ONLINE RESOURCES CORP
Form 10-K
March 16, 2006

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

Form 10-K

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

For the fiscal year ended December 31, 2005

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 Number)*
4795 Meadow Wood Lane, Suite 300 **Chantilly, Virginia** *(Address of principal executive offices)*	**20151** *(Zip code)*

(703) 653-3100
(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:

Title of Each Class
Common Stock, $0.0001 par value per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No þ

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer o Accelerated Filer þ Non-accelerated filer o

The aggregate market value of the registrant s voting and non-voting common stock held by non-affiliates of the registrant (without admitting that any person whose shares are not included in such calculation is an affiliate) computed by reference to $11.31 as of the last business day of the registrant s most recently completed second fiscal quarter was $283 million.

As of March 10, 2006, the registrant had 25,372,966 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The following documents (or parts thereof) are incorporated by reference into the following parts of this Form 10-K: Certain information required in Part III of this Annual Report on Form 10-K is incorporated from the Registrant s Proxy Statement for the Annual Meeting of Stockholders to be held on May 4, 2006.

ONLINE RESOURCES CORPORATION

ANNUAL REPORT ON FORM 10-K

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements that involve risks and uncertainties. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expect, anticipate, intend, plan, believe, estimate, potential, continue, the negative of these terms or other comparable terminolo statements are only predictions. Actual events or results may differ materially from any forward-looking statement. In evaluating these statements, you should specifically consider various factors, including the risks outlined under Risk Factors in Item 1 of Part I.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of the forward-looking statements. We undertake no obligation to update publicly any forward-looking statements for any reason after the date of this Annual Report on Form 10-K.

PART I

Item 1. *Business Overview*

Online Resources provides outsourced, Internet financial technology services, branded to over 800 financial services provider clients nationwide. We have over 4 million active consumer and business end-users of our services. An estimated 39 million additional members or customers of our clients are eligible to register for the services we provide. End-users may access and view their accounts online and perform various web-based self-service functions. They may also make electronic bill payments and funds transfers, utilizing our unique, real-time debit architecture. Additionally, we believe our value-added relationship management services reinforce a favorable user experience and drive a profitable and competitive Internet channel for our clients. Multi-year service contracts with these clients provide us with a recurring and predictable revenue stream that grows with increases in users and transactions. We currently derive 15% of our revenues from account presentation, 60% from payments and 25% from relationship management and professional services and other revenues.

We provide the following specialized product offerings for three vertical financial services markets banks and credit unions, credit card issuers and payment acquirers:

> Our *Quotien*sm product line is designed for banks, credit unions and other depository financial institutions. We provide a fully integrated suite of web-based banking and payment services, giving clients a single point of accountability, an enhanced experience for their users and the marketing processes to drive Internet channel adoption. We also offer our electronic bill payment services on a stand-alone basis. Our bill payment service uses our patented payments gateway, which leverages the nation s real-time electronic funds transfer, also known as EFT, infrastructure. By debiting end-users accounts in real-time, we are able to improve the speed, cost and quality of payments, while eliminating the risk that bills will be paid against unavailable funds. We process over $15 billion in bill payments annually.
>
> Our *Incurrent*sm product line is designed for credit card issuers and processors. Cardholders may access their account information, view transactions, set up payments and perform other self-service functions. Additionally, we offer card issuers a low-cost, web-based inquiry service, which allows cardholders to clearly identify merchants in disputed card transactions. We also offer a web-based tool that improves collections of late and delinquent funds in a private, non-confrontational manner. Incurrent Solutions, Inc. (Incurrent), which we acquired in December 2004, developed our credit card services. We plan to adapt and offer our payment and relationship management services to credit card issuers and processors as well.
>
> Our *CertnFunds*sm product line has been recently introduced and is designed for e-commerce providers, primarily payment acquirers and large online billers. These services, which enable real-time debit for a variety of web-originated consumer payments and fund transfers, use our patented EFT payments gateway. This gateway has operated for over 10 years as the backbone for our bank and credit union bill payment business. By routing their web-originated consumer payments through our CertnFunds platform, payment acquirers and billers can lower their transaction costs, and increase the speed and certainty of collections.

We believe our domain expertise fulfills the large and growing need among both smaller financial services providers, who lack the internal resources to build and operate web-based financial services, and larger providers, who choose to outsource niche portfolios in order to use their internal resources elsewhere. We also believe that, because our business requires significant infrastructure along with a high degree of flexibility, real-time solutions, and the ability to integrate financial information and transaction processing with a low tolerance for error, there are significant

barriers to entry for potential competitors.

We are headquartered in Chantilly, Virginia. We also maintain operations facilities in Parsippany, New Jersey, Woodland Hills, California and Pleasanton, California and a data center facility in McLean, Virginia. We were incorporated in Delaware in 1989.

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Our Industry

The Internet continues to grow in importance as an account presentation and payments channel for consumers and small businesses, driven in part by the 24 hours a day, seven days a week access to financial services providers that it makes available. Offering services through this channel allows financial services providers to enhance their competitive positions and gain market share by retaining their existing end-users, aggressively attracting new ones and expanding the end-user relationship. As referenced in its January 21, 2004 Online Banking Report, Jupiter Media Metrix, a technology research and advisory firm, supported this growth proposition for the bank and credit union market when it estimated that the number of U.S. households banking online will grow from 31.4 million in 2003 to 54.6 million in 2007.

Financial services providers are also increasing access to their services through the Internet in order to increase profitability. The advantages provided by a web-based channel include the opportunity to offer financial services to targeted audiences while reducing or eliminating workload, paper and other back office expenses associated with traditional distribution channels. The Boston Consulting Group, a financial research and advisory firm, conducted a study in 2003 of the depository financial institution market. It concluded that online bill payment customers of depository financial institutions were up to 40 percent more profitable at the end of a 12-month period compared to those customers who did not pay bills online, because the online bill payment customers:

- generate significantly higher revenues than offline customers by using more banking products and services and maintaining higher account balances;
- cost less to serve because online users tend to utilize more self-service functions and therefore interact with the more costly retail branch and call center service channels less frequently than offline customers; and
- are less likely to move their accounts to other financial institutions than offline customers.

This further supported the conclusions published in Bank of America s 2002 control group study, in which it reported that online bill payers were 31% more profitable for the bank than non-bill payers. Bank of America also concluded that online bill payers were less likely to move their accounts to other banks. Consequently, Bank of America and many other large financial institutions have eliminated their monthly end-user fees for online bill payment and launched aggressive marketing campaigns to promote adoption of the online channel. A rapidly growing segment of smaller financial institutions has also eliminated online bill payment fees and responded with similar marketing campaigns. This represents a positive trend for us because the elimination of online bill payment fees has generated significant increase in end-user adoption, more than offsetting any volume pricing discounts we may extend to our clients.

The largest U.S. financial services providers typically develop and maintain their own hosted solution for the delivery of web-based financial services. By contrast, the majority of small to mid-sized providers, including the approximately 18,000 banks and credit unions in the U.S. with assets of less than $20 billion, prefer to outsource their web-based financial services initiatives to a technology services provider. These smaller providers understand that they need to provide an increasing level of web-based services, but frequently lack the capital, expertise, or information technology resources to develop and maintain these services in-house.

Many of the factors driving the outsourcing of web-based financial services in the depository financial institution market are also driving the outsourcing of similar services in the credit card issuer and processor market. For example, credit card issuers are reducing operating costs while increasing cardholder loyalty as greater numbers of cardholders use the web to manage their credit card accounts. FiSite Research, a market research firm, reports that 53% of online consumers are using the Internet to manage their credit card accounts while almost one-third of these consumers use

the Internet to pay their credit card bills. Moreover, FiSite reports that almost two-thirds of those managing their credit card accounts online rate this experience as very to extremely satisfying. Such high satisfaction suggests increasing consumer adoption and usage of the online channel to manage credit card accounts. Additionally, large credit card issuers are often outsourcing web-based services for smaller niche card offerings in order to devote their internal IT resources to their core offerings.

Although the majority of financial services providers offer varying degrees of web-based services, and continue to look to technology to further improve operations and overall results, they are facing new obstacles created by technology adoption, including:

managing multiple technology vendors to provide account presentation, payments and other services;

providing integrated end-user support to an increasingly sophisticated client base;

understanding how to evaluate and enhance channel profitability; and

maximizing the value of the channel by increasing adoption.

As a technology services provider, we assist our clients in meeting these challenges by delivering outsourced account presentation, payments and relationship management solutions.

Our Solution

We provide proprietary account presentation, payments and relationship management services that enable our clients to maintain a competitive and profitable web-based channel. As an outsourcer, we bring economies of scale and technical expertise to our clients who would otherwise lack the resources to compete in the rapidly changing, complex financial services industry. We believe our services provide our clients with a cost-effective means to retain and expand their end-user base, deliver their services more efficiently and strengthen their end-user relationships, while competing successfully against offerings from other financial services providers. We provide our services through:

Our Technology Infrastructure. We connect to our clients, their core processors, their end-users and other financial services providers through our integrated communications, systems, processing and support capabilities. For our account presentation services, we employ both real-time and batch communications and processing to ensure reliable delivery of current financial information to end-users. For our payment services we use our patented process to ensure real-time funds availability and process payments through a real-time EFT gateway. This gateway consists of over 50 certified links to ATM networks and core processors, which in turn have real-time links to virtually all of the nation s consumer checking accounts. These key links were established on a one-by-one basis throughout our history and enable us to access end-user accounts in order to draw funds to pay bills as requested. This gateway infrastructure has improved the cost, speed and quality of our bill payment services for the banking and credit union community and is a significant differentiator for us in our marketplace. We believe this infrastructure is difficult to replicate and creates a significant barrier to entry for potential payment services competitors.

Our Operating and Technical Expertise. After more than a decade of continuous operating experience, we have established the processes, procedures, controls and staff necessary to provide our clients secure, reliable services. Further, this experience, coupled with our scale and industry focus, allows us to invest efficiently in new product development on our clients behalf. We add value to our clients by relieving them of the research and development required to provide highly competitive web-based services.

Our Integrated Marketing Process. We use a unique integrated consumer management process that combines data, technology and multiple consumer contact points to activate, support and sell new services to our bank and credit union end-users. This proprietary process not only provides, in our opinion, a superior end-user experience, it also creates new sales channels for our clients products and services, including the ones we offer. This enables us to increase adoption rates of our services. Using this process, we are able to sell multiple products to consumers, which ultimately makes them more profitable for our clients. For example, the success of our proprietary process is evident in our ability to cause the users of our account presentation services to add bill payments to their services at

approximately twice the estimated average industry rate.

Our Support Services. Our clients can purchase one or more of a comprehensive set of support services to complement our account presentation and payments services. These services include our web site design and hosting, training, information reporting and analysis, and other professional services.

Our Strategy

Our objective is to become the leading supplier of outsourced account presentation and payments services to banks and credit unions, credit card issuers and payment acquirers. Our strategy for achieving our objectives is to:

Grow Our Client Base. Our clients have traditionally been regional and community-based depository financial institutions with assets of under $10 billion. These small to mid-sized financial services providers are compelled to keep pace with the service and technology standards set by larger financial services providers in order to stay competitive, but often lack the capital and human resources required to develop and manage the technology infrastructure required to provide web-based services. With our June 2005 acquisition of Integrated Data Systems, Inc. (IDS), we have obtained relationships with larger depository financial institutions along with the highly customizable applications and professional services expertise to support expansion in this market segment. With our December 2004 acquisition of Incurrent, we have entered the credit card market, servicing mid-sized credit card issuers, processors for smaller issuers and large issuers who use us to service one or more of their niche portfolios. We believe that both our depository and credit card financial services providers can benefit from our flexible, cost-effective technology, and we intend to continue to market and sell our services to them under long-term recurring revenue contracts. As of December 31, 2005, we had 829 financial services provider clients, up 15% from December 31, 2004, at which time we had 723 financial services provider clients.

Increase Adoption Rates. Our clients typically pay us either usage or license fees based on their number of end-users and volume of transactions. Registered end-users using account presentation and payments services are the major drivers of our recurring revenues. Using our proprietary marketing processes, we will continue to assist our clients in growing the adoption rates for our services. At December 31, 2005, 29.0% of the 2.0 million checking accounts and 17.3% of the 16.3 million estimated active credit card accounts eligible to use our account presentation services were enrolled to do so. Additionally, at December 31, 2005, 9.6% of the 10.2 million checking accounts eligible for payments services were using these services.

Extend Target Markets. We believe that many of our services have application in new markets. We continue to look for opportunities to offer both our payments and funds transfer services and our value-added relationship management services to new market segments. For example, our recently introduced *CertnFunds*^{sm} product line extends the payments services we offer to banks and credit unions though our EFT payments gateway to e-commerce providers such as payment acquirers and large online billers. We will continue to pursue opportunities, either through acquisition or product extension, to enter related markets well suited for our proprietary services and technologies.

Provide Additional Products and Services to Our Installed Client Base. We intend to continue to leverage our installed client base by expanding the range of new products and services available to our clients, through internal development, partnerships and alliances. For example, in May 2003, we introduced *Money HQ*^{sm}, a product that integrates account aggregation, bill presentment and money movement capabilities across multiple financial institutions. In the credit card market, we have recently introduced a collections support product that allows credit card issuers to direct past due end-users to a website where they can set up payment plans and schedule payments. We also introduced a service that provides a profile of recognizable merchant names, logos, business descriptions, customer service contact information, and customer service policies to help resolve cardholders transaction issues. Additionally, we intend to adapt and offer our payment and relationship management services to the credit card market.

Maintain and Leverage Technological Leadership. We have a history of introducing innovative web-based financial services products for our clients. For example, we developed and currently obtain real-time funds through a patented EFT gateway with over 50 certified links to ATM networks and core processors. We were awarded additional patents covering the confidential use of payment information for targeted marketing that is integrated into our proprietary marketing processes. Our technology and integration expertise has further enabled us to be among the first to adopt an

outsourced web-based

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account presentation capability, and we pioneered the integration of real-time payments and relationship marketing.

We believe the scope and integration of our technology-based services give us a competitive advantage and with 75 personnel working on research and development, we intend to continue to maintain our technological leadership.

Pursue Strategic Acquisitions. To complement and accelerate our internal growth, we continue to explore acquisitions of businesses and products that will complement our existing institutional client offerings, extend our target markets and expand our client base.

Leverage Growth Over Our Relatively Fixed Cost Base. Our business model is highly scaleable. We have invested heavily in our processes and infrastructure and, as such, can add large numbers of clients and end-users without significant cost increases. We expect that, as our revenues grow, and as we begin to encounter the price pressures inherent to a maturing market, our cost structure will allow us to maintain or expand our operating margins.

Our Services

We provide our financial services provider clients with account presentation, payments, relationship management and custom solutions services that they, in turn, offer to end-users branded under their own names. Bank and credit union providers can purchase established service offerings in all four of our service lines. Established account presentation and custom solutions services are available for credit card providers, along with a new collections support service in the payments line and a new transaction dispute resolution service in the relationship management line. We are also now offering new payments services for payment acquirers and billers, with the first service being real-time account debit for online bill payment. The following chart depicts the services we now offer and plan to offer for the three markets we serve:

Our bank and credit union clients select one of two primary service configurations: full service, consisting of our integrated suite of account presentation, bill payment, customer care, end-user marketing and other support services; or stand-alone bill payment services. Our credit card clients use us for account presentation services, and we are offering our new payments and relationship marketing services to these clients and other card providers, either with or without account presentation services. We recently introduced real-time payment services for payment acquirers and billers.

Our clients typically enter into long-term recurring revenue contracts with us. Most of our services generate revenues from recurring monthly fees charged to the clients. These fees are typically fixed amounts for applications access or hosting, variable amounts based on the number of end-users or volume of transactions on our system, or a combination of both. Clients also separately engage our professional services capabilities for enhancement and maintenance of their applications.

In the banking market, our clients generally derive increased revenue, cost savings, account retention, increased payment speed and other benefits by offering our services to their end-users. Therefore, most of our clients offer the account presentation portion of our services free-of-charge to end-users and an increasing number are eliminating fees for bill payment services as well. In the credit card market, account presentation services are also typically offered to end-users free-of-charge, while usage based convenience fees may apply to certain payments services. Payment acquirers and billers also often charge convenience fees to their end-users for certain payment services.

Account Presentation Services. We currently offer account presentation services to banking and credit card markets. These services provide a comprehensive set of online capabilities that allow end-users to:

- view transaction histories and account balances;
- review and retrieve current and past statements;
- transfer funds and balances;
- initiate or schedule either one-time or recurring payments;
- access and maintain account information; and
- perform many self-service administrative functions.

In addition, we offer our banking clients a number of complementary services. We can provide these clients with either of two business banking services, a full cash management service for larger end-users and a basic business offering for small business end-users. Our web design and hosting capabilities give clients an integrated, outsourced solution for their informational web site. *Money HQ*sm allows end-users to obtain account information from multiple financial institutions, see their bills, transfer money between accounts at multiple financial institutions, make person-to-person payments and receive alerts without leaving their financial institution s web site. We also offer access to check images, check reorder, Quicken® interface, statement presentment and other functionality that enhances our solution.

Payments Services. For our banking clients, our web-based bill payment services may be bundled with our account presentation services or purchased as a stand-alone service integrated with a third-party account presentation solution. Our payments services are unique in the industry because they leverage the banking industry s ATM infrastructure through our real-time EFT gateway, which consists of over 50 certified links to ATM networks and core processors. Through this patented technology, our clients take advantage of existing trusted systems, security, clearing, settlement, regulations and procedures. End-users of our web-based payment service benefit from a secure, reliable, real-time direct link to their accounts. This enables them to schedule transactions using our intuitive web user interface. They can also obtain complete application support and payment inquiry processing through our customer care center. Additionally, clients offering our web-based payment services can enable their end-users to register for *Money HQ*sm.

Our remittance service is an attractive add-on service for banking providers of all sizes that run their own in-house online banking system, or for other providers of web-based banking solutions that lack a bill payment infrastructure.

Our remittance service enhances their systems by adding the extra functionality of bill payment processing, backed by complete funds settlement, payment research, inquiry resolution, and merchant services. End-users provide bill payment instructions through their existing online banking interface, which validates the availability of funds on the date bills are to be paid. On a daily basis, we receive a file of all bill payment requests from the financial institution. We process and remit the bill payments to the designated merchants or other payees and settle the transactions with our financial institution clients.

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For our credit card clients, we offer the ability to schedule either one-time or recurring payments to the provider through our account presentation software. We do not currently process those payments, but have plans to do so in the future. We have also recently introduced a new collections support product for credit card providers that allows them to direct past due end-users to a specialized website where they can review their balances, calculate and set up payment plans and make or schedule payments.

We have recently introduced our first service targeted toward billers and payment acquirers. Our real-time account debit allows billers and acquirers to accept payments from their customers at their web sites, and receive those funds immediately. This represents a significant advantage over other methods of payment, which can take one to three days to deliver the funds, especially in the case of past due or other high-risk payments.

Relationship Management Services. Our relationship management services consist of the customer care services we maintain for our bank and credit union clients, and the marketing programs we run on their behalf. Our customer care center, located in Chantilly, Virginia, responds to end-users questions relating to enrollment, transactions or technical support. End-users can contact one of our more than 50 consumer service representatives by phone, fax or e-mail 24 hours a day, seven days a week.

We view each interaction with an end-user or potential end-user as an opportunity to sell additional products and services, either our own or those offered by our clients. We use an integrated consumer management process as a significant service differentiator that is unique in the industry. It allows our traditionally small to mid-size financial institution client base to offer not only comprehensive support solutions to its consumers but also creates a sales channel and increases adoption of web-based services. This process combines data, technology and multiple consumer contacts to acquire and retain, and sell multiple services to, customers of our financial institution clients. Using this process, we help drive consumers through the online banking lifecycle, which ultimately makes these consumers more profitable for our clients. The success of our proprietary process is evident in our rate of up-selling account presentation customers to payments services at a rate that is approximately double the industry average.

We have recently introduced a new relationship management service targeted towards the credit card market. This service provides a profile of recognizable merchant names, logos, business descriptions, customer service contact information, and customer service policies to help resolve cardholders transaction issues. Often a cardholder does not recognize the merchant or transaction presented on their monthly statement. This service employs a patent-pending process to associate merchant information on the statement with detailed merchant information not available in the credit card billing process. Whether accessed directly by the cardholder or by a consumer service representative in a call center, providing clearer and more relevant information about the merchant increases the likelihood that the cardholder will recall the merchant and the transaction, the inquiry resolution effort will be greatly reduced, and disputes processing paperwork or chargebacks will be eliminated in many cases.

Custom Solutions Services. Our custom solutions services include implementation services, which convert existing data and integrate our platforms with the client s legacy host system or third party core processor, and ongoing maintenance of client specific applications or interfaces. Additionally, we offer professional services intended to tailor our services to meet the clients specific needs, including customization of applications, training of client personnel, and information reporting and analysis.

Third-Party Services. Though the majority of our technology is proprietary, embedded in our web-based financial services platforms are a limited number of service capabilities and content that are provided or controlled outside of our platform by third parties. These include:

fully integrated bill payment and account retrieval through Intuit s Quicken®;

check ordering available through Harland, Deluxe, Clarke American or Liberty;

inter-institution funds transfer and account aggregation provided by CashEdge;

check imaging provided by AFS, Bisys, Fiserv, FSI/ Vsoft, Empire, Intercept, and Mid-Atlantic; and

electronic statement through BIT Statement.

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Sales and Marketing

We seek to retain and expand our financial services provider client base, and to help our clients drive end-user adoption rates for our web-based services. As of December 31, 2005, our client services function consisted of 18 account managers who support and cross-sell our services to existing clients, a 20 person sales team focusing on new prospects, and a 13 person marketing department supporting both our sales efforts and those of our clients.

Our account managers focus primarily on helping our existing clients maximize the benefit of their web-based channel. They do this by introducing our extensive relationship management capabilities and supporting our clients own marketing programs. The account management team is also the first contact point for cross-selling new and enhanced services to our clients. Additionally, this team handles contract renewals and supports our clients in resolving operating issues.

Our sales team focuses on new client acquisition, either through direct contact with prospects or through our network of reseller relationships. Our target prospects are financial services providers who are either looking to replace their current web services provider, have no existing capability, or are looking for outsourced capability for a niche product line.

Our marketing department concentrates on two primary audiences: financial services providers and their end-users. Our corporate marketing team supports our sales efforts through marketing campaigns targeted at financial services provider prospects. It also supports account management through marketing campaigns and events targeted at existing financial services provider clients. Our consumer marketing team focuses on attracting and retaining end-users. It uses our proprietary integrated consumer management process, which combines consumer marketing expertise, cutting-edge technology using embedded ePiphany software, and our multiple consumer contact points.

Our Technology

Our systems and technology utilize both real-time and batch communications and processing to optimize reliability, scalability and cost. All of our systems are based on a multi-tiered architecture consisting of:

front-end servers proprietary and commercial communications software and hardware providing Internet and private communications access to our platform for end-users;

middleware proprietary and commercial software and hardware used to integrate end-user and financial data and to process financial transactions;

back-end systems databases and proprietary software which support our account presentation and payments services;

support systems proprietary and commercial systems supporting our end-user service and other support services; and

enabling technology software enabling clients and their end-users to easily access our platform.

Our systems architecture is designed to provide end-user access into one of two common databases. The first, for our bank and credit union clients, is integrated with our account presentation and payments services as well as our proprietary support services software. This integrated system also supports our payments offerings for payment acquirers and billers. The second database is integrated with our account presentation services for credit card clients.

Supplementary third-party financial services are linked to our systems through the Internet, which we integrate into our end-user applications and transaction processing. Incorporating such third-party capabilities into our system enables us to focus our technical resources on our proprietary middleware and integration capabilities.

We typically link to our clients or their core processors through the use of high-speed telecommunication circuits to facilitate the nightly download of account and transaction detail. We then use these same circuits to access the client or core processor databases when an end-user logs on to our systems to retrieve updated information. This approach allows us to deliver responsive, high performing and reliable services through the

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use of a local data warehouse, while ensuring presentation of the most current information and providing enhanced functionality through real-time use of our communications gateways.

For the processing of payments, we operate a unique, real-time EFT gateway, with over 50 certified links to ATM networks and core processors. This gateway, depicted below, allows us to use online debits to retrieve funds in real-time, perform settlement authentication and obtain limited supplemental financial information. By using an online payment network to link into a client s primary database for end-user accounts, we take advantage of established EFT infrastructure. This includes all telecommunications and software links, security, settlements and other critical operating rules and processes. Using this real-time payments architecture, clients avoid the substantial additional costs necessary to expand their existing infrastructure. We also believe that our real-time architecture is more flexible and scalable than traditional batch systems.

Note: This diagram is a representation of our gateway and does not include all links. Connections depicted are for illustrative purposes only.

Our payments gateway has allowed us to improve the cost, speed and quality of the bill payment services we provide to our bank and credit union clients. In addition to the benefits associated with bill payment, our ability to retrieve funds from end-user accounts in real-time is enabling us to develop the new payments services desired by financial services providers beyond our traditional client base. For example, we are now offering real-time account debit services to payment acquirers and billers. Other applications, such as the funding of stored value cards and the real-time movement of money between accounts at different financial institutions, are particularly well suited for our system of Internet delivery coupled with the real-time debiting of funds.

Our services and related products are designed to provide security and system integrity, based on Internet and other communications standards, EFT network transaction processing procedures, and banking industry standards for control and data processing. Prevailing security standards for Internet-based transactions are incorporated into our Internet services, including but not limited to, Secure Socket Layer 128K encryption, using public-private key algorithms developed by RSA Security, along with firewall technology for secure transactions. In the case of payment and transaction processing, we meet security transaction processing and

other operating standards for each EFT network or core processor through which we route transactions. Additionally, we have established a business resumption plan to ensure that our technical services and operating infrastructure could be resumed within an acceptable time frame should some sort of business interruption affect our data center. Furthermore, management receives feedback on the sufficiency of security and controls built into our information technology, payment processing, and end-user support processes from independent reviews such as semi-annual network penetration tests, an annual SAS70 Type II Examination, periodic FFIEC examinations, and internal audits.

Proprietary Rights

In June 1993, we were awarded U.S. patent number 5,220,501 covering our real-time EFT network-based payments process. This patent covers bill payment and other online payments made from the home using any enabling device where the transaction is routed in real-time through an EFT network. In March 1995, in settlement of litigation, we cross-licensed this patent to Citibank for their internal use.

On February 9, 1999, we were awarded U.S. patent number 5,870,724 for targeting advertising in a home banking delivery service. This patent provides for the targeting of advertising or messaging to home banking users, using their confidential bill payment and other financial information, while preserving consumer privacy.

On March 13, 2001, we were awarded U.S. patent number 6,202,054, a continuation of U.S. patent number 5,220,501. The continuation expands the claims in that patent, thereby increasing its applicability and usefulness.

In addition to our patents, we have registered trademarks. A significant portion of our systems, software and processes are proprietary. Accordingly, as a matter of policy, all management and technical employees execute non-disclosure agreements as a condition of employment.

Competition

We are not aware of any other company that offers a complete suite of account presentation, payments and relationship management services. However, a number of companies offer portions of the services provided by us and compete directly with us to provide such services. For example, companies such as Digital Insight, FundsXpress and S1 Corporation compete with our account presentation capabilities. These companies may in turn use bill payment providers, such as CheckFree, Princeton eCom, iPay and Metavante, to compete with our full service offering. These bill payment providers also compete with our stand-alone bill payment services. There are also other software providers such as Intelidata, Corillian and Sybase Financial Fusion that market their software to large financial institutions that may seek to penetrate our targeted regional and community banking market.

Other competitors that serve primarily smaller depository financial institutions, such as Jack Henry, Fidelity Information Services, Metavante, Certegy, Fiserv and other core banking processors, have large distribution channels that bundle broader services and products for their clients. These competitors also have developed or acquired account presentation capabilities of their own. Metavante, Jack Henry and Certegy have also acquired or developed bill payment services.

There are also Internet financial services providers who target non-banking firms, who may target our depository financial institution market. These potential competitors support brokerage firms, credit card issuers, insurance and other financial services companies. There are also Internet financial portals, such as Quicken.com, Yahoo Finance and MSN, who offer bill payment and aggregate consumer financial information from multiple financial institutions. Suppliers to these remote financial services providers potentially compete with us.

Many of our current and potential competitors have longer operating histories, greater name recognition, larger installed end-user bases and significantly greater financial, technical and marketing resources. Further, some of our more specialized competitors, such as CheckFree, while currently targeting bill payment services to large financial institutions, may increasingly direct their marketing initiatives toward our targeted client base.

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We believe our advantage in the financial services market will continue to stem from our ability to offer a fully integrated end-to-end solution to our clients. In addition to our large installed end-user base and proprietary payments architecture, we believe our ability to continue to execute successfully will be driven by our performance in the following areas, including:

- industry trust and reliability;
- technical capabilities, scalability, and security;
- speed to market;
- end-user service;
- ability to interface with financial services providers and their technology; and
- operating effectiveness.

Government Regulation

We are not licensed by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, the National Credit Union Administration or other federal or state agencies that regulate or supervise depository institutions or other providers of financial services. Under the authority of the Bank Service Company Act, the Gramm Leach Bliley Act of 1999 and other federal laws that apply to depository financial institutions, federal depository institution regulators have taken the position that we are subject to examination resulting from the services we provide to the institutions they regulate. In order not to compromise our clients standing with the regulatory authorities, we have agreed to periodic examinations by these regulators, who have broad supervisory authority to remedy any shortcomings identified in any such examination.

We are also subject to encryption and security export laws and regulations that, depending on future developments, could render our business or operations more costly, less efficient or impossible.

Federal, state or foreign agencies may attempt to regulate our activities. Congress could enact legislation that would require us to comply with consumer privacy, data, record keeping, processing and other requirements. The Federal Reserve Board may adopt new rules and regulations for electronic funds transfers that could lead to increased operating costs and could also reduce the convenience and functionality of our services, possibly resulting in reduced market acceptance. Because of the growth in the electronic commerce market, Congress has held hearings on whether to regulate providers of services and transactions in the electronic commerce market, and federal or state authorities could enact laws, rules or regulations affecting our business operations. We also may be subject to federal, state and foreign money transmitter laws, encryption and security export laws and regulations and state and foreign sales and use tax laws. If enacted or deemed applicable to us, such laws, rules or regulations could be imposed on our activities or our business thereby rendering our business or operations more costly, burdensome, less efficient or impossible, any of which could have a material adverse effect on our business, financial condition and operating results.

The market we currently target, depository financial institutions and credit card institutions, is subject to extensive and complex federal and state regulation. Our current and prospective clients, which consist of financial institutions such as commercial banks, credit unions, brokerage firms, credit card issuers, consumer finance companies, other loan originators, insurers and other providers of retail financial services, operate in markets that are subject to extensive and complex federal and state regulations and oversight.

Although we are not generally subject to such regulations, our services and related products must be designed to work within the extensive and evolving regulatory constraints in which our clients operate. These constraints include federal and state truth-in-lending disclosure rules, state usury laws, the Equal Credit Opportunity Act, the Electronic Funds Transfer Act, the Fair Credit Reporting Act, the Bank Secrecy Act, the Community Reinvestment Act, the Financial Services Modernization Act, the Bank Service Company Act, the Electronic Signatures in Global and National Commerce Act, privacy and information security regulations, laws against unfair or deceptive practices, the Electronic Signatures in Global and National Commerce Act,

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the USA Patriot Act of 2001 and other state and local laws and regulations. Because many of these regulations were promulgated before the development of our system, the application of such regulations to our system must be determined on a case-by-case basis. We do not make representations to clients regarding the applicable regulatory requirements, but instead rely on each such client making its own assessment of the applicable regulatory provisions in deciding whether to become a client. Furthermore, some consumer groups have expressed concern regarding the privacy, security and interchange pricing of financial electronic commerce services. It is possible that one or more states or the federal government may adopt laws or regulations applicable to the delivery of financial electronic commerce services in order to address these or other privacy concerns. We cannot predict the impact that any such regulations could have on our business.

We currently offer services on the web. It is possible that further laws and regulations may be enacted with respect to the web, covering issues such as user privacy, pricing, content, characteristics and quality of services and products.

Employees

At December 31, 2005, we had 421 employees. None of our employees are represented by a collective bargaining arrangement. We believe our relationship with our employees is good.

Available Information

For more information about us, visit our web site at www.orcc.com. Our electronic filings with the U.S. Securities and Exchange Commission (including our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K and any amendments to these reports) are available free of charge through our web site as soon as reasonably practicable after we electronically file with or furnish them to the U.S. Securities and Exchange Commission.

Item 1A. *Risk Factors*

You should carefully consider the following risks before investing in our common stock. These are not the only risks that we may face. If any of the events referred to below occur, our business, financial condition, liquidity and results of operations could suffer. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment.

Risks Related to Our Business

Prior to the third quarter of 2002, we had a history of net losses; we have achieved net income profitability for all, but two, fiscal quarters since the third quarter of 2002 and cannot be sure that we will be profitable in all future periods.

Although we achieved profitability under generally accepted accounting principles, or GAAP, in all but two of the fiscal quarters since the third quarter of 2002, we cannot be certain that we can be profitable in future periods. As of December 31, 2005, we had an accumulated deficit of $57.0 million. Although we believe we have achieved economies of scale, if growth in our revenues does not significantly outpace the increase in our expenses, we may not be profitable in future periods.

We are dependent on the financial services industry, and changes within that industry could reduce demand for our products and services.

The large majority of our revenues are derived from banks, credit unions and credit card issuers. Unfavorable economic conditions adversely impacting those parts of the financial services industry we serve could have a material adverse effect on our business, financial condition and results of operations. For example, depository financial institutions have experienced, and may continue to experience, cyclical fluctuations in profitability as well as increasing challenges to improve their operating efficiencies. Due to the entrance of non-traditional competitors and the current environment of low interest rates, the profit margins of depository financial institutions have narrowed. As a result, some financial institutions have slowed, and may

continue to slow, their capital spending, including spending on web-based products and solutions, which can negatively impact sales of our online payments, account presentation, marketing and support services to new and existing clients. Decreases in or reallocation of capital expenditures by our current and potential clients, unfavorable economic conditions and new or persisting competitive pressures could adversely affect our business, financial condition and results of operations.

The failure to retain existing end-users or changes in their continued use of our services will adversely affect our operating results.

There is no guarantee that the number of end-users using our services will continue to increase. Because our fee structure is designed to establish recurring revenues through monthly usage by end-users of our clients, our recurring revenues are dependent on the acceptance of our services by end-users and their continued use of account presentation, payments and other financial services we provide. Failing to retain the existing end-users and the change in spending patterns and budgetary resources of financial services providers and their end-users will adversely affect our operating results.

Any failure of our clients to effectively market our services could have a material adverse effect on our business.

To market our services to end-users, we require the consent, and often the assistance of, our clients. We generally charge our clients fees based on the number of their end-users who have enrolled with our clients for the services we provide. Therefore, end-user enrollment affects our revenue and is important to us. Because our clients offer our services under their name, we must depend on those clients to get their end-users to use our services. Although we offer extensive marketing programs to our clients, our clients may decide not to participate in our programs or our clients may not effectively market our services to their end-users. Any failure of our clients to allow us to effectively market our services could have a material adverse effect on our business.

Demand for low-cost or free online financial services and competition may place significant pressure on our pricing structure and revenues and may have an adverse effect on our financial condition.

Account holders eligible to use many of the online services we offer, including account presentation, bill payments and relationship management, may demand that these services be offered for lower cost or free. Clients and prospects may therefore reject our services in favor of companies that can offer more competitive prices. Thus, demand and competition may place significant pressure on our pricing structure and revenues and may have an adverse effect on our financial condition.

If we are unable to expand or adapt our services to support our end-users needs, our business may be materially adversely affected.

We may not be able to expand or adapt our services and related products to meet the demands of our clients and their end-users quickly or at a reasonable cost. The number of end-users registered for our services has increased from 3.1 million as of December 31, 2004 to 4.3 million as of December 31, 2005. This resulting growth has placed, and is expected to continue to place, significant demands on our personnel, management and other resources. We will need to continue to expand and adapt our infrastructure, services and related products to accommodate additional clients and their end-users, increased transaction volumes and changing end-user requirements. This will require substantial financial, operational and management resources. If we are unable to scale our system and processes to support the variety and number of transactions and end-users who ultimately use our services, our business may be materially adversely affected.

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

Loss of any material client contract could negatively impact our ability to increase our revenues and maintain profitability in the future. Additionally, the departure of a large client could impact our ability to attract and retain other clients.

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California Federal Bank, commonly known as Cal Fed, accounted for 9% of our revenues, including a $2.2 million one-time termination fee, for the year ended December 31, 2003. During 2002, Citigroup acquired Cal Fed and converted the Cal Fed end-users to the Citigroup banking and bill payment platform in the first quarter of 2003.

Additionally, BB&T Corporation acquired our second largest client, First Virginia Banks, Inc. (First Virginia), in the third quarter of 2003. In the year ended December 31, 2003, First Virginia accounted for 5% of our revenues. BB&T converted the First Virginia end-users to the BB&T banking and bill payment platform in the fourth quarter of 2003.

Finally, Sears sold its credit card portfolio to Citigroup in 2004 and Citigroup converted the Sears end-users to the Citigroup card services platform in the second quarter 2005. We anticipated the loss of Sears as part of our acquisition of Incurrent.

Currently, among our continuing client base, no one client accounts for more than 4% of our revenues.

Consolidation of the financial services industry could negatively impact our business.

The continuing consolidation of the financial services industry could result in a smaller market for our services. Consolidation frequently results in a change in the systems of, and services offered by, the combined entity. This could result in the termination of our services and related products if the acquirer has its own in-house system or outsources to competitive vendors. This would also result in the loss of revenues from actual or potential retail end-users of the acquired financial services provider.

Our failure to compete effectively in our markets would have a material adverse effect on our business.

We may not be able to compete with current and potential competitors, many of whom have longer operating histories, greater name recognition, larger, more established end-user bases and significantly greater financial, technical and marketing resources. Further, some of our competitors provide or have the ability to provide the same range of services we offer. They could market to our client and prospective client base. Other competitors, such as core banking processors, have broad distribution channels that bundle competing products directly to financial services providers. Also, competitors may compete directly with us by adopting a similar business model or through the acquisition of companies, such as resellers, who provide complementary products or services.

A significant number of companies offer portions of the services we provide and compete directly with us. For example, some companies compete with our web-based account presentation capabilities. Some software providers also offer some of the services we provide on an outsourced basis. These companies may use bill payers who integrate with their account presentation services. Also, certain services, such as Intuit s Quicken.com and Yahoo! Finance, may be available to retail end-users independent of financial services providers.

Many of our competitors may be able to afford more extensive marketing campaigns and more aggressive pricing policies in order to attract financial services providers. Our failure to compete effectively in our markets would have a material adverse effect on our business.

We may have exposure to greater than anticipated tax liabilities.

We are subject to income taxes and other taxes in a variety of jurisdictions. The determination of our provision for income taxes and other tax liabilities requires significant judgment. Although we believe our estimates are reasonable, the ultimate tax outcome may differ from the amounts recorded in our financial statements and may materially affect our financial results in the period or periods for which such determination is made.

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Our ability to utilize our net operating loss carryforwards in any given period may be limited.

Our federal net operating loss carryforwards are subject to limitation on how much may be utilized on an annual basis. If our net operating loss carryforwards in a period are limited, and we have taxable income which exceeds the available net operating loss carryforwards for that period, we would incur an income tax liability even though net operating loss carryforwards may be available in future years. This could negatively impact our future cash flow, financial position and financial results.

Our quarterly financial results are subject to fluctuations, which could have a material adverse effect on the price of our stock.

Our quarterly revenues, expenses and operating results may vary from quarter to quarter in the future based upon a number of factors, many of which are not within our control. Our revenue model is based largely on recurring revenues derived from actual end-user counts. The number of our total end-users is affected by many factors, many of which are beyond our control, including the number of new user registrations, end-user turnover, loss of clients, and general consumer trends. Our results of operations for a particular period may be adversely affected if the revenues based on the number of end-users forecasted for that period are less than expected. As a result, our operating results may fall below market analysts expectations in some future quarters, which could have a material adverse effect on the market price of our stock.

Our limited ability to protect our proprietary technology and other rights may adversely affect our ability to compete.

We rely on a combination of patent, copyright, trademark and trade secret laws, as well as licensing agreements, third-party nondisclosure agreements and other contractual provisions and technical measures to protect our intellectual property rights. There can be no assurance that these protections will be adequate to prevent our competitors from copying or reverse-engineering our products, or that our competitors will not independently develop technologies that are substantially equivalent or superior to our technology. To protect our trade secrets and other proprietary information, we require employees, consultants, advisors and collaborators to enter into confidentiality agreements. We cannot assure that these agreements will provide meaningful protection for our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or disclosure of such trade secrets, know-how or other proprietary information. Although we hold registered United States patents covering certain aspects of our technology, we cannot be sure of the level of protection that these patents will provide. We may have to resort to litigation to enforce our intellectual property rights, to protect trade secrets or know-how, or to determine their scope, validity or enforceability. Enforcing or defending our proprietary technology is expensive, could cause diversion of our resources and may not prove successful.

Our failure to properly develop, market or sell new products could adversely affect our business.

The expansion of our business is dependent, in part, on our developing, marketing and selling new financial products to financial services providers and their customers. If any new products we develop prove defective or if we fail to properly market these products to financial services providers or sell these products to these providers customers, the growth we envision for our company may not be achieved and our revenues and profits may be adversely affected.

If we are found to infringe the proprietary rights of others, we could be required to redesign our products, pay royalties or enter into license agreements with third parties.

There can be no assurance that a third party will not assert that our technology violates its intellectual property rights. As the number of products offered by our competitors increases and the functionality of these products further

overlap, the provision of web-based financial services technology may become increasingly subject to infringement claims. Any claims, whether with or without merit, could:

be expensive and time consuming to defend;

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cause us to cease making, licensing or using products that incorporate the challenged intellectual property;

require us to redesign our products, if feasible;

divert management s attention and resources; and

require us to pay royalties or enter into licensing agreements in order to obtain the right to use necessary technologies.

There can be no assurance that third parties will not assert infringement claims against us in the future with respect to our current or future products or that any such assertion will not require us to enter into royalty arrangements (if available) or litigation that could be costly to us.

System failures could hurt our business and we could be liable for some types of failures the extent or amount of which cannot be predicted.

Like other system operators, our operations are dependent on our ability to protect our system from interruption caused by damage from fire, earthquake, power loss, telecommunications failure, unauthorized entry or other events beyond our control. We maintain our own offsite disaster recovery facility for the Chantilly, Virginia data center. In the event of major disasters, both our primary and backup locations could be equally impacted. We do not currently have sufficient backup facilities to provide full Internet services, if our primary facility is not functioning. We could also experience system interruptions due to the failure of our systems to function as intended or the failure of the systems we rely upon to deliver our services such as ATM networks, the Internet, or the systems of financial institutions, processors that integrate with our systems and other networks and systems of third parties. Loss of all or part of our systems for a period of time could have a material adverse effect on our business. We may be liable to our clients for breach of contract for interruptions in service. Due to the numerous variables surrounding system disruptions, we cannot predict the extent or amount of any potential liability.

Security breaches could have a material adverse effect on our business.

Like other system operators, our computer systems may be vulnerable to computer viruses, hackers, and other disruptive problems caused by unauthorized access to, or improper use of, our systems by third parties or employees. We store and transmit confidential financial information in providing our services. Although we intend to continue to implement state-of-the-art security measures, computer attacks or disruptions may jeopardize the security of information stored in and transmitted through our computer systems of those of our clients and their end-users. Actual or perceived concerns that our systems may be vulnerable to such attacks or disruptions may deter financial services providers and consumers from using our services.

Additionally, California has adopted, and other states are adopting, laws and regulations requiring that in-state account holders of a financial services provider be notified if their personal confidential information is compromised. If the specific account holders whose information has been compromised cannot be identified, all in-state account holders of the provider must be notified. If any such notice is required of us, confidence in our systems integrity would be undermined and both financial services providers and consumers may be reluctant to use our services.

Data networks are also vulnerable to attacks, unauthorized access and disruptions. For example, in a number of public networks, hackers have bypassed firewalls and misappropriated confidential information. It is possible that, despite existing safeguards, an employee could divert end-user funds while these funds are in our control, exposing us to a risk of loss or litigation and possible liability. In dealing with numerous end-users, it is possible that some level of

fraud or error will occur, which may result in erroneous external payments. Losses or liabilities that we incur as a result of any of the foregoing could have a material adverse effect on our business.

The potential obsolescence of our technology or the offering of new, more efficient means of conducting account presentation and payments services could negatively impact our business.

The industry for account presentation and payments services is relatively new and subject to rapid change. Our success will depend substantially upon our ability to enhance our existing products and to develop and introduce, on a timely and cost-effective basis, new products and features that meet the changing financial services provider and retail end-user requirements and incorporate technological advancements. If we are unable to develop new products and enhanced functionalities or technologies to adapt to these changes or, if we cannot offset a decline in revenues of existing products by sales of new products, our business would suffer.

We rely on internally developed software and systems as well as third-party products, any of which may contain errors and bugs.

Our products may contain undetected errors, defects or bugs. Although we have not suffered significant harm from any errors or defects to date, we may discover significant errors or defects in the future that we may or may not be able to correct. Our products involve integration with products and systems developed by third parties. Complex software programs of third parties may contain undetected errors or bugs when they are first introduced or as new versions are released. There can be no assurance that errors will not be found in our existing or future products or third-party products upon which our products are dependent, with the possible result of delays in or loss of market acceptance of our products, diversion of our resources, injury to our reputation and increased expenses and/or payment of damages.

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

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

We could be sued for contract or product liability claims and lawsuits may disrupt our business, divert management s attention or have an adverse effect on our financial results.

Financial services providers use our products and services to provide web-based account presentation, bill payment, and other financial services to their end-users. Failures in a client s system could result in an increase in service and warranty costs or a claim for substantial damages against us. There can be no assurance that the limitations of liability set forth in our contracts would be enforceable or would otherwise protect us from liability for damages. We maintain general liability insurance coverage, including coverage for errors and omissions in excess of the applicable deductible amount. There can be no assurance that this coverage will continue to be available on acceptable terms or will be available in sufficient amounts to cover one or more large claims, or that the insurer will not deny coverage as to any future claim. The successful assertion of one or more large claims against us that exceeds available insurance coverage, or the occurrence of changes in our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, could have a material adverse effect on our business, financial condition and results of operations. Furthermore, litigation, regardless of its outcome, could result in substantial cost to us and divert management s attention from our operations. Any contract liability claim or litigation against us could,

therefore, have a material adverse effect on our business, financial condition and results of operations. In addition, because many of our projects are business-critical projects for financial services providers, a failure

or inability to meet a client s expectations could seriously damage our reputation and affect our ability to attract new business.

Government regulation could interfere with our business.

The financial services industry is subject to extensive and complex federal and state regulation. Financial institutions such as commercial banks, savings and loan associations, savings banks, and credit unions operate under high levels of governmental supervision. Our end-users must ensure that our services and related products work within the extensive and evolving regulatory requirements applicable to them.

We are not licensed by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, the National Credit Union Administration or other federal or state agencies that regulate or supervise depository institutions or other providers of financial services. Under the authority of the Bank Service Company Act, the Gramm Leach Bliley Act of 1999 and other federal laws that apply to depository financial institutions, federal depository institution regulators have taken the position that we are subject to examination resulting from the services we provide to the institutions they regulate. In order not to compromise our clients standing with the regulatory authorities, we have agreed to periodic examinations by these regulators, who have broad supervisory authority to remedy any shortcomings identified in any such examination.

Federal, state or foreign authorities could also adopt laws, rules or regulations relating to the financial services industry that affect our business, such as requiring us or our end-users to comply with data, record keeping and processing and other requirements. It is possible that laws and regulations may be enacted or modified with respect to the Internet, covering issues such as end-user privacy, pricing, content, characteristics, taxation and quality of services and products. If enacted or deemed applicable to us, these laws, rules or regulations could be imposed on our activities or our business, thereby rendering our business or operations more costly, burdensome, less efficient or impossible and requiring us to modify our current or future products or services.

If we cannot achieve and maintain a satisfactory rating from the federal depository institution regulators, we may lose existing clients and have difficulty attracting new clients.

The examination reports of the federal agencies that examine us are distributed and made available to our depository clients. A less than satisfactory rating from any regulatory agency increases the obligation of our clients to monitor our capabilities and performance as a part of their own compliance process. It could also cause our clients and prospective clients to lose confidence in our ability to adequately provide services, thereby possibly causing them to seek alternate providers, which would have a corresponding detrimental impact on our revenues and profits.

We are exposed to increased costs and risks associated with complying with increasing and new regulation of corporate governance and disclosure standards.

We are spending an increased amount of management time and external resources to comply with changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and Nasdaq National Market rules.

In particular, Section 404 of the Sarbanes-Oxley Act of 2002 requires management s annual review and evaluation of our internal control systems, and attestations of the effectiveness of these systems by our independent registered public accounting firm. We document and test our internal control systems and procedures and consider improvements that may be necessary in order for us to comply with the requirements of Section 404. This process requires us to hire outside advisory services and results in additional expenses for us. In addition, the evaluation and

attestation processes required by Section 404 are new, and neither companies nor auditing firms have significant experience in testing or complying with these requirements. Although we believe we currently have adequate internal controls over financial reporting, in the event that our chief executive officer, chief financial officer or independent registered public accounting firm determines that our controls over financial reporting are not effective as defined under Section 404 in the future, investor

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perceptions of our company may be adversely affected and could cause a decline in the market price of our stock.

Risks Related to Acquisitions

We may face difficulties in integrating acquired businesses.

We acquired Incurrent in December 2004 and IDS in June 2005 and may acquire additional businesses in the future. To achieve the anticipated benefits of these acquisitions, we need, and will need, to successfully integrate the acquired businesses with our operations, to consolidate certain functions and to integrate procedures, personnel, product lines and operations in an efficient and effective manner. The integration process may be disruptive to, and may cause an interruption of, or a loss of momentum in, our business as a result of a number of potential obstacles, such as:

- the loss of key employees or end-users;
- the need to coordinate diverse organizations;
- difficulties in integrating administrative and other functions;
- the loss of key members of management following the acquisition; and
- the diversion of our management s attention from our day-to-day operations.

If we are not successful in integrating these businesses or if the integrations takes longer than expected, we could be subject to significant costs and our business could be adversely affected.

Our acquisitions increase the size of our operations and the risks described in this annual report.

Our acquisitions increase the size of our operations and may intensify some of the other risks described herein. There are also additional risks associated with managing a significantly larger company, including, among other things, the application of company-wide controls and procedures.

We made our acquisitions and may make future acquisitions, on the basis of available information, and there may be liabilities or obligations that were not or will not be adequately disclosed.

In connection with any acquisition, we conduct a review of information as provided by the management of that company. It may have incurred contractual, financial, regulatory or other obligations and liabilities that may impact us in the future, which are not adequately reflected in unaudited financial and other information upon which we based our evaluation of the acquisition. If the unaudited financial and other information on which we have relied in making our offer for that company proves to be materially incorrect or incomplete, it could have a material adverse effect on our consolidated businesses, financial condition and operations.

Acquired companies give us limited warranties and indemnities in connection with their businesses, which may give rise to claims by us.

We rely upon limited representations and warranties of the companies we acquire. Although we put in place contractual and other legal remedies and limited escrow protection for losses that we may incur as a result of breaches of agreements, representations and warranties pertaining to the acquisition, we cannot assure you that our remedies will adequately cover any losses that we incur.

Risks Related to Our Capital Structure

Our stock price is volatile.

The market price of our common stock has been subject to significant fluctuations and may continue to be volatile in response to:

- actual or anticipated variations in quarterly operating results;

announcements of technological innovations;

new products or services offered by us or our competitors;

changes in financial estimates or ratings by securities analysts;

conditions or trends in the Internet and online commerce industries;

changes in the economic performance and/or market valuations of other Internet, online service industries;

announcements by us of significant acquisitions, strategic partnerships, joint ventures or capital commitments;

additions or departures of key personnel;

future equity or debt offerings or acquisitions or our announcements of these transactions; and

other events or factors, many of which are beyond our control.

The stock market in general and the Nasdaq National Market have experienced extreme price and volume fluctuations and volatility that has particularly affected the market prices of many technology, emerging growth and developmental stage companies. Such fluctuations and volatility have often been unrelated or disproportionate to the operating performance of such companies. In the past, following periods of volatility in the market price of a company s securities, securities class action litigation has often been instituted against a company. Litigation, if instituted, whether or not successful, could result in substantial costs and a diversion of management s attention and resources, which would have a material adverse effect on our business.

We have a substantial number of shares of common stock, including shares that may be issued upon exercise of options under our equity compensation plan and issued in connection to certain acquisitions that, if sold, could affect the trading price of our common stock.

We have approximately 4.8 million shares of common stock that may be issued upon the exercise of stock options, and 1.9 million shares reserved for the future issuance under our equity compensation plan and our employee stock purchase program. We have also issued shares of our common stock in connection with certain acquisitions and may issue additional shares of our common stock in connection to future acquisitions. We cannot predict the effect, if any, that future sales of shares of common stock or the availability of shares of common stock for future sale will have on the market price of our common stock. Sales of substantial amounts of common stock (including shares issued upon the exercise of stock options), or the perception that such sales could occur, may adversely affect prevailing market prices for our common stock.

Item 2. *Properties*

We are headquartered in Chantilly, Virginia where we lease approximately 75,000 square feet of office space. The lease expires September 30, 2014. We also lease data center space in McLean, Virginia and office space in Parsippany, New Jersey, Woodland Hills, California and Pleasanton, California. We believe that all of our facilities are in good condition and are suitable and adequate to meet our operations. Additionally, we believe that suitable additional or alternative space will be available in the future on commercially reasonable terms as needed.

Item 3. *Legal Proceedings*

From time to time we may be involved in litigation arising in the normal course of our business. We are not a party to any litigation, individually or in the aggregate, that we believe would have a material adverse effect on our financial condition or results of operations.

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

No matters were submitted to a vote of stockholders, through the solicitation of proxies or otherwise, during the fourth quarter of 2005.

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PART II

Item 5. *Market for the Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*

Our common stock began trading on the Nasdaq National Market on June 4, 1999 under the symbol ORCC . The following table sets forth the range of high and low closing sales prices of our common stock for the periods indicated, as reported by Nasdaq:

	2005		2004	
Fiscal Quarter Ended	**High**	**Low**	**High**	**Low**
First Quarter	$ 9.950	$ 7.250	$ 8.280	$ 5.700
Second Quarter	11.590	8.500	7.480	5.750
Third Quarter	11.170	9.180	7.270	5.900
Fourth Quarter	12.160	10.500	7.530	6.700

The market price of our common stock is highly volatile and fluctuates in response to a wide variety of factors. See Business Risk Factors Our Stock Price is Volatile.

On December 31, 2005, we had approximately 163 holders of record of common stock. This does not reflect persons or entities that hold their stock in nominee or street name through various brokerage firms.

We have not paid any cash dividends on our common stock and currently intend to retain any future earnings for use in our business. Accordingly, we do not anticipate declaring or paying any cash dividends on our common stock in the foreseeable future.

Item 6. *Selected Consolidated Financial Data*

The selected consolidated financial data set forth below with respect to Online Resources Consolidated Statements of Operations for the fiscal years ended December 31, 2005, 2004 and 2003 and with respect to Online Resources Consolidated Balance Sheets at December 31, 2005 and 2004 are derived from the audited Consolidated Financial Statements of Online Resources Corporation, which are included elsewhere in this Form 10-K. Consolidated Statements of Operations data for the fiscal years ended December 31, 2002 and 2001 and Consolidated Balance Sheet data at December 31, 2003, 2002 and 2001 are derived from Consolidated Financial Statements of Online Resources not included herein. The selected consolidated financial data set forth below is qualified in its entirety by, and should be read in conjunction with, the Consolidated Financial Statements, the related Notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Form 10-K.

	Year Ended December 31,				
	2005	**2004**	**2003**	**2002**	**2001**
Statement of Operations Data:					
Revenues:					

Service fees	$ 52,382,545	$ 39,202,146	$ 33,606,782	$ 29,603,510	$ 21,679,291
Professional services and other	8,118,358	3,083,306	4,800,833	2,750,673	2,956,472
Total revenues	60,500,903	42,285,452	38,407,615	32,354,183	24,635,763
Cost of revenues	24,517,002	18,058,726	16,630,868	14,846,015	14,313,734
Gross profit	35,983,901	24,226,726	21,776,747	17,508,168	10,322,029
General and administrative	13,125,412	9,107,176	8,161,018	6,819,850	6,930,462
Sales and marketing	10,174,312	7,415,788	6,433,211	5,368,177	5,931,222
Systems and development	4,787,994	3,792,611	3,830,565	4,344,765	5,854,866
Non-recurring charges(1)					209,434
Total expenses	28,087,718	20,315,575	18,424,794	16,532,792	18,925,984

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	Year Ended December 31,				
	2005	2004	2003	2002	2001
Income (loss) from operations	7,896,183	3,911,151	3,351,953	975,376	(8,603,955)
Other income (expense)	1,301,467	181,901	(1,234,081)	(1,380,959)	(2,291,756)
Gain from extinguishment of debt(2)					1,083,153
Income (loss) before income tax (benefit) provision	9,197,650	4,093,052	2,117,872	(405,583)	(9,812,558)
Income tax (benefit) provision	(13,465,640)	146,000	15,785		
Net income (loss)	$ 22,663,290	$ 3,947,052	$ 2,102,087	$ (405,583)	$ (9,812,558)
Net income (loss) per share					
Basic	$ 0.97	$ 0.22	$ 0.14	$ (0.03)	$ (0.82)
Diluted	$ 0.88	$ 0.20	$ 0.13	$ (0.03)	$ (0.82)
Shares used in calculation of income (loss) per share					
Basic	23,433,884	18,057,270	15,140,538	13,520,642	12,026,476
Diluted	25,880,338	20,128,093	16,685,602	13,520,642	12,026,476

Notes:

(1) We incurred and paid a one-time charge of $209,434, including severance and benefits payments, during the year ended December 31, 2001 as a result of a staff reduction for 23 employees, which represented approximately 9% of the total employees on January 3, 2001.

(2) In May 2001, we used $2.2 million of our cash to repurchase $3.5 million of the 8% convertible subordinated notes, which payments resulted in a one-time gain of $1,083,153.

	December 31,				
	2005	2004	2003	2002	2001
Balance Sheet Data:					
Cash, cash equivalents and investments	$ 55,864,265	$ 4,640,587	$ 13,038,406	$ 6,785,827	$ 7,703,622
Working capital	61,687,695	10,055,658	14,744,093	8,650,044	8,785,201
Total assets	115,596,111	44,533,268	26,734,578	21,329,940	21,521,614
Notes payable, less current portion				12,000,000	13,000,000
Capital lease obligations, less current portion			10,521	111,491	348,552
Other non-current liabilities	5,228,778	1,998,286	302,535	355,662	566,539
Total liabilities	12,559,943	9,711,633	4,378,202	15,831,810	17,183,999

Stockholders equity	103,036,168	34,770,656	22,309,237	5,498,130	4,337,615

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this report. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from the results anticipated in these forward-looking statements as a result of factors including, but not limited to, those under Business Risk Factors and elsewhere in this report.

Overview

We are a leading outsourcer of web-based account presentation, payment and relationship management services to financial services providers nationwide. Our services, branded in the clients name, integrate seamlessly into a single-vendor, end-to-end solution, supported by 24×7 customer care, targeted consumer marketing, training and other network and technical professional products and services. The Company currently operates in two business segments banking and card.

Registered end-users using account presentation, bill payment or both, are the major drivers of our revenues. Exclusive of the users obtained in the acquisition of Incurrent, from December 31, 2004 through December 31, 2005, the number of users using our account presentation services increased 32%, and the number of users using our payment services increased 27%, for an overall 31% increase in users. While we have seen some reduction in average monthly recurring revenue per user, due largely to our decisions to fix price the account presentation service to our clients and offer volume-based bill payment price reductions, this has been offset by a decline in the average monthly recurring cost per user, thereby improving our gross margin. Gross margin for the year ended December 31, 2004 was 57%, and it increased to 59% for the year ended December 31, 2005.

We have long-term service contracts with our financial services provider clients. The majority of our revenues are recurring, though these contracts also provide for implementation, set-up and other non-recurring fees. Account presentation services revenues are based on either a monthly license fee, allowing our financial institution clients to register an unlimited number of customers, or a monthly fee for each registered customer. Payment services revenues are based on either a monthly fee for each customer enrolled, a fee per executed transaction, or a combination of both. Our clients pay nearly all of our fees and then determine if or how they want to pass these costs on to their users. They typically provide account presentation services to users free of charge, as they derive significant potential benefits including account retention, delivery and paper cost savings, account consolidation and cross-selling of other products. As of December 31, 2005 approximately 60% of our clients were charging their users for providing payment services.

As a network-based service provider, we have made substantial up-front investments in infrastructure, particularly for our proprietary systems. While we continue to incur ongoing development and maintenance costs, we believe the infrastructure we have built provides us with significant operating leverage. In 2003 we began an effort to upgrade and rewrite certain of our applications infrastructure that will continue into 2006. We expect that this effort will require incremental capital expenditures, primarily for additional development labor, of between $3.0 million and $5.0 million over that period.

We continue to automate processes and develop applications that allow us to make only small increases in labor and other operating costs relative to increases in customers and transactions. We believe our financial and operating performance will be based primarily on our ability to leverage additional end-users and transactions over this relatively fixed cost base.

Critical Accounting Policies and Estimates

The policies discussed below are considered by management to be critical to an understanding of our annual audited consolidated financial statements because their application places the most significant demands on management s judgment, with financial reporting results relying on estimates about the effect of matters that are inherently uncertain. Specific risks for these critical accounting policies are described in the following paragraphs. For all of these policies, management cautions that future events rarely develop exactly as forecasted, and the best estimates routinely require adjustment.

Revenue Recognition Policy. We generate revenues from service fees, professional services, and other supporting services. Many of our contracts consist of multiple deliverables that require more than one unit of accounting, and these contracts are accounted for according to Emerging Issues Task Force Issue (EITF) No. 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF No. 00-21). Under EITF No. 00-21, we allocate revenues in arrangements with multiple deliverables to each qualifying separate unit of accounting based on either their relative fair values or the fair value of the undelivered elements. Fair value is determined by the prices charged when the element is sold separately or other vendor specific objective evidence.

Service fees are primarily composed of three business lines, account presentation services, payment services and relationship management services. Revenues from service fees include new user registration fees, account access fees, transaction fees, customer service fees and relationship marketing support fees. Revenues from service fees are recognized over the term of the contract as the services are provided.

We collect funds from end-users and aggregate them in clearing accounts, which are not included on our consolidated balance sheets, as we do not have ownership of these funds. For certain transactions, funds may remain in the clearing accounts until a payment check is deposited or other payment transmission is accepted by the receiving merchant. We earn interest on these funds for the period they remain in the clearing accounts. This interest totaled $1.8, $0.6 and $0.4 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Professional services revenues consist of implementation fees associated with the linking of our financial institution clients to our QuotienSM e-financial suite through various networks, web development and hosting fees, training fees, communication services and the sales of software licenses and related support. In accordance with Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition in Financial Statements* (SAB No. 104), implementation fees and related direct implementation costs are recognized on a straight-line basis over the contract term, which typically ranges from one to five years (generally three years).

Revenues from web development, web hosting, training and communications services are recognized over the term of the contract as the services are provided. Revenues from the sale of software licenses and related support are recognized according to Statement of Position (SOP) No. 97-2, *Software Revenue Recognition* (SOP No. 97-2), as amended by SOP No. 98-9, *Software Revenue Recognition With Respect to Certain Transactions* (SOP No. 98-9). For sales that require significant production, modification or customization, we apply the provisions of Accounting Research Bulletin (ARB) No. 45, *Long-Term Construction-Type Contracts* (ARB No. 45), and SOP No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* (SOP No. 81-1), and recognize the revenues related to software license fees using the percentage-of-completion method. The percentage-of-completion is measured by the percentage of labor effort incurred to date to estimated total labor effort to complete delivery of the software license. The amount of revenues allocated to each element of a software sale are based on the fair value of undelivered elements based on prices charged when the elements are sold separately. The revenues related to the support of a software license are recognized on a straight-line basis over the term of the support agreement.

Other revenues consist of service fees associated with enhanced third-party solutions and termination fees. Service fees for enhanced third-party solutions include fully integrated bill payment and account retrieval through Intuit s Quicken, check ordering, inter-institution funds transfer, account aggregation and check imaging. Revenues from these service fees are recognized over the term of the contract as the services are provided. Termination fees are recognized upon termination of a contract.

Allowance for Doubtful Accounts. The provision for losses on accounts receivable and allowance for doubtful accounts are recognized based on our estimate, which considers our historical loss experience, including the need to adjust for current conditions, and judgments about the probable effects of relevant observable data and financial health of specific customers. At December 31, 2005 the allowance for doubtful accounts was $154,000. This represents management s estimate of the probable losses in the accounts receivable balance at December 31, 2005. While the allowance for doubtful accounts and the provision for losses on accounts receivable depend to a large degree on future conditions, management does not forecast significant adverse developments in 2006. We incurred approximately $100,000 of bad debt expense in 2005.

Income Taxes. Deferred tax assets and liabilities are determined based on temporary differences between financial reporting and the tax bases of assets and liabilities. Deferred tax assets are also recognized for tax net operating loss carryforwards. These deferred tax assets and liabilities are measured using the enacted tax rates and laws that are expected to be in effect when such amounts are expected to reverse or be utilized. The realization of total deferred tax assets is contingent upon the generation of future taxable income. Valuation allowances are provided to reduce such deferred tax assets to amounts more likely than not to be ultimately realized.

Prior to December 31, 2005, we maintained a full valuation allowance on the deferred tax asset resulting primarily from our net operating loss carryforwards, since the likelihood of the realization of that asset had not become more likely than not as of those balance sheet dates. At December 31, 2005, we determined that our

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recent experience generating taxable income balanced against our history of losses, along with our projection of future taxable income, constituted significant positive evidence for partial realization of the deferred tax asset and, therefore, partial release of the valuation allowance against that asset. Therefore, in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS No. 109), we released valuation allowance against $36 million of our total $81 million net operating loss carryforwards, creating a $13.7 million deferred tax asset as of December 31, 2005 and a $13.5 million benefit to our earnings for the year ended December 31, 2005. At one or more future dates, if sufficient positive evidence exists that it is more likely than not that the benefit will be realized with respect to the remaining net operating loss carryforwards and deferred tax asset, we will release the remaining valuation allowance, realize the remaining deferred tax asset and report the associated benefit to our earnings in the appropriate period.

Cost of Internal Use Software and Computer Software to be Sold. We capitalize the cost of computer software developed or obtained for internal use in accordance with SOP No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (SOP No. 98-1). Capitalized computer software costs consist primarily of payroll-related and consulting costs incurred during the development stage. We expense costs related to preliminary project assessments, research and development, re-engineering, training and application maintenance as they are incurred. Capitalized software costs are being depreciated on a straight-line basis over a period of three years upon being placed in service.

We capitalize the cost of computer software to be sold according to Statement of Financial Accounting Standards (SFAS) No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed* (SFAS No. 86). Software development costs are capitalized beginning when a product s technological feasibility has been established by completion of a working model of the product and ending when a product is ready for general release to customers.

Impairment of Goodwill, Intangible Assets and Long-Lived Assets. We evaluate the recoverability of our identifiable intangible assets, goodwill and other long-lived assets in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142) and SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS No. 144). Under these provisions, we assess the recoverability of these types of assets at least annually and when events or circumstances indicate a potential impairment. We use the fair value method to assess the recoverability of our goodwill and have two reporting units, banking and card. We use the undiscounted cash flows method, when needed, to assess the recoverability of our identifiable intangible assets and other long-lived assets and the discounted cash flows method, at least annually, to assess the recoverability of our goodwill. We did not incur any impairment charges for the years ended December 31, 2005, 2004 or 2003. Future impairment assessments could result in impairment charges that would reduce the carrying values of these assets.

Recently Issued Pronouncement. On December 16, 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123(R)), which is a revision of SFAS No. 123. SFAS No. 123(R) supersedes APB No. 25, and amends SFAS No. 95, *Statement of Cash Flows.* Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123; however, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the statements of operations based on their fair values. Pro forma disclosure is no longer an alternative upon adopting SFAS No. 123(R). The Company will adopt SFAS No. 123(R) on January 1, 2006. SFAS No. 123(R)permits public companies to adopt its requirements using one of two methods:

i. A modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123(R) for all awards granted to employees prior to the effective date of SFAS 123(R) that remain unvested on the effective date.

ii. A modified retrospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS No. 123 for purposes of pro forma disclosures for either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

The Company will implement SFAS No. 123(R) in the first quarter of 2006 and intends to use the modified prospective method.

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Also see Note 2, Summary of Significant Accounting Policies, in the Notes to the Consolidated Financial Statements for the year ended December 31, 2005 included elsewhere in this Form 10-K, which discusses accounting policies.

Results of Operations

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

	Year Ended December 31,					
	2005		2004		2003	
	Dollars	%	Dollars	%	Dollars	%
Revenues:						
Banking	$ 52,445	87%	$ 42,285	100%	$ 38,408	100%
Card	8,056	13%		0%		0%
Total	$ 60,501	100%	$ 42,285	100%	$ 38,408	100%
	Dollars	Margin	Dollars	Margin	Dollars	Margin
Gross profit:						
Banking	$ 32,592	62%	$ 24,227	57%	$ 21,777	57%
Card	3,674	46%		0%		0%
Unallocated	(282)					
Total	$ 35,984	59%	$ 24,227	57%	$ 21,777	57%
	Dollars	%	Dollars	%	Dollars	%
Operating expenses:						
Banking	$ 24,994	90%	$ 20,316	100%	$ 18,425	100%
Card	2,943	11%		0%		0%
Unallocated	(151)	(1)%		0%		0%
Total	$ 27,786	100%	$ 20,316	100%	$ 18,425	100%
	Dollars	Margin	Dollars	Margin	Dollars	Margin
Income from operations:						
Banking	$ 7,598	14%	$ 3,911	9%	$ 3,352	9%
Card	731	9%		0%		0%
Unallocated	(433)					

Total	$ 7,896	13%	$ 3,911	9%	$ 3,352	9%

Year Ended December 31, 2005 Compared to the Year Ended December 31, 2004

Revenues

We generate revenues from account presentation services, payment services, relationship management services and professional services and other revenues. Revenues increased $18.2 million, or 43%, to $60.5 million for the year ended December 31, 2005, from $42.3 million for the same period of 2004. This increase was attributable to a $10.1 million, or 24%, increase in banking segment revenues and $8.1 million in revenues contributed by the new card segment acquired on December 22, 2004.

	Year Ended December 31, 2005	Year Ended December 31, 2004	Change Difference	Change %
Revenues (dollars in millions):				
Account presentation services	$ 8.8	$ 3.0	$ 5.8	191%
Payment services	35.9	28.3	7.6	27%
Relationship management services	7.7	7.9	(0.2)	(2)%
Professional services and other	8.1	3.1	5.0	163%
Total revenues	$ 60.5	$ 42.3	$ 18.2	43%
Users and transactions (000s):(1)				
Account presentation users	638	485	153	32%
Payment services users	984	776	208	27%
All services users	1,475	1,125	350	31%
Payment transactions	46,212	37,123	9,089	24%
Adoption rates:(2)				
Account presentation services(1)	29.0%	22.4%	6.6%	29%
Payment services(3)	9.6%	8.2%	1.4%	17%

Notes:

(1) Excludes card segment users.

(2) Represents the percentage of users subscribing to our account presentation services out of the total number of checking accounts enabled for account presentation services.

(3) Represents the percentage of users subscribing to our payment services out of the total number of checking accounts enabled for payment services.

Account Presentation Services. Both the banking and card segments contribute to account presentation services revenues, which increased $5.8 million compared to the same period of last year to $8.8 million. The inclusion of the new card segment, which was created with the acquisition of Incurrent in December 2004, is the reason for the increase, with account presentation services revenue generated by the banking segment decreasing by 3% compared to 2004. This is the result of the loss of two large banking clients in the first half of 2005 and our decision to fix price the account presentation service to our banking segment clients in an effort to drive adoption of those services. This allows our financial services provider clients to register an unlimited number of account presentation services users (as evidenced by the 29% increase in banking account presentation services adoption since December 31, 2004) to whom we can then attempt to up-sell our higher margin bill pay products and other services.

Payment Services. Primarily composed of revenues from the banking segment, payment services revenues increased to by $7.6 million to $35.9 million for the year ended December 31, 2005 from $28.3 million in the prior year. This was driven by a 27% increase in the number of period-end payment services users and a 24% increase in the number of payment transactions processed during the period. The increases in period-end payment services users and the number of payment transactions processed were driven by two factors: an increase in financial services provider clients using our payment services and an increase in payment services adoption by our payment services clients end-users. Compared to December 31, 2004, the number of financial services provider clients using our payment

services increased from 716 clients to 790 clients. Additionally, we increased the adoption rate of our payment services from 8.2% at December 31, 2004 to 9.6% at December 31, 2005.

Relationship Management Services. Consisting entirely of revenues from the banking segment, relationship management services revenues decreased to $7.7 million from $7.9 in 2004. This is the result of the loss of two large banking clients in the first half of 2005, partially offset by additional relationship management services revenues attributable to an increase of 31% in the number of period-end banking segment end-users utilizing either account presentation or payment services compared to 2004. We expect relationship

management services revenues growth to be flat as more of our financial services provider clients move to a monthly license fee pricing model similar to the one we use for account presentation services.

Professional Services and Other. Both the banking and card segments contribute to professional services and other revenues, which increased $5.0 million from $3.1 million in 2004 to $8.1 million in 2005. The increase was partially the result of $2.1 million in revenues generated by the new card segment, which was created with the acquisition of Incurrent in December 2004. The remaining $2.9 million of the increase was the result of increased professional services revenues in the banking segment in 2005 compared to 2004. Approximately 60% of the $2.9 million was the result of the addition of the custom solutions group, which was created with the acquisition of IDS in June 2005, to the banking segment.

Costs and Expenses

	Year Ended December 31,		Change	
	2005(1)	**2004(1)**	**Difference(1)**	**%**
Revenues	$ 60.5	$ 42.3	$ 18.2	43%
Costs of revenues	24.5	18.1	6.4	36%
Gross profit	36.0	24.2	11.8	49%
Gross margin	59%	57%	2%	4%
Operating expenses				
General & administrative	13.1	9.1	4.0	44%
Sales & marketing	10.2	7.4	2.8	37%
Systems & development	4.8	3.8	1.0	26%
Total operating expenses	28.1	20.3	7.8	38%
Income from operations	7.9	3.9	4.0	102%
Other income, net	1.3	0.1	1.2	615%
Income before tax (benefit) provision	9.2	4.0	5.2	125%
Tax (benefit) provision	(13.5)	0.1	13.6	
Net income	$ 22.7	$ 3.9	$ 16.8	474%
Net income per share:				
Basic	$ 0.97	$ 0.22	$ 0.75	341%
Diluted	$ 0.88	$ 0.20	$ 0.68	340%
Shares used in calculation of net income per share:				
Basic	23.4	18.1	5.3	30%
Diluted	25.9	20.1	5.8	29%

Notes:

(1) In millions except for per share information.

Costs of Revenues. Costs of revenues encompass the direct expenses associated with providing our services. These expenses include telecommunications, payment processing, systems operations, customer service, implementation and professional services work. Costs of revenues increased by $6.4 million to $24.5 million for the year ended December 31, 2005, from $18.1 million for the same period in 2004. In addition to the inclusion of costs associated with the new card segment, which was created with the acquisition of Incurrent in December 2004, and the addition of the custom solutions group, which was created with the acquisition of IDS in June 2005, to the banking segment, the increase related to increases in volume-related payment processing and systems operations costs and increased amortization of software development costs capitalized in accordance with SOP No. 98-1.

Gross Profit. Gross profit increased to $36.0 million for the year ended December 31, 2005 from $24.2 million for the same period of 2004. Of the $11.8 million increase, $3.4 million, or 9%, related to the inclusion of the new card segment. The remaining $8.4 million of the increase, or 91%, related to growth in the banking segment and the addition of the new custom solutions group to the banking segment. Gross margin increased to 59%, and exclusive of equity compensation costs, we expect to maintain or slightly increase our gross margin in future periods.

General and Administrative. General and administrative expenses primarily consist of salaries for executive, administrative and financial personnel, consulting expenses and facilities costs such as office leases, insurance, and depreciation. General and administrative expenses increased $4.0 million, or 44%, to $13.1 million for the year ended December 31, 2005, from $9.1 million in the same period of 2004. The increase related to the inclusion of the new card segment and the addition of the new custom solutions group to the banking segment. The increase also related to increased depreciation expense, rent expense, and salary and benefits costs as a result of additional headcount.

Sales and Marketing. Sales and marketing expenses include 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 increased $2.8 million, or 37%, to $10.2 million for the year ended December 31, 2005, from $7.4 million in 2004. In addition to the costs related to the inclusion of the new card segment and the addition of the new custom solutions group to the banking segment, the increase was the result of increased salary and benefits from the expansion of our sales and client services groups, increased remuneration expenses to our reseller partners owing to higher user and transaction volumes and increased marketing costs attributable to a higher number of client-sponsored marketing programs.

Systems and Development. Systems and development expenses include salaries, consulting fees and all other expenses incurred in supporting the research and development of new services and products and new technology to enhance existing products. Systems and development expenses increased $1.0 million to $4.8 million for the year ended December 31, 2005. The increase was the result of the inclusion of the new card segment and the addition of the new custom solutions group to the banking segment. Even though systems and development costs in the banking segment otherwise increased relative to 2004 as a result of increased headcount, this increase was partially offset by an increase in the amount of costs capitalized in accordance with SOP No. 98-1. We capitalized $3.6 million of development costs associated with software developed or obtained for internal use during the year ended December 31, 2005, compared to $2.7 million in 2004.

Income from Operations. Income from operations increased $4.0 million, or 102%, to $7.9 million for the year ended December 31, 2005. The increase was due to an increase in service fee revenues leveraged over relatively fixed costs and $0.7 million in additional operating income for the new card segment. Operating margin increased to 13% from 9% for the year ended December 31, 2004. Exclusive of the amortization of equity compensation costs, we expect operating margin to continue to increase in future periods.

Other Income, Net. Other income increased $1.1 million due to interest earned on the proceeds from the follow-on offering completed in April 2005.

Tax (Benefit) Provision. Our benefit for income taxes for the year ended December 31, 2005 was $13.5 million compared to a provision for income taxes of $146,000 for the year ended December 31, 2004. Prior to December 31, 2005, we maintained a full valuation allowance on the deferred tax asset resulting from our net operating loss carryforwards, since the likelihood of the realization of that asset had not become more likely than not as of those balance sheet dates. At December 31, 2005, we determined that our recent experience generating taxable income balanced against our history of losses, along with our projection of future taxable income, constituted significant positive evidence for partial realization of the deferred tax asset and, therefore, partial release of the valuation allowance against that asset. Therefore, in accordance with SFAS No. 109, we released valuation allowance against $36 million of our total $81 million net operating loss carryforwards, creating a $13.7 million deferred tax asset as of December 31, 2005 and an $13.5 million benefit to our earnings for the year ended December 31, 2005.

Net Income. Net income was $22.7 million for the year ended December 31, 2005, compared to $3.9 million for the same period of 2004. Basic net income per share was $0.97 and $0.22 for the years ended December 31, 2005 and 2004, respectively. Diluted net income per share was $0.88 and $0.20 for the years ended December 31, 2005 and

2004, respectively. Basic and diluted shares outstanding increased by 73% and 75%, respectively, as a result of shares issued as part of the follow-on offering in April 2005 and shares issued related to the Incurrent and IDS acquisitions. Diluted shares outstanding also increased as a result of the impact of our rising share price on the fully diluted share calculation.

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Year Ended December 31, 2004 Compared to the Year Ended December 31, 2003

Revenues

We generate revenues from account presentation services, payment services, relationship management services and professional services and other revenues. Revenues increased $3.9 million, or 10%, to $42.3 million for the year ended December 31, 2004, from $38.4 million for the same period of 2003. This was attributable to a 34% increase in payment services, partially offset by decreases of 25%, 7% and 36% in account presentation services, relationship management services and professional services and other revenues, respectively. Excluding from 2003 revenues, a one time $2.2 million termination fee received from Cal Fed in the first quarter of 2003, revenues increased $6.1 million, or 17%, for the year ended December 31, 2004 compared to the year ended December 31, 2003.

	Year Ended December 31,		Change	
	2004	2003	Difference	%
Revenues (dollars in millions):				
Account presentation services	$ 3.0	$ 4.1	$ (1.1)	(25)%
Payment services	28.3	21.0	7.3	34%
Relationship management services	7.9	8.5	(0.6)	(7)%
Professional services and other	3.1	4.8	(1.7)	(36)%
Total revenues	$ 42.3	$ 38.4	$ 3.9	10%
Users and transactions (000s):(1)				
Account presentation users	485	416	69	17%
Payment services users	776	528	248	47%
All services users	1,125	841	284	34%
Payment transactions	37,123	24,825	12,298	50%
Adoption rates:(1)				
Account presentation services(2)	22.4%	16.8%	5.6%	33%
Payment services(3)	8.2%	5.1%	3.1%	61%

Notes:

(1) Excludes card segment users.

(2) Represents the percentage of users subscribing to our account presentation services out of the total number of checking accounts enabled for account presentation services.

(3) Represents the percentage of users subscribing to our payment services out of the total number of checking accounts enabled for payment services.

Account Presentation Services. During 2004 account presentation services revenues decreased $1.1 million to $3.0 million, driven by the departures of Cal Fed and First Virginia in March and October 2003, respectively, and a decrease in the average monthly revenue per account presentation services user. Account presentation services revenues generated by our client base, exclusive of Cal Fed and First Virginia, decreased 7% versus 2003 even though the number of year-end account presentation services users increased by 17% compared to the prior year-end. This

was the result of a 33% decrease in the average monthly revenue per account presentation services user. This decrease was attributable to the fact that we price our account presentation service largely using a monthly license fee pricing model in an effort to drive adoption of those services. This allows our financial institution clients to register an unlimited number of account presentation services users (as evidenced by the 33% increase in account presentation services adoption in 2004) to whom we can then attempt to up-sell our higher margin bill pay products and other services.

Payment Services. Payment services revenues increased by $7.3 million to $28.3 million in 2004 compared to $21.0 million in the prior year. Even with the departures of Cal Fed and First Virginia during 2003, which together accounted for 4% of payment services revenues in 2003, payment services revenues increased 34%. This was driven by a 47% increase in the number of year-end payment services users and a

50% increase in the number of payment transactions processed during the year. The increases in year-end payment services users and the number of payment transactions processed were driven by two factors: an increase in financial institution clients using our payment services and an increase in payment services adoption by our payment services clients end-users. Compared to December 31, 2003, the number of financial services provider clients using our payment services increased from 633 clients to 716 clients. Additionally, we increased the adoption rate of our payment services from 5.1% at the end of 2003 to 8.2% at the end of 2004.

Relationship Management Services. Relationship management services revenues decreased from $8.5 million in 2003 to $7.9 million in 2004 as a result of the departures of Cal Fed and First Virginia in March and October 2003, respectively. Relationship management services revenues generated by our remaining client base; however, increased 4% compared to 2003, driven by an increase of 34% in the number of year-end users utilizing either account presentation or payment services.

Professional Services and Other. Professional services and other revenues decreased $1.7 million from $4.8 million in 2003 to $3.1 million in 2004. This decrease was the result of a $2.2 million termination payment received from Cal Fed in 2003. We received $0.8 million in termination payments during the year ended December 31, 2004, compared to $2.8 million, including the Cal Fed termination payment, during the year ended December 31, 2003.

Costs and Expenses

	Year Ended December 31,		Change	
	2004(1)	2003(1)	Difference(1)	%
Revenues	$ 42.3	$ 38.4	$ 3.9	10%
Costs of revenues	18.1	16.6	1.5	9%
Gross profit	24.2	21.8	2.4	11%
Gross margin	57%	57%	0%	0%
Operating expenses				
General & administrative	9.1	8.2	0.9	12%
Sales & marketing	7.4	6.4	1.0	15%
Systems & development	3.8	3.8		(1)%
Total operating expenses	20.3	18.4	1.9	10%
Income from operations	3.9	3.4	0.5	17%
Other expense, net		(1.2)	1.2	
Net income	$ 3.9	$ 2.2	$ 1.7	88%
Net income per share:				
Basic	$ 0.22	$ 0.14	$ 0.08	57%
Diluted	$ 0.20	$ 0.13	$ 0.07	54%
Shares used in calculation of net income per share:				
Basic	18.1	15.1	3.0	19%
Diluted	20.1	16.7	3.4	21%

Notes:

(1) In millions except for per share information.

Costs of Revenues. Costs of revenues encompass the direct expenses associated with providing our services. These expenses include telecommunications, payment processing, systems operations, customer service, implementation and professional services work. Costs of revenues increased by $1.5 million to $18.1 million for the year ended December 31, 2004, from $16.6 million for the same period in 2003. The increase related to increases in volume-related payment processing and systems operations costs and increased

amortization of software development costs capitalized in accordance with SOP No. 98-1, partially offset by decreases in bank implementation and telecommunications costs resulting from operating efficiencies and price reductions.

Gross Profit. Gross profit increased to $24.2 million for the year ended December 31, 2004 from $21.8 million for the same period of 2003. Gross margin remained constant at 57% due to the $2.2 million termination fee received from Cal Fed in 2003. Excluding this one-time fee from 2003 revenues, gross margin would have increased for the year ended December 31, 2004 when compared to the year ended December 31, 2003.

General and Administrative. General and administrative expenses primarily consist of salaries for executive, administrative and financial personnel, consulting expenses and facilities costs such as office leases, insurance, and depreciation. General and administrative expenses increased $0.9 million, or 12%, to $9.1 million for the year ended December 31, 2004, from $8.2 million in the same period of 2004. The increase related to increased depreciation expenses, fees related to Sarbanes-Oxley compliance, rent expense and salary and benefits costs as a result of additional headcount.

Sales and Marketing. Sales and marketing expenses include 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 increased $1.0 million, or 15%, to $7.4 million for the year ended December 31, 2004, from $6.4 million in 2003. The increase was the result of increased salary and benefits costs as a result of the expansion of our sales and client services groups, increased remuneration expenses to our reseller partners owing to higher user and transaction volumes and increased marketing costs resulting from running a higher number of client-sponsored marketing programs.

Systems and Development. Systems and development expenses include salaries, consulting fees and all other expenses incurred in supporting the research and development of new services and products and new technology to enhance existing products. Systems and development expenses remained constant at $3.8 million for the years ended December 31, 2004 and 2003. Although salaries and benefits costs and consulting costs increased compared to 2003, these increased costs were incurred working on capitalizable projects as defined by SOP No. 98-1. We capitalized $2.7 million of development costs associated with software developed or obtained for internal use during the year ended December 31, 2004, compared to $1.6 million in 2003.

Income from Operations. Income from operations increased $0.5 million, or 17%, to $3.9 million for the year ended December 31, 2004. The increase was due to an increase in service fee revenues leveraged over relatively fixed costs. Operating margin remained constant at 9% due to the $2.2 million termination fee received from Cal Fed in 2003. Excluding this one-time fee from 2003 revenues, operating margin would have increased for the year ended December 31, 2004 when compared to the year ended December 31, 2003.

Other Expense, Net. Other income increased $1.2 million owing to lower interest expense and amortization of debt issuance costs due to the repurchase and conversion of the remaining Convertible Notes in 2003.

Net Income. Net income was $3.9 million for the year ended December 31, 2004, compared to $2.1 million for the same period of 2003. Basic net income per share was $0.22 and $0.14 for the years ended December 31, 2004 and 2003, respectively. Diluted net income per share was $0.20 and $0.13 for the years ended December 31, 2004 and 2003, respectively. Basic and diluted shares outstanding increased by 19% and 21%, respectively, as a result of shares issued in connection to the exercise of company-issued stock options and our employees participation in our employee stock purchase plan. Diluted shares outstanding also increased as a result of the impact of our rising share price on the fully diluted share calculation.

Liquidity and Capital Resources

Since inception, we have primarily financed our operations through private placements and public offerings of our common and preferred stock, the issuance of debt and cash generated by operations. We have also entered into various capital lease financing agreements. Cash and investments in available-for-sale securities were $55.9 and $4.6 million as of December 31, 2005 and 2004, respectively. The $51.3 million increase in cash and investments in available-for-sale securities results from $18.5 million in cash generated by operating activities, $40.3 million in cash generated by our April 2005 follow-on offering and $3.3 million

in cash generated by the exercise of company-issued stock options and our employees participation in our employee stock purchase plan. These cash in-flows were partially offset by $7.5 million in capital expenditures and $3.3 million in cash used in the acquisition of IDS.

Net cash provided by operating activities was $18.5 million for the year ended December 31, 2005, of which, 93% was recurring in nature. This represented a $10.6 million increase in cash provided by operating activities compared to the prior year.

Net cash used in investing activities for the year ended December 31, 2005 was $9.5 million, which was the result of $7.5 million in capital expenditures and $3.3 million used in the acquisition of IDS, partially offset by a net increase of $1.3 million in securities available-for-sale.

Net cash provided by financing activities was $43.6 million for the year ended December 31, 2005 million. During 2005 we generated $40.3 million in cash through our April 2005 follow-on offering and $3.3 million through the exercise of company-issued stock options and our employees participation in our employee stock purchase plan.

Our material commitments under operating and capital leases and purchase obligations are as follows:

			Year Ended December 31,				
	Total	2006	2007	2008	2009	2010	Thereafter
Capital lease obligations	$ 8,268	$ 8,268	$	$	$	$	$
Operating leases	19,231,134	2,747,749	2,253,359	2,017,509	2,071,740	2,127,435	8,013,342
Purchase obligations	1,084,160	657,080	427,080				
Total obligations	$ 20,323,562	$ 3,413,097	$ 2,680,439	$ 2,017,509	$ 2,071,740	$ 2,127,435	$ 8,013,342

On May 21, 2004, we executed a ten-year lease covering 75,000 square feet of office and data center space. The rent commencement date of the new lease was October 1, 2004, and the total remaining obligation related to the lease at December 31, 2005 is $15.9 million. We also executed an amendment to the lease related to our pre-existing facility that allows us to occupy a portion of the facility from October 1, 2004 through July 31, 2007. The total remaining obligation related to the amendment at December 31, 2005 is $0.6 million. Finally, through the acquisitions of Incurrent in December 2004 and IDS in June 2005, we succeeded to office space leases in Parsippany, New Jersey, Woodland Hills, California and Pleasanton, California, which run through January 2007, April 2013 and May 2007, respectively. The total remaining obligations related to these leases at December 31, 2005 are $2.7 million.

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

We currently believe that cash on hand, investments and the cash we expect to generate from operations will be sufficient to meet our current anticipated cash requirements for at least the next twelve months. We expect to have additional cash requirements over the next year because of efforts we are undertaking to upgrade and rewrite certain of our infrastructure applications. We forecast that all incremental expenses related to this undertaking can be financed out of cash provided by operating activities.

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 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

We invest primarily in short-term, investment grade, marketable government, corporate, and mortgage-backed debt securities. The Company s interest income is most sensitive to changes in the general level of U.S. interest rates. 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.

Item 8. ***Consolidated Financial Statements and Supplementary Data***

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MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Online Resources Corporation (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting and for the assessment of the effectiveness of internal control over financial reporting. As defined by the SEC, internal control over financial reporting is a process designed under the supervision of the Company s principal executive, principal financial and principal accounting officers, and effected by the Company s board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles.

The Company s internal control over financial reporting is supported by written policies and procedures, that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the Company s assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of the Company s management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management of the Company conducted an assessment of the effectiveness of the Company s internal control over financial reporting as of December 31, 2005 based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO Framework). Based on this assessment, management has concluded that the Company s internal control over financial reporting was effective as of December 31, 2005.

Management s assessment of the effectiveness of the Company s internal control over financial reporting as of December 31, 2005, has been audited by Ernst & Young LLP, the registered public accounting firm that audited the Company s consolidated financial statements, as stated in their report, a copy of which is included in this Annual Report on Form 10-K.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of Online Resources Corporation

We have audited management s assessment, included in the accompanying Management s Report On Internal Control Over Financial Reporting, that Online Resources Corporation maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Online Resources Corporation s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that Online Resources Corporation maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Online Resources Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Online Resources Corporation as of December 31, 2005 and 2004, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2005 of Online Resources Corporation and our report dated March 15, 2006 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

McLean, Virginia
March 15, 2006

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of Online Resources Corporation

We have audited the accompanying consolidated balance sheets of Online Resources Corporation as of December 31, 2005 and 2004, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Online Resources Corporation at December 31, 2005 and 2004, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Online Resources Corporation s internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 15, 2006 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

McLean, Virginia
March 15, 2005

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ONLINE RESOURCES CORPORATION

CONSOLIDATED BALANCE SHEETS

	December 31, 2005	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 55,864,265	$ 3,341,678
Restricted cash	2,219,675	1,650,723
Short-term investments		1,298,909
Accounts receivable (net of allowance of approximately $154,000 and $152,000 at December 31, 2005 and 2004, respectively)	7,262,565	8,433,113
Deferred implementation costs	608,598	460,600
Deferred tax asset, current portion	2,029,731	
Prepaid expenses and other current assets	1,034,026	2,634,961
Total current assets	69,018,860	17,819,984
Property and equipment, net	15,241,718	13,099,829
Deferred tax asset, less current portion	11,635,269	
Deferred implementation costs, less current portion	520,768	420,035
Goodwill	16,322,659	11,272,463
Intangible assets	2,329,846	1,569,800
Other assets	526,991	351,157
Total assets	$ 115,596,111	$ 44,533,268
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,133,692	$ 1,654,650
Accrued expenses and other current liabilities	1,324,319	3,159,743
Accrued compensation	2,065,388	1,808,233
Deferred revenues, current portion	2,638,015	972,890
Deferred rent, current portion	161,483	158,237
Capital lease obligations	8,268	10,573
Total current liabilities	7,331,165	7,764,326
Deferred revenues, less current portion	1,213,542	379,036
Deferred rent, less current portion	1,795,561	1,524,828
Other long-term liabilities	2,219,675	94,422
Total liabilities	12,559,943	9,762,612
Commitments and contingencies		
Stockholders equity:		
Series A convertible preferred stock, $0.01 par value; none authorized at December 31, 2005; 1,000,000 authorized and none issued at December 31,		

2004		
Series B junior participating preferred stock, $0.01 par value; 297,500 shares authorized; none issued at December 31, 2005 and 2004		
Common stock, $0.0001 par value; 35,000,000 shares authorized; 25,288,886 issued and 25,213,361 outstanding at December 31, 2005; and 19,340,222 issued and 19,264,697 outstanding at December 31, 2004	2,521	1,926
Additional paid-in capital	160,249,466	114,647,954
Accumulated deficit	(56,988,019)	(79,651,309)
Treasury stock, 75,525 shares at December 31, 2005 and 2004	(227,800)	(227,800)
Accumulated other comprehensive loss		(115)
Total stockholders equity	103,036,168	34,770,656
Total liabilities and stockholders equity	$ 115,596,111	$ 44,533,268

See accompanying notes to consolidated financial statements.

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ONLINE RESOURCES CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2005	2004	2003
Revenues:			
Account presentation services	$ 8,825,894	$ 3,029,527	$ 4,064,083
Payment services	35,840,725	28,277,468	21,041,685
Relationship management services	7,715,926	7,895,151	8,501,014
Professional services and other	8,118,358	3,083,306	4,800,833
Total revenues	60,500,903	42,285,452	38,407,615
Costs and expenses:			
Service costs	19,845,854	16,751,394	15,148,318
Implementation and other costs	4,671,148	1,307,332	1,482,550
Costs of revenues	24,517,002	18,058,726	16,630,868
Gross profit	35,983,901	24,226,726	21,776,747
General and administrative	13,125,412	9,107,176	8,161,018
Sales and marketing	10,174,312	7,415,788	6,433,211
Systems and development	4,787,994	3,792,611	3,830,565
Total expenses	28,087,718	20,315,575	18,424,794
Income from operations	7,896,183	3,911,151	3,351,953
Other income (expense):			
Interest income	1,303,248	147,185	79,090
Interest expense	(4,639)	(3,391)	(817,603)
Other income (expense)	2,858	38,107	(455)
Debt repurchase/conversion expense			(495,113)
Total other income (expense)	1,301,467	181,901	(1,234,081)
Income before income tax (benefit) provision	9,197,650	4,093,052	2,117,872
Income tax (benefit) provision	(13,465,640)	146,000	15,785
Net income	$ 22,663,290	$ 3,947,052	$ 2,102,087
Net income per share:			
Basic	$ 0.97	$ 0.22	$ 0.14
Diluted	$ 0.88	$ 0.20	$ 0.13
Shares used in calculation of net income per share:			
Basic	23,433,884	18,057,270	15,140,538
Diluted	25,880,338	20,128,093	16,685,602

See accompanying notes to consolidated financial statements.

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ONLINE RESOURCES CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

	Common Stock		Additional Paid-In	Accumulated	Treasury	Accumulated Other Comprehensive (Loss)	Total Stockholders
	Shares	Amount	Capital	Deficit	Stock	Income	Equity
Balance at December 31, 2002	13,706,421	$ 1,370	$ 91,410,356	$ (85,700,448)	$ (227,800)	$ 14,652	$ 5,498,130
Comprehensive income:							
Net income				2,102,087			2,102,087
Unrealized loss on available-for-sale securities						(9,325)	(9,325)
Comprehensive income							2,092,762
Exercise of common stock options	746,911	75	2,167,806				2,167,881
Issuance of common stock	1,357,556	136	4,450,328				4,450,464
Conversion of notes payable	2,001,314	200	8,099,800				8,100,000
Balance at December 31, 2003	17,812,202	1,781	106,128,290	(83,598,361)	(227,800)	5,327	22,309,237
Comprehensive income:							
Net income				3,947,052			3,947,052
Unrealized loss on available-for-sale securities						(5,442)	(5,442)
Comprehensive income							3,941,610
Exercise of common stock options	424,434	42	1,072,572				1,072,614
Issuance of common stock	28,047	3	157,090				157,093
Issuance of common stock in connection with ncurrent acquisition	1,000,014	100	7,290,002				7,290,102
Balance at December 31, 2004	19,264,697	1,926	114,647,954	(79,651,309)	(227,800)	(115)	34,770,656
Comprehensive income:							
Net income				22,663,290			22,663,290
						115	115

Jnrealized gain on ıvailable-for-sale ecurities							
Comprehensive income							22,663,405
Exercise of common tock options	515,831	52	2,991,674				2,991,726
Tax benefit from the exercise of employee tock options			47,013				47,013
ssuance of common tock	130,991	13	339,465				339,478
ssuance of common tock in connection with ollow-on offering, net of costs	5,120,734	512	40,224,146				40,224,658
ssuance of common tock in connection with DS acquisition	181,108	18	1,999,214				1,999,232
Balance at December 31, 2005	25,213,361	$ 2,521	$ 160,249,466	$ (56,988,019)	$ (227,800)	$	$ 103,036,168

See accompanying notes to consolidated financial statements.

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ONLINE RESOURCES CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2005	**2004**	**2003**
Operating activities			
Net income	$ 22,663,290	$ 3,947,052	$ 2,102,087
Adjustments to reconcile net income to net cash provided by operating activities:			
Deferred tax benefit	(13,665,000)		
Debt conversion expense			495,113
Depreciation and amortization	5,855,497	3,665,074	3,137,072
Amortization of debt issuance costs			164,766
Loss on disposal of assets	103,967	38,014	
Provision for losses on accounts receivable	2,091		(10,000)
Net realized loss (gain) on investments		12,939	(6,867)
Amortization of bond (discount) premium	(976)	(37,590)	1,366
Changes in assets and liabilities, net of acquisitions:			
Restricted cash	(568,952)	(1,102,342)	(595,520)
Accounts receivable	1,327,062	(1,997,625)	17,669
Prepaid expenses and other current assets	1,603,102	(1,592,810)	(138,645)
Deferred implementation costs	(248,731)	29,572	121,931
Other assets	(150,100)	(78,645)	332,568
Accounts payable	(565,321)	1,008,119	(244,782)
Accrued expenses and other current liabilities	(1,887,750)	1,674,427	1,055,277
Deferred revenues	1,577,905	463,587	888
Deferred rent	273,979	1,683,065	
Other long-term liabilities	2,125,253	94,422	
Net cash provided by operating activities	18,445,316	7,807,259	6,432,923
Investing activities			
Purchases of property and equipment	(7,481,561)	(9,158,494)	(2,677,013)
Purchases of available-for-sale securities	(3,100,000)	(11,482,953)	(12,658,680)
Sales of available-for-sale securities	4,400,000	16,187,121	11,165,864
Acquisition of Incurrent, net of cash acquired		(8,198,520)	
Acquisition of IDS, net of cash acquired	(3,316,655)		
Net cash used in investing activities	(9,498,216)	(12,652,846)	(4,169,829)
Financing activities			
Net proceeds from issuance of common stock	3,378,152	1,229,707	6,618,345
Net proceeds from issue of common stock in follow-on offering	40,224,146		
Repayment of capital lease obligations	(26,811)	(96,979)	(217,852)
Repurchase of notes payable			(3,900,000)
Net cash provided by financing activities	43,575,487	1,132,728	2,500,493

Net increase (decrease) in cash and cash equivalents	52,522,587	(3,712,859)	4,763,587
Cash and cash equivalents at beginning of year	3,341,678	7,054,537	2,290,950
Cash and cash equivalents at end of year	$ 55,864,265	$ 3,341,678	$ 7,054,537
Supplemental information to statement of cash flows:			
Cash paid for interest	$ 3,789	$ 10,403	$ 830,170
Income taxes paid	$ 281,550	$ 37,274	$ 48,500
Conversion of notes payable	$	$	$ 8,100,000
Net unrealized gain (loss) on investments	$ 115	$ (5,442)	$ (9,325)
Common stock issued in connection with Incurrent acquisition	$	$ 7,290,102	$
Common stock issued in connection with IDS acquisition	$ 1,999,214	$	$

See accompanying notes to consolidated financial statements.

ONLINE RESOURCES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION

Online Resources Corporation (the Company) is a leading outsourcer of web-based account presentation, payment and relationship management services to financial services providers nationwide. The Company offers services, branded in the clients name, that integrate seamlessly into a single-vendor, end-to-end solution, supported by 24×7 customer care, targeted consumer marketing, training and other network and technical professional products and services. The Company currently operates in two business segments banking and card.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of financial statements in conformity with United States generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant accounts, transactions and profits between the consolidated companies have been eliminated in consolidation.

Cash and Cash Equivalents

The Company considers all highly liquid instruments purchased with an original maturity of three months or less to be cash equivalents. Cash held for bill payments in process is immediately disbursed on behalf of users and no net cash balance is reflected on the Company s consolidated financial statements.

Restricted Cash

The Company s restricted cash consists of funds from unclaimed bill payment checks, which the Company will either return to the initiator of the bill payment or surrender the funds to the appropriate state escheat funds.

Fair Value of Financial Instruments

At December 31, 2005 and 2004, the carrying values of the following financial instruments: cash and cash equivalents, restricted cash, accounts receivable, accounts payable, accrued expenses and other liabilities approximate their fair values based on the liquidity of these financial instruments or based on their short-term nature.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk at December 31, 2005 and 2004 consist primarily of cash and cash equivalents and investments in available-for-sale securities. The Company has cash in financial institutions that is insured by the Federal Deposit Insurance Corporation (FDIC) up to $100,000 per

institution. At December 31, 2005 and 2004, the Company had cash and cash equivalent accounts in excess of the FDIC insured limits. Investments in available-for-sale securities were limited to investment-grade securities. The fair value of the Company s financial instruments is substantially

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ONLINE RESOURCES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

equivalent to their carrying value and, although there is some credit risk associated with theses instruments, the Company believes this risk to be insignificant.

Revenue Recognition

The Company generates revenues from service fees, professional services, and other supporting services. Many of its contracts consist of multiple deliverables that require more than one unit of accounting, and these contracts are accounted for according to Emerging Issues Task Force Issues (EITF) No. 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF No. 00-21). Under EITF No. 00-21, the Company allocates revenues in arrangements with multiple deliverables to each qualifying separate unit of accounting based on either their relative fair values or the fair value of the undelivered elements. Fair value is determined by the prices charged when the element is sold separately or other vendor specific objective evidence.

Service fees are primarily composed of three business lines, account presentation services, payment services and relationship management services. Revenues from service fees include new user registration fees, account access fees, transaction fees, customer service fees and relationship marketing support fees. Revenues from service fees are recognized over the term of the contract as the services are provided.

The Company collects funds from end-users and aggregates them in clearing accounts, which are not included on its consolidated balance sheets, as the Company does not have ownership of these funds. For certain transactions, funds may remain in the clearing accounts until a payment check is deposited or other payment transmission is accepted by the receiving merchant. The Company earns interest on these funds for the period they remain in the clearing accounts. This interest totaled $1.8, $0.6 and $0.4 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Professional services revenues consist of implementation fees associated with the linking of the Company s financial institution clients to its Quotien^{sm} e-financial suite through various networks, web development and hosting fees, training fees, communication services and the sales of software licenses and related support. In accordance with Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition in Financial Statements* (SAB No. 104), implementation fees and related direct implementation costs are recognized on a straight-line basis over the contract term, which typically ranges from one to five years (generally three years). Revenues from web development, web hosting, training and communications services are recognized over the term of the contract as the services are provided. Revenues from the sale of software licenses and related support are recognized according to Statement of Position No. 97-2, *Software Revenue Recognition* (SOP No. 97-2), as amended by SOP No. 98-9, *Software Revenue Recognition With Respect to Certain Transactions* (SOP No. 98-9). For sales that require significant production, modification or customization, the Company applies the provisions of Accounting Research Bulletin (ARB) No. 45, *Long-Term Construction-Type Contracts* (ARB No. 45), and SOP No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* (SOP No. 81-1), and recognizes the revenues related to software license fees using the percentage-of-completion method. The percentage-of-completion is measured by the percentage of labor effort incurred to date to estimated total labor effort to complete delivery of the software license. The amount of revenues allocated to each element of a software sale are based on the fair value of undelivered elements based on prices charged when the elements are sold separately. The revenues related to the support of a software license are recognized on a straight-line basis over the term of the support agreement.

Other revenues consist of service fees associated with enhanced third-party solutions and termination fees. Service fees for enhanced third-party solutions include fully integrated bill payment and account retrieval through Intuit s Quicken, check ordering, inter-institution funds transfer, account aggregation and check imaging. Revenues from these service fees are recognized over the term of the contract as the services are provided. Termination fees are recognized upon termination of a contract.

ONLINE RESOURCES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Deferred Income Taxes

Deferred tax assets and liabilities are determined based on temporary differences between financial reporting and the tax bases of assets and liabilities. Deferred tax assets are also recognized for tax net operating loss carryforwards. These deferred tax assets and liabilities are measured using the enacted tax rates and laws that are expected to be in effect when such amounts are expected to reverse or be utilized. The realization of total deferred tax assets is contingent upon the generation of future taxable income. Valuation allowances are provided to reduce such deferred tax assets to amounts more likely than not to be ultimately realized. See Note 9 for further discussion.

Allowance for Doubtful Accounts

The Company performs ongoing credit evaluations of its customers financial condition and limits the amount of credit extended when deemed necessary, but generally does not require collateral. Management believes that any risk of loss is significantly reduced due to the nature of the customers being financial institutions and credit unions as well as the number of its customers and geographic areas. The Company maintains an allowance for doubtful accounts to provide for probable losses in accounts receivable.

Property and Equipment

Property and equipment, including leasehold improvements, are recorded at cost. Depreciation is calculated using the straight-line method over the assets estimated useful lives, which are generally three to five years. The useful life of leasehold improvements is the shorter of the life of the asset or the lease term. Equipment recorded under capital leases is also amortized over the lease term or the asset s estimated useful life. Depreciation and amortization expense was $3.9, $2.9 and $2.6 million for the years ended December 31, 2005, 2004, and 2003, respectively.

Capitalized Software Costs

The Company capitalizes the cost of computer software developed or obtained for internal use in accordance with SOP No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (SOP No. 98-1). Capitalized computer software costs consist primarily of payroll-related and consulting costs incurred during the development stage. The Company expenses costs related to preliminary project assessments, research and development, re-engineering, training and application maintenance as they are incurred. Capitalized software costs are being depreciated on the straight-line method over a period of three years upon being placed in service.

The Company capitalizes the cost of computer software to be sold according to Statement of Financial Accounting Standards (SFAS) No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed* (SFAS No. 86). Software development costs are capitalized beginning when a product s technological feasibility has been established by completion of a working model of the product and ending when a product is ready for general release to customers.

Amortization of capitalized computer software costs was $1.6, $0.8 and $0.5 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Goodwill and Intangible Assets

With the acquisitions of Incurrent Solutions, Inc. (Incurrent) on December 22, 2004 and Integrated Data Systems, Inc. (IDS) on June 27, 2005, the Company recorded goodwill and intangible assets in accordance with SFAS No. 141, *Business Combinations* (SFAS No. 141). In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142), goodwill is not amortized and is tested at the reporting unit level at least annually or whenever events or circumstances indicate that goodwill might be impaired. The

ONLINE RESOURCES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Company has elected to test for goodwill impairment annually as of October 1. Other intangible assets include customer lists, non-compete agreements and purchased technology, and they are amortized using the straight-line method over the periods benefited, which is five years. Other intangible assets represent long-lived assets and are assessed for potential impairment whenever significant events or changes occur that might impact recovery of recorded costs.

Impairment of Long-Lived Assets

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Asset* (SFAS No. 144), the Company periodically evaluates the recoverability of long-lived assets, including deferred implementation costs, property and equipment and intangible assets, whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. There were no indicators of impairment that might indicate that impairment exists for a particular asset group.

Reclassification

Certain amounts reported in prior periods have been reclassified to conform to the 2005 presentation.

Net Income Per Share

Net income per share is computed by dividing the net income for the period by the weighted average number of common shares outstanding. Shares associated with stock options, warrants and convertible securities are not included to the extent they are anti-dilutive.

Comprehensive Income

SFAS No. 130, *Reporting Comprehensive Income* (SFAS No. 130) requires that items defined as comprehensive income or loss be separately classified in the financial statements and that the accumulated balance of other comprehensive income or loss be reported separately from accumulated deficit and additional paid-in capital in the equity section of the balance sheet.

Stock-Based Compensation

The Company has accounted for stock option grants using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB No. 25), for stock-based compensation and to furnish the pro forma disclosures required under SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (SFAS No. 148). In electing to continue to follow APB No. 25 for expense recognition purposes, the Company has provided below the expanded disclosures required under SFAS No. 148 for stock-based compensation granted, including, if materially different from reported results, disclosure of pro forma net income and net income per share had compensation expense relating to grants been measured under the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123).

The weighted-average fair values per share at date of grant for options granted during 2005, 2004, and 2003 with an exercise price equal to the market price of the Company s stock on the date of grant were $6.52, $4.74 and $3.49, respectively. The weighted-average fair values per share at date of grant for options granted during 2004 with an

exercise price greater than the market price of the Company s stock on the date of grant were $4.77. No options were issued in 2005 and 2003 with an exercise price greater than the market price of the Company s stock on the date of grant, and no options were issued in 2005, 2004 or 2003 with an exercise

ONLINE RESOURCES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

price less than the market price of the Company s stock on the date of grant. The fair values were estimated using the Black-Scholes option valuation model with the following weighted-average assumptions:

	Year Ended December 31,		
	2005	2004	2003
Dividend yield			
Expected volatility	74%	82%	91%
Risk-free interest rate	3.87%	3.42%	2.97%
Expected life in years	5.1	5.2	5.2

A reconciliation of the Company s net income to pro forma net income (loss), and the related basic and diluted pro forma net income (loss) per share amounts, for the years ended December 31, 2005, 2004 and 2003, is provided below. For purposes of pro forma disclosure, stock-based compensation expense is recognized in accordance with the provisions of SFAS No. 123. Further, pro forma stock-based compensation expense is amortized to expense on a straight-line basis over the vesting period.

	Year Ended December 31,		
	2005	2004	2003
Net income as reported	$ 22,663,290	$ 3,947,052	$ 2,102,087
Adjustment to net income for:			
Pro forma stock-based compensation expense	(2,782,944)	(2,244,518)	(2,558,313)
Pro forma net income (loss)	$ 19,880,346	$ 1,702,534	$ (456,226)
Basic net income (loss) per share			
As reported	$ 0.97	$ 0.22	$ 0.14
Pro forma	$ 0.85	$ 0.09	$ (0.03)
Diluted net income (loss) per share			
As reported	$ 0.88	$ 0.20	$ 0.13
Pro forma	$ 0.77	$ 0.08	$ (0.03)

Recently Issued Pronouncements

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123(R)), which is a revision of SFAS No. 123. SFAS No. 123(R) supersedes APB No. 25, and amends SFAS No. 95, *Statement of Cash Flows*. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123; however, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the statements of operations based on their fair values. Pro forma disclosure is no longer an alternative upon adopting SFAS No. 123(R). The Company will adopt SFAS No. 123(R) on January 1, 2006. SFAS No. 123(R) permits public companies to adopt its requirements

using one of two methods:

i. A modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123(R) for all awards granted to employees prior to the effective date of SFAS 123(R) that remain unvested on the effective date.

ii. A modified retrospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously

ONLINE RESOURCES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

recognized under SFAS No. 123 for purposes of pro forma disclosures for either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

The Company will implement SFAS No. 123(R) in the first quarter of 2006 and intends to use the modified prospective method.

3. ACQUISITIONS

IDS

On June 27, 2005, the Company completed the acquisition of IDS, a California corporation, pursuant to which IDS merged with and into the Company s wholly-owned subsidiary, IDS LLC, a California limited liability company. The Company now operates the IDS business as part of its banking segment. Founded in 1990, IDS was a privately held software development firm that developed and implemented software applications for credit unions and other financial institutions. The acquisition added approximately 30 employees and facilities in Woodland Hills, California and Pleasanton, California.

The Company s primary reasons for acquiring IDS were to acquire additional distribution and complimentary software products and to exploit the potential product synergies between the companies and to acquire management for that business line. The value of this acquisition to the Company lies in what could be created by exploiting the potential product synergies between the two companies.

The Company issued 181,108 shares of common stock to the IDS shareholders. The Company paid to, and for the benefit of, the IDS shareholders, approximately $3.3 million in cash. The acquisition has been accounted for using the purchase method of accounting. The purchase price was allocated to the estimated fair value of the assets acquired and liabilities assumed. The estimated fair value of the assets acquired and liabilities assumed approximated historical basis. IDS lacked significant intangible assets other than its customer list, non-compete agreements, technology and employee base. Identified values were assigned for the customer list, non-compete agreements and technology and the identified value assigned to the employee base was included in goodwill. The Company engaged a qualified, independent valuation firm to identify and value

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ONLINE RESOURCES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

intangible assets acquired in the transaction. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition:

		At June 30, 2005 (In thousands)
Current assets	$	145
Property, plant and equipment		82
Other assets		26
Identifiable Intangible Assets (five year weighted-average useful life):		
Purchased technology (five year weighted-average useful life)		823
Non-compete agreements (five year useful life)		32
Customer list (five year weighted-average useful life)		338
		1,193
		1,446
Goodwill		4,815
Total assets acquired		6,261
Current liabilities		(960)
Total liabilities assumed		(960)
Net assets acquired	$	5,301

The purchase price allocation to identifiable intangible assets will be amortized on a straight-line basis over the estimated useful life of five years. The amortization will be $0.2 million for each of the next five years.

As the acquisition occurred June 27, 2005, it was determined that IDS results were immaterial from the period June 27, 2005 through June 30, 2005, and thus, the acquisition was assumed to have taken place on June 30, 2005.

Pending the achievement of certain financial metrics in 2005 and 2006, the selling stockholders will receive contingent payments of as much as $1.0 million. Any contingent payment is payable sixty percent in cash and forty percent in equity.

Assuming the acquisition had taken place on January 1, 2004, the Company s pro forma results for the years ended December 31, 2005 and 2004 would have been:

	For the Year Ended December 31	
	2005	2004
Revenues	$ 61,905,650	$ 45,105,883
Net income	$ 21,749,185	$ 2,953,128

Incurrent

On December 22, 2004, the Company completed the acquisition of Incurrent, a New Jersey corporation, pursuant to which Incurrent merged with and into the Company s wholly-owned subsidiary, Incurrent Acquisition LLC, a New Jersey limited liability company. The Company now operates the Incurrent business as its card segment.

ONLINE RESOURCES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. REPORTABLE SEGMENTS

The Company manages its business through two reportable segments: banking and card. On January 1, 2005, the Company established the card segment with the acquisition of Incurrent. Factors used to identify the Company s reportable segments include the organizational structure of the Company and the financial information available for evaluation by the chief operating decision-maker in making decisions about how to allocate resources and assess performance. The Company s operating segments have been broken out based on similar economic and other qualitative criteria. The Company operates both reporting segments in one geographical area, the United States. The Company assesses the performance of its assets in the aggregate, and accordingly, they are not presented on a segment basis. The operating results of the business segments exclude the allocation of intangible asset amortization.

The results of operations from these reportable segments were as follows for the years ended December 31, 2005 (the Company operated under one reportable segment prior to the Incurrent acquisition):

	Banking	Card	Unallocated Expenses(1)	Total
Year ended December 31, 2005:				
Revenues	$ 52,444,884	$ 8,056,019	$	$ 60,500,903
Costs of revenues	19,853,127	4,381,595	282,280	24,517,002
Gross profit	32,591,757	3,674,424	(282,280)	35,983,901
Operating expenses	24,994,222	2,942,482	151,014	28,087,718
Income from operations	$ 7,597,535	$ 731,942	$ (433,294)	$ 7,896,183
Year ended December 31, 2004:				
Revenues	$ 42,285,452	$	$	$ 42,285,452
Costs of revenues	18,058,726			18,058,726
Gross profit	24,226,726			24,226,726
Operating expenses	20,315,575			20,315,575
Income from operations	$ 3,911,151	$	$	$ 3,911,151
Year ended December 31, 2003:				
Revenues	$ 38,407,615	$	$	$ 38,407,615
Costs of revenues	16,630,868			16,630,868
Gross profit	21,776,747			21,776,747
Operating expenses	18,424,794			18,424,794

Income from operations	$ 3,351,953	$	$	$ 3,351,953

(1) Unallocated expenses are comprised of intangible asset amortization that is not included in the measure of segment profit or loss used internally to evaluate the segments.

5. INVESTMENTS

The Company classified its investments as available-for-sale. Investments in securities that were classified as available-for-sale and had readily determinable fair values were measured at fair market value in the balance sheet. Fair market value was based on quoted market value. Any unrealized gains or losses were reported as a separate component of stockholders equity. Realized gains and losses were included in investment income. Interest and dividends also were included in investment income. There was no net realized

ONLINE RESOURCES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

gain or loss for the year ended December 31, 2005. The net realized loss for the year ended December 31, 2004 was approximately $12,900 and the net realized gain for the year ended December 31, 2003 was approximately $6,900. For purposes of determining gross realized gains and losses, the cost of securities sold was based on the average cost method. As of December 31, 2005 there were no investments and therefore no unrealized gain or loss on investments, and the unrealized loss on investments as of December 31, 2004 was $115.

6. PROPERTY AND EQUIPMENT AND CAPITALIZED SOFTWARE COSTS

Property and equipment and capitalized software costs consist of the following:

	December 31,	
	2005	2004
Central processing systems and terminals	$ 20,195,175	$ 17,596,603
Office furniture and equipment	2,721,409	2,634,148
Central processing systems and terminals under capital leases	508,701	500,532
Office furniture and equipment under capital leases	572,117	572,117
Internal use software	9,767,427	5,286,918
Leasehold improvements	2,343,571	2,215,958
	36,108,400	28,806,276
Less accumulated depreciation and amortization	(16,845,288)	(13,183,900)
Less accumulated amortization of internal use software	(2,940,576)	(1,449,898)
Less accumulated depreciation on assets held under capital leases	(1,080,818)	(1,072,649)
	$ 15,241,718	$ 13,099,829

7. GOODWILL AND INTANGIBLE ASSETS

Goodwill consists of the following:

	Banking Segment	Card Segment	Total
Balance at December 31, 2004		11,272,463	11,272,463
Goodwill acquired (IDS acquisition)	4,735,871		4,735,871
Adjustments		314,325	314,325
Balance at December 31, 2005	$ 4,735,871	$ 11,586,788	$ 16,322,659

Intangible assets consist of the following:

	December 31, 2005	December 31, 2004
Purchased technology	$ 1,882,800	$ 1,000,000
Customer lists	907,740	569,800
Non-compete agreements	32,600	
Less accumulated amortization of purchased technology	(282,280)	
Less accumulated amortization of customer lists	(147,754)	
Less accumulated amortization of non-compete agreements	(3,260)	
	$ 2,389,846	$ 1,569,800

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ONLINE RESOURCES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Amortization expense related to intangible assets was $0.4 million for the year ended December 31, 2005. There was no amortization expense related to intangible assets for the years ended December 31, 2004 and 2003. All intangible assets are being amortized over five years. Amortization expense for the years ended December 31, 2006, 2007, 2008 and 2009 is expected to approximate $0.6 million per year and then $0.1 million for the year ended December 31, 2010.

8. COMMITMENTS

The Company leases office space under operating leases expiring in 2007, 2013 and 2014. All but one of the leases provide for escalating rent over the respective lease term. Rent expense under the operating leases for the years ended December 31, 2005, 2004, and 2003, was as follows:

2005	$ 2,050,000
2004	$ 1,636,000
2003	$ 1,312,000

On May 21, 2004, the Company executed a ten-year lease covering 75,000 square feet of office and data center space. The rent commencement date of the new lease was October 1, 2004, and the Company received a lease incentive of approximately $1.7 million in connection with the lease. The benefit of this lease incentive has been deferred as part of lease incentive obligation, recorded as a reduction to lease expense and will be recognized ratably over the term of the lease. The Company amortized $0.2 million of the lease incentive in 2005, and the remaining balance as of December 31, 2005 is $1.5 million.

The Company also leases certain equipment under capital leases. Future minimum lease payments under operating and capital leases are as follows:

	Operating	Capital
2006	2,747,749	9,495
2007	2,253,359	
2008	2,017,509	
2009	2,071,740	
2010	2,127,435	
Thereafter	8,013,342	
Total minimum lease payments	$ 19,231,134	9,495
Less amount representing interest		(1,227)
Present value of minimum lease payments		8,268
Less current portion		8,268

Long-term portion of minimum lease payments	$

9. INCOME TAXES

The Company incurred a current tax liability for federal income taxes resulting from alternative minimum tax (AMT), of $231,000 and $105,000 for years ended December 31, 2005 and 2004, respectively. In addition, the Company incurred a current state tax liability of $13,000 and $41,000 for the years ended December 31, 2005 and 2004, respectively. As a result of the AMT paid, the Company has approximately $308,000 in AMT credits that can be used to offset regular income taxes when paid in the future.

At December 31, 2005, the Company has net operating loss carryforwards of approximately $81 million that expire at varying dates from 2010 to 2022. Of that $81 million, approximately $ 5.0 million relates to the exercise of stock options. Associated with the acquisition of Incurrent in December 2004, the Company generated a net deferred tax asset of $1.6 million representing the acquisition of Incurrent s net operating loss

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ONLINE RESOURCES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

carryforwards and the inclusion of non-deductible intangible assets. The timing and manner in which the Company may utilize the net operating loss carryforwards in subsequent tax years will be limited to the Company s ability to generate future taxable income and, potentially, by the application of the ownership change rules under Section 382 of the Internal Revenue Code. The Company will utilize approximately $11.6 of net operating loss carryforwards for the year ended December 31, 2005.

As of December 31, 2005, Online generated three years of cumulative operating profits. As a result of this positive earnings trend and projected operating results over the next two years, the Company reversed approximately $36 million of its deferred tax asset valuation allowance, having now determined that it is more likely than not that this portion of the deferred tax asset will be realized. This reversal resulted in recognition of an income tax benefit totaling $13.7 million. Of the total income tax benefit recognized, approximately $11.5 million relates to a Federal deferred tax benefit with the remainder representing the state deferred tax benefit.

As of December 31, 2004, the Company recognized a valuation allowance to the full extent of its deferred tax asset of $35.4 million since the likelihood of realization of the benefit did not meet the criteria for release.

Significant components of the Company s net deferred tax assets are as follows:

	December 31,	
	2005	**2004**
Deferred tax assets:		
Net operating loss carryforwards	$ 30,649,000	$ 35,842,000
Deferred wages	127,000	107,000
Deferred rent	742,000	
Other deferred tax assets	587,000	255,000
Total deferred tax assets	32,105,000	36,204,000
Deferred liabilities:		
Acquired intangible assets	(884,000)	(568,000)
Depreciation	(488,000)	(268,000)
Other	(626,000)	
Total deferred tax liabilities	(1,998,000)	(836,000)
Valuation allowance for net deferred tax assets	(16,442,000)	(35,368,000)
Net deferred tax assets	$ 13,665,000	$

Section 382 of the Internal Revenue Code limits the utilization of net operating losses when ownership changes, as defined by that section, occur. Based on the analysis the Company has completed to date, a sufficient amount of net operating losses are available to offset the Company s taxable income for the year ended December 31, 2005. In addition, the Company has recognized a deferred tax asset at December 31, 2005 with respect to a portion of its net

operating losses. This deferred tax asset represents the amount of tax benefit that the Company currently believes it will, more likely than not, have taxable income to apply that benefit against over the next two years. A valuation allowance has been established at December 31, 2005 for the remaining portion of the net operating losses, given the length of time prior to the potential utilization and the uncertainty of having sufficient taxable income in future periods. Assuming no future changes in ownership within the meaning of Section 382, the Company does not currently believe it will have any material limitations on the eventual use of all of its net operating losses, however limitations could be created if the net operating losses are not used within the required time periods.

ONLINE RESOURCES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following is a summary of the items that caused the income tax expense to differ from taxes computed using the statutory federal income tax rate for the years ended December 31, 2005, 2004 and 2003:

	Year Ended December 31,		
	2005	**2004**	**2003**
Tax expense at statutory Federal rate	$ 3,127,000	$ 1,743,000	$ 945,000
Effect of:			
State income tax, net	380,000	197,000	35,000
Other	34,000	112,000	20,000
Alternative minimum tax	187,360	105,000	16,000
Decrease in valuation allowance	(17,194,000)	(2,011,000)	(1,000,000)
Income tax expense	$ (13,465,640)	$ 146,000	$ 16,000

10. PREFERRED STOCK

Of the 3,000,000 authorized preferred shares of the Company, 1,000,000 shares have been designated as Series A Convertible Preferred Stock (Series A Preferred Stock). Holders of Series A Preferred Stock shares are entitled to receive dividends at the same rate as holders of common stock and have voting rights equal to their common stock equivalent on an as if converted basis. Additionally, each Series A Preferred Stock holder is entitled to a liquidation preference equal to $1.00 plus declared but unpaid dividends. There were no shares of Series A Preferred Stock outstanding at December 31, 2004, and it was eliminated from the Company s capital structure at the Annual Meeting of Stockholders in May 2005 through an amendment to the Company s Certificate of Incorporation.

In connection with the adoption of a stockholders rights plan that was implemented on January 11, 2002, the Company, through a certificate of designation that became effective on December 24, 2001, authorized 297,500 shares of Series B Junior Participating Preferred Stock (Series B Preferred Stock). Under the stockholders right plan, which is intended to protect the Company s stockholders from unsolicited attempts to acquire or gain control of the Company, each holder of record of a share of common stock received a right to purchase a unit of 1/100th of a share of Series B Preferred Stock at a price, subject to adjustment, of $115 per unit. The right is not exercisable until an attempt occurs to acquire or gain control of the Company that is unsolicited and does not have the approval of the Company s board of directors. Upon exercise of a right, each holder of a right will be entitled to receive 1/100th of a share of Series B Preferred Stock or, in lieu thereof, a number of shares of common stock equal to the exercise price of the right divided by one-half of the current market price of the Company s common stock. Until exercise of a right for 1/100th of a share of Series B Preferred Stock, no shares of Series B Preferred Stock will be issued. Holders of a share of Series B Preferred Stock are entitled to receive cumulative quarterly dividends equal to the greater of $1.00 per share or 100 times any dividend declared on the Company s common stock and have voting rights equal to 100 votes per share. Additionally, each holder of a share of Series B Preferred Stock is entitled to a liquidation preference equal to $100 plus accrued and unpaid dividends thereon, whether or not declared.

11. STOCKHOLDERS EQUITY

Stock Options

In February 1989, the Company adopted an Incentive Stock Option Plan (the Plan), which has since been amended to allow the issuance of up to 2,316,730 shares of common stock. The option price under the Plan cannot be less than fair market value of the Company s common stock on the date of grant. The vesting period of the options is determined by the Board of Directors and is generally four years. Outstanding options expire after ten years.

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ONLINE RESOURCES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During 1999, the Company adopted the 1999 Stock Option Plan (the 1999 Plan), which permits the granting of both incentive stock options and nonqualified stock options to employees, directors and consultants. The aggregate number of shares that can be granted under the 1999 Plan is 5,858,331. The option exercise price under the 1999 Plan cannot be less than the fair market value of the Company s common stock on the date of grant. The vesting period of the options is determined by the Board of Directors and is generally four years. Outstanding options expire after seven to ten years.

On May 4, 2005, the stockholders approved the 2005 Restricted Stock and Option Plan (the 2005 Plan), which permits the granting of restricted stock units and awards, stock appreciation rights, incentive stock options and nonstatutory stock options to employees, directors and consultants. The aggregate number of shares that can be granted under the 2005 Plan is 1,700,000.

As of December 31, 2005, the Company has 6,538,608 shares reserved for issuance for stock options and restricted stock awards.

On December 8, 2004, the Board of Directors authorized the acceleration of the vesting of 99,500 options with an exercise price equal to or above $13 in order to avoid recognizing an expense in relation to these options in future financial statements.

On August 30, 2005, the Board of Directors authorized the issuance of stock options to employees as a part of the Company s 2005 bonus plan with a determination grant and vest date of December 31, 2005. Based on the Company s 2005 operating performance, approximately 74,000 options were issued in connection with the 2005 bonus plan.

Additional information with respect to stock option activity under the stock option plans is summarized as follows:

	Year Ended December 31,					
	2005		2004		2003	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	5,128,591	$ 5.67	5,357,563	$ 5.38	5,918,376	$ 5.13
Options granted exercise price equal to market price	518,271	$ 10.29	456,497	$ 6.89	438,677	$ 4.87
Options granted exercise price greater than market price		$	36,300	$ 8.59		$
Options exercised	(540,514)	$ 6.00	(424,434)	$ 2.53	(746,911)	$ 2.86
	(316,482)	$ 7.13	(297,335)	$ 7.23	(252,579)	$ 6.16

Options canceled or expired								
Outstanding at end of year	4,789,866	$	6.03	5,128,591	$	5.67	5,357,563	$	5.38
Options exercisable at end of year	3,433,451	$	6.03	3,241,761	$	6.63	3,377,085	$	6.12

ONLINE RESOURCES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes information about stock options outstanding at December 31, 2005.

	December 31, 2005				
	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted-Average Remaining Contractual Life (In Years)	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
$ 0.06 to $ 2.30	831,310	4.63	$ 2.01	798,056	$ 2.00
$ 2.38 to $ 2.86	805,671	5.86	$ 2.81	568,021	$ 2.81
$ 2.90 to $ 3.20	702,085	5.05	$ 3.08	421,191	$ 3.08
$ 3.27 to $ 6.81	711,053	5.04	$ 5.42	457,492	$ 5.45
$ 6.85 to $ 9.80	698,564	4.42	$ 8.10	402,179	$ 8.15
$ 9.82 to $14.06	921,617	3.51	$ 12.34	666,946	$ 12.81
$14.13 to $21.50	119,566	1.44	$ 16.04	119,566	$ 16.04
	4,789,866	4.63	$ 6.03	3,433,451	$ 6.03

Warrants

The Company has no outstanding warrants at December 31, 2005, as the final 200,000 outstanding warrants were exercised in April 2005.

12. NET INCOME PER SHARE

The following table sets forth the computation of basic and diluted net income per share:

	Year Ended December 31,		
	2005	2004	2003
Net income	$ 22,663,290	$ 3,947,052	$ 2,102,087
Weighted average shares outstanding used in calculation of income per share:			
Basic	23,433,884	18,057,270	15,140,538
Dilutive warrants		62,525	38,073
Dilutive options	2,446,455	2,008,298	1,506,991
Diluted	25,880,339	20,128,093	16,685,602

Net income per share:						
Basic	$	0.97	$	0.22	$	0.14
Diluted	$	0.88	$	0.20	$	0.13

Due to their anti-dilutive effects, outstanding shares from the conversion of the Convertible Notes, stock options and warrants to purchase 2,597,068, 3,432,622, and 4,113,639 shares of common stock at December 31, 2005, 2004 and 2003, respectively, were excluded from the computation of diluted net income per share.

13. EMPLOYEE BENEFIT PLANS

Employee Savings and Retirement Plan

The Company has a 401(k) plan that allows eligible employees to contribute up to 15% of their salary. The Company has total discretion about whether to make an employer contribution to the plan and the amount of the employer contribution. The Company has historically chosen not to match the employee contributions

ONLINE RESOURCES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and, therefore, has not incurred any contribution expense. Beginning January 1, 2006, the Company will begin matching employee contributions to the 401(k) plan at a rate of fifty percent on the first two percent of the employee s contributions to the plan, up to an annual limitation of $1,000 per employee. The Company incurred $9,389, $8,868 and $15,583 in expense for administration of its 401(k) plan for the years ended December 31, 2005, 2004 and 2003, respectively.

Employee Stock Purchase Plan

The Company has an employee stock purchase plan for all eligible employees to purchase shares of common stock at 85% of the lower of the fair market value on the first or the last day of each six-month offering period. Employees may authorize the Company to withhold up to 10% of their compensation during any offering period, subject to certain limitations. The employee stock purchase plan authorizes up to 400,000 shares to be granted. During the year ended December 31, 2005 and 2004, shares totaling 41,466 and 28,046 were issued under the plan at an average price of $8.17 and $5.62 per share, respectively. At December 31, 2005, 198,074 shares were reserved for future issuance. Beginning January 1, 2006, the Company is changing its employee stock purchase plan to allow all eligible employees to purchase shares of common stock at 95% of the fair market value on the last day of each three-month offering period.

14. SUMMARIZED QUARTERLY DATA (UNAUDITED)

The following financial information reflects all normal recurring adjustments that are, in the opinion of management, necessary for a fair statement of the results of the interim periods. Summarized quarterly data for the years 2005 and 2004 is as follows:

	Quarter Ended			
	March 31, 2005	June 30, 2005	September 30, 2005	December 31, 2005
Total revenues	$ 15,111,540	$ 14,329,447	$ 15,292,492	$ 15,767,424
Gross profit	$ 9,187,056	$ 8,250,176	$ 9,219,776	$ 9,326,893
Net income	$ 2,207,942	$ 1,563,525	$ 2,363,403	$ 16,528,420
Net income per share:				
Basic	$ 0.11	$ 0.06	$ 0.09	$ 0.66
Diluted	$ 0.10	$ 0.06	$ 0.09	$ 0.60

	Quarter Ended			
	March 31, 2004	June 30, 2004	September 30, 2004	December 31, 2004
Total revenues	$ 9,767,367	$ 10,068,458	$ 11,046,654	$ 11,402,973
Gross profit	$ 5,122,888	$ 5,716,319	$ 6,650,366	$ 6,737,153
Net income	$ 224,333	$ 983,208	$ 1,810,657	$ 928,854

Net income per share:								
Basic	$	0.01	$	0.05	$	0.10	$	0.05
Diluted	$	0.01	$	0.05	$	0.09	$	0.05

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Item 9. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

No changes in or disagreements with accountants on accounting and financial disclosure have occurred during the two most recent fiscal years.

Item 9A. ***Controls and Procedures***

(a) Disclosure Controls and Procedures

As of the end of the period covered by this report, Online Resources carried out an evaluation, under the supervision and with the participation of Online Resources management, including Online Resources Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer, of the effectiveness of the design and operation of Online Resources disclosure controls and procedures (as defined in Rule 13a-15 of the Securities Exchange Act of 1934). Based on that evaluation, our Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer have concluded that Online Resources current disclosure controls and procedures are effective in timely alerting them of material information relating to Online Resources that is required to be disclosed by Online Resources in the reports it files or submits under the Securities Exchange Act of 1934.

(b) Internal Control Over Financial Reporting

(1) Management s Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934 and for the assessment of the effectiveness of internal control over financial reporting.

Management s assessment of the effectiveness of our internal control over financial reporting as of December 31, 2005, has been audited by Ernst & Young LLP, the independent registered accounting firm that audited our financial statements, as stated in their report which is included in this Annual Report on Form 10-K.

Management s report on internal control over financial reporting and the attestation report of Ernst & Young LLP, an independent registered public accounting firm, thereon are set forth under the headings Management s Report on Internal Control over Financial Reporting and Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting in this Annual Report.

(2) Attestation Report of the Registered Public Accounting Firm

Our independent registered public accounting firm, Ernst & Young LLP, has issued an attestation report concurring with management s assessment, which is included at the beginning of Part II, Item 8 of this Annual Report on Form 10-K.

(3) Changes in Internal Control Over Financial Reporting

There have been no changes in Online Resources internal control over financial reporting that occurred during the quarter ended December 31, 2005 that have materially affected, or are reasonably likely to materially affect, Online Resources internal control over financial reporting.

Item 9B. ***Other Information***

None.

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PART III

Item 10. ***Directors and Executive Officers of the Company***

The information required by this item is incorporated by reference to the sections and subsections entitled Management , Executive Compensation , Code of Ethics , Audit Committee , Audit Committee Financial Experts a Section 16(a) Beneficial Ownership Reporting Compliance contained in our Proxy Statement for the 2006 Annual Meeting of Stockholders to be filed with the SEC pursuant to Regulation 14A.

Item 11. ***Executive Compensation***

The information required by this item is incorporated by reference to the section entitled Executive Compensation and Transactions contained in our Proxy Statement for the 2006 Annual Meeting of Stockholders to be filed with the SEC pursuant to Regulation 14A.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

The information required by this item is incorporated by reference to the section entitled Security Ownership of Certain Beneficial Owners and Management contained in our Proxy Statement for the 2006 Annual Meeting of Stockholders to be filed with the SEC pursuant to Regulation 14A.

Item 13. ***Certain Relationships and Related Transactions***

The information required by this item is incorporated by reference to the section entitled Certain Relationships and Related Transactions contained in our Proxy Statement for the 2006 Annual Meeting of Stockholders to be filed with the SEC pursuant to Regulation 14A.

Item 14. ***Principal Accountant Fees and Services***

The information required by this item is incorporated by reference to the section entitled Principal Accountant Fees and Services contained in our Proxy Statement for the 2006 Annual Meeting of Stockholders to be filed with the SEC pursuant to Regulation 14A.

PART IV

Item 15. ***Exhibits and Financial Statement Schedules***

(a) The following documents are filed as part of this report:

(1) *Consolidated Financial Statements.* All financial statements are filed in Part II, Item 8 of this report on Form 10-K.

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets

Consolidated Statements of Operations

Consolidated Statements of Stockholders Equity

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

(2) *Schedule II Valuation and Qualifying Accounts.*

All other schedules set forth in the applicable accounting regulations of the Securities and Exchange Commission either are not required under the related instructions or are not applicable and, therefore, have been omitted.

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(3) *List of Exhibits.*

3.1	Form of Amended and Restated Certificate of Incorporation of the Company (Incorporated by reference from our registration statement on Form S-1; Registration No. 333-74777)
3.2	Form of Amended and Restated Bylaws of the Company (Incorporated by reference from our registration statement on Form S-1; Registration No. 333-74777)
3.3	Certificate of Designation of Shares of Series B Junior Participating Preferred Stock (Filed as Exhibit 3.3 to our Form 10-K for the year ended December 31, 2002 filed on March 31, 2003 and incorporated herein by reference)
4.1	Specimen of Common Stock Certificate of the Company (Incorporated by reference from our registration statement on Form S-1; Registration No. 333-74777)
4.2	Registration Rights Agreement dated September 28, 2000 among the Registrant and Jefferies & Company, Inc. as the placement agent (Filed as Exhibit 4.2 to our Form 10-Q for the quarter ended September 30, 2000 filed on November 14, 2000 and incorporated herein by reference)
4.3	Rights Agreement dated as of January 11, 2002, between the registrant and American Stock Transfer & Trust Company (filed as Exhibit 4.1 to our Form 8-K filed on January 15, 2002 and incorporated herein by reference.)
10.1	Lease Agreement for premises at 7600 Colshire Drive, McLean, Virginia (Incorporated by reference from our registration statement on Form S-1; Registration No. 333-74777)
10.2	Online Resources & Communications Corporation 1989 Stock Option Plan (Incorporated by reference from our registration statement on Form S-1; Registration No. 333-74777)
10.3	1999 Stock Option Plan (Incorporated by reference from our registration statement on Form S-1; Registration No. 333-74777)
10.4	Employee Stock Purchase Plan (Incorporated by reference from our registration statement on Form S-8; Registration No. 333-40674)
10.5	Lease Agreement for premises at 4795 Meadow Wood Lane, Chantilly, Virginia (filed as an exhibit to our Form 10-Q for the quarter ended September 30, 2004 filed on November 5, 2004 and incorporated herein by reference.)
10.6	2005 Restricted Stock and Option Plan (Incorporated by reference from our Definitive Proxy Statement filed on April 5, 2005)
23	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act, as amended
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act, as amended
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sabanes-Oxley Act of 2002

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON FINANCIAL STATEMENT SCHEDULE

We have audited the consolidated financial statements of Online Resources Corporation as of December 31, 2005 and 2004, and for each of the three years in the period ended December 31, 2005, and have issued our report thereon dated March 15, 2006. Our audits also included the financial statement schedule listed in Item 14(a)(2) of the Form 10-K. This schedule is the responsibility of the Company s management. Our responsibility is to express an opinion based on our audits.

In our opinion, the financial statement schedule referred to above, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ ERNST & YOUNG LLP

McLean, Virginia
March 15, 2006

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Schedule II Valuation and Qualifying Accounts:

Classification	Balance at Beginning of Period	Additions	Deductions	Balance at End of Period
Allowance for doubtful accounts:				
Year ended December 31, 2003	$ 76,905	$	$ 10,000(2)	$ 66,905
Year ended December 31, 2004	$ 66,905	$ 99,685(3)	$ 14,275(1)	$ 152,315
Year ended December 31, 2005	$ 152,315	$ 10,091	$ 8,000(1)	$ 154,406
Allowance for deferred tax asset:				
Year ended December 31, 2003	$ 45,516,168	$	$ 2,117,872(4)	$ 43,398,296
Year ended December 31, 2004	$ 43,398,296	$	$ 4,093,052(4)	$ 39,305,244
Year ended December 31, 2005	$ 39,305,244	$	$ 22,862,650(5)	$ 16,442,594

Notes:

(1) Uncollectible accounts written off.

(2) Reversal of previously reserved amounts that were collected.

(3) $85,410 related to the acquisition of Incurrent Solutions, Inc.

(4) Income before income tax provision

(5) Income before income tax provision and release of deferred tax asset of $13.7 million

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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

By: /s/ MATTHEW P. LAWLOR
Matthew P. Lawlor
Chairman and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Signature	Title	Date
/s/ MATTHEW P. LAWLOR Matthew P. Lawlor	Chairman and Chief Executive Officer (Principal Executive Officer)	March 16, 2006
/s/ CATHERINE A. GRAHAM Catherine A. Graham	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	March 16, 2006
/s/ WILLIAM J. NEWMAN, III William J. Newman, III	Director of Finance and Corporate Controller (Principal Accounting Officer)	March 16, 2006
/s/ WILLIAM H. WASHECKA William H. Washecka	Director	March 16, 2006
/s/ JOSEPH J. SPALLUTO Joseph J. Spalluto	Director	March 16, 2006
/s/ STEPHEN S. COLE Stephen S. Cole	Director	March 16, 2006
/s/ ERVIN R. SHAMES Ervin R. Shames	Director	March 16, 2006
/s/ EDWARD E. FURASH	Director	March 16, 2006

Edward E. Furash		
/s/ BARRY D. WESSLER	Director	March 16, 2006
Barry D. Wessler		
/s/ MICHAEL H. HEATH	Director	March 16, 2006
Michael H. Heath		