

VALASSIS COMMUNICATIONS INC

Form 10-Q

November 06, 2012

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

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the Quarterly Period Ended September 30, 2012

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

VALASSIS COMMUNICATIONS, INC.  
(Exact Name of Registrant as Specified in its Charter)

Delaware  
(State or Other Jurisdiction of  
Incorporation or Organization)  
19975 Victor Parkway  
Livonia, Michigan 48152  
(Address of Principal Executive Offices)  
Registrant's Telephone Number: (734) 591-3000

38-2760940  
(IRS Employer Identification Number)

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

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

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

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

As of November 1, 2012, there were 39,222,212 shares of the Registrant's Common Stock outstanding.

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## PART I – FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## VALASSIS COMMUNICATIONS, INC.

## Condensed Consolidated Balance Sheets

(U.S. dollars in thousands, except share amounts)

(unaudited)

	September 30, 2012	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	\$90,344	\$101,971
Accounts receivable, net (Note 1)	399,341	448,320
Inventories (Note 1)	31,860	41,120
Prepaid expenses and other	55,080	37,655
Total current assets	576,625	629,066
Property, plant and equipment, net (Note 1)	131,566	148,905
Goodwill (Note 2)	628,886	636,471
Other intangible assets, net (Note 2)	221,403	213,613
Other assets	16,085	16,392
Total assets	\$1,574,565	\$1,644,447
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion long-term debt (Note 3)	\$18,750	\$15,000
Accounts payable	284,473	334,378
Progress billings	40,552	39,975
Accrued expenses (Note 4)	82,008	98,409
Total current liabilities	425,783	487,762
Long-term debt (Note 3)	572,561	587,560
Deferred income taxes	66,672	67,404
Other non-current liabilities	44,450	52,187
Total liabilities	1,109,466	1,194,913
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Preferred stock (\$0.01 par value; 25,000,000 shares authorized; no shares issued or outstanding at September 30, 2012 and December 31, 2011)	—	—
Common stock (\$0.01 par value; 100,000,000 shares authorized; 65,394,999 and 65,398,539 shares issued at September 30, 2012 and December 31, 2011, respectively; 39,155,646 and 42,347,368 shares outstanding at September 30, 2012 and December 31, 2011, respectively)	654	654
Additional paid-in capital	111,600	123,881
Retained earnings	1,106,434	1,021,566
Accumulated other comprehensive income	2,340	2,775
Treasury stock, at cost (26,239,353 and 23,051,171 shares at September 30, 2012 and December 31, 2011, respectively)	(755,929)	(699,342)
Total stockholders' equity	465,099	449,534

Total liabilities and stockholders' equity	\$1,574,565	\$1,644,447
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See accompanying notes to condensed consolidated financial statements.

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VALASSIS COMMUNICATIONS, INC.  
Condensed Consolidated Statements of Income  
(U.S. dollars in thousands, except per share data)  
(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Revenues	\$523,822	\$528,391	\$1,582,645	\$1,640,622
Costs and expenses:				
Cost of sales	388,284	395,728	1,180,905	1,222,345
Selling, general and administrative	73,358	80,520	234,498	239,778
Amortization expense	3,245	3,156	9,557	9,467
Goodwill impairment (Note 2)	—	—	7,585	—
Total costs and expenses	464,887	479,404	1,432,545	1,471,590
Earnings from operations	58,935	48,987	150,100	169,032
Other expenses and income:				
Interest expense	7,563	8,148	21,372	29,649
Interest income	(46	) (54	) (174	) (315
Loss on extinguishment of debt (Note 3)	—	—	—	16,318
Other expenses (income), net	249	(3,856	) (525	) (6,168
Total other expenses, net	7,766	4,238	20,673	39,484
Earnings before income taxes	51,169	44,749	129,427	129,548
Income tax expense (Note 1)	14,429	17,255	44,559	50,391
Net earnings	\$36,740	\$27,494	\$84,868	\$79,157
Net earnings per common share, basic (Note 6)	\$0.94	\$0.60	\$2.08	\$1.65
Net earnings per common share, diluted (Note 6)	\$0.90	\$0.58	\$2.00	\$1.58
Weighted-average common shares outstanding, basic (Note 6)	39,047	45,689	40,777	47,831
Weighted-average common shares outstanding, diluted (Note 6)	40,832	47,766	42,532	50,089

See accompanying notes to condensed consolidated financial statements.

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VALASSIS COMMUNICATIONS, INC.  
Condensed Consolidated Statements of Comprehensive Income  
(U.S. dollars in thousands)  
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net earnings	\$36,740	\$27,494	\$84,868	\$79,157
Other comprehensive income, net of tax:				
Unrealized changes in fair value of cash flow hedges	(862 )	(2,738 )	(1,841 )	(2,991 )
Unrealized changes in fair value of available-for-sale securities	—	—	—	(117 )
Realized losses on cash flow hedges reclassified from accumulated other comprehensive income ("AOCI") into earnings	656	—	656	3,040
Foreign currency translation adjustment	197	(1,254 )	750	(447 )
Total other comprehensive income (loss)	\$(9 )	\$(3,992 )	\$(435 )	\$(515 )
Comprehensive income	\$36,731	\$23,502	\$84,433	\$78,642

See accompanying notes to condensed consolidated financial statements.

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VALASSIS COMMUNICATIONS, INC.  
Condensed Consolidated Statements of Cash Flows  
(U.S. dollars in thousands)  
(unaudited)

	Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities:		
Net earnings	\$84,868	\$79,157
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	43,022	45,487
Amortization of debt issuance costs	1,438	1,785
Provision for losses on accounts receivable	1,231	2,515
Goodwill impairment	7,585	—
Loss on extinguishment of debt	—	5,748
Gain on derivatives, net	194	6,952
Loss on sale of property, plant and equipment	400	13
Stock-based compensation expense	7,021	6,564
Deferred income taxes	1,513	2,356
Changes in assets and liabilities:		
Accounts receivable, net	52,260	50,151
Inventories	9,260	5,852
Prepaid expenses and other	(16,877)	(24,333)
Other assets	(1,038)	(394)
Accounts payable	(51,616)	(34,490)
Progress billings	577	(393)
Accrued expenses	(21,626)	(10,253)
Other non-current liabilities	(7,018)	(13,519)
Total adjustments	26,326	44,041
Net cash provided by operating activities	111,194	123,198
Cash flows from investing activities:		
Additions to property, plant and equipment	(15,783)	(18,127)
Digital acquisitions, net of cash acquired	(18,344)	—
Proceeds from sale of property, plant and equipment	256	46
Proceeds from sale of available-for-sale securities	—	1,494
Net cash used in investing activities	(33,871)	(16,587)
Cash flows from financing activities:		
Borrowings of long-term debt	—	610,000
Repayments of long-term debt	(11,250)	(709,919)
Debt issuance costs	—	(11,580)
Repurchases of common stock	(87,130)	(155,817)
Proceeds from issuance of common stock	8,956	5,646
Net cash used in financing activities	(89,424)	(261,670)
Effect of exchange rate changes on cash and cash equivalents	474	158
Net decrease in cash and cash equivalents	(11,627)	(154,901)
Cash and cash equivalents at beginning of period	101,971	245,935
Cash and cash equivalents at end of period	\$90,344	\$91,034

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Supplemental disclosure of cash flow information:

Cash paid during the period for interest	\$24,923	\$28,567
Cash paid during the period for income taxes	\$67,016	\$72,026
Non-cash financing activities:		
Stock issued under stock-based compensation plans	\$—	\$3,184

See accompanying notes to condensed consolidated financial statements.

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VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

**1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES****Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP principles for complete financial statements. In the opinion of management, the information contained herein reflects all adjustments necessary for a fair presentation of the information presented. All such adjustments are of a normal recurring nature. The results of operations for the interim periods are not necessarily indicative of results to be expected for the fiscal year. For further information, refer to the consolidated financial statements and footnotes thereto included in the Valassis Communications, Inc. (“Valassis,” “we,” and “our”) Annual Report on Form 10-K for the year ended December 31, 2011, as amended (the “2011 Form 10-K”).

**Significant Accounting Policies****Accounts Receivable**

The allowance for doubtful accounts was \$7.0 million and \$6.9 million as of September 30, 2012 and December 31, 2011, respectively.

**Income Taxes**

We are required to adjust our effective tax rate each quarter to be consistent with our estimated annual effective tax rate. We are also required to record the tax impact of certain unusual or infrequently occurring items, including the effects of changes in tax laws or rates, in the interim period in which they occur. The effective tax rate during a particular quarter may be higher or lower as a result of the timing of actual earnings versus annual projections.

**Inventories**

Inventories are accounted for at the lower of cost, determined on a first in, first out (“FIFO”) basis, or market.

Inventories included on the condensed consolidated balance sheets consisted of:

(in thousands of U.S. dollars)	September 30, 2012	December 31, 2011
Raw materials	\$20,532	\$28,075
Work in progress	11,328	13,045
Inventories	\$31,860	\$41,120

**Property, Plant and Equipment**

The following table summarizes the costs and ranges of useful lives of the major classes of property, plant and equipment and the total accumulated depreciation related to property, plant and equipment, net included on the condensed consolidated balance sheets:

	Useful Lives (in years)	September 30, 2012	December 31, 2011
		(in thousands of U.S. dollars)	
Land, at cost	N/A	\$7,185	\$7,167
Buildings, at cost	10 - 30	37,960	37,511
Machinery and equipment, at cost	3 - 20	224,679	217,764
Office furniture and equipment, at cost	3 - 10	241,765	236,994
Leasehold improvements, at cost	5 - 10	28,935	28,563
		540,524	527,999

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Less accumulated depreciation	(408,958	)	(379,094	)
Property, plant and equipment, net	\$131,566		\$148,905	

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VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

## 2. GOODWILL AND OTHER INTANGIBLE ASSETS

The changes in the carrying amount of goodwill for the nine months ended September 30, 2012 are as follows:

(in thousands of U.S. dollars)	Shared Mail	Neighborhood Targeted	Free-standing Inserts	International, Digital Media & Services	Total
Balance as of December 31, 2011					
Total goodwill acquired	\$721,384	\$5,325	\$22,357	\$93,405	\$842,471
Accumulated impairment losses	(187,200 )	—	—	(18,800 )	(206,000 )
Goodwill	534,184	5,325	22,357	74,605	636,471
Impairment charges	—	(3,985 )	—	(3,600 )	(7,585 )
Balance as of September 30, 2012					
Total goodwill acquired	721,384	5,325	22,357	93,405	842,471
Accumulated impairment losses	(187,200 )	(3,985 )	—	(22,400 )	(213,585 )
Goodwill	\$534,184	\$1,340	\$22,357	\$71,005	\$628,886

The impairment charges of \$7.6 million recognized during the nine months ended September 30, 2012 resulted from our decision to exit our newspaper polybag advertising and sampling business, a reporting unit within our Neighborhood Targeted reportable segment, and our solo direct mail business, a reporting unit within International, Digital Media & Services.

The components of other intangible assets, net included on the condensed consolidated balance sheets consisted of:

(in thousands of U.S. dollars)	September 30, 2012			Weighted Average Remaining Useful Life (in years)	December 31, 2011			Weighted Average Remaining Useful Life (in years)
	Gross Amount	Accumulated Amortization	Net Amount		Gross Amount	Accumulated Amortization	Net Amount	
Finite-lived intangible assets:								
Mailing lists, non-compete agreements and other	\$41,520	\$(11,498 )	\$30,022	14.1	\$40,457	\$(9,894 )	\$30,563	15.1
Customer relationships	140,000	(52,544 )	87,456	8.2	140,000	(44,591 )	95,409	9.0
Total	\$181,520	(64,042 )	117,478		\$180,457	(54,485 )	125,972	
Indefinite-lived intangible assets:								
Valassis name, tradenames, trademarks and other			103,925				87,641	

Other intangible assets, net	\$221,403	\$213,613
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The increase in the gross amount of mailing lists, non-compete agreements and other finite-lived intangible assets during the nine months ended September 30, 2012 reflects the acquisition of technology related to our digital business. The \$16.3 million increase in indefinite-lived intangible assets during the nine months ended September 30, 2012 relates to the acquisition of Brand.net, which is described in Note 9, Brand.net Acquisition.

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VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

## 3. LONG-TERM DEBT

Long-term debt included on the condensed consolidated balance sheets consisted of:

(in thousands of U.S. dollars)	September 30, 2012	December 31, 2011
Senior Secured Revolving Credit Facility	\$50,000	\$50,000
Senior Secured Term Loan A	281,250	292,500
Senior Secured Convertible Notes due 2033, net of discount	61	60
6 5/8% Senior Notes due 2021	260,000	260,000
Total debt	591,311	602,560
Current portion long-term debt	18,750	15,000
Long-term debt	\$572,561	\$587,560

## Senior Secured Credit Facility

## General

On June 27, 2011, we entered into a senior secured credit facility with JPMorgan Chase Bank, N.A., as administrative agent, and a syndicate of lenders jointly arranged by J.P. Morgan Securities LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated and RBS Securities Inc. (the "Senior Secured Credit Facility"). The Senior Secured Credit Facility and related loan documents replaced and terminated our prior credit agreement, dated as of March 2, 2007, as amended (the "Prior Senior Secured Credit Facility"), by and among Valassis, Bear Stearns Corporate Lending Inc., as Administrative Agent, and a syndicate of lenders jointly arranged by Bear, Stearns & Co. Inc. and Banc of America Securities LLC. In connection with the termination of the Prior Senior Secured Credit Facility, all obligations and rights under the related guarantee, security and collateral agency agreement, dated as of March 2, 2007, as amended (the "Prior Security Agreement"), by Valassis and certain of its domestic subsidiaries signatory thereto, as grantors, in favor of Bear Stearns Corporate Lending Inc., in its capacity as collateral agent for the benefit of the Secured Parties (as defined in the Prior Security Agreement), were also simultaneously terminated.

The Senior Secured Credit Facility consists of:

a five-year term loan A in an aggregate principal amount equal to \$300.0 million, with principal repayable in quarterly installments at a rate of 5.0% during each of the first two years from issuance, 10.0% during the third year from issuance, 15.0% during the fourth year from issuance and 11.25% during the fifth year from issuance, with the remaining 53.75% due at maturity (the "Term Loan A");

a five-year revolving credit facility in an aggregate principal amount of \$100.0 million (the "Revolving Line of Credit"), including \$15.0 million available in Euros, Pounds Sterling or Canadian Dollars, \$50.0 million available for letters of credit and a \$20.0 million swingline loan subfacility, of which \$50.0 million was drawn at closing and remains outstanding as of September 30, 2012 (exclusive of outstanding letters of credit described below); and

an incremental facility pursuant to which, prior to the maturity of the Senior Secured Credit Facility, we may incur additional indebtedness in an amount up to \$150.0 million under the Revolving Line of Credit or the Term Loan A or a combination thereof, subject to certain conditions, including receipt of additional lending commitments for such additional indebtedness. The terms of the incremental facility will be substantially similar to the terms of the Senior Secured Credit Facility, except with respect to the pricing of the incremental facility, the interest rate for which could be higher than that for the Revolving Line of Credit and the Term Loan A.

We used the initial borrowing under the Revolving Line of Credit, the proceeds from the Term Loan A and existing cash of \$120.0 million to repay the \$462.2 million outstanding under our Prior Senior Secured Credit Facility (reflecting all outstanding borrowings thereunder), to pay accrued interest with respect to such loans and to pay the fees and expenses related to the Senior Secured Credit Facility. We recognized a pre-tax loss on extinguishment of

debt of \$3.0 million during the nine months ended September 30, 2011, which represents the write-off of related capitalized debt issuance costs. In addition, as further discussed in Note 7, Derivative Financial Instruments and Fair Value Measurements, we recorded in interest expense a pre-tax loss of \$2.6 million related to the discontinuation of hedge accounting on the related interest rate swap. We capitalized related debt issuance costs of approximately \$6.2 million, which will be amortized over the term of the Senior Secured Credit Facility.

All borrowings under our Senior Secured Credit Facility, including, without limitation, amounts drawn under the Revolving Line of Credit, are subject to the satisfaction of customary conditions, including absence of a default and accuracy of representations and warranties. As of September 30, 2012, we had approximately \$41.6 million available under the Revolving

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VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

Line of Credit portion of our Senior Secured Credit Facility (after giving effect to the reductions in availability pursuant to \$8.4 million in standby letters of credit outstanding as of September 30, 2012).

**Interest and Fees**

Borrowings under our Senior Secured Credit Facility bear interest, at our option, at either the alternate base rate (defined as the higher of the prime rate announced by the Administrative Agent, the federal funds effective rate or one-month LIBOR, in each case, plus an applicable interest rate margin) (the “Base Rate”) or at the Eurodollar Rate (one-, two-, three- or six-month LIBOR, at our election, as defined in the credit agreement governing the Senior Secured Credit Facility), except for borrowings made in alternate currencies which may not accrue interest based upon the alternate base rate, in each case, plus an applicable interest rate margin. The applicable margins are currently 0.75% per annum for Base Rate loans and 1.75% per annum for Eurodollar Rate loans. The margins applicable to the borrowings under our Senior Secured Credit Facility may be adjusted based on our consolidated leverage ratio, with 1.00% being the maximum Base Rate margin and 2.00% being the maximum Eurodollar Rate. See Note 7, Derivative Financial Instruments and Fair Value Measurements, for discussion regarding our various interest rate swap agreements.

**Guarantees and Security**

Our Senior Secured Credit Facility is guaranteed by certain of our existing and future domestic restricted subsidiaries pursuant to a Guarantee and Collateral Agreement. In addition, our obligations under our Senior Secured Credit Facility and the guarantee obligations of the subsidiary guarantors are secured by first priority liens on substantially all of our and our subsidiary guarantors’ present and future assets and by a pledge of all of the equity interests in our domestic subsidiary guarantors and 65% of the capital stock of certain of our existing and future foreign subsidiaries.

The Guarantee and Collateral Agreement also secures our Senior Secured Convertible Notes due 2033 on an equal and ratable basis with the indebtedness under our Senior Secured Credit Facility to the extent required by the indenture governing such notes.

**Prepayments**

The Senior Secured Credit Facility also contains a requirement that we make mandatory principal prepayments on the Term Loan A and Revolving Line of Credit in certain circumstances, including, without limitation, with 100% of the aggregate net cash proceeds from certain asset sales, casualty events or condemnation recoveries (in each case, to the extent not otherwise used for reinvestment in our business or related business and subject to certain other exceptions). The Senior Secured Credit Facility further provides that, subject to customary notice and minimum amount conditions, we may make voluntary prepayments without payment of premium or penalty.

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VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

Covenants

Subject to customary and otherwise agreed upon exceptions, our Senior Secured Credit Facility contains affirmative and negative covenants, including, but not limited to:

- the payment of other obligations;
- the maintenance of organizational existences, including, but not limited to, maintaining our property and insurance;
- compliance with all material contractual obligations and requirements of law;
- limitations on the incurrence of indebtedness;
- limitations on creation and existence of liens;
- limitations on certain fundamental changes to our corporate structure and nature of our business, including mergers;
- limitations on asset sales;
- limitations on restricted payments, including certain dividends and stock repurchases and redemptions;
- limitations on capital expenditures;
- limitations on any investments, provided that certain “permitted acquisitions” and strategic investments are allowed;
- limitations on optional prepayments and modifications of certain debt instruments;
- limitations on modifications to organizational documents;
- limitations on transactions with affiliates;
- limitations on entering into certain swap agreements;
- limitations on negative pledge clauses or clauses restricting subsidiary distributions;
- limitations on sale-leaseback and other lease transactions; and
- limitations on changes to our fiscal year.

Our Senior Secured Credit Facility also requires us to comply with:

a maximum consolidated leverage ratio, as defined in our Senior Secured Credit Facility (generally, the ratio of our consolidated total debt to consolidated earnings before interest, taxes, depreciation and amortization, or EBITDA, for the most recent four quarters), of 3.50:1.00; and

a minimum consolidated interest coverage ratio, as defined in our Senior Secured Credit Facility (generally, the ratio of our consolidated EBITDA to consolidated interest expense for the most recent four quarters), of 3.00:1.00.

The following table shows the required and actual financial ratios under our Senior Secured Credit Facility as of September 30, 2012:

	Required Ratio	Actual Ratio
Maximum consolidated leverage ratio	No greater than 3.50:1.00	1.94:1.00
Minimum consolidated interest coverage ratio	No less than 3.00:1.00	11.70:1.00

In addition, we are required to give notice to the administrative agent and the lenders under our Senior Secured Credit Facility of defaults under the facility documentation and other material events, make any new wholly-owned domestic subsidiary (other than an immaterial subsidiary) a subsidiary guarantor and pledge substantially all after-acquired property as collateral to secure our and our subsidiary guarantors’ obligations in respect of the facility.

Events of Default

Our Senior Secured Credit Facility contains customary events of default, including upon a change in control. If such an event of default occurs, the lenders under our Senior Secured Credit Facility would be entitled to take various actions, including in certain circumstances increasing the effective interest rate and accelerating the amounts due under our Senior Secured Credit Facility.



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VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

8 1/4% Senior Notes due 2015

On January 13, 2011, we commenced a cash tender offer and consent solicitation to purchase any and all of our outstanding 8 1/4% Senior Notes due 2015 (the "2015 Notes") and to amend the indenture governing the 2015 Notes (the "2015 Indenture") to eliminate substantially all of the restrictive covenants and certain events of default. We used the net proceeds from the 2021 Notes (described below) to fund the purchase of the 2015 Notes, the related consent payments pursuant to the tender offer and consent solicitation, and the subsequent redemption of the 2015 Notes that were not tendered and remained outstanding after the expiration of the tender offer and consent solicitation. We recognized a pre-tax loss on extinguishment of debt of \$13.3 million during the nine months ended September 30, 2011, which represents the difference between the aggregate purchase price and the aggregate principal amount of the 2015 Notes purchased and the write-off of related capitalized debt issuance costs.

6 5/8% Senior Notes due 2021

On January 28, 2011, we issued in a private placement \$260.0 million aggregate principal amount of our 6 5/8% Senior Notes due 2021 (the "2021 Notes"). The net proceeds were used to fund the purchase of the outstanding 2015 Notes and the related consent payments in a concurrent tender offer and consent solicitation as described above and the redemption of the remaining outstanding 2015 Notes. We capitalized related debt issuance costs of approximately \$5.1 million, which are being amortized over the term of the 2021 Notes.

Interest on the 2021 Notes is payable every six months on February 1 and August 1. The 2021 Notes are fully and unconditionally guaranteed, jointly and severally, by substantially all of our existing and future domestic restricted subsidiaries on a senior unsecured basis.

In July 2011, in accordance with the terms of the registration rights agreement between us and the initial purchasers of the 2021 Notes, we completed an exchange offer to exchange the original notes issued in the private placement for a like principal amount of exchange notes registered under the Securities Act of 1933, as amended. An aggregate principal amount of \$260.0 million, or 100%, of the original notes were exchanged for exchange notes in the exchange offer. The exchange notes are substantially identical to the original notes, except that the exchange notes are not subject to certain transfer restrictions.

The 2021 Notes were issued under an indenture with Wells Fargo Bank, National Association, as trustee (the "2021 Indenture"). Subject to a number of exceptions, the 2021 Indenture restricts our ability and the ability of our restricted subsidiaries (as defined in the 2021 Indenture) to incur or guarantee additional indebtedness, transfer or sell assets, make certain investments, pay dividends or make distributions or other restricted payments, create certain liens, merge or consolidate, repurchase stock, create or permit restrictions on the ability of our restricted subsidiaries to pay dividends or make other distributions to us and enter into transactions with affiliates.

We may redeem all or a portion of the 2021 Notes at our option at any time prior to February 1, 2016, at a redemption price equal to 100% of the principal amount of 2021 Notes to be redeemed, plus a make-whole premium as described in the 2021 Indenture, plus accrued and unpaid interest to the redemption date, if any. At any time on or after February 1, 2016, we may redeem all or a portion of the 2021 Notes at our option at the following redemption prices (expressed as percentages of the principal amount thereof) if redeemed during the twelve-month period commencing on February 1 of the years set forth below:

Year	Percentage
2016	103.313%
2017	102.208%
2018	101.104%
2019 and thereafter	100.000%

In addition, we must pay accrued and unpaid interest to the redemption date, if any. On or prior to February 1, 2014, we may also redeem at our option up to 35% of the principal amount of the outstanding 2021 Notes with the proceeds of certain equity offerings at the redemption price specified in the 2021 Indenture, plus accrued and unpaid interest to the date of redemption, if any. Upon the occurrence of a change of control, as defined in the 2021 Indenture, we must make a written offer to purchase all of the 2021 Notes for cash at a purchase price equal to 101% of the principal amount of the 2021 Notes, plus accrued and unpaid interest to the date of repurchase, if any.

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**Additional Provisions**

The indenture governing the Senior Secured Convertible Notes due 2033 contains a cross-default provision which becomes applicable if we default under any mortgage, indenture or instrument evidencing indebtedness for money borrowed by us and the default results in the acceleration of such indebtedness prior to its express maturity, and the principal amount of any such accelerated indebtedness aggregates in excess of \$25.0 million. The 2021 Indenture contains a cross-default provision which becomes applicable if we (a) fail to pay the stated principal amount of any of our indebtedness at its final maturity date, or (b) default under any of our indebtedness and the default results in the acceleration of indebtedness, and, in each case, the principal amount of any such indebtedness, together with the principal amount of any other such indebtedness under which there has been a payment default or the maturity of which has been so accelerated, aggregates \$50.0 million or more. Our credit agreement contains a cross-default provision which becomes applicable if we (a) fail to make any payment under any indebtedness for money borrowed by us (other than the obligations under such credit agreement) in an aggregate outstanding principal amount of at least \$50.0 million or, (b) otherwise default under any such indebtedness, or trigger another event which causes such indebtedness to become due or to be repurchased, prepaid, defeased or redeemed or become subject to an offer to repurchase, prepay, defease or redeem such indebtedness prior to its stated maturity.

**Repurchases of Debt**

Subject to applicable limitations in our Senior Secured Credit Facility and indentures, we may from time to time repurchase our debt in the open market, through tender offers, through exchanges for debt or equity securities, in privately negotiated transactions or otherwise.

**Covenant Compliance**

As of September 30, 2012, we were in compliance with all of our indenture and Senior Secured Credit Facility covenants.

**4. ACCRUED EXPENSES**

Accrued expenses included on the condensed consolidated balance sheets consisted of:

(in thousands of U.S. dollars)	September 30, 2012	December 31, 2011
Accrued interest	\$3,027	\$7,205
Accrued compensation and benefits	42,470	55,030
Other accrued expenses	36,511	36,174
Accrued expenses	\$82,008	\$98,409

**5. COMMITMENTS AND CONTINGENCIES**

The application and interpretation of applicable state sales tax laws to certain of our products is uncertain.

Accordingly, we may be exposed to additional sales tax liability to the extent various state jurisdictions determine that certain of our products are subject to such jurisdictions' sales tax. As of September 30, 2012, we have recorded a liability of \$6.8 million, reflecting our best estimate of our potential sales tax liability.

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



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## 6. EARNINGS PER SHARE

Earnings per common share data were as follows:

(in thousands, except per share data)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Net earnings	\$36,740	\$27,494	\$84,868	\$79,157
Weighted-average common shares outstanding, basic	39,047	45,689	40,777	47,831
Shares issued on exercise of dilutive options	4,595	4,981	4,613	5,756
Shares purchased with assumed proceeds of options and unearned restricted shares	(2,810 )	(2,908 )	(2,859 )	(3,502 )
Shares contingently issuable	—	4	1	4
Weighted-average common shares outstanding, diluted	40,832	47,766	42,532	50,089
Net earnings per common share, diluted	\$0.90	\$0.58	\$2.00	\$1.58
Anti-dilutive options excluded from calculation of weighted-average common shares outstanding, diluted	3,184	3,681	3,397	3,170

## 7. DERIVATIVE FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

We are exposed to market risks arising from adverse changes in foreign exchange rates and interest rates. We manage these risks through a variety of strategies which include the use of derivatives. Certain derivatives are designated as cash flow hedges and qualify for hedge accounting treatment, while others do not qualify or have not been designated as hedges and are marked to market through earnings. The notional amounts of derivative financial instruments and related fair values measured on a recurring basis and included in the condensed consolidated balance sheets were as follows:

(in millions of U.S. dollars)	Notional Amounts		Fair Values		Balance Sheet Location
	September 30, 2012	December 31, 2011	September 30, 2012	December 31, 2011	
Derivatives designated as cash flow hedging instruments:					
Interest rate swap contract	\$183.4	\$186.3	\$(6.5 )	\$(4.6 )	Accrued expenses / Other non-current liabilities
Derivatives not receiving hedge accounting treatment:					
Interest rate swap contract	—	140.0	—	(0.8 )	Accrued expenses
Foreign exchange contracts	7.9	11.7	0.4	(1.0 )	Prepaid expenses and other / Accrued expenses
Total derivative financial instruments	\$191.3	\$338.0	\$(6.1 )	\$(6.4 )	

The fair values of our interest rate swap contracts and foreign exchange contracts are determined based on third-party valuation models and observable foreign exchange forward contract rates, respectively, both of which represent Level 2 fair value inputs.



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## VALASSIS COMMUNICATIONS, INC.

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The following tables summarize the impact of derivative financial instruments on the condensed consolidated financial statements for the indicated periods:

(in millions of U.S. Dollars)	Three Months Ended September 30,					
	2012	2011	2012	2011	2012	2011
	Amount of Pre-tax Loss Recognized in Earnings*		Amount of Pre-tax Loss Recognized in OCI		Amount of Pre-tax Loss Reclassified from AOCI into Earnings*	
Derivatives designated as cash flow hedging instruments:						
Interest rate swap contract	\$—	\$—	\$(1.0	) \$(4.5	) \$(0.7	) \$—
Derivatives not receiving hedge accounting treatment:						
Interest rate swap contracts	\$—	\$0.1	\$—	\$—	\$—	\$—
Foreign exchange contracts	0.5	(2.0	) —	—	—	—
	\$0.5	\$(1.9	) \$(1.0	) \$(4.5	) \$(0.7	) \$—

(in millions of U.S. Dollars)	Nine Months Ended September 30,					
	2012	2011	2012	2011	2012	2011
	Amount of Pre-tax Gain (Loss) Recognized in Earnings*		Amount of Pre-tax Loss Recognized in OCI		Amount of Pre-tax Loss Reclassified from AOCI into Earnings*	
Derivatives designated as cash flow hedging instruments:						
Interest rate swap contract	\$—	\$—	\$(2.6	) \$(4.9	) \$(0.7	) \$(5.0
Derivatives not receiving hedge accounting treatment:						
Interest rate swap contracts	\$(0.1	) \$—	\$—	\$—	\$—	\$—
Foreign exchange contracts	1.4	(2.0	) —	—	—	—
	\$1.3	\$(2.0	) \$(2.6	) \$(4.9	) \$(0.7	) \$(5.0

Amounts recognized in earnings related to interest rate swap contracts are included in interest expense in the \*unaudited condensed consolidated statements of income and amounts recognized in earnings related to foreign exchange contracts are included in cost of sales in the unaudited condensed consolidated statements of income.

**Interest Rate Swaps**

On December 17, 2009, we entered into an interest rate swap agreement with an initial notional amount of \$300.0 million to fix three-month LIBOR at 2.005%, for an effective rate of 4.255%, including the applicable margin, for an equivalent portion of our variable rate debt under our Prior Senior Secured Credit Facility. The effective date of this

agreement was December 31, 2010. The notional amount of \$300.0 million amortized by \$40.0 million at the end of every quarter until it reached \$100.0 million for the quarter ended June 30, 2012, the expiration date. The swap was designated as, and qualified as, a cash flow hedge through the termination of the Prior Senior Secured Credit Facility on June 27, 2011. Changes in the fair value of this swap subsequent to the termination of hedge accounting were recognized in earnings as a component of interest expense until expiration of the swap.

On July 6, 2011, we entered into an interest rate swap agreement with an initial notional amount of \$186.3 million. The effective date of this agreement was June 30, 2012. Under the swap agreement, we are required to make quarterly payments at a fixed interest rate of 1.8695% per annum to the counterparty on an amortizing notional amount in exchange for receiving



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variable payments based on the three-month LIBOR interest rate for the same notional amount. After giving effect to the swap agreement, our effective interest rate for the notional amount, based on the current applicable margin under our Senior Secured Credit Facility, is 3.6195% per annum. The initial notional amount of \$186.3 million amortizes quarterly by (i) \$2.8 million from the effective date through the quarter ending September 30, 2013, (ii) \$5.6 million from September 30, 2013 through the quarter ending September 30, 2014, and (iii) \$8.4 million from September 30, 2014 until June 30, 2015, the expiration date of the agreement. The swap is designated as and qualifies as a cash flow hedge.

**Foreign Currency**

Currencies to which we have exposure are the Mexican peso, Canadian dollar, British pound, Polish zloty and Euro. Currency restrictions are not expected to have a significant effect on our cash flows, liquidity, or capital resources. We purchase the Mexican peso and Polish zloty under two to twelve-month forward foreign exchange contracts to stabilize the cost of production. As of September 30, 2012, we had a commitment to purchase \$7.1 million in Mexican pesos and \$0.8 million in Polish zlotys over the next year.

**Long-Term Debt**

The estimated fair market value of our long-term debt was \$2.9 million above carrying value and \$25.0 million below carrying value as of September 30, 2012 and December 31, 2011, respectively. Our 2021 Notes are traded in an active market with the fair value determined based on quoted active market prices, which represents a Level 1 fair value input. Borrowings under our Senior Secured Credit Facility are not traded in an active market and are valued based on an implied price derived from industry averages and relative loan performance, which represent Level 3 fair value inputs.

**Cash and Cash Equivalents**

The carrying amounts of cash and cash equivalents and accruals approximate fair value due to the near-term maturity of these instruments.

**8. REPURCHASES OF COMMON STOCK**

The following table summarizes our repurchases of common stock during the indicated periods:

in thousands, except per share data	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Shares repurchased	838	2,094	4,133	5,861
Aggregate repurchase price	\$21,229	\$49,961	\$87,130	\$155,817
Average price paid per share	\$25.34	\$23.86	\$21.08	\$26.59

As of September 30, 2012, we had authorization to repurchase an additional 3.4 million shares of our common stock under the share repurchase program approved by our Board of Directors.

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VALASSIS COMMUNICATIONS, INC.

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9. BRAND.NET ACQUISITION

On June 20, 2012, we acquired, through a wholly-owned subsidiary, Brand.net, an online display, video and mobile advertising platform. The acquisition was accounted for as a purchase under the acquisition method in accordance with Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") No. 805, Business Combinations. The total purchase price was approximately \$18.0 million and did not include direct acquisition costs of approximately \$0.7 million. The acquisition was recorded by allocating the purchase price to the assets acquired, including identifiable intangible assets and liabilities assumed, based on their estimated fair values at the date of acquisition. The acquisition of Brand.net did not have a material impact on our revenues or net earnings for the nine months ended September 30, 2012, and would not have had a material impact on our revenues or net earnings for any of the periods included in the unaudited, condensed consolidated statements of income if the acquisition had been consummated at the beginning of such periods.

In accordance with FASB ASC No. 805, the preliminary purchase price allocation is subject to adjustment within one year after the acquisition as additional information on asset and liability valuations becomes available.

10. SEGMENT REPORTING

Our segments meeting the quantitative thresholds to be considered reportable are Shared Mail, Neighborhood Targeted and Free-standing Inserts ("FSI"). All other lines of business fall below a materiality threshold and are, therefore, combined together in an "other" segment named International, Digital Media & Services. These business lines include NCH Marketing Services, Inc., our coupon clearing and analytics business, as well as our digital and in-store businesses. Our reportable segments are strategic business units that offer different products and services and are subject to regular review by our chief operating decision-maker. They are managed separately because each business requires different executional strategies and caters to different client marketing needs.

The accounting policies of the segments are the same as those described in the 2011 Form 10-K and Note 1, Basis of Presentation and Significant Accounting Policies. We evaluate reportable segment performance based on segment profit, which we define as earnings from operations excluding unusual or infrequently occurring items. Assets are not allocated to reportable segments and are not used to assess the performance of a reportable segment.

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The following tables set forth, by segment, revenues, depreciation/amortization and segment profit for the indicated periods:

(in millions of U.S. dollars)	Three Months Ended September 30,				Total
	Shared Mail	Neighborhood Targeted	FSI	International, Digital Media & Services	
2012					
Revenues from external customers	\$331.4	\$75.8	\$72.2	\$44.4	\$523.8
Intersegment revenues	\$4.3	\$15.7	\$9.3	\$—	\$29.3
Depreciation/amortization	\$7.7	\$1.0	\$3.2	\$2.0	\$13.9
Segment profit (loss)	\$52.3	\$(1.1)	) \$7.6	\$0.1	\$58.9
2011					
Revenues from external customers	\$330.5	\$76.9	\$73.5	\$47.5	\$528.4
Intersegment revenues	\$4.4	\$13.8	\$9.6	\$0.1	\$27.9
Depreciation/amortization	\$8.9	\$1.2	\$3.6	\$0.7	\$14.4
Segment profit (loss)	\$46.2	\$0.4	\$(0.8)	) \$3.2	\$49.0
(in millions of U.S. dollars)	Nine Months Ended September 30,				Total
	Shared Mail	Neighborhood Targeted	FSI	International, Digital Media & Services	
2012					
Revenues from external customers	\$1,008.2	\$225.5	\$219.0	\$129.9	\$1,582.6
Intersegment revenues	\$12.7	\$42.3	\$29.4	\$—	\$84.4
Depreciation/amortization	\$24.2	\$3.1	\$9.6	\$6.1	\$43.0
Segment profit (loss)	\$147.0	\$(5.1)	) \$20.3	\$5.2	\$167.4
2011					
Revenues from external customers	\$990.3	\$255.8	\$251.9	\$142.6	\$1,640.6
Intersegment revenues	\$13.0	\$36.0	\$29.2	\$0.3	\$78.5
Depreciation/amortization	\$28.4	\$3.2	\$9.6	\$4.3	\$45.5
Segment profit	\$136.0	\$3.1	\$14.9	\$15.0	\$169.0

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## VALASSIS COMMUNICATIONS, INC.

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The following table provides reconciliations of total segment profit to earnings from operations for the indicated periods (nonoperating expenses are not allocated to reportable segments and are not used to assess the performance of a reportable segment):

(in millions of U.S. dollars)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Total segment profit	\$58.9	\$49.0	\$167.4	\$169.0
Unallocated amounts:				
Goodwill impairment	\$—	\$—	\$7.6	\$—
Restructuring and other charges	\$—	\$—	\$9.7	\$—
Earnings from operations	\$58.9	\$49.0	150.1	\$169.0

The \$9.7 million of restructuring and other charges recognized during the nine months ended September 30, 2012 consisted of \$5.3 million of severance and related costs and \$0.7 million of Brand.net acquisition costs, both of which were included in selling, general and administrative expenses in the unaudited, condensed consolidated statements of income, and \$3.7 million of lease termination, severance, asset impairment and other costs associated with our decision to exit our solo direct mail business and our newspaper polybag advertising and sampling business, which were included in cost of sales in the unaudited, condensed consolidated statements of income. The results of operations of these businesses were immaterial to our consolidated results of operations for each of the nine months ended September 30, 2012 and 2011.

Domestic and foreign revenues were as follows:

(in millions of U.S. dollars)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
United States	\$514.6	\$516.4	\$1,550.5	\$1,601.6
Foreign	9.2	12.0	32.1	39.0
Revenues	\$523.8	\$528.4	\$1,582.6	\$1,640.6

Domestic and foreign long-lived assets (property, plant and equipment, net) were as follows:

(in millions of U.S. dollars)	September 30,	December 31,
	2012	2011
United States	\$123.9	\$140.7
Foreign	7.7	8.2
Property, plant and equipment, net	\$131.6	\$148.9

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VALASSIS COMMUNICATIONS, INC.

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11. GUARANTOR AND NON-GUARANTOR CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

The following information is presented in accordance with Rule 3-10 of Regulation S-X. The operating and investing activities of the separate legal entities included in the consolidated financial statements are fully interdependent and integrated. Revenues and operating expenses of the separate legal entities include intercompany charges for management and other services. The 2021 Notes issued by Valassis (referred to for purposes of this note only as the “Parent Company”) are guaranteed by substantially all of the Parent Company’s domestic wholly-owned subsidiaries (collectively, the “Guarantor Subsidiaries”) on a senior unsecured basis. Each of the Guarantor Subsidiaries is 100% owned, directly or indirectly, by the Parent Company and has guaranteed the 2021 Notes on a joint and several, full and unconditional basis, subject to certain customary exceptions. Pursuant to the terms of the 2021 Indenture, the Guarantor Subsidiaries are subject to release under certain customary conditions as described below.

Non-wholly-owned subsidiaries, joint ventures, partnerships and foreign subsidiaries (collectively, the “Non-Guarantor Subsidiaries”) are not guarantors of these obligations. Substantially all of the Guarantor Subsidiaries also guarantee the Parent Company’s Senior Secured Credit Facility.

The 2021 Indenture provides for a Guarantor Subsidiary to be automatically and unconditionally released and discharged from its guarantee obligations in certain circumstances, including:

• The sale or other transfer or disposition of all of the Guarantor Subsidiary's capital stock to any person that is not an affiliate of the Parent Company;

• The sale or other transfer of all or substantially all the assets or capital stock of a Guarantor Subsidiary, by way of merger, consolidation or otherwise, to any person that is not an affiliate of the Parent Company;

• If a Guarantor Subsidiary ceases to be a “Domestic Restricted Subsidiary” for purposes of the indenture covenants; and

• Legal defeasance or covenant defeasance of the indenture obligations when provision has been made for them to be fully satisfied.

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## Condensed Consolidating Balance Sheet

September 30, 2012

(in thousands of U.S. dollars)

	Parent Company	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Total
<b>Assets</b>					
Current assets:					
Cash and cash equivalents	\$58,768	\$7,530	\$24,046	\$—	\$90,344
Accounts receivable, net	107,972	274,327	17,042	—	399,341
Inventories	24,273	7,584	3	—	31,860
Prepaid expenses and other (including intercompany)	1,382,334	3,214,001	1,309	(4,542,564 )	55,080
Total current assets	1,573,347	3,503,442	42,400	(4,542,564 )	576,625
Property, plant and equipment, net	18,871	111,655	1,040	—	131,566
Goodwill	23,699	598,198	6,989	—	628,886
Other intangible assets, net	11,540	209,863	—	—	221,403
Investments	627,723	15,100	—	(639,432 )	3,391
Intercompany note receivable (payable)	344,146	(340,069 )	(4,077 )	—	—
Other assets	8,116	4,564	14	—	12,694
Total assets	\$2,607,442	\$4,102,753	\$46,366	\$(5,181,996 )	\$1,574,565
<b>Liabilities and Stockholders' Equity</b>					
Current liabilities:					
Current portion, long-term debt	\$18,750	\$—	\$—	\$—	\$18,750
Accounts payable and intercompany payable	1,475,441	3,334,726	16,870	(4,542,564 )	284,473
Progress billings	16,449	11,764	12,339	—	40,552
Accrued expenses	42,259	33,059	6,690	—	82,008
Total current liabilities	1,552,899	3,379,549	35,899	(4,542,564 )	425,783
Long-term debt	572,561	—	—	—	572,561
Deferred income taxes	(3,573 )	74,242	(3,997 )	—	66,672
Other non-current liabilities	20,456	24,363	(369 )	—	44,450
Total liabilities	2,142,343	3,478,154	31,533	(4,542,564 )	1,109,466
Stockholders' equity	465,099	624,599	14,833	(639,432 )	465,099
Total liabilities and stockholders' equity	\$2,607,442	\$4,102,753	\$46,366	\$(5,181,996 )	\$1,574,565

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## VALASSIS COMMUNICATIONS, INC.

## Notes to Condensed Consolidated Financial Statements

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## Condensed Consolidating Balance Sheet

December 31, 2011

(in thousands of U.S. dollars)

	Parent Company	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Total
<b>Assets</b>					
Current assets:					
Cash and cash equivalents	\$68,887	\$7,543	\$25,541	\$—	\$101,971
Accounts receivable, net	123,558	302,096	22,666	—	448,320
Inventories	32,159	8,958	3	—	41,120
Prepaid expenses and other (including intercompany)	1,157,263	1,993,450	23,217	(3,136,275 )	37,655
Total current assets	1,381,867	2,312,047	71,427	(3,136,275 )	629,066
Property, plant and equipment, net	24,790	122,565	1,550	—	148,905
Goodwill	23,584	605,898	6,989	—	636,471
Other intangible assets, net	11,558	202,055	—	—	213,613
Investments	547,366	21,385	—	(565,261 )	3,490
Intercompany note receivable (payable)	359,649	(333,683 )	(25,966 )	—	—
Other assets	9,710	5,271	(2,079 )	—	12,902
Total assets	\$2,358,524	\$2,935,538	\$51,921	\$(3,701,536 )	\$1,644,447
<b>Liabilities and Stockholders' Equity</b>					
Current liabilities:					
Current portion, long-term debt	\$15,000	\$—	\$—	\$—	\$15,000
Accounts payable and intercompany payable	1,210,296	2,246,381	13,976	(3,136,275 )	334,378
Progress billings	15,952	10,358	13,665	—	39,975
Accrued expenses	52,675	38,543	7,191	—	98,409
Total current liabilities	1,293,923	2,295,282	34,832	(3,136,275 )	487,762
Long-term debt	587,560	—	—	—	587,560
Deferred income taxes	(2,840 )	74,241	(3,997 )	—	67,404
Other non-current liabilities	30,347	20,887	953	—	52,187
Total liabilities	1,908,990	2,390,410	31,788	(3,136,275 )	1,194,913
Stockholders' equity	449,534	545,128	20,133	(565,261 )	449,534
Total liabilities and stockholders' equity	\$2,358,524	\$2,935,538	\$51,921	\$(3,701,536 )	\$1,644,447

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## Condensed Consolidating Statement of Comprehensive Income

Three Months Ended September 30, 2012

(in thousands of U.S. dollars)

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Total
Revenues	\$172,888	\$445,063	\$12,868	\$(106,997)	) \$523,822
Costs and expenses:					
Cost of sales	145,467	286,533	9,093	(52,809)	) 388,284
Selling, general and administrative	23,033	101,614	2,899	(54,188)	) 73,358
Amortization expense	6	3,239	—	—	3,245
Total costs and expenses	168,506	391,386	11,992	(106,997)	) 464,887
Earnings from operations	4,382	53,677	876	—	58,935
Other expenses and income:					
Interest expense	7,563	—	—	—	7,563
Interest income	(20)	) 3	(29)	) —	(46)
Intercompany interest	(9,062)	) 9,062	—	—	—
Other expenses, net	49	197	3	—	249
Total other expenses (income), net	(1,470)	) 9,262	(26)	) —	7,766
Earnings before income taxes	5,852	44,415	902	—	51,169
Income tax expense (benefit)	(3,429)	) 17,632	226	—	14,429
Equity in net earnings of subsidiaries	27,459	4,276	—	(31,735)	) —
Net earnings	\$36,740	\$31,059	\$676	\$(31,735)	) \$36,740
Other comprehensive income (loss)	(9)	) 197	197	(394)	) (9)
Comprehensive income	\$36,731	\$31,256	\$873	\$(32,129)	) \$36,731



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## Condensed Consolidating Statement of Comprehensive Income

Three Months Ended September 30, 2011

(in thousands of U.S. dollars)

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Total
Revenues	\$173,543	\$443,671	\$17,008	\$(105,831 )	\$528,391
Costs and expenses:					
Cost of sales	148,817	287,173	12,368	(52,630 )	395,728
Selling, general and administrative	30,065	100,223	3,433	(53,201 )	80,520
Amortization expense	5	3,151	—	—	3,156
Total costs and expenses	178,887	390,547	15,801	(105,831 )	479,404
Earnings (loss) from operations	(5,344 )	53,124	1,207	—	48,987
Other expenses and income:					
Interest expense	8,148	—	—	—	8,148
Interest income	(28 )	—	(26 )	—	(54 )
Intercompany interest	(1,179 )	1,179	—	—	—
Other expenses (income), net	(2,877 )	(972 )	(7 )	—	(3,856 )
Total other expenses (income), net	4,064	207	(33 )	—	4,238
Earnings (loss) before income taxes	(9,408 )	52,917	1,240	—	44,749
Income tax expense	(10 )	16,891	374	—	17,255
Equity in net earnings of subsidiaries	36,892	866	—	(37,758 )	—
Net earnings	\$27,494	\$36,892	\$866	\$(37,758 )	\$27,494
Other comprehensive loss	(3,992 )	(1,254 )	(1,254 )	2,508 )	(3,992 )
Comprehensive income (loss)	\$23,502	\$35,638	\$(388 )	\$(35,250 )	\$23,502

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VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

## Condensed Consolidating Statement of Comprehensive Income

Nine Months Ended September 30, 2012

(in thousands of U.S. dollars)

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Total
Revenues	\$515,716	\$1,332,741	\$44,754	\$(310,566 )	\$1,582,645
Costs and expenses:					
Cost of sales	435,750	864,353	34,637	(153,835 )	1,180,905
Selling, general and administrative	76,842	305,097	9,290	(156,731 )	234,498
Amortization expense	17	9,540	—	—	9,557
Goodwill impairment	3,985	3,600	—	—	7,585
Total costs and expenses	516,594	1,182,590	43,927	(310,566 )	1,432,545
Earnings (loss) from operations	(878 )	150,151	827	—	150,100
Other expenses and income:					
Interest expense	21,372	—	—	—	21,372
Interest income	(80 )	3	(97 )	—	(174 )
Intercompany interest	(19,817 )	19,770	47	—	—
Other expenses (income), net	34	(526 )	(33 )	—	(525 )
Total other expenses (income), net	1,509	19,247	(83 )	—	20,673
Earnings (loss) before income taxes	(2,387 )	130,904	910	—	129,427
Income tax expense (benefit)	(6,016 )	49,540	1,035	—	44,559
Equity in net earnings (loss) of subsidiaries	81,239	3,475	—	(84,714 )	—
Net earnings (loss)	\$84,868	\$84,839	\$(125 )	\$(84,714 )	\$84,868
Other comprehensive income (loss)	(435 )	750	750	(1,500 )	(435 )
Comprehensive income	\$84,433	\$85,589	\$625	\$(86,214 )	\$84,433

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VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

## Condensed Consolidating Statement of Comprehensive Income

Nine Months Ended September 30, 2011

(in thousands of U.S. dollars)

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Total
Revenues	\$572,298	\$1,317,568	\$54,658	\$(303,902 )	\$1,640,622
Costs and expenses:					
Cost of sales	483,751	851,885	38,660	(151,951 )	1,222,345
Selling, general and administrative	76,040	305,162	10,527	(151,951 )	239,778
Amortization expense	16	9,451	—	—	9,467
Total costs and expenses	559,807	1,166,498	49,187	(303,902 )	1,471,590
Earnings from operations	12,491	151,070	5,471	—	169,032
Other expenses and income:					
Interest expense	29,649	—	—	—	29,649
Interest income	(242 )	—	(73 )	—	(315 )
Intercompany interest	(15,533 )	15,371	162	—	—
Loss on extinguishment of debt	16,318	—	—	—	16,318
Other expenses (income), net	(3,095 )	(3,242 )	169	—	(6,168 )
Total other expenses, net	27,097	12,129	258	—	39,484
Earnings (loss) before income taxes	(14,606 )	138,941	5,213	—	129,548
Income tax expense	556	48,199	1,636	—	50,391
Equity in net earnings of subsidiaries	94,319	3,577	—	(97,896 )	—
Net earnings	\$79,157	\$94,319	\$3,577	\$(97,896 )	\$79,157
Other comprehensive loss	(515 )	(447 )	(447 )	894	(515 )
Comprehensive income	\$78,642	\$93,872	\$3,130	\$(97,002 )	\$78,642

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VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

## Condensed Consolidating Statement of Cash Flows

Nine Months Ended September 30, 2012

(in thousands of U.S. dollars)

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Total
Net cash provided by (used in) operating activities	\$153,569	\$(40,611 )	\$(1,764 )	\$—	\$111,194
Cash flows from investing activities:					
Additions to property, plant and equipment	(4,472 )	(11,100 )	(211 )	—	(15,783 )
Digital acquisitions, net of cash acquired	—	(18,344 )	—	—	(18,344 )
Proceeds from sale of property, plant and equipment	250	—	6	—	256
Net cash used in investing activities	(4,222 )	(29,444 )	(205 )	—	(33,871 )
Cash flows from financing activities:					
Cash provided by (used in) intercompany activity	(70,042 )	70,042	—	—	—
Repayments of long-term debt	(11,250 )	—	—	—	(11,250 )
Repurchases of common stock	(87,130 )	—	—	—	(87,130 )
Proceeds from issuance of common stock	8,956	—	—	—	8,956
Net cash provided by (used in) by financing activities	(159,466 )	70,042	—	—	(89,424 )
Effect of exchange rate changes on cash and cash equivalents	—	—	474	—	474
Net decrease in cash and cash equivalents	(10,119 )	(13 )	(1,495 )	—	(11,627 )
Cash and cash equivalents at beginning of period	68,887	7,543	25,541	—	101,971
Cash and cash equivalents at end of period	\$58,768	\$7,530	\$24,046	\$—	\$90,344

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VALASSIS COMMUNICATIONS, INC.

Notes to Condensed Consolidated Financial Statements

(unaudited)

## Condensed Consolidating Statement of Cash Flows

Nine Months Ended September 30, 2011

(in thousands of U.S. dollars)

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Total
Net cash provided by (used in) operating activities	\$246,069	\$(120,960 )	\$(1,911 )	\$—	\$123,198
Cash flows from investing activities:					
Additions to property, plant and equipment	(11,101 )	(6,829 )	(197 )	—	(18,127 )
Proceeds from sale of property, plant and equipment	46	—	—	—	46
Proceeds from sale of available-for-sale securities	1,494	—	—	—	1,494
Net cash used in investing activities	(9,561 )	(6,829 )	(197 )	—	(16,587 )
Cash flows from financing activities:					
Cash provided by (used in) intercompany activity	(121,522 )	121,522	—	—	—
Borrowings of long-term debt	610,000	—	—	—	610,000
Repayments of long-term debt	(709,919 )	—	—	—	(709,919 )
Debt issuance costs	(11,580 )	—	—	—	(11,580 )
Repurchases of common stock	(155,817 )	—	—	—	(155,817 )
Proceeds from issuance of common stock	5,646	—	—	—	5,646
Net cash provided by (used in) financing activities	(383,192 )	121,522	—	—	(261,670 )
Effect of exchange rate changes on cash and cash equivalents	—	—	158	—	158
Net decrease in cash and cash equivalents	(146,684 )	(6,267 )	(1,950 )	—	(154,901 )
Cash and cash equivalents at beginning of period	211,933	8,026	25,976	—	245,935
Cash and cash equivalents at end of period	\$65,249	\$1,759	\$24,026	\$—	\$91,034

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

Forward-Looking Statements

This document contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks and uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: price competition from our existing competitors; new competitors in any of our businesses; a shift in client preferences for different promotional materials, strategies or coupon delivery methods, including, without limitation, as a result of declines in newspaper circulation and/or increased competition from new media formats including digital; an unforeseen increase in paper or postal costs; changes which affect the businesses of our clients and lead to reduced sales promotion spending, including, without limitation, a decrease of marketing budgets which are generally discretionary in nature and easier to reduce in the short-term than other expenses; our substantial indebtedness, and ability to refinance such indebtedness, if necessary, and our ability to incur additional indebtedness, may affect our financial health; the financial condition, including bankruptcies, of our clients, suppliers, senior secured credit facility lenders or other counterparties; certain covenants in our debt documents could adversely restrict our financial and operating flexibility; fluctuations in the amount, timing, pages, weight and kinds of advertising pieces from period to period, due to a change in our clients' promotional needs, inventories and other factors, including, without limitation, high levels of coupon redemption rates; our failure to attract and retain qualified personnel may affect our business and results of operations; a rise in interest rates could increase our borrowing costs; possible governmental regulation or litigation affecting aspects of our business; clients experiencing financial difficulties, or otherwise being unable to meet their obligations as they become due, could affect our results of operations and financial condition; uncertainty in the application and interpretation of applicable state sales tax laws may expose us to additional sales tax liability; and general economic conditions, whether nationally, internationally, or in the market areas in which we conduct our business, including the adverse impact of the ongoing economic downturn on the marketing expenditures and activities of our clients and prospective clients as well as our vendors, with whom we rely on to provide us with quality materials at the right prices and in a timely manner. These and other risks and uncertainties related to our business are described in greater detail in our Annual Report on Form 10-K for the year ended December 31, 2011, as amended, or the 2011 Form 10-K, and other filings by us with the United States Securities and Exchange Commission, or the SEC, and this Quarterly Report on Form 10-Q should be read in conjunction with these filings. We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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Overview

Valassis is one of the nation's leading media and marketing services companies, offering unparalleled reach and scale to more than 15,000 advertisers. Our RedPlum® media portfolio delivers value on a weekly basis to over 100 million shoppers across a multi-media platform – in-home, in-store and in-motion. Through our digital offerings, including redplum.com and save.com, consumers can find compelling national and local deals online.

Our products and services are positioned to help our clients reach their customers through mass-delivered or targeted programs. We provide our clients with blended media solutions, including shared mail, newspaper, in-store and digital delivery. We offer the only national shared mail distribution network in the industry. We utilize a proprietary patent pending targeting tool that provides our clients with multi-media recommendations and optimization. We are committed to providing innovative marketing solutions to maximize the efficiency and effectiveness of promotions for our clients and to deliver value to consumers how, when and where they want.

Our results for the nine months ended September 30, 2012 were adversely impacted by several factors which occurred during the second quarter of 2012. First, we elected to exit our newspaper polybag advertising and sampling and solo direct mail businesses. This decision was based on several factors, including: declining demand from our consumer packaged goods ("CPG") client base, the primary users of both of these products; these products were expensive to execute and our highest-priced products for these clients; and, in the case of our sampling product, it faced secular declines based on its exclusive reliance on home-delivered newspaper distribution. Combined, these two products represented approximately \$12.8 million in revenue for the second half of 2011 and \$6.2 million for the six months ended June 30, 2012. Second, we executed a restructuring plan designed to right-size our organization to appropriate levels to support product demand. As the result of our decision to exit our newspaper polybag advertising and sampling and solo direct mail businesses and the activities to right-size our organization, we recognized charges of \$17.3 million, or \$10.7 million net of tax, during the nine months ended September 30, 2012, which included:

Restructuring costs of \$9.7 million ("Q2 Restructuring Activities"), which consisted of \$5.3 million of severance and related costs and \$0.7 million of Brand.net acquisition costs, both of which were included in selling, general and administrative expenses in the unaudited, condensed consolidated statements of income, and \$3.7 million of lease termination, severance, asset impairment and other costs associated with our decision to exit our solo direct mail business and our newspaper polybag advertising and sampling business, which were included in cost of sales in the unaudited, condensed consolidated statements of income; and

Non-cash goodwill impairment charges of \$7.6 million.

Our results for the three months ended September 30, 2012 benefited from cost reductions associated with the Q2 Restructuring Activities.

Finally, our results were adversely impacted by the continuation of reduced advertising spending by clients in the CPG vertical, which began in the third quarter of 2011, across many of our products (the "reduction in CPG programs"). In addition, during the nine months ended September 30, 2012, we increased our investment in our digital business with the acquisition of Brand.net, an online display, video and mobile advertising platform.

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## Consolidated Results of Operations

The following table sets forth our consolidated results of operations for the periods indicated:

(in millions of U.S. dollars, except per share data)	Three Months Ended		Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Revenues:				
Shared Mail	\$331.4	\$330.5	\$1,008.2	\$990.3
Neighborhood Targeted	75.8	76.9	225.5	255.8
Free-standing Inserts	72.2	73.5	219.0	251.9
International, Digital Media & Services	44.4	47.5	129.9	142.6
Total revenues	523.8	528.4	1,582.6	1,640.6
Cost of sales	388.3	395.7	1,180.9	1,222.3
Gross profit	135.5	132.7	401.7	418.3
Selling, general and administrative	73.4	80.5	234.5	239.8
Amortization expense	3.2	3.2	9.6	9.5
Goodwill impairment	—	—	7.6	—
Earnings from operations	58.9	49.0	150.1	169.0
Other expenses and income:				
Interest expense, net	7.5	8.1	21.2	29.3
Loss on extinguishment of debt	—	—	—	16.3
Other income, net	0.2	(3.9)	(0.5)	(6.2)
Total other expenses, net	7.8	4.2	20.7	39.4
Earnings before income taxes	51.2	44.8	129.4	129.6
Income tax expense	14.4	17.3	44.6	50.4
Net earnings	\$36.7	\$27.5	\$84.9	\$79.2
Net earnings per common share, diluted	\$0.90	\$0.58	\$2.00	\$1.58
Weighted-average common shares outstanding, diluted	40,832	47,766	42,532	50,089

## Revenues

We reported revenues of \$523.8 million and \$528.4 million for the three months ended September 30, 2012 and 2011, respectively, a decrease of 0.9%, and revenues of \$1,582.6 million and \$1,640.6 million for the nine months ended September 30, 2012 and 2011, respectively, a decrease of 3.5%. These declines in revenues were due primarily to the reduction in CPG programs affecting many of our products and the absence of custom co-op programs within our Free-standing Inserts ("FSI") segment during the three and nine months ended September 30, 2012.

## Cost of Sales

Cost of sales was \$388.3 million and \$395.7 million for the three months ended September 30, 2012 and 2011, respectively, and \$1,180.9 million and \$1,222.3 million for the nine months ended September 30, 2012 and 2011, respectively. Gross profit as a percentage of revenues was 25.9% and 25.1% for the three months ended September 30, 2012 and 2011, respectively, and 25.4% and 25.5% for the nine months ended September 30, 2012 and 2011, respectively. The increase in gross profit as a percentage of revenues for the three months ended September 30, 2012 as compared to the three months ended September 30, 2011 reflected optimization efforts in our Shared Mail segment and improved performance within our FSI segment, both of which will be further discussed in Segment Results below. The slight decrease in gross profit as a percentage of revenues for the nine months ended September 30, 2012 as compared to the nine months ended September 30, 2011 reflected the decline in revenues discussed above and \$3.7 million of charges related to Q2 2012 Restructuring Activities, which were almost completely offset by the savings



resulting from the Q2 2012 Restructuring Activities.

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Selling, General and Administrative (“SG&A”) Expenses

SG&A expenses were \$73.4 million and \$80.5 million for the three months ended September 30, 2012 and 2011, respectively, which included non-cash stock-based compensation expense of \$2.2 million in each period. SG&A expenses were \$234.5 million and \$239.8 million for the nine months ended September 30, 2012 and 2011, respectively, which included non-cash stock-based compensation expense of \$7.0 million and \$6.6 million, respectively. In addition, SG&A expenses for the nine months ended September 30, 2012 included \$6.0 million of charges related to Q2 2012 Restructuring Activities. These reductions in SG&A expenses primarily reflect savings resulting from the Q2 2012 Restructuring Activities.

Goodwill Impairment

During the nine months ended September 30, 2012, we recognized a non-cash goodwill impairment charge of \$7.6 million, which resulted from our decision to exit the newspaper polybag advertising and sampling business, a reporting unit within our Neighborhood Targeted reportable segment, and the solo direct mail business, a reporting unit within International, Digital Media & Services.

Loss on Extinguishment of Debt

On June 27, 2011, we entered into the Senior Secured Credit Facility, which replaced and terminated our Prior Senior Secured Credit Facility (both of which as defined and further described below). We used the proceeds of the Senior Secured Credit Facility along with existing cash to repay all outstanding borrowings under our Prior Senior Secured Credit Facility, to pay accrued interest with respect to such loans and to pay the fees and expenses related to the Senior Secured Credit Facility. We recognized a pre-tax loss on extinguishment of debt of \$3.0 million during the nine months ended September 30, 2011, which represents the write-off of related capitalized debt issuance costs.

On January 13, 2011, we commenced a cash tender offer and consent solicitation to purchase any and all of our outstanding 8 1/4% Senior Notes due 2015 (the “2015 Notes”) and to amend the indenture governing the 2015 Notes (the “2015 Indenture”) to eliminate substantially all of the restrictive covenants and certain events of default. We used the net proceeds from the 2021 Notes (described below) to fund the purchase of the 2015 Notes, the related consent payments pursuant to the tender offer and consent solicitation, and the subsequent redemption of the 2015 Notes that were not tendered and remained outstanding after the expiration of the tender offer and consent solicitation. We recognized a pre-tax loss on extinguishment of debt of \$13.3 million during the nine months ended September 30, 2011, which represents the difference between the aggregate purchase price and the aggregate principal amount of the 2015 Notes purchased and the write-off of related capitalized debt issuance costs.

Interest Expense, Net

Interest expense, net was \$7.5 million and \$8.1 million for the three months ended September 30, 2012 and 2011, respectively, and \$21.2 million and \$29.3 million for the nine months ended September 30, 2012 and 2011, respectively. These decreases in interest expense, net were due to the following:

- The \$112.2 million reduction in outstanding indebtedness that resulted from the replacement and termination of our Prior Senior Secured Credit facility with the Senior Secured Credit Facility on June 27, 2011; and
- The reduced interest rate associated with the 2021 Notes (as defined below) as compared to the 2015 Notes and the reduced margins associated with the Senior Secured Credit Facility as compared to the Prior Senior Secured Credit Facility.

On December 17, 2009, we entered into an interest rate swap agreement with an initial notional amount of \$300.0 million to fix three-month LIBOR at 2.005%, plus the applicable margin, for \$300.0 million of our variable rate debt under our prior senior secured credit facility. The swap was designated as and qualified as a cash flow hedge through the termination of the prior senior secured credit facility on June 27, 2011. During the nine months ended September 30, 2011, as a result of the termination of the Prior Senior Secured Credit Facility, pre-tax losses of \$2.6 million were reclassified from accumulated other comprehensive income to earnings as a component of interest expense, the non-recurrence of which also contributed to the decreases in interest expense, net described above.

Income Tax Expense

Income tax expense represented 28.2% and 38.6% of earnings before income taxes for the three months ended September 30, 2012 and 2011, respectively, and 34.4% and 38.9% of earnings before income taxes for the nine months ended September 30, 2012 and 2011, respectively. These decreases in our effective tax rate reflect a favorable income tax adjustment recognized during the three and nine months ended September 30, 2012 resulting from the expiration of certain tax reserves. We are required to adjust our effective tax rate each quarter to be consistent with our estimated annual effective tax rate. We are also

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required to record the tax impact of certain unusual or infrequently occurring items, including the effects of changes in tax laws or rates, in the interim period in which they occur. The effective tax rate during a particular quarter may be higher or lower as a result of the timing of actual earnings versus annual projections.

**Net Earnings and Net Earnings per Common Share, Diluted**

Net earnings were \$36.7 million and \$27.5 million for the three months ended September 30, 2012 and 2011, respectively, or \$0.90 and \$0.58, respectively, per common share, diluted ("diluted EPS"). As further discussed above, net earnings and diluted EPS for the three months ended September 30, 2012 increased as compared to net earnings and diluted EPS for the three months ended September 30, 2011 due to:

- A favorable income tax adjustment recognized during the three and nine months ended September 30, 2012 resulting from the expiration of certain tax reserves; and

- Savings resulting from the Q2 2012 Restructuring Activities.

Net earnings were \$84.9 million and \$79.2 million for the nine months ended September 30, 2012 and 2011, respectively, or diluted EPS of \$2.00 and \$1.58, respectively. As further discussed above, net earnings and diluted EPS for the nine months ended September 30, 2012 increased as compared to net earnings and diluted EPS for the nine months ended September 30, 2011 due to:

- A favorable income tax adjustment recognized during the three and nine months ended September 30, 2012 resulting from the expiration of certain tax reserves;

- Savings resulting from the Q2 2012 Restructuring Activities, which were more than offset by a goodwill impairment charge and charges related to our Q2 2012 Restructuring Activities during the nine months ended September 30, 2012;

- The reduction in interest expense, net described above; and

- The non-recurrence during the nine months ended September 30, 2012 of the loss on extinguishment of debt and related charges recognized during the nine months ended September 30, 2011.

Diluted EPS for the three and nine months ended September 30, 2012 were also favorably impacted by the repurchases of our common stock in 2011 and during the three and nine months ended September 30, 2012, which was the primary driver in the reduction of our weighted-average common shares outstanding, diluted.

The aforementioned goodwill impairment charge, charges related to our Q2 2012 Restructuring Activities and the loss on extinguishment of debt and related charges affect the comparability of net earnings and diluted EPS for the nine months ended September 30, 2012 and 2011. In Non-GAAP Financial Measures below, we compare net earnings and diluted EPS for the nine months ended September 30, 2012 and 2011 excluding these items.

**Non-GAAP Financial Measures**

We define adjusted net earnings and adjusted diluted EPS as net earnings and diluted EPS excluding the goodwill impairment charge, net of tax, the charges related to the Q2 2012 Restructuring Activities, net of tax, and the loss on extinguishment of debt and related charges, net of tax. We present adjusted net earnings and adjusted diluted EPS because we believe these measures are useful to investors as they provide measures of our profitability on a more comparable basis to historical periods because they exclude items we do not believe are indicative of our core operating performance. In addition, we exclude these items when we internally evaluate our company's performance.

Adjusted net earnings and adjusted diluted EPS are not calculated or presented in accordance with U.S. GAAP and have limitations as analytical tools and should not be considered in isolation from, or as alternatives to, operating income, net income, cash flow, EPS or other income or cash flow data prepared in accordance with GAAP. We compensate for these limitations by relying primarily on our GAAP results and using these non-GAAP financial measures only supplementally. Further, other companies, including companies in our industry, may calculate adjusted net earnings and adjusted diluted EPS differently and as the differences in the way two different companies calculate these measures increase, the degree of their usefulness as comparative measures correspondingly decreases.



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The following tables reconcile net earnings and diluted EPS to adjusted net earnings and adjusted diluted EPS for the nine months ended September 30, 2012 and 2011 (the reconciling items included in the tables below are presented net of an estimated tax rate of 38.0%):

	Nine Months Ended		2011	
	September 30,			
	2012		2011	
	U.S.	Per	U.S.	Per
	Dollars	Common	Dollars	Common
	in	Share,	in	Share,
	Millions	Diluted	Millions	Diluted
Net earnings	\$84.9	\$2.00	\$79.2	\$1.58
Excluding:				
Goodwill impairment, net of tax of \$2.9 million	4.7	0.11	—	—
Q2 2012 Restructuring Activities, net of tax of \$3.7 million	6.0	0.14	—	—
Loss on extinguishment of debt and related charges, net of tax of \$7.3 million	—	—	11.6	0.23
Adjusted net earnings	\$95.6	\$2.25	\$90.8	\$1.81

## Segment Results

We currently operate our business in the following reportable segments:

Shared Mail – Products that have the ability to reach 9 out of 10 U.S. households through shared mail distribution. Our Shared Mail programs combine the individual print advertisements of various clients into a single shared mail package delivered primarily through the United States Postal Service (“USPS”).

Neighborhood Targeted – Products that are targeted to specific newspaper zones or neighborhoods based on geographic and demographic characteristics.

Free-standing Inserts – Four-color booklets that contain promotions, primarily coupons, from multiple advertisers (cooperative), which we publish and distribute to approximately 60 million households through newspapers and shared mail, as well as customized FSIs (custom co-ops) featuring multiple brands of a single client.

In addition, all other lines of business that are not separately reported are captioned as International, Digital Media & Services, which includes NCH Marketing Services, Inc. (“NCH”), our coupon clearing and analytics business, as well as our digital and in-store businesses.

We evaluate reportable segment performance based on segment profit, which we define as earnings from operations excluding unusual or non-recurring items. For additional information, including a reconciliation of total segment profit to earnings from operations, see Note 10 to the unaudited condensed consolidated financial statements included in this Quarterly Report on Form 10-Q.

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## Shared Mail

Shared Mail revenues were \$331.4 million and \$330.5 million for the three months ended September 30, 2012 and 2011, respectively, an increase of 0.3%, and \$1,008.2 million and \$990.3 million for the nine months ended September 30, 2012 and 2011, respectively, an increase of 1.8%. Shared Mail revenues were relatively flat for the three months ended September 30, 2012 and 2011. For the nine months ended September 30, 2012, the increase in revenues as compared to the nine months ended September 30, 2011 was attributable to increased volume and the postal rate increase effective in January 2012 and was partially offset by decreased RedPlum® wrap product revenues due to lower sell-through rates.

Shared Mail pieces were 9.1 billion and 27.4 billion for the three and nine months ended September 30, 2012, respectively, increasing 1.6% and 0.2% from the three and nine months ended September 30, 2011, respectively. Shared Mail packages delivered were 0.9 billion for the three months ended September 30, 2012, decreasing 2.3% from the three months ended September 30, 2011. For the nine months ended September 30, 2012, Shared Mail packages delivered were 2.7 billion, remaining flat from the nine months ended September 30, 2011. Shared Mail average pieces per package were 10.0 pieces for the three months ended September 30, 2012, increasing 3.8% from the three months ended September 30, 2011. For the nine months ended September 30, 2012, Shared Mail average pieces per package were 9.8 pieces, remaining relatively flat from the nine months ended September 30, 2011. Gross margin as a percentage of revenues was 29.2% and 28.6% for the three months ended September 30, 2012 and 2011, respectively, and 28.6% and 28.5% for the nine months ended September 30, 2012 and 2011, respectively. For the three months ended September 30, 2012, gross margin as a percentage of revenues was favorably impacted by our package optimization efforts and print cost savings due to the in-sourcing of certain print volumes, which were partially offset by the reduction in RedPlum® wrap product revenues and the postal rate increase. In addition, the increase in average pieces per package and resultant efficiencies in unused postage contributed to the increase in gross margin as a percentage of revenue. Unused postage as a percentage of base postage decreased 1.2 percentage points to 15.2% for the three months ended September 30, 2012. For the nine months ended September 30, 2012, the relatively flat gross margin as a percentage of revenues was the result of the favorable impact of our package optimization and print cost savings and was offset by the reduction in RedPlum® wrap product revenues and the postal rate increase. Segment profit was \$52.3 million and \$46.2 million for the three months ended September 30, 2012 and 2011, respectively, an increase of 13.2 %, and \$147.0 million and \$136.0 million for the nine months ended September 30, 2012 and 2011, respectively, an increase of 8.1%. Segment profit as a percentage of revenues was 15.8% and 14.0% for the three months ended September 30, 2012 and 2011, respectively, and 14.6% and 13.7% for the nine months ended September 30, 2012 and 2011, respectively. The increases in segment profit and segment profit as a percentage of revenues were the result of gross margin improvements and decreased SG&A costs.

## Neighborhood Targeted

Neighborhood Targeted revenues were \$75.8 million and \$76.9 million for the three months ended September 30, 2012 and 2011, respectively, a decrease of 1.4%, and \$225.5 million and \$255.8 million for the nine months ended September 30, 2012 and 2011, respectively, a decrease of 11.8%. Segment loss was \$1.1 million for the three months ended September 30, 2012 as compared to segment profit of \$0.4 million for the three months ended September 30, 2011. Segment loss was \$5.1 million for the nine months ended September 30, 2012 as compared to segment profit of \$3.1 million for the nine months ended September 30, 2011. The decreases in Neighborhood Targeted revenues reflect:

- The reduction in CPG programs, which adversely affected the sampling business prior to our decision to exit the business;

- The impact of exiting the sampling business; and

A market-driven change in the way Newspaper Inserts business is contracted, which resulted in the recognition of a portion of related revenues on a net, rather than gross, basis. The impact of this change in revenue recognition is currently expected to increase in the fourth quarter of 2012 and during 2013.

For the three months ended September 30, 2012, these decreases were offset, in part, by increased revenues associated with our Run-of-Press ("ROP") product.

The decrease in segment profit for the three and nine months ended September 30, 2012 as compared to the three and nine months ended September 30, 2011 reflects continued margin pressure associated with the products in this segment.

Neighborhood Targeted revenues and segment profit discussed above include the operations of our newspaper polybag advertising and sampling business, but exclude the goodwill impairment charge and charges related to our Q2 Restructuring Activities that resulted, in part, from our decision to exit this business.



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## Free-standing Inserts

FSI revenues were \$72.2 million and \$73.5 million for the three months ended September 30, 2012 and 2011, respectively, a decrease of 1.8%, and \$219.0 million and \$251.9 million for the nine months ended September 30, 2012 and 2011, respectively, a decrease of 13.1%. FSI segment profit was \$7.6 million for the three months ended September 30, 2012 as compared to a segment loss of \$0.8 million for the three months ended September 30, 2011, and \$20.3 million and \$14.9 million for the nine months ended September 30, 2012 and 2011, respectively, an increase of 36.2%. These declines in revenues for the three and nine months ended September 30, 2012 as compared to the three and nine months ended September 30, 2011 reflect the absence of custom co-op business during the three and nine months ended September 30, 2012, and, for the nine months ended September 30, 2012, reflect the reduction in CPG programs. The increases in segment profit reflect an increase in pages per book during the three months ended September 30, 2012.

## International, Digital Media &amp; Services

International, Digital Media & Services revenues were \$44.4 million and \$47.5 million for the three months ended September 30, 2012 and 2011, respectively, a decrease of 6.5%, and \$129.9 million and \$142.6 million for the nine months ended September 30, 2012 and 2011, respectively, a decrease of 8.9%. Segment profit was \$0.1 million and \$3.2 million for the three months ended September 30, 2012 and 2011, respectively, a decrease of 96.9%, and \$5.2 million and \$15.0 million for the nine months ended September 30, 2012 and 2011, respectively, a decrease of 65.3%. Revenues were negatively impacted by the reduction in CPG programs affecting our in-store business as well as a decrease in coupon redemption volume impacting NCH, which more than offset the increase in revenues associated with our digital business. In addition to the items adversely affecting revenues, segment profit was negatively impacted by continued investment in our digital business. International, Digital Media & Services revenues and segment profit discussed above include the operations of our solo direct mail business, but exclude the goodwill impairment charge and charges related to our Q2 Restructuring Activities that resulted, in part, from our decision to exit this business.

## Financial Condition, Liquidity and Sources of Capital

Our operating cash flows are our primary source of liquidity. We believe we will generate sufficient cash flows from operating activities and will have sufficient existing cash balances and lines of credit available to meet currently anticipated liquidity needs, including the working capital requirements of our operations, interest and required repayments of indebtedness and capital expenditures necessary to support growth and productivity improvement. We may consider other uses for our cash flows from operating activities and other sources of cash (such as additional borrowings under our Senior Secured Credit Facility), including, without limitation, future acquisitions, dividends and repurchases of our common stock.

The following table presents our available sources of liquidity as of September 30, 2012:

(in millions of U.S. dollars)	Facility Amount	Amount Outstanding	Available	
Cash and cash equivalents			\$90.3	(a)
Debt facilities:				
Senior Secured Revolving Credit Facility	\$100.0	58.4	(b) 41.6	
Total Available			\$131.9	

The foreign subsidiaries for which we have elected to permanently reinvest earnings outside of the U.S. held \$24.0 (a) million of cash and cash equivalents as of September 30, 2012. In the event we alter our current position and repatriate funds in the future, we may be required to accrue and pay U.S. taxes on a portion thereof.

(b) Represents \$50 million outstanding under our Revolving Line of Credit (as defined below) and \$8.4 million in outstanding letters of credit.



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## Sources and Uses of Cash and Cash Equivalents

The following table summarizes the decrease in cash and cash equivalents for the indicated period:

(in millions of U.S. dollars)	Nine Months Ended September 30, 2012
Net cash provided by operating activities	\$111.2
Net cash used in investing activities	(33.9 )
Net cash used in financing activities	(89.4 )
Effect of exchange rate changes on cash and cash equivalents	0.5
Net decrease in cash and cash equivalents	(11.6 )
Cash and cash equivalents at beginning of period	102.0
Cash and cash equivalents at end of period	\$90.3

Operating Activities – Net cash provided by operating activities was \$111.2 million for the nine months ended September 30, 2012. In addition to cash received related to our net earnings, the following changes in assets and liabilities affected cash from operating activities for the nine months ended September 30, 2012:

net cash inflows of \$52.3 million associated with the decrease in accounts receivable, net, which was almost entirely offset by net cash outflows of \$51.6 million related to the decrease in accounts payable, both of which reflect the decreases in our revenues and cost of sales for the nine months ended September 30, 2012 as compared to the nine months ended September 30, 2011;

net cash outflows of \$21.6 million associated with the decrease in accrued expenses; and

net cash outflows of \$16.9 million associated with the increase in prepaid expenses and other, which is primarily attributable to the timing of estimated income tax payments.

Investing Activities – Net cash used in investing activities was \$33.9 million for the nine months ended September 30, 2012, which primarily reflects the acquisitions within our digital business and capital acquisitions of property, plant and equipment.

Financing Activities – Net cash used in financing activities was \$89.4 million for the nine months ended September 30, 2012, which resulted from \$11.3 million of principal payments of long-term debt and the repurchase of \$87.1 million, or 4.1 million shares of our common stock at an average price of \$21.08 per share, which were offset, in part, by \$9.0 million of proceeds from stock option exercises.

## Current and Long-term Debt

As of September 30, 2012, we had outstanding \$591.3 million in aggregate indebtedness, which consisted of \$260.0 million of our unsecured 6<sup>5</sup>/<sub>8</sub>% Senior Notes due 2021, or the 2021 Notes, \$281.2 million and \$50.0 million under the Term Loan A and Revolving Line of Credit portions of our Senior Secured Credit Facility, respectively, and \$0.1 million of our Senior Secured Convertible Notes due 2033, or the 2033 Secured Notes. As of September 30, 2012, we had total outstanding letters of credit of approximately \$8.4 million.

## Senior Secured Credit Facility

General – On June 27, 2011, we entered into a senior secured credit facility with JPMorgan Chase Bank, N.A., as administrative agent, and a syndicate of lenders jointly arranged by J.P. Morgan Securities LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated and RBS Securities Inc. (the “Senior Secured Credit Facility”). The Senior Secured Credit Facility and related loan documents replaced and terminated our prior credit agreement, dated as of March 2, 2007, as amended (the “Prior Senior Secured Credit Facility”), by and among Valassis, Bear Stearns Corporate Lending Inc., as Administrative Agent, and a syndicate of lenders jointly arranged by Bear, Stearns & Co. Inc. and Banc of America Securities LLC. In connection with the termination of the Prior Senior Secured Credit Facility, all obligations and rights under the related guarantee, security and collateral agency agreement, dated as of March 2, 2007, as amended (the “Prior Security Agreement”), by Valassis and certain of its domestic subsidiaries signatory thereto, as grantors, in favor of Bear Stearns Corporate Lending Inc., in its capacity as collateral agent for the benefit of the Secured Parties (as defined in the Prior Security Agreement), were also simultaneously terminated.



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The Senior Secured Credit Facility consists of:

a five-year term loan A in an aggregate principal amount equal to \$300.0 million, with principal repayable in quarterly installments at a rate of 5.0% during each of the first two years from issuance, 10.0% during the third year from issuance, 15.0% during the fourth year from issuance and 11.25% during the fifth year from issuance, with the remaining 53.75% due at maturity (the “Term Loan A”);

a five-year revolving credit facility in an aggregate principal amount of \$100.0 million (the “Revolving Line of Credit”), including \$15.0 million available in Euros, Pounds Sterling or Canadian Dollars, \$50.0 million available for letters of credit and a \$20.0 million swingline loan subfacility, of which \$50.0 million was drawn at closing and remains outstanding as of September 30, 2012 (exclusive of outstanding letters of credit described below); and

an incremental facility pursuant to which, prior to the maturity of the Senior Secured Credit Facility, we may incur additional indebtedness in an amount up to \$150.0 million under the Revolving Line of Credit or the Term Loan A or a combination thereof, subject to certain conditions, including receipt of additional lending commitments for such additional indebtedness. The terms of the incremental facility will be substantially similar to the terms of the Senior Secured Credit Facility, except with respect to the pricing of the incremental facility, the interest rate for which could be higher than that for the Revolving Line of Credit and the Term Loan A.

We used the initial borrowing under the Revolving Line of Credit, the proceeds from the Term Loan A and existing cash of \$120.0 million to repay the \$462.2 million outstanding under our Prior Senior Secured Credit Facility (reflecting all outstanding borrowings thereunder), to pay accrued interest with respect to such loans and to pay the fees and expenses related to the Senior Secured Credit Facility.

All borrowings under our Senior Secured Credit Facility, including, without limitation, amounts drawn under the Revolving Line of Credit, are subject to the satisfaction of customary conditions, including absence of a default and accuracy of representations and warranties. As of September 30, 2012, we had approximately \$41.6 million available under the Revolving Line of Credit portion of our Senior Secured Credit Facility (after giving effect to the reductions in availability pursuant to \$8.4 million in standby letters of credit outstanding as of September 30, 2012).

Interest and Fees – Borrowings under our Senior Secured Credit Facility bear interest, at our option, at either the alternate base rate (defined as the higher of the prime rate announced by the Administrative Agent, the federal funds effective rate plus 0.5% or one-month LIBOR plus 1%) (the “Base Rate”) or at the Eurodollar Rate (one-, two-, three- or six-month LIBOR, at our election, as defined in the credit agreement governing the Senior Secured Credit Facility), except for borrowings made in alternate currencies which may not accrue interest based upon the alternate base rate, in each case, plus an applicable interest rate margin. The applicable margins are currently 0.75% per annum for Base Rate loans and 1.75% per annum for Eurodollar Rate loans. The margins applicable to the borrowings under our Senior Secured Credit Facility may be adjusted based on our consolidated leverage ratio, with 1.00% being the maximum Base Rate margin and 2.00% being the maximum Eurodollar Rate. See Note 7 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for discussion regarding our various interest rate swap agreements.

Guarantees and Security – Our Senior Secured Credit Facility is guaranteed by certain of our existing and future domestic restricted subsidiaries pursuant to a Guarantee and Collateral Agreement. In addition, our obligations under our Senior Secured Credit Facility and the guarantee obligations of the subsidiary guarantors are secured by first priority liens on substantially all of our and our subsidiary guarantors’ present and future assets and by a pledge of all of the equity interests in our domestic subsidiary guarantors and 65% of the capital stock of certain of our existing and future foreign subsidiaries.

The Guarantee and Collateral Agreement also secures our Senior Secured Convertible Notes due 2033 on an equal and ratable basis with the indebtedness under our Senior Secured Credit Facility to the extent required by the indenture governing such notes.

Prepayments – The Senior Secured Credit Facility also contains a requirement that we make mandatory principal prepayments on the Term Loan A and Revolving Line of Credit in certain circumstances, including, without limitation, with 100% of the aggregate net cash proceeds from certain asset sales, casualty events or condemnation

recoveries (in each case, to the extent not otherwise used for reinvestment in our business or related business and subject to certain other exceptions). The Senior Secured Credit Facility further provides that, subject to customary notice and minimum amount conditions, we may make voluntary prepayments without payment of premium or penalty.

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Covenants – Subject to customary and otherwise agreed upon exceptions, our Senior Secured Credit Facility contains affirmative and negative covenants, including, but not limited to:

- the payment of other obligations;
- the maintenance of organizational existences, including, but not limited to, maintaining our property and insurance;
- compliance with all material contractual obligations and requirements of law;
- limitations on the incurrence of indebtedness;
- limitations on creation and existence of liens;
- limitations on certain fundamental changes to our corporate structure and nature of our business, including mergers;
- limitations on asset sales;
- limitations on restricted payments, including certain dividends and stock repurchases and redemptions;
- limitations on capital expenditures;
- limitations on any investments, provided that certain “permitted acquisitions” and strategic investments are allowed;
- limitations on optional prepayments and modifications of certain debt instruments;
- limitations on modifications to organizational documents;
- limitations on transactions with affiliates;
- limitations on entering into certain swap agreements;
- limitations on negative pledge clauses or clauses restricting subsidiary distributions;
- limitations on sale-leaseback and other lease transactions; and
- limitations on changes to our fiscal year.

Our Senior Secured Credit Facility also requires us to comply with:

a maximum consolidated leverage ratio, as defined in our Senior Secured Credit Facility (generally, the ratio of our consolidated total debt to consolidated earnings before interest, taxes, depreciation and amortization, or EBITDA, for the most recent four quarters), of 3.50:1.00; and

a minimum consolidated interest coverage ratio, as defined in our Senior Secured Credit Facility (generally, the ratio of our consolidated EBITDA to consolidated interest expense for the most recent four quarters), of 3.00:1.00.

The following table shows the required and actual financial ratios under our Senior Secured Credit Facility as of September 30, 2012:

	Required Ratio	Actual Ratio
Maximum consolidated leverage ratio	No greater than 3.50:1.00	1.94:1.00
Minimum consolidated interest coverage ratio	No less than 3.00:1.00	11.70:1.00

In addition, we are required to give notice to the administrative agent and the lenders under our Senior Secured Credit Facility of defaults under the facility documentation and other material events, make any new wholly-owned domestic subsidiary (other than an immaterial subsidiary) a subsidiary guarantor and pledge substantially all after-acquired property as collateral to secure our and our subsidiary guarantors’ obligations in respect of the facility.

Events of Default – Our Senior Secured Credit Facility contains customary events of default, including upon a change in control. If such an event of default occurs, the lenders under our Senior Secured Credit Facility would be entitled to take various actions, including in certain circumstances increasing the effective interest rate and accelerating the amounts due under our Senior Secured Credit Facility.

8 1/4% Senior Notes due 2015

On January 13, 2011, we commenced a cash tender offer and consent solicitation to purchase any and all of our outstanding 2015 Notes and to amend the 2015 Indenture to eliminate substantially all of the restrictive covenants and certain events of default. We used the net proceeds from the 2021 Notes to fund the purchase of the 2015 Notes, the related consent payments pursuant to the tender offer and consent solicitation, and the subsequent redemption of the 2015 Notes that were not tendered and remained outstanding after the expiration of the tender offer and consent solicitation.





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## 6 5/8% Senior Notes due 2021

On January 28, 2011, we issued in a private placement \$260.0 million aggregate principal amount of our 2021 Notes. The net proceeds were used to fund the purchase of the outstanding 2015 Notes and the related consent payments in a concurrent tender offer and consent solicitation as described above and the redemption of the remaining outstanding 2015 Notes.

Interest on the 2021 Notes is payable every six months on February 1 and August 1. The 2021 Notes are fully and unconditionally guaranteed, jointly and severally, by substantially all of our existing and future domestic restricted subsidiaries on a senior unsecured basis.

In July 2011, in accordance with the terms of the registration rights agreement between us and the initial purchasers of the 2021 Notes, we completed an exchange offer to exchange the original notes issued in the private placement for a like principal amount of exchange notes registered under the Securities Act of 1933, as amended. An aggregate principal amount of \$260.0 million, or 100%, of the original notes were exchanged for exchange notes in the exchange offer. The exchange notes are substantially identical to the original notes, except that the exchange notes are not subject to certain transfer restrictions.

The 2021 Notes were issued under an indenture with Wells Fargo Bank, National Association, as trustee (the “2021 Indenture”). Subject to a number of exceptions, the 2021 Indenture restricts our ability and the ability of our restricted subsidiaries (as defined in the 2021 Indenture) to incur or guarantee additional indebtedness, transfer or sell assets, make certain investments, pay dividends or make distributions or other restricted payments, create certain liens, merge or consolidate, repurchase stock, create or permit restrictions on the ability of our restricted subsidiaries to pay dividends or make other distributions to us and enter into transactions with affiliates.

We may redeem all or a portion of the 2021 Notes at our option at any time prior to February 1, 2016, at a redemption price equal to 100% of the principal amount of 2021 Notes to be redeemed, plus a make-whole premium as described in the 2021 Indenture, plus accrued and unpaid interest to the redemption date, if any. At any time on or after February 1, 2016, we may redeem all or a portion of the 2021 Notes at our option at the following redemption prices (expressed as percentages of the principal amount thereof) if redeemed during the twelve-month period commencing on February 1 of the years set forth below:

Year	Percentage
2016	103.313%
2017	102.208%
2018	101.104%
2019 and thereafter	100.000%

In addition, we must pay accrued and unpaid interest to the redemption date, if any. On or prior to February 1, 2014, we may also redeem at our option up to 35% of the principal amount of the outstanding 2021 Notes with the proceeds of certain equity offerings at the redemption price specified in the 2021 Indenture, plus accrued and unpaid interest to the date of redemption, if any. Upon the occurrence of a change of control, as defined in the 2021 Indenture, we must make a written offer to purchase all of the 2021 Notes for cash at a purchase price equal to 101% of the principal amount of the 2021 Notes, plus accrued and unpaid interest to the date of repurchase, if any.

**Additional Provisions**

The indenture governing the Senior Secured Convertible Notes due 2033 contains a cross-default provision which becomes applicable if we default under any mortgage, indenture or instrument evidencing indebtedness for money borrowed by us and the default results in the acceleration of such indebtedness prior to its express maturity, and the principal amount of any such accelerated indebtedness aggregates in excess of \$25.0 million. The 2021 Indenture contains a cross-default provision which becomes applicable if we (a) fail to pay the stated principal amount of any of our indebtedness at its final maturity date, or (b) default under any of our indebtedness and the default results in the acceleration of indebtedness, and, in each case, the principal amount of any such indebtedness, together with the

principal amount of any other such indebtedness under which there has been a payment default or the maturity of which has been so accelerated, aggregates \$50.0 million or more. Our credit agreement contains a cross-default provision which becomes applicable if we (a) fail to make any payment under any indebtedness for money borrowed by us (other than the obligations under such credit agreement) in an aggregate outstanding principal amount of at least \$50.0 million or, (b) otherwise default under any such indebtedness, or trigger another event which causes such indebtedness to become due or to be repurchased, prepaid, defeased or redeemed or become subject to an offer to repurchase, prepay, defease or redeem such indebtedness prior to its stated maturity.

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### Repurchases of Debt

Subject to applicable limitations in our Senior Secured Credit Facility and indentures, we may from time to time repurchase our debt in the open market, through tender offers, through exchanges for debt or equity securities, in privately negotiated transactions or otherwise.

### Covenant Compliance

As of September 30, 2012, we were in compliance with all of our indenture and Senior Secured Credit Facility covenants.

### Other Indebtedness

We have entered into various interest rate swap agreements. For further detail regarding these agreements, see Note 7 to the unaudited condensed consolidated financial statements included in this Quarterly Report on Form 10-Q.

### Off-balance Sheet Arrangements

As of September 30, 2012, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

### Capital Expenditures

Capital expenditures were \$15.8 million for the nine months ended September 30, 2012, and are expected to be an aggregate amount of approximately \$20.0 million to \$22.0 million for the 2012 fiscal year. It is expected these expenditures will be made using funds provided by operations.

### Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that in certain circumstances affect amounts reported in the accompanying unaudited condensed consolidated financial statements. The SEC has defined a company's most critical accounting policies as the ones that are most important to the portrayal of the company's financial condition and results of operations, and which require the company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Our critical accounting policies have not changed materially from those disclosed in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2011 Form 10-K.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our principal market risks are interest rates on various debt instruments and foreign exchange rates at our international subsidiaries.

### Interest Rates

As of September 30, 2012, \$331.3 million of aggregate indebtedness remained outstanding under our Senior Secured Credit Facility and was subject to variable interest rates. However, on July 6, 2011, we entered into an interest rate swap agreement with an initial notional amount of \$186.3 million. The effective date of this agreement was June 30, 2012. This interest rate swap agreement effectively fixes, at 3.6195% (including the current applicable margin), the interest rate for the portion of our variable rate debt outstanding under our Senior Secured Credit Facility equal to the outstanding notional amount of the interest rate swap agreement. The initial notional amount of \$186.3 million amortizes quarterly by (i) \$2.8 million from the effective date through the quarter ending September 30, 2013, (ii) \$5.6 million from September 30, 2013 through the quarter ending September 30, 2014, and (iii) \$8.4 million from September 30, 2014 until June 30, 2015, the expiration date of the agreement.

As of September 30, 2012, the variable rate indebtedness outstanding under our Senior Secured Credit Facility in excess of the outstanding notional amount of the effective interest rate swap agreement described above was an aggregate principal amount of \$147.8 million, and is subject to interest rate risk, as our interest payments will fluctuate as the underlying interest rate changes. If there is a 1% increase in the Eurodollar Rate, the interest rate currently applicable to this variable rate indebtedness, and we do not alter the terms of our current interest rate swap

agreements or enter into a new interest rate swap agreement, our debt service obligations on our variable rate indebtedness would increase by a total of \$4.9 million between July 1, 2012 and June 27, 2016, the maturity date of the Senior Secured Credit Facility, which would affect our cash flows and results of operations. If we borrow additional amounts under the Revolving Line of Credit portion of our Senior Secured Credit Facility, our interest rate risk may increase.

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## Foreign Currency

Currencies to which we have exposure are the Mexican peso, Canadian dollar, Polish zloty, British pound and Euro. Currency restrictions are not expected to have a significant effect on our cash flows, liquidity, or capital resources. Actual exchange losses or gains are recorded against production expense when the contracts are executed. As of September 30, 2012, we had commitments to purchase \$7.1 million in Mexican pesos and \$0.8 million in Polish zlotys over the next 12 months.

## ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this Quarterly Report on Form 10-Q, we carried out an evaluation, under the supervision and with the participation of our Disclosure Committee, including our Chief Executive Officer and Chief Financial Officer, of our disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of such period, the disclosure controls and procedures are effective in ensuring that the information required to be disclosed in the reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There has been no change in our internal control over financial reporting during the three months ended September 30, 2012 that has materially affected, or is likely to materially affect, internal control over financial reporting.

## PART II – OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

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

## ITEM 1A. RISK FACTORS

In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our 2011 Form 10-K, which could materially affect our business, financial condition and future results. The risks described in our 2011 Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following table reflects our repurchases of our common stock during the three months ended September 30, 2012:

Period	Total Number of Shares Purchased	Average Price Paid per Share (including broker commissions)	Total Number of Shares Purchased as Part of Publicly Announced Plan (a)	Maximum Number of Shares that May Yet be Purchased under the Plan (b)
July 1, 2012 to July 31, 2012	—	\$—	—	4,192,485
August 1, 2012 to August 31, 2012	472,237	\$24.35	472,237	3,720,248
September 1, 2012 to September 30, 2012	365,424	\$26.62	365,424	3,354,824
	837,661	\$25.34	837,661	

On August 25, 2005, our Board of Directors approved the repurchase of 5 million shares of our common stock.

This share repurchase plan was suspended in February 2006. On May 6, 2010, our Board of Directors reinstated

(a) this share repurchase plan. In May 2011, our Board of Directors approved an increase of 6 million shares to this share repurchase plan. In May 2012, our Board of Directors approved an additional increase of 6 million shares to this share repurchase plan.

(b) Our ability to make share repurchases may be limited by the documents governing our indebtedness.

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ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit Number Description

31.1	Section 302 Certification of Robert A. Mason
31.2	Section 302 Certification of Robert L. Recchia
32.1	Section 906 Certification of Robert A. Mason
32.2	Section 906 Certification of Robert L. Recchia
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase
101.DEF*	XBRL Taxonomy Extension Definition Linkbase
101.LAB*	XBRL Taxonomy Extension Label Linkbase
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase

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Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files included as Exhibits 101 hereto (i) shall not be deemed “filed” or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, (ii) shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and (iii) otherwise are not subject to liability under those sections.

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SIGNATURE

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

Dated: November 6, 2012

Valassis Communications, Inc.  
(Registrant)

By: /s/ Robert L. Recchia  
Robert L. Recchia  
Executive Vice President and Chief Financial Officer

Signing on behalf of the Registrant and as principal  
financial and accounting officer.



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EXHIBIT INDEX

Exhibit Number Description

31.1	Section 302 Certification of Robert A. Mason
31.2	Section 302 Certification of Robert L. Recchia
32.1	Section 906 Certification of Robert A. Mason
32.2	Section 906 Certification of Robert L. Recchia
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase
101.DEF*	XBRL Taxonomy Extension Definition Linkbase
101.LAB*	XBRL Taxonomy Extension Label Linkbase
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase

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Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files included as Exhibits 101 hereto (i) shall not be deemed “filed” or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, (ii) shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and (iii) otherwise are not subject to liability under those sections.