COINSTAR INC
Form 10-Q
July 29, 2005
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For The Quarter Ended June 30, 2005

OR

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

Commission File Number: 000-22555

COINSTAR, INC.

(Exact name of registrant as specified in its charter)

Delaware	**94-3156448**
(State or other jurisdiction of	**(IRS Employer**
incorporation or organization)	**Identification No.)**
1800 114th Avenue SE, Bellevue, Washington	**98004**
(Address of principal executive offices)	**(Zip Code)**

(425) 943-8000

(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 x No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes x No ¨

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

Class	Outstanding at July 15, 2005
Common Stock, $0.001 par value	25,495,834

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COINSTAR, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

COINSTAR, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

(unaudited)

	June 30, 2005	December 31, 2004
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 99,598	$ 94,640
Cash being processed	63,120	62,147
Trade accounts receivable, net of allowance for doubtful accounts of $582 and $481 at June 30, 2005 and December 31, 2004, respectively	9,700	5,283
Inventory	27,245	25,877
Deferred income taxes	19,687	18,833
Prepaid expenses and other current assets	8,516	11,626
Total current assets	227,866	218,406
PROPERTY AND EQUIPMENT, NET	136,957	131,267
DEFERRED INCOME TAXES	9,836	15,880
OTHER ASSETS	5,888	6,200
INTANGIBLE ASSETS, net of accumulated amortization of $4,287 and $2,152 at June 30, 2005 and December 31, 2004, respectively	35,015	35,033
GOODWILL	144,813	140,348
TOTAL ASSETS	$ 560,375	$ 547,134
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 25,591	$ 23,661
Accrued liabilities payable to retailers	64,517	63,504
Other accrued liabilities	22,388	22,904
Current portion of long-term debt and capital lease obligations	3,406	3,350
Total current liabilities	115,902	113,419
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS	206,581	207,569
Total liabilities	322,483	320,988
STOCKHOLDERS EQUITY:		
Preferred stock, $0.001 par value Authorized, 5,000,000 shares; no shares issued and outstanding in 2005 or 2004		
	284,682	282,046

Common stock, $0.001 par value Authorized, 45,000,000 shares; 26,650,289 and 26,460,701 shares issued and 25,417,075 and 25,227,487 shares outstanding at June 30, 2005 and December 31, 2004, respectively		
Accumulated deficit	(25,497)	(35,430)
Treasury stock	(22,783)	(22,783)
Accumulated other comprehensive income	1,490	2,313
Total stockholders equity	237,892	226,146
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 560,375	$ 547,134

See notes to consolidated financial statements.

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COINSTAR, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Six Month Periods Ended June 30,		Three Month Periods Ended June 30,	
	2005	**2004**	**2005**	**2004**
REVENUE	$ 215,425	$ 90,877	$ 109,840	$ 47,825
EXPENSES:				
Direct operating	147,269	43,311	74,389	23,093
Sales and marketing	2,932	4,716	1,975	3,666
Research and development	2,825	2,997	1,516	1,556
General and administrative	17,279	9,954	8,687	4,890
Depreciation and other	21,764	15,365	10,958	7,450
Amortization of intangible assets	2,135	137	1,104	84
Income from operations	21,221	14,397	11,211	7,086
OTHER INCOME (EXPENSE):				
Interest income and other, net	1,020	130	532	61
Interest expense	(5,950)	(372)	(3,100)	(126)
Income before income taxes	16,291	14,155	8,643	7,021
Income taxes	(6,358)	(4,987)	(3,378)	(2,470)
NET INCOME	$ 9,933	$ 9,168	$ 5,265	$ 4,551
NET INCOME PER SHARE:				
Basic	$ 0.39	$ 0.43	$ 0.21	$ 0.21
Diluted	$ 0.39	$ 0.43	$ 0.21	$ 0.21
WEIGHTED SHARES OUTSTANDING:				
Basic	25,313	21,325	25,354	21,357
Diluted	25,613	21,565	25,561	21,593

See notes to consolidated financial statements.

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COINSTAR, INC.

CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

Six Month Period Ended June 30, 2005

(in thousands, except share data)

(unaudited)

	Common Stock				Accumulated Other		
	Shares	Amount	Accumulated Deficit	Treasury Stock	Comprehensive Income	Total	Comprehensive Income
BALANCE, January 1, 2005	25,227,487	$ 282,046	$ (35,430)	$ (22,783)	$ 2,313	$ 226,146	
Proceeds from issuance of shares under employee stock purchase plan	37,470	448				448	
Proceeds from exercise of stock options, net	50,347	655				655	
Stock-based compensation expense, net of unearned compensation of $1,063	49,130	157				157	
Tax benefit on options and employee stock purchase plan		187				187	
Common stock issued in conjunction with acquisition, net of issue costs of $44	52,641	1,189				1,189	
Comprehensive income:							
Net income			9,933			9,933	$ 9,933
Other comprehensive income :							
Short term investments, net of tax benefit of $3					(6)	(6)	(6)
Foreign currency translation adjustments, net of tax benefit of $468					(778)	(778)	(778)
Interest rate hedge on long-term debt, net of tax benefit of $24					(39)	(39)	(39)
Total comprehensive income							$ 9,110
BALANCE, June 30, 2005	25,417,075	$ 284,682	$ (25,497)	$ (22,783)	$ 1,490	$ 237,892	

See notes to consolidated financial statements.

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COINSTAR, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six Month Periods Ended June 30,	
	2005	**2004**
OPERATING ACTIVITIES:		
Net income	$ 9,933	$ 9,168
Adjustments to reconcile income to net cash provided by operating activities:		
Depreciation and other	21,764	15,365
Amortization of intangible assets	2,135	137
Amortization of deferred financing fees	379	
Non-cash stock-based compensation	157	21
Deferred income taxes	6,086	4,612
Other	(328)	
Cash provided (used) by changes in operating assets and liabilities, net of effect of business acquisitions:		
Accounts receivable	(3,718)	(436)
Inventory	(1,166)	(92)
Prepaid expenses and other current assets	1,680	(772)
Other assets	(240)	(12)
Accounts payable	(667)	3,693
Accrued liabilities payable to retailers	1,343	(4,679)
Accrued liabilities	(1,535)	895
Net cash provided by operating activities	35,823	27,900
INVESTING ACTIVITIES:		
Purchase of available-for-sale securities		(12)
Purchase of property and equipment	(24,985)	(14,515)
Proceeds from sale of fixed assets	63	117
Acquisitions, net of cash acquired of $0 and $1,087 in 2005 and 2004, respectively	(3,622)	(4,893)
Return of equity investment in investee	426	
Fees paid for ACMI acquisition		(2,416)
Net cash used by investing activities	(28,118)	(21,719)
FINANCING ACTIVITIES:		
Principal payments on long-term debt and capital lease obligations	(1,811)	(8,605)
Proceeds from exercise of stock options and issuance of shares under employee stock purchase plan	1,103	2,351
Net cash used by financing activities	(708)	(6,254)
Effect of exchange rate changes on cash	(1,066)	150
NET INCREASE IN CASH, CASH EQUIVALENTS AND CASH BEING PROCESSED:	5,931	77
CASH AND CASH EQUIVALENTS AND CASH BEING PROCESSED:		
Beginning of period	156,787	99,664

End of period	$ 162,718	$ 99,741
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for interest	$ 5,526	$ 433
Cash paid during the period for taxes	272	375
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Purchase of vehicles financed by capital lease obligations	$ 1,049	$ 1,462
Common stock issued in conjunction with acquisition, net of issue costs of $44 in 2005	1,189	
Accrued acquisition costs	123	1,119
Issuance of warrants for acquisition		595

See notes to consolidated financial statements.

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COINSTAR, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Three and Six Month Periods Ended June 30, 2005 and 2004

(unaudited)

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of company: Coinstar, Inc. is a multi-national company offering a range of services consisting of coin counting, entertainment and electronic payment (e-payment) services. Our network of automated, self-service coin-counting machines provides consumers with a convenient and innovative means to convert loose coins into cash. As a result of our July 2004 acquisition of ACMI Holdings, Inc. and its subsidiary, American Coin Merchandising, Inc., (collectively referred to as ACMI), we offer various entertainment services to consumers in mass merchandisers, supermarkets, warehouse clubs, restaurants, entertainment centers, truck stops and other distribution channels. These entertainment services include skill-crane machines, bulk vending, kiddie rides and video games. In addition, we offer various e-payment services through point-of-sale and non-coin-counting kiosks in drugstores, universities, shopping malls and convenience stores. As of June 30, 2005, we had a total of approximately 12,400 coin-counting machines installed, approximately 176,000 entertainment services machines installed and over 17,000 locations where our point-of-sale and non-coin-counting kiosks were installed. Coinstar was incorporated as a Delaware company in 1993.

Basis of presentation: The unaudited consolidated financial statements of Coinstar, Inc. included herein reflect all adjustments, consisting only of normal recurring adjustments which, in the opinion of management, are necessary to present fairly our consolidated financial position, results of operations and cash flows for the periods presented.

These financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) and in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such SEC rules and regulations. These financial statements should be read in conjunction with our audited financial statements and the accompanying notes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2004, filed with the SEC. The results of operations for the three and six month periods ended June 30, 2005 are not necessarily indicative of the results to be expected for any future quarter or for the entire fiscal year. Acquisitions are recorded and included in our results of operations as of the date acquired.

Principles of consolidation: The accompanying consolidated financial statements include the accounts of Coinstar, Inc. and our wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of estimates: The preparation of financial statements in conformity with GAAP 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. These judgments are difficult as matters that are inherently uncertain directly impact their valuation and accounting. Actual results may vary from management s estimates and assumptions.

In connection with our acquisitions, we have allocated the respective purchase prices plus transaction costs to the estimated fair values of assets acquired and liabilities assumed. These purchase price allocation estimates were based on our estimates of fair values and estimates from third-party consultants. During the six months ended June 30, 2005, certain purchase accounting adjustments related to the ACMI acquisition were made in accordance with Statement of Financial Accounting Standards (SFAS) No. 141 *Business Combinations*. These adjustments related to refinement of income tax and other liability estimates made during the purchase and increased goodwill by approximately $2.0 million. As of June 30, 2005, the Company had completed the allocation phase of this acquisition.

We have estimated the value of our entertainment services coin-in-machine which was approximately $4.1 million and $4.4 million at June 30, 2005 and December 31, 2004, respectively. Coin-in-machine represents the cash deposited into our entertainment services machines at period end which has not yet been collected. Based on our estimate of coin-in-machine, we have recognized the related revenue, the corresponding reduction to inventory and increase to accrued liabilities which represents the direct operating expenses associated with the coin-in-machine estimate.

Stock-based compensation: We account for stock-based awards to employees using the intrinsic value method in accordance with Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees.* All options granted under the stock-based compensation plans had an exercise price equal to the fair market value of the stock at the date of grant. Accordingly, no compensation expense has been recognized for our stock option grants. Certain directors and members of management receive compensation in the form of stock or restricted stock. Unrestricted stock awards are expensed when issued. Restricted stock grants are

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recorded as unearned compensation measured at the date of grant and recognized as compensation expense over the vesting period. The following illustrates the effect on net income and net income per share had we applied the fair value recognition provision of SFAS No. 123, *Accounting for Stock-Based Compensation*, to the stock option awards.

	Six Month Periods Ended June 30,		Three Month Periods Ended June 30,	
	2005	**2004**	**2005**	**2004**
	(in thousands except per share data)			
Net income as reported:	$ 9,933	$ 9,168	$ 5,265	$ 4,551
Total stock-based employee compensation included in the determination of net income as reported, net of $61 and $18 tax effect for the six months ended June 30, 2005 and 2004, respectively. Compensation amounts are net of $33 and $10 tax effect for the three months ended June 30, 2005 and 2004, respectively.	96	27	51	15
Total stock-based employee compensation determined under fair value method for all awards, net of $1,087 and $1,223 tax effect for the six months ended June 30, 2005 and 2004, respectively. Fair value compensation amounts are net of $536 and $606 tax effect for the three months ended June 30, 2005 and 2004, respectively.	(2,522)	(2,530)	(1,237)	(1,256)
Pro forma net income:	$ 7,507	$ 6,665	$ 4,079	$ 3,310
Net income per share:				
Basic:				
As reported	$ 0.39	$ 0.43	$ 0.21	$ 0.21
Pro forma	0.30	0.31	0.16	0.15
Diluted:				
As reported	$ 0.39	$ 0.43	$ 0.21	$ 0.21
Pro forma	0.30	0.31	0.16	0.15

The assumptions used to calculate the fair value of options granted are evaluated and revised, as necessary, to reflect market conditions and the Company s experience.

Recent accounting pronouncements: In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R). SFAS 123R will require that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. SFAS 123R covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans. SFAS 123R will be effective for us January 1, 2006. We are in process of evaluating the impact of adopting SFAS 123R and determining the impact on our results of operations, financial position and cash flows.

Reclassifications: Certain reclassifications have been made to the prior period amounts to conform to the current period presentation.

NOTE 2: PROPERTY AND EQUIPMENT

	June 30, 2005	December 31, 2004
	(in thousands)	
Coin, entertainment and e-payment machines	$ 281,217	$ 261,908
Computers	6,215	9,931
Office furniture and equipment	4,680	4,415
Leased vehicles	5,730	5,569
Leasehold improvements	1,394	737
	299,236	282,560
Accumulated depreciation and amortization	(162,279)	(151,293)
	$ 136,957	$ 131,267

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NOTE 3: COMPREHENSIVE INCOME

Comprehensive income, net of related tax effects, is as follows:

	Six Month Periods Ended June 30,		Three Month Periods Ended June 30,	
	2005	2004	2005	2004
	(in thousands)			
Net income	$ 9,933	$ 9,168	$ 5,265	$ 4,551
Other comprehensive income (loss)	(823)	70	(684)	(106)
Total comprehensive income	$ 9,110	$ 9,238	$ 4,581	$ 4,445

NOTE 4: INCOME PER SHARE

Basic net income per share is computed by dividing the net income available to common stockholders for the period by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the net income for the period by the weighted average number of common and potential common shares outstanding (if dilutive) during the period. Potential common shares, composed of incremental common shares issuable upon the exercise of stock options and warrants, are included in the calculation of diluted net income per share to the extent such shares are dilutive.

The following table sets forth the computation of basic and diluted net income per share for the periods indicated:

	Six Month Periods Ended June 30,		Three Month Periods Ended June 30,	
	2005	2004	2005	2004
	(in thousands)			
Numerator:				
Net income	$ 9,933	$ 9,168	$ 5,265	$ 4,551
Denominator:				
Weighted average shares for basic calculation	25,313	21,325	25,354	21,357
Warrants		1		
Incremental shares from employee stock options and awards	300	239	207	236
Weighted average shares for diluted calculation	25,613	21,565	25,561	21,593

For the six month periods ended June 30, 2005 and 2004, options and unvested restricted stock awards to acquire 1.0 million and 1.9 million shares of common stock, respectively, were excluded from the computation of net income per common share because their impact would be antidilutive. For the three month periods ended June 30, 2005 and 2004, 1.6 million and 1.9 million shares were excluded, respectively.

NOTE 5: BUSINESS SEGMENT INFORMATION

SFAS No. 131, *Disclosure about Segments of an Enterprise and Related Information*, requires that companies report separately in the financial statements certain financial and descriptive information about operating segments profit or loss, certain specific revenue and expense items and segment assets. The method for determining what information is reported is based on the way that management organizes the operating segments for making operational decisions and assessments of financial performance. Our Chief Executive Officer (CEO) is considered our chief operating decision maker. We are organized into two reportable business segments: the North American business (which includes the United States, Canada and Mexico), and our International business (which includes the United Kingdom). The total revenue of the North American segment mainly relates to operations located within the United States, and the total revenue of the International segment mainly relates to the operations located within the United Kingdom. Goodwill arising from our acquisitions has been allocated to the North American segment.

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	Six Month Periods Ended June 30,		Three Month Periods Ended June 30,	
	2005	2004	2005	2004
	(in thousands)			
Revenue:				
North American business	$ 205,621	$ 83,243	$ 104,786	$ 43,824
International business	9,804	7,634	5,054	4,001
Total revenue	$ 215,425	$ 90,877	$ 109,840	$ 47,825
Net income:				
North American business	$ 8,213	$ 7,805	$ 4,421	$ 3,822
International business	1,720	1,363	844	729
Total net income	$ 9,933	$ 9,168	$ 5,265	$ 4,551

	June 30, 2005	Dec. 31, 2004
	(in thousands)	
Total assets:		
North American business	$ 548,588	$ 535,864
International business	24,910	25,886
Intercompany eliminations	(13,123)	(14,616)
Total assets	$ 560,375	$ 547,134

Currently, management does not use product line financial performance as a basis for business operating decisions. However, our CEO does analyze our revenue based on revenue generated from our coin-counting and e-payment services business separate from revenue generated from our entertainment service business. Revenue for these two product lines is as follows:

	Six Month Periods Ended June 30,		Three Month Periods Ended June 30,	
	2005	2004	2005	2004
	(in thousands)			
Revenue:				
Coin-counting and e-payment services	$ 103,113	$ 90,877	$ 54,786	$ 47,825
Entertainment services	112,312		55,054	
Total revenue	$ 215,425	$ 90,877	$ 109,840	$ 47,825

We have coin-counting, entertainment and e-payment services machines that are placed with retailers that accounted for the following percentages of our consolidated revenue:

	Six Month Periods Ended June 30,		Three Month Periods Ended June 30,	
	2005	**2004**	**2005**	**2004**
Wal-Mart, Inc.	28.0%	4.7%	27.5%	4.7%
The Kroger Company	10.6%	23.7%	11.0%	23.6%
Albertson s, Inc.	7.4%	13.3%	7.7%	14.3%

NOTE 6: RELATED PARTY TRANSACTIONS

Randall J. Fagundo, President of our entertainment services subsidiary, is a member of a limited liability company which has agreed to lease to Coinstar a 31,000 square foot building located in Louisville, Colorado. The terms of the agreement provide for a ten year lease term, commencing March 1, 2003, at monthly rental payments ranging from $25,353 for the first year to $33,076 for the tenth year, together with additional payments in respect of the tenant s proportionate share of the maintenance and insurance costs and

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property tax assessments for the leased premises. We believe that the terms of this lease are comparable to those that would be entered into between unrelated parties on an arms length basis.

Approximately $1.3 million of our accounts receivable balance is due from a related party of our e-payment subsidiary. This receivable arose in the ordinary course of business and relates to the purchase of prepaid air time.

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

The following discussion and analysis should be read in conjunction with the Financial Statements and related Notes thereto included elsewhere in this Quarterly Report on Form 10-Q. Except for the historical information, the following discussion contains forward-looking statements that involve risks and uncertainties, such as our objectives, expectations and intentions. Our actual results could differ materially from results that may be anticipated by such forward-looking statements and discussed elsewhere herein. Factors that could cause or contribute to such differences include, but are not limited to, those discussed below, those discussed under the caption Factors That May Affect Our Business, Future Operating Results and Financial Condition, and those discussed elsewhere in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2004. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. We undertake no obligation to revise any forward-looking statements in order to reflect events or circumstances that may subsequently arise. Readers are urged to carefully review and consider the various disclosures made in this report and in our other reports filed with the Securities and Exchange Commission that attempt to advise interested parties of the risks and factors that may affect our business, prospects and results of operations.

Overview

We are the leader in the self-service coin-counting services market. We own and operate the only multi-national fully automated network of self-service coin-counting machines across the United States, in Canada and in the United Kingdom. We believe we are the leading owner and operator of skill-crane machines and bulk vending machines in the United States. We refer to these services collectively as entertainment services. We also offer a range of electronic payment (e-payment) services such as stored value cards, payroll cards, prepaid Visa® and MasterCard® cards and prepaid wireless products at point-of-sale terminals, stand-alone e-payment kiosks and e-payment enabled coin-counting machines in drugstores, universities, shopping malls, supermarkets and convenience stores in the United States and the United Kingdom.

We launched our business in North America with the installation of the first Coinstar coin-counting machine in the early 1990s, and in 2001 we began our commercial rollout of coin-counting services in the United Kingdom. Since inception, our coin-counting machines have counted and processed more than 235 billion coins worth more than $11.9 billion in more than 335 million self-service coin-counting transactions. We now own and operate more than 12,400 coin-counting machines in the United States, Canada and United Kingdom and approximately 176,000 entertainment services machines, which include skill-cranes, bulk vending heads and kiddie rides, in the United States and Mexico. We also utilize point-of-sale terminals in more than 17,000 locations and own and operate approximately 330 stand-alone e-payment kiosks for e-payment services in the United States and the United Kingdom. In addition, approximately 4,300 of our 12,400 coin-counting machines are e-payment enabled.

Revenue

Coin services

We estimate that at any one time, there is approximately $10.5 billion worth of coin sitting idle in households in the United States. In 2004, consumers processed more than $2.1 billion worth of coin through our coin-counting machines.

We own all of our coin-counting machines, providing a turn-key, headache-free service to retailers. Our machines are easy to use, highly accurate, durable, easy to service and capable of processing up to 600 coins per minute. Consumers feed loose change into the machines, which count the change and then dispense vouchers or, in some cases, issue e-payment products, at the consumer s election. Each voucher lists the dollar value of coins counted, less our transaction fee. Our patented, proprietary technology helps us to maintain high up-time, remotely monitor performance and minimize the potential for losses associated with voucher fraud.

Since we pay a percentage of our transaction fees to our retail partners, our coin services benefit our retail partners by providing an additional source of revenue. In addition, our studies show that our coin services increase foot traffic in our retail partners stores and that approximately 45% of our customers spend all or a part of the proceeds of their vouchers in the store. Our leading coin services retail partners include The Kroger Co. and Albertson s, Inc. supermarket chains.

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Entertainment services

We estimate that the market for our entertainment services is approximately $1.1 billion in the United States. We believe we are the leading owner and operator of skill-crane and bulk vending machines in the United States. We also have machines placed in Mexico.

Our entertainment services machines consist primarily of skill-crane machines, bulk vending, kiddie rides and video games, which are installed in more than 18,000 retail locations, totaling approximately 176,000 pieces of equipment which include skill-cranes, bulk vending heads and kiddie rides. The majority of our entertainment services revenue is derived from skill-crane machines that dispense plush toys, novelties and other items. For each play, customers maneuver the skill-crane into position and attempt to retrieve the desired item in the machine s enclosed display area before play is ended. We utilize appealing displays of quality merchandise, new product introductions and other merchandising techniques to attract new and repeat customers. Our leading entertainment services partners include Wal-Mart, Inc. and Denny s Corporation.

Since we pay our retail partners a portion of the fee per play, our entertainment services machines, like our coin-counting machines, provide an additional revenue stream for our retail partners. In addition, our entertainment services machines add an element of entertainment for consumers. We own and service all of our entertainment machines, providing a convenient service to retailers.

E-payment services

We estimate that the e-payment services market is over $5.0 billion in the United States. We offer e-payment services, including loading prepaid wireless accounts, reloading prepaid Visa and MasterCard cards and prepaid phone cards and providing payroll card services. We believe these and other e-payment services represent a significant growth opportunity for us. We offer various e-payment services through point-of-sale terminals, stand-alone e-payment kiosks and e-payment enabled coin-counting machines in supermarkets, drugstores, universities, shopping malls and convenience stores. These services provide an easy way for consumers to perform a variety of useful transactions without having to obtain a bank account or credit card. Our leading e-payment services partners include the Albertson s, Inc. supermarket chain and the Walgreens Co. and CVS Corporation drug stores.

We generate revenue for ourselves and pay our retail partners a fee through our commissions earned on the sales of e-payment services. We have relationships with national wireless carriers, such as Sprint, Verizon, T-Mobile, Virgin Mobile and Cingular Wireless. As part of our strategy to increase and augment our e-payment services business, we have acquired three regional e-payment businesses.

Expenses

Our direct operating expenses consist of expenses associated with our coin-counting, e-payment and entertainment services operations and support, as follows:

For coin services and e-payment services, these expenses consist primarily of the cost of (1) coin pick-up, transportation and processing expenses, (2) field operations support and related expenses, (3) retail operations support and (4) the percentage of transaction fees we pay to our retail partners. Variations in the percentage of transaction fees we pay to our retail partners may result in increased expenses. Such variations are based on our evaluation of certain factors with the retailer, such as total revenue, e-payment capabilities, long-term non-cancelable contracts, installation of our machines in high traffic and/or urban or rural locations, new product commitments, or other criteria.

For entertainment services, these expenses consist primarily of the cost of plush toys and other products dispensed from the skill-crane and bulk-vending machines. Our plush toys are produced abroad, primarily in China. We purchase other products, including products provided in our bulk vending machines, from other third party suppliers. Similar to our coin services business, other expenses of our entertainment business also consist of (1) the cost of coin pick-up, transportation and processing expenses, (2) field operations support and related expenses and (3) the fees we pay our retail partners for the placement of our machines.

Our sales and marketing expenses consist primarily of marketing, advertising and public relations efforts in existing market regions and startup marketing expenses incurred to launch our services in new regional markets.

Our research and development expenses consist primarily of development costs of our coin-counting machine software, network applications, machine improvements and new product development.

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Our general and administrative expenses consist primarily of administrative support for field operations, customer service, systems and engineering support, computer network operations, finance, human resources, occupancy expenses, legal expenses and insurance.

Our depreciation and other expenses consist primarily of depreciation charges on our installed coin-counting, entertainment and e-payment services machines and, to a lesser extent, depreciation on computer equipment, leasehold improvements and leased automobiles.

Our amortization expense consists of amortization of intangible assets including retailer relationships that were valued when we acquired our various subsidiaries.

We expect to continue devoting significant resources to building our sales and marketing organization, adding administrative personnel and developing the systems and infrastructure necessary to support our machines. We expect to continue evaluating new marketing and promotional programs to increase consumer utilization of our services. We also intend to continue to engage in information technology systems and product research and development.

We believe that our future coin-counting, entertainment and e-payment product revenue growth, operating margin gains and profitability will depend on the success of our efforts to increase customer usage, retain our current retail partners, respond to competitive pressures, expand our installed base with retail partners in existing markets, expand into new geographies and distribution formats and undertake ongoing marketing and promotional activities that will sustain the growth in unit coin volume over time. Given the unpredictability of the timing of installations with retail partners and the resulting revenues, the growth in coin processing volumes of our installed base and the continued market acceptance of our services by consumers and retail partners, our operating results for any future periods may be subject to significant variation, and we believe that period-to-period comparisons of our results of operations are not necessarily predictive and should not be relied on as indications of future performance.

Results of Operations

We acquired ACMI on July 7, 2004 and consequently, ACMI s 2004 second quarter and six month financial results are not included in our consolidated financial results for the three and six months ended June 30, 2004.

The following table shows revenue and expense as a percent of revenue for the periods indicated:

	Six Month Periods Ended June 30,		**Three Month Periods Ended June 30,**	
	2005	**2004**	**2005**	**2004**
Revenue.	100.0%	100.0%	100.0%	100.0%
Expenses:				

Direct operating	68.4	47.7	67.7	48.3
Sales and marketing	1.4	5.2	1.8	7.7
Research and development	1.3	3.3	1.4	3.2
General and administrative	8.0	10.9	7.9	10.2
Depreciation and other	10.1	16.9	10.0	15.6
Amortization of intangibles	1.0	0.2	1.0	0.2
Income from operations	9.8%	15.8%	10.2%	14.8%

Three Month Periods Ended June 30, 2005 and 2004

Revenue

Revenue increased to $109.8 million in the three months ended June 30, 2005 from $47.8 million for the comparable 2004 period. Our revenue grew as a result of two primary factors: (1) the acquisition of our subsidiary, ACMI, and (2) an increase in coin-counting activity.

Revenue for our coin and e-payment services increased from $47.8 million to $54.8 million, or 14.6% as a result of an increase in the number of transactions, an increase in the number of coin-counting machines and e-payment point of sale locations in service and the volume of coins processed by the machines in service during this period. The total dollar value of coins processed through our

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network increased to approximately $595 million during the three months ended June 30, 2005 from approximately $538 million for the comparable 2004 period. The installed base of coin-counting machines increased to approximately 12,400 in the three months ended June 30, 2005 from approximately 11,200 machines as of June 30, 2004.

Entertainment services revenue during the three months ended June 30, 2005 was $55.0 million. In the comparable prior year period, ACMI as a standalone company, reported revenue of $55.6 million. Due to various factors, including the timing of the Easter holiday which occurred in the first quarter in 2005 versus the second quarter in 2004, as well as lower same store comps in some of our major retail store partners, our entertainment services revenue was mainly flat over the same year-ago period. Our entertainment services revenue is derived primarily from skill-crane machines, which comprised approximately 70% of our entertainment revenue, and bulk vending equipment installed in retail locations. Total entertainment services machines installed at June 30, 2005 was approximately 176,000 machines, an increase of over 14,000 machines since July 7, 2004, the date of our acquisition.

Direct Operating Expenses

Direct operating expenses increased to $74.4 million in the three months ended June 30, 2005 from $23.1 million in the comparable prior year period. Direct operating expenses increased primarily due to (1) our acquisition of ACMI, (2) changes in the transaction fee arrangements we pay certain of our coin services retail partners and (3) increased expenses to develop and provide ongoing support to our retail partners as we make additional services available through our coin-counting machines. Direct operating expenses as a percentage of revenue increased to 67.7% in the three months ended June 30, 2005 from 48.3% in the same period of 2004 primarily due to the addition of our entertainment subsidiary which has higher direct operating expenses, mainly due to the plush toys and other items dispensed from our entertainment machines. We expect transportation expenses to continue increasing if the current trend of rising fuel costs continues, and labor costs may increase as we expand into less densely populated regions.

Sales and Marketing

Sales and marketing expenses decreased to $2.0 million in the quarter ended June 30, 2005 from $3.7 million in the comparable prior year quarter. This year we have targeted our advertising and focused on regional promotions as new products are introduced in new and existing markets. Since revenues increased significantly and our marketing expenditures decreased, sales and marketing expenses as a percentage of revenue decreased to 1.8% in the three months ended June 30, 2005 from 7.7% in the comparable prior year period.

Research and Development

Product research and development expenses decreased slightly to $1.5 million in the quarter ended June 30, 2005 from $1.6 million in the comparable prior year quarter. Research and development expenses represent expenditures to support research and development to design complementary new product ideas and continue our ongoing efforts to enhance our existing products and services, primarily our coin-counting system. Since revenues increased significantly and our research and development expenditures remained relatively consistent, research and development expenses as a percentage of revenue decreased to 1.4% for the three months ended June 30, 2005 from 3.2% in the comparable prior year period.

General and Administrative

General and administrative expenses increased to $8.7 million for the three month period ended June 30, 2005 from $4.9 million in the comparable prior year quarter. General and administrative expenses increased primarily due to the acquisition of ACMI, which resulted in additional expenses of $3.1 million. In addition to the impact from ACMI, our general and administrative expenses increased to support our ongoing business expansion and acquisition strategy. For example, we experienced increased registration, legal and software maintenance cost this year. General and administrative expenses as a percentage of revenue decreased to 7.9% in the three months ended June 30, 2005 from 10.2% in the comparable prior year period.

Depreciation and Other

Depreciation and other expense increased to $11.0 million in the quarter ended June 30, 2005 from $7.5 million in the comparable prior year quarter. Depreciation expense increased primarily due to our acquisition of ACMI which recognized depreciation expense of $4.3 million in the three months ended June 30, 2005. Depreciation and other expense as a percentage of revenue decreased to 10.0% in the three months ended June 30, 2005 from 15.6% in the comparable prior year period.

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Amortization of Intangible Assets

Amortization of intangible assets increased to $1.1 million in the three months ended June 30, 2005, from $0.1 million in the comparable 2004 period. Amortization expense of intangible assets increased due to our acquisitions, mainly ACMI; specifically the amortization of the value allocated to retailer relationships. Amortization expense as a percentage of revenue increased to 1.0% in the three months ended June 30, 2005, from 0.2% in the same period during 2004.

Other Income and Expense

Interest income and other, net, increased to $532,000 in the three months ended June 30, 2005 from $61,000 in the comparable prior year period. The increase in other income was due to a combination of factors, including an increase in interest income earned on the proceeds received in connection with our secondary offering in December 2004, as well as miscellaneous income earned and recognized under equity method accounting by our e-payment subsidiary.

Interest expense increased to $3.1 million in the three months ended June 30, 2005 from $0.1 million in the comparable prior year period. With our acquisition of ACMI on July 7, 2004, we entered into a $310.0 million credit facility of which $206.8 million was outstanding at June 30, 2005. As a result, the increase in interest expense was attributed to a significantly larger amount of outstanding debt at the quarter ended June 30, 2005 compared to 2004.

Six Month Periods Ended June 30, 2005 and 2004

Revenue

Revenue increased to $215.4 million in the six months ended June 30, 2005 from $90.9 million for the comparable 2004 period. Our revenue grew as a result of two primary factors: (1) the acquisition of our subsidiary, ACMI, and (2) an increase in coin-counting activity.

Revenue for our coin and e-payment services increased from $90.9 million to $103.1 million, or 13.5% as a result of an increase in the number of transactions, an increase in the number of coin-counting machines and e-payment point of sale locations in service and the volume of coins processed by the machines in service during this period. The total dollar value of coins processed through our network increased to approximately $1.1 billion during the six months ended June 30, 2005 from approximately $1.0 billion for the comparable 2004 period. The installed base of coin-counting machines increased to approximately 12,400 in the six months ended June 30, 2005 from approximately 11,200 machines as of June 30, 2004.

Entertainment services revenue during the six months ended June 30, 2005 was $112.3 million. In the comparable prior year period, ACMI as a standalone company, reported revenue of $111.9 million. Due to various factors, including low same store comps in some of our major retail store partners , our entertainment services revenue was mainly flat over the same year-ago period. Our entertainment services revenue is derived primarily from skill-crane machines, which comprised approximately 70% of our entertainment revenue, and bulk vending equipment installed in retail locations. Total entertainment services machines installed at June 30, 2005 was approximately 176,000 machines, an increase of over 14,000 machines since July 7, 2004, the date of our acquisition.

Direct Operating Expenses

Direct operating expenses increased to $147.3 million in the six months ended June 30, 2005 from $43.3 million in the comparable prior year period. Direct operating expenses increased primarily due to (1) our acquisition of ACMI, (2) changes in the transaction fee arrangements we pay certain of our coin services retail partners and (3) increased expenses to develop and provide ongoing support to our retail partners as we make additional services available through our coin-counting machines. Direct operating expenses as a percentage of revenue increased to 68.4% in the six months ended June 30, 2005 from 47.7% in the same period of 2004 primarily due to the addition of our entertainment subsidiary which has higher direct operating expenses, mainly due to the plush toys and other items dispensed from our entertainment machines. We expect transportation expenses to continue increasing if the current trend of rising fuel costs continues, and labor costs may increase as we expand into less densely populated regions.

Sales and Marketing

Sales and marketing expenses decreased to $2.9 million in the six months ended June 30, 2005 from $4.7 million in the comparable prior year period. This year we have targeted our advertising and focused on regional promotions as new products are introduced in new and existing markets. Sales and marketing expenses as a percentage of revenue decreased to 1.4% in the six months ended June 30, 2005 from 5.2% in the comparable prior year period.

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Research and Development

Research and development expenses decreased to $2.8 million in the six months ended June 30, 2005 from $3.0 million in the comparable prior year period. Research and development expenses represent expenditures to support research and development to design complementary new product ideas and continue our ongoing efforts to enhance our existing products and services, primarily our coin-counting system. Since revenues increased significantly and our research and development expenditures remained relatively consistent, research and development expenses as a percentage of revenue decreased to 1.3% for the six months ended June 30, 2005 from 3.3% in the comparable prior year period.

General and Administrative

General and administrative expenses increased to $17.3 million for the six month period ended June 30, 2005 from $10.0 million in the comparable prior year period. General and administrative expenses increased primarily due to the acquisition of ACMI, which resulted in additional expenses of $6.1 million. Excluding the impact from ACMI, our general and administrative expenses increased to support our ongoing business expansion and acquisition strategy. For example, we experienced increased registration, legal and software maintenance cost this year. General and administrative expenses as a percentage of revenue decreased to 8.0% in the six months ended June 30, 2005 from 10.9% in the comparable prior year period.

Depreciation and Other

Depreciation and other expense increased to $21.8 million in the six months ended June 30, 2005 from $15.4 million in the comparable prior year period. Depreciation expense increased primarily due to our acquisition of ACMI which recognized depreciation expense of $8.5 million in the six months ended June 30, 2005. During the six months ended June 30, 2004, in addition to depreciation expense, there was other expense of $1.9 million related to the disposal of fixed assets which did not recur in 2005. Depreciation and other expense as a percentage of revenue decreased to 10.1% in the six months ended June 30, 2005 from 16.9% in the comparable prior year period.

Amortization of Intangible Assets

Amortization of intangible assets increased to $2.1 million in the six months ended June 30, 2005, from $0.1 million in the comparable 2004 period. Amortization expense of intangible assets increased due to our acquisitions, mainly ACMI; specifically the amortization of the value allocated to retailer relationships. Amortization expense as a percentage of revenue increased to 1.0% in the six months ended June 30, 2005, from 0.2% in the same period during 2004.

Other Income and Expense

Interest income and other, net, increased to $1.0 million in the six months ended June 30, 2005 from $0.1 million in the comparable prior year period. The increase in other income was due to a combination of factors including an increase in interest income earned on the proceeds received in connection with our secondary offering in December 2004, as well as miscellaneous income earned and recognized under equity method accounting by our e-payment subsidiary.

Interest expense increased to $6.0 million in the six months ended June 30, 2005 from $0.4 million in the comparable prior year period. With our acquisition of ACMI on July 7, 2004, we entered into a $310.0 million credit facility of which $206.8 million was outstanding at June 30, 2005. As a result, the increase in interest expense was attributed to a significantly larger amount of outstanding debt at the six months ended June 30, 2005 compared to 2004.

Liquidity and Capital Resources

As of June 30, 2005, we had cash, cash equivalents and cash being processed totaling $162.7 million, which consisted of cash and cash equivalents available to fund our operations of $99.6 million and cash being processed of $63.1 million. Cash being processed represents cash residing in our machines, cash in transit or cash which is payable to our retail partners as service fees. Working capital was $112.0 million at June 30, 2005 compared with $105.0 million at December 31, 2004.

Net cash provided by operating activities was $35.8 million for the six months ended June 30, 2005, compared to net cash provided by operating activities of $27.9 million for the six months ended June 30, 2004. Cash provided by operating activities increased primarily as the result of an increase in net income of $0.8 million and by an increase in non-cash expenses on our income statement of $10.0 million offset by a net increase in cash used by changes in our operating assets and liabilities of $2.9 million. The

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cash used by operating assets and liabilities increased in 2005 by $2.9 million mainly from the timing of payments from customers and payments of accrued liabilities compared to the prior year.

Net cash used by investing activities for the six month period ended June 30, 2005 was $28.1 million compared to $21.7 million in the comparable prior year. Net cash used by investing activities consisted primarily of capital expenditures made in each of the six month periods ended June 30, 2005 and 2004, mainly for the purchase of coin and entertainment machines. Additionally we have paid $3.6 million in 2005 and $7.3 million in 2004 in connection with acquisitions and acquisition related costs. As of June 30, 2005, we had entered into certain purchase agreements with suppliers of our machines which require aggregate future purchases for coin and entertainment machines and components in the amount of $7.0 million.

Net cash used by financing activities for the six month period ended June 30, 2005 was $0.7 million. This amount represented cash used to make scheduled principal payments on our term loan and on capital lease payments of $1.8 million offset by proceeds from the exercise of stock options and employee stock purchases of $1.1 million. Net cash used by financing activities for the six months ended June 30, 2004 was $6.3 million. This amount represented cash used to make principal payments of $8.6 million on our term loan, offset by proceeds from the exercise of stock options and employee stock purchases of $2.4 million.

On July 7, 2004, we entered into a senior secured credit facility funded by a syndicate of lenders led by JPMorgan Chase Bank and Lehman Brothers Inc. to provide for the financing of our acquisition of ACMI. The credit agreement provided for advances totaling up to $310.0 million, consisting of a $60.0 million revolving credit facility and a $250.0 million term loan facility. Fees for this facility of approximately $5.7 million are being amortized over the life of the revolving line of credit and the term loan which are 5 years and 7 years, respectively. Loans made pursuant to the credit agreement are secured by a first security interest in substantially all of our assets and the assets of our subsidiaries, as well as a pledge of our subsidiaries capital stock. The credit facility matures on July 7, 2011. As of June 30, 2005, our original term loan balance of $250.0 million had been reduced to $206.8 million.

Advances under this credit facility may be made as either base rate loans (the higher of the Prime Rate or Federal Funds Effective Rate) or LIBOR rate loans at our election. Applicable interest rates are based upon either the LIBOR or base rate plus an applicable margin dependent upon a consolidated leverage ratio of outstanding indebtedness to EBITDA (to be calculated in accordance with the terms specified in the credit agreement). Initially, interest rates payable upon advances were based upon either an initial rate of LIBOR plus 225 basis points or the base rate plus 125 basis points. Due to improved consolidated leverage ratios, as of February 28, 2005, the basis points added to either LIBOR or the base rate have been respectively reduced to 200 basis points and 100 basis points. At June 30, 2005, our interest rate on this facility was 5.13%. On July 7, 2005, due to increases in the LIBOR rate, our interest rate was adjusted to 5.55%.

The credit facility contains standard negative covenants and restrictions on actions by us including, without limitation, restrictions on indebtedness, liens, fundamental changes or dispositions of our assets, payments of dividends or common stock repurchases, capital expenditures, foreign investments, acquisitions, sale and leaseback transactions and swap agreements, among other restrictions. In addition, the credit agreement requires that we meet certain financial covenants, ratios and tests, including maintaining a maximum consolidated leverage ratio and a minimum interest coverage ratio, as defined in the agreement. As of June 30, 2005, we were in compliance with all covenants.

Quarterly principal payments on the term loan of $0.5 million terminate on March 31, 2011. The remaining principal balance of $194.8 million will be due July 7, 2011, the maturity date of the facility. Commitment fees on the unused portion of the facility, currently 50 basis points, may vary and are based on our consolidated leverage ratio.

On September 23, 2004 we purchased an interest rate cap and sold an interest rate floor at zero net cost, which protects us against certain interest rate fluctuations of the LIBOR rate, on $125.0 million of our variable rate debt under our credit facility. The effective date of the interest rate cap and floor is October 7, 2004 and expires in three years on October 9, 2007. The interest rate cap and floor consists of a LIBOR ceiling of 5.18% and a LIBOR floor that step up in each of the three years beginning October 7, 2004, 2005 and 2006. The LIBOR floor rates are 1.85%, 2.25% and 2.75% for each of the respective three-year periods. Under this hedge, we will continue to pay interest at prevailing rates plus any spread, as defined by our credit facility, but will be reimbursed for any amounts paid on LIBOR in excess of the ceiling. Conversely, we will be required to pay the financial institution that originated the instrument if LIBOR is less than the respective floor rates. We have recognized the fair value of the interest rate cap and floor as an asset of $50,800 at June 30, 2005.

As of June 30, 2005, we had eight irrevocable letters of credit that totaled $16.7 million. These letters of credit, which expire at various times through May 2006, are available to collateralize certain obligations to third parties. As of June 30, 2005, no amounts were outstanding under these letters of credit.

Under the terms of our credit agreement entered into on July 7, 2004, we are permitted and our Board has authorized us to repurchase up to $3.0 million of our common stock plus proceeds from the issuance of new shares of capital stock under our employee equity compensation plans. (This authorization is in addition to the 1,233,214 shares repurchased previous to July 7, 2004 for an

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aggregate of $22.8 million.) As of June 30, 2005, the cumulative proceeds received from option exercises or other equity purchases under our equity compensation plans subsequent to July 7, 2004, totaled approximately $6.1 million bringing the total authorized for purchase under our credit agreement to $9.1 million. We have not made further share repurchases since entering into our new credit facility on July 7, 2004.

As of June 30, 2005, our net deferred income tax assets totaled $29.5 million. In the quarter ended June 30, 2005, we recorded $3.4 million in income tax expense, which, as a result of our federal and state NOL carryforwards, will not result in cash payments for income taxes other than those required by some foreign jurisdictions and states, and federal alternative minimum taxes.

Contractual Obligations and Commercial Commitments

The tables below summarize our contractual obligations and other commercial commitments as of June 30, 2005:

	Payments Due by Period				
Contractual Obligations as of June 30, 2005	**Total**	**Less than 1 year**	**1 3 years**	**4 5 years**	**After 5 years**
	(in thousands)				
Long-term debt	$ 206,808	$ 2,089	$ 4,178	$ 4,178	$ 196,363
Capital lease obligations	3,558	1,520	1,777	261	
Operating leases	20,104	7,258	9,165	2,636	1,045
Purchase obligations*	17,698	17,698			
Total contractual cash obligations	$ 248,168	$ 28,565	$ 15,120	$ 7,075	$ 197,408

* Purchase obligations consist of outstanding purchase orders issued in the ordinary course of our business.

	Amount of Commitment Expiration Per Period				
Other Commercial Commitments as of June 30, 2005	**Total**	**Less than 1 year**	**1 3 years**	**4 5 years**	**After 5 years**
	(in thousands)				
Letters of credit	$ 16,669	$ 16,669	$	$	$
Total commercial commitments	$ 16,669	$ 16,669	$	$	$

We believe our existing cash, cash equivalents and amounts available to us under our credit facility will be sufficient to fund our cash requirements and capital expenditure needs for at least the next 12 months. After that time, the extent of additional financing needed, if any, will depend on the success of our business. If we significantly increase installations beyond planned levels, or if coin counting machine volumes generated or entertainment services machine plays are lower than historical levels, our cash needs may increase. Furthermore, our future capital requirements will depend on a number of factors, including cash required by future acquisitions, our consumer usage, the timing and number of installations, the number of available installable machines held, the type and scope of service enhancements and the cost of developing potential new product and service offerings and enhancements.

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Quarterly Financial Results

The following table sets forth selected unaudited quarterly financial information for the last eight quarters. This information has been prepared on the same basis as our audited consolidated financial statements as of December 31, 2004 and includes, in the opinion of management, all normal and recurring adjustments that management considers necessary for a fair presentation of the quarterly results for the periods. The operating results for any quarter are not necessarily indicative of the results for future periods. Certain reclassifications have been made to the prior period amounts to conform with the current period presentation.

	Three Month Periods Ended							
	June 30, 2005	March 31, 2005	Dec. 31, 2004	Sept. 30, 2004	June 30, 2004	March 31, 2004	Dec. 31, 2003	Sept. 30, 2003
	(in thousands, except per share data) (unaudited)							
Consolidated Statements of Operations:								
Revenue	$ 109,840	$ 105,585	$ 109,793	$ 106,430	$ 47,825	$ 43,052	$ 46,366	$ 48,671
Expenses:								
Direct operating	74,389	72,880	73,678	69,937	23,093	20,218	20,904	20,870
Sales and marketing	1,975	957	4,567	3,642	3,666	1,050	5,262	3,440
Research and development	1,516	1,309	1,058	1,410	1,556	1,441	1,389	1,566
General and administrative	8,687	8,592	9,423	8,098	4,890	5,064	4,376	4,783
Depreciation and other	10,958	10,806	10,116	9,821	7,450	7,915	7,245	6,764
Amortization of intangible assets	1,104	1,031	993	884	84	53	37	38
Income from operations	11,211	10,010	9,958	12,638	7,086	7,311	7,153	11,210
Interest income and other, net	532	488	201	190	61	69	41	38
Interest expense and early retirement of debt	(3,100)	(2,850)	(3,812)	(2,793)	(126)	(246)	(216)	(300)
Income before income taxes	8,643	7,648	6,347	10,035	7,021	7,134	6,978	10,948
Income taxes	(3,378)	(2,980)	(1,796)	(3,386)	(2,470)	(2,517)	(2,548)	(4,014)
Net income	$ 5,265	$ 4,668	$ 4,551	$ 6,649	$ 4,551	$ 4,617	$ 4,430	$ 6,934
Net income per share:								
Basic	$ 0.21	$ 0.18	$ 0.20	$ 0.31	$ 0.21	$ 0.22	$ 0.21	$ 0.32
Diluted	$ 0.21	$ 0.18	$ 0.20	$ 0.30	$ 0.21	$ 0.21	$ 0.21	$ 0.32

Seasonality

We have historically experienced seasonality in our coin services business, with highest revenues experienced in the third calendar quarter, followed by the fourth calendar quarter, and relatively lower revenues in the first half of the year. ACMI has also experienced seasonality, with peak revenues in the fourth quarter and periods surrounding the Easter holiday season. While our acquisition of ACMI may impact the historical seasonality of our business to some degree, we expect our results of operations will continue to fluctuate both as a result of seasonal fluctuations and our revenue mix between relatively higher margin coin and e-payment services and relatively lower margin entertainment services.

Factors That May Affect Our Business, Future Operating Results and Financial Condition

You should carefully consider the risks described below before making an investment decision. The risks and uncertainties described below are not the only ones facing our company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations. If any of the following risks actually occur, our business could be harmed, the trading price of our common stock could decline and you could lose all or part of your investment.

Certain statements in the risks described below are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include any statement that may predict, forecast, indicate, or imply future results performance, or achievements. Forward-looking statements can be identified by the use of terminology such as believe, anticipate, expect, estimate, may, w should, project, continue, plans, aims, intends, likely, or other similar words or phrases. Except for historical matters, the matters disc this Quarterly Report on Form 10-Q and other statements or filings made by Coinstar from time-to-time may be forward-looking statements. We caution you that forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from the forward-looking statements. We are including this Cautionary Statement to make applicable and take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 for any such forward-looking statements.

We have substantial indebtedness as a result of our acquisition of ACMI.

On July 7, 2004, we acquired ACMI for $235.0 million in cash. To finance the acquisition, we entered into a senior secured credit facility funded by a syndicate of lenders led by JPMorgan Chase Bank and Lehman Brothers Inc. The credit agreement provides for advances totaling up to $310.0 million, consisting of a $60.0 million revolving credit facility and a $250.0 million term loan

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facility. Since this acquisition, we have repaid $43.2 million of the debt outstanding. The credit facility bears interest at variable rates pegged to prevailing interest rates. As a result, our operating results are exposed to risks of fluctuations in interest rates. Loans made pursuant to the credit agreement are secured by a first security interest in substantially all of our assets and the assets of our subsidiaries, as well as a pledge of our subsidiaries capital stock. The credit facility matures on July 7, 2011. This debt financing may limit our ability to effect future financings or may negatively impact our business, financial condition, results of operations and growth. Substantial financial leverage poses the risk that we may not be able to generate sufficient cash flow to service the indebtedness, or to adequately fund our operations. We may be unable to increase our revenue and leverage the acquisition of ACMI to achieve sufficient cash flow to meet our debt service obligations. Moreover, the credit agreement governing our indebtedness contains financial and other covenants that could impair our flexibility and restrict our ability to pursue growth opportunities. The credit agreement contains negative covenants and restrictions on actions by us including, without limitation, restrictions on certain common stock repurchases, liens, investments, capital expenditures, indebtedness, restricted payments including cash payments of dividends, and fundamental changes or dispositions of our assets. In addition, the credit agreement requires that we meet certain financial covenants, ratios and tests, including maintaining a maximum consolidated leverage ratio and a minimum interest coverage ratio, all as defined in the credit agreement. If the covenants are not met, our lenders would be entitled, under certain circumstances, to declare such indebtedness immediately due and payable.

We have limited experience in operating ACMI s entertainment services business. If this business does not meet our performance expectations, our business and financial condition could be materially and adversely affected.

We completed our acquisition of ACMI on July 7, 2004, and have included its operations in our financial results since that date. As a result of ACMI s higher operating expenses, as well as the impact from acquisition-related charges, including the amortization of intangibles and financing fees, our blended operating margin was 9.8% in the six months ended June 30, 2005, compared to 15.8% in the first six months of 2004, which was prior to the ACMI acquisition. We expect our future operating margins to fluctuate on a quarterly and annual basis as a function of our coin-counting, e-payment and entertainment services revenues. In addition, as a result of the ACMI acquisition, we are now required to maintain inventory of consumer products to support our skill-crane and bulk vending machine businesses. As of June 30, 2005, we carried $27.2 million of inventory on our balance sheet, approximately 75% of which is attributable to the entertainment business. While we will regularly evaluate the carrying value of this inventory and establish reserves for obsolete inventory, our experience in evaluating this inventory is limited. If we determine that the value of our inventory has become impaired, we may be required to take substantial write-downs, which would be charged to direct operating expenses. Because we have limited experience in operating our entertainment services business, there may be other expenses or liabilities associated with this business that we are not aware of, or we may not be able to achieve the operating results for the entertainment services business in line with ACMI s historical results or our expectations. For any of the foregoing reasons, we may not achieve the strategic and financial objectives of the ACMI acquisition, and our failure to do so could materially and adversely affect our businesses, operating results and financial condition.

The termination, non-renewal or renegotiation on materially adverse terms of our contracts with any one or more of our significant retail partners could seriously harm our business, financial condition and results of operations.

We derive substantially all of our revenue from two sources: coin-counting machines installed in high traffic supermarkets and entertainment services machines installed in supermarkets, mass merchandisers, restaurants, bowling centers, truckstops, warehouse clubs and similar locations. The success of our business depends in large part on our ability to maintain relationships with our existing retail partners in locations where we can operate profitably. For example, since our acquisition of our entertainment services subsidiary, Wal-Mart, Inc. and the Kroger Company account for approximately 28.0% and 10.6% of our consolidated revenue, respectively. If we are unable to persuade existing retail partners that our coin and entertainment services provide direct and indirect benefits that are superior to or competitive with other systems (including coin-counting systems which the retail partners could operate themselves or through a third party) or alternative potential uses of the floor space that our machines occupy, we may encounter difficulties maintaining existing retailer relationships. We typically operate pursuant to separate agreements with each of our retail partners. Our typical contract is for a set term, which typically ranges from one to three years and automatically renews until we or our partner gives notice of termination before a certain time prior to the end of the initial term or renewal period. However, there are variations on certain contract provisions with some of our retail partners, including product offerings, the service fee we pay each retail partner, frequency of service, and the ability to cancel the contract upon notice after a certain period of time. Our entertainment services relationship with Wal-Mart, Inc. is governed by a contract that Wal-Mart, Inc. may terminate at any time, for any reason.

Cancellation of this contract would seriously harm our entertainment services business and reputation. More generally, if we are unable to maintain or renew such contracts with our other existing retail partners, our business, financial condition and results of operations could be significantly impaired. For example, a contract with one of our brokers recently expired. We are currently still providing machines in accordance with the contract and have not yet agreed upon a deinstallation schedule. Although the contract expiration is expected to result in the loss of certain relationships, we do not believe that any such loss will have a material adverse effect on our financial results.

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We may be unable to continue to pay our retail partners a service fee that allows us to operate our coin-counting and entertainment services machines at historical levels of profitability.

We have faced and continue to face ongoing pricing pressure from our current retail partners to increase the service fee we pay on coin and entertainment services or to make other financial concessions to win or retain business. If we are unable to respond effectively to ongoing pricing pressures, we may fail to retain certain of our retail partners. We have, in some cases, implemented new fee arrangements for our coin services. These fee arrangements are based on our evaluation of certain unique factors with the retailer, such as total revenue, e-payment capabilities, long-term non-cancelable contracts, installation of our machines in high traffic and/or urban or rural locations, new product commitments, or other criteria. Together with other factors, these arrangements could increase our expenses relative to coin services significantly in future periods.

We may be unable to attract new retail partners and penetrate new markets and distribution channels.

In order to continue our coin-counting and entertainment services machine installation growth, we will need to attract new retail partners and develop operational or unit production cost efficiencies that make it feasible for us to penetrate lower density markets and/or new distribution channels. We may be unable to attract new retail partners or drive down costs relating to the manufacture, installation or servicing of coin-counting or entertainment services machines to levels that would enable us to operate profitably in lower density markets. If we are unable to do so, our future operating results could be adversely affected.

We may be unable to identify and define product trends, as well as to anticipate, gauge and react to changing consumer demands in a timely manner.

To be competitive, we need to develop new services that are accepted by the market and establish third-party relationships necessary to develop and commercialize such services. For example, toy and other products dispensed in our entertainment services machines must appeal to a broad range of consumers whose preferences cannot be predicted with certainty and are subject to change. If we misjudge the market for our toy products, we may be faced with significant excess inventories for some products and missed opportunities for other products. In addition, because we place orders for toy products well in advance of purchases by consumers, we could experience excess inventory if our consumers purchase fewer products than anticipated. In order to develop and commercialize new non-entertainment vending products or services, we will need to enhance the capabilities of our coin-counting and entertainment services machines and our network and establish market acceptance of such products or services. We cannot assure you that new or additional products or services that we may attempt to commercialize will be successful.

Competitive pressures could seriously harm our business, financial condition and results of operations.

Our coin-counting business faces competition from supermarket retailers, banks and other companies that purchase and operate coin-counting equipment from companies such as ScanCoin AB, Cummins-Allison Corporation and others, and who service such equipment themselves or through third parties. Other retail partners may choose to replace our coin-counting machines with self-installed machines. In addition, retailers, some of which have significantly more resources than us, may decide to enter the coin-counting business and some banks and other competitors already provide coin-counting free of charge or for an amount that yields very low margins or that may not generate a profit at all. An expansion of the coin-counting services provided by any of such competitors could materially and adversely affect our business and results of operations.

As a result of our acquisition of ACMI, we now compete with a number of regional and local operators of entertainment services equipment. Many of these competitors are engaged in expansion programs, and ACMI has experienced and we expect to continue to experience intense competition for new locations and acquisition candidates. We may be unable to compete effectively with these companies in the future. Our entertainment services equipment also competes with other vending machines, coin-operated entertainment devices, and seasonal and bulk merchandise for sites within retail locations. We cannot assure you that we will be able to maintain current sites in the retail locations or that we will be able to obtain sites in the future on attractive terms or at all. It is possible that a well-financed vending machine manufacturer or other vending machine operator with existing relationships with retail accounts could compete with us in certain markets or capture additional market share at our expense.

Defects or failures in our coin-counting machines   operating system could harm our business.

The operation of our coin-counting machines depends on sophisticated software, computing systems and communication services that may contain undetected errors or may be subject to failures. These errors may arise particularly when new services or service enhancements are added. We have in the past experienced limited delays and disruptions resulting from upgrading or improving our operating systems. Future upgrades or improvements that may be necessary to expand and maintain our business could result in delays or disruptions that could have the effect of seriously harming our operations. We also rely on a long distance telecommunication network that is not owned by us and is subject to service disruptions. Further, while we have taken significant steps to protect the security of our network, security breaches may result from intentional acts of third parties or from computer viruses. Any service disruptions, whether due to errors or delays in our software or computing systems, interruptions or breaches in the communications network, or security breaches of the system, could seriously harm our business, financial condition and results of operations.

Lack of consumer confidence, whether real or perceived, in our coin-counting machines could harm our business.

The accuracy of the coin-counting functionality of our machines is important to consumers and our retail partners. The failure to maintain consumer confidence in our technology and systems could harm our business. Our inability to collect the data from our coin-counting machines could lead to a delay in processing coins and crediting the accounts of our retail partners for vouchers that have already been redeemed. Any loss or delay in collecting coin data could seriously harm our operations.

We may be unable to adequately protect or enforce our patents and other proprietary rights.

Our success depends, in part, on our ability to protect our intellectual property and maintain the proprietary nature of our technology through a combination of patents, licenses and other intellectual property arrangements, without infringing the proprietary rights of third parties. We have 59 United States and international patents relevant to aspects of self-service coin-counting, including: machine networking, fraud avoidance and voucher authentication, among others. We also have additional patent applications pending in the United States and several foreign jurisdictions directed to this technology.

Our patents may not be held valid if challenged, pending patent applications may not be issued, and other parties may claim rights in or ownership of our patents and other proprietary rights. Since many patent applications in the United States are not publicly disclosed until the patent is issued, others may have filed applications, which, if issued as patents, could cover our products or technology. Patents issued to us may be circumvented or fail to provide adequate protection of our technologies. Our competitors might independently develop or patent technologies that are substantially equivalent or superior to our technologies.

We also rely on trademarks, copyrights, trade secrets and other proprietary intellectual property to develop and maintain our competitive position. Although we protect our intellectual property in part by confidentiality agreements with our employees, consultants, vendors and corporate partners, these parties may breach these agreements. We may have inadequate remedies for any such breach and our trade secrets may otherwise become known or be discovered independently by our competitors. The failure to protect our intellectual property rights effectively or to avoid infringing the intellectual property rights of others could seriously harm our business, financial condition and results of operations.

Certain parties may assert claims of patent infringement or misappropriation against us based on current or pending United States and/or foreign patents, copyrights or trade secrets, or contracts. If such claims were successful, our business could be harmed. Defending our company and our retail partners against these types of claims, regardless of their merits, could require us to incur substantial costs and divert the attention of key personnel. Parties making these types of claims may be able to obtain injunctive or other equitable relief, which could effectively block our ability to provide our coin-counting service and operate our coin-counting equipment in the United States and abroad. Such types of claims could also result in an award of substantial damages. If third parties have or obtain proprietary rights that our products infringe, we may be unable to obtain necessary licenses from others at a reasonable cost or at all. For example, we have from time to time engaged in discussions with a former supplier, ScanCoin AB, in an effort to clarify certain contract rights and obligations as well as ownership of certain of our intellectual property. In addition, if we instigate litigation to enforce our patents or protect our other proprietary rights, or to determine the validity and scope of other parties proprietary rights, such litigation could cause us to spend significant financial and management resources.

Acquisitions involve risks that could harm our business and impair our ability to realize potential benefits from such acquisitions.

As part of our business strategy, we have in the past sought and may in the future seek to acquire or invest in businesses, products or technologies that we feel could complement or expand our business. We may be unable to adequately address the financial, legal and operational risks raised by acquisitions, which could harm our business and prevent us from realizing the projected benefits of the acquisitions. Further, the evaluation and negotiation of potential acquisitions, as well as the integration of an acquired business, will divert management time and other resources. In addition, we cannot assure you that any particular transaction, even if successfully completed, will ultimately benefit our business. Certain financial and operational risks related to acquisitions that may have a material impact on our business are:

- use of cash resources and incurrence of debt and contingent liabilities in funding acquisitions,
- stockholder dilution if an acquisition is consummated through an issuance of our securities,
- amortization expenses related to acquired intangible assets and other adverse accounting consequences,
- costs incurred in identifying and performing due diligence on potential acquisition targets that may or may not be successful,

difficulties and expenses in assimilating the operations, products, technology, information systems or personnel of the acquired company,

impairment of relationships with employees, retailers and affiliates of our business and the acquired business,

the assumption of known and unknown liabilities of the acquired company, including intellectual property claims, and

entrance into markets in which we have no direct prior experience.

In addition, acquisitions we make may have adverse accounting consequences or may result in highly restrictive debt covenants. For example, in connection with our acquisition of our entertainment business, we recorded approximately $34.4 million of identifiable intangible assets, which will result in annual amortization expense of approximately $3.4 million over the next 10 years. In addition, we also recorded approximately $136.1 million of goodwill in connection with the acquisition that will not be amortized, but instead must be tested periodically for impairment. Any impairment of this goodwill in the future could result in substantial charges to our operating results. Finally, to finance our acquisition of the entertainment business, we entered into a senior secured credit facility that places substantial restrictions on our business operations. Any further acquisitions we may make may involve additional accounting charges or operational restrictions that may impact our future operating results.

Our future operating results may fluctuate.

Our future operating results will depend significantly on our ability to continue to drive new and repeat consumer utilization of our coin-counting services and entertainment services equipment, our ability to develop and commercialize new products and services and the costs incurred to do so, and our ability to successfully integrate our entertainment business into our operations. Our operating results have a history of fluctuating and may fluctuate in the future. Our future operating results also may fluctuate based upon many other factors, including:

the transaction fee we charge consumers to use our service,

the amount of service fees that we pay to our retail partners,

our ability to establish or maintain relationships with significant retail partners,

the commercial success of our retail partners, which could be affected by such factors as severe weather, strikes or general economic conditions,

fluctuations in revenue generated by our coin-counting and entertainment services equipment,

fluctuations in product cost and of operations caused by various factors including rising petroleum costs, labor costs and transportation costs.

our ability to effectively manage the product mix of our entertainment services equipment to maximize consumer preferences,

fluctuations in interest rates, which affects our debt service obligations,

the timing of, and our ability to develop and successfully commercialize, product enhancements and new products,

the level of product and price competition,

our success in maintaining and expanding our network and managing our growth,

the successful operation of our coin-counting network,

activities of and acquisitions or announcements by competitors,

the impact from any impairment of goodwill related to our acquisitions,

fluctuations in consumer spending patterns, and

relationships with manufacturers and suppliers.

In addition, we have historically experienced seasonality in our coin services business, with highest revenues experienced in the third calendar quarter, followed by the fourth calendar quarter, and relatively lower revenues in the first half of the year. Our entertainment business has also experienced seasonality, with peak revenues in the fourth quarter and periods surrounding the Easter holiday season. While our acquisition of the entertainment business may impact the historical seasonality of the coin-counting business to some degree, we expect our results of operations will continue to fluctuate both as a result of seasonal fluctuations and our revenue mix between relatively higher margin coin and e-payment services and relatively lower margin entertainment services.

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We depend upon third-party manufacturers, suppliers and service providers.

We currently conduct limited manufacturing operations and depend, and will continue to depend, on outside parties to manufacture our coin-counting machines and key components of our coin-counting and entertainment services machines. We intend to continue to expand our installed base for coin-counting machines in North America and in the United Kingdom and for entertainment services machines in the United States and Mexico. Such expansion may be limited by the manufacturing capacity of our third-party manufacturers and suppliers. Third-party manufacturers may not be able to meet our manufacturing needs in a satisfactory and timely manner. If there is an unanticipated increase in demand for coin-counting machine or entertainment services equipment installations, we may be unable to meet such demand due to manufacturing constraints.

We obtain some key hardware components used in the coin-counting machines and entertainment services equipment from a limited number of suppliers. We may be unable to continue to obtain an adequate supply of these components in a timely manner or, if necessary, from alternative sources. If we are unable to obtain sufficient quantities of components or to locate alternative sources of supply on a timely basis, we may experience delays in installing or maintaining coin-counting machines or entertainment services equipment, either of which could seriously harm our business, financial condition and results of operations.

We rely on third-party service providers for substantial support and service efforts that we currently do not provide directly. In particular, we contract with third-party providers to arrange for pick-up, processing and deposit of coins as well as limited servicing of our machines. We generally contract with a single transportation provider and coin processor to service a particular region and either party generally can terminate the contracts with advance notice ranging from 30 to 90 days. We do not currently have, nor do we expect to have in the foreseeable future, the internal capability to provide back-up coin processing service in the event of a sudden disruption in service from a commercial coin processor. Any failure by us to maintain our existing coin processing relationships or to establish new relationships on a timely basis or on acceptable terms would harm our business, financial condition and results of operations.

There are risks associated with conducting our businesses and sourcing goods internationally.

We currently have coin operations in Canada and the United Kingdom. We also now have entertainment services equipment operating in Mexico. We expect to continue increasing our deployment of both coin-counting machines and entertainment services equipment internationally. Exposure to exchange rate fluctuations, restrictions on the repatriation of funds, adverse changes in tax, tariff and trade regulations, difficulties with foreign distributors and difficulties in managing an organization outside the United States are risks that could seriously harm the development of our business and ability to operate our machines profitably.

In addition, substantially all of the plush toys and other products dispensed from our entertainment services machines are produced by foreign manufacturers, including a majority purchased directly from manufacturers in China. We purchase our other vending products indirectly from vendors who obtain a significant percentage of such products from foreign manufacturers. In 2003, our entertainment business transitioned its product fulfillment operations to a third-party distribution center in Shanghai, China. As a result, we are subject to changes in governmental policies, the imposition of tariffs, import and export controls, transportation delays and interruptions, political and economic disruptions and labor strikes that could disrupt the supply of products from such manufacturers. A reduction or interruption in supplies or a significant increase in the price of one or more supplies necessary for our toy manufacture could have a material adverse effect on our business. We also could be affected by labor strikes in the sea shipping, trucking and railroad industries. Such disruptions could interrupt supplies or increase our transportation costs and thereby reduce profit margins in a particular period.

Our business is subject to federal, state, local and foreign laws and government regulation.

Our current businesses are subject to federal, state, local and foreign laws and government regulation, including government regulation relating to coins, toy safety, child protection, vehicle safety, access to machines in public places, charitable fundraising, the transfer of money or things of value, weights and measures, gaming, sweepstakes, contests and consumer protection. The application of existing laws and regulations, changes in or enactment of new laws and regulations that apply or may in the future apply to our current or future products or services, changes in governmental authorities interpretation of the application of various government regulations to our business, or the failure or inability to gain and retain required permits and approvals could materially and adversely affect our business in the future.

In addition, certain jurisdictions may also require us to hold certain licenses, permits and approvals in connection with the operation of our coin-counting and entertainment services machines. For example, in Washington state, skill-crane machines are subject to the licensing requirements of the Washington State Gambling Commission. There can be no assurance that we will be granted all necessary permits or approvals in the future or that current permits and approvals will be renewed. Given the unique nature of our businesses and new products and services we may develop in the future, the application of various laws and regulations to our business is or in the future may be uncertain.

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Recall of any of the products dispensed by our entertainment services machines or by the entertainment services industry generally could adversely affect our entertainment services business.

Our entertainment services machines, and the entertainment services industry generally, are subject to regulation by the Consumer Product Safety Commission and similar state and international regulatory authorities. The toys and other products dispensed from our entertainment services machines could be subject to involuntary recalls and other actions by such authorities. Concerns about product safety may lead us to voluntarily recall or discontinue offering selected products and may generally reduce consumers willingness to purchase the products distributed through our entertainment services business. We cannot assure you that our toy or other entertainment services products may not experience defects or errors after their production and sale to consumers. Such defects or errors could result in the rejection of our entertainment services products by consumers, damage to our reputation, lost sales, potential inventory valuation write-downs, excess inventory, diverted development resources and increased customer service and support costs, any of which could harm our business. Any such errors, defects or recalls may not be covered by insurance or cause our insurance costs to increase in future periods.

We may be subject to product liability claims if people or property are harmed by our products and services.

Some of the products we sell, especially through our entertainment services machines, may expose us to product liability claims arising from personal injury, death or property damage. Any such product liability claim may result in adverse publicity regarding us, our entertainment service machines and the products we sell. Even if we successfully defend ourselves against this type of claim, we could be forced to spend a substantial amount of money in litigation expenses and our management could be required to spend valuable time in defending against these claims. Our vendors may not indemnify us against product liability. There is a risk that such claims or liabilities may exceed, or fall outside the scope of, our insurance coverage and we cannot be certain that insurance will continue to be available to us on economically reasonable terms, or at all. Any imposition of product liability could harm our business, financial condition and operating results.

Our stock price has been and may continue to be volatile.

Our stock price has fluctuated substantially since our initial public offering in July 1997. For example, during the last twelve months, the sale price of our common stock has ranged from $16.95 to $27.85 per share. The market price of our stock could decline from current levels or continue to fluctuate. The market price of our stock may be significantly affected by the following factors:

- the termination, modification or non-renewal of one or more retail partner relationships,

- operating results below market expectations and changes in, or our failure to meet, financial estimates of securities analysts or our own guidance,

- trends and fluctuations in the use of our coin-counting and entertainment services machines,

- period-to-period fluctuations in our financial results,

- release of analyst reports,

- announcements regarding the establishment, modification or termination of relationships regarding the development of new products and services,

- announcements of technological innovations or new products or services by us or our competitors,

- industry developments, and

- economic or other external factors.

In addition, the securities markets have experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. These market fluctuations may also seriously harm the market price of our common stock.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud.

Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud. Any inability to provide reliable financial reports or prevent fraud could harm our business. We have completed the process of evaluating our internal control procedures to satisfy the requirements of the Sarbanes-Oxley Act of 2002, which require management and our auditors to evaluate and assess the effectiveness of our internal controls. We continue to evaluate and, where appropriate, enhance our policies, procedures and internal controls. If we fail to maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time, we could be subject to regulatory scrutiny, civil or criminal penalties or shareholder

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litigation. In addition, failure to maintain adequate internal controls could result in financial statements that do not accurately reflect our financial condition. We cannot assure you that we will be able to complete the work necessary to fully comply with the requirements of the Sarbanes-Oxley Act, that our auditors will complete their review and assessment of our internal controls in a timely manner or that management or our auditors will conclude that our internal controls are effective.

Our anti-takeover mechanisms may affect the price of our common stock and make it harder for a third party to acquire us without the consent of our board of directors.

We have implemented anti-takeover provisions that may discourage takeover attempts and depress the market price of our stock. Provisions of our certificate of incorporation, bylaws and rights plan could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. Delaware law also imposes some restrictions on mergers and other business combinations between us and any acquirer of 15% or more of our outstanding common stock. Furthermore, Washington law may impose additional restrictions on mergers and other business combinations between us and any acquirer of 10% or more of our outstanding common stock. These provisions may make it harder for a third party to acquire us without the consent of our board of directors, even if the offer from a third party may be considered beneficial by some stockholders.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The following discussion about our market risk involves forward-looking statements. Actual results could differ from those projected in our forward-looking statements.

We are subject to the risk of fluctuating interest rates in the normal course of business, primarily as a result of our credit agreement with JPMorgan Chase Bank and investment activities that generally bear interest at variable rates. Because our investments have maturities of three months or less, and our credit facility interest rates are based upon either the LIBOR or base rate plus an applicable margin, we believe that the risk of material loss is low and that the carrying amount of these balances approximates fair value. For our debt obligation which has a variable interest rate, the rate presented reflects the current rate in effect at July 7, 2005, which is 5.55%. This rate is based on LIBOR plus a margin of 2.0%.

The table below presents principal amounts, at book value, by year of maturity and our current interest rates.

Liabilities	**Expected Maturity Date**						**June 30, 2005**		
(in thousands)	**2005**	**2006**	**2007**	**2008**	**2009**	**Thereafter**	**Total**	**Fair Value**	**Current interest rate***
Long-term debt:									
Variable rate	$ 1,044	$ 2,089	$ 2,089	$ 2,089	$ 2,089	$ 197,408	$ 206,808	$ 206,808	5.55%

* Our current interest rate approximates our average interest rate. In an environment of rising interest rates, we believe our current interest rate indicates our expected future interest rates better than our historical average interest rates.

We have variable-rate debt that, at June 30, 2005, had an outstanding balance of $206.8 million. Under the terms of our credit agreement, we have entered into a zero net cost interest rate hedge on $125.0 million of this outstanding debt balance which will decrease our sensitivity to changes in the LIBOR rate. Based on our outstanding debt obligations as of June 30, 2005, an increase of 1.0% in interest rates over the next four years would increase our annualized interest expense and related cash payments by approximately $2.1 million; a decrease of 1.0% in interest rates over the next four years would decrease our annualized interest expense and related cash payments by approximately $2.1 million. Such potential increases or decreases are based on certain simplified assumptions, including minimum quarterly principal repayments made on variable-rate debt for all maturities and an immediate, across-the-board increase or decrease in the level of interest rates with no other subsequent changes for the remainder of the periods.

As discussed above, on September 23, 2004 we purchased an interest rate cap and sold an interest rate floor at zero net cost, which protects us against certain interest rate fluctuations of the LIBOR rate on $125.0 million of our variable rate debt under our credit facility. The effective date of the interest rate cap and floor is October 7, 2004 and expires in three years on October 9, 2007. The interest rate cap and floor consists of a LIBOR ceiling of 5.18% and LIBOR floors that will step up in each of the three years beginning October 7, 2004, 2005 and 2006. The LIBOR floor rates are 1.85%, 2.25% and 2.75% for each of the respective years in the three-year period. Under this hedge, we will continue to pay interest at prevailing rates plus any spread, as defined by our credit facility, but will be reimbursed for any amounts paid on LIBOR in excess of the ceiling. Conversely, we will be required to pay the financial institution that originated the instrument if LIBOR is less than the respective floor rates.

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Item 4. Controls and Procedures

We maintain a set of disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e)) of the Securities Exchange Act of 1934, as amended (the Exchange Act), designed to ensure that information required to be disclosed in our filings under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. Management, with the participation of our chief executive officer and chief financial officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report and has determined that such disclosure controls and procedures are effective.

We also maintain a system of internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act). No changes in our internal control over financial reporting occurred during the second quarter ended June 30, 2005 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

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

At our Annual Meeting of Stockholders held on June 9, 2005, the following actions were taken:

1. Election of Directors

	For	Withheld
Deborah L. Bevier	21,639,515	2,006,447
David M. Eskenazy	21,473,390	2,172,572
Robert D. Sznewajs	21,638,928	2,007,034

2. To approve amendments to the Coinstar, Inc. 1997 Amended and Restated Equity Incentive Plan to increase the total number of shares available for issuance by 1,000,000 shares and to increase the limit on the number of shares that can be issued as stock awards.

For	Against	Abstain	Broker Non-Votes
13,751,777	5,211,618	12,829	4,669,738

3. To ratify the appointment of KPMG LLP as independent registered public accounting firm of Coinstar for the fiscal year ending December 31, 2005.

For	Against	Abstain

23,481,864	160,574	3,524

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Item 6. Exhibits

(a) *Exhibits:*

Exhibit Number	Description of Document
10.1	Coinstar, Inc. 1997 Amended and Restated Equity Incentive Plan (incorporated by reference to Appendix B of the definitive proxy statement filed by Coinstar on April 28, 2005.)
31.1	Certification of Chief Executive Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Where You Can Get Information We File with the SEC

We file annual, quarterly and current reports, as well as registration and proxy statements and other information, with the SEC. These documents are available on our website at www.coinstar.com under: About Us Investor Relations SEC Filings. In addition, copies of these reports and other information may be obtained at prescribed rates from the Public Reference Section of the SEC, 450 Fifth Street, N.W., Washington, D.C. 20549. You can get further information about the SEC s Public Reference Room by calling 1-800-SEC-0330. The SEC also maintains a website at http://www.sec.gov that contains reports, registration statements and other information regarding registrants like us that file electronically with the SEC.

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SIGNATURE

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

COINSTAR, INC.

By: /s/ BRIAN V. TURNER
Brian V. Turner
Chief Financial Officer
July 29, 2005