VALASSIS COMMUNICATIONS INC
Form 10-Q
November 08, 2010
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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 September 30, 2010

¨ **Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission File Number: 1-10991

VALASSIS COMMUNICATIONS, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**38-2760940**
(State or Other Jurisdiction of	**(IRS Employer**
Incorporation or Organization)	**Identification Number)**

19975 Victor Parkway

Livonia, Michigan 48152

(address of principal executive offices)

Registrant s Telephone Number: (734) 591-3000

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes ¨ No x

As of November 1, 2010, there were 49,655,221 shares of the Registrant s Common Stock outstanding.

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Valassis Communications, Inc.

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Quarter Ended September 30, 2010

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Part I - Financial Information

Item 1. Financial Statements

VALASSIS COMMUNICATIONS, INC.

Condensed Consolidated Balance Sheets

(U.S. dollars in thousands)

(unaudited)

Assets	**September 30, 2010**	**December 31, 2009**
Current assets:		
Cash and cash equivalents	$ 208,520	$ 129,846
Accounts receivable (less allowance for doubtful accounts of $6,934 at September 30, 2010 and $7,593 at December 31, 2009)	419,259	428,836
Inventories:		
Raw materials	31,049	23,263
Work in progress	12,712	17,209
Prepaid expenses and other	37,397	37,046
Refundable income taxes		12,578
Total current assets	**708,937**	**648,778**
Property, plant and equipment, at cost:		
Land and buildings	44,613	44,285
Machinery and equipment	220,422	218,397
Office furniture and equipment	219,369	206,931
Automobiles	1,212	1,266
Leasehold improvements	28,325	28,896
	513,941	499,775
Less accumulated depreciation and amortization	(336,259)	(301,874)
Net property, plant and equipment	177,682	197,901
Intangible assets (Note 3):		
Goodwill	636,471	640,073
Other intangible assets, net	236,973	238,859
Net intangible assets	**873,444**	**878,932**
Investments	2,782	2,298

Other assets		13,002		16,113
Total assets	**$**	**1,775,847**	**$**	**1,744,022**

See accompanying notes to condensed consolidated financial statements.

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VALASSIS COMMUNICATIONS, INC.

Condensed Consolidated Balance Sheets, Continued

(U.S. dollars in thousands)

(unaudited)

Liabilities and Stockholders Equity	**September 30, 2010**	**December 31, 2009**
Current liabilities:		
Current portion long-term debt (Note 4)	$ 7,074	$ 6,197
Accounts payable	293,810	338,418
Accrued interest	1,742	15,103
Accrued compensation and benefits	47,572	53,258
Accrued other expenses	38,886	59,275
Progress billings	51,453	40,532
Income taxes payable	12,160	
Deferred income taxes	66	22
Total current liabilities	**452,763**	**512,805**
Long-term debt (Note 4)	700,919	1,004,875
Other non-current liabilities	51,141	40,567
Deferred income taxes	90,952	87,914
Commitments and contingencies (Note 5)		
Stockholders equity:		
Preferred stock ($0.01 par value; 25,000,000 shares authorized; no shares issued or outstanding at September 30, 2010 and December 31, 2009		
Common stock ($0.01 par value; 100,000,000 shares authorized; 65,071,749 and 64,241,359 shares issued at September 30, 2010 and December 31, 2009, respectively; 49,577,162 and 48,762,242 shares outstanding at September 30, 2010 and December 31, 2009, respectively)	651	642
Additional paid-in capital	122,203	98,927
Retained earnings	883,343	522,731
Accumulated other comprehensive income (loss)	574	(4,269)
Treasury stock, at cost (15,494,587 and 15,479,117 shares at September 30, 2010 and December 31, 2009, respectively)	(526,699)	(520,170)
Total stockholders equity	**480,072**	**97,861**
Total liabilities and stockholders equity	**$ 1,775,847**	**$ 1,744,022**

See accompanying notes to condensed consolidated financial statements.

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VALASSIS COMMUNICATIONS, INC.

Condensed Consolidated Statements of Income

(U.S. dollars in thousands, except per share data)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenues	$ 572,406	$ 544,064	$ 1,702,358	$ 1,639,256
Costs and expenses:				
Cost of products sold	421,510	407,572	1,248,664	1,245,105
Selling, general and administrative	91,800	90,660	275,421	263,547
Amortization expense	3,156	3,156	9,467	9,468
Total costs and expenses	516,466	501,388	1,533,552	1,518,120
Gain from litigation settlement (Note 6)			490,085	
Earnings from operations	55,940	42,676	658,891	121,136
Other expenses (income):				
Interest expense	14,091	23,172	52,084	66,201
Interest income	(116)	(87)	(510)	(491)
Loss (gain) on extinguishment of debt (Note 4)		(609)	23,873	(9,388)
Other income, net	(2,120)	(1,182)	(4,471)	(3,864)
Total other expenses, net	11,855	21,294	70,976	52,458
Earnings before income taxes	44,085	21,382	587,915	68,678
Income tax expense	17,106	7,582	227,303	25,902
Net earnings	$ 26,979	$ 13,800	$ 360,612	$ 42,776
Net earnings per common share, basic (Note 8)	$ 0.55	$ 0.29	$ 7.33	$ 0.89
Net earnings per common share, diluted (Note 8)	$ 0.52	$ 0.28	$ 6.93	$ 0.87
Shares (in thousands) used in computing net earnings per share, basic (Note 8)	49,138	48,008	49,216	47,992
Shares (in thousands) used in computing net earnings per share, diluted (Note 8)	51,995	49,586	52,033	49,343

See accompanying notes to condensed consolidated financial statements.

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VALASSIS COMMUNICATIONS, INC.

Condensed Consolidated Statements of Cash Flows

(U.S. dollars in thousands)

(unaudited)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Cash flows from operating activities:		
Net earnings	$ 360,612	$ 42,776
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization of intangibles	45,919	52,025
Amortization of debt issuance costs	1,855	2,467
Provision for losses on accounts receivable	3,577	4,644
Loss (gain) on debt extinguishment, net of premiums and fees	3,429	(9,388)
Loss on derivatives, net	14,586	4,570
Loss (gain) on sale of property, plant and equipment	62	(184)
Gain on equity investments	(3,963)	(3,263)
Stock-based compensation charge	22,371	5,572
Deferred income taxes	10,749	998
Changes in assets and liabilities which increase (decrease) cash flow:		
Accounts receivable	6,000	59,059
Inventories	(3,289)	13,849
Prepaid expenses and other	697	5,427
Other assets	1,484	2,579
Other liabilities	14,177	2,506
Accounts payable	(44,606)	(37,578)
Accrued expenses, compensation and interest	(47,112)	3,455
Income taxes	24,738	(7,925)
Progress billings	10,921	(4,233)
Total adjustments	61,595	94,580
Net cash provided by operating activities	422,207	137,356
Cash flows from investing activities:		
Additions to property, plant and equipment	(16,447)	(13,505)
Additions to intangible assets	(7,581)	
Proceeds from sale of property, plant and equipment	59	96
Net cash used in investing activities	(23,969)	(13,409)
Cash flows from financing activities:		
Borrowings of long-term debt		20,000
Payments of long-term debt	(303,079)	(159,817)
Financing costs		(937)
Repurchase of common stock	(58,225)	
Proceeds from issuance of common stock	41,603	537

Net cash used in financing activities	(319,701)	(140,217)
Effect of exchange rate changes on cash	137	579
Net increase (decrease) in cash	78,674	(15,691)
Cash at beginning of period	129,846	126,556
Cash at end of period	$ 208,520	$ 110,865
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	$ 63,894	$ 66,397
Cash paid during the period for income taxes	$ 188,804	$ 31,390
Non-cash financing activities:		
Stock issued under stock-based compensation plan	$ 1,592	$ 20

See accompanying notes to condensed consolidated financial statements.

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VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. 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 (generally accepted accounting principles) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the information contained herein reflects all adjustments necessary for a fair presentation of the information presented. All such adjustments are of a normal recurring nature. The results of operations for the interim periods are not necessarily indicative of results to be expected for the fiscal year. For further information, refer to the consolidated financial statements and footnotes thereto included in the Valassis Communications, Inc. (Valassis, the Company, we or our) Annual Report on Form 10-K for the year ended December 31, 2009 (the 2009 Form 10-K).

Gains on extinguishment of debt of $0.6 million and $9.4 million for the three and nine months ended September 30, 2009, respectively, which were previously included in Other income, net in the condensed consolidated statements of income, have been reclassified as a separate line item to conform to the current presentation.

2. NEW ACCOUNTING PRONOUNCEMENTS

RECENTLY ADOPTED

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-06, Improving Disclosures about Fair Value Measurements. ASU No. 2010-06 require companies to: (1) disclose separately the amounts of significant transfers between Level 1 and Level 2 of the fair value hierarchy, (2) disclose activity in Level 3 fair value measurements including transfers into and out of Level 3 and the reasons for such transfers, and (3) present separately in its reconciliation of recurring Level 3 measurements information about purchases, sales, issuances and settlements on a gross basis. The adoption of this new guidance did not impact our financial condition, results of operations or liquidity.

In February 2010, the FASB issued ASU No. 2010-09, Amendments to Certain Recognition and Disclosure Requirements to eliminate the requirement for public companies to disclose the date through which subsequent events have been evaluated. We will continue to evaluate subsequent events through the date of the issuance of the financial statements; however, consistent with this guidance, the date will no longer be disclosed.

YET-TO-BE ADOPTED

In October 2009, the FASB issued ASU No. 2009-13, Multiple-Deliverable Revenue Arrangements which addresses the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. ASU No. 2009-13 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. We are currently evaluating the impact, if any, of the adoption of ASU No. 2009-13 on our financial statements and will adopt ASU No. 2009-13 in the first quarter of 2011.

VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements (Continued)

(unaudited)

3. GOODWILL AND OTHER INTANGIBLES

Goodwill as of September 30, 2010 and December 31, 2009 was comprised of:

(in thousands of U.S. dollars)	September 30, 2010	December 31, 2009
Goodwill:		
Shared Mail	$ 534,184	$ 534,184
Neighborhood Targeted	5,325	5,325
Free-standing Inserts	22,357	22,357
International, Digital Media & Services	74,605	78,207
Total goodwill	**$ 636,471**	**$ 640,073**

During the nine months ended September 30, 2010, we disposed of a reporting unit within the International, Digital Media & Services segment, which resulted in a $3.6 million reduction in goodwill and the cancellation of a related note payable. No material gain or loss was recognized related to this transaction.

The components of other intangible assets are as follows:

	September 30, 2010				December 31, 2009			
(in thousands of U.S. dollars)	Gross Amount	Accumulated Amortization	Net Amount	Weighted Average Remaining Useful Life (in years)	Gross Amount	Accumulated Amortization	Net Amount	Weighted Average Remaining Useful Life (in years)
Amortizing intangible assets								
Mailing lists, non compete agreements, patents and other	$ 48,036	$ (7,364)	$ 40,672	15.2	$ 40,455	$ (5,847)	$ 34,608	17.1
Customer relationships	140,000	(31,340)	$ 108,660	10.2	140,000	(23,390)	116,610	11.0
Non-amortizing intangible assets								
Valassis name, tradenames, trademarks, and other	87,641		87,641		87,641		87,641	
	$ 275,677	$ (38,704)	$ 236,973		$ 268,096	$ (29,237)	$ 238,859	

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VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements (Continued)

(unaudited)

4. LONG-TERM DEBT

Long-term debt is summarized as follows:

(in thousands of U.S. dollars)	September 30, 2010	December 31, 2009
Senior Secured Revolving Credit Facility	$	$
Senior Secured Convertible Notes due 2033, net of discount	58	58
8 1/4% Senior Notes due 2015	242,224	540,000
Senior Secured Term Loan B	349,198	353,624
Senior Secured Delayed Draw Term Loan	116,513	117,390
	707,993	1,011,072
Less current portion	7,074	6,197
Total long-term debt	**$ 700,919**	**$ 1,004,875**

On April 15, 2010, we entered into the second amendment to our senior secured credit facility (the Second Amendment). The Second Amendment, among other things:

permits us to use up to $325 million to repurchase our outstanding 8 1/4% Senior Notes due 2015 (the 2015 Notes) through April 15, 2011;

provides us flexibility to extend the maturity of the revolving line of credit portion of the senior secured credit facility beyond the current expiration date of March 2, 2012;

allows us additional features with respect to any future convertible or exchangeable debt securities;

reduced the aggregate revolving credit commitments under the senior secured credit facility from $100 million to $50 million; and

increased by 50 basis points the interest rate margins applicable to borrowings under the senior secured credit facility.

On May 12, 2010, we commenced a cash tender offer (the Tender Offer) to purchase up to $270 million aggregate principal amount of the 2015 Notes at a purchase price equal to $1,070 per $1,000 principal amount of the 2015 Notes purchased, plus accrued and unpaid interest. On June 11, 2010, we purchased $269.9 million aggregate principal amount of the 2015 Notes validly tendered pursuant to the terms of the Tender

Offer. In addition, during the nine months ended September 30, 2010, we purchased in the open market an additional $27.9 million aggregate principal amount of the 2015 Notes at weighted-average purchase prices of $1,056 per $1,000 principal amount of the 2015 Notes purchased, plus accrued and unpaid interest. We recognized a pre-tax loss on extinguishment of debt of $23.9 million during the nine months ended September 30, 2010, which represents the amount of the purchase price of the 2015 Notes in excess of the principal amount of the 2015 Notes purchased and the proportionate write-off of related capitalized debt issuance costs.

During the three and nine months ended September 30, 2009, we repurchased, at a discount to par, aggregate principal amounts of $39.3 million and $93.7 million, respectively, of outstanding term loans under our senior secured credit facility, pursuant to modified Dutch auctions for aggregate purchase prices of $38.7 million and $84.3 million, respectively, including fees. As a result of these repurchases, during the three and nine months ended September 30, 2009, we recognized pre-tax gains of $0.6 million and $9.4 million, respectively, which represent the difference between the face amounts (par value) of the term loans repurchased and the actual repurchase prices of the term loans, including fees.

The estimated fair market value of our debt was $6.0 million above carrying value and $18.4 million below carrying value as of September 30, 2010 and December 31, 2009, respectively. The fair market value was estimated based on borrowing rates currently available for bank loans with similar terms and average maturities.

VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements (Continued)

(unaudited)

As of September 30, 2010, we had total outstanding letters of credit of approximately $9.9 million.

5. COMMITMENTS AND CONTINGENCIES

Upon its completion of the acquisition of ADVO, Inc. (ADVO), the Company assumed responsibility for ADVO s pending securities class action lawsuits. In September 2006, three securities class action lawsuits (Robert Kelleher v. ADVO, Inc., et al., Jorge Cornet v. ADVO, Inc., et al., Richard L. Field v. ADVO, Inc., et al.) were filed against ADVO and certain of its officers in the United States District Court for the District of Connecticut by certain ADVO shareholders seeking to certify a class of all persons who purchased ADVO stock between July 6, 2006 and August 30, 2006. The cases were consolidated under a single action titled Robert Kelleher et al. v. ADVO, Inc., et al., Civil Case No. 3:06CV01422(AVC) and a consolidated amended complaint was filed on June 8, 2007. The complaint generally alleges ADVO violated federal securities law by making a series of materially false and misleading statements concerning ADVO s business and financial results in connection with the proposed merger and, as a result, the price of ADVO s stock was allegedly inflated.

On August 24, 2007, the defendants filed a Motion to Dismiss the complaint, which was denied. On August 29, 2008, plaintiff moved for certification of the case as a class action. This motion was granted on March 27, 2009. On October 28, 2009, the parties entered into an agreement providing for the settlement of the action and filed papers seeking preliminary approval of a settlement agreement in the United States District Court for the District of Connecticut. Following preliminary approval of the settlement and notice, on March 3, 2010 the Court issued its order of final approval of the settlement. No appeal was filed from the final order and the settlement amount of $12.5 million was paid from the proceeds of ADVO s directors and officers insurance policy, with no adverse impact to Valassis financial statements.

The application and interpretation of applicable state sales tax laws to certain of our products is uncertain. Accordingly, we may be exposed to additional sales tax liability to the extent various state jurisdictions determine that certain of our products are subject to such jurisdictions sales tax. We have recorded a liability of $9.6 million, reflecting our best estimate of our potential sales tax liability.

In addition to the above matters, we are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on our financial position, results of operations or liquidity.

6. GAIN FROM LITIGATION SETTLEMENT

On January 30, 2010, we announced that we had reached an agreement to settle our outstanding lawsuits against News America Incorporated, a/k/a News America Marketing Group, News America Marketing, FSI, Inc. a/k/a News America Marketing FSI, LLC and News America Marketing In-Store Services, Inc. a/k/a News America Marketing In-Store Services, LLC (collectively News). The operative complaint alleged violations of the Sherman Act and various state competitive statutes and the commission of torts by News in connection with the marketing and sale of FSI space and in-store promotion and advertising services.

On February 4, 2010, we executed a settlement agreement and release (the Settlement Agreement) with News, and pursuant to the terms of the Settlement Agreement, News paid us $500.0 million. News America, Inc. also entered into a 10-year shared mail distribution agreement with our subsidiary, Valassis Direct Mail, Inc., which provides for our sale of certain shared mail services to News on specified terms.

In connection with the settlement, the parties are working with the Court, under the Honorable Arthur J. Tarnow, on a set of procedures to handle future disputes among the parties with respect to conduct at issue in the litigation. The precise timing and form of the relief rests with the Court.

The settlement resolves all outstanding claims between us and News as of February 4, 2010. As a result, the parties agreed to dismiss all outstanding litigation between them and release all existing and potential claims against each other that were or could have been asserted in the litigation as of the date of the Settlement Agreement.

During the first quarter of 2010, in connection with the successful settlement of these lawsuits, we made $9.9 million in related payments, including special bonuses to certain of our employees (including our executive officers identified as the named executive

VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements (Continued)

(unaudited)

officers in our proxy statement filed with the SEC on March 30, 2010) in an aggregate amount of $8.1 million. These expenses were netted against the $500.0 million of proceeds received, and the net proceeds of $490.1 million have been recorded as a separate line item Gain from litigation settlement in our condensed consolidated statement of income for the nine months ended September 30, 2010.

7. STOCK-BASED COMPENSATION

The following table summarizes stock-based compensation expense included in selling, general and administrative expenses for the periods indicated:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
(in millions of U.S. dollars)	**2010**	**2009**	**2010**	**2009**
Stock-based compensation expense	$ 8.6	$ 2.8	$ 22.4	$ 5.6

Generally, stock-based compensation expense is recognized by applying the straight-line attribution method over the requisite service period to the grant-date fair value. The grant-date fair value of stock option awards is calculated using a Black-Scholes valuation model, while the grant-date fair value of restricted stock awards is equal to the closing price of the stock on the date of grant. The increases in stock-based compensation expense for the three and nine months ended September 30, 2010 as compared to the respective prior year periods resulted from the accelerated recognition of previously unrecognized stock-based compensation expense related to the following:

- The appreciation of our stock price, which triggered the accelerated vesting of certain executives stock options and the immediate recognition of related stock-based compensation expense; and

- Our adoption of a new policy applicable to both outstanding and future stock option and restricted stock awards to employees and directors that provides for the continued vesting and exercisability in accordance with the terms as originally granted of any outstanding stock options or restricted stock awards held by a grantee, if the grantee has satisfied specified service and age requirements at the time the grantee s employment or directorship with the Company terminates. As a result of this new policy, we recognized previously unrecognized compensation expense that we would have been required to expense in future periods related to grantees who have met or will meet the specified service and age requirements prior to the original vesting date.

Total compensation expense related to non-vested stock options and restricted stock not yet recognized at September 30, 2010 was approximately $12.6 million, which we expect to recognize as compensation expense over the next five years.

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VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements (Continued)

(unaudited)

8. EARNINGS PER SHARE

Earnings per common share (EPS) data were computed as follows:

(in thousands of U.S. dollars, except per share data)	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Net earnings	$ 26,979	$ 13,800	$ 360,612	$ 42,776
Basic EPS:				
Weighted average common shares outstanding	49,138	48,008	49,216	47,992
Earnings per common share - basic	$ 0.55	$ 0.29	$ 7.33	$ 0.89
Diluted EPS:				
Weighted average common shares outstanding	49,138	48,008	49,216	47,992
Weighted average shares issued on exercise of dilutive options and restricted shares	8,368	3,381	8,303	2,584
Shares purchased with assumed proceeds of options and unearned restricted shares	(5,520)	(1,814)	(5,495)	(1,244)
Shares contingently issuable	9	11	9	11
Shares applicable to diluted earnings	51,995	49,586	52,033	49,343
Earnings per common share - diluted	$ 0.52	$ 0.28	$ 6.93	$ 0.87