

FINAL TRANSCRIPT

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VCI - Q2 2009 Valassis Communications Inc. Earnings Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Valassis Communications second quarter 2009 earnings conference call.

During today's presentation, all parties will be in a listen-only mode. Following the presentation the conference will be open for questions. (Operator Instructions). This conference is being recorded today, Thursday, July 30, 2009. Please refer to the Safe Harbor language on the earnings documents released this morning. This call will be governed by the language stated thereon.

I would now like to turn the conference over to your host, Mr. Alan Schultz, Chief Executive Officer. Please go ahead, sir.

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Thank you, Christopher. I'd like to welcome everyone to the call today.

I have with me Bob Recchia, our Chief Financial Officer; and I will go through our prepared remarks and then Bob and I look forward to answering your questions. I'd like to begin by commenting on last week's jury verdict in the first of three cases we have filed against News America that awarded us \$300 million in compensatory damages. Interest is accruing from the date of filing our complaint. Any recovery will be treated as other income and taxed appropriately when received.

Our claims in the case were for unfair competition and tortious interference by News America. More specifically, we alleged and offered substantial evidence to support our claims that News America had engaged in tying, bundling and leveraging of their



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in-store business in which they have market dominance into FSI negotiations to unfairly gain FSI business during the last eight years with the intent of harming Valassis' FSI business for the ultimate objective of driving us out of that business.

Our evidence covered News America's conduct with over 60 different FSI purchasers between 2001 and 2008. The eight member jury's unanimous verdict found News America liable on both counts. News America has stated it intends to appeal the ruling. We will vigorously oppose their appeal and support the legitimacy of the jury's verdict in the fair handling of the case by Wayne County circuit court judge Michael Sapala.

As a result of this decision, our shareholders have been inquiring about how the verdict may affect our FSI business going forward. We don't know but we assume any law abiding company would follow the law and stop any behavior that was found to be illegal in a court of law. In the meantime, clients may be examining their existing News America contracts with an eye toward their enforceability. News America's response to the verdict referenced items that were inadmissible during the trial. Their response is consistent with their overall strategy to divert attention from the testimony and facts of the case. The Judge ruled all prior litigation was inadmissible, including cases involving News America by Menasha, Theme Co-Op Promotions, Insignia Systems, Robert Emmel, and Floor Graphics.

We have two additional lawsuits pending against News America. One in Federal Court, asserting violations of the Sherman Act, and another in the Supreme Court of the State of California raising claims under California's Cartwright Unfair Competition and Unfair Practices Acts. These cases are yet to be scheduled for trial but we intend to aggressively pursue these claims. Any damage awards under the Sherman or Cartwright Acts would be tripled by law. Our most recent Form 10Q has additional information on these pending cases. Due to the pending litigation on this matter, we will be limiting comments on the litigation to these prepared remarks, so we will not be answering questions on this topic.

Now, moving forward to the primary purpose of this call, which is the discussion of our Q2 results. We will be discussing several areas with you today. Number one, we would like to talk about our revenue results relative to other media companies. Secondly, we would like to discuss highlights from our individual business segments. We would also like to discuss our performance in managing the cost side of our business as well as updating you on capital expenditures, liquidity and our covenant cushions. And finally, our outlook and our decision to raise our full year 2009 adjusted EBITDA guidance.

From a revenue perspective, although the economy has driven down client media spending, we continue to outperform most other media companies who are reporting advertising revenue declines in the 13% to 30% range. Our reported revenue for the quarter was down 8.6% versus prior year quarter. When you remove \$9.8 million of revenue from divested and discontinued businesses and the \$1.8 million impact of currency fluctuations from the prior year quarter, revenue declined 6.7% on a proforma basis this quarter. It is worth noting that second quarter 2008 was a decent quarter with revenues down just 2.8% as we didn't begin to feel the full impact of the economic downturn until September of last year.

We are aware of at least three research studies that indicate the U.S. has experienced a permanent shift in shopper behavior. A shift that has been made seeking value number one in shoppers minds. One of the key reasons we continue to outperform most other media companies on a revenue basis is our value oriented product portfolio. Our RedPlum products help marketers reach increasingly value minded consumers. NCH Marketing Services, our coupon processing and analytics subsidiary is reporting a 23% increase in coupon redemption volume this quarter versus the prior year quarter, the third consecutive quarter of double digit redemption volume growth. Q4 of 2008 was up 17% and Q1 of 2009 was up 15%.

CPG marketers continue to face fierce competition from growing private label brands. They turn to coupons and discounting to help keep their customers loyal by lowering the price differential between branded products and private label alternatives. Coupon distribution was also up again this quarter and that makes five consecutive quarters. We are enthusiastic about the future prospects of our NCH business. Valassis also benefits from a relatively stable and diverse customer base. Our business is not dependent on housing, construction, or automotive advertising, and does include grocery retailers and consumer package goods manufacturers as our largest client verticals who fare well regardless of economic conditions.



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Moving on to segment highlights. The increase in newspaper pre-prints, our largest product within our neighborhood targeted segment, was the bright spot in our revenue story this quarter with a 42.1% increase in newspaper pre-print revenue versus the prior year quarter. Despite declining circulation trends in the newspaper industry, our pre-print growth was driven by several factors. Number one, success in selling newspaper pre-prints to Shared Mail clients. Number two, organic growth in our existing pre-print clients. Number three, new client acquisition due to our ability to blend Shared Mail and newspaper distribution into a single optimized buy. And finally, strength in specialty retail, grocery retail and communications client verticals.

Overall revenue in our neighborhood targeted segment, however, was driven down due to decreases in our ROP and sampling businesses. The ROP decline was due to significantly reduced spending by two major customers. One in the telecom vertical and the other in the financial services vertical. Declines in our polybag and sampling business were not surprising, as polybags are typically used in store grand openings, and sampling is used for new product introductions both of which have declined in this economic climate. Polybags and samplings are by far our most cyclical products.

The revenue decline in our Shared Mail segment was due to a reduction in mass merchandiser spending, continued grocery retail or lightweighting, and the general competitiveness of the marketplace. On the plus side, we are pleased that Shared Mail margins continued to do well, which may seem counterintuitive considering the high operating leverage associated with this business. As you saw in our release, revenue declined 10.5%, but segment profit increased 2.6%. We continue to drive efficiency with package optimization efforts, newspaper alliances, and overall improvement in expense management. We also made a small improvement of one percentage point in unused postage and a 3% increase in pieces per package versus last year.

Revenue in our FSI business is up 3.8% this quarter due entirely to an approximately 8% growth in industry unit volume driven by positive trends towards value oriented media, which I mentioned earlier, along with the shift in pre-Easter revenue from the first quarter of last year to the second quarter of this year. While the increase in FSI segment profit versus the prior quarter is noteworthy, the FSI segment profit remains dramatically depressed from historical levels due to the unfair competitive behavior of News America including their tying, leveraging, and bundling of their in-store business into FSI negotiations and contracts. For example, in 2002, the annual segment profit for the FSI business was \$195.2 million compared to just \$1.8 million in the last full calendar year of 2008.

While we don't have a crystal ball on the economy, we do believe that the worst of quarterly revenue declines is behind us with an overall 8.6% rate of decline this quarter. For the last four quarters, the percentage revenue decline versus the prior year quarter is as follows - Q3, 2008 revenue was down 7.2%; Q4, 2008 down 5.3%; Q1, 2009 - 7.7%; and of course Q2 down 8.6%.

Moving on to the management of the cost side of the business. I'm often asked how we're doing with our integration of Shared Mail. The best example of integration achievement I can think of is how the team responded last September when everyone was asked to step up to drive down cost in response to the sudden economic downturn and its negative impact on our clients marketing budgets. I'm incredibly proud of how our team responded. A team with many divisions, many locations, producing diverse products, and serving a variety of clients. One team with a common goal - drive down costs, while maintaining quality and service in order to maximize profits. We moved with speed as one company to deliver our 2009 profit maximization plan, and we are really hitting it out of the park. Each and every employee in the Company has contributed.

Our original forecast for cost savings from our 2009 profit maximization plan was \$57.5 million to be accomplished through a combination of cost of goods sold and SG&A reductions, and the elimination of unprofitable businesses or product lines. We now forecast cost savings of \$20 million to \$25 million over our original forecast of \$57.5 million. The best way to model this impact moving forward would be to use a gross profit margin of about 24% and a quarterly SG&A run rate of approximately \$88 million, which includes legal expenses.

Capital spending for the first six months of 2009 is at \$8.6 million in line with our guidance of \$15 million to \$20 million for the full year. Cash flow from operations during the quarter was \$83.7 million including a \$50 million improvement in working capital, which allowed us to decrease our net debt to \$952 million. We also paid off \$23.1 million of our term loan B debt primarily through modified Dutch auctions at an average discount to par of 7.3%. As of June 30, 2009, our senior secured leverage ratio



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was 2.57 to 1 providing a covenant cushion of 31%. And our interest coverage ratio was 2.59 to 1 providing a covenant cushion of 32%.

Given our belief that we have hit the bottom from a rate of decline in revenue, along with our diligent cost management efforts and our profit maximization plan results and excluding any future negative economic surprises, we have decided to increase our full year 2009 adjusted EBITDA guidance by \$30 million from \$215 million to \$245 million. Our forecast, both from a sales and cost side of the business perspective, point to this number. The recent verdict in our first case against News America is not a contributor to or consideration in our decision to raise guidance.

With that I'd like to open the call to your questions. As a reminder we will not be answering questions regarding our litigation with News America.

So Christopher if you could open up the call we would appreciate it.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). Our first question is from Alexia Quadrani with JPMorgan. Please go ahead.

Alexia Quadrani - *JPMorgan Chase & Co. - Analyst*

Hi, thank you.

A couple of questions about what you're really seeing in the third quarter. First on the--in the ads of the Shared Mail side of the business. Are you seeing early indications of a pick up in July, any indications that maybe there's stronger back-to-school spending? And then on the FSI side of the business, I know it's only been about a week, but are your salespeople seeing any change in competitive behavior from News following the results of the lawsuit? And do you think the industry-wide volume growth that you saw in the second quarter is continuing to the third quarter?

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Alexia, in terms of third quarter Shared Mail business, I would say in general Shared Mail and kind of across-the-board in terms of our product portfolio, I think we have seen a relatively strong back-to-school promotional time period. With that said right now, September is not crystal clear to us and from an overall revenue perspective, I think we--the way we look at it is we still think we're going to experience a small revenue decline in Q3 as I said earlier. We think the rate of decline in Q2, we think the worst is behind us now. That doesn't mean we're back to revenue growth. We don't know exactly when revenue growth will return at this point in time, but the answer to your question on back-to-school is yes, it does look to us as if the spending is pretty strong in that July/August time period.

From an FSI side of the business it really only has been a week now so from a competitive perspective we really can't comment on anything we've seen there because we really haven't seen much at this point in time.

Alexia Quadrani - *JPMorgan Chase & Co. - Analyst*

Can you remind us where your market share stands right now in the FSI business and what is your pricing outlook for next year if you have one?



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Alan Schultz - Valassis Communications Inc. - Chairman, President & CEO

Yes. At this point in time we're not commenting on the pricing. It isn't until we usually get into like the October/November time period that we really have a good handle on the pricing side. As far as market share goes, we're in the low 40% right now, 42% to 43% is kind of the market share. As always that includes the custom Co-Op programs that we do. [Technical Difficulties]

Operator

Thank you for standing by, ladies and gentlemen, I've re-added Mr. Schultz to the line. Once again, we are in the question-and-answer session. (Operator Instructions). Mr. Schultz, please begin.

Alan Schultz - Valassis Communications Inc. - Chairman, President & CEO

Hello, this is Al Schultz, returning to the call. I apologize. We had a power outage here at our office. I'm on my mobile, hopefully it comes through clear.

I was with Alexia's question at the time we broke off and Alexia's question was what was our market share in the FSI business. The answer to that is we're in 42% to 43% range in terms of market share. As I have mentioned many times in the past, we do always include custom Co-Ops in our market share number. The reason for that is we don't want anyone to know what specific customers are doing in the way of custom Co-Ops and what volume they're running. So that is part of what has been requested by clients who do custom Co-Ops. So that's what our market share looks like.

Alexia Quadrani - JPMorgan Chase & Co. - Analyst

Thank you.

Sir, would you like to take the next question?

Alan Schultz - Valassis Communications Inc. - Chairman, President & CEO

Yes, let's go to the next question.

Operator

Excellent.

Our next question is with Dan Leben with Robert W. Baird. Please go ahead.

Daniel Leben - Robert W. Baird & Company, Inc. - Analyst

Great. Thanks.

Al, if you could help me out on the cost side just in terms of the nice performance you guys have had, how much of that is due to some of the mix shift away from the ROP business versus just kind of core cutting out fixed cost in the business and lowering the overall cost base?

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Alan Schultz - Valassis Communications Inc. - Chairman, President & CEO

Well, I think we've done a pretty good job on the cost of goods sold side of the business also, but you're right when you point out the fact that some of the revenue that we have lost or actually a pretty large percentage of the revenue we have lost has been lower margin business. So you're correct to point that out. We had a pretty significant decline, in excess of 50% decline in our ROP business; and as you know, ROP tends to be one of our lower margin businesses.

Daniel Leben - Robert W. Baird & Company, Inc. - Analyst

Great.

And could you just--going back to the guidance real quickly, the increase in the guidance could you give us a sense of how much of that is baking in the feeling that the sales line has stabilized versus what you've done in advance of expectation on the cost side?

Alan Schultz - Valassis Communications Inc. - Chairman, President & CEO

Yes. I would say probably in the neighborhood of two-thirds of the increase in our adjusted EBITDA guidance is in the form of cost, and the other third is in the way of the revenue. Looks like it's firmed up a little more than we had built into our budget for the second half of the year. So as I stated earlier, it doesn't mean we get to see revenue growth in the second half of the year, but it looks as if revenue will be a little stronger than what we had anticipated in the second half of the year in terms of our modeling.

Daniel Leben - Robert W. Baird & Company, Inc. - Analyst

Great and then last one for me.

Could you just give us a little bit more depth on some of the verticals and the spending habits you're seeing there both in the quarter and also looking out to July and August what you see in terms of back-to-school.

Alan Schultz - Valassis Communications Inc. - Chairman, President & CEO

When you get into the different verticals, it looks to us as if in the neighborhood targeted segment our pre-print business continues to perform very well. It looks as if it continues to be relatively strong. From what we see from an FSI segment standpoint, I think we got the question earlier, do we see continued growth in the back half of the year in the FSI business? And the answer to that question is yes, we do think this leaning towards value oriented media is going to continue to benefit the FSI business here in the back half of the year.

So we anticipate that we'll continue to see growth there. And in terms of our international digital segment and services segment, we believe based on everything we've seen so far that these trends in terms of U.S. coupon clearing volume are going to continue whether it will be plus 20% like we saw in the fourth quarter--or the most recent quarter, the second quarter is difficult to say, but we don't see any reason at this point in time why we wouldn't continue to see sort of double digit increases in coupon clearing volumes. So I think that tends to be pretty solid. And from a Shared Mail perspective, again, we've seen pretty good activity in terms of back-to-school, but September is not crystal clear to us yet in terms of exactly what September is going to look like. So September will have a pretty significant impact on the quarter for Shared Mail.

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Daniel Leben - *Robert W. Baird & Company, Inc. - Analyst*

I'm sorry, Al. I guess what I was actually looking for--and that was great commentary, but just in terms of what you're seeing from CPG versus grocery versus specialty retail, some of those different segments or industry verticals what they are doing both in the quarter and then looking forward in July and August what you see in terms of trends?

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Okay. From a client vertical standpoint, consumer package goods looks like it's going to continue to be pretty strong in terms of spending. I would tell you in terms of specialty retail, I think pretty stable, I think grocery pretty stable, I think mass merchandisers will continue to be down a little bit here. And the one area where we have seen some pick up is in the foodservice industry, casual dining, etc. It appears to us as if they've decided for whatever reason they need to start increasing their spending.

Daniel Leben - *Robert W. Baird & Company, Inc. - Analyst*

Great. Thanks, Al.

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Okay.

Operator

Thank you.

Our next question is from Dan Salmon with BMO Capital Markets. Please go ahead.

Dan Salmon - *BMO Capital Markets - Analyst*

Good morning, Al.

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Hello, Dan.

Dan Salmon - *BMO Capital Markets - Analyst*

Thanks for taking the question.

I want to maybe dial in a little bit more on uses of free cash flow from here on out. We've obviously got some bank debt and some notes out there, also digital remains a priority to invest in that area. So maybe--I don't know if you feel comfortable with this, but maybe frame how you're looking at using your free cash flow. Where you stand today and then perhaps if ultimately the News America legislation, excuse me, litigation settles where it looks like it is today with considerable amount of cash coming to you?

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Alan Schultz - Valassis Communications Inc. - Chairman, President & CEO

Yes. You brought up one area: digital, and what I would tell you is in our profit maximization plan, literally every area in profit maximization is exceeding our expectations with the exception of digital. Digital is actually losing more money than we had anticipated losing. Now, with that said, although I tend to and Bob Recchia tends to be a real stickler for people meeting and achieving their budgets, it's an area that we feel like we're making significant progress in and it's an area that we feel like we need to continue to invest in. So we've actually been spending a fair amount of time on that lately and we agreed on the fact that since our performance has improved and it's beyond what our original expectations are that we would continue to invest more money in the digital area.

As I said, we have been making some excellent progress. I think we're now of the 235 million websites that are out there. I think RedPlum is now cracked up into the top 600 websites in terms of activity in the world, and we've also now reached Google's page one in terms of coupon search so I think we are making great progress there. We're seeing great progress and we're going to continue to invest in that area.

The way it stands today is that our first priority continues to be debt reduction and I think that will continue. As far as proceeds from the litigation with News America go, obviously we're talking about very substantial dollars there, and I think that would require us to reconsider exactly what we do with any of those proceeds. And that ultimately would be a board decision, and it's something that we have had some conversation about but it's not something that we've made any firm decisions on at this point.

Dan Salmon - BMO Capital Markets - Analyst

Okay, great. That's great detail. Thank you.

Alan Schultz - Valassis Communications Inc. - Chairman, President & CEO

Okay.

Operator

Thank you. Our next question is from Trent Porter with [Arc Glow] Capital. Please go ahead.

Trent Porter - Arklow Capital - Analyst

Hi, good morning. I think you took care of most of my questions.

Maybe I'll just ask this one, it's sort of at the risk of sounding optimistic. When you did your deal in 2007, as I recall your proforma EBITDA was in the \$270 neighborhood; and now what's been described as the worst advertising recession in history, if you make your guidance you'll do a solid \$240. So the question is, can you kind of—is there a way to sort of quantify the permanent fixed cost savings that you've achieved relative to what you would bake into that \$270 million proforma number? And also, quantify any sort of market share gains that you've accomplished as a result of the cross-selling synergies and so on and so forth. And then maybe bridge that as any structural change to the negative, for example, the lower profitability of FSI relative to what you baked into that \$270 number.

Alan Schultz - Valassis Communications Inc. - Chairman, President & CEO

Right.

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Just the one part of your question was—is from a market share perspective if the cross-selling yield did anything for us. And the answer to that is yes, that is something that we have been measuring, and one of the things we looked at is if you looked at the entire universe of what every client is spending on products and services that we offer, our goal has been to increase our share of that. And I believe we're up about one percentage point in that particular area which is 1% on what's a pretty big number in terms of overall spending on products and services that we offer. So that is clearly an area we've made some progress in from a market share perspective.

When you look at the cost side of the equation, I don't think I can specifically tell you exactly what is kind of permanent cost changes, but we definitely feel as if the majority of the cost changes that we've made on the SG&A side of the equation do have a pretty permanent nature associated with them. And even on the cost of goods sold side, we've done some things from a contractual standpoint to lock in these costs well into next year. So I think we've done some good work in that regard. Referencing back to the original \$270, one of the things I recently did is I went back and looked at our kind of original forecast for the Shared Mail business for 2009, what we had projected and kind of like our first effort; and actually, the Shared Mail business even with the decline in revenue that we've experienced, is outperforming what we had built in our original model from a EBITDA perspective.

So that's a result of the tremendous amount of work on the management side of that business, cost management side of that business. And what I could tell you that I really like about that is the changes that we are making in that business are very much of a permanent nature in terms of the cost structure in that business, and so if we can start to see revenue growth in that business, you're going to see a very, very large percentage of that revenue growth fall right through to the bottom line.

Trent Porter - *Arklow Capital - Analyst*

Okay. That is helpful. Thank you.

And so I'm dying to ask about your litigation but I won't. But are you allowed to say at what rate the interest accrues on the award?

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Yes. I don't know—I don't recall exactly what it is, but it seems like it's in the neighborhood of 4.5% to 5% somewhere around there, and it's 1% over some particular benchmark and I don't recall exactly what that benchmark is. But it seems like it's in that—let's call it to be safe in the 4% to 5% range.

Trent Porter - *Arklow Capital - Analyst*

Okay, and is that on the \$300 million or the net of tax amount?

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

No, that would be on the gross amount.

Trent Porter - *Arklow Capital - Analyst*

Okay.

And then final question, a follow on to sort of Dan's question. If you were fat and happy and debt reduction was not the priority, what do you feel like you need to do, what would you do that you feel like you may be constrained in doing today in terms of

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investment in the digital space? Do you feel like you have catching up to do or do you feel like there's sort of strategically what you've done with RedPlum and what you are doing is appropriate for the changes that are happening in the industry?

Alan Schultz - Valassis Communications Inc. - Chairman, President & CEO

Yes. I think we feel as if we do have catch-up to do. I mean, we do feel like we're playing some catch-up in the digital arena. As you know, we were very early on back in 1999, so we were--we got kind of an early start on it really too early an idea before its time. And then--and now when we relaunched here in January of 2008, we found ourselves playing catch-up. So with that said, I think the progress that we've made has been pretty substantial and as I said before, we are willing to invest in that area.

In terms of what other kind of areas we might invest in, again that's a board decision. If you look at it from a historical basis, certainly share repurchase has been an area that the board has been interested in in the past and we've had a long term strategy to grow our product portfolio, and we've had a long term strategy to diversify our customer base. And I don't think that has really changed in the last 10 or 11 years, so I think we would continue to look at those opportunities too.

Trent Porter - Arklow Capital - Analyst

Okay. All right, thank you. That's it for me.

Alan Schultz - Valassis Communications Inc. - Chairman, President & CEO

Okay.

Operator

Thank you.

Our next question is with Jonathan Levine with Jefferies. Please go ahead.

Jonathan Levine - Jefferies & Company - Analyst

Yes.

I just wanted to follow-up just on a couple of the questions asked earlier. Firstly, can you provide us some color in terms of the monthly trends in Shared Mail during the second quarter?

Alan Schultz - Valassis Communications Inc. - Chairman, President & CEO

Jonathan, I don't have a whole lot in terms of monthly trends in Shared Mail in the second quarter. I can kind of go by memory and my memory tells me that it was really pretty stable throughout the quarter. I don't think it was necessarily improving as the quarter went on. I don't think it was declining as the quarter went on. I think it was pretty stable month against month. Now with that said, you did have Easter move from the first quarter in 2008 to the second quarter here in 2009, and so that kind of pre-Easter week would have moved. And so April was a little bit better than the year before, but I think it had more to do with that reason than anything else. So if you factor that out I would say pretty consistent, pretty flat.



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Jonathan Levine - *Jefferies & Company - Analyst*

Okay.

And then just following up on the question on the free cash flow in terms of repurchasing debt. Do you have kind of preference between bank debt and notes, and then if you could provide a little bit of color in terms of where your RP basket is in terms of what the availability is right now?

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Yes. We really don't--our preference would obviously be our notes versus the bank debt, but we've kind of looked at our debt agreements and we've made a decision that although it's sort of a gray area in terms of what we could do in terms of buying back notes, we've decided that we're going to focus on the bank debt side, so our focus is really there. In terms of our basket amounts, in terms of what we can do with baskets, I have not looked at--and our basket kind of changes over time based on the results of the Company, and I have not looked at the basket here for the recent quarter but that's something that we could look into.

Jonathan Levine - *Jefferies & Company - Analyst*

Okay, thank you.

Operator

Thank you. (Operator Instructions). Our next question is with Chuck Cerankosky with Northcoast Research. Please go ahead.

Charles Cerankosky - *Northcoast Research - Analyst*

Good morning, everyone.

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Good morning, Chuck.

Charles Cerankosky - *Northcoast Research - Analyst*

Question, Al, keying off of what somebody else asked. If you're looking at your current verticals and customers & companies, do any of them feel a sudden urge that they need to reposition their value image and that they are now looking at Shared Mail or the FSI product as a way to do that; whereas in the past they may have shunned it, or alternatively are some of them saying I've got to move from Shared Mail to the FSI or vice versa?

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Well I would tell you, Chuck, I know specifically in the grocery retail arena there were some grocery retailers that went very quickly with more of a value oriented approach. Kind of moving towards every day low price approach, and they seem to have been more successful than others. And there have been some other companies that have been slow to make that transition, and I think they haven't fared as well. So it seems like they are now moving more in that direction of value oriented media and conveying value to consumers. So I would say the answer to your question is yes, there are some differences. I don't want to

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name specific grocery retailers, but I know you follow them very closely. You probably know exactly who they are, and I think the answer to your question is yes, I think we'll see more activity from those who are kind of late followers on this trend.

Charles Cerankosky - *Northcoast Research - Analyst*

Well how about other segments of retailing or other types of consumer companies that are looking at FSI for the first time or Shared Mail? Are you seeing of that? Because the consumer is extremely value conscience right now and seems to be reacting to promotions.

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Yes. I would tell you the other one is one that I mentioned earlier, which is this whole food service arena franchise type restaurants. We're certainly seeing more activity and more spending out of them also as of late, and it kind of surprises me a little bit in the sense that I don't think they are doing particularly well in the current environment. They have been struggling a bit those particular customers and historically, they've spent a percentage of revenue on advertising and promotion. It looks to us right now as if they've made a decision to increase that percentage because the revenue isn't necessarily there right now, but it looks as if they have been and are going to be spending more.

Charles Cerankosky - *Northcoast Research - Analyst*

All right, thank you.

Operator

Thank you.

Our next question is from Victor Console with PW Partners. Please go ahead.

Victor Console - *PW Partners - Analyst*

Yes, hi, this is Victor Console.

I know you can't talk too much. I just need facts and clarification on the litigation. One, is any settlement you receive, how was that taxed? Is there a difference between a jury award or a damage settlement? And also could you just give us the calendar as you know it, so we can keep track of this on our own for the likely appeal date from the News Corp. entity, and the trial date that's coming up in the Michigan Federal Court and the California State Supreme Court so we can start marking our calendars, please?

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Yes. As it relates in terms of the treatment of money received, it would be other income. There's a variety of different issues as it relates to tax and what's appropriate from a tax standpoint, and we're currently researching those. And so the answer to that question is not perfectly clear to us at this point. So that's something that we're doing some more research on. It definitely is--a portion of it is definitely taxable whether it's entirely taxable and whether it's taxable at ordinary income or exactly how it works is, again, being researched at this point.

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Victor Console - *PW Partners - Analyst*

Can you get a credit for your legal expenses I'm sure?

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Well, the legal expenses are in our SG&A costs in essence so that's already been taken into consideration. And in terms of the calendar on appeal, I don't want to say exactly what that looks like because I really don't know. My understanding is there's a period of time that you have to request an appeal, and then there's a period of time after that that you have to actually file the appeal and so that's up to the courts.

Victor Console - *PW Partners - Analyst*

Yes. They have to put up like a \$300 million bond to do that too.

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Well there's issues around that also in terms of the bond; and so again, I don't have the answers to all of those questions right now. And then in terms of the calendar for the other cases, as I said, we're aggressively looking to get those scheduled as quickly as we possibly can; but we don't have a firm calendar date for those other two cases yet.

Victor Console - *PW Partners - Analyst*

Yes. That's what I was leading to is--does the appeal process put the other two cases on hold? So the appeal has to be heard first and then the Michigan District Court case and then the California case get heard after that?

I don't understand the process, that's why I'm asking.

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

I don't believe that is the case, but that's not what we believe to be true, but I think I should probably back off any other questions at this point as it relates to the case.

Victor Console - *PW Partners - Analyst*

Okay. Thank you very much.

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

All right, thank you.

Operator

Thank you.

Our next question is from Andrew Finkelstein with Barclays Capital. Please go ahead.

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Andrew Finkelstein - *Barclays Capital - Analyst*

Hey, guys. Just a couple quick questions.

Just wanted to follow-up on Shared Mail in your prepared remarks I think you mentioned competitiveness as one of the issues as to hurting our revenue trends there and I was wondering if you could give us a little more color on what you're referring to? And then just to come back to the COGS, again, you mentioned mix and I just want to know how much of that improvement there is attributable to mix? And if there are any other major factors driving that lower? Thanks.

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Okay. So I'm sorry, Andrew, what was the first part of your question again?

Andrew Finkelstein - *Barclays Capital - Analyst*

I think in your prepared remarks you discussed competitiveness in the Shared Mail business. I was wondering more specifically what you had meant there?

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Yes. Basically, what I'm referring to in terms of competitiveness in Shared Mail is it's a marketplace where everyone that we're competing with is living through the same economic downturn that we're living through, and everyone is being very competitive from a price perspective in order to secure business. And so basically what I'm referring to there is just the overall competitiveness of living through a market that's like this market.

I was a little confused on your question in terms of mix because I wasn't sure whether you were talking about mix in terms of revenue and gross profit margins on different businesses, or whether you were specifically talking about the issue of COGS.

Andrew Finkelstein - *Barclays Capital - Analyst*

Well I guess it's--you had mentioned the drop in the ROP business was a lower margin business.

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Correct.

Andrew Finkelstein - *Barclays Capital - Analyst*

So I'm sort of tying the revenue in. Did that change in the mix in the business? Is that the main driver of the improvement on the COGS side? Or was there other structural changes in COGS?

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

No, no, no.

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What really what I was referring to when I was talking about ROP was the gross margins on ROP tend to be one of the lowest in our company. So as we've seen a decline in ROP revenue, it hasn't had a big impact in terms of overall margins of the Company. As far as on the COGS side, no, the answer is we have had reductions in terms of COGS in just about every productline that we have.

Andrew Finkelstein - *Barclays Capital - Analyst*

And on that, I think there were some articles today from the postal service, maybe facing some more difficulties given the environment. Any concern looking out on postage?

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Well, obviously, yes, the postal service is struggling a bit from a financial perspective. Part of that has to do with some of the required payments that they need to make for healthcare, which is kind of catch up from the past; and I think if you took that out of the mix, the postal service isn't in as bad shape as it actually looks like because of these payments that they need to make for past healthcare cost. So that is something that we're concerned about. Obviously, what we try to do is blend newspaper and Shared Mail and digital into an optimized solution for customers; and so if postal costs go up, then we could see ourselves shifting business into other media.

Andrew Finkelstein - *Barclays Capital - Analyst*

Okay, great. Thanks.

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

Okay.

Operator

Thank you.

Mr. Schultz, at this time there are no further questions, sir.

Alan Schultz - *Valassis Communications Inc. - Chairman, President & CEO*

All right well thank you.

I apologize for the interruption in our call there when our power went out, but I'm glad we were able to finish the call. I guess what I'd say is we're obviously pleased with our results and that our products are well aligned with what we believe is a permanent shift in consumer behavior towards value oriented media. Our experience tells us that typically marketing dollars follow the consumer. So as the consumer moves to and spends more time with value oriented media, advertising dollars should follow that. So at this point, we don't know exactly when those dollars are going to arrive and when marketing budgets are going to start to increase again, but we certainly think that will be the case at some point in the future.

In addition with the cost structure that we've put in place, if we do get some revenue growth, we should see a substantial flow through to the bottom line; and as I mentioned earlier in the call, I think the best example of that is the Shared Mail business. If we see revenue growth in Shared Mail, a very large percentage of that growth will fall through to the bottom line.

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And finally, I would say that I'm extremely proud of our entire team here. I'm really proud of their diligence and resolve to deliver these results. I'm really proud of the fact that we just recovered our 149th missing children as a result of the products and services that we put in the marketplace as part of our "America's Looking For Its Missing Children Program". I'm also proud of our associates and employees for their achievement related to our profit maximization plan, and I'm really exceptionally proud of them for their efforts in competing in the FSI business, and in a marketplace that has been unfair on an uneven playing field in this FSI business for nearly a decade now. They've really done an outstanding job when you consider what they were up against.

So thank you all very much for attending the call and we appreciate your time and attention. Goodbye.

Operator

Thank you. Ladies and gentlemen, this concludes the Valassis Communications second quarter 2009 earnings conference call. Once again we would like to thank you for your participation. You may now disconnect.

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