MEMBERWORKS INC
Form 10-Q
November 09, 2004

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

FORM 10-Q

_X_ Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2004
or
___ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from ________ to _________.

Commission File No. 0-21527

MEMBERWORKS INCORPORATED
(Exact name of registrant as specified in its charter)

DELAWARE	06-1276882
(State of Incorporation)	(IRS Employer Identification No.)
680 Washington Boulevard Stamford, Connecticut	06901
(Address of principal executive offices)	(Zip Code)

(203) 324-7635
(Registrant's telephone number, including area code)

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

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

Indicate the number of shares outstanding of each of the registrant's class of common stock as of the latest practicable date: 10,002,792 shares of Common Stock, $0.01 par value as of October 29, 2004.

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

	September 3 2004
Assets	
Current assets:	
Cash and cash equivalents	$ 151,96
Restricted cash	2,11
Short-term investments	15,54
Accounts receivable (net of allowance for doubtful accounts of $236 and $235 at September 30, 2004 and June 30, 2004, respectively)	9,96
Prepaid membership materials	3,37
Prepaid expenses and other current assets	6,49
Membership solicitation and other deferred costs	46,24
Total current assets	235,69

Fixed assets, net	34,05
Goodwill	126,58
Intangible assets, net	37,68
Other assets	10,86
Total assets	$ 444,88

Liabilities and Shareholders' Deficit

Current liabilities:	
Current maturities of long-term obligations	$ 33
Accounts payable	32,69
Accrued liabilities	69,62
Deferred revenues	122,32
Deferred income taxes	10,49
Total current liabilities	235,48
Deferred income taxes	10,65
Other long-term liabilities	4,89
Long-term debt	237,69
Total liabilities	488,72
Commitments and contingencies (Note 9)	
Shareholders' deficit:	
Preferred stock, $0.01 par value -- 1,000 shares authorized; no shares issued	
Common stock, $0.01 par value -- 40,000 shares authorized; 19,155 shares issued (19,089 shares at June 30, 2004)	19
Capital in excess of par value	157,50
Accumulated earnings (deficit)	17,72
Accumulated other comprehensive loss	47
Treasury stock, 9,131 shares at cost (8,852 shares at June 30, 2004)	(219,73
Total shareholders' deficit	(43,84
Total liabilities and shareholders' deficit	$ 444,88

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

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

	Three Sep
	2004
Revenues	$ 135,62

Expenses:	
Marketing	68,53
Operating	24,21
General and administrative	24,60
Amortization of intangibles	1,54
Operating income	16,73
Interest (expense) income, net	(4,64
Other expense, net	(13
Income before income taxes	11,95
Provision for income taxes	4,35
Net income	$ 7,59
Basic earnings per share	$ 0.7
Diluted earnings per share	$ 0.6
Weighted average common shares used in earnings per share calculations:	
Basic	10,17
Diluted	12,94

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

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

	Three Sep
	2004
Operating activities	
Net income	$ 7,59
Adjustments to reconcile net income to net cash provided by operating activities:	
Change in deferred revenues	(16,33
Change in membership solicitation and other deferred costs	6,34
Depreciation and amortization	5,03
Deferred and other income taxes	3,10
Tax benefit from employee stock plans	12
Other	82
Change in assets and liabilities:	
Restricted cash	1,00
Accounts receivable	59
Prepaid membership materials	(13

Prepaid expenses	(1,22
Other assets	(1
Accounts payable	(2,46
Accrued and other liabilities	3,45
Net cash provided by (used in) operating activities	7,90
Investing activities	
Acquisition of fixed assets	(71
Purchase of short-term investments	(8,19
Other investing activities	30
Net cash used in investing activities	(8,60
Financing activities	
Net proceeds from issuance of stock	91
Treasury stock purchases	(7,25
(Debt issuance costs) net proceeds from issuance of debt	(58
Payments of long-term obligations	(9
Net cash (used in) provided by financing activities	(7,00
Effect of exchange rate changes on cash and cash equivalents	17
Net (decrease) increase in cash and cash equivalents	(7,53
Cash and cash equivalents at beginning of year	159,49
Cash and cash equivalents at end of year	$ 151,96

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

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MEMBERWORKS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 - NATURE OF BUSINESS

MemberWorks Incorporated (the "Company"), a Delaware Corporation, began doing business as Cardmember Publishing Corporation in 1986, was organized as MemberWorks Incorporated in 1996 and has been doing business as MemberWorks Incorporated since that time. On October 13, 2004, the Company began doing business as Vertrue Incorporated. The name change was intended to reflect the ever-broadening base of membership services that the Company offers to its customers. The Company is a category leader in both membership and loyalty programs. The Company's membership programs are both subscription and transaction based offerings focused on meeting consumer needs in large spending categories - healthcare, discounts, security and personals. The Company's programs offer everyday savings, event-oriented discounts, peace of mind and unique consumer benefits. Programs are available in English, French and Spanish and are increasingly customized for specific client customer segments or consumer communities. The Company's loyalty programs provide clients with a wide range of benefits to offer or market to their customers and include stand-alone benefits, reward point accumulation and management, gift certificate, merchandise and travel reward redemption. The Company's versatility in designing loyalty strategies and providing turnkey execution is essential in supporting and promoting the client's brand.

NOTE 2 - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, such statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The preparation of these consolidated financial statements in conformity with generally accepted accounting principles requires management of the Company to make estimates, judgments and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Operating results for the three months ended September 30, 2004 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2005. For further information, refer to the financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K with respect to the fiscal year ended June 30, 2004.

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

On April 1, 2004, the Company acquired Lavalife Inc. Therefore, the results of operations of Lavalife Inc. have been included in the consolidated results of operations since the date of acquisition and are not included in the results of operations for the three months ended September 30, 2003.

NOTE 3 - RECLASSIFICATIONS

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

NOTE 4 - STOCK-BASED COMPENSATION

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

	Three Months Ended September 30,	
	2004	2003
Net income reported	$ 7,596	$ 3,895
Add: Stock-based employee compensation expense determined under the		

intrinsic value based method for all awards, net of related tax effects	-	-
Deduct: Stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	979	1,265
Pro forma net income	$ 6,617	$ 2,630
Earnings per share:		
As reported:		
Basic	$ 0.75	$ 0.33
Diluted	$ 0.65	$ 0.30
Pro forma:		
Basic	$ 0.65	$ 0.23
Diluted	$ 0.56	$ 0.20

NOTE 5 - GOODWILL AND OTHER INTANGIBLE ASSETS

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

	As of September 30, 2004		As of Jun
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount
Amortizable intangible assets:			
Membership and client relationships	$ 27,994	$ (9,889)	$ 27,999
Trade name	18,543	(618)	18,543
Other	1,520	(919)	1,162
Total amortizable intangible assets	48,057	(11,426)	47,704
Amortizable intangible assets, net	$ 36,631		$ 37,822
Unamortizable intangible assets:			
Goodwill	$ 126,586		$ 125,675
Intangible asset related to minimum pension liability	$ 1,050		$ 1,050

The future intangible amortization expense for the next five years is estimated to be as follows

Fiscal Year	
2005	$ 6,331
2006	6,062
2007	5,195
2008	3,175
2009	2,754

MEMBERWORKS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The changes in the carrying amount of goodwill for the three months ended

September 30, 2004 are as follows (in thousands):

Balance at June 30, 2004	$ 125,675
Arising from purchase price adjustments	911
Balance at September 30, 2004	$ 126,586

Goodwill was tested for impairment during the quarters ended September 30, 2004 and 2003 as required by SFAS 142. The Company concluded that none of its goodwill was impaired. Fair value was estimated using a discounted cash flow method. In addition, the Company reassessed the estimated useful lives of its indefinite lived intangible assets and determined that the lives were appropriate. The Company will continue to test the goodwill of each of its reporting units annually or more frequently if impairment indicators exist.

NOTE 6 - FOREIGN CURRENCY INSTRUMENTS

The Company uses purchase option contracts and forward contacts to minimize its exposure to changes in future cash flows caused by movements in foreign currency exchange rates between the US dollar and the Canadian dollar. Derivatives are held only for the purpose of hedging such risks and are not used for speculative purposes. Derivatives used to hedge forecasted transactions and specific cash flows associated with Canadian dollar denominated financial assets and liabilities that meet the criteria for hedge accounting are designated as cash flow hedges. The effective portion of gains and losses is deferred as a component of accumulated other comprehensive income and is recognized in earnings in the same line item as the underlying hedged item at the time the hedged item affects earnings.

The fair value of these contracts is included in prepaid and other current assets and the related gains and losses were recorded in operating expenses and general administrative expenses and amounted to $44,000 for the quarter ended September 30, 2004. As of September 30, 2004, the fair value of these instruments was $862,000 (asset). All forecasted transactions currently being hedged are expected to occur over the next twelve months. There were no such instruments utilized during the quarter ended September 30, 2003.

NOTE 7 - ALLOWANCE FOR MEMBERSHIP CANCELLATIONS

Accrued liabilities set forth in the accompanying condensed consolidated balance sheets as of September 30, 2004 and June 30, 2004 include an allowance for membership cancellations of $12,017,000 and $14,156,000, respectively. Recording an allowance for membership cancellations has the effect of reducing the amount of deferred membership fees recorded.

NOTE 8 - RESTRUCTURING CHARGES

The restructuring reserve balance, which is recorded in accrued liabilities and other long-term liabilities, amounted to $1,596,000 and $1,644,000 as of September 30, 2004 and June 30, 2004, respectively. Cash payments for the quarter ended September 30, 2004 were $48,000 and relate to lease obligations.

NOTE 9 - COMMITMENTS AND CONTINGENCIES

The Company operates in leased facilities. Management expects that leases currently in effect will be renewed or replaced by other leases of a similar nature and term.

On March 25, 2004, the Company entered into an amended and restated senior secured credit facility that allows borrowings of up to $45,000,000. Borrowings under the senior secured credit facility accrue interest at either the Eurodollar rate, or the higher of the Prime rate or the Federal Funds rate, plus an applicable margin. The availability under the senior secured credit facility is reduced by an outstanding letter of credit of $5,459,000 and by one years' worth of interest on the Senior Notes. There were no borrowings outstanding under this bank credit facility as of September 30, 2004. As of September 30, 2004, the availability under the senior secured credit facility is $25,663,000.

Legal proceedings

Except as set forth below, in management's opinion, there are no significant legal proceedings to which the Company or any of its subsidiaries is a party or to which any of their properties are subject. The Company is involved in other lawsuits and claims generally incidental to its business including, but not limited to, various suits, including previously disclosed suits, brought against the Company by individual consumers seeking monetary and/or injunctive relief relating to the marketing of the Company's programs. In addition, from time to time, and in the regular course of its business, the Company receives inquiries from various federal and/or state regulatory authorities.

On October 21, 2003, the Florida Attorney General's Office filed a civil complaint against the Company based upon concerns that some of its past marketing practices may have violated various consumer laws. On June 28, 2004, the Company announced that it had reached a voluntary settlement with the Florida Attorney General's office to alleviate these concerns. In connection with the settlement, the Company agreed to formalize its existing national Best Marketing Practices in the state of Florida and to pay the state of Florida costs of investigation of $950,000. The Company expects that the agreement will have little new effect on its business in Florida as the agreement serves to formalize the Company's already existing national marketing best practices in the state.

On January 24, 2003, the Company filed a motion with the Superior Court for the Judicial District of Hartford, Connecticut to vacate and oppose the confirmation of an arbitration award issued in December 2002. The arbitration, filed against the Company by MedValUSA Health Programs, Inc. ("MedVal") in September 2000, involved claims of breach of contract, breach of the duty of good faith and fair dealing, and violation of the Connecticut Unfair Trade Practices Act ("CUTPA"). Even though the arbitrators found that the Company was not liable to MedVal for any compensatory damages, they awarded $5,495,000 in punitive damages and costs against the Company solely under CUTPA. The Company believes that this arbitration award is unjustified and not based on any existing legal precedent. Specifically, the Company is challenging the award on a number of grounds, including that it violates a well defined public policy against excessive punitive damage awards, raises constitutional issues and disregards certain legal requirements for a valid award under CUTPA. The hearing on the Company's motion was held on February 10, 2003. On June 22, 2003, the Superior Court denied the Company's motion to vacate the award, and the Company filed an appeal of that decision. While the Company intends to take action to prevent the enforcement of the award by, among other things, vigorously pursuing an appeal, there can be no assurance that the Company will be successful in its efforts. The Company has made no provision in its financial statements for this contingency because it believes that a loss is not probable. If the Company was ultimately unsuccessful in this or other available appeals, and a final non-appealable court order confirming the arbitration award is rendered, the payment of the award could have a material adverse effect on the Company's results of operations in the period in which the final order is entered.

In March 2001, an action was instituted by plaintiff Teresa McClain against Coverdell & Company ("Coverdell"), a wholly-owned subsidiary of the Company, Monumental Life Insurance Company and other defendants in the United States

District Court for the Eastern District of Michigan, Southern Division. The suit, which seeks unspecified monetary damages, alleges that Coverdell and the other defendants violated the Michigan Consumer Protection Act and other applicable Michigan laws in connection with the marketing of Monumental Life Insurance Company insurance products. The Court certified a class of Michigan residents. The Court has now signed an Order granting preliminary approval of a settlement agreement that has been signed by all parties. The Court will hold the Fairness/Approval hearing on November 22, 2004. The settlement agreement will have no financial or other material impact on the Company's business.

NOTE 10 - INCOME TAX EXPENSE

Income tax expense as a percentage of pre-tax income was 36.5% and 40% for the three months ended September 30, 2004 and 2003, respectively. The effective tax rate was higher than the U.S. statutory rate for the three months ended September 30, 2004 and 2003 primarily due to state taxes and other non-deductible items. The estimated effective tax rate for the three months ended September 30, 2004 decreased from the prior year quarter due to certain tax planning strategies implemented. The Company expects an effective tax rate of approximately 37% for fiscal 2005. Tax benefits resulting from the exercise of nonqualified stock options and the disqualifying dispositions of shares issued under the Company's stock based compensation plans reduced taxes payable by $129,000 and $1,515,000 for the quarter ended September 30, 2004 and 2003, respectively. Such benefits are credited to capital in excess of par value.

The Company has open tax years in the U.S., Canada and other jurisdictions that are currently not under examination by the applicable tax authorities and may be subject to examination in the future. The Company periodically evaluates the adequacy of its related tax reserves, taking into account its open tax return positions and tax law changes. The Company believes that its tax reserves are appropriate. However, the final determination of tax audits could impact the Company's assessment of tax requirements.

NOTE 11 - EARNINGS PER SHARE

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

	Thr
	200
Numerator:	
Income available to common shareholders used in basic earnings per share	$ 7,
Add Back: Interest expense on convertible securities	
Income available to common shareholders after assumed conversion of dilutive securities and cumulative effect of accounting change for diluted earning per share	$ 8,
Denominator :	
Weighted average number of common shares outstanding- basic	10,
Effect of dilutive securities:	

Convertible securities	
Stock options	2,
Weighted average number of common shares outstanding- diluted	12,
Basic earnings per share	$ 0
Diluted earnings per share	$ 0

The diluted earnings per common share calculation excludes the effect of potentially dilutive shares when their effect is antidilutive. Excluded from the diluted share calculation above for the three months ended September 30, 2004 and 2003 are incremental weighted average stock option shares of approximately 1,169,000 and 0, respectively.

NOTE 12 - COMPREHENSIVE INCOME

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

	Three Months Ended September 30,	
	2004	2003
Net income	$ 7,596	$ 3,895
Unrealized gain on derivative assets	749	-
Foreign currency translation gain	98	2
Comprehensive income	$ 8,443	$ 3,897

NOTE 13 - BUSINESS SEGMENTS

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

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MEMBERWORKS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

	Three Months Ended September 30,	
	2004	2003
Revenues:		

Membership	$ 117,278	$ 113,824
Personals	18,345	-
Total	$ 135,623	$ 113,824
Operating Income:		
Membership	$ 16,784	$ 6,620
Personals	(52)	-
Total	$ 16,732	$ 6,620

	September 30, 2004	June 30, 2004
Assets:		
Membership	$ 178,576	$ 178,723
Personals	138,896	136,874
Corporate and other (1)	127,414	137,565
Total	$ 444,886	$ 453,162

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

NOTE 14 - GUARANTOR AND NONGUARANTOR FINANCIAL INFORMATION

In April 2004, the Company issued $150,000,000 aggregate principal amount of 9.25% Senior Notes in a private placement pursuant to Rule 144A. The Senior Notes are unsecured obligations and will rank pari passu in right of payment to all of the Company's existing and future senior unsecured indebtedness and senior in right of payment to all of the Company's existing and future subordinated indebtedness that expressly provides for its subordination to the Notes. The Senior Notes are fully and unconditionally guaranteed by all of the Company's existing and future domestic subsidiaries and certain of the Company's existing and future foreign subsidiaries.

The following consolidating financial information presents the consolidating balance sheets as of September 30, 2004 and June 30, 2004, the related statements of operations for the three months ended September 30, 2004 and 2003 and the related statements of cash flows for the three months ended September 30, 2004 and 2003. The information includes the elimination entries necessary to consolidate the Company ("Parent") with the guarantor and nonguarantor entities.

Investments in subsidiaries are accounted for by the Parent using the equity method of accounting. The guarantor and nonguarantor subsidiaries are presented on a combined basis. The principal elimination entries eliminate investments in subsidiaries and intercompany balances and transactions.

CONSOLIDATED BALANCE SHEETS

As of September

	Parent	Guarantor Subsidiaries	Nonguara Subsidia
Assets			(in thous
Current assets	$ 184,171	$ 48,337	$ 11,
Fixed assets, net	18,300	13,650	2,
Goodwill	-	119,867	6,
Intangible assets, net	1,408	36,273	
Other assets	10,821	43	
Intercompany notes receivable	2,052	-	
Investment in subsidiaries	172,174	-	
Total assets	$ 388,926	$ 218,170	$ 20,
Liabilities and Shareholders' (Deficit) Equity			
Current liabilities	$ 189,991	$ 43,361	$ 10,
Deferred income taxes	1,424	9,243	
Other long-term liabilities	3,657	-	1,
Intercompany notes payable	-	2,052	
Long-term debt	237,696	-	
Total liabilities	432,768	54,656	11,
Shareholders' (deficit) equity:			
Preferred stock	-	-	
Common stock	191	6	
Capital in excess of par value	157,505	165,070	9,
Accumulated (deficit) earnings	17,727	(2,218)	(
Accumulated other comprehensive loss	474	656	(
Treasury stock	(219,739)	-	
Total shareholders' (deficit) equity	(43,842)	163,514	8,
Total liabilities and shareholders' (deficit) equity	$ 388,926	$ 218,170	$ 20,

MEMBERWORKS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

CONSOLIDATED BALANCE SHEETS

	As of June 30		
	Parent	Guarantor Subsidiaries	Nonguara Subsidia
Assets			(in thous
Current assets	$ 194,227	$ 42,955	$ 10,
Fixed assets, net	19,675	14,823	2,
Goodwill	-	118,956	6,
Intangible assets, net	1,050	37,822	
Other assets	10,666	39	
Intercompany notes receivable	95,543	-	
Investment in subsidiaries	78,633	-	

Total assets	$ 399,794	$ 214,595	$ 19,
Liabilities and Shareholders' (Deficit) Equity			
Current liabilities	$ 206,915	$ 40,549	$ 11,
Deferred income taxes	(2,402)	6,647	
Other long-term liabilities	3,705	-	1,
Intercompany notes payable	-	95,543	
Long-term debt	237,659	-	
Total liabilities	445,877	142,739	12,
Shareholders' (deficit) equity:			
Preferred stock	-	-	
Common stock	191	6	
Capital in excess of par value	156,457	71,744	9,
Accumulated (deficit) earnings	10,131	(15)	(2,
Accumulated other comprehensive loss	(373)	121	(
Treasury stock	(212,489)	-	
Total shareholders' (deficit) equity	(46,083)	71,856	6,
Total liabilities and shareholders' (deficit) equity	$ 399,794	$ 214,595	$ 19,

MEMBERWORKS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

CONSOLIDATED STATEMENTS OF OPERATIONS

	For Three Months End		
	Parent	Guarantor Subsidiaries	Nonguara Subsidia
			(in thous
Revenues	$ 96,285	$ 34,506	$ 5,
Expenses:			
Marketing	50,499	16,565	1,
Operating	15,132	7,189	2,
General and administrative	15,514	8,181	
Amortization of intangible assets	-	1,544	
Operating income	15,140	1,027	
Equity in income of subsidiary	820	-	
Interest (expense) income, net	(4,700)	54	
Other income (expense), net	(93)	(64)	
Income before income taxes	11,167	1,017	
Provision for income taxes	3,571	521	
Net income	$ 7,596	$ 496	$

CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Three Months		
	Parent	Guarantor Subsidiaries	Nonguara Subsidia
			(in thous
Revenues	$ 98,170	$ 12,870	$ 3,
Expenses:			
Marketing	59,111	6,507	1,
Operating	17,382	3,202	1,
General and administrative	15,385	2,506	
Amortization of intangible assets	-	318	
Operating income	6,292	337	
Equity in income of subsidiaries	210	-	
Interest (expense) income, net	(23)	28	
Other (expense) income, net	(128)	-	
Income before income taxes	6,351	365	
Provision for income taxes	2,456	146	
Net income	$ 3,895	$ 219	$

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MEMBERWORKS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Three Months		
	Parent	Guarantor Subsidiaries	Nonguara Subsidia
			(in thous
Net cash provided by (used in) operating activities	$ 95,806	$ (86,872)	$ (
Investing activities			
Acquisition of fixed assets	(435)	(161)	(
Purchase of short-term investments	(7,948)	(245)	
Other investing activities	(358)	662	
Investment in subsidiaries	(94,146)	93,326	
Net cash (used in) provided by investing activities	(102,887)	93,582	(
Financing activities			
Net proceeds from issuance of stock	919	-	
Treasury stock purchases	(7,250)	-	
Net proceeds from issuance of debt	(583)	-	
Payments of long-term obligations	(82)	(8)	
Net cash used in financing activities	(6,996)	(8)	

Effect of exchange rate changes on cash and cash equivalents	-	(88)	
Net increase (decrease) in cash and cash equivalents	(14,077)	6,614	
Cash and cash equivalents at beginning of period	130,581	26,657	2,
Cash and cash equivalents at end of period	$ 116,504	$ 33,271	$ 2,

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Three Months		
	Parent	Guarantor Subsidiaries	Nonguara Subsidia
			(in thous
Net cash provided by (used in) operating activities	$ (1,902)	$ 520	$ (
Investing activities			
Acquisition of fixed assets	(775)	(105)	
Investment in subsidiaries	(210)	-	
Net cash provided by (used in) investing activities	(985)	(105)	
Financing activities			
Net proceeds from issuance of stock	22,089	-	
Treasury stock purchases	(56,352)	-	
Net proceeds from the issuance of debt	87,019	-	
Payments of long-term obligations	-	(67)	
Net cash provided by (used in) financing activities	52,756	(67)	
Effect of exchange rate changes on cash and cash equivalents	-	-	
Net increase (decrease) in cash and cash equivalents	49,869	348	(
Cash and cash equivalents at beginning of period	51,895	18,716	1,
Cash and cash equivalents at end of period	$ 101,764	$ 19,064	$ 1,

MEMBERWORKS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 15 - SUBSEQUENT EVENTS

On October 20, 2004, the Company announced that it had entered into an agreement to acquire Bargain Network Inc. a privately held provider of premier pricing services for homes, vehicles and consumer durables. The Company has agreed to pay $27,000,000 in cash at closing in addition to assuming certain liabilities. In addition, the Company will pay additional amounts in 2005 if certain milestones are achieved.

On November 8, 2004, the Company announced its intention to initiate a Dutch auction tender offer for up to 500,000 shares of its common stock, which represents approximately 5 percent of its outstanding shares. Under this procedure, the Company's stockholders will be given the opportunity to sell part or all of their shares to the Company at a price of not less than $30.00 per share and not more than $35.00 per share. This price range represents a 5.9% discount to a 9.8% premium when compared to the November 5, 2004 closing price of $31.874 per share. Based upon the minimum and maximum offering prices specified in the offer, the aggregate purchase price, if 500,000 shares are purchased, would range from $15,000,000 to $17,500,000.

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

OVERVIEW

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

The Company operates in two business segments: Membership and Personals. For additional financial information about these business segments, see Note 13 to the condensed consolidated financial statements.

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

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

CRITICAL ACCOUNTING POLICIES

Critical accounting policies are those policies that are important to the Company's financial condition and results of operations and involve subjective or complex judgments on the part of management, often as a result of the need to make estimates. The following areas require the use of judgments and estimates: membership cancellation rates, deferred marketing costs, valuation of goodwill and other intangible assets, estimation of remaining useful lives of intangible assets and valuation of deferred tax assets. Estimates in each of these areas are based on historical experience and various assumptions that the Company believes are appropriate. Actual results may differ from these estimates. The Company believes the areas listed above represent the critical accounting policies of the Company as contemplated by Financial Reporting Release No. 60, "Cautionary Advice Regarding Disclosure about Critical Accounting Policies." The Company's critical accounting policies are disclosed in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended June 30, 2004. Since the date of the Annual Report on Form 10-K, there have been no material changes to the Company's critical accounting policies. For a summary of all of the Company's significant accounting policies, see Note 2 to the consolidated financial statements located in the Company's 2004 Annual Report on Form 10-K.

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

RESULTS OF OPERATIONS

For the Three Months Ended September 30, 2004

	Three Months Ended September 30,		Percent Increase
Revenues:	2004	2003	'04 vs.'03
Membership	$ 117,278	$ 113,824	3%
Personals	18,345	-	NM
Total	$ 135,623	$ 113,824	19%

NM = Not Meaningful

Membership

Revenues increased 3% in 2004 primarily due to expanded product marketing with certain existing retail and loyalty clients. The net active retail members decreased 13% to 5.5 million as of September 30, 2004 primarily due to the decrease in members enrolled through the outbound telemarketing channel which was not completely offset by an increase in members enrolled through the Company's online and MemberLink channels. The decline in net active retail members may impact future revenues and profitability. The mix of new members enrolled in a monthly payment plan program was 83% and 63% in 2004 and 2003, respectively.

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

	Three Months Ended September 30, 2004		Percent Increase/ (Decrease)
Revenues:	2004	2003	'04 vs.'03
Monthly payment plans	$ 49,457	$ 26,348	88%
Annual payment plans:			
Initial year	19,050	41,055	(54)%
Renewal year	48,771	46,421	5%
Total	$ 117,278	$ 113,824	3%

Personals
Revenues were $18.3 million and represent the revenues of Lavalife, which was acquired by the Company on April 1, 2004. There were approximately 600,000 active customers as of September 30, 2004.

Operating income:	Three Months Ended September 30, 2004	2003	Percent Increase '04 vs. '03
Membership	$ 16,784	$ 6,620	154%
Personals	(52)	-	NM
Total	$ 16,732	$ 6,620	153%

NM = Not Meaningful

Membership
Operating income increased 154% primarily due to a decrease in marketing expenses incurred of 9% while revenues increased 3%. Marketing expenses were $60.9 million in 2004 versus $66.7 million in 2003 and, as a percentage of revenues, marketing expenses were 52% in 2004 versus 59% in 2003. These decreases were primarily due to the maturing of the monthly membership base. Operating income further benefited from a decrease in operating expenses. Operating expenses decreased 4% in 2004 and, as a percent of revenues were 18% in 2004 and 19% in 2003, primarily driven by the decreased costs incurred to service the lower membership base.

Personals
Operating loss was $52,000 in 2004 and represented the results of Lavalife. Operating loss reported for 2004 reflected $1.3 million of expense for the amortization of intangible assets.

Corporate:	Three Months Ended September 30, 2004	2003	Percent Increase '04 vs.'03
Interest (expense) income, net	$ (4,643)	$ 33	NM
Other expense, net	(135)	(162)	17%
Provision for income taxes	4,358	2,596	68%

NM = Not Meaningful

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

Provision for income taxes. The Company recorded a provision for income taxes of $4.4 million and $2.6 million based on an effective tax rate of 36.5% and 40% in 2004 and 2003, respectively. The effective tax rate was higher than the U.S.

federal statutory rate due to state tax expense and other non-deductible items. The estimated effective tax rate in 2004 decreased from the prior year due to certain tax planning strategies implemented. The Company expects an effective tax rate of approximately 37% for fiscal 2005.

LIQUIDITY AND CAPITAL RESOURCES

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

Net cash provided by operating activities was $7.9 million for the quarter ended September 30, 2004 and cash used by operating activities was $2.0 million for the quarter ended September 30, 2003.

Revenues before deferral increased 19% to $119.3 million for the quarter ended September 30, 2004 from $100.2 million for the quarter ended September 30, 2003 primarily due to revenues before deferral generated by Lavalife. The new annual weighted average program price point per retail member was flat compared to the prior year period at $105 for the quarter ended September 30, 2004. Monthly weighted average program price points per retail member were $11.83 and $10.72 for the quarter ended September 30, 2004 and 2003, respectively.

The table below summarizes the components of revenues before deferral for the three months ended September 30:

	2004	2003
Monthly payment plans	$ 50,295	$ 31,823
Annual payment plans:		
Initial year	9,627	21,000
Renewal year	40,768	47,339
Personals	18,598	-
Total	$ 119,288	$ 100,162

Marketing costs before deferral were $62.2 million and $57.4 million for the quarter ended September 30, 2004 and 2003, respectively. For the quarter ended September 30, 2004, marketing costs before deferral increased 8% primarily due to marketing costs incurred by Lavalife offset by a decrease in the level of marketing through the outbound telemarketing channel. As a percent of revenue before deferral, marketing costs before deferral were 52% for the quarter ended September 30, 2004 versus 57% for the quarter ended September 30, 2003 due to the effect of the maturing base of members enrolled in a monthly payment plan program and the reduced level and mix of the higher cost outbound telemarketing.

Net cash provided by operating activities for the quarter ended September 30, 2004 was negatively impacted by increased general and administrative and operating expenses. The increase in these expenses was primarily due to the acquisition of Lavalife. Net cash provided by operating activities was also impacted by changes in assets and liabilities, which provided $1.2 million of cash for the quarter ended September 30, 2004 and used $7.3 million of cash for the quarter ended September 30, 2003. The primary driver of the increase in cash provided by changes in assets and liabilities for the quarter ended September 30, 2004 was the increase in accrued interest related to the Company's outstanding debt offset by a decrease in the allowance for membership cancellations which reflects the decrease in the programs marketed with an annual payment program.

Net cash used in investing activities was $8.6 million for the quarter ended September 30, 2004 compared to $0.9 million for the quarter ended September 30, 2003. For the quarter ended September 30, 2004, the Company purchased $8.2 million of short-term investments. Capital expenditures were $0.7 million and $0.9 million for the quarter ended September 30, 2004 and 2003, respectively.

Net cash used in financing activities was $7.0 million for the quarter ended September 30, 2004 compared to net cash provided by financing activities of $52.7 million for the quarter ended September 30, 2003. Net cash used in financing activities for the quarter ended September 30, 2004 principally reflected the use of $7.3 million in cash to repurchase the Company's stock offset by proceeds from the exercise of employee stock options of $0.9 million. Net cash provided by financing activities for the quarter ended September 30, 2003 principally reflected the issuance of $87.0 million in debt, net of issuance costs, and proceeds from the exercise of employee stock options of $22.1 million. These sources of cash were partially offset by the use of $56.4 million in cash to repurchase the Company's stock.

Debt Issuances

As of September 30, 2004, the Company has $237.7 million of debt outstanding. In September 2003, the Company issued $90.0 million aggregate principal amount 5.5% convertible senior subordinated notes ("Convertible Notes") due September 2010. The Convertible Notes bear interest at the rate of 5.5% per year, which is payable in cash semi-annually in arrears on April 1 and October 1 of each year. Upon the occurrence of a change in control, holders of the Convertible Notes may require the Company to repurchase all or part of the Convertible Notes for cash.

In April 2004, the Company issued $150.0 million aggregate principal amount of 9.25% Senior Notes due 2014 ("Senior Notes"). The Senior Notes were sold at 98.418% of the principal amount which results in an effective yield of 9.5%. Interest is payable in cash semi-annually in arrears on April 1 and October 1 of each year. A portion of the proceeds from the offering of the Senior Notes was used to repay amounts borrowed under the senior secured credit facility to fund a portion of the Lavalife acquisition. The Company intends to use the remaining proceeds for general corporate purposes, including working capital, future acquisitions and repurchases of the Company's common stock under the Company's stock buyback program to the extent permitted under the indenture governing the Senior Notes and the senior secured credit facility. The Senior Notes offering was made solely by means of a private placement to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended, and to certain persons in offshore transactions pursuant to Regulation S under the Securities Act. The Senior Notes have not been registered under the Securities Act and may not be offered or sold in the United States, or to a U.S. person, absent registration or an applicable exemption from registration requirements. On November 5, 2004, the Company filed a registration statement on Form S-4 with the Securities and Exchange Commission ("SEC") related to the Senior Notes. The Company intends to use its best efforts to cause the registration statement to be declared effective by the SEC no later than 210 days after the original issuance of the Senior Notes.

Credit Facility

The Company has an amended and restated senior secured credit facility that allows borrowings of up to $45.0 million. Borrowings under the senior secured credit facility accrue interest at either the Eurodollar rate, or the higher of the Prime rate or the Federal Funds rate, plus an applicable margin. As of September 30, 2004, the availability under the senior secured credit facility was reduced by an outstanding letter of credit of $5.5 million and one year's worth of interest on the Senior Notes. As of September 30, 2004, the availability under the senior secured credit facility is approximately $25.7 million. As of September 30, 2004, the effective interest rate for borrowings under the senior secured credit facility was 4.75%. The senior secured credit facility has certain financial covenants, including a maximum debt coverage ratio, potential restrictions on additional borrowings and potential restrictions on additional stock repurchases. As of September 30, 2004, the Company was in compliance with all such debt covenants.

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

Stock Repurchase Program

The Company purchased 0.3 million shares for $7.3 million at an average price of $26.03 for the quarter ended September 30, 2004 compared to 1.7 million shares for $56.4 million at an average price of $33.24 for the quarter ended September 30, 2003. The Company utilized existing cash balances to repurchase shares for the quarter ended September 30, 2004. In October 2004, the Company's Board of Directors authorized the repurchase of an additional one million shares of its common stock under its ongoing stock repurchase program. Subsequent to this additional authorization, the Company has 1.7 million shares available for repurchase under its stock repurchase program.

On November 8, 2004, the Company announced its intention to initiate a Dutch auction tender offer for up to 500,000 shares of its common stock, which represents approximately 5 percent of its outstanding shares. Under this procedure, the Company's stockholders will be given the opportunity to sell part or all of their shares to the Company at a price of not less than $30.00 per share and not more than $35.00 per share. This price range represents a 5.9% discount to a 9.8% premium when compared to the November 5, 2004 closing price of $31.874 per share. Based upon the minimum and maximum offering prices specified in the offer, the aggregate purchase price, if 500,000 shares are purchased, would range from $15.0 million to $17.5 million.

On October 20, 2004, the Company announced that it had entered into an agreement to acquire Bargain Network Inc., a privately held provider of premier pricing services for homes, vehicles and consumer durables. The Company has agreed to pay $27 million in cash at closing in addition to assuming certain liabilities. In addition, the Company will pay additional amounts in 2005 if certain milestones are achieved.

As of September 30, 2004, the Company had cash and cash equivalents of $152.0 million in addition to its senior secured credit facility. The Company believes that existing cash and short term investment balances, together with funds available under its senior secured credit facility, will be sufficient to meet its funding requirements for the foreseeable future.

The Company did not have any material commitments for capital expenditures as of September 30, 2004. The Company intends to utilize cash on hand and cash generated from operations to fulfill any capital expenditure requirements during 2005.

RECONCILIATION OF NON-GAAP MEASURES

Management believes that revenues before deferral and marketing costs before deferral are important measures of liquidity and are significant factors in understanding the Company's operating cash flow trends. These non-GAAP measures are used by management and the Company's investors to understand the liquidity trends of the Company's marketing margins related to the current period operations which are reflected within the operating cash flow section of the cash flow statement. GAAP revenues and marketing expenses are important measures used to understand the marketing margins earned during the period in the income statement. However, in order to understand the Company's operating cash flow, it is important to understand the primary, current period drivers of that cash flow. Two of the primary indicators of operating liquidity for the period are revenues before deferral and marketing costs before deferral. Revenues before deferral are revenues before the application of SAB 104 and represent the revenues billed during the current reporting period less an allowance for membership cancellations. That is, revenues before deferral for a reporting period include membership fees received in the current reporting period that will be recorded as GAAP revenues in future reporting periods and exclude membership fees received in prior reporting periods that are recorded as GAAP revenues in the current reporting period. Marketing costs before deferral are marketing costs before the application of SAB 104 and SOP 93-7 and represent marketing costs paid for or accrued for during the current reporting period. That is, marketing costs before deferral for a reporting period include costs paid or accrued in the current reporting period that will be recorded as GAAP marketing expenses in future reporting periods and exclude marketing expenses paid or accrued in prior reporting periods that are recorded as GAAP marketing expenses in the current reporting period. Neither revenues before deferral nor marketing costs before deferral exclude charges or liabilities that will require cash settlement. Additionally, these measures are not a substitute for, or superior to, Revenues and Marketing Expenses prepared in accordance with generally accepted accounting principles. In light of the difference between revenues before deferral, marketing expenses before deferral and their most directly comparable GAAP measures, the Company solely uses these measures as liquidity measures and not as performance measures.

Revenues before deferral for the three months ended September 30, 2004 and 2003 are calculated as follows:

	2004	2003
Revenues	$ 135,623	$ 113,824
Change in deferred revenues	(16,335)	(13,662)
Revenues before deferral	$ 119,288	$ 100,162

Marketing cost before deferral for the three months ended September 30, 2004 and 2003 is calculated as follows:

	2004	2003
Marketing expenses	$ 68,532	$ 66,656
Change in membership solicitation and other deferred costs	(6,348)	(9,221)
Marketing costs before deferral	$ 62,184	$ 57,435

FORWARD LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements that are based on current expectations, estimates, forecasts and projections about the industry in which the Company operates and the Company's management's beliefs and assumptions. These forward-looking statements include statements that do not relate solely to historical or current facts and can be identified by the use of words such as "believe," "expect," "estimate," "project," "continue" or "anticipate." These forward-looking statements are made pursuant to safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements are not guarantees of future performance and are based on a number of assumptions and estimates that are inherently subject to significant risks and uncertainties, many of which are beyond our control, cannot be foreseen and reflect future business decisions that are subject to change. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. Among the many factors that could cause actual results to differ materially from the forward-looking statements are:

- higher than expected membership cancellations or lower than expected membership renewal rates;
- changes in the marketing techniques of credit card issuers;
- increases in the level of commission rates and other compensation required by marketing partners to actively market with the Company;
- potential reserve requirements by business partners such as the Company's credit card processors;
- unanticipated termination of marketing agreements;
- the extent to which the Company can continue to successfully develop and market new products and services and introduce them in a timely basis;
- the Company's ability to integrate acquired businesses into the Company's management and operations and operate successfully;
- unanticipated changes in or termination of the Company's ability to process revenues through third parties, including credit card processors and bank card associations;
- the Company's ability to develop and implement operational and financial systems to manage growing operations;
- the Company's ability to recover from a complete or partial system failure or impairment, other hardware or software related malfunctions or programming errors;
- the degree to which the Company is leveraged;
- the Company's ability to obtain financing on acceptable terms to finance the Company's growth strategy and to operate within the limitations imposed by financing arrangements;
- further changes in the already competitive environment for the Company's products or competitors' responses to the Company's strategies;
- changes in the growth rate of the overall U.S. economy, or the international economy where the Company does business, such that credit

availability, interest rates, consumer spending and related consumer debt are impacted;

- additional government regulations and changes to existing government regulations of the Company's industry;
- the Company's ability to compete with other companies that have financial or other advantages;
- adverse movement of foreign exchange rates;
- the Company's ability to attract and retain active members and users;
- adverse results of litigation or regulatory matters; and
- new accounting pronouncements.

Many of these factors are beyond the Company's control, and, therefore, its business, financial condition, results of operations and cash flows may be adversely affected by these factors.

The Company cautions that such factors are not exclusive. All of the forward-looking statements made in this Quarterly Report on Form 10-Q are qualified by these cautionary statements and readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. Except as required by law, the Company does not have any intention or obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate
The Company has a senior secured credit facility that allows borrowings of up to $45.0 million. Borrowings under the senior secured credit facility accrue interest at either the Eurodollar rate or the higher of the Prime rate or the Federal Funds rate plus an applicable margin. There were no borrowings outstanding under this senior secured credit facility as of September 30, 2004. As of September 30, 2004, availability under the senior secured credit facility was reduced by an outstanding letter of credit of $5.5 million and one year's worth of interest on the Senior Notes. As of September 30, 2004, the availability under the senior secured credit facility is approximately $25.7 million. Management believes that an increase in the Eurodollar rate, the Prime rate or the Federal Funds rate would not be material to the Company's financial position or its results of operations. If the Company is not able to renew its existing credit facility agreement, which matures on March 25, 2005, it is possible that any replacement lending facility obtained by the Company may be

more sensitive to interest rate changes. In addition, the Company has $90.0 million aggregate principal amount of 5.5% Convertible Notes due 2010 and $150.0 million aggregate principal amount of 9.25% Senior Notes due 2014. The Convertible Notes and the Senior Notes pay interest in cash semi-annually in arrears on April 1 and October 1 of each year. The fair value of the fixed interest instruments are affected by changes in interest rates, and with respect to the Convertible Notes, are also affected by changes in the Company's stock price and volatility. The Company does not currently hedge interest rates with respect to its outstanding debt. As of September 30, 2004, the carrying value of the Convertible Notes and the Senior Notes was $90.0 million and $147.7 million, respectively, and the fair value of the notes were $85.5 million and $150.0 million, respectively.

Foreign Currency

The Company conducts business in certain foreign markets, primarily in Canada. The Company's primary exposure to foreign currency risk relates to investments in foreign subsidiaries that transact business in functional currencies other than the U.S. Dollar, primarily the Canadian Dollar. As the Company increases its operations in international markets, it becomes increasingly exposed to potentially volatile movements in currency exchange rates. The economic impact of currency exchange rate movements on the Company are often linked to variability in real growth, inflation, interest rates, governmental actions and other factors. These changes, if material, could cause the Company to adjust its financing and operating strategies. As currency exchange rates change, translation of the income statements of the Company's international business into U.S. dollars affects year-over-year comparability of operating results.

The Company uses purchase option contracts and forward contacts to minimize its exposure to changes in future cash flows caused by movements in foreign currency exchange rates between the US dollar and the Canadian dollar. However, there can be no assurance that the Company's foreign currency hedging activities will substantially offset the impact of fluctuations in currency exchange rates on its results of operations and financial position. The Company does not use derivatives for speculative purposes. Derivatives used to hedge forecasted transactions and specific cash flows associated with Canadian dollar denominated financial assets and liabilities that meet the criteria for hedge accounting are designated as cash flow hedges. The effective portion of gains and losses is deferred as a component of accumulated other comprehensive income and is recognized in earnings in the same line item as the underlying hedged item at the time the hedged item affects earnings.

Fair Value of Investments

The Company does not have material exposure to market risk with respect to investments, as the Company's investments are short-term in nature (original maturities of less than one year).

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures.

The Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Company's disclosure controls and procedures (as defined under Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this report and have concluded that the Company's disclosure controls and procedures were effective at the reasonable assurance level. The Company's disclosure controls and procedures are designed to ensure that material information relating to the Company and its consolidated subsidiaries that is required to be disclosed in its reports under the Exchange Act is accumulated and communicated to the Chief Executive Officer and Chief Financial Officer.

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

PART II. OTHER INFORMATION

Item 1. Legal proceedings

Except as set forth below, in management's opinion, there are no significant legal proceedings to which the Company or any of its subsidiaries is a party or to which any of their properties are subject. The Company is involved in other lawsuits and claims generally incidental to its business including, but not limited to, various suits, including previously disclosed suits, brought against the Company by individual consumers seeking monetary and/or injunctive relief relating to the marketing of the Company's programs. In addition, from time to time, and in the regular course of its business, the Company receives inquiries from various federal and/or state regulatory authorities.

On October 21, 2003, the Florida Attorney General's Office filed a civil complaint against the Company based upon concerns that some of its past marketing practices may have violated various consumer laws. On June 28, 2004, the Company announced that it had reached a voluntary settlement with the Florida Attorney General's office to alleviate these concerns. In connection with the settlement, the Company agreed to formalize its existing national Best Marketing Practices in the state of Florida and to pay the state of Florida costs of investigation of $950,000. The Company expects that the agreement will have little new effect on its business in Florida as the agreement serves to formalize the Company's already existing national marketing best practices in the state.

On January 24, 2003, the Company filed a motion with the Superior Court for the Judicial District of Hartford, Connecticut to vacate and oppose the confirmation of an arbitration award issued in December 2002. The arbitration, filed against the Company by MedValUSA Health Programs, Inc. ("MedVal") in September 2000, involved claims of breach of contract, breach of the duty of good faith and fair dealing, and violation of the Connecticut Unfair Trade Practices Act ("CUTPA"). Even though the arbitrators found that the Company was not liable to MedVal for any compensatory damages, they awarded $5.5 million in punitive damages and costs against the Company solely under CUTPA. The Company believes that this arbitration award is unjustified and not based on any existing legal precedent. Specifically, the Company is challenging the award on a number of grounds, including that it violates a well defined public policy against excessive punitive damage awards, raises constitutional issues and disregards certain legal requirements for a valid award under CUTPA. The hearing on the Company's motion was held on February 10, 2003. On June 22, 2003, the Superior Court denied the Company's motion to vacate the award, and the Company filed an appeal of that decision. While the Company intends to take action to prevent the enforcement of the award by, among other things, vigorously pursuing an appeal, there can be no assurance that the Company will be successful in its efforts. The Company has made no provision in its financial statements for this contingency because it believes that a loss is not probable. If the Company was ultimately unsuccessful in this or other available appeals, and a final non-appealable court order confirming the arbitration award is rendered, the payment of the award could have a material adverse effect on the Company's results of operations in the period in which the final order is entered.

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

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MEMBERWORKS INCORPORATED
PART II. OTHER INFORMATION

Item 2. Changes in Securities and Use of Proceeds and Issuer Purchases of Equity Securities

The following table summarizes the shares of the Company's equity securities purchased by or on behalf of the Company:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)
July 1, 2004 to July 31, 2004	-	$ -	-
August 1, 2004 to August 31, 2004	110,000	$ 25.00	110,000
September 1, 2004 to September 30, 2004	168,500	$ 26.70	168,500
Total	278,500	$ 26.03	278,500

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

Item 6. Exhibits

Exhibits
- 31.1 Rule 13a-14(a) CEO Certification.
- 31.2 Rule 13a-14(a) CFO Certification.
- 32.1 CEO Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 CFO Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

MEMBERWORKS INCORPORATED
SIGNATURES

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

MEMBERWORKS INCORPORATED
(Registrant)

Date: November 9, 2004	By: /s/ Gary A. Johnson Gary A. Johnson, President, Chief Executive Officer and Director
November 9, 2004	By: /s/ James B. Duffy James B. Duffy, Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)