

RENTRAK CORP
Form 10-Q
November 08, 2005

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2005

OR

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

For the transition period from to

Commission file number: 0-15159

RENTRAK CORPORATION

(Exact name of registrant as specified in its charter)

Oregon

(State or other jurisdiction of incorporation
or organization)

93-0780536

(I.R.S. Employer Identification No.)

7700 NE Ambassador Place, Portland, Oregon

(Address of principal executive offices)

97220

(Zip Code)

Registrant's telephone number, including area code: **503-284-7581**

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 No

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock \$0.001 par value
(Class)

10,564,726
(Outstanding at November 1, 2005)

RENTRAK CORPORATION

FORM 10-Q

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Rentrak Corporation and Subsidiaries
Condensed Consolidated Balance Sheets
(In thousands, except per share amounts)

| | September 30, 2005 (Unaudited) | March 31, 2005 (1) |
|--|--------------------------------------|-----------------------|
| Assets | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 10,292 | \$ 21,983 |
| Marketable securities | 14,813 | |
| Accounts receivable, net of allowances for doubtful accounts of \$521 and \$654 | 12,703 | 14,428 |
| Advances to program suppliers, net of program supplier reserves of \$3,047 and \$3,246 | 192 | 1,185 |
| Income tax receivable | 456 | 580 |
| Deferred income tax assets | 14 | 944 |
| Notes receivable - related party | | 753 |
| Other current assets | 981 | 1,028 |
| Total Current Assets | 39,451 | 40,901 |
| Property and Equipment, net | 3,417 | 3,216 |
| Deferred Income Tax Assets | 77 | 115 |
| Other Assets | 625 | 851 |
| Total Assets | \$ 43,570 | \$ 45,083 |
| Liabilities and Stockholders Equity | | |
| Current Liabilities: | | |
| Accounts payable | \$ 9,200 | \$ 12,470 |
| Accrued liabilities | 696 | 711 |
| Accrued compensation | 1,345 | 1,539 |
| Deferred revenue | 519 | 379 |
| Total Current Liabilities | 11,760 | 15,099 |
| Long-Term Obligations: | | |
| Lease obligations and deferred gain | | 52 |
| Commitments and Contingencies | | |
| Stockholders Equity: | | |
| Preferred stock, \$0.001 par value; 10,000 shares authorized; none issued | | |
| Common stock, \$0.001 par value; 30,000 shares authorized; shares issued and outstanding: 10,565 and 10,545 | 10 | 10 |
| Capital in excess of par value | 47,106 | 46,988 |
| Accumulated other comprehensive income | 181 | 181 |
| Accumulated deficit | (15,487) | (17,247) |
| Total Stockholders Equity | 31,810 | 29,932 |
| Total Liabilities and Stockholders Equity | \$ 43,570 | \$ 45,083 |

(1) Derived from our March 31, 2005 audited consolidated financial statements.

See accompanying Notes to Condensed Consolidated Financial Statements.

Rentrak Corporation and Subsidiaries
Condensed Consolidated Income Statements
(Unaudited)
(In thousands, except per share amounts)

| | For the Three Months Ended September 30, | | For the Six Months Ended September 30, | |
|--|--|-----------|--|-----------|
| | 2005 | 2004 | 2005 | 2004 |
| Revenue | \$ 20,164 | \$ 26,998 | \$ 41,046 | \$ 52,331 |
| Operating expenses: | | | | |
| Cost of sales | 13,518 | 19,775 | 28,350 | 38,543 |
| Selling and administrative | 5,161 | 4,424 | 10,333 | 8,864 |
| | 18,679 | 24,199 | 38,683 | 47,407 |
| Income from operations | 1,485 | 2,799 | 2,363 | 4,924 |
| Other income (expense): | | | | |
| Interest income | 254 | 53 | 410 | 111 |
| Interest expense | (1) | (1) | (2) | (2) |
| | 253 | 52 | 408 | 109 |
| Income before income taxes | 1,738 | 2,851 | 2,771 | 5,033 |
| Provision for income taxes | 634 | 1,041 | 1,011 | 1,837 |
| Net income | \$ 1,104 | \$ 1,810 | \$ 1,760 | \$ 3,196 |
| Basic net income per share | \$ 0.10 | \$ 0.18 | \$ 0.17 | \$ 0.33 |
| Diluted net income per share | \$ 0.10 | \$ 0.17 | \$ 0.16 | \$ 0.31 |
| Shares used in per share calculations: | | | | |
| Basic | 10,551 | 9,822 | 10,550 | 9,810 |
| Diluted | 11,061 | 10,471 | 11,080 | 10,459 |

See accompanying Notes to Condensed Consolidated Financial Statements.

Rentrak Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(In thousands)

| | For the Six Months Ended September 30, | |
|---|---|-------------|
| | 2005 | 2004 |
| Cash flows from operating activities: | | |
| Net income | \$ 1,760 | \$ 3,196 |
| Adjustments to reconcile net income to net cash flows provided by operating activities: | | |
| Tax benefit from stock option exercises | 43 | 98 |
| Depreciation and amortization | 815 | 547 |
| Adjustment to allowance for doubtful accounts | (133) | (141) |
| Deferred income taxes | 968 | 1,739 |
| (Increase) decrease in: | | |
| Accounts receivable | 1,858 | (2,517) |
| Advances to program suppliers | 993 | 2,538 |
| Income taxes receivable | 124 | 23 |
| Other current assets | 6 | 26 |
| Increase (decrease) in: | | |
| Accounts payable | (3,246) | 33 |
| Accrued liabilities and compensation | (209) | (167) |
| Deferred revenue and other liabilities | 88 | (44) |
| Net cash provided by operating activities | 3,067 | 5,331 |
| Cash flows from investing activities: | | |
| Purchases of marketable securities | (14,813) | |
| Payments for purchase of property and equipment | (1,001) | (882) |
| Note receivable payments received | 252 | 188 |
| Other assets, net | | (32) |
| Net cash used in investing activities | (15,562) | (726) |
| Cash flows from financing activities: | | |
| Payments on capital lease obligations | (24) | |
| Issuance of common stock | 75 | 550 |
| Note receivable, related party | 753 | |
| Net cash provided by financing activities | 804 | 550 |
| Increase (decrease) in cash and cash equivalents | (11,691) | 5,155 |
| Cash and cash equivalents: | | |
| Beginning of year | 21,983 | 8,736 |
| End of period | \$ 10,292 | \$ 13,891 |
| Supplemental cash flow information: | | |
| Cash paid during the period for interest | \$ 2 | \$ 2 |
| Cash paid (refunds received) during the period for income taxes, net | (110) | 53 |

See accompanying Notes to Condensed Consolidated Financial Statements.

RENTRAK CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements of Rentrak Corporation have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with the accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. The results of operations for the three and six-month periods ended September 30, 2005, are not necessarily indicative of the results to be expected for the entire fiscal year ending March 31, 2006. The Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and footnotes thereto included in our 2005 Annual Report to Shareholders.

The Condensed Consolidated Financial Statements reflect, in the opinion of management, all material adjustments (which include only normal recurring adjustments) necessary to present fairly our financial position, results of operations and cash flows.

Note 2. Net Income Per Share

Basic net income per share (EPS) and diluted EPS are computed using the methods prescribed by Statement of Financial Accounting Standards (SFAS) No. 128, Earnings per Share. Following is a reconciliation of the shares used for the basic EPS and diluted EPS calculations (in thousands):

| | Three Months Ended Sept. 30, | | Six Months Ended Sept. 30, | |
|---|-------------------------------------|-------------|-----------------------------------|-------------|
| | 2005 | 2004 | 2005 | 2004 |
| Basic EPS: | | | | |
| Weighted average number of shares of common stock outstanding | 10,551 | 9,822 | 10,550 | 9,810 |
| Diluted EPS: | | | | |
| Effect of dilutive stock options and warrants | 510 | 649 | 530 | 649 |
| | 11,061 | 10,471 | 11,080 | 10,459 |
| Options not included in diluted EPS because the exercise price of the options was greater than the average market price of the common shares for the period | | | | |
| | 227 | 84 | 217 | 86 |

Note 3. Business Segments, Significant Suppliers and Major Customers

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During fiscal 2005, we operated in one business segment, Entertainment (previously referred to as our PPT segment). Effective April 1, 2005, we implemented a new corporate structure, which includes separate Pay-Per-Transaction (PPT) and Advanced Media and Information (AMI) operating divisions and, accordingly, we are now reporting certain financial information by individual segment under this new structure. The PPT Division focuses on managing our business operations that facilitate the delivery of home entertainment products and related rental and sales information to our Participating Retailers on a revenue sharing basis. The AMI Division concentrates on the management and growth of our Essentials Suite of business intelligence services offered on a recurring subscription basis, as well as operating our direct revenue sharing (DRS) services.

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Certain information by segment for the three and six month periods ended September 30, 2005 and 2004 was as follows (in thousands):

| | PPT | AMI | Other(1) | Total |
|---|-----------|----------|----------|-----------|
| Three months ended September 30, 2005(2) | | | | |
| Sales to external customers | \$ 17,442 | \$ 2,401 | \$ 321 | \$ 20,164 |
| Depreciation and amortization | 5 | 215 | 283 | 503 |
| Income (loss) from operations | 3,125 | 992 | (2,632) | 1,485 |
| Three months ended September 30, 2004(2) (3) | | | | |
| Sales to external customers | \$ 24,349 | \$ 2,512 | \$ 137 | \$ 26,998 |
| Six months ended September 30, 2005(2) | | | | |
| Sales to external customers | \$ 35,641 | \$ 4,927 | \$ 478 | \$ 41,046 |
| Depreciation and amortization | 20 | 417 | 378 | 815 |
| Income (loss) from operations | 5,602 | 2,103 | (5,342) | 2,363 |
| Six months ended September 30, 2004(2) (3) | | | | |
| Sales to external customers | \$ 47,043 | \$ 5,021 | \$ 267 | \$ 52,331 |

(1) Includes revenue and expenses relating to products and/or services which are still in the development stage, as well as corporate expenses and other expenses which are not allocated to a specific segment.

(2) Assets are not specifically identified by segment as the information is not used by the chief operating decision maker to measure the segments performance.

(3) The depreciation and amortization and operating income (loss) segment information for the three and six month periods ended September 30, 2004 is not included as it would be impracticable to do so.

During the three and six-month periods ended September 30, 2005 and 2004, we had Program Suppliers that supplied product which generated in excess of 10% of our total revenues as follows:

| | Three Months Ended Sept. 30, | | Six Months Ended Sept. 30, | |
|--------------------|------------------------------|------|----------------------------|------|
| | 2005 | 2004 | 2005 | 2004 |
| Program Supplier 1 | 28% | 59% | 28% | 59% |
| Program Supplier 2 | 20% | 4% | 18% | 4% |
| Program Supplier 3 | 14% | 7% | 15% | 9% |
| Program Supplier 4 | 10% | | 10% | |

There were no other Program Suppliers who provided product that accounted for 10% or more of our total revenues for the three or six-month periods ended September 30, 2005 or 2004. A loss of any of these suppliers could have a material adverse effect on our financial condition, results of operations and liquidity.

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We had one customer that accounted for 32% and 31%, respectively, of our total revenue in the three and six-month periods ended September 30, 2004. The agreement with this customer expired in September 2004. There were no other customers that accounted for 10% or more of our total revenue in the three or six-month periods ended September 30, 2005 or 2004.

Note 4. Stock-Based Compensation

We account for stock-based compensation utilizing the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, as interpreted by FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation. Pursuant to SFAS No. 148 Accounting for Stock-Based Compensation Transition and Disclosure, we have computed, for pro forma disclosure purposes, the impact on net income and net

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income per share as if we had accounted for our stock-based compensation plans in accordance with the fair value method prescribed by SFAS No. 123 Accounting for Stock-Based Compensation as follows (in thousands, except per share amounts):

| | Three Months Ended Sept. 30, | | Six Months Ended Sept. 30, | |
|--|------------------------------|----------|----------------------------|----------|
| | 2005 | 2004 | 2005 | 2004 |
| Net income, as reported | \$ 1,104 | \$ 1,810 | \$ 1,760 | \$ 3,196 |
| Deduct - total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects | (199) | (213) | (397) | (441) |
| Net income, pro forma | \$ 905 | \$ 1,597 | \$ 1,363 | \$ 2,755 |
| Net income per share basic, as reported | \$ 0.10 | \$ 0.18 | \$ 0.17 | \$ 0.33 |
| Net income per share basic, pro forma | \$ 0.09 | \$ 0.16 | \$ 0.13 | \$ 0.28 |
| Net income per share diluted, as reported | \$ 0.10 | \$ 0.17 | \$ 0.16 | \$ 0.31 |
| Net income per share diluted, pro forma | \$ 0.08 | \$ 0.15 | \$ 0.12 | \$ 0.26 |

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To determine the fair value of stock-based awards granted during the six-month period ended September 30, 2005 and the three and six-month periods ended September 30, 2004, we used the Black-Scholes option pricing model and the following weighted average assumptions:

| | Six Months Ended September 30, 2005 | Three and Six Months Ended September 30, 2004 |
|-------------------------|---|--|
| Risk-free interest rate | 4.16% | 4.29% - 4.58% |
| Expected dividend yield | | |
| Expected lives | 6.39 years | 6.55 - 7.24 years |
| Expected volatility | 70.08% | 74.08% - 74.98% |

No stock-based awards were granted during the three-month period ended September 30, 2005.

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123R, Share-Based Payment, which requires companies to recognize in their statement of operations the grant-date fair value of stock options and other equity-based compensation issued to employees. SFAS No. 123R is effective for annual periods beginning after June 15, 2005. Accordingly, we will adopt SFAS No. 123R in the first quarter of fiscal 2007. We are in the process of evaluating how the adoption of SFAS 123R will affect our results of operations, financial position and cash flows.

Note 5. Marketable Securities

In the second quarter of fiscal 2006, we purchased \$12.3 million of fixed-rate corporate bonds and \$2.5 million of fixed rate government bonds, all of which mature March 31, 2006 and are included as short-term marketable securities on our balance sheet as of September 30, 2005. We have classified these marketable securities as held-to-maturity, and, accordingly, they are reported at amortized cost with earnings included as a component of interest income.

Note 6. Related Party Transactions

In February 2005, pursuant to his separation agreement, we loaned Mr. F. Kim Cox, our former President and Secretary, \$0.8 million to assist him with exercising a portion of his vested options to purchase shares of our common stock. The loan bore interest at 2.78% per annum and was repaid in full, including accrued interest, in May 2005.

In addition, we entered into a consulting agreement with Mr. Cox on January 25, 2005 whereby he is assisting us with strategic planning and product development issues. Pursuant to the agreement, we will pay Mr. Cox \$25,000 per month from February 2005 through March 2007. We paid Mr. Cox a total of \$75,000 and \$150,000, respectively, in the three and six-month periods ended September 30, 2005.

Note 7. Shareholder Rights Plan

In May 2005, we entered into a new rights plan to replace our previously existing rights plan, which expired on May 18, 2005. The terms of the new rights plan are similar to those of the previous rights plan. The new rights plan expires May 18, 2015.

Note 8. Approval of 2005 Stock Incentive Plan

At our annual meeting of shareholders, which was held on August 25, 2005, our shareholders approved the Rentrak Corporation 2005 Stock Incentive Plan (the 2005 Plan). The 2005 Plan replaces the 1997 Non-Officer Employee Stock Option Plan and the 1997 Equity Participation Plan (the Prior Plans).

Under the 2005 Plan, we may grant incentive or nonqualified stock options, stock appreciation rights, restricted stock or units with time-based vesting, performance shares with vesting tied to performance goals and other equity-based awards to eligible participants, including our officers, other key employees, our non-employee directors and certain consultants. Up to a total of 1.0 million shares of our common stock may be issued pursuant to awards granted under the 2005 Plan, subject to adjustment for changes in capitalization. In addition, shares covered by outstanding stock options under the Prior Plans that are cancelled, terminate or otherwise expire without being exercised will become available for grants of new awards under the 2005 Plan.

As of August 25, 2005, there were approximately 1.6 million shares subject to outstanding options under the Prior Plans. No further awards will be made under the Prior Plans.

Note 9. Customer Bankruptcy

On November 3, 2005, one of our customers, who filed a voluntary petition for relief under Chapter 11 in the U.S. Bankruptcy Court on August 2, 2005, converted that petition to a revised petition for relief under Chapter 7 in the U.S. Bankruptcy Court. The balance this customer owes us on its account was approximately \$563,000 at September 30, 2005. We are currently pursuing all means available to us in regard to recovering this receivable.

Note 10. Reclassifications

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Certain reclassifications have been made to the prior year statements to conform to the current year presentation.

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

Forward Looking Statements

Certain information included in this Quarterly Report on Form 10-Q (including Management's Discussion and Analysis of Financial Condition and Results of Operations regarding revenue growth, gross profit margin and liquidity) constitute forward looking statements that involve a number of risks and uncertainties. Forward looking statements may be identified by the use of forward looking words such as may, will, expects, intends, anticipates, estimates or continues or the negative thereof or variations thereon or comparable terminology. The following factors are among the factors that could cause actual results to differ materially from the forward looking statements: our ability to retain and grow our customer base of retailers participating in the Pay-Per-Transaction system (the PPT System) (Participating Retailers) and customers for our business intelligence software and services; the financial stability of the Participating Retailers and their

performance of their obligations under our PPT System; business conditions and growth in the video industry and general economic conditions, both domestic and international; customer demand for movies in various media formats subject to company guarantees; competitive factors, including increased competition, expansion of revenue sharing programs other than the PPT System by motion picture studios or other licensees or owners of the rights to certain video programming or video game publishers (Program Suppliers) and new technology; the continued availability of digital videodiscs (DVDs), video games and videocassettes (Cassettes) (collectively Units) leased/licensed to home video specialty stores and other retailers from Program Suppliers; the loss of significant Program Suppliers; our ability to successfully develop and market new services, including our business intelligence services, to create new revenue streams; and non-renewal of our line of credit. This Quarterly Report on Form 10-Q further describes some of these factors.

Business Trends

Our financial results continue to be affected by the changing dynamics in the home video and game rental market, as they impact our PPT business. We continue to experience the impact of the migration from higher historical rentals of Cassettes to greater rentals of DVDs by our Participating Retailers. We have successfully implemented new agreements with Program Suppliers to incorporate the availability of DVDs, and we are continuing our efforts in fiscal 2006 to secure more DVD arrangements to address this impact. In addition, our PPT business continues to be affected by a shift to output programs under which we agree with a Program Supplier to a lower order processing and transaction fee in exchange for the Participating Retailers' commitment to order a greater number of Units of all the Program Supplier's titles. The result is an increased number of Units leased by the Participating Retailers, but a reduced amount of fees per Unit earned by the Program Supplier and us. These output programs are, in part, an economic response to the changing dynamics of the home video rental market, and have become more prevalent since the migration from Cassette format to the DVD format. We expect the growth of these output programs to continue, and believe that they will be financially beneficial for the Participating Retailers, Program Suppliers and us.

Our base of Participating Retailers continues to be strong. We had one Participating Retailer that accounted for \$8.3 million, or 32%, and \$16.5 million, or 31%, of total revenues in the three and six-month periods ended September 30, 2004, respectively. Our agreement with this Participating Retailer expired in September 2004 and we have not received, nor do we expect to receive, any appreciable revenue from this Participating Retailer in fiscal 2006. We are implementing strategies to obtain new Participating Retailers and Program Suppliers in an effort to further stabilize and grow our overall PPT revenue and earnings streams.

We continue to be in good standing with all of our Program Suppliers and we make on-going efforts to enhance those business relationships through improvement of current services offered and the development of new service offerings. We are also continually seeking to develop business relationships with new Program Suppliers. In September 2003, we entered into a combined VHS/DVD revenue sharing program with one of the world's largest studios that has resulted in their becoming our largest Program Supplier representing 28% and 59% of our total revenues in the six months ended September 30, 2005 and 2004, respectively. The percentage decrease in total revenues related to this Program Supplier was primarily due to the loss of the major Participating Retailer noted above. Additional Program Suppliers represented 18%, 15% and 10% of our total revenues in the six months ended September 30, 2005. As is typical of our agreements with Program Suppliers, our relationships with these Program Suppliers may be terminated without cause upon thirty days' written notice by either party.

We are also allocating significant resources towards our business intelligence service offerings, both those services that are currently operational as well as those that are in various stages of development. Our suite of business intelligence services has been well received in the various targeted markets to date, as our offerings fit well with the needs identified by those market participants. Our Essentials business intelligence service offerings, which are fully operational and no longer in significant stages of development, saw revenue increases of 7.7% and 9.9%, respectively, during the three and six-month periods ended September 30, 2005 compared to the same periods of the prior fiscal year. We intend to continue to invest in our existing, as well as new, business intelligence services in the near-term as we expand the markets we serve and our

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service lines, which likely will lower our earnings. Longer-term, we believe these services will provide significant future revenue and earnings streams and ultimately be the cornerstone of our success.

In March 2004, we announced an agreement with Comcast Cable, a division of Comcast Corporation, the country's leading cable and broadband communications provider, to conduct a 12 month pilot trial of OnDemand Essentials, a system created for measuring and reporting anonymous video on demand (VOD) usage data. The trial began in May 2004 and has expanded to include all Comcast markets across the United States. On July 29, 2005, we signed a multi-year contract with Comcast to continue this VOD measurement relationship.

In July 2004, we announced a similar trial agreement with Insight Communications and have extended the trial while we work through a commercial agreement. We have also announced agreements with Cablevision Systems Corporation (February 2005), Charter Communications (March 2005) and Bresnan Communications (July 2005).

In July 2004, we announced our first content provider service agreement with Music Choice and are working with them to develop anonymous profiling reports from their set top box application, My Music Choice, which allows the consumer to program their own VOD channel.

On August 1, 2005 we launched our OnDemand Essentials™ Content Provider site, which is a transactional tracking and reporting system that enables users to view and analyze on-demand content. This is significant as we now can generate revenue for the OnDemand Essentials line of business. In September 2005, we announced multi-year service agreements with 12 leading content providers, bringing our total number of subscribers to the service to 13. The 13 subscribers are: Music Choice, Paramount Studios, CBS, MTV, Nickelodeon, Noggin, The N, Comedy Central, VH1, Expo TV, NFL Network, Ripe TV and National Geographic Channel. Several of these subscribers are owned by Viacom Inc., which will also utilize this service for its Logo and Country Music Television stations when they launch VOD content, which is expected to be in 2006. These content provider customers will have access to the data we are collecting pursuant to the cable operator agreements we have in place with Comcast, Insight Communications, Charter Communications, Cablevision Systems and Bresnan Communications. These operators represent 53% of VOD enabled homes.

Revenues and costs associated with our OnDemand Essentials™ services are classified as other as these services are still in the development stage. While we are optimistic regarding the future potential revenue from these services, it is too soon to estimate what their impact will be on our future results of operations.

Sources of Revenue

Effective April 1, 2005, we implemented a new corporate structure, which includes separate Pay-Per-Transaction (PPT) and Advanced Media and Information (AMI) operating divisions and, accordingly, we are now reporting certain financial information by individual segment under this new structure. The PPT Division focuses on managing our business operations that facilitate the delivery of home entertainment products and related rental and sales information to our Participating Retailers on a revenue sharing basis. The AMI Division concentrates on the management and growth of our Essentials Suite of business intelligence services offered on a recurring subscription basis, as well as operating

our direct revenue sharing (DRS) services.

Revenue by segment includes the following:

PPT Segment

order processing fees generated when DVDs, video games and Cassettes (Units) are ordered by and distributed to retailers;

transaction fees generated when retailers rent Units to consumers;

sell-through fees generated when retailers sell Units to consumers;

buy-out fees generated when retailers purchase Units at the end of the lease term;

communication fees when retailers' point-of-sale systems are connected to our information system; and charges for Internet services provided by our subsidiary, Formovies.com.

AMI Segment

direct revenue sharing fees from data tracking and reporting services provided to Program Suppliers (DRS); revenues from Box Office Essentials™ and revenues from Home Video Essentials™.

Other

revenue relating to products and/or services which are still in the development stage; OnDemand Essentials™; Supply Chain Essentials™; and Retail Essentials™.

Results of Operations

| (Dollars in thousands) | Three Months Ended September 30, (1) | | | |
|--------------------------------|--------------------------------------|----------|-----------|----------|
| | 2005 | % of | 2004 | % of |
| | Dollars | revenues | Dollars | revenues |
| Revenues: | | | | |
| PPT | \$ 17,442 | 86.5% | \$ 24,349 | 90.2% |
| AMI | 2,401 | 11.9 | 2,512 | 9.3 |
| Other | 321 | 1.6 | 137 | 0.5 |
| | 20,164 | 100.0 | 26,998 | 100.0 |
| Operating expenses: | | | | |
| Cost of sales | 13,518 | 67.0 | 19,775 | 73.2 |
| Selling and administrative | 5,161 | 25.6 | 4,424 | 16.4 |
| | 18,679 | 92.6 | 24,199 | 89.6 |
| Income from operations | 1,485 | 7.4 | 2,799 | 10.4 |
| Other income (expense): | | | | |
| Interest income | 254 | 1.3 | 53 | 0.2 |
| Interest expense | (1) | | (1) | |

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| | | | | | |
|------------------------------------|----------|------|----|-------|------|
| | 253 | 1.3 | | 52 | 0.2 |
| Income before income tax provision | 1,738 | 8.6 | | 2,851 | 10.6 |
| Income tax provision | 634 | 3.1 | | 1,041 | 3.9 |
| Net income | \$ 1,104 | 5.5% | \$ | 1,810 | 6.7% |

| (Dollars in thousands) | Six Months Ended September 30, (1) | | | |
|------------------------------------|------------------------------------|---------------|-----------|---------------|
| | 2005 | | 2004 | |
| | Dollars | % of revenues | Dollars | % of revenues |
| Revenues: | | | | |
| PPT | \$ 35,641 | 86.8% | \$ 47,043 | 89.9% |
| AMI | 4,927 | 12.0 | 5,021 | 9.6 |
| Other | 478 | 1.2 | 267 | 0.5 |
| | 41,046 | 100.0 | 52,331 | 100.0 |
| Operating expenses: | | | | |
| Cost of sales | 28,350 | 69.1 | 38,543 | 73.7 |
| Selling and administrative | 10,333 | 25.2 | 8,864 | 16.9 |
| | 38,683 | 94.2 | 47,407 | 90.6 |
| Income from operations | 2,363 | 5.8 | 4,924 | 9.4 |
| Other income (expense): | | | | |
| Interest income | 410 | 1.0 | 111 | 0.2 |
| Interest expense | (2) | | (2) | |
| | 408 | 1.0 | 109 | 0.2 |
| Income before income tax provision | 2,771 | 6.8 | 5,033 | 9.6 |
| Income tax provision | 1,011 | 2.5 | 1,837 | 3.5 |
| Net income | \$ 1,760 | 4.3% | \$ 3,196 | 6.1% |

(1) Percentages may not add due to rounding.

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Certain results of operations information by segment is as follows:

| (Dollars in thousands) | Three Months Ended September 30, | | | |
|------------------------|----------------------------------|---------------|-----------|---------------|
| | 2005 | | 2004 | |
| | Dollars | % of revenues | Dollars | % of revenues |
| <u>PPT</u> | | | | |
| Revenues | \$ 17,442 | 100.0% | \$ 24,349 | 100.0% |
| Cost of sales | 13,037 | 74.7 | 19,497 | 80.1 |
| Gross margin | \$ 4,405 | 25.3% | \$ 4,852 | 19.9% |
| <u>AMI</u> | | | | |
| Revenues | \$ 2,401 | 100.0% | \$ 2,512 | 100.0% |
| Cost of sales | 268 | 11.2 | 266 | 10.6 |
| Gross margin | \$ 2,133 | 88.8% | \$ 2,246 | 89.4% |
| <u>Other</u> | | | | |
| Revenues | \$ 321 | 100.0% | \$ 137 | 100.0% |
| Cost of sales | 213 | 66.4 | 12 | 8.8 |
| Gross margin | \$ 108 | 33.6% | \$ 125 | 91.2% |

| (Dollars in thousands) | Six Months Ended September 30, | | | |
|------------------------|--------------------------------|---------------|-----------|---------------|
| | 2005 | | 2004 | |
| | Dollars | % of revenues | Dollars | % of revenues |
| <u>PPT</u> | | | | |
| Revenues | \$ 35,641 | 100.0% | \$ 47,043 | 100.0% |
| Cost of sales | 27,557 | 77.3 | 38,015 | 80.8 |
| Gross margin | \$ 8,084 | 22.7% | \$ 9,028 | 19.2% |
| <u>AMI</u> | | | | |
| Revenues | \$ 4,927 | 100.0% | \$ 5,021 | 100.0% |
| Cost of sales | 577 | 11.7 | 506 | 10.1 |
| Gross margin | \$ 4,350 | 88.3% | \$ 4,515 | 89.9% |
| <u>Other</u> | | | | |
| Revenues | \$ 478 | 100.0% | \$ 267 | 100.0% |
| Cost of sales | 216 | 45.2 | 22 | 8.2 |
| Gross margin | \$ 262 | 54.8% | \$ 245 | 91.8% |

Revenue

Revenue decreased \$6.8 million, or 25.3%, to \$20.2 million in the three months ended September 30, 2005 (the second quarter of fiscal 2006) compared to \$27.0 million in the three months ended September 30, 2004 (the second quarter of fiscal 2005). Revenue decreased \$11.3 million, or 21.6%, to \$41.0 million in the six months ended September 30, 2005 compared to \$52.3 million in the six months ended September 30, 2004. The decreases in revenue were primarily due to decreases in transaction fees and sell-through fees, partially offset by small increases in order processing fees and our Essentials Suite™ of business intelligence services as described more fully below.

PPT Segment

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PPT revenues decreased \$6.9 million, or 28.4%, and \$11.4 million, or 24.2%, respectively, in the three and six month periods ended September 30, 2005 compared to the same periods of the prior fiscal year primarily as a result of decreases in transaction and sell-through fees, partially offset by increases in order processing fees as described below.

Order processing fees increased \$0.3 million, or 23.3%, and \$0.8 million, or 35.1%, respectively, in the three and six month periods ended September 30, 2005 compared to the same periods of the prior fiscal year due to a new output program with a major supplier, which was effective April 1, 2005. The terms of this new agreement, and its utilization by our Participating Retailers during the current periods, resulted in higher order processing fees per unit compared with the prior year periods.

Transaction fees decreased \$6.1 million, or 32.7%, and \$10.5 million, or 29.0%, respectively, in the three and six month periods ended September 30, 2005 compared to the same periods of the prior fiscal year.

The decreases in transaction fees were primarily due to the loss of a significant customer whose contract expired in September 2004, partially offset by increased fees related to the new output program discussed above.

Sell-through fees decreased \$1.2 million, or 26.5%, and \$1.6 million, or 19.9%, respectively, in the three and six month periods ended September 30, 2005 compared to the same periods of the prior fiscal year. The decreases in sell-through fees were primarily due to the loss of the significant customer mentioned above.

AMI Segment

Revenues from our AMI segment were relatively flat for the three and six month periods ended September 30, 2005 compared to the same periods of the prior fiscal year. Our Essentials™ business intelligence service offerings, which include those services that management considers fully operational and no longer in significant stages of development, saw revenue increases of \$0.1 million, or 7.7%, and \$0.2 million, or 9.9%, respectively, during the three and six month periods ended September 30, 2005 compared to the same periods of the prior fiscal year. These increases were offset by a \$0.2 million, or 13.6%, and a \$0.3 million, or a 10.3%, decrease, respectively, in DRS revenue in the same periods due to a decrease in the total number of DRS rental transactions processed. This decrease resulted from a decline in the number of DRS rental transactions processed for one of our major studios in the first six months of fiscal 2006 compared to the first six months of fiscal 2005 due to a change in the relationship between the studio and one of its direct revenue sharing customers.

Cost of Sales

Cost of sales consists of order processing costs, transaction costs, sell-through costs, handling and freight costs, and costs associated with certain Essentials™ business intelligence service offerings. These expenditures represent the direct costs to produce revenues. Order processing costs, transaction costs and sell through costs represent the amounts due to the Program Suppliers that hold the distribution rights to the Units. Freight costs represent the cost to pick, pack and ship orders of Units to the Participating Retailers. A portion of the Essentials™ business intelligence service offerings costs represent costs associated with the operation of a call center.

Cost of sales decreased \$6.3 million, or 31.6%, to \$13.5 million in the second quarter of fiscal 2006 compared to \$19.8 million in the second quarter of fiscal 2005 and decreased \$10.1 million, or 26.4%, to \$28.4 million in the six-month period ended September 30, 2005 compared to \$38.5 million in the same period of the prior fiscal year. Cost of sales as a percentage of revenue was 67.0% and 69.1%, respectively, in the three and six-month periods ended September 30, 2005 compared to 73.2% and 73.7%, respectively, in the same periods of the prior fiscal year.

The decreases in cost of sales were primarily due to the decrease in revenues discussed above. The decreases in cost of sales as a percentage of revenue were primarily due to lower costs for the PPT segment, offset by higher costs in the AMI segment, as well as costs associated with revenues from services which are still in the development stage and included in other. The PPT segment experienced lower costs of sales as a percentage of revenue as a result of the new output program mentioned above. The higher order processing fees per unit from this new output

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program generate no corresponding costs, which resulted in improved margins. The higher costs for the AMI segment primarily related to increased costs associated with the operation of our call center.

Selling and Administrative

Selling and administrative expenses consist primarily of compensation and benefits, development, marketing and advertising costs, legal and professional fees, communications costs, depreciation and amortization of tangible fixed assets and software, real and personal property leases, as well as other general corporate expenses.

Selling and administrative expenses increased \$0.8 million, or 16.7%, to \$5.2 million in the second quarter of fiscal 2006 compared to \$4.4 million in the second quarter of fiscal 2005 and increased \$1.4 million, or

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16.6%, to \$10.3 million in the six-month period ended September 30, 2005 compared to \$8.9 million in the same period of the prior fiscal year.

The increases in selling and administrative expenses in the three and six-month periods ended September 30, 2005 compared to the same periods of the prior fiscal year were primarily due to a \$0.4 million and a \$0.8 million increase, respectively, in expenditures related to our continued investment in the development and marketing of our Essentials™ business service offerings, a \$0.1 million and a \$0.3 million increase, respectively, in professional and audit fees relating primarily to our compliance with Section 404 of the Sarbanes-Oxley Act and our reorganization. These increases were offset by lower legal costs and improvements in trends relating to the collection of accounts receivable, which had a positive impact on the provision for bad debts. Additionally, the prior year amounts include recoveries, net of expenses, related to an embezzlement, which was discovered in March 2004, totaling \$0.2 million and \$0.1 million, respectively, as well as \$0.3 million and \$0.4 million, respectively, in higher advertising credits.

As a percentage of revenues, selling and administrative expenses increased to 25.6% and 25.2%, respectively, for the three and six-month periods ended September 30, 2005 compared to 16.4% and 16.9%, respectively, for the same periods of the prior fiscal year, due to a combination of increased expenses and lower revenues over which to spread those costs.

Interest Income

Interest income was \$254,000 and \$410,000, respectively, for the three and six-month periods ended September 30, 2005 compared to \$53,000 and \$111,000, respectively, for the same periods of the prior fiscal year. The increases in interest income primarily relate to higher interest rates and higher average cash balances in the current periods compared to the same periods of the prior fiscal year. Our average cash balance was \$22.9 million and \$9.9 million for the six months ended September 30, 2005 and 2004, respectively. We also purchased \$14.8 million of low-risk marketable securities during the second quarter of fiscal 2006, which contributed to higher yields on our invested cash. These securities mature March 31, 2006.

Income Taxes

Our effective tax rate was 36.5% in both the three and six-month periods ended September 30, 2005 and 2004. Our effective tax rate differs from the federal statutory tax rate primarily due to state income taxes.

Liquidity and Capital Resources

Our sources of liquidity include our cash, cash equivalents and marketable securities, cash expected to be generated from future operations and our \$6.0 million line of credit. Based on our current financial projections and projected cash needs, we believe that our available sources of liquidity will be sufficient to fund our current operations, the continued current development of our business intelligence services and other cash requirements through at least September 30, 2006.

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Cash and cash equivalents decreased \$11.7 million to \$10.3 million at September 30, 2005 compared to \$22.0 million at March 31, 2005. This decrease resulted primarily from \$14.8 million used for the purchase of marketable securities and \$1.0 million invested in property and equipment and internally developed software for our business intelligence service offerings, which were partially offset by \$3.1 million provided by operations, \$252,000 received on a note receivable, \$753,000 received on a related party note receivable and \$75,000 received from the issuance of common stock. Our current ratio was 3.4:1.0 at September 30, 2005 compared to 2.7:1.0 at March 31, 2005.

Accounts receivable, net of allowances, decreased \$1.7 million to \$12.7 million at September 30, 2005 compared to \$14.4 million at March 31, 2005, due primarily to lower revenues in the second quarter of fiscal 2006 compared to the fourth quarter of fiscal 2005.

Advances to Program Suppliers decreased \$1.0 million to \$0.2 million at September 30, 2005 compared to \$1.2 million at March 31, 2005. These amounts represent the unearned portion of guarantees with certain Program Suppliers, offset by reserves for estimated shortages under the guarantees. These advances to

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Program Suppliers increase and decrease over time based on changes in business volume, as well as timing of payments.

Deferred tax assets, short and long-term, were \$91,000 at September 30, 2005 compared to \$1.1 million at March 31, 2005. The reduction of \$1.0 million primarily relates to utilizing net operating loss carryforwards (NOLs) at September 30, 2005 to reduce taxes payable in fiscal 2006. The remaining deferred tax asset balance primarily relates to net operating loss carryforwards and various reserves not currently deductible for tax purposes.

Note receivable from related party of \$0.8 million at March 31, 2005 represented a note receivable from our former president plus accrued interest pursuant to his January 2005 separation agreement. This amount was paid in full on May 4, 2005.

During the first two quarters of fiscal 2006, we spent \$1.0 million on property and equipment, including \$0.7 million for the capitalization of internally developed software for our business intelligence service offerings. We anticipate spending a total of approximately \$2.5 million on property and equipment in fiscal 2006, including approximately \$1.4 million for the capitalization of internally developed software, primarily for our business intelligence service offerings.

Accounts payable decreased \$3.3 million to \$9.2 million at September 30, 2005 compared to \$12.5 million at March 31, 2005 primarily due to the timing of Program Supplier and other vendor payments.

We currently have a secured revolving line of credit for \$6.0 million, with a maturity of December 1, 2005. We expect to renew this line under similar terms. Interest on the line of credit is at our choice of either the bank's prime interest rate minus 0.5 percent or LIBOR plus 2 percent. The credit line is secured by substantially all of our assets. The line of credit includes certain financial covenants requiring: (1) a consolidated pre-tax income to be achieved each fiscal quarter of a minimum of \$1.00, and consolidated after-tax income not less than \$1.00 on an annual basis, determined at fiscal year end; (2) a minimum current ratio of 1.5:1.0, measured quarterly; and (3) a maximum debt-to-tangible net worth ratio of 1.5:1.0, measured quarterly. Based upon the financial results reported as of, and for the quarter ended, September 30, 2005, we determined that we were in compliance with the financial covenants at September 30, 2005. At September 30, 2005, we had no outstanding borrowings under this agreement.

Critical Accounting Policies and Estimates

We reaffirm the critical accounting policies and estimates as reported in our Form 10-K for the fiscal year ended March 31, 2005, which was filed with the Securities and Exchange Commission on June 13, 2005.

Additionally, please refer to Note 5 of Notes to Condensed Consolidated Financial Statements for a discussion of our policy regarding marketable securities.

Additionally, please refer to Note 5 of Notes to Condensed Consolidated Financial Statements for a discussion of our

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.

As of September 30, 2005, we had additional exposure to interest rate risk related to our marketable securities. We utilized sensitivity analyses to assess the potential effect of this risk and concluded that near-term changes in interest rates should not materially adversely affect our financial position, results of operations or cash flows.

There have been no other material changes in our reported market risks since the filing of our fiscal 2005 Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on June 13, 2005.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended (Exchange Act). Based on that evaluation our Chief Executive Officer and our Chief Financial Officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective in ensuring that material information required to be disclosed in our Exchange Act reports is (1) recorded, processed, summarized and reported in a timely manner, and (2) accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

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There has been no change in our internal control over financial reporting that occurred during our last fiscal quarter that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

PART II OTHER INFORMATION

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

Our annual meeting of shareholders was held on August 25, 2005, at which time the shareholders elected six nominees for director to our Board of Directors and approved the Rentrak Corporation 2005 Stock Incentive Plan.

The six directors elected, along with the voting results, are as follows:

| Name | No. of Shares Voting For | No. of Shares Withheld Voting |
|--------------------------|-----------------------------|----------------------------------|
| Judith G. Allen | 8,359,035 | 1,115,074 |
| Cecil D. Andrus | 8,304,033 | 1,170,076 |
| George H. Kuper | 8,333,748 | 1,140,361 |
| Paul A. Rosenbaum | 8,611,619 | 862,490 |
| Ralph R. Shaw | 8,408,935 | 1,065,174 |
| Stanford C. Bud Stoddard | 8,608,634 | 865,475 |

The Rentrak Corporation 2005 Stock Incentive Plan was approved as follows:

| No. of Shares Voting For: | No. of Shares Voting Against: | No. of Shares Abstaining: | No. of Broker Non-Votes: |
|------------------------------|-------------------------------------|------------------------------|-----------------------------|
| 3,030,979 | 2,031,569 | 427,498 | 3,984,063 |

ITEM 6. EXHIBITS

The following exhibits are filed herewith and this list is intended to constitute the exhibit index:

- 10.1 Form of Award Agreement for Non-Qualified Stock Option.
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
- 32.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
- 32.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.

SIGNATURE

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.

Date: November 8, 2005

RENTRAK CORPORATION

By: */s/ Mark L. Thoenes*
Mark L. Thoenes
Senior Vice President and Chief Financial Officer