MEMBERWORKS INC
Form 10-Q
February 12, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2001

Commission File No. 0-21527

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

DELAWARE	06-1276882
(State of Incorporation)	(I.R.S. Employer Identification No.)
9 West Broad Street; Stamford, Connecticut	06902
(Address of principal executive offices)	(Zip Code)

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

Indicate by checkmark 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, and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

The number of shares outstanding of the Registrant's capital stock:

14,279,333 shares of Common Stock, $0.01 par value as of January 31, 2002.

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MEMBERWORKS INCORPORATED

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

ASSETS	December 2001 (unaudite
Current assets:	
Cash and cash equivalents	$ 47,30
Marketable securities	3,20
Accounts receivable	12,75
Prepaid membership materials	4,19
Prepaid expenses	4,19
Membership solicitation and other deferred costs	135,22
Total current assets	206,86
Fixed assets, net	34,58
Goodwill, net	42,03
Intangible assets, net	8,87
Other assets	2,12
Total assets	$ 294,49

LIABILITIES AND SHAREHOLDERS' DEFICIT

Current liabilities:

Current maturities of long-term obligations	$ 65
Accounts payable	37,45
Accrued liabilities	58,71
Due to related parties	
Deferred membership fees	208,27
Total current liabilities	305,09
Long-term liabilities	4,82
Total liabilities	309,92
Minority interest	
Mandatorily redeemable convertible preferred securities of subsidiary	
Shareholders' deficit:	
Preferred stock, $0.01 par value - 1,000 shares authorized; no shares issued	
Common stock, $0.01 par value - 40,000 shares authorized; 17,437 shares issued (17,308 shares at June 30, 2001)	17
Capital in excess of par value	108,89
Accumulated deficit	(54,91
Accumulated other comprehensive loss	(62
Treasury stock, 3,059 shares at cost (1,920 shares at June 30, 2001)	(68,96
Total shareholders' deficit	(15,43
Total liabilities and shareholders' deficit	$ 294,49

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

MEMBERWORKS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(In thousands, except per share data)

	Three months ended December 31,	
	2001	2000
Revenues	$ 102,684	$ 117,616
Expenses:		
Operating	19,508	21,711
Marketing	57,444	76,637
General and administrative	18,570	23,997
Restructuring and other charges (Note 4)	6,893	-
Amortization of intangible assets	440	2,827
Operating loss	(171)	(7,556)
Gain on sale of subsidiary (Note 5)	-	-
Net loss on investment (Note 5)	(9,043)	(2,401)
Other income (expense), net	54	(242)

(Loss) income before equity in affiliate and minority interest	(9,160)	(10,199)
Equity in income of affiliate	-	-
Minority interest (Note 6)	-	2,932
(Loss) income before income taxes	(9,160)	(7,267)
Provision for income taxes	-	-
(Loss) income before cumulative effect of accounting change	(9,160)	(7,267)
Cumulative effect of accounting change (Note 2)	-	-
Net (loss) income	$ (9,160)	$ (7,267)
Basic (loss) earnings per share:		
(Loss) income before cumulative effect of accounting change	$ (0.62)	$ (0.48)
Cumulative effect of accounting change	-	-
Basic (loss) earnings per share	$ (0.62)	$ (0.48)
Diluted (loss) earnings per share:		
(Loss) income before cumulative effect of accounting change	$ (0.62)	$ (0.48)
Cumulative effect of accounting change	--	--
Diluted (loss) earnings per share	$ (0.62)	$ (0.48)
Weighted average common shares used in (loss) earnings per share calculations:		
Basic	14,789	15,274
Diluted	14,789	15,274

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

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MEMBERWORKS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In thousands)

	Six months December
	2001
OPERATING ACTIVITIES	
Net income (loss)	$ 25,284
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:	
Cumulative effect of accounting change	5,907

Gain on sale of subsidiary	(65,608)
Net loss on investment	31,339
Restructuring and other charges	1,585
Minority interest	(450)
Equity in income of affiliate	--
Revenues before deferral	206,697
Revenues recognized	(221,648)
Marketing costs before deferral	(125,446)
Marketing costs expensed	134,234
Depreciation and amortization	6,677
Other	688
Changes in assets and liabilities:	
Accounts receivable	6,358
Prepaid membership materials	(1,173)
Prepaid expenses	(2,087)
Other assets	32
Related party payables	12
Accounts payable	(6,241)
Accrued liabilities and other	455
Net cash (used in) provided by operating activities	(3,385)
INVESTING ACTIVITIES	
Acquisition of fixed assets	(2,999)
Proceeds from sale of subsidiary, net of cash sold	45,997
Business combinations, net of cash acquired	--
Net cash provided by (used in) investing activities	42,998
FINANCING ACTIVITIES	
Net proceeds from issuance of stock and warrants	1,196
Net borrowings from credit facility	--
Treasury stock purchases	(15,665)
Payments of long-term obligations	(359)
Net cash (used in) provided by financing activities	(14,828)
Effect of exchange rate changes on cash and cash equivalents	(221)
Net increase in cash and cash equivalents	24,564
Cash and cash equivalents at beginning of period	22,736
Cash and cash equivalents at end of period	$ 47,300

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

MEMBERWORKS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, such statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six months ended December 31, 2001 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2002. For further information, refer to the financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K with respect to the fiscal year ended June 30, 2001.

Certain reclassifications have been made to prior period financial statements to conform to the current presentation of the financial statements.

NOTE 2 - CUMULATIVE EFFECT OF ACCOUNTING CHANGE

Adoption of SFAS 142

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), which is effective for fiscal years beginning after December 15, 2001. Early adoption is permitted for entities with fiscal years beginning after March 15, 2001, provided that the first interim financial statements have not been previously issued. The Company adopted SFAS 142 effective July 1, 2001. SFAS 142 addresses how intangible assets that are acquired individually or with a group of other assets should be accounted for in the financial statements upon their acquisition and after they have been initially recognized in the financial statements. SFAS 142 requires that goodwill and intangible assets that have indefinite useful lives not be amortized but rather tested at least annually for impairment, and intangible assets that have finite useful lives be amortized over their useful lives.

With the adoption of SFAS 142, the Company reassessed the useful lives and residual values of all acquired intangible assets to make any necessary amortization period adjustments. Based on that assessment, only goodwill was determined to have an indefinite useful life and no adjustments were made to the amortization period or residual values of other intangible assets. The Company determined that there was an impairment of goodwill of $5,907,000 at one of its reporting units due to the change in methodology of calculating impairment under SFAS 142 and recent downward trends in the operations of the reporting unit (see Note 8). This amount was recorded as a cumulative effect of accounting change in the statement of operations in the fiscal quarter ended September 30, 2001.

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MEMBERWORKS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following pro forma net income and earnings per share have been prepared assuming SFAS 142 was adopted as of July 1, 2000. Pro forma balances have been adjusted to exclude goodwill amortization expense which is no longer recorded under the provisions of SFAS 142 (in thousands, except per share data).

	Three Months Ended December 31,

	2001	2000	
Net (loss) income from continuing operations:			
Reported net (loss) income from continuing operations	$ (9,160)	$ (7,267)	$
Indefinite lived intangible asset amortization	--	2,006	
Adjusted net (loss) income from continuing operations	$ (9,160)	$ (5,261)	$
Basic (loss) earnings per share:			
Reported (loss) earnings per share	$ (0.62)	$ (0.48)	$
Indefinite lived intangible asset amortization	--	0.13	
Adjusted (loss) earnings per share	$ (0.62)	$ (0.34)	$
Diluted (loss) earnings per share:			
Reported (loss) earnings per share	$ (0.62)	$ (0.48)	$
Indefinite lived intangible asset amortization	--	0.13	
Adjusted (loss) earnings per share	$ (0.62)	$ (0.34)	$

Adoption of SAB 101

The Company adopted Staff Accounting Bulletin 101, "Revenue Recognition in Financial Statements" ("SAB 101") as of July 1, 2000. SAB 101 establishes the Security and Exchange Commission's (the "Staff") preference that membership fees should not be recognized in earnings prior to the expiration of refund privileges. Effective July 1, 2000, the Company changed its method of accounting for membership fee revenue to comply with the Staff's preferred method as outlined in SAB 101. Membership fees, and the related direct costs associated with acquiring the underlying memberships, are no longer recognized on a pro-rata basis over the corresponding membership period, but instead are recognized in earnings upon the expiration of membership refund privileges. The cumulative effect of this change in accounting principle as of July 1, 2000 of $25,730,000 was recorded in the fiscal quarter ended September 30, 2000. The membership fees, net of estimated refunds and associated direct costs, which were deferred as part of the cumulative effect adjustment at July 1, 2000 were recognized in earnings during fiscal year 2001 as the underlying refund privileges expired. During the three and six months ended December 31, 2000, the Company recognized $22,142,000 and $53,877,000, respectively, of revenue which was included as a component of the cumulative effect of accounting change booked July 1, 2000.

MEMBERWORKS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 3 - EARNINGS PER SHARE

Basic and diluted (loss) earnings per share amounts are determined in accordance with the provisions of FASB Statement No. 128 "Earnings Per Share". The following table sets forth the reconciliation of the numerators and denominators in the computation of basic and diluted (loss) earnings per share (in thousands, except per share data):

	Three months ended December 31,	
	2001	2000
Numerator for basic and diluted (loss) earnings per share:		
Net (loss) income before cumulative effect of accounting change	$ (9,160)	$ (7,267)
Cumulative effect of accounting change	--	--
Net (loss) income	$ (9,160)	$ (7,267)
Denominator for basic (loss) earnings per share:		
Weighted average number of common shares outstanding - basic	14,789	15,274
Effect of dilutive securities:		
Options	--	--
Weighted average number of common shares outstanding - diluted	14,789	15,274
Basic (loss) earnings per share	$ (0.62)	$ (0.48)
Diluted (loss) earnings per share	$ (0.62)	$ (0.48)

The diluted (loss) earnings per common share calculation excludes the effect of potentially dilutive shares when their effect is antidilutive. For the three and six months ended December 31, 2001, the Company had 4,553,000 and 3,479,000, respectively, of potentially dilutive stock options outstanding that are not included in the calculation as they are antidilutive. For the three and six months ended December 31, 2000, the Company had 3,075,000 and 3,041,000, respectively, of potentially dilutive stock options outstanding that are not included in the calculation as they are antidilutive.

NOTE 4 - RESTRUCTURING AND OTHER CHARGES

On October 11, 2001, the Company announced the implementation of several cost saving initiatives due to a recent slowdown in consumer response rates and increased economic uncertainty in both the U.S. and abroad. This restructuring program includes a workforce reduction, the closing of the Company's United Kingdom operations and the downsizing of the operational infrastructure throughout the Company.

As a result of the restructuring program, the Company recorded restructuring and other charges of $6,893,000 which are included in the operating loss for the three months ended December 31, 2001.

The major components of the restructuring and other charges and the remaining

accrual balances as of December 31, 2001 are as follows (in thousands):

	Total Charges	Non-cash Charges to date	Cash Charges to date
Workforce reduction	$ 2,214	$ -	$ 1,098
Lease obligations	3,094	-	152
Asset disposals	1,585	1,585	-
Total	$ 6,893	$ 1,585	$ 1,250

Workforce Reduction

As part of the restructuring plan announced on October 11, 2001, the Company reduced its workforce by approximately 190 regular employees, consisting of membership service representatives and other professional personnel. As of December 31, 2001, all 190 employees have been terminated.

Lease Obligations and Asset Write-Downs

In connection with the closing of the United Kingdom offices and the downsizing of the Company's infrastructure, the Company recorded $73,000 for lease terminations, $3,021,000 for non-cancelable lease obligations and $1,585,000 for asset disposals and write-downs related to the closing of our United Kingdom operations.

NOTE 5 - GAIN ON SALE OF SUBSIDIARY/LOSS ON INVESTMENT

In August 2001, the Company sold its investment in and advances to iPlace, Inc. in exchange for $50,111,000 in cash, including $3,703,000 held in escrow, and 1,601,000 shares of Homestore.com common stock, including 451,000 shares held in escrow. The fair value of the Homestore.com common stock as of the date of sale was $34,540,000. The Homestore.com common stock received is unregistered. Once the Homestore.com stock is registered, MemberWorks may only sell 1/12th of the shares in any calendar month. In connection with this sale, the Company recognized a gain of $65,608,000.

Subsequently, the investment in Homestore.com declined in value and management determined that the decline was other than temporary. As a result, the Company wrote down its investment in Homestore.com to its fair value and recognized a loss of $22,296,000 in the first fiscal quarter of 2002 and a loss of $9,043,000 in the second fiscal quarter of 2002. As of December 31, 2001, the Company's investment in Homestore.com is valued at $3,201,000.

NOTE 6 - MINORITY INTEREST

Prior to the sale of iPlace, Inc. in August 2001, the Company was the majority shareholder of iPlace, Inc. with an approximate 58% ownership share. Minority interest in the statement of operations for the six months ended December 31, 2001 represents approximately 42% of iPlace's losses incurred from July 1, 2001 through the date of the sale.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 7 - COMPREHENSIVE INCOME

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

	Three months ended December 31,		Si
	2001	2000	2
Net (loss) income	$ (9,160)	$ (7,267)	$ 2
Unrealized loss on marketable securities	--	--	
Reclassification adjustment for losses included in net loss	--	532	
Foreign currency translation (loss) gain	(87)	106	
Comprehensive (loss) income	$ (9,247)	$ (6,629)	$ 2

NOTE 8 - GOODWILL AND OTHER INTANGIBLE ASSETS

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

	As of December 31, 2001		As of June 30, 2001	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulat Amortizat
Amortized intangible assets:				
Membership and Client Relationships	$ 13,194	$ (4,726)	$ 17,465	$ (5,6
Non-Compete Agreements	238	(216)	3,009	(9
Other	950	(565)	950	(5
Total amortized intangible assets	$ 14,382	$ (5,507)	$ 21,424	$ (7,1
Unamortized intangible assets:				
Goodwill	$ 42,039		$ 84,814	

The gross carrying amount and accumulated amortization of amortized intangible assets at December 31, 2001 decreased from June 30, 2001 due to the sale of iPlace.

The total intangible amortization expense reflected in the statement of operations for the three and six months ended December 31, 2001 is $440,000 and $1,115,000, respectively. The future intangible amortization expense for the next five fiscal years is estimated to be as follows (in thousands):

Fiscal Year:	
2002	$ 1,172
2003	697
2004	419

2005	275
2006	183

The changes in the carrying amount of goodwill for the six months ended December 31, 2001 are as follows (in thousands):

Balance as of July 1, 2001	$ 84,814
Goodwill disposed during the first quarter due to sale of subsidiary	(36,868)
Impairment losses recorded in first quarter	(5,907)
Balance as of December 31, 2001	$ 42,039

Goodwill was tested for impairment in the quarter ending September 30, 2001 in connection with the adoption of SFAS 142. Due to the slow down in the business of one of the Company's reporting units, future cash flows for this reporting unit are expected to decline over the next few years. During the quarter ended September 30, 2001, an impairment loss of $5,907,000 was recorded to write down the goodwill related to this reporting unit to fair value. The impairment loss was calculated utilizing the methodology set forth in SFAS 142. As prescribed by SFAS 142, this write down is reflected in the statement of operations as a cumulative effect of accounting change. The fair value of this subsidiary was estimated by conducting a discounted cash flow analysis of the subsidiary's future cash flows.

NOTE 9 - ALLOWANCE FOR MEMBERSHIP CANCELLATIONS

Accrued liabilities set forth in the accompanying condensed consolidated balance sheets as of December 31, 2001 and June 30, 2001 include an allowance for membership cancellations of $25,892,000 and $30,004,000, respectively.

NOTE 10 - LEGAL PROCEEDINGS

Except as set forth below, in management's opinion, there are no significant legal proceedings to which the Company or any of its subsidiaries is a party or to which any of their properties are subject. The Company is involved in other lawsuits and claims generally incidental to its business. In addition, from time to time, and in the regular course of its business, the Company receives inquiries from various federal and/or state regulatory authorities.

In January 2001, an action was instituted by plaintiff Brandy L. Ritt against the Company and other defendants in the Court of Common Pleas in Cuyahoga County, Ohio. The suit, which seeks unspecified monetary damages, alleges that the Company and the other defendants violated various provisions of Ohio's consumer protection laws in connection with the marketing of certain membership programs offered by the Company. The plaintiff's motion to have the suit certified as a class action was denied on February 6, 2002. The Company believes that the claims asserted against it are unfounded and the Company will vigorously defend its interests against this suit.

In March 2001, an action was instituted by plaintiff Teresa McClain against Coverdell & Company ("Coverdell"), a wholly-owned subsidiary of the Company, Monumental Life Insurance Company and other defendants in the United States District Court for the Eastern District of Michigan, Southern Division. The suit, which seeks unspecified monetary damages, alleges that Coverdell and the other defendants violated the Michigan Consumer Protection Act and other applicable Michigan laws in connection with the marketing of Monumental Life Insurance Company insurance products. The complaint includes a claim that the suit should be certified as a class action and the plaintiff has filed a motion for class certification to which all of the defendants have filed opposing papers regarding the same. The court has not ruled on the motion. The Company believes that the claims asserted against Coverdell are unfounded and the Company and Coverdell will vigorously defend their interests against this suit.

In June 2001, actions were instituted by plaintiffs Judith Jeselskis and Marcia Walters against the Company and other defendants in Circuit Court of the Tenth Judicial District, Highlands County Civil Division, Florida, and Circuit Court of the Sixth Judicial Circuit, Pinellas County Civil Division, Florida, respectively. The suits, which seek unspecified monetary damages, allege that the Company and the other defendants violated the Florida Deceptive and Unfair Trade Practices Act, in connection with the marketing of certain membership programs offered by the Company. While the respective complaints include claims that the suits should be certified as class actions, the plaintiffs have not filed motions for class certification. The Company believes that the allegations made in this lawsuit are unfounded and the Company will vigorously defend its interests against the suits.

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MEMBERWORKS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

In July 2001, an action was instituted by Alan Stone against the Company and other defendants in Superior Court of the State of California, County of Orange. The suit, which seeks unspecified monetary damages, alleges that the Company and the other defendants violated California business practices law. While the complaint includes a claim that the suit should be certified as a class action, the plaintiff has not filed a motion for class certification. The Company believes that the allegations made in this lawsuit are unfounded and the Company will vigorously defend its interests against this suit.

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MEMBERWORKS INCORPORATED

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

OVERVIEW

MemberWorks addresses the needs of organizations seeking to leverage the expertise of an outside provider in offering membership service programs. Membership service programs offer selected products and services from a variety of vendors intended to enhance existing relationships between businesses and consumers. The Company derives its revenues principally from annually renewable membership fees. The Company receives full payment of annual fees at or near the beginning of the membership period, but recognizes revenue as the member's refund privilege expires. Similarly, the costs associated with soliciting each new member, as well as the cost of royalties, are recognized as the related

revenue is recognized. Profitability and cash flow generated from renewal memberships exceed that of new memberships due to the absence of solicitation costs associated with new member procurement.

THREE MONTHS ENDED DECEMBER 31, 2001 VS. THREE MONTHS ENDED DECEMBER 31, 2000

REVENUES. Revenues decreased 13% to $102.7 million for the quarter ended December 31, 2001 from $117.6 million for the quarter ended December 31, 2000 due to the effect of the timing of amortization of revenues deferred in prior periods and the effect of the sale of iPlace, Inc. Revenues before deferral decreased 16% to $101.2 million for the quarter ended December 31, 2001 from $120.5 million for the quarter ended December 31, 2000 due to the effect of the sale of iPlace and a decrease in the net members during the quarter. The Company's membership base decreased to approximately 6.5 million members at December 31, 2001 from 7.8 million members at December 31, 2000. The decrease in the Company's membership base was due to a lower level of new member marketing, the sale of iPlace and the closing of the United Kingdom operations. As a percentage of total revenues, renewal revenues were 56% in 2001 and 46% in 2000. As a percentage of total revenues before deferrals, renewal revenues were 56% in 2001 and 45% in 2000.

OPERATING EXPENSES. Operating expenses decreased 10% to $19.5 million in 2001 from $21.7 million in 2000 primarily due to the effect of the sale of iPlace, Inc. As a percentage of revenues before deferral, operating expenses increased to 19.3% in 2001 from 18.0% in 2000 primarily due to the effect of lower revenues reported this quarter.

MARKETING EXPENSES. Marketing expenses decreased 25% to $57.4 million in 2001 from $76.6 million in 2000 and, as a percent of revenue, decreased to 55.9% in 2001 from 65.2% in 2000. These decreases were due to the effect of a lower level of new member marketing and the sale of iPlace, Inc. The lower level of new member marketing resulted in an increase in the ratio of renewal member revenues to total revenues. Marketing expenses related to renewal revenues are typically lower than expenses related to new member revenues. Expenses related to new member marketing, as a percent of new member revenues, increased in 2001 compared to 2000 primarily due to a decrease in consumer response rates. Marketing expenses before deferral decreased 25% to $55.1 million in 2001 from $73.7 million in 2000 and, as a percent of revenues, decreased to 54.4% in 2001 from 61.2% in 2000. These decreases were due to the effect of a lower level of new member marketing and the sale of iPlace, Inc.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses decreased 23% to $18.6 million in 2001 from $24.0 million in 2000 primarily due to the effect of the sale of iPlace, Inc. As a percentage of revenues before deferral, general and administrative expenses decreased to 18.3% in 2001 from 19.9% in 2000 due to the sale of iPlace, Inc. and cost saving initiatives related to the restructuring.

RESTRUCTURING AND OTHER CHARGES. In October 2001, the Company implemented certain cost saving initiatives due to a recent slowdown in consumer response rates and increased economic uncertainty in both the U.S. and abroad. This restructuring program includes a workforce reduction of approximately 190 employees, the closing of the Company's United Kingdom operations and the downsizing of the operational infrastructure throughout the Company. As a result

of this restructuring program, the Company recorded restructuring and other charges of $6.9 million during the second quarter ending December 31, 2001.

AMORTIZATION OF GOODWILL AND OTHER INTANGIBLES. Intangible amortization decreased to $0.4 million in 2001 from $2.8 million in 2000 due to the adoption of SFAS 142, which no longer requires the amortization of indefinite lived intangible assets. Excluding the amortization of indefinite lived intangible assets in 2000, amortization of goodwill and other intangibles would have been $0.8 million.

OTHER INCOME/EXPENSE, NET. Other income/expense, net is primarily composed of interest income from cash and cash equivalents and interest expense on the Company's borrowings under its line of credit. Other income was $0.1 million in 2001 compared to expense of $0.2 million in 2000 due to the increase in the Company's cash balance. In addition, the Company had no borrowings under its line of credit during the quarter.

PROVISION FOR INCOME TAXES. The Company was not required to record a provision for income taxes for the three months ended December 31, 2001 and 2000 due to tax losses realized in those periods.

SIX MONTHS ENDED DECEMBER 31, 2001 VS. SIX MONTHS ENDED DECEMBER 31, 2000

REVENUES. Revenues increased 3% to $221.6 million for the six months ended December 31, 2001 from $215.4 million for the six months ended December 31, 2000 primarily due to the effect of the timing of amortization of revenues deferred in prior periods. Revenues before deferral decreased 12% to $206.7 million for the six months ended December 31, 2001 from $233.9 million for the six months ended December 31, 2000. The Company's membership base decreased to approximately 6.5 million members at December 31, 2001 from 7.8 million members at December 31, 2000 due to a lower level of new member marketing, the sale of iPlace, Inc. and the closing of the United Kingdom operations. As a percentage of total revenues, renewal revenues were 54% in 2001 and 45% in 2000. As a percentage of total revenues before deferrals, renewal revenues were 56% in 2001 and 45% in 2000.

OPERATING EXPENSES. Operating expenses decreased 3% to $40.6 million in 2001 from $42.0 million in 2000 primarily due to the sale of iPlace, Inc. As a percentage of revenues before deferral, operating expenses increased to 19.6% in 2001 from 17.9% in 2000 primarily due to the effect of lower revenues reported in 2001.

MARKETING EXPENSES. Marketing expenses decreased 3% to $134.2 million in 2001 from $137.9 million in 2000 and, as a percent of revenue, decreased to 60.6% in 2001 from 64.0% in 2000. These decreases were due to the effect of a lower level of new member marketing and the sale of iPlace, Inc. The lower level of new member marketing resulted in an increase in the ratio of renewal member revenues to total revenues. Marketing expenses related to renewal revenues are typically lower than expenses related to new member revenues. Expenses related to new member marketing, as a percent of new member revenues, increased in 2001 compared to 2000 primarily due to a decrease in consumer response rates. Marketing expenses before deferral decreased 14% to $125.4 million in 2001 from $146.4 million in 2000 and, as a percent of revenues, decreased to 60.7% in 2001 from 62.6% in 2000. These decreases were due to the effect of a lower level of new member marketing and the sale of iPlace, Inc.

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses decreased 13% to $41.6 million in 2001 from $47.6 million in 2000 primarily due to the effect of the sale of iPlace, Inc. As a percentage of revenues before deferral, general and administrative expenses decreased to 20.1% in 2001 from 20.4% in 2000 primarily due to the effect of the sale of iPlace, Inc. and cost saving initiatives related to the restructuring.

RESTRUCTURING AND OTHER CHARGES. In October 2001, the Company implemented certain cost saving initiatives due to a recent slowdown in consumer response rates and increased economic uncertainty in both the U.S. and abroad. This restructuring program includes a workforce reduction of approximately 190 employees, the closing of the Company's United Kingdom operations and the downsizing of the operational infrastructure throughout the Company. As a result of this restructuring program, the Company recorded restructuring and other charges of $6.9 million during the second quarter ending December 31, 2001.

AMORTIZATION OF GOODWILL AND OTHER INTANGIBLES. Intangible amortization decreased to $1.1 million in 2001 from $5.1 million in 2000 due to the adoption of SFAS 142, which no longer requires the amortization of indefinite lived intangible assets. Excluding the amortization of indefinite lived intangible assets in 2000, amortization of goodwill and other intangibles would have been $1.4 million.

OTHER EXPENSE/INCOME, NET. Other expense/income, net is primarily composed of interest income from cash and cash equivalents and interest expense on the Company's borrowings under its line of credit. Other expense decreased to less than $0.1 million in 2001 from expense of $0.2 million in 2000 due to the increase in the Company's cash balance. In addition, the Company had no borrowings under its line of credit during the six months ended December 31, 2001.

PROVISION FOR INCOME TAXES. In connection with the gain on the sale of iPlace, the Company recorded a provision for alternative minimum taxes of approximately $0.7 million. The Company was not required to record a provision for income taxes for the six months ended December 31, 2000.

LIQUIDITY AND CAPITAL RESOURCES

Operating cash flow before changes in assets and liabilities was negative $0.7 million for the six months ended December 31, 2001 compared to positive $3.0 million in 2000. The decrease in operating cash flow before changes in assets and liabilities was primarily due to a decrease in revenues before deferral, net of marketing costs before deferral, and the costs incurred related to the restructuring. The decrease was partially offset by decreased losses incurred related to iPlace, Inc. and the United Kingdom. Revenues before deferral decreased 12% to $206.7 million for the six months ended December 31, 2001 from $233.9 million for the six months ended December 31, 2000. The Company's membership base decreased to approximately 6.5 million members at December 31, 2001 from 7.8 million members at December 31, 2000 due to a slow down in new member marketing, the sale of iPlace, Inc. and the closing of the United Kingdom operations. Marketing expenses before deferral decreased 14% to $125.4 million in 2001 from $146.4 million in 2000 and, as a percent of revenues, decreased to 60.7% in 2001 from 62.6% in 2000. These decreases were due to the effect of a lower level of new member marketing and the sale of iPlace, Inc. The lower level of new member marketing resulted in an increase in the ratio of renewal member revenues to total revenues. Marketing expenses related to renewal revenues are typically lower than expenses related to new member revenues. Expenses related to new member marketing, as a percent of new member revenues, increased in 2001 compared to 2000 primarily due to a decrease in consumer response rates. Changes in assets and liabilities decreased cash by $2.6 million for 2001 and increased

cash by $9.0 million in 2000. In total, cash used in operations was $3.4 million for the six months ended December 31, 2001 compared to cash provided by operations of $12.0 million in 2000.

Net cash provided by investing activities was $43.0 million in 2001 compared to cash used in investing activities of $10.8 million in 2000. Net cash provided by investing activities reflected the receipt of $46.0 million in net proceeds from the sale of iPlace, Inc. Capital expenditures were $3.0 million in 2001 and $8.0 million in 2000.

Net cash used in financing activities was $14.8 million in 2001 versus net cash provided by financing activities of $0.3 million in 2000. The increase in cash used in financing activities was due to an increase in the number of treasury shares acquired under the Company's stock repurchase program. The Company purchased 1,142,000 shares for $15.7 million in 2001 and 181,000 shares for $5.1 million in 2000. On October 25, 2001, the Board of Directors authorized an additional 1 million shares to be purchased under the buyback program. As of December 31, 2001, the Company had 556,000 shares available for repurchase under its buyback program. On January 24, 2002, the Board of Directors authorized an additional 1 million shares to be purchased under the buyback program.

As of December 31, 2001, the Company had cash and cash equivalents of $47.3 million. In addition, the Company has a $28 million bank credit facility which bears interest at the higher of the base commercial lending rate for the bank or the Federal Funds Rate plus 0.5% per annum. There were no borrowings outstanding under this bank credit facility as of December 31, 2001. The available bank credit facility is temporarily limited to the sum of the compensating balance and eligible securities on deposit with the bank. Such limitations may be imposed and removed based on certain financial covenants. The bank credit facility requires MemberWorks to maintain a compensating balance of $10.0 million in addition to certain financial covenants. The Company believes that existing cash balances, together with its available bank credit facility, will be sufficient to meet its funding requirements for at least the next twelve months.

In August 2001, the Company received 1.6 million shares of Homestore.com common stock at a market value of $34.5 million. The Homestore.com common stock received is unregistered. Once the Homestore.com stock is registered, MemberWorks may only sell 1/12th of the shares in any calendar month. During the six months ended December 31, 2001, the Company wrote down its investment in Homestore.com to its fair value as of December 31, 2001 and recognized a loss of $31.3 million. Accordingly, the net gain on the sale of iPlace Inc. was $34.3 million.

The Company did not have any material commitments for capital expenditures as of December 31, 2001. The Company intends to utilize cash generated from operations and its funds available under its credit facility to fulfill any capital expenditure requirements for the remainder of fiscal 2002.

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement No. 141, "Business Combinations" ("SFAS 141"), which is effective for business combinations initiated after June 30, 2001. SFAS 141 eliminates the pooling of

interest method of accounting for business combinations and requires that all business combinations occurring on or after July 1, 2001 are accounted for under the purchase method. The Company has evaluated the impact of SFAS 141 and believes that it will not have a material impact on its financial statements.

In July 2001, the FASB issued Statement No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), which is effective for fiscal years beginning after December 15, 2001. Early adoption is permitted for entities with fiscal years beginning after March 15, 2001, provided that the first interim financial statements have not been previously issued. The Company adopted SFAS 142 effective July 1, 2001. SFAS 142 addresses how intangible assets that are acquired individually or with a group of other assets should be accounted for in the financial statements upon their acquisition and after they have been initially recognized in the financial statements. SFAS 142 requires that goodwill and intangible assets that have indefinite useful lives not be amortized but rather tested at least annually for impairment, and intangible assets that have finite useful lives be amortized over their useful lives.

With the adoption of SFAS 142, the Company reassessed the useful lives and residual values of all acquired intangible assets to make any necessary amortization period adjustments. Based on that assessment, only goodwill was determined to have an indefinite useful life and no adjustments were made to the amortization period or residual values of other intangible assets. The Company determined there was an impairment of goodwill of $5.9 million at one of its reporting units due to the change in methodology of calculating impairment under SFAS 142 and recent downward trends in the operations of the reporting unit. This amount was recorded as a cumulative effect of accounting change in the statement of operations in the fiscal quarter ended September 30, 2001.

In August 2001, the FASB issued Statement No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"), which is effective for fiscal years beginning after June 15, 2002. SFAS 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The adoption of SFAS 143 will not have a material impact on the Company's financial statements.

In October 2001, the FASB issued Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), which is effective for fiscal years beginning after December 15, 2001. SFAS 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes FASB Statement No. 121, "Accounting for the Impairment of Long-Lived Assets to be Disposed of." The adoption of SFAS 144 will not have a material impact on Company's financial statements.

FORWARD LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements that are based on current expectations, estimates, forecasts and projections about the industry in which MemberWorks operates and the Company's management's beliefs and assumptions. These forward-looking statements are made pursuant to safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements are not guarantees of future performance and are based on a number of assumptions and estimates that are inherently subject to

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

- The Company's ability to integrate into the Company's management and operations and operate successfully acquired businesses;
- Changes in the marketing techniques of credit card issuers;
- Unanticipated cancellation or termination of marketing agreements and the extent to which we can continue successful development and marketing of new products and services;
- The Company's ability to develop and implement operational and financial systems to manage rapidly growing operations;
- The Company's ability to obtain financing on acceptable terms to finance the Company's growth strategy and to operate within the limitations imposed by financing arrangements;
- Further changes in the already competitive environment for the Company's products or competitors' responses to the Company's strategies;
- Changes in the growth rate of the overall U.S. economy, or the international economies where MemberWorks does business, such that consumer spending and related consumer debt are impacted;
- Additional government regulation of the Company's industry; and
- New accounting pronouncements

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

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate

The Company has a $28.0 million bank credit facility which bears interest at the

higher of the base commercial lending rate for the bank or the Federal Funds Rate plus 0.5% per annum. There were no borrowings outstanding under this bank credit facility as of December 31, 2001. Management believes that an increase in the commercial lending rate or the Federal Funds rate would not be material to the Company's financial position or its results of operations. If the Company is not able to renew its existing credit facility agreement, which matures on April 1, 2002, it is possible that any replacement lending facility obtained by the Company may be more sensitive to interest rate changes. The Company does not currently hedge interest rates with respect to its outstanding debt.

Foreign Currency

The Company has international sales and facilities in the United Kingdom and Canada and therefore, is subject to foreign currency rate exposure. Historically, international sales have been denominated in British pounds sterling and the Canadian dollar. The functional currencies of the Company's foreign operations are the local currencies. Assets and liabilities of these subsidiaries are translated into U.S. dollars at exchange rates in effect as of the Balance Sheet date. Income and expense items are translated at average exchange rates for the period. Accumulated net translation adjustments are recorded in shareholders' equity. Foreign exchange transaction gains and losses are included in the results of operations, and were not material for all periods presented. As a result, the Company's financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic condition. To the extent the Company incurs expenses that are based on locally denominated sales volume paid in local currency, the exposure to foreign exchange risk is reduced. The Company has determined that the impact of a near-term 10% appreciation or depreciation of the U.S. dollar would have an insignificant effect on its financial position, results of operations and cash flows. The Company does not maintain any derivative instruments to mitigate the exposure to translation and transaction risk. However, this does not preclude the Company's adoption of specific hedging strategies in the future. MemberWorks will assess the need to utilize financial instruments to hedge currency exposures on an ongoing basis.

Fair Value

In August 2001, MemberWorks acquired stock in Homestore.com valued at $34.5 million in exchange for its interest in iPlace, Inc. The carrying value of this investment is affected by changes in the quoted market prices of Homestore.com common stock. The investment in Homestore.com declined in value and management determined that the decline was other than temporary. As a result, the Company wrote down its investment in Homestore.com to its fair value and recognized a loss of $31.3 million during the six months ended December 31, 2001. MemberWorks does not use derivative financial instruments for speculative or trading purposes. However, this does not preclude the Company's adoption of specific hedging strategies in the future.

MEMBERWORKS INCORPORATED

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Except as set forth below, in management's opinion, there are no significant legal proceedings to which the Company or any of its subsidiaries is a party or to which any of their properties are subject. The Company is involved in other lawsuits and claims generally incidental to its business. In addition, from time to time, and in the regular course of its business, the Company receives

inquiries from various federal and/or state regulatory authorities.

In January 2001, an action was instituted by plaintiff Brandy L. Ritt against the Company and other defendants in the Court of Common Pleas in Cuyahoga County, Ohio. The suit, which seeks unspecified monetary damages, alleges that the Company and the other defendants violated various provisions of Ohio's consumer protection laws in connection with the marketing of certain membership programs offered by the Company. The plaintiff's motion to have the suit certified as a class action was denied on February 6, 2002. The Company believes that the claims asserted against it are unfounded and the Company will vigorously defend its interests against this suit.

In March 2001, an action was instituted by plaintiff Teresa McClain against Coverdell & Company ("Coverdell"), a wholly-owned subsidiary of the Company, Monumental Life Insurance Company and other defendants in the United States District Court for the Eastern District of Michigan, Southern Division. The suit, which seeks unspecified monetary damages, alleges that Coverdell and the other defendants violated the Michigan Consumer Protection Act and other applicable Michigan laws in connection with the marketing of Monumental Life Insurance Company insurance products. The complaint includes a claim that the suit should be certified as a class action and the plaintiff has filed a motion for class certification to which all of the defendants have filed opposing papers regarding the same. The court has not ruled on the motion. The Company believes that the claims asserted against Coverdell are unfounded and the Company and Coverdell will vigorously defend their interests against this suit.

In June 2001, actions were instituted by plaintiffs Judith Jeselskis and Marcia Walters against the Company and other defendants in Circuit Court of the Tenth Judicial District, Highlands County Civil Division, Florida, and Circuit Court of the Sixth Judicial Circuit, Pinellas County Civil Division, Florida, respectively. The suits, which seek unspecified monetary damages, allege that the Company and the other defendants violated the Florida Deceptive and Unfair Trade Practices Act, in connection with the marketing of certain membership programs offered by the Company. While the respective complaints include claims that the suits should be certified as class actions, the plaintiffs have not filed motions for class certification. The Company believes that the allegations made in this lawsuit are unfounded and the Company will vigorously defend its interests against the suits.

In July 2001, an action was instituted by Alan Stone against the Company and other defendants in Superior Court of the State of California, County of Orange. The suit, which seeks unspecified monetary damages, alleges that the Company and the other defendants violated California business practices law. While the complaint includes a claim that the suit should be certified as a class action, the plaintiff has not filed a motion for class certification. The Company believes that the allegations made in this lawsuit are unfounded and the Company will vigorously defend its interests against this suit.

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

a) MemberWorks Incorporated's 2001 Annual Meeting of Stockholders was held on November 15, 2001.

b) At the annual meeting the following Class II Directors were elected to the

Board of Directors as follows:

Stephen J. Clearman:	For -	14,495,958
	Against -	7,161
	Abstain -	0
	Nonvotes -	719,024
Michael R. O'Brien:	For -	14,495,958
	Against -	7,161
	Abstain -	0
	Nonvotes -	719,024
Michael T. McClorey:	For -	14,495,958
	Against -	7,161
	Abstain -	0
	Nonvotes -	719,024

Class I Directors, Marc S. Tesler and Alec L. Ellison, and Class III Directors, Gary A. Johnson and Dennis P. Walker, continue to serve as Directors of the Company.

c) The ratification of PricewaterhouseCoopers LLP as the Company's independent auditors was also approved at the annual meeting as follows:

For -	13,677,281
Against -	825,577
Abstain -	261
Nonvotes -	719,024

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a) Exhibits
None

b) Reports on Form 8-K
On November 6, 2001, the Company filed a Current Report on Form 8-K/A under Item 2 "Acquisition or Disposition of Assets" and Item 7 "Financial Statements and Exhibits" a press release announcing the completion of the sale of iPlace, Inc. to Homestore.com, Inc. and pro forma financial statements of the Company.

MEMBERWORKS INCORPORATED

SIGNATURES

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

MEMBERWORKS INCORPORATED
(Registrant)

Date: February 12, 2002 By: /s/ Gary A. Johnson

Gary A. Johnson, President, Chief
Executive Officer and Director

February 12, 2002 By: /s/ James B. Duffy

James B. Duffy, Executive Vice President
and Chief Financial Officer (Principal
Financial and Accounting Officer)