

VALASSIS COMMUNICATIONS INC

Form 10-Q

August 09, 2011

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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 June 30, 2011**

**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)

**38-2760940**  
(IRS Employer Identification Number)

**19975 Victor Parkway  
Livonia, Michigan 48152**  
(Address of Principal Executive Offices)  
Registrant's Telephone Number: **(734) 591-3000**

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  Smaller reporting company   
(Do not check if a 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 August 3, 2011, there were 47,107,690 shares of the Registrant's Common Stock outstanding.

**VALASSIS COMMUNICATIONS, INC.  
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Quarter Ended June 30, 2011**

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**VALASSIS COMMUNICATIONS, INC.**  
**Condensed Consolidated Balance Sheets**  
**(U.S. dollars in thousands)**  
**(unaudited)**

|                                                                                                                                                                                                                                                                 | <b>June 30,<br/>2011</b> | <b>December 31,<br/>2010</b> |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------|------------------------------|
| <b>Assets</b>                                                                                                                                                                                                                                                   |                          |                              |
| Current assets:                                                                                                                                                                                                                                                 |                          |                              |
| Cash and cash equivalents                                                                                                                                                                                                                                       | \$ 118,962               | \$ 245,935                   |
| Accounts receivable, net (Note 1)                                                                                                                                                                                                                               | 411,423                  | 459,952                      |
| Inventories (Note 1)                                                                                                                                                                                                                                            | 39,219                   | 41,987                       |
| Prepaid expenses and other                                                                                                                                                                                                                                      | 62,622                   | 38,657                       |
| <b>Total current assets</b>                                                                                                                                                                                                                                     | <b>632,226</b>           | <b>786,531</b>               |
| Property, plant and equipment, net (Note 1)                                                                                                                                                                                                                     | 162,399                  | 175,567                      |
| Goodwill (Note 2)                                                                                                                                                                                                                                               | 636,471                  | 636,471                      |
| Other intangible assets, net (Note 2)                                                                                                                                                                                                                           | 227,506                  | 233,817                      |
| Other assets                                                                                                                                                                                                                                                    | 17,573                   | 13,272                       |
| <b>Total assets</b>                                                                                                                                                                                                                                             | <b>\$1,676,175</b>       | <b>\$1,845,658</b>           |
| <b>Liabilities and Stockholders Equity</b>                                                                                                                                                                                                                      |                          |                              |
| Current liabilities:                                                                                                                                                                                                                                            |                          |                              |
| Current portion long-term debt (Note 3)                                                                                                                                                                                                                         | \$ 15,000                | \$ 7,058                     |
| Accounts payable                                                                                                                                                                                                                                                | 320,193                  | 329,602                      |
| Progress billings                                                                                                                                                                                                                                               | 44,615                   | 53,001                       |
| Accrued expenses (Note 4)                                                                                                                                                                                                                                       | 85,589                   | 99,612                       |
| <b>Total current liabilities</b>                                                                                                                                                                                                                                | <b>465,397</b>           | <b>489,273</b>               |
| Long-term debt (Note 3)                                                                                                                                                                                                                                         | 595,060                  | 699,169                      |
| Deferred income taxes                                                                                                                                                                                                                                           | 80,003                   | 78,764                       |
| Other non-current liabilities                                                                                                                                                                                                                                   | 45,830                   | 49,568                       |
| <b>Total liabilities</b>                                                                                                                                                                                                                                        | <b>1,186,290</b>         | <b>1,316,774</b>             |
| <b>Commitments and contingencies (Note 5)</b>                                                                                                                                                                                                                   |                          |                              |
| Stockholders equity:                                                                                                                                                                                                                                            |                          |                              |
| Preferred stock (\$0.01 par value; 25,000,000 shares authorized; no shares issued or outstanding at June 30, 2011 and December 31, 2010)                                                                                                                        |                          |                              |
| Common stock (\$0.01 par value; 100,000,000 shares authorized; 65,371,689 and 65,283,749 shares issued at June 30, 2011 and December 31, 2010, respectively; 47,079,040 and 50,361,749 shares outstanding at June 30, 2011 and December 31, 2010, respectively) | 654                      | 653                          |

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|                                                                                                                 |                    |                    |
|-----------------------------------------------------------------------------------------------------------------|--------------------|--------------------|
| Additional paid-in capital                                                                                      | 123,898            | 124,988            |
| Retained earnings                                                                                               | 959,799            | 908,136            |
| Accumulated other comprehensive earnings                                                                        | 6,776              | 3,299              |
| Treasury stock, at cost (18,292,649 and 14,922,000 shares at June 30, 2011 and December 31, 2010, respectively) | (601,242)          | (508,192)          |
| <b>Total stockholders equity</b>                                                                                | <b>489,885</b>     | <b>528,884</b>     |
| <b>Total liabilities and stockholders equity</b>                                                                | <b>\$1,676,175</b> | <b>\$1,845,658</b> |

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)**

|                                                                             | <b>Three Months Ended</b> |                  | <b>Six Months Ended</b> |                    |
|-----------------------------------------------------------------------------|---------------------------|------------------|-------------------------|--------------------|
|                                                                             | <b>June 30,</b>           |                  | <b>June 30,</b>         |                    |
|                                                                             | <b>2011</b>               | <b>2010</b>      | <b>2011</b>             | <b>2010</b>        |
| <b>Revenues</b>                                                             | <b>\$565,252</b>          | <b>\$579,950</b> | <b>\$1,112,231</b>      | <b>\$1,129,952</b> |
| Costs and expenses:                                                         |                           |                  |                         |                    |
| Cost of sales                                                               | 418,040                   | 423,765          | 826,617                 | 827,154            |
| Selling, general and administrative                                         | 80,831                    | 92,663           | 159,258                 | 183,621            |
| Amortization expense                                                        | 3,155                     | 3,155            | 6,311                   | 6,311              |
| Total costs and expenses                                                    | 502,026                   | 519,583          | 992,186                 | 1,017,086          |
| Gain from litigation settlement, net (Note 6)                               |                           |                  |                         | 490,085            |
| <b>Earnings from operations</b>                                             | <b>63,226</b>             | <b>60,367</b>    | <b>120,045</b>          | <b>602,951</b>     |
| Other expenses and income:                                                  |                           |                  |                         |                    |
| Interest expense                                                            | 11,726                    | 17,837           | 21,501                  | 37,993             |
| Interest income                                                             | (122)                     | (248)            | (261)                   | (394)              |
| Loss on extinguishment of debt (Note 3)                                     | 2,966                     | 23,873           | 16,318                  | 23,873             |
| Other income, net                                                           | (1,436)                   | (561)            | (2,312)                 | (2,351)            |
| Total other expenses, net                                                   | 13,134                    | 40,901           | 35,246                  | 59,121             |
| <b>Earnings before income taxes</b>                                         | <b>50,092</b>             | <b>19,466</b>    | <b>84,799</b>           | <b>543,830</b>     |
| Income tax expense (Note 1)                                                 | 19,840                    | 8,361            | 33,136                  | 210,197            |
| <b>Net earnings</b>                                                         | <b>\$ 30,252</b>          | <b>\$ 11,105</b> | <b>\$ 51,663</b>        | <b>\$ 333,633</b>  |
| <b>Net earnings per common share, basic</b><br>(Note 7)                     | <b>\$ 0.63</b>            | <b>\$ 0.22</b>   | <b>\$ 1.06</b>          | <b>\$ 6.77</b>     |
| <b>Net earnings per common share, diluted</b><br>(Note 7)                   | <b>\$ 0.60</b>            | <b>\$ 0.21</b>   | <b>\$ 1.01</b>          | <b>\$ 6.41</b>     |
| <b>Weighted-average common shares</b><br><b>outstanding, basic (Note 7)</b> | <b>47,877</b>             | <b>49,531</b>    | <b>48,903</b>           | <b>49,251</b>      |

|                                                                         |               |               |               |               |
|-------------------------------------------------------------------------|---------------|---------------|---------------|---------------|
| <b>Weighted-average common shares<br/>outstanding, diluted (Note 7)</b> | <b>50,167</b> | <b>52,499</b> | <b>51,250</b> | <b>52,028</b> |
|-------------------------------------------------------------------------|---------------|---------------|---------------|---------------|

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)**

|                                                                                                       | <b>Three Months Ended</b> |                 | <b>Six Months Ended</b> |                  |
|-------------------------------------------------------------------------------------------------------|---------------------------|-----------------|-------------------------|------------------|
|                                                                                                       | <b>June 30,</b>           |                 | <b>June 30,</b>         |                  |
|                                                                                                       | <b>2011</b>               | <b>2010</b>     | <b>2011</b>             | <b>2010</b>      |
| <b>Net earnings</b>                                                                                   | <b>\$30,252</b>           | <b>\$11,105</b> | <b>\$51,663</b>         | <b>\$333,633</b> |
| Other comprehensive income, net of tax:                                                               |                           |                 |                         |                  |
| Unrealized changes in fair value of cash flow hedges and available-for-sale securities                | (83)                      | (1,043)         | (370)                   | (2,370)          |
| Realized losses on cash flow hedges reclassified from AOCI into earnings                              | 2,261                     |                 | 3,040                   |                  |
| Amortization of realized losses and unrealized changes in fair value of discontinued cash flow hedges |                           | 2,763           |                         | 5,538            |
| Foreign currency translation adjustment                                                               | (58)                      | (1,060)         | 807                     | (1,416)          |
| <b>Total other comprehensive income</b>                                                               | <b>2,120</b>              | <b>660</b>      | <b>3,477</b>            | <b>1,752</b>     |
| <b>Comprehensive income</b>                                                                           | <b>\$32,372</b>           | <b>\$11,765</b> | <b>\$55,140</b>         | <b>\$335,385</b> |

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)**

|                                                                                     | <b>Six Months Ended</b> |                |
|-------------------------------------------------------------------------------------|-------------------------|----------------|
|                                                                                     | <b>June 30,</b>         |                |
|                                                                                     | <b>2011</b>             | <b>2010</b>    |
| <b>Cash flows from operating activities:</b>                                        |                         |                |
| Net earnings                                                                        | \$ 51,663               | \$ 333,633     |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                         |                |
| Depreciation and amortization                                                       | 31,121                  | 30,663         |
| Amortization of debt issuance costs                                                 | 1,181                   | 1,607          |
| Provision for losses on accounts receivable                                         | 1,589                   | 2,695          |
| Loss on extinguishment of debt                                                      | 5,748                   | 3,429          |
| Loss on derivatives, net                                                            | 2,345                   | 10,106         |
| Loss on sale of property, plant and equipment                                       | 36                      | 58             |
| Earnings on equity investments                                                      | (2,256)                 | (1,897)        |
| Stock-based compensation expense                                                    | 4,367                   | 13,782         |
| Deferred income taxes                                                               | 2,159                   | 7,976          |
| Changes in assets and liabilities:                                                  |                         |                |
| Accounts receivable, net                                                            | 46,940                  | 13,345         |
| Inventories                                                                         | 2,768                   | 7,198          |
| Prepaid expenses and other                                                          | 2,874                   | 2,608          |
| Other assets                                                                        | 1,140                   | (34)           |
| Other non-current liabilities                                                       | (1,829)                 | 7,228          |
| Accounts payable                                                                    | (9,409)                 | (35,050)       |
| Progress billings                                                                   | (8,386)                 | (7,395)        |
| Accrued expenses                                                                    | (41,018)                | 43,954         |
| Total adjustments                                                                   | 39,370                  | 100,273        |
| <b>Net cash provided by operating activities</b>                                    | <b>91,033</b>           | <b>433,906</b> |
| <b>Cash flows from investing activities:</b>                                        |                         |                |
| Additions to property, plant and equipment                                          | (11,626)                | (8,401)        |
| Proceeds from sale of property, plant and equipment                                 | 20                      | 36             |
| Proceeds from sale of available-for-sale securities                                 | 1,494                   |                |
| <b>Net cash used in investing activities</b>                                        | <b>(10,112)</b>         | <b>(8,365)</b> |
| <b>Cash flows from financing activities:</b>                                        |                         |                |
| Borrowings of long-term debt                                                        | 610,000                 |                |
| Repayments of long-term debt                                                        | (706,169)               | (301,312)      |
| Debt issuance costs                                                                 | (11,266)                |                |

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|                                                                        |                   |                   |
|------------------------------------------------------------------------|-------------------|-------------------|
| Repurchases of common stock                                            | (105,856)         | (54,623)          |
| Proceeds from issuance of common stock                                 | 4,672             | 30,433            |
| <b>Net cash used in financing activities</b>                           | <b>(208,619)</b>  | <b>(325,502)</b>  |
| Effect of exchange rate changes on cash and cash equivalents           | 725               | (1,177)           |
| Net increase (decrease) in cash and cash equivalents                   | (126,973)         | 98,862            |
| Cash and cash equivalents at beginning of period                       | 245,935           | 129,846           |
| <b>Cash and cash equivalents at end of period</b>                      | <b>\$ 118,962</b> | <b>\$ 228,708</b> |
| <b>Supplemental disclosure of cash flow information:</b>               |                   |                   |
| Cash paid during the period for interest                               | \$ 17,011         | \$ 45,193         |
| Cash paid during the period for income taxes                           | \$ 58,042         | \$ 127,050        |
| Non-cash financing activities:                                         |                   |                   |
| Stock issued under stock-based compensation plans                      | \$ 2,684          | \$ 1,399          |
| 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, 2010 (the 2010 Form 10-K ).

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

The allowance for doubtful accounts was \$7.3 million and \$12.1 million as of June 30, 2011 and December 31, 2010, 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) | <b>June 30,<br/>2011</b> | <b>December<br/>31,<br/>2010</b> |
|--------------------------------|--------------------------|----------------------------------|
| Raw materials                  | \$28,439                 | \$ 27,035                        |
| Work in progress               | 10,780                   | 14,952                           |
| <b>Inventories</b>             | <b>\$39,219</b>          | <b>\$ 41,987</b>                 |

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**VALASSIS COMMUNICATIONS, INC.**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

**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<br>(in years) | June 30,<br>2011<br>(in thousands of U.S. dollars) | December 31,<br>2010 |
|-------------------------------------------|----------------------------|----------------------------------------------------|----------------------|
| Land, at cost                             | N/A                        | \$ 7,208                                           | \$ 7,195             |
| Buildings, at cost                        | 10 - 30                    | 37,733                                             | 37,657               |
| Machinery and equipment, at cost          | 3 - 20                     | 231,694                                            | 225,762              |
| Office furniture and equipment, at cost   | 3 - 10                     | 226,827                                            | 221,804              |
| Leasehold improvements, at cost           | 5 - 10                     | 28,126                                             | 28,174               |
|                                           |                            | 531,588                                            | 520,592              |
| Less accumulated depreciation             |                            | (369,189)                                          | (345,025)            |
| <b>Property, plant and equipment, net</b> |                            | <b>\$ 162,399</b>                                  | <b>\$ 175,567</b>    |

**New Accounting Pronouncements**

In June 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*, which eliminates the option to present the components of other comprehensive income as a part of the statement of stockholders' equity. Instead, ASU 2011-05 requires all non-owner transactions that affect an entity's equity be presented either in a single continuous statement of comprehensive income or in two separate, but consecutive, statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present the components of other comprehensive income, total other comprehensive income and the total of comprehensive income. We have adopted the provisions of ASU 2011-05 and retrospectively applied herein the two-statement approach described above.

In October 2009, the FASB issued ASU 2009-13, *Multiple-Deliverable Revenue Arrangements*, which addresses the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. The adoption of ASU 2009-13, applied prospectively for revenue arrangements entered into or materially modified beginning on or after January 1, 2011, did not have a material impact on our financial position or results of operations.

**2. GOODWILL AND OTHER INTANGIBLE ASSETS**

Goodwill included on the condensed consolidated balance sheets consisted of:

| (in thousands of U.S. dollars)          | June 30,<br>2011 | December 31,<br>2010 |
|-----------------------------------------|------------------|----------------------|
| Shared Mail                             | \$534,184        | \$ 534,184           |
| Neighborhood Targeted                   | 5,325            | 5,325                |
| Free-standing Inserts                   | 22,357           | 22,357               |
| International, Digital Media & Services | 74,605           | 74,605               |
| <b>Goodwill</b>                         | <b>\$636,471</b> | <b>\$ 636,471</b>    |



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**VALASSIS COMMUNICATIONS, INC.**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

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

|                                                 | June 30, 2011    |                                       |                  |                                                                     | December 31, 2010 |                                       |                  |                                                                     |
|-------------------------------------------------|------------------|---------------------------------------|------------------|---------------------------------------------------------------------|-------------------|---------------------------------------|------------------|---------------------------------------------------------------------|
|                                                 | Gross<br>Amount  | Accum-<br>ulated<br>Amort-<br>ization | Net<br>Amount    | Weighted<br>Average<br>Remaining<br>Useful<br>Life<br>(in<br>years) | Gross<br>Amount   | Accum-<br>ulated<br>Amort-<br>ization | Net<br>Amount    | Weighted<br>Average<br>Remaining<br>Useful<br>Life<br>(in<br>years) |
| (in thousands of U.S. dollars)                  |                  |                                       |                  |                                                                     |                   |                                       |                  |                                                                     |
| Amortizing intangible assets:                   |                  |                                       |                  |                                                                     |                   |                                       |                  |                                                                     |
| Mailing lists, non compete agreements and other | \$ 48,037        | \$ (8,881)                            | \$ 39,156        | 14.5                                                                | \$ 48,037         | \$ (7,871)                            | \$ 40,166        | 15.0                                                                |
| Customer relationships                          | 140,000          | (39,291)                              | 100,709          | 9.5                                                                 | 140,000           | (33,990)                              | 106,010          | 10.0                                                                |
| Non-amortizing intangible assets:               |                  |                                       |                  |                                                                     |                   |                                       |                  |                                                                     |
| Valassis name, tradenames, trademarks and other | 87,641           |                                       | 87,641           |                                                                     | 87,641            |                                       | 87,641           |                                                                     |
| <b>Other intangible assets, net</b>             | <b>\$275,678</b> | <b>\$(48,172)</b>                     | <b>\$227,506</b> |                                                                     | <b>\$275,678</b>  | <b>\$(41,861)</b>                     | <b>\$233,817</b> |                                                                     |

**3. LONG-TERM DEBT**

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

| (in thousands of U.S. dollars)                             | June 30,<br>2011 | December 31,<br>2010 |
|------------------------------------------------------------|------------------|----------------------|
| New Senior Secured Revolving Credit Facility               | \$ 50,000        | \$                   |
| Prior Senior Secured Revolving Credit Facility             |                  |                      |
| Senior Secured Term Loan A                                 | 300,000          |                      |
| Senior Secured Convertible Notes due 2033, net of discount | 60               | 58                   |
| 8 <sup>1</sup> / <sub>4</sub> % Senior Notes due 2015      |                  | 242,224              |
| 6 <sup>5</sup> / <sub>8</sub> % Senior Notes due 2021      | 260,000          |                      |
| Senior Secured Term Loan B                                 |                  | 347,723              |
| Senior Secured Delayed Draw Term Loan                      |                  | 116,222              |
| Total debt                                                 | 610,060          | 706,227              |
| <b>Current portion long-term debt</b>                      | <b>15,000</b>    | <b>7,058</b>         |
| <b>Long-term debt</b>                                      | <b>\$595,060</b> | <b>\$699,169</b>     |

**Senior Secured Credit Facility****General**

On June 27, 2011, we entered into a new 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 new senior secured credit facility ). The new 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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**VALASSIS COMMUNICATIONS, INC.**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

The new 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, 10% during the third year, 15% during the fourth year and 11.25% during the fifth year, 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 million, 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 (the revolving line of credit ), of which \$50.0 million was drawn at closing and remains outstanding as of June 30, 2011 (exclusive of outstanding letters of credit described below); and

an incremental facility pursuant to which, prior to the maturity of the new 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 new 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 the Term Loan B and Delayed Draw Term Loan portions of 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 new senior secured credit facility. We recognized a pre-tax loss on extinguishment of debt of \$3.0 million during the three and six months ended June 30, 2011, which represents the write-off of related capitalized debt issuance costs. In addition, as further discussed in Note 8, *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 new senior secured credit facility.

All borrowings under our new 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 June 30, 2011, we had approximately \$39.0 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 \$11.0 million in standby letters of credit outstanding as of June 30, 2011).

***Interest and Fees***

Borrowings under our new 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 an Adjusted LIBO Rate (as defined in the credit agreement governing the new senior secured credit facility) (the Eurodollar Rate ), 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 initially 0.75% per annum for Base Rate loans and 1.75% per annum for Eurodollar Rate loans. Beginning with the delivery of the financial statements and the compliance certificate for the quarter ending September 30, 2011, the margins applicable to the borrowings under our new 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 8, *Derivative Financial Instruments and Fair Value Measurements*, for discussion regarding our various interest rate swap agreements.

***Guarantees and Security***

Our new 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.

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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 new senior secured credit facility to the extent required by the indenture governing such notes.

***Prepayments***

The new 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 new 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.

***Covenants***

Subject to customary and otherwise agreed upon exceptions, our new 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 new 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 new 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 new senior secured credit facility as of June 30, 2011:

|                                                     | <b>Required Ratio</b>     | <b>Actual Ratio</b> |
|-----------------------------------------------------|---------------------------|---------------------|
| <b>Maximum consolidated leverage ratio</b>          | No greater than 3.50:1.00 | 1.90:1.00           |
| <b>Minimum consolidated interest coverage ratio</b> | No less than 3.00:1.00    | 7.25:1.00           |

In addition, we are required to give notice to the administrative agent and the lenders under our new 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

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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 new 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 new 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 new senior secured credit facility.

**8<sup>1</sup>/<sub>4</sub>% 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<sup>1</sup>/<sub>4</sub>% Senior Notes due 2015 (the 2015 Notes ) and to amend the indenture governing the 2015 Notes, which we refer to as 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 six months ended June 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.

During the three and six months ended June 30, 2010, we purchased \$297.8 million aggregate principal amount of the 2015 Notes pursuant to a cash tender offer and open market repurchases. We recognized a pre-tax loss on extinguishment of debt of \$23.9 million during the three and six months ended June 30, 2010, which represents the difference between the aggregate purchase price and the aggregate principal amount of the 2015 Notes purchased and the proportionate write-off of related capitalized debt issuance costs.

**6<sup>5</sup>/<sub>8</sub>% Senior Notes due 2021**

On January 28, 2011, we issued in a private placement \$260.0 million aggregate principal amount of our 6<sup>5</sup>/<sub>8</sub>% 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 will be amortized over the term of the 2021 Notes.

Interest on the 2021 Notes is payable every six months on February 1 and August 1, commencing August 1, 2011. 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.

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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:

| <b>Year</b>         | <b>Percentage</b> |
|---------------------|-------------------|
| 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 prices 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.

**Covenant Compliance**

As of June 30, 2011, we were in compliance with all of our indenture and new 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)    | <b>June 30,<br/>2011</b> | <b>December<br/>31,<br/>2010</b> |
|-----------------------------------|--------------------------|----------------------------------|
| Accrued interest                  | \$ 7,352                 | \$ 6,710                         |
| Accrued compensation and benefits | 40,803                   | 57,781                           |
| Other accrued expenses            | 37,434                   | 35,121                           |
| <b>Accrued expenses</b>           | <b>\$85,589</b>          | <b>\$99,612</b>                  |

**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 June 30, 2011, we have recorded a liability of \$10.0 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.

**6. GAIN FROM LITIGATION SETTLEMENT**

On January 30, 2010, we announced that we had reached an agreement to settle our outstanding lawsuits against News America Incorporated, a/k/a News America Marketing Group, News America Marketing, FSI, Inc. a/k/a News America Marketing FSI, LLC and News America Marketing In-Store Services, Inc. a/k/a News America Marketing

In-Store Services, LLC (collectively News ). The operative complaint alleged violations of the Sherman Act and various state competitive statutes and the commission of torts by News in connection with the marketing and sale of FSI space and in-store promotion and advertising services.

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On February 4, 2010, we executed a settlement agreement and release (the Settlement Agreement) with News, and pursuant to the terms of the Settlement Agreement, News paid us \$500.0 million. News America, Inc. also entered into a 10-year shared mail distribution agreement with our subsidiary, Valassis Direct Mail, Inc., which provides for our sale of certain shared mail services to News on specified terms.

In connection with the settlement, the parties worked with the United States District Court for the Eastern District of Michigan (the Court), under the Honorable Arthur J. Tarnow, on a set of procedures to handle future disputes among the parties with respect to conduct at issue in the litigation. The Court issued the order on this matter on June 15, 2011. The settlement resolves all outstanding claims between us and News as of February 4, 2010. As a result, the parties agreed to dismiss all outstanding litigation between them and release all existing and potential claims against each other that were or could have been asserted in the litigation as of the date of the Settlement Agreement.

During the six months ended June 30, 2010, in connection with the successful settlement of these lawsuits, we made \$9.9 million in related payments, including special bonuses to certain of our employees (including our named executive officers in our proxy statement) in an aggregate amount of \$8.1 million. These expenses were netted against the \$500.0 million of proceeds received, and the net proceeds of \$490.1 million were recorded as a separate line item

Gain from litigation settlement, net in our condensed consolidated statement of income for the three and six months ended June 30, 2010.

**7. EARNINGS PER SHARE**

Earnings per common share data were as follows:

| (in thousands, except per share data)                                                                  | <b>Three Months Ended<br/>June 30,</b> |                 | <b>Six Months Ended<br/>June 30,</b> |                  |
|--------------------------------------------------------------------------------------------------------|----------------------------------------|-----------------|--------------------------------------|------------------|
|                                                                                                        | <b>2011</b>                            | <b>2010</b>     | <b>2011</b>                          | <b>2010</b>      |
| <b>Net earnings</b>                                                                                    | <b>\$30,252</b>                        | <b>\$11,105</b> | <b>\$51,663</b>                      | <b>\$333,633</b> |
| <b>Weighted-average common shares outstanding, basic</b>                                               | <b>47,877</b>                          | <b>49,531</b>   | <b>48,903</b>                        | <b>49,251</b>    |
| Shares issued on exercise of dilutive options                                                          | 5,591                                  | 9,142           | 6,142                                | 8,237            |
| Shares purchased with assumed proceeds of options and unearned restricted shares                       | (3,305)                                | (6,183)         | (3,799)                              | (5,469)          |
| Shares contingently issuable                                                                           | 4                                      | 9               | 4                                    | 9                |
| <b>Weighted-average common shares outstanding, diluted</b>                                             | <b>50,167</b>                          | <b>52,499</b>   | <b>51,250</b>                        | <b>52,028</b>    |
| <b>Net earnings per common share, diluted</b>                                                          | <b>\$ 0.60</b>                         | <b>\$ 0.21</b>  | <b>\$ 1.01</b>                       | <b>\$ 6.41</b>   |
| Anti-dilutive options excluded from calculation of weighted-average common shares outstanding, diluted | 3,285                                  | 1,472           | 2,915                                | 2,729            |





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**8. 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 Value       |                         | Balance Sheet<br>Location                                   |
|-----------------------------------------------------------------|------------------|-------------------------|------------------|-------------------------|-------------------------------------------------------------|
|                                                                 | June 30,<br>2011 | December<br>31,<br>2010 | June 30,<br>2011 | December<br>31,<br>2010 |                                                             |
| <i>Derivatives designated as cash flow hedging instruments:</i> |                  |                         |                  |                         |                                                             |
| Interest rate swap contract                                     | N/A              | \$ 300.0                | N/A              | \$ (4.6)                | Other non-current liabilities                               |
| <i>Derivatives not receiving hedge accounting treatment:</i>    |                  |                         |                  |                         |                                                             |
| Interest rate swap contract                                     | 220.0            | N/A                     | (2.7)            | N/A                     | Other non-current liabilities<br>Prepaid expenses and other |
| Foreign exchange contracts                                      | 11.0             | 11.4                    | 0.7              | 0.7                     |                                                             |
| Total derivative financial instruments                          | \$231.0          | \$ 311.4                | \$ (2.0)         | \$ (3.9)                |                                                             |

The fair values of our interest rate swap contract 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.

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) | 2011                      |                                  | 2010                      |                   | Three Months Ended June 30,                                                     |                                                                                 |
|-------------------------------|---------------------------|----------------------------------|---------------------------|-------------------|---------------------------------------------------------------------------------|---------------------------------------------------------------------------------|
|                               | Amount of Pre-tax<br>Gain | (Loss) Recognized in<br>Earnings | Amount of Pre-tax<br>Loss | Recognized in OCI | 2011<br>Amount of Pre-tax<br>Loss<br>Reclassified from<br>AOCI<br>into Earnings | 2010<br>Amount of Pre-tax<br>Loss<br>Reclassified from<br>AOCI<br>into Earnings |
|                               |                           |                                  |                           |                   |                                                                                 |                                                                                 |

*Derivatives designated as cash flow hedging instruments:*

|                                 |    |    |         |         |         |    |
|---------------------------------|----|----|---------|---------|---------|----|
| Interest rate swap contract (a) | \$ | \$ | \$(0.2) | \$(1.6) | \$(3.7) | \$ |
|---------------------------------|----|----|---------|---------|---------|----|

*Derivatives not receiving hedge accounting treatment:*

|                                  |         |         |         |         |         |         |
|----------------------------------|---------|---------|---------|---------|---------|---------|
| Interest rate swap contracts (a) | \$(0.1) | \$ 0.3  | \$      | \$      | \$      | \$(4.4) |
| Foreign exchange contracts (b)   | (0.2)   | (0.6)   |         |         |         |         |
|                                  | \$(0.3) | \$(0.3) | \$(0.2) | \$(1.6) | \$(3.7) | \$(4.4) |

(a) Recognized in Interest expense

(b) Recognized in Cost of sales

| (in millions of U.S. Dollars) | 2011                          |      | 2010                   |      | Six Months Ended June 30,            |      |
|-------------------------------|-------------------------------|------|------------------------|------|--------------------------------------|------|
|                               | 2011                          | 2010 | 2011                   | 2010 | 2011                                 | 2010 |
|                               | Amount of Pre-tax Gain        |      | Amount of Pre-tax Loss |      | Amount of Pre-tax Loss               |      |
|                               | (Loss) Recognized in Earnings |      | Recognized in OCI      |      | Reclassified from AOCI into Earnings |      |

*Derivatives designated as cash flow hedging instruments:*

|                                 |    |    |         |         |         |    |
|---------------------------------|----|----|---------|---------|---------|----|
| Interest rate swap contract (a) | \$ | \$ | \$(0.4) | \$(3.8) | \$(5.0) | \$ |
|---------------------------------|----|----|---------|---------|---------|----|

*Derivatives not receiving hedge accounting treatment:*

|                                  |         |        |         |         |         |         |
|----------------------------------|---------|--------|---------|---------|---------|---------|
| Interest rate swap contracts (a) | \$(0.1) | \$ 3.2 | \$      | \$      | \$      | \$(8.9) |
| Foreign exchange contracts (b)   |         | (0.1)  |         |         |         |         |
|                                  | \$(0.1) | \$ 3.1 | \$(0.4) | \$(3.8) | \$(5.0) | \$(8.9) |

(a) Recognized in Interest expense

(b) Recognized in Cost of sales

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**Interest Rate Swaps**

During the second quarter of 2007, we entered into two interest rate swap agreements with an aggregate notional principal amount of \$480.0 million. These interest rate swaps effectively fixed three-month LIBOR at 5.045%, for a then-effective interest rate of 6.795%, including the applicable margin, for \$480.0 million of our variable rate debt under our senior secured credit facility. In February 2009, we reduced the notional principal amount of the interest rate swaps by \$32.8 million and paid termination fees of approximately \$2.6 million. The termination fees, or deferred losses, related to the terminated portion of the swaps were amortized to interest expense over the original life of the interest rate swaps, through December 31, 2010. As a result of the reduced notional amount of the swaps, three-month LIBOR was effectively fixed at 5.026%, for a then-effective interest rate of 6.776%, including the applicable margin. We initially designated the swaps as hedging instruments and recorded changes in the fair value of these interest rate swaps as a component of accumulated other comprehensive income. We discontinued cash flow hedge accounting treatment for the interest rate swap agreements effective April 1, 2009. The deferred losses on the interest rate swaps previously charged to accumulated other comprehensive income were amortized to interest expense and subsequent changes in the fair value of the swaps were recognized in earnings as a component of interest expense until the swaps expired on December 31, 2010.

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 \$300.0 million 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 amortizes by \$40.0 million at the end of every quarter until it reaches \$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. During the three and six months ended June 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. This interest rate swap remains in effect and subsequent changes in the fair value of this swap will be recognized in earnings as a component of interest expense until the swap expires.

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 is June 30, 2012, the expiration date of our existing interest rate swap. 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 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 the new senior secured credit facility of 1.75% per annum, will be 3.6195% per annum. The initial notional amount of \$186.3 million amortizes quarterly by (i) \$2,812,500 from the effective date through the quarter ended September 30, 2013, (ii) \$5,625,000 from September 30, 2013 through the quarter ended September 30, 2014, and (iii) \$8,437,500 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 June 30, 2011, we had a commitment to purchase \$10.7 million in Mexican pesos and \$0.3 million in Polish zlotys over the next 12 months.

**Long-Term Debt**

The estimated fair market value of our long-term debt was \$5.5 million below carrying value and \$10.6 million above carrying value as of June 30, 2011 and December 31, 2010, respectively. Our 2021 Notes are traded in the market and are classified as a Level 1 measurement with the fair value determined based on the quoted active market prices.

Borrowings under our new senior secured credit facility are classified as Level 3 measurements as these securities are not traded in an active market and are valued based on an implied price derived from industry averages and relative loan performance.

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**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.

**9. REPURCHASES OF COMMON STOCK**

The following table summarizes our repurchases of common stock during the three and six months ended June 30, 2011 and 2010:

|                                     | <b>Three Months Ended</b> |               | <b>Six Months Ended</b> |               |
|-------------------------------------|---------------------------|---------------|-------------------------|---------------|
|                                     | <b>June 30,</b>           |               | <b>June 30,</b>         |               |
|                                     | <b>2011</b>               | <b>2010</b>   | <b>2011</b>             | <b>2010</b>   |
| <b>Shares repurchased</b>           | 2,144,067                 | 1,619,600     | 3,766,852               | 1,619,600     |
| <b>Aggregate repurchase price</b>   | \$ 60,326,065             | \$ 54,622,971 | \$ 105,856,445          | \$ 54,622,971 |
| <b>Average price paid per share</b> | \$ 28.14                  | \$ 33.73      | \$ 28.10                | \$ 33.73      |

As of June 30, 2011, we had authorization to repurchase an additional 6,590,301 shares of our common stock under the share repurchase program approved by our Board of Directors.

**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., direct mail, software analytics, security services, digital and in-store. 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 2010 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. A reconciliation of total segment profit to earnings from operations is provided below. Assets are not allocated in all cases to reportable segments and are not used to assess the performance of a segment.

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

| (in millions of U.S. dollars)    | <b>Three Months Ended June 30,</b> |                                  |            |                                                                |              |
|----------------------------------|------------------------------------|----------------------------------|------------|----------------------------------------------------------------|--------------|
|                                  | <b>Shared<br/>Mail</b>             | <b>Neighborhood<br/>Targeted</b> | <b>FSI</b> | <b>International,<br/>Digital<br/>Media &amp;<br/>Services</b> | <b>Total</b> |
| <b>2011</b>                      |                                    |                                  |            |                                                                |              |
| Revenues from external customers | \$ 337.2                           | \$ 88.8                          | \$ 89.2    | \$ 50.0                                                        | \$ 565.2     |
| Intersegment revenues            | \$ 4.1                             | \$ 12.9                          | \$ 9.8     | \$ 0.1                                                         | \$ 26.9      |
| Depreciation/amortization        | \$ 9.5                             | \$ 1.0                           | \$ 3.0     | \$ 1.9                                                         | \$ 15.4      |
| Segment profit                   | \$ 47.7                            | \$ 0.8                           | \$ 8.3     | \$ 6.4                                                         | \$ 63.2      |

|                                  |          |          |         |         |          |
|----------------------------------|----------|----------|---------|---------|----------|
| <b>2010</b>                      |          |          |         |         |          |
| Revenues from external customers | \$ 326.3 | \$ 116.3 | \$ 94.6 | \$ 42.8 | \$ 580.0 |
| Intersegment revenues            | \$ 3.9   | \$ 6.8   | \$ 9.3  | \$      | \$ 20.0  |
| Depreciation/amortization        | \$ 10.2  | \$ 1.0   | \$ 3.1  | \$ 0.8  | \$ 15.1  |
| Segment profit                   | \$ 40.6  | \$ 5.3   | \$ 11.4 | \$ 3.1  | \$ 60.4  |

| (in millions of U.S. dollars)    | <b>Six Months Ended June 30,</b> |                                  |            |                                                                |              |
|----------------------------------|----------------------------------|----------------------------------|------------|----------------------------------------------------------------|--------------|
|                                  | <b>Shared<br/>Mail</b>           | <b>Neighborhood<br/>Targeted</b> | <b>FSI</b> | <b>International,<br/>Digital<br/>Media &amp;<br/>Services</b> | <b>Total</b> |
| <b>2011</b>                      |                                  |                                  |            |                                                                |              |
| Revenues from external customers | \$ 659.8                         | \$ 178.9                         | \$ 178.4   | \$ 95.1                                                        | \$ 1,112.2   |
| Intersegment revenues            | \$ 8.6                           | \$ 22.2                          | \$ 19.6    | \$ 0.2                                                         | \$ 50.6      |
| Depreciation/amortization        | \$ 19.5                          | \$ 2.0                           | \$ 6.0     | \$ 3.6                                                         | \$ 31.1      |
| Segment profit                   | \$ 89.8                          | \$ 2.7                           | \$ 15.7    | \$ 11.8                                                        | \$ 120.0     |

|                                  |          |          |          |         |            |
|----------------------------------|----------|----------|----------|---------|------------|
| <b>2010</b>                      |          |          |          |         |            |
| Revenues from external customers | \$ 639.2 | \$ 216.1 | \$ 192.1 | \$ 82.6 | \$ 1,130.0 |
| Intersegment revenues            | \$ 7.4   | \$ 12.4  | \$ 18.9  | \$      | \$ 38.7    |
| Depreciation/amortization        | \$ 20.9  | \$ 2.0   | \$ 6.2   | \$ 1.6  | \$ 30.7    |
| Segment profit                   | \$ 72.2  | \$ 12.4  | \$ 19.7  | \$ 8.6  | \$ 112.9   |

The following table provides reconciliations of total segment profit to earnings from operations for the indicated periods:

| (in millions of U.S. dollars) | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|-------------------------------|----------------------------------------|-------------|--------------------------------------|-------------|
|                               | <b>2011</b>                            | <b>2010</b> | <b>2011</b>                          | <b>2010</b> |

|                                 |                |                |                 |                 |
|---------------------------------|----------------|----------------|-----------------|-----------------|
| Total segment profit            | \$ 63.2        | \$ 60.4        | \$ 120.0        | \$ 112.9        |
| Unallocated amounts:            |                |                |                 |                 |
| Gain from litigation settlement |                |                |                 | 490.1           |
| <b>Earnings from operations</b> | <b>\$ 63.2</b> | <b>\$ 60.4</b> | <b>\$ 120.0</b> | <b>\$ 603.0</b> |

Domestic and foreign revenues were as follows:

| (in millions of U.S. dollars) | Three Months<br>Ended<br>June 30, |                 | Six Months Ended<br>June 30, |                   |
|-------------------------------|-----------------------------------|-----------------|------------------------------|-------------------|
|                               | 2011                              | 2010            | 2011                         | 2010              |
| United States                 | \$ 550.3                          | \$ 566.2        | \$ 1,085.2                   | \$ 1,102.9        |
| Foreign                       | 14.9                              | 13.8            | 27.0                         | 27.1              |
| <b>Revenues</b>               | <b>\$ 565.2</b>                   | <b>\$ 580.0</b> | <b>\$ 1,112.2</b>            | <b>\$ 1,130.0</b> |



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**VALASSIS COMMUNICATIONS, INC.**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

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

| (in millions of U.S. dollars)             | June 30,<br>2011 | December<br>31,<br>2010 |
|-------------------------------------------|------------------|-------------------------|
| United States                             | \$ 153.9         | \$ 166.8                |
| Foreign                                   | 8.5              | 8.8                     |
| <b>Property, plant and equipment, net</b> | <b>\$ 162.4</b>  | <b>\$ 175.6</b>         |

**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 existing and future 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. 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 following tables present the condensed consolidating balance sheets as of June 30, 2011 and December 31, 2010, the condensed consolidating statements of income for the three and six months ended June 30, 2011 and 2010, and the condensed consolidating statements of cash flows for the six months ended June 30, 2011 and 2010. As a result of combining our general ledgers of record into an existing, single general ledger module within our enterprise resource planning system on July 1, 2010, the condensed consolidating statements of income for the three and six months ended June 30, 2011 below reflect certain revenues and costs and expenses between the Parent Company and the Guarantor Subsidiaries differently than the condensed consolidating statements of income for the three and six months ended June 30, 2010. Although it is not practicable to reclassify the amounts presented for the three and six months ended June 30, 2010 to reflect these changes in presentation, if such reclassifications could be made they would have no effect on any of the Consolidated Total amounts included below and would have no effect on the net income of the Parent Company or the Non-Guarantor Subsidiaries.

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**VALASSIS COMMUNICATIONS, INC.**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**  
**Condensed Consolidating Balance Sheet**  
**June 30, 2011**  
**(in thousands of U.S. dollars)**

| <b>Assets</b>                                          | <b>Parent<br/>Company</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Consolidating<br/>Adjustments</b> | <b>Consolidated<br/>Total</b> |
|--------------------------------------------------------|---------------------------|-----------------------------------|---------------------------------------|--------------------------------------|-------------------------------|
| Current assets:                                        |                           |                                   |                                       |                                      |                               |
| Cash and cash equivalents                              | \$ 84,913                 | \$ 5,480                          | \$ 28,569                             | \$                                   | \$ 118,962                    |
| Accounts receivable, net                               | 114,688                   | 273,820                           | 22,915                                |                                      | 411,423                       |
| Inventories                                            | 30,941                    | 8,275                             | 3                                     |                                      | 39,219                        |
| Prepaid expenses and other<br>(including intercompany) | 1,008,120                 | 1,047,338                         | 1,712                                 | (1,994,548)                          | 62,622                        |
| Total current assets                                   | 1,238,662                 | 1,334,913                         | 53,199                                | (1,994,548)                          | 632,226                       |
|                                                        |                           |                                   |                                       |                                      |                               |
| Property, plant and<br>equipment, net                  | 26,154                    | 134,415                           | 1,830                                 |                                      | 162,399                       |
| Goodwill and other<br>intangible assets, net           | 42,735                    | 814,253                           | 6,989                                 |                                      | 863,977                       |
| Investments                                            | 399,493                   | 21,137                            |                                       | (417,566)                            | 3,064                         |
| Intercompany note receivable<br>(payable)              | (73,639)                  | 86,187                            | (12,548)                              |                                      |                               |
| Other assets                                           | 10,478                    | 2,948                             | 1,083                                 |                                      | 14,509                        |
| Total assets                                           | \$1,643,883               | \$2,393,853                       | \$ 50,553                             | \$(2,412,114)                        | \$1,676,175                   |
|                                                        |                           |                                   |                                       |                                      |                               |
| <b>Liabilities and Stockholders<br/>Equity</b>         | <b>Parent<br/>Company</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Consolidating<br/>Adjustments</b> | <b>Consolidated<br/>Total</b> |
| Current liabilities:                                   |                           |                                   |                                       |                                      |                               |
| Current portion, long-term debt                        | \$ 15,000                 | \$                                | \$                                    | \$                                   | \$ 15,000                     |
| Accounts payable and intercompany<br>payable           | 464,676                   | 1,840,636                         | 9,429                                 | (1,994,548)                          | 320,193                       |
| Progress billings                                      | 14,800                    | 14,170                            | 15,645                                |                                      | 44,615                        |
| Accrued expenses                                       | 42,876                    | 35,601                            | 7,112                                 |                                      | 85,589                        |
| Total current liabilities                              | 537,352                   | 1,890,407                         | 32,186                                | (1,994,548)                          | 465,397                       |
|                                                        |                           |                                   |                                       |                                      |                               |
| Long-term debt                                         | 595,060                   |                                   |                                       |                                      | 595,060                       |
| Deferred income taxes                                  | (3,616)                   | 87,614                            | (3,995)                               |                                      | 80,003                        |
| Other non-current liabilities                          | 25,202                    | 18,377                            | 2,251                                 |                                      | 45,830                        |

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|                                            |             |             |          |               |             |
|--------------------------------------------|-------------|-------------|----------|---------------|-------------|
| Total liabilities                          | 1,153,998   | 1,996,398   | 30,442   | (1,994,548)   | 1,186,290   |
| Stockholders' equity                       | 489,885     | 397,455     | 20,111   | (417,566)     | 489,885     |
| Total liabilities and stockholders' equity | \$1,643,883 | \$2,393,853 | \$50,553 | \$(2,412,114) | \$1,676,175 |

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**VALASSIS COMMUNICATIONS, INC.**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**  
**Condensed Consolidating Balance Sheet**  
**December 31, 2010**  
**(in thousands of U.S. dollars)**

| <b>Assets</b>                                          | <b>Parent<br/>Company</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Consolidating<br/>Adjustments</b> | <b>Consolidated<br/>Total</b> |
|--------------------------------------------------------|---------------------------|-----------------------------------|---------------------------------------|--------------------------------------|-------------------------------|
| Current assets:                                        |                           |                                   |                                       |                                      |                               |
| Cash and cash equivalents                              | \$ 211,933                | \$ 8,026                          | \$ 25,976                             | \$                                   | \$ 245,935                    |
| Accounts receivable, net                               | 175,115                   | 259,001                           | 25,836                                |                                      | 459,952                       |
| Inventories                                            | 33,305                    | 8,679                             | 3                                     |                                      | 41,987                        |
| Prepaid expenses and other<br>(including intercompany) | 278,489                   | 630,972                           | 2,083                                 | (872,887)                            | 38,657                        |
| Total current assets                                   | 698,842                   | 906,678                           | 53,898                                | (872,887)                            | 786,531                       |
|                                                        |                           |                                   |                                       |                                      |                               |
| Property, plant and<br>equipment, net                  | 31,475                    | 142,006                           | 2,086                                 |                                      | 175,567                       |
| Goodwill and other<br>intangible assets, net           | 42,745                    | 820,554                           | 6,989                                 |                                      | 870,288                       |
| Investments                                            | 400,404                   | 12,486                            |                                       | (409,744)                            | 3,146                         |
| Intercompany note receivable<br>(payable)              | 479,365                   | (460,369)                         | (18,996)                              |                                      |                               |
| Other assets                                           | 6,982                     | 3,130                             | 14                                    |                                      | 10,126                        |
| Total assets                                           | \$1,659,813               | \$1,424,485                       | \$ 43,991                             | \$(1,282,631)                        | \$1,845,658                   |
|                                                        |                           |                                   |                                       |                                      |                               |
| <b>Liabilities and Stockholders<br/>Equity</b>         | <b>Parent<br/>Company</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Consolidating<br/>Adjustments</b> | <b>Consolidated<br/>Total</b> |
| Current liabilities:                                   |                           |                                   |                                       |                                      |                               |
| Current portion, long-term debt                        | \$ 7,058                  | \$                                | \$                                    | \$                                   | \$ 7,058                      |
| Accounts payable and intercompany<br>payable           | 323,277                   | 866,614                           | 12,598                                | (872,887)                            | 329,602                       |
| Progress billings                                      | 26,353                    | 11,751                            | 14,897                                |                                      | 53,001                        |
| Accrued expenses                                       | 51,035                    | 41,300                            | 7,277                                 |                                      | 99,612                        |
| Total current liabilities                              | 407,723                   | 919,665                           | 34,772                                | (872,887)                            | 489,273                       |
|                                                        |                           |                                   |                                       |                                      |                               |
| Long-term debt                                         | 699,169                   |                                   |                                       |                                      | 699,169                       |
| Deferred income taxes                                  | (4,044)                   | 86,804                            | (3,996)                               |                                      | 78,764                        |
| Other non-current liabilities                          | 28,081                    | 19,575                            | 1,912                                 |                                      | 49,568                        |

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|                                            |             |             |          |               |             |
|--------------------------------------------|-------------|-------------|----------|---------------|-------------|
| Total liabilities                          | 1,130,929   | 1,026,044   | 32,688   | (872,887)     | 1,316,774   |
| Stockholders' equity                       | 528,884     | 398,441     | 11,303   | (409,744)     | 528,884     |
| Total liabilities and stockholders' equity | \$1,659,813 | \$1,424,485 | \$43,991 | \$(1,282,631) | \$1,845,658 |

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**VALASSIS COMMUNICATIONS, INC.**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**  
**Condensed Consolidating Statement of Income**  
**Three Months Ended June 30, 2011**  
**(in thousands of U.S. dollars)**

|                                                | Parent<br>Company | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Consolidating<br>Adjustments | Consolidated<br>Total |
|------------------------------------------------|-------------------|---------------------------|-------------------------------|------------------------------|-----------------------|
| <b>Revenues</b>                                | <b>\$200,589</b>  | <b>\$444,629</b>          | <b>\$ 20,281</b>              | <b>\$(100,247)</b>           | <b>\$565,252</b>      |
| Cost and expenses:                             |                   |                           |                               |                              |                       |
| Cost of sales                                  | 168,597           | 286,880                   | 13,973                        | (51,410)                     | 418,040               |
| Selling, general and<br>administrative         | 21,461            | 104,561                   | 3,646                         | (48,837)                     | 80,831                |
| Amortization expense                           | 5                 | 3,150                     |                               |                              | 3,155                 |
| Total costs and expenses                       | 190,063           | 394,591                   | 17,619                        | (100,247)                    | 502,026               |
| <b>Earnings from operations</b>                | <b>10,526</b>     | <b>50,038</b>             | <b>2,662</b>                  |                              | <b>63,226</b>         |
| Other expenses and income:                     |                   |                           |                               |                              |                       |
| Interest expense                               | 11,726            |                           |                               |                              | 11,726                |
| Interest income                                | (96)              |                           | (26)                          |                              | (122)                 |
| Intercompany interest                          | (3,157)           | 2,995                     | 162                           |                              |                       |
| Loss on extinguishment of debt                 | 2,966             |                           |                               |                              | 2,966                 |
| Other income, net                              | 9                 | (1,481)                   | 36                            |                              | (1,436)               |
| Total other expenses, net                      | 11,448            | 1,514                     | 172                           |                              | 13,134                |
| <b>Earnings (loss) before income<br/>taxes</b> | <b>(922)</b>      | <b>48,524</b>             | <b>2,490</b>                  |                              | <b>50,092</b>         |
| Income tax expense                             | 241               | 18,844                    | 755                           |                              | 19,840                |
| Equity in net earnings of<br>subsidiaries      | 31,415            | 1,735                     |                               | (33,150)                     |                       |
| <b>Net earnings</b>                            | <b>\$ 30,252</b>  | <b>\$ 31,415</b>          | <b>\$ 1,735</b>               | <b>\$ (33,150)</b>           | <b>\$ 30,252</b>      |

**Condensed Consolidating Statement of Income**  
**Three Months Ended June 30, 2010**  
**(in thousands of U.S. dollars)**

|                 | Parent<br>Company | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Consolidating<br>Adjustments | Consolidated<br>Total |
|-----------------|-------------------|---------------------------|-------------------------------|------------------------------|-----------------------|
| <b>Revenues</b> | <b>\$210,345</b>  | <b>\$375,691</b>          | <b>\$ 19,016</b>              | <b>\$(25,102)</b>            | <b>\$579,950</b>      |

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|                                            |                  |                  |                 |                    |                  |
|--------------------------------------------|------------------|------------------|-----------------|--------------------|------------------|
| Cost and expenses:                         |                  |                  |                 |                    |                  |
| Cost of sales                              | 164,074          | 271,879          | 12,914          | (25,102)           | 423,765          |
| Selling, general and administrative        | 36,274           | 52,619           | 3,770           |                    | 92,663           |
| Amortization expense                       | 5                | 3,150            |                 |                    | 3,155            |
| Total costs and expenses                   | 200,353          | 327,648          | 16,684          | (25,102)           | 519,583          |
| <b>Earnings from operations</b>            | <b>9,992</b>     | <b>48,043</b>    | <b>2,332</b>    |                    | <b>60,367</b>    |
| Other expenses and income:                 |                  |                  |                 |                    |                  |
| Interest expense                           | 17,837           |                  |                 |                    | 17,837           |
| Interest income                            | (230)            | 1                | (19)            |                    | (248)            |
| Intercompany interest                      | (16,298)         | 16,186           | 112             |                    |                  |
| Loss on extinguishment of debt             | 23,873           |                  |                 |                    | 23,873           |
| Other income, net                          | 280              | (860)            | 19              |                    | (561)            |
| Total other expenses (income), net         | 25,462           | 15,327           | 112             |                    | 40,901           |
| <b>Earnings (loss) before income taxes</b> | <b>(15,470)</b>  | <b>32,716</b>    | <b>2,220</b>    |                    | <b>19,466</b>    |
| Income tax (benefit) expense               | (3,325)          | 10,906           | 780             |                    | 8,361            |
| Equity in net earnings of subsidiaries     | 23,250           | 1,440            |                 | (24,690)           |                  |
| <b>Net earnings</b>                        | <b>\$ 11,105</b> | <b>\$ 23,250</b> | <b>\$ 1,440</b> | <b>\$ (24,690)</b> | <b>\$ 11,105</b> |

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**VALASSIS COMMUNICATIONS, INC.**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**  
**Condensed Consolidating Statement of Income**  
**Six Months Ended June 30, 2011**  
**(in thousands of U.S. dollars)**

|                                                | Parent<br>Company | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Consolidating<br>Adjustments | Consolidated<br>Total |
|------------------------------------------------|-------------------|---------------------------|-------------------------------|------------------------------|-----------------------|
| <b>Revenues</b>                                | <b>\$398,755</b>  | <b>\$873,897</b>          | <b>\$ 37,650</b>              | <b>\$(198,071)</b>           | <b>\$1,112,231</b>    |
| Cost and expenses:                             |                   |                           |                               |                              |                       |
| Cost of sales                                  | 334,934           | 564,712                   | 26,292                        | (99,321)                     | 826,617               |
| Selling, general and<br>administrative         | 45,975            | 204,939                   | 7,094                         | (98,750)                     | 159,258               |
| Amortization expense                           | 11                | 6,300                     |                               |                              | 6,311                 |
| Total costs and expenses                       | 380,920           | 775,951                   | 33,386                        | (198,071)                    | 992,186               |
| <b>Earnings from operations</b>                | <b>17,835</b>     | <b>97,946</b>             | <b>4,264</b>                  |                              | <b>120,045</b>        |
| Other expenses and income:                     |                   |                           |                               |                              |                       |
| Interest expense                               | 21,501            |                           |                               |                              | 21,501                |
| Interest income                                | (214)             |                           | (47)                          |                              | (261)                 |
| Intercompany interest                          | (14,354)          | 14,192                    | 162                           |                              |                       |
| Loss on extinguishment of debt                 | 16,318            |                           |                               |                              | 16,318                |
| Other income, net                              | (218)             | (2,270)                   | 176                           |                              | (2,312)               |
| Total other expenses, net                      | 23,033            | 11,922                    | 291                           |                              | 35,246                |
| <b>Earnings (loss) before income<br/>taxes</b> | <b>(5,198)</b>    | <b>86,024</b>             | <b>3,973</b>                  |                              | <b>84,799</b>         |
| Income tax expense                             | 566               | 31,308                    | 1,262                         |                              | 33,136                |
| Equity in net earnings of<br>subsidiaries      | 57,427            | 2,711                     |                               | (60,138)                     |                       |
| <b>Net earnings</b>                            | <b>\$ 51,663</b>  | <b>\$ 57,427</b>          | <b>\$ 2,711</b>               | <b>\$(60,138)</b>            | <b>\$ 51,663</b>      |

**Condensed Consolidating Statement of Income**  
**Six Months Ended June 30, 2010**  
**(in thousands of U.S. dollars)**

|                 | Parent<br>Company | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Consolidating<br>Adjustments | Consolidated<br>Total |
|-----------------|-------------------|---------------------------|-------------------------------|------------------------------|-----------------------|
| <b>Revenues</b> | <b>\$404,373</b>  | <b>\$737,009</b>          | <b>\$ 36,956</b>              | <b>\$(48,386)</b>            | <b>\$1,129,952</b>    |



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|                                        |                   |                  |                 |                   |                   |
|----------------------------------------|-------------------|------------------|-----------------|-------------------|-------------------|
| Cost and expenses:                     |                   |                  |                 |                   |                   |
| Cost of sales                          | 312,663           | 537,913          | 24,964          | (48,386)          | 827,154           |
| Selling, general and administrative    | 72,194            | 104,290          | 7,137           |                   | 183,621           |
| Amortization expense                   | 11                | 6,300            |                 |                   | 6,311             |
| Total costs and expenses               | 384,868           | 648,503          | 32,101          | (48,386)          | 1,017,086         |
| Gain from litigation settlement, net   | 490,085           |                  |                 |                   | 490,085           |
| <b>Earnings from operations</b>        | <b>509,590</b>    | <b>88,506</b>    | <b>4,855</b>    |                   | <b>602,951</b>    |
| Other expenses and income:             |                   |                  |                 |                   |                   |
| Interest expense                       | 37,993            |                  |                 |                   | 37,993            |
| Interest income                        | (373)             | 3                | (24)            |                   | (394)             |
| Intercompany interest                  | (33,544)          | 33,432           | 112             |                   |                   |
| Loss on extinguishment of debt         | 23,873            |                  |                 |                   | 23,873            |
| Other income, net                      | (813)             | (1,416)          | (122)           |                   | (2,351)           |
| Total other expenses (income), net     | 27,136            | 32,019           | (34)            |                   | 59,121            |
| <b>Earnings before income taxes</b>    | <b>482,454</b>    | <b>56,487</b>    | <b>4,889</b>    |                   | <b>543,830</b>    |
| Income tax expense                     | 188,743           | 20,178           | 1,276           |                   | 210,197           |
| Equity in net earnings of subsidiaries | 39,922            | 3,613            |                 | (43,535)          |                   |
| <b>Net earnings</b>                    | <b>\$ 333,633</b> | <b>\$ 39,922</b> | <b>\$ 3,613</b> | <b>\$(43,535)</b> | <b>\$ 333,633</b> |

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**VALASSIS COMMUNICATIONS, INC.**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**  
**Condensed Consolidating Statement of Cash Flows**  
**Six Months Ended June 30, 2011**  
**(in thousands of U.S. dollars)**

|                                                                 | Parent<br>Company | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Consolidating<br>Adjustments | Consolidated<br>Total |
|-----------------------------------------------------------------|-------------------|---------------------------|-------------------------------|------------------------------|-----------------------|
| <b>Net cash provided by (used in)<br/>operating activities</b>  | <b>\$ 134,756</b> | <b>\$(45,665)</b>         | <b>\$ 1,942</b>               | <b>\$</b>                    | <b>\$ 91,033</b>      |
| <b>Cash flows from investing<br/>activities:</b>                |                   |                           |                               |                              |                       |
| Additions to property, plant and<br>equipment                   | (7,124)           | (4,428)                   | (74)                          |                              | (11,626)              |
| Proceeds from sale of property,<br>plant and equipment          | 20                |                           |                               |                              | 20                    |
| Proceeds from sale of<br>available-for-sale securities          | 1,494             |                           |                               |                              | 1,494                 |
| <b>Net cash used in investing<br/>activities</b>                | <b>(5,610)</b>    | <b>(4,428)</b>            | <b>(74)</b>                   |                              | <b>(10,112)</b>       |
| <b>Cash flows from financing<br/>activities:</b>                |                   |                           |                               |                              |                       |
| Cash provided by (used in)<br>intercompany activity             | (47,547)          | 47,547                    |                               |                              |                       |
| Borrowings of long-term debt                                    | 610,000           |                           |                               |                              | 610,000               |
| Repayments of long-term debt                                    | (706,169)         |                           |                               |                              | (706,169)             |
| Debt issuance costs                                             | (11,266)          |                           |                               |                              | (11,266)              |
| Repurchases of common stock                                     | (105,856)         |                           |                               |                              | (105,856)             |
| Proceeds from issuance of<br>common stock                       | 4,672             |                           |                               |                              | 4,672                 |
| <b>Net cash provided (used in) by<br/>financing activities</b>  | <b>(256,166)</b>  | <b>47,547</b>             |                               |                              | <b>(208,619)</b>      |
| Effect of exchange rate changes<br>on cash and cash equivalents |                   |                           | 725                           |                              | 725                   |
| Net increase (decrease) in cash<br>and cash equivalents         | (127,020)         | (2,546)                   | 2,593                         |                              | (126,973)             |
| Cash and cash equivalents at<br>beginning of period             | 211,933           | 8,026                     | 25,976                        |                              | 245,935               |
| <b>Cash and cash equivalents at<br/>end of period</b>           | <b>\$ 84,913</b>  | <b>\$ 5,480</b>           | <b>\$ 28,569</b>              | <b>\$</b>                    | <b>\$ 118,962</b>     |

**Condensed Consolidating Statement of Cash Flows**  
**Six Months Ended June 30, 2010**  
(in thousands of U.S. dollars)

|                                                              | <b>Parent<br/>Company</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Consolidating<br/>Adjustments</b> | <b>Consolidated<br/>Total</b> |
|--------------------------------------------------------------|---------------------------|-----------------------------------|---------------------------------------|--------------------------------------|-------------------------------|
| <b>Net cash provided by operating activities</b>             | <b>\$ 339,620</b>         | <b>\$ 86,971</b>                  | <b>\$ 7,315</b>                       | <b>\$</b>                            | <b>\$ 433,906</b>             |
| <b>Cash flows from investing activities:</b>                 |                           |                                   |                                       |                                      |                               |
| Additions to property, plant and equipment                   | (5,393)                   | (2,861)                           | (147)                                 |                                      | (8,401)                       |
| Proceeds from sale of property, plant and equipment          | 36                        |                                   |                                       |                                      | 36                            |
| <b>Net cash used in investing activities</b>                 | <b>(5,357)</b>            | <b>(2,861)</b>                    | <b>(147)</b>                          |                                      | <b>(8,365)</b>                |
| <b>Cash flows from financing activities:</b>                 |                           |                                   |                                       |                                      |                               |
| Cash provided by (used in) intercompany activity             | 90,923                    | (90,923)                          |                                       |                                      |                               |
| Repayments of long-term debt                                 | (301,312)                 |                                   |                                       |                                      | (301,312)                     |
| Repurchase of common stock                                   | (54,623)                  |                                   |                                       |                                      | (54,623)                      |
| Proceeds from issuance of common stock                       | 30,433                    |                                   |                                       |                                      | 30,433                        |
| <b>Net cash provided by (used in) financing activities</b>   | <b>(234,579)</b>          | <b>(90,923)</b>                   |                                       |                                      | <b>(325,502)</b>              |
| Effect of exchange rate changes on cash and cash equivalents |                           |                                   | (1,177)                               |                                      | (1,177)                       |
| Net increase (decrease) in cash and cash equivalents         | 99,684                    | (6,813)                           | 5,991                                 |                                      | 98,862                        |
| Cash and cash equivalents at beginning of period             | 104,477                   | 7,614                             | 17,755                                |                                      | 129,846                       |
| <b>Cash and cash equivalents at end of period</b>            | <b>\$ 204,161</b>         | <b>\$ 801</b>                     | <b>\$ 23,746</b>                      | <b>\$</b>                            | <b>\$ 228,708</b>             |

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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 preference for different promotional materials, strategies or coupon delivery methods, including, without limitation, as a result of declines in newspaper circulation; 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; 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. 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, except as required by applicable law. Additional risks include, but are not limited to, those risk factors described in our Annual Report on Form 10-K for the year ended December 31, 2010, or the 2010 Form 10-K, and other filings by us with the United States Securities and Exchange Commission, or the SEC.

**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 offering, 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.

**Table of Contents****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<br>June 30, |                | Six Months Ended<br>June 30, |                 |
|------------------------------------------------------|--------------------------------|----------------|------------------------------|-----------------|
|                                                      | 2011                           | 2010           | 2011                         | 2010            |
| Revenues:                                            |                                |                |                              |                 |
| Shared Mail                                          | \$337.2                        | \$326.3        | \$ 659.8                     | \$ 639.2        |
| Neighborhood Targeted                                | 88.8                           | 116.3          | 178.9                        | 216.1           |
| Free-standing Inserts ( FSI )                        | 89.2                           | 94.6           | 178.4                        | 192.1           |
| International, Digital Media & Services              | 50.0                           | 42.8           | 95.1                         | 82.6            |
| <b>Total revenues</b>                                | <b>565.2</b>                   | <b>580.0</b>   | <b>1,112.2</b>               | <b>1,130.0</b>  |
| Cost of sales                                        | 418.0                          | 423.8          | 826.6                        | 827.2           |
| <b>Gross profit</b>                                  | <b>147.2</b>                   | <b>156.2</b>   | <b>285.6</b>                 | <b>302.8</b>    |
| Selling, general and administrative                  | 80.8                           | 92.7           | 159.3                        | 183.6           |
| Amortization expense                                 | 3.2                            | 3.1            | 6.3                          | 6.3             |
| Gain from litigation settlement, net                 |                                |                |                              | 490.1           |
| <b>Earnings from operations</b>                      | <b>63.2</b>                    | <b>60.4</b>    | <b>120.0</b>                 | <b>603.0</b>    |
| Other expenses and income:                           |                                |                |                              |                 |
| Interest expense, net                                | 11.6                           | 17.6           | 21.2                         | 37.6            |
| Loss on extinguishment of debt                       | 3.0                            | 23.9           | 16.3                         | 23.9            |
| Other income, net                                    | (1.5)                          | (0.6)          | (2.3)                        | (2.3)           |
| Total other expenses, net                            | 13.1                           | 40.9           | 35.2                         | 59.2            |
| <b>Earnings before income taxes</b>                  | <b>50.1</b>                    | <b>19.5</b>    | <b>84.8</b>                  | <b>543.8</b>    |
| Income tax expense                                   | 19.8                           | 8.4            | 33.1                         | 210.2           |
| <b>Net earnings</b>                                  | <b>\$ 30.3</b>                 | <b>\$ 11.1</b> | <b>\$ 51.7</b>               | <b>\$ 333.6</b> |
| <b>Net earnings per common share, diluted</b>        | <b>\$ 0.60</b>                 | <b>\$ 0.21</b> | <b>\$ 1.01</b>               | <b>\$ 6.41</b>  |

**Revenues**

We reported revenues of \$565.2 million and \$580.0 million for the three months ended June 30, 2011 and 2010, respectively, and \$1,112.2 million and \$1,130.0 million for the six months ended June 30, 2011 and 2010, respectively. As further discussed in **Segment Results** below, these decreases in consolidated revenues resulted from decreased revenues in the Neighborhood Targeted and FSI segments, which were offset, in part, by increased revenues in the Shared Mail segment and International, Digital Media & Services.

**Cost of Sales**

Cost of sales was \$418.0 million and \$423.8 million for the three months ended June 30, 2011 and 2010, respectively. Gross profit as a percentage of revenues for the three months ended June 30, 2011 was 26.0%, compared to 26.9% for

the three months ended June 30, 2010. Cost of sales was \$826.6 million and \$827.2 million for the six months ended June 30, 2011 and 2010, respectively. Gross profit as a percentage of revenues for the six months ended June 30, 2011 was 25.7%, compared to 26.8% for the six months ended June 30, 2010. These decreases in gross profit as a percentage of revenues resulted primarily from decreased revenues in the Neighborhood Targeted and FSI segments and cost increases in paper and energy in the FSI segment.

**Table of Contents*****Selling, General and Administrative ( SG&A ) Expenses***

SG&A expenses were \$80.8 million and \$92.7 million for the three months ended June 30, 2011 and 2010, respectively, and \$159.3 million and \$183.6 million for the six months ended June 30, 2011 and 2010, respectively. SG&A expenses for the six months ended June 30, 2010 included \$2.1 million in legal costs associated with our lawsuits against News (as defined and further described in ***Gain from Litigation Settlement*** below). In addition, stock-based compensation expense for the three and six months ended June 30, 2011 decreased \$5.4 million and \$9.4 million, respectively, as compared to the three and six months ended June 30, 2010. The remaining decreases in SG&A expenses primarily reflect reduced incentive compensation expense and our cost containment efforts.

***Gain from Litigation Settlement***

On February 4, 2010, we executed a settlement agreement and release (the Settlement Agreement ) settling our outstanding lawsuits against News America Incorporated, a/k/a News America Marketing Group, News America Marketing, FSI, Inc. a/k/a News America Marketing FSI, LLC and News America Marketing In-Store Services, Inc. a/k/a News America Marketing In-Store Services, LLC (collectively, News ). The operative complaint alleged violations of the Sherman Act and various state competitive statutes and the commission of torts by News in connection with the marketing and sale of FSI space and in-store promotion and advertising services. Pursuant to the terms of the Settlement Agreement, News paid us \$500.0 million and entered into a 10-year shared mail distribution agreement with our subsidiary, Valassis Direct Mail, Inc., which provides for our sale of certain shared mail services to News on specified terms.

During the six months ended June 30, 2010, in connection with the successful settlement of these lawsuits, we made \$9.9 million in related payments, including special bonuses to certain of our employees (including our named executive officers in our proxy statement) in an aggregate amount of \$8.1 million. These expenses were netted against the \$500.0 million of proceeds received, and the net proceeds of \$490.1 million have been recorded as a separate line item Gain from litigation settlement, net in our condensed consolidated statement of income for the six months ended June 30, 2010.

***Loss on Extinguishment of Debt***

On June 27, 2011, we entered into a new senior secured credit facility, which replaced and terminated our prior senior secured credit facility (both of which as described below). We used the proceeds of the new 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 new senior secured credit facility. We recognized a pre-tax loss on extinguishment of debt of \$3.0 million during the three and six months ended June 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<sup>1</sup>/<sub>4</sub>% Senior Notes due 2015 (the 2015 Notes ) and to amend the indenture governing the 2015 Notes, which we refer to as 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 six months ended June 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.

During the three and six months ended June 30, 2010, we purchased \$297.8 million aggregate principal amount of the 2015 Notes pursuant to a cash tender offer and open market repurchases. We recognized a pre-tax loss on extinguishment of debt of \$23.9 million during the three and six months ended June 30, 2010, which represents the difference between the aggregate purchase price and the aggregate principal amount of the 2015 Notes purchased and the proportionate write-off of related capitalized debt issuance costs.

***Interest Expense, Net***

Interest expense, net was \$11.6 million and \$17.6 million for the three months ended June 30, 2011 and 2010, respectively, and \$21.2 million and \$37.6 million for the six months ended June 30, 2011 and 2010, respectively. The decreases in interest expense, net were primarily due to lower debt balances as a result of our repurchase of

\$297.8 million aggregate principal amount of the 2015 Notes during the second quarter of 2010 and the reduced interest rate associated with the 2021 Notes as compared to the 2015 Notes.



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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 three and six months ended June 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, which partially offset the decreases in interest expense described above.

**Income Tax Expense**

Income tax expense represented 39.5% and 43.1% of earnings before income taxes for the three months ended June 30, 2011 and 2010, respectively, and 39.0% and 38.7% of earnings before income taxes for the six months ended June 30, 2011 and 2010, respectively. 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.

**Net Earnings**

Net earnings were \$30.3 million and \$11.1 million for the three months ended June 30, 2011 and 2010, respectively, or \$0.60 and \$0.21, respectively, per common share, diluted. Net earnings were \$51.7 million and \$333.6 million for the six months ended June 30, 2011 and 2010, respectively, or \$1.01 and \$6.41, respectively, per common share, diluted. As discussed above, net earnings and net earnings per common share, diluted for the three and six months ended June 30, 2011 and 2010 included certain items affecting the comparability of such periods; specifically, losses on extinguishment of debt and related charges in the each of three and six month periods ended June 30, 2011 and 2010 and a gain from litigation settlement in the six months ended June 30, 2010. In **Non-GAAP Financial Measures** below, we compare net earnings and net earnings per common share, diluted for the three and six months ended June 30, 2011 and 2010 excluding these items.

**Non-GAAP Financial Measures**

We define adjusted net earnings and adjusted net earnings per common share, diluted, as net earnings excluding losses on extinguishment of debt, including the related reclassification of previously unrealized losses on interest rate swaps from accumulated other comprehensive income to earnings, net of tax, and the gain from litigation settlement, net of tax. We present adjusted net earnings and adjusted net earnings per common share, diluted, 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 net earnings per common share, diluted, 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 net earnings per common share, diluted, 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 net earnings per common share, diluted, for the three and six months ended June 30, 2011 and 2010 to adjusted net earnings and adjusted net earnings per common share, diluted:

|                                                                   | <b>Three Months Ended<br/>June 30,</b>      |                                              |                                             |                                              |
|-------------------------------------------------------------------|---------------------------------------------|----------------------------------------------|---------------------------------------------|----------------------------------------------|
|                                                                   | <b>2011</b>                                 |                                              | <b>2010</b>                                 |                                              |
|                                                                   | <b>U.S.<br/>Dollars<br/>in<br/>Millions</b> | <b>Per<br/>Common<br/>Share,<br/>Diluted</b> | <b>U.S.<br/>Dollars<br/>in<br/>Millions</b> | <b>Per<br/>Common<br/>Share,<br/>Diluted</b> |
| <b>Net earnings</b>                                               | <b>\$30.3</b>                               | <b>\$0.60</b>                                | <b>\$11.1</b>                               | <b>\$0.21</b>                                |
| Excluding:                                                        |                                             |                                              |                                             |                                              |
| Loss on extinguishment of debt and related charges,<br>net of tax | 3.4                                         | 0.07                                         | 14.7                                        | 0.28                                         |
| <b>Adjusted net earnings</b>                                      | <b>\$33.7</b>                               | <b>\$0.67</b>                                | <b>\$25.8</b>                               | <b>\$0.49</b>                                |

|                                                                   | <b>Six Months Ended<br/>June 30,</b>        |                                              |                                             |                                              |
|-------------------------------------------------------------------|---------------------------------------------|----------------------------------------------|---------------------------------------------|----------------------------------------------|
|                                                                   | <b>2011</b>                                 |                                              | <b>2010</b>                                 |                                              |
|                                                                   | <b>U.S.<br/>Dollars<br/>in<br/>Millions</b> | <b>Per<br/>Common<br/>Share,<br/>Diluted</b> | <b>U.S.<br/>Dollars<br/>in<br/>Millions</b> | <b>Per<br/>Common<br/>Share,<br/>Diluted</b> |
| <b>Net earnings</b>                                               | <b>\$51.7</b>                               | <b>\$1.01</b>                                | <b>\$ 333.6</b>                             | <b>\$ 6.41</b>                               |
| Excluding:                                                        |                                             |                                              |                                             |                                              |
| Loss on extinguishment of debt and related charges,<br>net of tax | 11.6                                        | 0.23                                         | 14.7                                        | 0.28                                         |
| Gain from litigation settlement, net of tax                       |                                             |                                              | (301.4)                                     | (5.79)                                       |
| <b>Adjusted net earnings</b>                                      | <b>\$63.3</b>                               | <b>\$1.24</b>                                | <b>\$ 46.9</b>                              | <b>\$ 0.90</b>                               |

The increases in adjusted net earnings and adjusted net earnings per common share, diluted, for the three and six months ended June 30, 2011 as compared to the three and six months ended June 30, 2010 reflect a net improvement in our total segment profit and decreased interest expense.

**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 our coupon clearing and analytics business, NCH Marketing Services, Inc. ( NCH ), Valassis Canada, Inc., Promotion Watch, direct mail, analytics, digital and in-store.

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 condensed consolidated financial statements included in this Quarterly Report on Form 10-Q.

**Table of Contents*****Shared Mail***

Shared Mail revenues were \$337.2 million and \$326.3 million for the three months ended June 30, 2011 and 2010, respectively, an increase of 3.3%, and \$659.8 million and \$639.2 million for the six months ended June 30, 2011 and 2010, respectively, an increase of 3.2%. These increases were attributable to volume gains in inserts as demonstrated by the growth in Shared Mail pieces distributed. Shared Mail pieces increased 2.3% to 9.2 billion pieces for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010, and increased 3.5% to 18.3 billion pieces for the six months ended June 30, 2011 as compared to the six months ended June 30, 2010. Revenue attributable to the volume gains was offset, in part, by lower revenue from the RedPlum® wrap product.

Shared Mail packages delivered were 0.9 billion and 1.8 billion, respectively, for the three and six months ended June 30, 2011, increasing 0.7% and 0.1%, respectively, from the three and six months ended June 30, 2010. The growth in Shared Mail pieces, on relatively flat Shared Mail packages volumes, resulted in the increase in average pieces per package. Shared Mail average pieces per package were 9.8 pieces and 9.9 pieces, respectively, for the three and six months ended June 30, 2011 increasing 2.0% and 3.1%, respectively, from the three and six months ended June 30, 2010.

Gross margin as a percentage of revenues was 28.8% and 29.4% for the three months ended June 30, 2011 and 2010, respectively, and 28.5% for each of the six month periods ended June 30, 2011 and 2010. Gross margin as a percentage of revenues was favorably impacted by the flow-through of the increased insert volume and related efficiencies in unused postage. Unused postage as a percentage of base postage was 13.8% and 16.0% for the three months ended June 30, 2011 and 2010, respectively, and 14.3% and 16.8% for the six months ended June 30, 2011 and 2010, respectively. Offsetting the favorable impact of the above items, gross margin as a percentage of revenues was negatively impacted by a product mix shift toward printed products, which drove an increase in print costs. In addition, gross margin as a percentage of revenues for the three months ended June 30, 2011 was unfavorably affected by the reduction in RedPlum® wrap product revenues.

Segment profit was \$47.7 million and \$40.6 million for the three months ended June 30, 2011 and 2010, respectively, an increase of 17.5%, and \$89.8 million and \$72.2 million for the six months ended June 30, 2011 and 2010, respectively, an increase of 24.4%. Segment profit as a percentage of revenues was 14.1% and 12.4% for the three months ended June 30, 2011 and 2010, respectively, and 13.6% and 11.3% for the six months ended June 30, 2011 and 2010, respectively. The increases in segment profit and segment profit as a percentage of revenues were the result of the growth in revenues achieved through the increase in insert volumes and decreased SG&A costs.

***Neighborhood Targeted***

Neighborhood Targeted revenues were \$88.8 million and \$116.3 million for the three months ended June 30, 2011 and 2010, respectively, a decrease of 23.6%, and \$178.9 million and \$216.1 million for the six months ended June 30, 2011 and 2010, respectively, a decrease of 17.2%. These decreases resulted primarily from a decline in Run-of-Press ( ROP ) revenues associated with reduced advertising spending by one client in each of the telecommunications and energy verticals. Based on recent trends, we are projecting ROP revenue being down approximately \$80 million for the year ended December 31, 2011 as compared to the year ended December 31, 2010. In addition, during the three months ended June 30, 2011, we experienced reduced revenue from our polybag advertising and sampling business as compared to the three months ended June 30, 2010.

Segment profit was \$0.8 million and \$5.3 million for the three months ended June 30, 2011 and 2010, respectively, a decrease of 84.9%, and \$2.7 million and \$12.4 million for the six months ended June 30, 2011 and 2010, respectively, a decrease of 78.2%. Segment profit was negatively impacted by:

margin pressure associated with a changing client base as we have been strategically targeting larger, higher frequency newspaper insert clients who typically need optimized media solutions that blend newspaper inserts with higher margin shared mail products; and

the aforementioned decline in ROP and polybag advertising and sampling revenues.

**Table of Contents*****Free-standing Inserts***

FSI revenues were \$89.2 million and \$94.6 million for the three months ended June 30, 2011 and 2010, respectively, a decrease of 5.7%, and \$178.4 million and \$192.1 million for the six months ended June 30, 2011 and 2010, respectively, a decrease of 7.1%. These decreases reflect volume declines associated with reduced market share. In addition, industry units declined approximately 1.5% during the six months ended June 30, 2011 as compared to the six months ended June 30, 2010, which, we believe, reflects our clients' response to increased coupon redemptions by consumers.

FSI segment profit was \$8.3 million and \$11.4 million for the three months ended June 30, 2011 and 2010, respectively, a decrease of 27.2%, and, \$15.7 million and \$19.7 million for the six months ended June 30, 2011 and 2010, respectively, a decrease of 20.3%. In addition to the decline in FSI revenues, segment profit was negatively impacted by increased cost of sales.

***International, Digital Media & Services***

International, Digital Media & Services revenues were \$50.0 million and \$42.8 million for the three months ended June 30, 2011 and 2010, respectively, an increase of 16.8%, and \$95.1 million and \$82.6 million for the six months ended June 30, 2011 and 2010, respectively, an increase of 15.1%. International, Digital Media & Services segment profit was \$6.4 million and \$3.1 million for the three months ended June 30, 2011 and 2010, respectively, an increase of 106.5%, and \$11.8 million and \$8.6 million for the six months ended June 30, 2011 and 2010, respectively, an increase of 37.2%. These increases in revenues and segment profit were due primarily to strong performance by NCH, which was driven by increased coupon redemptions in the United States and Italy, and continued growth in our digital and in-store businesses. These contributions to segment profit were offset, in part, by continued investments in our digital business and the expansion of our in-store network.

**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 interest and required payments of indebtedness, repurchases of our common stock and capital expenditures necessary to support growth and productivity improvement.

The following table presents our available sources of liquidity as of June 30, 2011:

| (in millions of U.S. dollars)                | Facility<br>Amount | Amount<br>Outstanding | Available |
|----------------------------------------------|--------------------|-----------------------|-----------|
| Cash and cash equivalents                    |                    |                       | \$ 119.0  |
| Debt facilities:                             |                    |                       |           |
| New Senior Secured Revolving Credit Facility | \$ 100.0           | 61.0(a)               | 39.0      |
| Total Available                              |                    |                       | \$ 158.0  |

(a) Represents \$50.0 million outstanding under the new senior secured revolving line of credit and \$11.0 million in outstanding letters of credit.

**Table of Contents*****Sources and Uses of Cash and Cash Equivalents***

Cash and cash equivalents totaled \$119.0 million at June 30, 2011 compared to \$245.9 million at December 31, 2010. This decrease in cash and cash equivalents was comprised of net cash provided by operating activities of \$91.0 million, offset by net cash used in investing activities of \$10.1 million and net cash used in financing activities of \$208.6 million during the six months ended June 30, 2011.

*Operating Activities* Net cash provided by operating activities was \$91.0 million for the six months ended June 30, 2011. In addition to cash received related to our net earnings, the following changes in assets and liabilities affected cash from operating activities for the six months ended June 30, 2011:

a net cash inflow of \$46.9 million associated with the decrease in accounts receivable, net, which was offset by net cash outflows of \$9.4 million and \$8.4 million related to decreases in accounts payable and progress billings, respectively; and

a reduction of \$41.0 million in accrued expenses due primarily to accrued incentive and profit sharing payments made during the six months ended June 30, 2011.

*Investing Activities* Net cash used in investing activities was \$10.1 million for the six months ended June 30, 2011, which reflects capital acquisitions of property, plant and equipment of \$11.6 million, offset by proceeds of \$1.5 million related to the sales of property, plant and equipment and available-for-sale securities.

*Financing Activities* Net cash used in financing activities was \$208.6 million for the six months ended June 30, 2011, which resulted from \$350.0 million in proceeds from the new senior secured credit facility (described below), \$260.0 million in proceeds related to the issuance of the 2021 Notes (described below) and \$4.7 million of proceeds from stock option exercises, offset by \$706.2 million of principal payments of long-term debt, primarily related to the repayment and termination of the prior senior secured credit facility (described below) and the cash tender offer, consent solicitation and redemption of the 2015 Notes (described above) and \$11.3 million of costs associated with the new senior secured credit facility and issuance of the 2021 Notes. In addition, during the six months ended June 30, 2011, we repurchased \$105.9 million, or 3,766,852 shares, of our common stock at an average price of \$28.10 per share.

***Current and Long-term Debt***

As of June 30, 2011, we had outstanding \$610.1 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, \$300.0 million and \$50.0 million under the term loan A and revolving credit facility 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 June 30, 2011, we had total outstanding letters of credit of approximately \$11.0 million.

***Senior Secured Credit Facility***

*General* On June 27, 2011, we entered into a new 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 new senior secured credit facility). The new 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 new 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, 10% during the third year, 15% during the fourth year and 11.25% during the fifth year, 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 million, 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 (the revolving line of credit ), of which \$50.0 million was drawn at closing and remains outstanding as of June 30, 2011 (exclusive of outstanding letters of credit described below); and

an incremental facility pursuant to which, prior to the maturity of the new 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 new 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 the Term Loan B and Delayed Draw Term Loan portions of 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 new senior secured credit facility.

All borrowings under our new 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 June 30, 2011, we had approximately \$39.0 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 \$11.0 million in standby letters of credit outstanding as of June 30, 2011).

*Interest and Fees* Borrowings under our new 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 an Adjusted LIBO Rate (as defined in the credit agreement governing the new senior secured credit facility) (the Eurodollar Rate ), 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 initially 0.75% per annum for Base Rate loans and 1.75% per annum for Eurodollar Rate loans. Beginning with the delivery of the financial statements and the compliance certificate for the quarter ending September 30, 2011, the margins applicable to the borrowings under our new 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 8 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 new 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 2033 Secured Notes on an equal and ratable basis with the indebtedness under our new senior secured credit facility to the extent required by the indenture governing such notes.

*Prepayments* The new 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 new 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 new 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 new 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 new 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 new senior secured credit facility as of June 30, 2011:

|                                                     | <b>Required Ratio</b>     | <b>Actual Ratio</b> |
|-----------------------------------------------------|---------------------------|---------------------|
| <b>Maximum consolidated leverage ratio</b>          | No greater than 3.50:1.00 | 1.90:1.00           |
| <b>Minimum consolidated interest coverage ratio</b> | No less than 3.00:1.00    | 7.25:1.00           |

In addition, we are required to give notice to the administrative agent and the lenders under our new 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 new 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 new 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 new senior secured credit facility.

***8<sup>1</sup>/<sub>4</sub>% 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<sup>1</sup>/<sub>4</sub>% Senior Notes due 2015 (the 2015 Notes ) and to amend the indenture governing the 2015 Notes, which we refer to as 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.

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During the three and six months ended June 30, 2010, we purchased \$297.8 million aggregate principal amount of the 2015 Notes pursuant to a cash tender offer and open market repurchases.

***6<sup>5</sup>/<sub>8</sub>% Senior Notes due 2021***

On January 28, 2011, we issued in a private placement \$260.0 million aggregate principal amount of our 6<sup>5</sup>/<sub>8</sub>% 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.

Interest on the 2021 Notes is payable every six months on February 1 and August 1, commencing August 1, 2011. 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:

| <b>Year</b>         | <b>Percentage</b> |
|---------------------|-------------------|
| 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 prices 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.

***Senior Secured Convertible Notes due 2033***

In May 2003, we issued \$239,794,000 aggregate principal amount of the 2033 Secured Notes in a private placement transaction at an issue price of \$667.24 per note, resulting in gross proceeds to us of \$160.0 million. During the second quarter of 2008, we conducted a cash tender offer for the 2033 Secured Notes that was intended to satisfy the put rights of the holders of such notes that were exercisable on May 22, 2008 under the indenture governing such notes. Pursuant to the tender offer, we repurchased an aggregate principal amount of \$239.7 million (or \$159.9 million net of discount) for an aggregate of \$159.9 million. We used the delayed draw term loan portion of our prior senior secured credit facility to finance the tender offer. As of June 30, 2011, an aggregate principal amount of \$85,000 (or approximately \$60,000 net of discount) of the 2033 Secured Notes remained outstanding pursuant to the 2033 Secured

Notes indenture.

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***Additional Provisions***

The indenture governing the 2033 Secured Notes 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.

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, by exercising rights to call, by satisfying put obligations, or in privately negotiated transactions or otherwise.

***Other Indebtedness***

We have entered into various interest rate swap agreements. For further detail regarding these agreements, see Note 8 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q.

***Covenant Compliance***

As of June 30, 2011, we were in compliance with all of our indenture and new senior secured credit facility covenants.

***Off-balance Sheet Arrangements***

As of June 30, 2011, 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 \$11.6 million for the six months ended June 30, 2011, and are expected to be an aggregate amount of approximately \$30.0 million for the 2011 fiscal year. It is expected these expenditures will be made using funds provided by operations.

***Recent Accounting Pronouncements***

See Note 1 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for further details of new accounting pronouncements.

***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 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 2010 Form 10-K.

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**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 described above, our borrowings under our new senior secured credit facility are subject to a variable rate of interest. In December 2009, we entered into an interest rate swap agreement with an effective date of December 31, 2010 and an initial notional amount of \$300.0 million, which amortizes by \$40.0 million at the end of each quarter subsequent to the effective date to \$100.0 million for the quarter ended June 30, 2012, the expiration date of the interest rate swap agreement. This interest rate swap agreement effectively fixes, at 3.755%, the interest rate for the portion of our variable rate debt outstanding under our new senior secured credit facility equal to the outstanding notional amount of the interest rate swap agreement. As of June 30, 2011, the notional amount of this interest rate swap agreement was \$220.0 million and the fair value of this derivative was a liability of \$2.7 million.

As of June 30, 2011, the variable rate indebtedness outstanding under our new senior secured credit facility in excess of the outstanding notional amount of the interest rate swap agreement described above was an aggregate principal amount of \$130.0 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 agreement or enter into a new interest rate swap agreement, our debt service obligations on our variable rate indebtedness would increase by a total of \$13.5 million between July 1, 2011 and June 27, 2016, the maturity date of the new senior secured credit facility. However, as a result of the interest rate swap agreement we entered into on July 6, 2011, the increase in our debt service obligations under the same scenario would be \$7.2 million.

**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 June 30, 2011, we had commitments to purchase \$10.7 million in Mexican pesos and \$0.3 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 June 30, 2011 that has materially affected, or is likely to materially affect, internal control over financial reporting.

**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

**News**

On February 4, 2010, we executed a settlement agreement and release (the "Settlement Agreement") settling our outstanding lawsuits against News America Incorporated, a/k/a News America Marketing Group, News America Marketing, FSI, Inc. a/k/a News America Marketing FSI, LLC and News America Marketing In-Store Services, Inc. a/k/a News America Marketing In-Store Services, LLC (collectively "News"). The operative complaint alleged violations of the Sherman Act and various state competitive statutes and the commission of torts by News in connection with the marketing and sale of FSI space and in-store promotion and advertising services. Pursuant to the terms of the Settlement Agreement,



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News paid us \$500.0 million and entered into a 10-year shared mail distribution agreement with our subsidiary, Valassis Direct Mail, Inc., which provides for our sale of certain shared mail services to News on specified terms. In connection with the settlement, the parties worked with the United States District Court for the Eastern District of Michigan (the Court), under the Honorable Arthur J. Tarnow, on a set of procedures to handle future disputes among the parties with respect to conduct at issue in the litigation. The Court issued the order on this matter on June 15, 2011. The settlement resolves all outstanding claims between us and News as of February 4, 2010. As a result, the parties agreed to dismiss all outstanding litigation between them and release all existing and potential claims against each other that were or could have been asserted in the litigation as of the date of the Settlement Agreement.

We are involved in various other 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 Annual Report on Form 10-K for the year ended December 31, 2010, or 2010 Form 10-K, which could materially affect our business, financial condition and future results. As previously disclosed in this Quarterly Report on Form 10-Q, we recently refinanced our senior secured credit facility. Accordingly, any reference to our senior secured credit facility contained in the risk factors of our 2010 Form 10-K shall now refer to the new senior secured credit facility we entered into in June 2011. In addition, as previously disclosed in this Quarterly Report on Form 10-Q, we entered into a new interest rate swap agreement in July 2011. The following risks should be considered in lieu of the risks set forth in our 2010 Form 10-K under the same heading.

***Some of our debt, including borrowings under our senior secured credit facility, is based on variable rates of interest, which could result in higher interest expense in the event of an increase in interest rates.***

As of June 30, 2011, \$350.0 million of our \$610.1 million aggregate indebtedness was subject to variable interest rates. However, in December 2009, we entered into an interest rate swap agreement with an effective date of December 31, 2010 and an initial notional amount of \$300.0 million, which effectively fixes the interest rate for an amortizing notional amount of this variable rate debt under our senior secured credit facility at an interest rate of 4.255%. The notional amount of \$300.0 million amortizes by \$40.0 million at the end of every quarter until it reaches \$100.0 million for the quarter ended June 30, 2012, the expiration date. In July 2011, we entered into a new interest rate swap agreement with an effective date of June 30, 2012, which effectively fixes the interest rate for an amortizing notional amount (initially \$186.3 million) of this variable rate debt under our senior secured credit facility at an interest rate of 3.6195% per annum and expires on June 30, 2015. Our remaining variable rate indebtedness, which was an aggregate principal amount of \$130.0 million outstanding under our senior secured credit facility as of June 30, 2011 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 (as defined in the credit agreement governing the new senior secured credit facility), the interest rate currently applicable to this variable rate debt, 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 \$13.5 million between January 1, 2011 and June 27, 2016, the maturity date of the term loan and revolving line of credit under the senior secured credit facility, which would affect our cash flows and results of operations. If we borrow additional amounts under the revolving loan portion of our senior secured credit facility, our interest rate risk may increase.

The risks described above and in our 2010 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.



**Table of Contents****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 June 30, 2011:

| <b>Period</b>                   | <b>Total<br/>Number of<br/>Shares<br/>Purchased</b> | <b>Average<br/>Price<br/>Paid per<br/>Share<br/>(including<br/>broker<br/>commissions)</b> | <b>Total Number<br/>of Shares<br/>Purchased<br/>as Part of<br/>Publicly<br/>Announced Plan<br/>(a)</b> | <b>Maximum<br/>Number<br/>of Shares that<br/>May<br/>Yet be<br/>Purchased<br/>under the Plan<br/>(b)</b> |
|---------------------------------|-----------------------------------------------------|--------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------|
| April 1, 2011 to April 30, 2011 |                                                     | \$                                                                                         |                                                                                                        | 2,734,368                                                                                                |
| May 1, 2011 to May 31, 2011     | 1,535,766                                           | \$ 27.91                                                                                   | 1,535,766                                                                                              | 7,198,602(c)                                                                                             |
| June 1, 2011 to June 30, 2011   | 608,301                                             | \$ 28.71                                                                                   | 608,301                                                                                                | 6,590,301                                                                                                |
|                                 | 2,144,067                                           | \$ 28.14                                                                                   | 2,144,067                                                                                              |                                                                                                          |

(a) 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 this share repurchase plan.

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

(c) In May 2011, our Board of Directors approved an increase of 6 million shares to our August 25, 2005 share repurchase plan.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. REMOVED AND RESERVED****ITEM 5. OTHER INFORMATION**

None.

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**ITEM 6. EXHIBITS**

| Exhibit Number | Description                                                                                                                                                                                                                                                                                                                                                                                                                                        |
|----------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 4.1            | Second Supplemental Indenture, dated as of June 27, 2011, between Valassis Communications, Inc. and The Bank of New York Mellon Trust Company, N.A., as trustee, to the Indenture dated as of May 22, 2003 (incorporated by reference to Exhibit 4.1 to Valassis Form 8-K (SEC File No. 001-10991) filed on July 1, 2011)                                                                                                                          |
| 10.1           | Credit Agreement, dated as of June 27, 2011, by and among Valassis Communications, Inc., JPMorgan Chase Bank, N.A., as administrative agent, and J.P. Morgan Securities LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated and RBS Securities Inc., as joint bookrunners and joint lead arrangers, and a syndicate of lenders (incorporated by reference to Exhibit 10.1 to Valassis Form 8-K (SEC File No. 001-10991) filed on July 1, 2011) |
| 10.2           | Guarantee and Collateral Agreement, dated as of June 27, 2011, by and among Valassis Communications, Inc. and certain of its domestic subsidiaries signatory thereto, as grantors, in favor of JPMorgan Chase Bank, N.A., in its capacity as administrative agent for the benefit of the secured parties thereunder (incorporated by reference to Exhibit 10.2 to Valassis Form 8-K (SEC File No. 001-10991) filed on July 1, 2011)                |
| 31.1           | Section 302 Certification of Alan F. Schultz                                                                                                                                                                                                                                                                                                                                                                                                       |
| 31.2           | Section 302 Certification of Robert L. Recchia                                                                                                                                                                                                                                                                                                                                                                                                     |
| 32.1           | Section 906 Certification of Alan F. Schultz                                                                                                                                                                                                                                                                                                                                                                                                       |
| 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.LAB*       | XBRL Taxonomy Extension Label Linkbase                                                                                                                                                                                                                                                                                                                                                                                                             |
| 101.PRE*       | XBRL Taxonomy Extension Presentation Linkbase                                                                                                                                                                                                                                                                                                                                                                                                      |

\* 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: August 9, 2011

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**

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