POLARIS INDUSTRIES INC/MN
Form 10-Q
May 06, 2011

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark one)

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

For the quarterly period ended March 31, 2011

OR

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

For the transition period from __________ to __________

Commission File Number 1-11411

Polaris Industries Inc.

(Exact name of registrant as specified in its charter)

Minnesota	41-1790959
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2100 Highway 55, Medina, MN	55340
(Address of principal executive offices)	(Zip Code)

(763) 542-0500

(Registrant s telephone number, including area code)

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 þ No o

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 þ No o

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

As of April 29, 2011, 34,368,274 shares of Common Stock of the issuer were outstanding.

POLARIS INDUSTRIES INC.
FORM 10-Q
For Quarterly Period Ended March 31, 2011

Table of Contents

Part I FINANCIAL INFORMATION

Item 1 Financial Statements

POLARIS INDUSTRIES INC.
CONSOLIDATED BALANCE SHEETS
(In Thousands)

	March 31, 2011 (Unaudited)	December 31, 2010
Assets		
Current Assets:		
Cash and cash equivalents	$ 345,921	$ 393,927
Trade receivables, net	121,696	89,294
Inventories, net	244,436	235,927
Prepaid expenses and other	20,556	21,628
Deferred tax assets	68,863	67,369
Total current assets	801,472	808,145
Property and equipment, net	184,553	184,011
Investments in finance affiliate	38,517	37,169
Investments in manufacturing affiliates	990	1,009
Goodwill and other intangible assets, net	31,551	31,313
Total Assets	$ 1,057,083	$ 1,061,647
Liabilities and Shareholders Equity		
Current Liabilities:		
Current portion of long term borrowings under credit agreement	$ 100,000	$ 100,000
Accounts payable	132,210	113,248
Accrued expenses:		
Compensation	98,912	126,781
Warranties	31,029	32,651
Sales promotions and incentives	76,118	75,494
Dealer holdback	52,263	79,688
Other	56,934	52,194
Income taxes payable	12,245	2,604
Current liabilities of discontinued operations	1,550	1,550
Total current liabilities	561,261	584,210
Long term income taxes payable	5,835	5,509
Deferred income taxes	811	937
Long-term borrowings under credit agreement	100,000	100,000
Total liabilities	667,907	690,656

Shareholders Equity:				
Preferred stock $0.01 par value, 20,000 shares authorized, no shares issued and outstanding				
Common stock $0.01 par value, 80,000 shares authorized, 34,109 and 34,234 shares issued and outstanding		341		342
Additional paid-in capital		64,342		79,257
Retained earnings		317,489		285,494
Accumulated other comprehensive income, net		7,004		5,898
Total shareholders equity		389,176		370,991
Total Liabilities and Shareholders Equity	$	1,057,083	$	1,061,647

The accompanying footnotes are an integral part of these consolidated statements.

3

Table of Contents

POLARIS INDUSTRIES INC.
CONSOLIDATED STATEMENTS OF INCOME
(In Thousands, Except Per Share Data)
(Unaudited)

	For Three Months Ended March 31,	
	2011	**2010**
Sales	$ 537,198	$ 361,708
Cost of Sales	385,363	266,794
Gross profit	151,835	94,914
Operating expenses		
Selling and marketing	37,213	30,098
Research and development	22,999	18,738
General and administrative	27,326	18,398
Total operating expenses	87,538	67,234
Income from financial services	5,286	4,256
Operating Income	69,583	31,936
Non-operating Expense (Income):		
Interest expense	511	699
Other expense (income), net	(3,201)	180
Income before income taxes	72,273	31,057
Provision for Income Taxes	24,963	11,286
Net Income	$ 47,310	$ 19,771
Basic Net Income per share	$ 1.38	$ 0.60
Diluted Net Income per share	$ 1.34	$ 0.59
Weighted average shares outstanding:		
Basic	34,268	33,069
Diluted	35,331	33,750

The accompanying footnotes are an integral part of these consolidated statements.

4

Table of Contents

POLARIS INDUSTRIES INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)
(Unaudited)

	For the Three Months Ended March 31, 2011	2010
Operating Activities:		
Net income	$ 47,310	$ 19,771
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	18,782	16,037
Noncash compensation	4,590	3,559
Noncash income from financial services	(1,178)	(1,204)
Noncash loss from manufacturing affiliates	20	643
Deferred income taxes	(1,402)	2,466
Tax effect of stock based compensation exercises	(2,452)	(3,998)
Changes in current operating items:		
Trade receivables	(30,276)	(930)
Inventories	(5,395)	(1,001)
Accounts payable	18,576	14,065
Accrued expenses	(53,035)	(44,658)
Income taxes payable/receivable	12,359	957
Prepaid expenses and others, net	(3,115)	(1,901)
Net cash provided by operating activities	4,784	3,806
Investing Activities:		
Purchase of property and equipment	(18,968)	(8,126)
Investments in finance affiliate, net	(170)	5,114
Acquisition of business, net of cash acquired		(2,500)
Net cash used for investing activities	(19,138)	(5,512)
Financing Activities:		
Repurchase and retirement of common shares	(30,964)	(27,166)
Cash dividends to shareholders	(15,315)	(13,096)
Proceeds from stock issuances under employee plans	9,005	22,125
Tax effect of proceeds from stock based compensation exercises	2,452	3,998
Net cash used for financing activities	(34,822)	(14,139)
Impact of currency translation on cash balances	1,170	
Net decrease in cash and cash equivalents	(48,006)	(15,845)
Cash and cash equivalents at beginning of period	393,927	140,240

Cash and cash equivalents at end of period	$ 345,921	$ 124,395

The accompanying footnotes are an integral part of these consolidated statements.

POLARIS INDUSTRIES INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Significant Accounting Policies

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial statements and, therefore, do not include all information and disclosures of results of operations, financial position and changes in cash flow in conformity with accounting principles generally accepted in the United States for complete financial statements. Accordingly, such statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2010 previously filed with the Securities and Exchange Commission. In the opinion of management, such statements reflect all adjustments (which include only normal recurring adjustments) necessary for a fair presentation of the financial position, results of operations, and cash flows for the periods presented. Due to the seasonality of the Snowmobiles; Off-Road Vehicles (ORV), which includes all-terrain vehicles (ATV) and side-by-side vehicles; On-Road Vehicles, which is comprised of motorcycles and neighborhood electric vehicles; and Parts, Garments and Accessories (PG&A) businesses, and to certain changes in production and shipping cycles, results of such periods are not necessarily indicative of the results to be expected for the complete year.

Product Warranties

Polaris provides a limited warranty for ORVs for a period of six months and for a period of one year for its snowmobiles and motorcycles. Polaris may provide longer warranties related to certain promotional programs, as well as longer warranties in certain geographical markets as determined by local regulations and market conditions. Polaris standard warranties require the Company or its dealers to repair or replace defective product during such warranty period at no cost to the consumer. The warranty reserve is established at the time of sale to the dealer or distributor based on management s best estimate using historical rates and trends. Adjustments to the warranty reserve are made from time to time as actual claims become known in order to properly estimate the amounts necessary to settle future and existing claims on products sold as of the balance sheet date.

Factors that could have an impact on the warranty accrual in any given period include the following: improved manufacturing quality, shifts in product mix, changes in warranty coverage periods, snowfall and its impact on snowmobile usage, product recalls and any significant changes in sales volume.

The activity in Polaris accrued warranty reserve for the periods presented is as follows (in thousands):

	For the Three Months Ended March 31,	
	2011	**2010**
Accrued warranty reserve, beginning	$ 32,651	$ 25,520
Additions charged to expense	8,925	9,948
Warranty claims paid	(10,547)	(13,124)
Accrued warranty reserve, ending	$ 31,029	$ 22,344

NOTE 2. Share-Based Employee Compensation

The amount of compensation cost for share-based awards to be recognized during a period is based on the portion of the awards that are ultimately expected to vest. The Company estimates option forfeitures at the time of grant and revises those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company analyzes historical data to estimate pre-vesting forfeitures and records share compensation expense for those awards expected to vest.

Table of Contents

Total share-based compensation expenses are as follows (in thousands):

	For the Three months ended March 31, 2011	For the Three months ended March 31, 2010
Option plans	$ 2,273	$ 1,284
Other share-based awards	13,095	6,591
Total share-based compensation before tax	15,368	7,875
Tax benefit	5,866	3,036
Total share-based compensation expense included in net income	$ 9,502	$ 4,839

In addition to the above share-based compensation expense, Polaris sponsors a qualified non-leveraged employee stock ownership plan (ESOP). Shares allocated to eligible participants accounts vest at various percentage rates based on years of service and require no cash payments from the recipient.

At March 31, 2011 there was $26,033,000 of total unrecognized share-based compensation expense related to unvested share-based awards. Unrecognized share-based compensation expense is expected to be recognized over a weighted-average period of 1.9 years. Included in unrecognized share-based compensation is $20,458,000 related to stock options and $5,575,000 related to restricted stock.

NOTE 3. Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market. The major components of inventories are as follows (in thousands):

	March 31, 2011	December 31, 2010
Raw materials and purchased components	$ 40,719	$ 35,580
Service parts, garments and accessories	67,360	60,813
Finished goods	153,266	155,744
Less: reserves	(16,909)	(16,210)
Inventories	$ 244,436	$ 235,927

NOTE 4. Financing Agreement

Polaris is a party to an unsecured bank agreement comprised of a $250,000,000 revolving loan facility for working capital needs and a $200,000,000 term loan. The entire amount of the $200,000,000 term loan was utilized in December 2006 principally to fund an accelerated share repurchase transaction. The agreement expires on December 2, 2011. Interest is charged at rates based on LIBOR or prime (effective rate was 0.64 percent at March 31, 2011).

Polaris has entered into the following interest rate swap agreements to manage exposures to fluctuations in interest rates by fixing the LIBOR interest rate as follows:

Year Swap entered into	Fixed Rate	Notional Amount	Expiration Date
2009	1.34%	$ 25,000,000	April 2011
2009	0.98%	$ 25,000,000	April 2011

Each of these interest rate swaps were designated as and met the criteria of cash flow hedges. The fair value of the interest rate swap agreements on March 31, 2011 was a liability of $17,000.

In December 2010 the Company entered into a Master Note Purchase Agreement to issue $25,000,000 of 3.81 percent unsecured Senior Notes due May 2018 and $75,000,000 of 4.60 percent unsecured Senior Notes due May 2021 (collectively, The Senior Notes). The Senior Notes are expected to be issued in May 2011. As a result, the Company has classified $100,000,000 of the $200,000,000 term loan outstanding as of March 31, 2011 as a long-term liability in the consolidated balance sheet.

Table of Contents

The Company entered into and settled an interest rate lock contract in November 2010 in connection with the Master Note Purchase Agreement. The interest rate lock settlement resulted in a $251,000 gain, net of deferred taxes of $149,000, which is being amortized into income over the life of the related debt.

NOTE 5. Financial Services Arrangements

In 1996, a wholly-owned subsidiary of Polaris entered into a partnership agreement with an entity that is now a subsidiary of GE Commercial Distribution Finance Corporation (GECDF) to form Polaris Acceptance. Polaris subsidiary has a 50 percent equity interest in Polaris Acceptance. In November 2006, Polaris Acceptance sold a majority of its receivable portfolio (the Securitized Receivables) to a securitization facility (Securitization Facility) arranged by General Electric Capital Corporation, a GECDF affiliate, and the partnership agreement was amended to provide that Polaris Acceptance would continue to sell portions of its receivable portfolio to the Securitization Facility from time to time on an ongoing basis. The sale of receivables from Polaris Acceptance to the Securitization Facility is accounted for in Polaris Acceptance s financial statements as a true-sale under ASC Topic 860. Substantially all of Polaris U.S. sales are financed through Polaris Acceptance and the Securitization Facility whereby Polaris receives payment within a few days of shipment of the product. The net amount financed for dealers under this arrangement at March 31, 2011, including both the portfolio balance in Polaris Acceptance and the Securitized Receivables, was $492,928,000 which includes $180,269,000 in the Polaris Acceptance portfolio and $312,659,000 of Securitized Receivables. Polaris has agreed to repurchase products repossessed by Polaris Acceptance or the Securitization Facility up to an annual maximum of 15 percent of the aggregate average month-end balances outstanding during the prior calendar year with respect to receivables retained by Polaris Acceptance and Securitized Receivables. For calendar year 2011, the potential 15 percent aggregate repurchase obligation is approximately $74,073,000. Polaris financial exposure under this arrangement is limited to the difference between the amount paid to the finance company for repurchases and the amount received on the resale of the repossessed product. No material losses have been incurred under this agreement. Polaris total investment in Polaris Acceptance at March 31, 2011 of $38,517,000 is accounted for under the equity method, and is recorded as Investments in finance affiliate in the accompanying consolidated balance sheets. Polaris allocable share of the income of Polaris Acceptance and the Securitization Facility has been included as a component of Income from financial services in the accompanying consolidated statements of income. During February 2011, Polaris and GECDF amended and restated its Polaris Acceptance partnership agreement through February 2017 with similar terms to the previous agreement.

In August 2005, a wholly-owned subsidiary of Polaris entered into a multi-year contract with HSBC Bank Nevada, National Association (HSBC), formerly known as Household Bank (SB), N.A., under which HSBC manages the Polaris private label credit card program under the StarCard label, currently providing revolving retail credit for Polaris products. The agreement provides for income to be paid to Polaris based on a percentage of the volume of revolving retail credit business generated. During the 2010 second quarter, Polaris and HSBC extended the agreement to October 2013. Polaris income generated from the HSBC agreement has been included as a component of Income from financial services in the accompanying consolidated statements of income.

In April 2006, a wholly-owned subsidiary of Polaris entered into a multi-year contract with GE Money Bank (GE Bank) under which GE Bank makes available closed-end installment consumer and commercial credit to customers of Polaris dealers for both Polaris and non-Polaris products. In November 2010, the Company extended its installment credit agreement to March 2016 under which GE Bank will provide exclusive installment credit lending for Victory motorcycles only. Polaris income generated from the GE Bank agreement has been included as a component of Income from financial services in the accompanying consolidated statements of income.

In January 2009, a wholly-owned subsidiary of Polaris entered into a multi-year contract with Sheffield Financial (Sheffield) pursuant to which Sheffield agreed to make available closed-end installment consumer and commercial credit to customers of Polaris dealers for Polaris products. In October 2010, Polaris extended its installment credit agreement to February 2016 under which Sheffield will provide exclusive installment credit lending for ORV and

Snowmobiles. Polaris income generated from the Sheffield agreement has been included as a component of Income from financial services in the accompanying consolidated statements of income.

Table of Contents

Polaris also provides extended service contracts to consumers and certain insurance contracts to dealers and consumers through various third-party suppliers. Polaris does not retain any warranty, insurance or financial risk in any of these arrangements. Polaris service fee income generated from these arrangements has been included as a component of Income from financial services in the accompanying consolidated statements of income.

NOTE 6. Investment in Manufacturing Affiliates

The caption Investments in manufacturing affiliates in the consolidated balance sheets represents Polaris 40 percent equity ownership investment in Robin Manufacturing, U.S.A. (Robin), which builds engines in the United States for recreational and industrial products. Fuji and Polaris have agreed to close the Robin facility by mid-2011 as the production volume of engines made at the facility has declined significantly in recent years. In the third quarter of 2010, the Company sold its remaining equity investment in the Austrian motorcycle company, KTM Power Sports AG (KTM) which manufactures off-road and on-road motorcycles. Prior to the sale of the KTM investment, the Company owned less than 5 percent of KTM s outstanding shares. The KTM investment, prior to the sale, had been classified as available for sale securities under ASC Topic 320.

NOTE 7. Shareholders Equity

During the first three months of 2011, Polaris paid $30,964,000 to repurchase and retire approximately 400,000 shares of its common stock related primarily to open market share repurchases. As of March 31, 2011, the Company has authorization from its Board of Directors to repurchase up to an additional 2,700,000 shares of Polaris stock. The repurchase of any or all such shares authorized for repurchase will be governed by applicable SEC rules and dependent on management s assessment of market conditions.

Polaris paid a regular cash dividend of $0.45 per share on February 15, 2011 to holders of record on February 1, 2011.

On April 21, 2011, the Polaris Board of Directors declared a regular cash dividend of $0.45 per share payable on or about May 16, 2011 to holders of record of such shares at the close of business on May 2, 2011.

Net Income per Share

Basic earnings per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during each period, including shares earned under the nonqualified deferred compensation plan (Director Plan), the ESOP and deferred stock units under the 2007 Omnibus Incentive Plan (Omnibus Plan). Diluted earnings per share is computed under the treasury stock method and is calculated to compute the dilutive effect of outstanding stock options issued under the 1995 Stock Option Plan and the 2003 Non-Employee Director Stock Option Plan (collectively, the Option Plans) and the Omnibus Plan and certain shares issued under the Restricted Stock Plan (Restricted Plan).

A reconciliation of these amounts is as follows (in thousands):

	For the Three Months Ended March 31,	
	2011	**2010**
Weighted average number of common shares outstanding	34,028	32,747
Director Plan and deferred stock units	163	174
ESOP	77	148
Common shares outstanding basic	34,268	33,069
Dilutive effect of Restricted Plan and Omnibus Plan	79	57
Dilutive effect of Option Plans and Omnibus Plan	984	624
Common and potential common shares outstanding diluted	35,331	33,750

During the first quarter ending March 31, 2011 and 2010, the number of options that could potentially dilute earnings per share on a fully diluted basis that were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive were 190,000 and 1,050,000, respectively.

Table of Contents

Comprehensive Income

Comprehensive income represents net income adjusted for foreign currency translation adjustments, unrealized gains or losses on available for sale securities and deferred gains or losses on derivative instruments utilized to hedge Polaris interest and foreign exchange exposures. Comprehensive income is as follows (in thousands):

	For the Three Months Ended March 31,	
	2011	**2010**
Net income	$ 47,310	$ 19,771
Other comprehensive income:		
Foreign currency translation adjustments, net of tax of $369 in 2011 and tax benefit of $138 in 2010	3,256	(332)
Unrealized loss on available for sale securities, net of tax benefit of $229 in 2010		(330)
Unrealized loss on derivative instruments, net of tax benefit of $1,255 in 2011 and $428 in 2010	(2,150)	(711)
Comprehensive income	$ 48,416	$ 18,398

Changes in the Accumulated other comprehensive income (loss) balances are as follows (in thousands):

	Foreign currency items	Cash flow hedging derivatives	Accumulated other comprehensive income
Balance at December 31, 2010	$ 6,991	$ (1,093)	$ 5,898
Reclassification to the income statement		401	401
Change in fair value	3,256	(2,551)	705
Balance at March 31, 2011	$ 10,247	$ (3,243)	$ 7,004

NOTE 8. Commitments and Contingencies

Polaris is subject to product liability claims in the normal course of business. Polaris is currently self-insured for all product liability claims. The estimated costs resulting from any losses are charged to operating expenses when it is probable a loss has been incurred and the amount of the loss is reasonably determinable. The Company utilizes historical trends and actuarial analysis tools to assist in determining the appropriate loss reserve levels.

Polaris is a defendant in lawsuits and subject to claims arising in the normal course of business. In the opinion of management, it is not probable that any legal proceedings pending against or involving Polaris will have a material adverse effect on Polaris financial position or results of operations.

NOTE 9. Derivative Instruments and Hedging Activities

The Company is exposed to certain risks relating to its ongoing business operations. The primary risks managed by using derivative instruments are foreign currency risk, interest rate risk and commodity price fluctuations. Derivative contracts on various currencies are entered into in order to manage foreign currency exposures associated with certain product sourcing activities and intercompany sales. Interest rate swaps are entered into in order to manage interest rate risk associated with the Company s variable-rate borrowings. Commodity hedging contracts are entered into in order to manage fluctuating market prices of certain purchased commodities and raw materials that are integrated into the Company s end products.

The Company s foreign currency management objective is to mitigate the potential impact of currency fluctuations on the value of its U.S. dollar cash flows and to reduce the variability of certain cash flows at the subsidiary level. The Company actively manages certain forecasted foreign currency exposures and uses a centralized currency management operation to take advantage of potential opportunities to naturally offset foreign currency exposures against each other. The decision of whether and when to execute derivative instruments, along with the duration of the instrument, can vary from period to period depending on market conditions,

Table of Contents

the relative costs of the instruments and capacity to hedge. The duration is linked to the timing of the underlying exposure, with the connection between the two being regularly monitored. Polaris does not use any financial contracts for trading purposes. At March 31, 2011, Polaris had the following open contracts (in thousands):

Foreign Currency	Notional Amounts (in US Dollars)	Unrealized Gain (Loss)
Australian Dollar	$ 6,799	$ (528)
Canadian Dollar	188,658	(4,897)
Swedish Krona	10,208	(107)
Total	$ 205,665	$ (5,532)

These contracts, with maturities through December 2011, met the criteria for cash flow hedges and the unrealized gains or losses, after tax, are recorded as a component of Accumulated other comprehensive income in Shareholders Equity.

Polaris has entered into derivative contracts to hedge a portion of the exposure related to diesel fuel and aluminum for 2011. These diesel fuel and aluminum derivative contracts did not meet the criteria for hedge accounting.

The table below summarizes the carrying values of derivative instruments as of March 31, 2011 and 2010 (in thousands):

	Carrying Values of Derivative Instruments as of March 31, 2011			
	Fair Value Assets	Fair Value (Liabilities)	Derivative Net Carrying Value	
	-	545,485	-	
General and administrative expenses	583,862	1,162,907	1,206,842	2,168,262
Loss from Operations	(179,656)	(457,820)	(304,200)	(767,476)
Other Income (Expense):				
Interest income	695	6,143	1,979	15,103
Interest expense	-	(3,571)	-	(4,010)
	695	2,572	1,979	11,093
Loss before income taxes	(178,961)	(455,248)	(302,221)	(756,383)
Income tax benefit (expense)	-	-	-	-
Net Loss	$ (178,961)	$ (455,248)	$ (302,221)	$ (756,383)
Loss per Common Share: (Note 1)				
Basic and Dilutied	$ (0.03)	$ (0.07)	$ (0.04)	$ (0.11)
	6,794,600	6,794,600	6,794,600	6,794,600

Weighted Average Common Shares
Outstanding:

The Accompanying Notes are an Integral
Part of these Condensed Financial Statements

CALIBRUS, INC.
CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Six Months Ended June 30, 2009	For the Six Months Ended June 30, 2008
Increase (decrease) in cash and cash equivalents:		
Cash flows from operating activities:		
Net Loss	$ (302,221)	$ (756,383)
Adjustments to reconcile net loss to net cash flows from operating activities:		
Depreciation and amortization	61,294	99,590
Bad debt expense	(43,534)	-
Changes in assets and liabilities:		
Accounts receivable - trade	53,142	(311,415)
Prepaid expenses	82,472	92,243
Deposits	4,512	-
Accounts payable - trade	5,183	36,248
Accrued liabilities	(15,838)	177,488
Net cash used by operating activities	(154,990)	(662,229)
Cash flows from investing activities:		
Purchase of fixed assets	(14,538)	(36,331)
Purchase of software development	(115,654)	-
Net cash used by investing activities	(130,192)	(36,331)
Cash flows from financing activities:		
Repayment of debt	-	(16,981)
Net cash used by financing activities	-	(16,981)
Net decrease in cash and cash equivalents	(285,182)	(715,541)
Cash and cash equivalents at beginning of period	854,159	1,591,704
Cash and cash equivalents at end of period	$ 568,977	$ 876,163
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$ -	$ 4,010

Income taxes	$ 50	$ 50

The Accompanying Notes are an Integral
Part of these Condensed Financial Statements

F-3

CALIBRUS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies and Use of Estimates:

Presentation of Interim Information:

The condensed financial statements included herein have been prepared by Calibrus, Inc. (“we”, “us”, “our” or “Company”) without audit, pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”) and should be read in conjunction with the audited financial statements as of December 31, 2008. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted, as permitted by the SEC, although we believe such disclosures are adequate to make the information presented not misleading. Further, the condensed financial statements reflect, in the opinion of management, all normal recurring adjustments necessary to present fairly our financial position at June 30, 2009, and the results of our operations and cash flows for the periods presented. The December 31, 2008 condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Interim results are subject to significant seasonal variations and the results of operations for the six months ended June 30, 2009 are not necessarily indicative of the results to be expected for the full year.

Nature of Corporation:

Calibrus, Inc. (the “Company”) was incorporated on October 22, 1999, in the State of Nevada. The Company’s principal business purpose is to operate a customer contact center for a variety of clients, who are located throughout the United States. The Company provides customer contact support services for various companies wishing to outsource these functions.

Use of Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Earnings per Share:

Statement of Financial Accounting Standards No. 128, “Earnings per Share” (“SFAS 128”) provides for the calculation of Basic and Diluted earnings per share. Basic earnings per share includes no dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution of securities that could share in the earnings of an entity.

CALIBRUS, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS (Continued)

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Loss available to common stockholders	$ (302,221)	$ (756,383)
Weighted average number of common shares used in basic loss per share	6,794,600	6,794,600
Effect of dilutive securities:		
Stock options	-	-
Stock warrants	-	-
Weighted average number of common shares and dilutive potential comon stock used in diluted loss per share	6,794,600	6,794,600

All dilutive common stock equivalents are reflected in our loss per share calculations. Anti-dilutive common stock equivalents are not included in our loss per share calculations. For the six month periods ended June 30, 2009 and 2008 the Company had outstanding options to purchase 1,525,832 and 1,414,999 shares of common stock at a per share weighted average exercise price of $1.31 and $1.51, respectively, which were not included in the loss per share calculation as they were anti-dilutive. In addition, the Company did not include in either period warrants to purchase 691,104 shares of common stock at a price of $1.00 per share in the loss per share calculation as they were anti-dilutive.

Capitalized Software Costs:

The Company capitalizes certain software costs in accordance with Statement of Financial Accounting Standards No. 86, " Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed " ("SFAS 86").

Revenue Recognition

Revenue for inbound calls is recorded on a per-call or per-minute basis in accordance with the rates established in the respective contracts. Revenue for outbound calls is on a commission basis, with revenue being recognized as the commission is earned. As the Company’s customers are primarily well established, creditworthy institutions collectability is reasonably assured at the time of performance.

Stock-Based Compensation:

The Company has stock-based compensation plans. Effective January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"), using the modified prospective transition method. Under this transition method, stock-based compensation expense for the year ended December 31, 2006 includes compensation expense for all stock-based compensation awards granted during the year, or granted in a prior year if not fully vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provision of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-based Compensation" ("SFAS 123"). Stock-based compensation expense for all stock-based compensation awards granted after January 1, 2006 is based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. The value of the compensation cost is amortized on a straight-line basis over the requisite service periods of the award (the option vesting term).

CALIBRUS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS (Continued)

The Company estimates fair value using the Black-Scholes valuation model. Assumptions used to estimate compensation expense are determined as follows:

- Expected term is determined using an average of the contractual term and vesting period of the award;
- Expected volatility of award grants made under the Company's plans is measured using the historical daily changes in the market price of similar industry indices, which are publicly traded, over the expected term of the award;
- Risk-free interest rate is equivalent to the implied yield on zero-coupon U.S. Treasury bonds with a remaining maturity equal to the expected term of the awards; and
- Forfeitures are based on the history of cancellations of awards granted by the Company and management's analysis of potential forfeitures.

Income Taxes:

The Company's effective tax rate is based on expected income, statutory tax rates and tax planning opportunities available in the various jurisdictions in which it operates. For interim financial reporting, in accordance with APB Opinion No. 28, the Company estimates the annual tax rate based on projected taxable income for the full year and records a quarterly income tax provision in accordance with the anticipated annual rate. As the year progresses, we refine the estimates of the year's taxable income as new information becomes available, including year-to-date financial results. This continual estimation process can result in a change to the expected effective tax rate for the year. When this occurs, the Company adjusts the income tax provision during the quarter in which the change in estimate occurs so that the year-to-date provision reflects the expected annual tax rate. Significant judgment may be required in determining the Company's effective tax rate and in evaluating our tax positions.

The effective income tax rate of 0% for the six months ended June 30, 2009 and 2008 differed from the statutory rate, due primarily to net operating losses incurred by the Company in the respective periods. The tax benefit generated by the net operating losses at the effective income tax rate should have been approximately $108,000 and $272,000 as of June 30, 2009 and 2008, respectively. However, these benefits have been fully offset through an allowance account due to the uncertainty of the utilization of the net operating losses.

Recently Issued Accounting Pronouncements and Adopted Accounting:

In June 2009, the FASB issued SFAS No. 168, "The FASB Accounting Standards CodificationTM and Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162" ("SFAS 168"). SFAS 168 establishes the FASB Standards Accounting Codification ("Codification") as the source of authoritative GAAP recognized by the FASB to be applied to nongovernmental entities and rules and interpretive releases of the SEC as authoritative GAAP for SEC registrants. The Codification will supersede all the existing non-SEC accounting and reporting standards upon its effective date and subsequently, the FASB will not issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. SFAS 168 will become effective for us in the third quarter of 2009 and will not have a material impact on our financial position or results of operations.

In May 2009, the FASB issued SFAS No. 165, “Subsequent Events” (“SFAS 165”), which establishes general standards of accounting for, and disclosure of, events that occur after the balance sheet date, but before financial statements are issued or are available to be issued. SFAS 165 is effective for interim or annual financial periods ending after June 15, 2009. The adoption of SFAS 165 did not have a material effect on our financial position or results of operations. We evaluated subsequent events through the date of the filing of this report.

In April 2009, the FASB issued the FASB Staff Position on FAS 107-1 and APB 28-1, “Interim Disclosures About Fair Value of Financial Instruments” (“FSP FAS 107-1 and APB 28-1”). FSP FAS 107-1 and APB 28-1 requires disclosures about fair value of financial instruments in interim reporting periods of publicly-traded companies that were previously only required to be disclosed in annual financial statements. FSP FAS 107-1 and APB 28-1 is effective for interim reporting periods ending after June 15, 2009. The adoption of this standard did not have a material impact on our financial position or results of operations.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following is management's discussion and analysis of certain significant factors affecting the Company's financial position and operating results during the periods included in the accompanying condensed financial statements. Except for the historical information contained herein, the matters set forth in this discussion are forward-looking statements.

Overview

Our performance for the three months and six months ended June 30, 2009 continued to reflect the overall decline in the Third Party Verification business as a whole. Fortunately, we have been able to significantly reduce our operating expenses to be more in line with our current revenue rate. As such, for the six months and three months ended June 30, 2009 we are operating our existing TPV business at a small profit. We have also continued to increase our research and development expenditures in an effort to diversify our business offerings and generate alternative revenue sources. The product under development is an interactive/social networking website community that will allow communication and expression among its users. The product is currently in the beta testing phase. As a result of these research and development expenses the Company is continued to operate at a net loss.

Results of Operations

The following table sets forth certain items derived from our Condensed Statements of Operations for the periods indicated and the corresponding percentage of total revenue for each item:

	Six Months Ended June 30,				Three Months Ended June 30,			
	2009		2008		2009		2008	
	(Unaudited)				(Unaudited)			
Revenue	$2,425,624	100.0%	$2,848,312	100.0%	$1,115,261	100.0%	$1,395,283	100.0%
Cost of Goods Sold	977,497	40.3 %	1,447,526	50.8 %	448,062	40.2 %	690,196	49.5 %
Gross Profit	1,448,127	59.7 %	1,400,786	49.2 %	667,199	59.8 %	705,087	50.5 %
Research and Development	545,485	22.5 %	-	0.0 %	262,993	23.6 %	-	0.0 %
General and Administrative Expenses	1,206,842	49.8 %	2,168,262	76.1 %	583,862	52.4 %	1,162,907	83.3 %
Loss from Operations	(304,200)	-12.5 %	(767,476)	-26.9 %	(179,656)	-16.1 %	(457,820)	-32.8 %
Interest Income	1,979	0.1 %	15,103	0.5 %	695	0.1 %	6,143	0.4 %
Interest Expense	-	0.0 %	(4,010)	-0.1 %	-	0.0 %	(3,571)	-0.3 %
Net Loss	$(302,221)	-12.5 %	$(756,383)	-26.6 %	$(178,961)	-16.0 %	$(455,248)	-32.6 %

Liquidity and Capital Resources

As of June 30, 2009 we had cash on hand of $568,977 and working capital of $892,416. Historically, the Company was able to fund operations through the generation of positive cash flow from its business operations. The Company is currently using cash in its operations. The Company believes it has sufficient cash to fund its operations through at least the next twelve months. If the Company is not able to return its operations to profitability, it will need to raise additional capital. The Company plans to raise such capital through the sale of its common stock or from shareholder loans, although there is no guarantee such funds will be available, or if available, on terms acceptable to it.

Three Months Ended June 30, 2009 compared to Three Months Ended June 30, 2008

Revenue – Revenue decreased 20.07% to $1,115,261 for the three months ended June 30, 2009, which we refer to as "2nd quarter 2009," from $1,395,283 for the three months ended June 30, 2008, which we refer to as "2nd quarter 2008." The decrease was due to the continued decline of the Third Party Verification business.

Cost of Revenue – Cost of Revenue decreased 35.08% to $448,062 for the 2nd quarter 2009, from $690,196 for the 2nd quarter 2008. The decrease was due to lower revenue and the Company's efforts to reduce fixed expenses related to its business. Of the $242,134 reduction, approximately 20% was attributable to reduced sales and approximately 80% was attributable to cost reductions.

Gross Profit – Gross profit decreased to $667,199 in the 2nd quarter 2009 from $705,087 in the 2nd quarter 2008 and the gross profit margin increased to 59.82% from 50.53% in the respective periods. The decrease in the gross profit was directly related to lower sales levels. The increase in gross profit margin during the 2nd quarter 2009 was primarily due to the Company's reduction of fixed expenses related to its Third Party Verification business and higher percentage of call recording business which has higher profit margins.

Research and Development – Research and development expenses increased to $262,993 in the 2nd quarter of 2009 from $0 in the 2nd quarter of 2008. This is a result of the Company's effort to diversify its product offerings and generate additional streams of revenue as its core business continues to decline.

General and Administrative Expenses – General and administrative expense decreased 49.79% to 583,862 in the 2nd quarter of 2009 from $1,162,907 in the 2nd quarter of 2008. The reduction was primarily due the Company consolidating its operations into one facility during the 4th quarter of 2008, which accounts for approximately 85% of the total reduction. The remaining 15% was a result of a reduction in administrative salaries and wages.

Net Loss – Net loss decreased 60.69% to $178,961 for the 2nd quarter of 2009 from a net loss of $455,248 in the 2nd quarter of 2008. This decrease was due to the Company's reduced expenses as discussed above.

Six Months Ended June 30, 2009 compared to Six Months Ended June 30, 2008

Revenue – Revenue decreased 14.84% to $2,425,624 for the six months ended June 30, 2009, which we refer to as "Half Year 2009," from $2,848,312 for the six months ended June 30, 2008, which we refer to as "Half Year 2008." The decrease was due to the continued decline of Third Party Verification business.

Cost of Revenue – Cost of Revenue decreased 32.47% to $977,497 for the Half Year 2009, from $1,447,526 for the Half Year 2008. The decrease was due to lower revenue and the Company's efforts to reduce fixed expenses related to its business. Of the $470,029 reduction, approximately 20% was attributable to reduced sales and approximately 80% was attributable to cost reductions.

Gross Profit – Gross profit increased to $1,448,127 in the Half Year 2009 from $1,400,786 in the Half Year 2008 and the gross profit margin increased to 59.7% from 49.18% in the respective periods. The increase in the gross profit and gross profit margin during the Half Year 2009 was primarily due to the Company's reduction of fixed expenses related to its Third Party Verification business and higher percentage of call recording business which has higher profit margins. Of the $47,341 increase, approximately 80% was attributable to cost reductions and approximately 20% was attributable to increased margin business.

Research and Development – Research and development expenses increased to $545,485 in the Half Year 2009 from $0 in the Half Year 2008. This is a result of the Company's effort to diversify its product offerings and generate additional streams of revenue as the Company's core business continues to decline.

General and Administrative Expenses – General and administrative expense decreased 44.34% to 1,206,842 in the Half Year of 2009 from $2,168,262 in the Half Year of 2008. The reduction was primarily due the Company consolidating its operations into one facility during the 4th quarter of 2008 which accounted for approximately 90% of the total reduction. The Company has also reduced its administrative salaries and wages which accounts for the remaining 10% reduction.

Net Loss – Net loss decreased 60.04% to $302,221 in the Half Year of 2009 from a net loss of $756,383 in the Half Year of 2008. This decrease was due to the Company's reduced expenses as discussed above.

Forward-Looking Statements

We have made forward-looking statements, within the meaning of Section 21E of the Securities and Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended, in this quarterly report on Form 10-Q, including the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" that are based on our beliefs and assumptions and on information currently available to us. Forward-looking statements include the information concerning our possible or assumed search for new business opportunities and future costs of operations. Forward-looking statements include all statements that are not historical facts and can be identified by the use of forward-looking terminology such as the words "believe," "expect," "anticipate," "intend," "pla "estimate" or similar expressions.

Forward-looking statements involve risks, uncertainties and assumptions. Actual results may differ materially from those expressed in the forward-looking statements. You should understand that many important factors could cause our results to differ materially from those expressed in the forward-looking statements. These factors include, without limitation, the difficulty in locating new business opportunities, our regulatory environment, our limited operating history, our ability to implement our growth strategy, our ability to integrate acquired companies and their assets and personnel into our business, our obligations to pay professional fees, and other economic conditions and increases in corporate maintenance and reporting costs. Unless legally required, we undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not required.

Item 4. Controls and Procedures.

An evaluation as of the end of the period covered by this report was carried out under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Disclosure controls and procedures are defined as those controls and other procedures of an issuer that are designed to ensure that the information required to be disclosed by the issuer in the reports it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported, within the time periods specified in the United States Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, is accumulated and communicated to the issuer's management, including its principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that those disclosure controls and procedures were effective in providing reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the United States Securities and Exchange Commission's rules and forms. In addition, there has been no change in our internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

None.

Item 1A. Risk Factors.

In addition to the other information set forth in this 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, 2008, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks we face. 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. There are no material changes to the risk factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008 during the six months ended June 30, 2009.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

None.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

Calibrus, Inc.

By: Jeff W Holmes Jeff W. Holmes, CEO	Date: August 14, 2009
By: Kevin J. Asher Kevin J. Asher, CFO	Date: August 14, 2009

In accordance with the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
Jeff W. Holmes Jeff W. Holmes	Director, CEO	August 14, 2009
Kirk Blosch Kirk Blosch	Director	August 14, 2009
Christian J. Hoffmann, III Christian J. Hoffmann, III	Director	August 14, 2009
Charles House Charles House	Director	August 14, 2009