is for four years and is effective in September 2002. Starting then, we will only be providing to the customers of California Federal Bank our bill presentment and payment services. Had this restructured agreement become effective on January 1, 2002, our revenue for the quarter ended March 31, 2002 would have been reduced approximately 9.9% and the amount of our gross profit would have declined approximately 3.7%.

LIQUIDITY AND CAPITAL RESOURCES

Cash and investments in available for sale securities decreased $1.0 million to $6.7 million from $7.7 million as of March 31, 2002 and December 31, 2001, respectively, primarily as a result of capital expenditures of $1.1 million.

Net cash provided by operating activities was $170,000 for the three months ended March 31, 2002. The increase resulted primarily from our normal business operations for the three months ended March 31, 2002.

Net cash provided by investing activities for the three months ended March 31, 2002 was $70,000, which reflected the net reduction of $1.2 million in available for sale securities offset in part by capital expenditures of $1.1 million.

Net cash provided by financing activities was $21,000 for the three months ended March 31, 2002 relating primarily to proceeds of $86,000 from issuance of common stock partially offset by capital lease payments of $65,000. At March 31, 2002, we had cash and cash equivalents of $2.4 million, investments in available for sale securities of $4.3 million, working capital of $8.2 million, long-term obligations of $12.8 million and stockholder equity of $4.8 million.

We currently believe that cash, cash equivalents and investment balances will be sufficient to meet our current anticipated operating 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.

	MARCH 31, 2002		
	BOOK VALUE	FAIR VALUE	INTEREST RATE
U.S. government treasury obligations	$2,808,832	$2,804,823	2.53%
Commercial bonds	1,537,095	1,539,920	2.53%
Total investments	$4,345,927	$4,344,743	

The long-term debts on March 31, 2002 are comprised of convertible subordinated notes with an 8% fixed interest rate and capital lease obligations with interest rates ranging from 4% to 13%. 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.

None

ITEM 5. OTHER INFORMATION.

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(A) Exhibits required to be filed by Item 601 of Regulation S-K.

Exhibit No.	Description of Exhibit
4.1	Registration Rights Agreement dated January 11, 2002 among the Registrant an American Stock Transfer & Trust Company as Rights agent (Filed as Exhibit 4.

filed on January 15, 2002 and incorporated herein by reference.)

(B) Reports on Form 8-K

On January 15, 2002, Registrant filed a current report on Form 8-K disclosing that, effective January 11, 2002, its Board of Directors adopted a stockholder rights plan designed to protect the interest of the stockholders in the event of an unsolicited attempt to acquire the Company.

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: May 15, 2002 By: /s/ Matthew P. Lawlor

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

Date: May 15, 2002 By: /s/ Catherine A. Graham

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