

NEUSTAR INC  
Form 10-Q  
May 12, 2008

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

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

**For the quarterly period ended March 31, 2008**

**OR**

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

**For the transition period from to**

**Commission file number 001-32548**

**NeuStar, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**52-2141938**

(I.R.S. Employer  
Identification No.)

**46000 Center Oak Plaza  
Sterling, Virginia 20166**

(Address of principal executive offices) (zip code)

**(571) 434-5400**

(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  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

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

There were 77,552,828 shares of Class A common stock, \$0.001 par value, and 4,538 shares of Class B common stock, \$0.001 par value, outstanding at May 1, 2008.

**NeuStar, Inc.**  
**Index**

**PART I FINANCIAL INFORMATION**

Item 1. Financial Statements

Consolidated Balance Sheets as of December 31, 2007 and March 31, 2008 (unaudited)

Unaudited Consolidated Statements of Operations for the three months ended March 31, 2007 and 2008

Unaudited Consolidated Statements of Cash Flows for the three months ended March 31, 2007 and 2008

Notes to Unaudited Consolidated Financial Statements

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Item 4. Controls and Procedures

**PART II OTHER INFORMATION**

Item 1. Legal Proceedings

Item 1A. Risk Factors

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

Item 3. Defaults upon Senior Securities

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

Item 5. Other Information

Item 6. Exhibits

Signatures

**PART I FINANCIAL INFORMATION****Item 1. Financial Statements**

**NEUSTAR, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share and per share data)

|  | <b>December<br/>31,<br/>2007</b> | <b>March 31,<br/>2008<br/>(unaudited)</b> |
|--|----------------------------------|---|
| <b>ASSETS</b>  |                                  |   |
| Current assets:  |                                  |   |
| Cash and cash equivalents  | \$ 98,630                        | \$ 54,396                                 |
| Restricted cash  | 488                              | 532                                       |
| Short-term investments   | 100,048                          | 32,059                                    |
| Accounts receivable, net of allowance for doubtful accounts of \$1,654 and \$2,299, respectively | 76,632                           | 62,745                                    |
| Unbilled receivables   | 383                              | 744                                       |
| Notes receivable   | 2,159                            | 2,202                                     |
| Prepaid expenses and other current assets  | 9,608                            | 10,547                                    |
| Deferred costs   | 8,281                            | 9,216                                     |
| Deferred tax assets  | 13,907                           | 13,192                                    |
| Total current assets   | 310,136                          | 185,633                                   |
| Investments, long-term   |                                  | 39,371                                    |
| Property and equipment, net  | 56,191                           | 57,813                                    |
| Goodwill   | 204,093                          | 181,451                                   |
| Intangible assets, net   | 36,851                           | 39,524                                    |
| Notes receivable, long-term  | 759                              | 192                                       |
| Deferred costs, long-term  | 3,575                            | 3,272                                     |
| Other assets   | 5,056                            | 4,804                                     |
| Total assets   | \$ 616,661                       | \$ 512,060                                |

*See accompanying notes.*

**NEUSTAR, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share and per share data)

|   | <b>December<br/>31,<br/>2007</b> | <b>March 31,<br/>2008<br/>(unaudited)</b> |
|---|----------------------------------|---|
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                                  |   |
| Current liabilities:  |                                  |   |
| Accounts payable  | \$ 9,742                         | \$ 7,443                                  |
| Accrued expenses  | 47,501                           | 49,822                                    |
| Deferred revenue  | 32,236                           | 33,660                                    |
| Notes payable   | 2,501                            | 2,495                                     |
| Capital lease obligations   | 3,511                            | 3,803                                     |
| Accrued restructuring reserve   | 413                              | 426                                       |
| Income tax payable  | 3,254                            | 1,999                                     |
| Other liabilities   | 108                              |   |
| <br>Total current liabilities   | <br>99,266                       | <br>99,648                                |
| <br>Deferred revenue, long-term   | <br>18,063                       | <br>16,232                                |
| Notes payable, long-term  | 5,206                            | 4,364                                     |
| Capital lease obligations, long-term  | 5,717                            | 5,033                                     |
| Accrued restructuring reserve, long-term  | 1,793                            | 1,679                                     |
| Other liabilities, long-term  | 3,866                            | 4,470                                     |
| Deferred tax liability  | 2,215                            | 4,022                                     |
| <br>Total liabilities   | <br>136,126                      | <br>135,448                               |
| <br>Commitments and contingencies   |                                  |   |
| Stockholders equity:  |                                  |   |
| Preferred stock, \$0.001 par value; 100,000,000 shares authorized; No shares issued or outstanding as of December 31, 2007 and March 31, 2008   |                                  |   |
| Class A common stock, par value \$0.001; 200,000,000 shares authorized; 77,082,161 and 77,528,281 shares issued and outstanding at December 31, 2007 and March 31, 2008, respectively |                                  |   |
|   | 77                               | 77  |
| Class B common stock, par value \$0.001; 100,000,000 shares authorized; 4,538 and 4,538 shares issued and outstanding at December 31, 2007 and March 31, 2008, respectively           |                                  |   |
| Additional paid-in capital  | 293,785                          | 299,822                                   |
| Treasury stock, 99,286 and 4,136,458 shares at cost at December 31, 2007 and March 31, 2008, respectively   | (3,221)                          | (107,108)                                 |
| Accumulated other comprehensive loss  | (140)                            | (1,753)                                   |
| Retained earnings   | 190,034                          | 185,574                                   |
| <br>Total stockholders equity   | <br>480,535                      | <br>376,612                               |

|   |            |            |
|---|------------|------------|
| Total liabilities and stockholders equity | \$ 616,661 | \$ 512,060 |
|---|------------|------------|

*See accompanying notes.*

4

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**NEUSTAR, INC.**  
**UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands, except per share data)

|  | <b>Three Months Ended</b> |             |
|--|---------------------------|-------------|
|  | <b>March 31,</b>          |             |
|  | <b>2007</b>               | <b>2008</b> |
| Revenue:   |                           |             |
| Addressing   | \$ 27,003                 | \$ 30,161   |
| Interoperability   | 14,932                    | 16,440      |
| Infrastructure and other   | 55,513                    | 70,812      |
| <br>Total revenue  | <br>97,448                | <br>117,413 |
| Operating expense:   |                           |             |
| Cost of revenue (excluding depreciation and amortization shown separately below) | 23,078                    | 24,489      |
| Sales and marketing  | 18,636                    | 18,724      |
| Research and development   | 6,569                     | 7,548       |
| General and administrative   | 10,769                    | 16,482      |
| Depreciation and amortization  | 9,064                     | 10,120      |
| Impairment of goodwill   |                           | 29,021      |
|  | 68,116                    | 106,384     |
| Income from operations   | 29,332                    | 11,029      |
| Other (expense) income:  |                           |             |
| Interest expense   | (350)                     | (442)       |
| Interest and other income  | 649                       | 1,592       |
| Income before income taxes   | 29,631                    | 12,179      |
| Provision for income taxes   | 11,663                    | 16,639      |
| Net income (loss)  | \$ 17,968                 | \$ (4,460)  |
| Net income (loss) per common share:  |                           |             |
| Basic  | \$ 0.24                   | \$ (0.06)   |
| Diluted  | \$ 0.23                   | \$ (0.06)   |
| Weighted average common shares outstanding:                                      |                           |             |
| Basic  | 74,688                    | 76,247      |
| Diluted  | 79,031                    | 76,247      |

*See accompanying notes.*

**NEUSTAR, INC.**  
**UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

|  | <b>Three Months Ended</b> |             |
|--|---------------------------|-------------|
|  | <b>March 31,</b>          |             |
|  | <b>2007</b>               | <b>2008</b> |
| Operating activities:  |                           |             |
| Net income (loss)  | \$ 17,968                 | \$ (4,460)  |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                           |             |
| Depreciation and amortization  | 9,064                     | 10,120      |
| Stock-based compensation   | 3,563                     | 4,429       |
| Amortization of deferred financing costs   | 29                        | 44          |
| Excess tax benefits from stock-based compensation  | (10,326)                  | (91)        |
| Deferred income taxes  | 3,849                     | 3,481       |
| Provision for doubtful accounts  | 484                       | 1,024       |
| Impairment of goodwill   |                           | 29,021      |
| Changes in operating assets and liabilities, net of acquisitions:                        |                           |             |
| Accounts receivable  | (9,164)                   | 13,727      |
| Unbilled receivables   | 89                        | (361)       |
| Notes receivable   | 484                       | 524         |
| Prepaid expenses and other current assets  | (540)                     | (742)       |
| Deferred costs   | (300)                     | (632)       |
| Income tax receivable  | 2,126                     |             |
| Other assets   | (914)                     | 216         |
| Other liabilities  | 39                        | 271         |
| Accounts payable and accrued expenses  | (10,994)                  | 87          |
| Income tax payable   |                           | (1,164)     |
| Accrued restructuring reserve  | (92)                      | (101)       |
| Deferred revenue   | 4,298                     | (1,313)     |
| Net cash provided by operating activities  | 9,663                     | 54,080      |
| Investing activities:  |                           |             |
| Purchases of property and equipment  | (4,623)                   | (6,702)     |
| Sales of investments, net  | 1,802                     | 25,904      |
| Businesses acquired, net of cash   | (1,569)                   | (12,915)    |
| Net cash (used in) provided by investing activities                                      | (4,390)                   | 6,287       |
| Financing activities:  |                           |             |
| Disbursement of restricted cash  | (100)                     | (44)        |
| Principal repayments on notes payable  | (316)                     | (848)       |
| Principal repayments on capital lease obligations  | (1,495)                   | (1,573)     |
| Proceeds from exercise of common stock options   | 5,081                     | 1,518       |
| Excess tax benefits from stock-based compensation  | 10,326                    | 91          |
| Repurchase of common stock   | (3,128)                   | (103,887)   |

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|   |           |           |
|---|-----------|-----------|
| Net cash provided by (used in) financing activities           | 10,368    | (104,743) |
| Effect of foreign exchange rates on cash and cash equivalents |           | 142       |
| Net increase (decrease) in cash and cash equivalents          | 15,641    | (44,234)  |
| Cash and cash equivalents at beginning of period              | 39,242    | 98,630    |
| Cash and cash equivalents at end of period                    | \$ 54,883 | \$ 54,396 |

*See accompanying notes.*

6

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**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2007 AND 2008**

**1. DESCRIPTION OF BUSINESS AND ORGANIZATION**

NeuStar, Inc. (the Company) was incorporated as a Delaware corporation in 1998. The Company provides the communications industry with essential clearinghouse services. Its customers use the databases the Company contractually maintains in its clearinghouse to obtain data required to successfully route telephone calls in North America, to exchange information with other communications service providers and to manage technological changes in their own networks. The Company operates the authoritative directories that manage virtually all telephone area codes and numbers, and it enables the dynamic routing of calls among thousands of competing communications service providers, or CSPs, in the United States and Canada. All CSPs that offer telecommunications services to the public at large, or telecommunications service providers, must access the Company's clearinghouse to properly route virtually all of their customers' calls. The Company also provides clearinghouse services to emerging CSPs, including Internet service providers, mobile network operators, cable television operators, and voice over Internet Protocol, or VoIP, service providers. In addition, the Company provides domain name services, including internal and external managed DNS solutions that play a key role in directing and managing traffic on the Internet, and it also manages the authoritative directories for the .us and .biz Internet domains. The Company operates the authoritative directory for U.S. Common Short Codes, part of the short messaging service relied upon by the U.S. wireless industry, and provides solutions used by mobile network operators throughout Europe to enable mobile instant messaging for their end users.

The Company was founded to meet the technical and operational challenges of the communications industry when the U.S. government mandated local number portability in 1996. While the Company remains the provider of the authoritative solution that the communications industry relies upon to meet this mandate, the Company has developed a broad range of innovative services to meet an expanded range of customer needs. The Company provides the communications industry with critical technology services that solve the addressing, interoperability and infrastructure needs of CSPs. These services are now used by CSPs to manage a range of their technical and operating requirements, including:

*Addressing.* The Company enables CSPs to use critical, shared addressing resources, such as telephone numbers, Internet top-level domain names, and U.S. Common Short Codes.

*Interoperability.* The Company enables CSPs to exchange and share critical operating data so that communications originating on one provider's network can be delivered and received on the network of another CSP. The Company also facilitates order management and work flow processing among CSPs.

*Infrastructure and Other.* The Company enables CSPs to manage their networks more efficiently by centrally managing certain critical data they use to route communications over their own networks.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Unaudited Interim Financial Information**

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The results of operations for the three months ended March 31, 2008 are not necessarily indicative of the results that may be expected for the full fiscal year. The consolidated balance sheet as of December 31, 2007 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements.

These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007

filed with the Securities and Exchange Commission (SEC).

7

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**NEUSTAR, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting periods. Significant estimates and assumptions are inherent in the analysis and the measurement of deferred tax assets, the identification and quantification of income tax liabilities due to uncertain tax positions, and the determination of the allowance for estimated uncollectible accounts. Actual results could differ from those estimates.

The annual and any required interim goodwill impairment test and the determination of the fair value of intangible assets involve the use of significant estimates and assumptions by management, and are inherently subjective. In particular, for each of the Company's reporting units, the significant assumptions used include market penetration, anticipated growth rates, and risk-adjusted discount rates for the income approach, as well as the selection of comparable companies and comparable transactions for the market approach. Changes in estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. Specifically, for the Company's NGM reporting unit, due to the early stage of its operations and the emerging nature of mobile instant messaging technology, the assumptions and estimates used by management that are incorporated within the NGM valuation have a high degree of subjectivity, and are thus more likely to change over time. In addition, because relatively few carriers control a substantial portion of the end users who will drive the success of mobile instant messaging, the activities of NGM's largest customers can have a significant impact on these assumptions and estimates. For example, the Company changed certain of its key assumptions, most notably assumptions relating to end-user adoption rates, to reflect changes in the market and identified customer-related events that occurred late in the first quarter of 2008. The effect of these changes on the Company's projections of future cash flows resulted in a \$29.0 million impairment charge in March 2008. The Company believes that the assumptions and estimates used to determine the estimated fair values of each of its reporting units, including revised assumptions underlying the valuation of its NGM reporting unit, are reasonable; however, there are a number of factors that could cause actual results to differ from the Company's estimates, including further delays from changes in strategy by participants in the mobile instant messaging market, lack of effective marketing efforts to promote mobile instant messaging to end users and unforeseen changes in the market. Any changes in key assumptions about the Company's businesses and their prospects, or changes in market conditions, could result in an impairment charge. Such a charge could have a material effect on the Company's consolidated financial statements because of the significance of goodwill and intangible assets to the Company's consolidated balance sheet. As of March 31, 2008, the Company had \$94.5 million and \$86.9 million, respectively, in goodwill for its Clearinghouse reporting unit and its NGM reporting unit subject to future impairment tests.

**Investments**

The Company's short-term investments are classified as available-for-sale and carried at estimated fair value, as determined by quoted market prices or other valuation methods, with unrealized gains and losses reported in a separate component of accumulated other comprehensive income (loss). Realized gains and losses and declines in value judged to be other-than-temporary, if any, on available-for-sale securities are included in interest income. The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale is included in interest and other income.

The Company periodically evaluates whether any declines in the fair value of investments are other-than-temporary. This evaluation consists of a review of several factors, including but not limited to: the length of time and extent that a security has been in an unrealized loss position; the existence of an event that would impair the issuer's future earnings potential; the near-term prospects for recovery of the market value of a security; and the intent and ability of the Company to hold the security until the market value recovers. Declines in value below cost for investments where it is considered probable that all contractual terms of the investment will be satisfied, due primarily to changes in market demand (and not because of increased credit risk), and where the Company intends and has the

ability to hold the investment for a period of time sufficient to allow a market recovery, are not assumed to be other-than-temporary.

**Goodwill**

Goodwill represents the excess of the purchase price over the fair value of assets acquired, as well as other definite-lived intangible assets. In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, goodwill and indefinite-lived intangible assets are not amortized, but are reviewed for impairment upon the occurrence of events or changes in circumstances that would reduce the fair value of such assets below their carrying amount. Goodwill and indefinite-lived intangible assets are required to be tested for impairment at least annually, or on an interim basis if circumstances change that would indicate the possibility of impairment. For purposes of the Company's annual impairment test, the Company has identified and assigned goodwill to two reporting units, Clearinghouse Services and NGM Services.

**NEUSTAR, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Goodwill is tested for impairment at the reporting unit level using a two-step approach. The first step is to compare the fair value of a reporting unit's net assets, including assigned goodwill, to the book value of its net assets, including assigned goodwill. Fair value of the reporting unit is determined using both an income and market approach. To assist in the process of determining if goodwill impairment exists, the Company performs internal valuation analyses and considers other market information that is publicly available, and the Company may obtain appraisals from external advisors. If the fair value of the reporting unit is greater than its net book value, the assigned goodwill is not considered impaired. If the fair value is less than the reporting unit's net book value, the Company performs a second step to measure the amount of the impairment, if any. The second step is to compare the book value of the reporting unit's assigned goodwill to the implied fair value of the reporting unit's goodwill, using a theoretical purchase price allocation based on the estimated fair value of the reporting unit to determine the magnitude of the impairment. If the Company determines that an impairment has occurred, the Company is required to record a write-down of the carrying value and charge the impairment as an operating expense in the period the determination is made. During the three months ended March 31, 2008, the Company recorded a goodwill impairment charge of \$29.0 million related to its NGM business segment (see Note 6). There was no goodwill impairment charge during the three months ended March 31, 2007.

**Identifiable Intangible Assets**

Identifiable intangible assets are amortized over their respective estimated useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used and are reviewed for impairment in accordance with SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets* (SFAS No. 144).

The Company's identifiable intangible assets are amortized as follows:

|                                  | <b>Years</b> | <b>Method</b> |
|----------------------------------|--------------|---------------|
| Acquired technologies            | 3 to 5       | Straight-line |
| Customer lists and relationships | 3 to 7       | Various       |
| Trade name                       | 3            | Straight-line |

Amortization expense related to acquired technologies and customer lists and relationships is included in depreciation and amortization expense in the consolidated statements of operations.

**Impairment of Long-Lived Assets**

In accordance with SFAS No. 144, the Company reviews long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the assets. Recoverability measurement and estimating of undiscounted cash flows is done at the lowest possible level for which there is identifiable assets. If such assets are considered impaired, the amount of impairment recognized is equal to the amount by which the carrying amount of assets exceeds the fair value of the assets. Assets to be disposed of are recorded at the lower of the carrying amount or fair value less costs to sell. At March 31, 2008, the Company performed a recoverability test of the long-lived assets of its NGM business segment. The Company concluded that the future undiscounted cash flows of the NGM asset group exceeded its carrying value. Accordingly, there were no asset impairment charges recognized during the three months ended March 31, 2008. In addition, there were no asset impairment charges recognized during the three months ended March 31, 2007.

**Revenue Recognition**

The Company provides the North American communications industry with essential clearinghouse services that address the industry's addressing, interoperability, and infrastructure needs. The Company's revenue recognition policies are in accordance with the Securities and Exchange Commission Staff Accounting Bulletin No. 104, *Revenue Recognition*. The Company provides the following services pursuant to various private commercial and government contracts.



**NEUSTAR, INC.**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Addressing***

The Company's addressing services include telephone number administration, implementing the allocation of pooled blocks of telephone numbers, directory services for Internet domain names and U.S. Common Short Codes, and internal and external managed domain name services. The Company generates revenue from its telephone number administration services under two government contracts. Under its contract to serve as the North American Numbering Plan Administrator, the Company earns a fixed annual fee and recognizes this fee as revenue on a straight-line basis as services are provided. Under the Company's contract to serve as the National Pooling Administrator, the Company earns a fixed fee associated with administration of the pooling system plus reimbursement for costs incurred. The Company recognizes revenue for this contract based on costs incurred plus a pro rata amount of the fixed fee. In the event the Company estimates losses on its fixed fee contracts, the Company recognizes these losses in the period in which a loss becomes apparent.

In addition to the administrative functions associated with its role as the National Pooling Administrator, the Company also generates revenue from implementing the allocation of pooled blocks of telephone numbers under its long-term contracts with North American Portability Management LLC, and the Company recognizes revenue on a per transaction fee basis as the services are performed. For its Internet domain name services, the Company generates revenue for Internet domain registrations, which generally have contract terms between one and ten years. The Company recognizes revenue on a straight-line basis over the lives of the related customer contracts.

The Company generates revenue through internal and external managed domain name services. The Company's revenue consists of customer set-up fees, monthly recurring fees and per transaction fees for transactions in excess of pre-established monthly minimums under contracts with terms ranging from one to three years. Customer set-up fees are not considered a separate deliverable and are deferred and recognized on a straight-line basis over the term of the contract. Under the Company's contracts to provide its managed domain name services, customers have contractually established monthly transaction volumes for which they are charged a recurring monthly fee. Transactions processed in excess of the pre-established monthly volume are billed at a contractual per transaction rate. Each month the Company recognizes the recurring monthly fee and usage in excess of the established monthly volume on a per transaction basis as services are provided. The Company generates revenue from its U.S. Common Short Code services under short-term contracts ranging from three to twelve months, and the Company recognizes revenue on a straight-line basis over the term of the customer contracts.

***Interoperability***

The Company's interoperability services consist primarily of wireline and wireless number portability and order management services. The Company generates revenue from number portability under its long-term contracts with North American Portability Management LLC and Canadian LNP Consortium, Inc. The Company recognizes revenue on a per transaction fee basis as the services are performed. The Company provides order management services (OMS), consisting of customer set-up and implementation followed by transaction processing, under contracts with terms ranging from one to three years. Customer set-up and implementation is not considered a separate deliverable; accordingly, the fees are deferred and recognized as revenue on a straight-line basis over the term of the contract. Per transaction fees are recognized as the transactions are processed. The Company generates revenue from its inter-carrier mobile instant messaging services under contracts with mobile operators that range from one to three years. These contracts consist of license fees based on the number of subscribers that use mobile instant messaging services, as well as fees for set-up and implementation. The Company recognizes license fee revenue ratably over the term of the contract after completion of customer set-up and implementation. Customer set-up and implementation is not considered a separate deliverable; accordingly, the fees are deferred and recognized as revenue on a straight line basis over the remaining term of the contract following delivery of the set-up and implementation services.

***Infrastructure and Other***

The Company's infrastructure services consist primarily of network management and connection services. The Company generates revenue from network management services under its long-term contracts with North American Portability Management LLC. The Company recognizes revenue on a per transaction fee basis as the services are

performed. In addition, the Company generates revenue from connection fees and system enhancements under its contracts with North American Portability Management LLC. The Company recognizes its connection fee revenue as the service is performed. System enhancements are provided under contracts in which the Company is reimbursed for costs incurred plus a fixed fee, and revenue is recognized based on costs incurred plus a pro rata amount of the fee. The Company generates revenue from its intra-carrier mobile instant messaging services under contracts with mobile operators that range from one to three years. These contracts consist of license fees based on the number of subscribers that use mobile instant messaging services, as well as fees for set-up and implementation. The Company recognizes license fee revenue ratably over the term of the contract after completion of customer set-up and implementation. Customer set-up and implementation is not considered a separate deliverable; accordingly, the fees are deferred and recognized as revenue on a straight line basis over the remaining term of the contract following delivery of the set-up and implementation services.



**NEUSTAR, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Significant Contracts***

The Company provides wireline and wireless number portability, implements the allocation of pooled blocks of telephone numbers and provides network management services pursuant to seven contracts with North American Portability Management LLC, an industry group that represents all telecommunications service providers in the United States. The Company recognizes revenue under its contracts with North American Portability Management LLC primarily on a per transaction basis. The aggregate fees for transactions processed under these contracts are determined by the total number of transactions, and these fees are billed to telecommunications service providers based on their allocable share of the total transaction charges. This allocable share is based on each respective telecommunications service provider's share of the aggregate end-user services revenues of all U.S. telecommunications service providers, as determined by the Federal Communications Commission (FCC). Under the Company's contracts, the Company also bills a Revenue Recovery Collections (RRC) fee of a percentage of monthly billings to its customers, which is available to the Company if any telecommunications service provider fails to pay its allocable share of total transactions charges.

For 2007, pricing was \$0.91 per transaction regardless of transaction volume. Beginning January 1, 2008, per transaction pricing is derived on a straight-line basis using an effective rate calculation formula based on annualized volume between 200 million and 587.5 million. For annualized volumes less than or equal to 200 million, the per transaction price is equal to a flat rate of \$0.95 per transaction. For annualized volumes greater than or equal to 587.5 million, the per transaction price is equal to a flat rate of \$0.75 per transaction. For the three months ended March 31, 2008, the weighted average per transaction price was \$0.88. The applicable per transaction price is subject to change during the course of the year if the annualized transaction volume, as calculated under the terms of the contracts, changes.

***Service Level Standards***

Pursuant to certain of the Company's private commercial contracts, the Company is subject to service level standards and to corresponding penalties for failure to meet those standards. The Company records a provision for these performance-related penalties when it becomes aware that required service levels have not been met triggering the requirement to pay a penalty, which results in a corresponding reduction to revenue.

**Cost of Revenue and Deferred Costs**

Cost of revenue includes all direct materials, direct labor, and those indirect costs related to generation of revenue such as indirect labor, materials and supplies and facilities cost. The Company's primary cost of revenue is related to personnel costs associated with service implementation, product maintenance, customer deployment and customer care, including salaries, stock-based compensation and other personnel-related expense. In addition, cost of revenue includes costs relating to maintaining the Company's existing technology and services, as well as royalties paid related to the Company's U.S. Common Short Code services. Cost of revenue also includes the costs incurred by the Company's information technology and systems department, including network costs, data center maintenance, database management, data processing costs, and facilities costs.

Deferred costs represent direct labor related to professional services incurred for the setup and implementation of contracts. These costs are recognized in cost of revenue on a straight-line basis over the contract term. Deferred costs also include royalties paid related to the Company's U.S. Common Short Code services, which are recognized in cost of revenue on a straight-line basis over the contract term. Deferred costs are classified as such on the consolidated balance sheets.

**Stock-Based Compensation**

The Company accounts for its stock-based compensation plans under the recognition and measurement provisions of SFAS No. 123(R), *Share-Based Payment* (SFAS No. 123(R)). Stock-based compensation expense includes: (a) compensation cost for all stock-based awards granted prior to but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all stock-based awards granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R).



**NEUSTAR, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Basic and Diluted Net Income (Loss) per Common Share**

Basic net income (loss) per common share excludes dilution for potential common stock issuances and is computed by dividing net income (loss) by the weighted-average number of common shares outstanding for the period. Diluted net income (loss) per common share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

**Income Taxes**

The Company accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS No. 109). Under SFAS No. 109, the liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on temporary differences between the financial reporting bases and the tax bases of assets and liabilities. Deferred tax assets are also recognized for tax net operating loss carryforwards. These deferred tax assets and liabilities are measured using the enacted tax rates and laws that will be in effect when such amounts are expected to be reversed or utilized. The realization of total deferred tax assets is contingent upon the generation of future taxable income. Valuation allowances are provided to reduce such deferred tax assets to amounts more likely than not to be ultimately realized.

Income tax provision includes U.S. federal, state, local and foreign income taxes and is based on pre-tax income or loss. The interim period provision or benefit for income taxes is based upon the Company's estimate of its annual effective income tax rate. In determining the estimated annual effective income tax rate, the Company analyzes various factors, including projections of the Company's annual earnings and taxing jurisdictions in which the earnings will be generated, the impact of state and local income taxes and the ability of the Company to use tax credits and net operating loss carryforwards.

Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (FIN 48), clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109. FIN 48 provides a two-step approach to recognize and measure tax benefits when the realization of the benefits is uncertain. The first step is to determine whether the benefit is to be recognized; the second step is to determine the amount to be recognized. Income tax benefits should be recognized when, based on the technical merits of a tax position, the entity believes that if a dispute arose with the taxing authority and were taken to a court of last resort, it is more likely than not (*i.e.*, a probability of greater than 50 percent) that the tax position would be sustained as filed. If a position is determined to be more likely than not of being sustained, the reporting enterprise should recognize the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority. The Company's practice is to recognize interest and penalties related to income tax matters in income tax expense.

**Foreign Currency**

Assets and liabilities of consolidated foreign subsidiaries, whose functional currency is the local currency, are translated to U.S. dollars at period end exchange rates. Revenue and expense items are translated to U.S. dollars at the average rates of exchange prevailing during the period. The adjustment resulting from translating the financial statements of such foreign subsidiaries to U.S. dollars is reflected as a cumulative translation adjustment and reported as a component of accumulated other comprehensive income (loss).

Transactions denominated in currencies other than the functional currency are recorded based on exchange rates at the time such transactions arise. Subsequent changes in exchange rates result in transaction gains or losses, which are reflected within other income (expense) in the consolidated statement of operations.

**Comprehensive Income (Loss)**

Comprehensive income (loss) is comprised of net earnings and other comprehensive income (loss), which includes certain changes in equity that are excluded from income. The Company includes unrealized holding gains and losses on available-for-sale securities, if any, and foreign currency translation adjustments in other comprehensive income. Comprehensive loss was approximately \$6.1 million for the three months ended March 31, 2008. There were no material differences between net income and comprehensive net income for the three months ended March 31, 2007.



## NEUSTAR, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Recent Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS No. 141 (R)), which replaces SFAS No. 141. SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non-controlling interest in the acquiree and the goodwill acquired. SFAS No. 141(R) also establishes disclosure requirements which will enable users to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. Early adoption of this standard is prohibited. In the absence of any planned future business combinations, the Company does not currently expect SFAS No. 141(R) to have a material impact on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained non-controlling equity investments when a subsidiary is deconsolidated. SFAS No. 160 also establishes reporting requirements that require sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. Early adoption of this standard is prohibited. In the absence of any noncontrolling (minority) interests, the Company does not currently expect SFAS No. 160 to have a material impact on its consolidated financial statements.

In February 2008, the FASB issued FASB Staff Position (FSP) FAS 157-b, *Effective Date of FASB Statement No. 157*, which delays the effective date of SFAS No. 157, for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The effective date would be delayed by one year to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. The Company is currently evaluating the impact of FSP FAS 157-b on its consolidated financial statements.

## 3. INVESTMENTS

A summary of the Company's securities available for sale as of March 31, 2008 and December 31, 2007 is as follows:

|                                    | Amortized<br>Cost | March 31, 2008            |            | Estimated<br>Fair Value |
|------------------------------------|-------------------|---------------------------|------------|-------------------------|
|                                    |                   | Gross Unrealized<br>Gains | Losses     |                         |
| Cash reserve fund                  | \$ 33,047         | \$ ¾                      | \$ (988)   | \$ 32,059               |
| High grade auction rate securities | 41,725            | ¾                         | (2,354)    | 39,371                  |
|                                    | \$ 74,772         | \$ ¾                      | \$ (3,342) | \$ 71,430               |
|                                    | Amortized<br>Cost | December 31, 2007         |            | Estimated<br>Fair Value |
|                                    |                   | Gross Unrealized<br>Gains | Losses     |                         |
| Cash reserve fund                  | \$ 49,851         | \$ ¾                      | \$ (628)   | \$ 49,223               |
| High grade auction rate securities | 50,825            | ¾                         | ¾          | 50,825                  |
|                                    | \$ 100,676        | \$ ¾                      | \$ (628)   | \$ 100,048              |

**NEUSTAR, INC.**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In December 2007, the Company was advised that a cash reserve fund that the Company had invested in would be closed to new investments and immediate redemptions and that there had been a one percent decline in the net asset value of the fund. As of December 31, 2007, the Company had approximately \$49.2 million invested in this fund. For the three months ended December 31, 2007, the Company recorded an unrealized loss of \$628,000 related to this fund. During the three months ended March 31, 2008, the Company redeemed \$16.6 million from this fund and recognized realized losses of \$240,000. During the three months ended March 31, 2008, the Company recorded an unrealized loss of \$360,000 related to this fund. As of March 31, 2008, the Company had approximately \$32.1 million invested in this fund. The fund currently has a projected schedule that will result in approximately 90 percent of the fund being redeemed in 2008.

As of March 31, 2008, the Company has long-term investments of \$39.4 million that consist of auction rate securities (ARS) with AAA ratings whose underlying assets are student loans the majority of which are guaranteed by the federal government. These auction rate securities are intended to provide liquidity via an auction process that resets the applicable interest rate approximately every 30 days and allows investors to either roll over their holdings or gain immediate liquidity by selling such investments at par. The underlying maturities of these investments range from 17 to 39 years. As a result of current negative conditions in the global credit markets, auctions for the \$39.4 million investment in these securities as of March 31, 2008 either have failed or may fail to settle on their respective settlement dates. Consequently, the investments are not currently liquid and the Company will not be able to access these funds until a future auction of these investments is successful, issuers refinance or a buyer is found outside of the auction process.

As a result of the temporary decline in fair value of these auction rate securities, which the Company attributes to market-related liquidity issues rather than the issuer's credit issues, approximately \$2.4 million in unrealized losses have been included in accumulated other comprehensive income. The Company believes that the credit markets for these securities will improve sufficiently to enable a full liquidation of these securities without significant losses in the long term. The Company also maintains the intent and ability to hold these securities for a long period of time without any adverse effect on its operations. The Company does not currently anticipate liquidity being restored in the near-term, and has classified these investments as non-current on its consolidated balance sheet. Any future fluctuations in fair value, including recoveries of previously unrealized losses relating to these investments, would be recorded as accumulated other comprehensive income. Any adjustments in fair value that are determined to be other-than-temporary would require the Company to recognize associated adjustments to earnings.

**4. FAIR VALUE MEASUREMENTS**

The Company adopted SFAS No. 157, *Fair Value Measurements* (SFAS No. 157) on January 1, 2008. SFAS No. 157 applies to all assets and liabilities that are being measured and reported on a fair value basis. As defined in SFAS No. 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 also establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. SFAS No. 157 requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1. Observable inputs such as quoted prices in active markets

Level 2. Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

Level 3. Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

We evaluate assets and liabilities subject to fair value measurements on a recurring basis to determine the appropriate level to classify them for each reporting period. This determination requires significant judgments to be made by us.



**NEUSTAR, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As of March 31, 2008, observable market information was not available to determine the fair value of the Company's investments in the cash reserve fund and its ARS portfolio. Therefore, the Company estimated fair value using valuation models that relied on Level 3 inputs to value these securities, including those that are based on expected cash flow streams and collateral values, assessments of counterparty credit quality, default risk underlying the security, market discount rates and overall capital market liquidity. The valuation of the Company's cash reserve fund and its ARS investment portfolio is subject to uncertainties that are difficult to predict. Factors that may impact the valuation of the Company's cash reserve fund and its ARS portfolio in the future include, changes to credit ratings of the securities, as well as to the underlying assets supporting those securities, rates of default of the underlying assets, underlying collateral value, discount rates, timing of estimated cash flows, counterparty risk and ongoing strength and quality of market credit and liquidity. The following table sets forth the Company's financial assets and liabilities that were measured at fair value on a recurring basis as of March 31, 2008, by level within the fair value hierarchy (in thousands):

|                        | <b>Level<br/>1</b> | <b>Level<br/>2</b> | <b>Level 3</b> | <b>Total</b> |
|------------------------|--------------------|--------------------|----------------|--------------|
| Short-term investments |                    |                    | \$32,059       | \$32,059     |
| Long-term investments  |                    |                    | \$39,371       | \$39,371     |

The following table provides a reconciliation of the beginning and ending balances for the major class of assets measured at fair value using significant unobservable inputs (Level 3) (in thousands):

|   | <b>Short-term<br/>Investments</b> | <b>Long-term<br/>Investments</b> |
|---|-----------------------------------|----------------------------------|
| Balance on January 1, 2008                            | \$                                | \$                               |
| Transfers in and/or (out) of Level 3                  | 49,223                            | 50,825                           |
| Total losses realized/unrealized included in earnings | (240)                             |                                  |
| Total losses included in other comprehensive income   | (360)                             | (2,354)                          |
| Purchases, sales, issuances and settlements, net      | (16,564)                          | (9,100)                          |
| Balance on March 31, 2008                             | \$ 32,059                         | \$ 39,371                        |

For the three months ended March 31, 2008, there were no gains or losses included in earnings that were attributable to the unrealized gains or losses related to Level 3 assets held at March 31, 2008.

**5. ACQUISITION****Webmetrics, Inc.**

On January 10, 2008, the Company acquired Webmetrics, Inc. (Webmetrics) for cash consideration of \$12.5 million, subject to certain purchase price adjustments and contingent cash consideration of up to \$6.0 million, and acquisition costs of approximately \$685,000. The acquisition of Webmetrics, a provider of web and network performance testing, monitoring and measurement services, expands the Company's Internet and infrastructure services. The acquisition was accounted for as a purchase business combination in accordance with SFAS No. 141 and the results of operations of Webmetrics have been included in the accompanying consolidated statement of operations since the date of acquisition. Of the total purchase price, a preliminary estimate of \$0.4 million has been allocated to net tangible assets acquired, \$6.4 million to definite-lived intangible assets and \$6.4 million to goodwill. Definite-lived intangible assets consist of customer relationships and acquired technology. The Company is amortizing the value of the customer relationships in proportion to the discounted cash flows over an estimated useful life of 3 years. Acquired technology is being amortized on a straight-line basis over 5 years.

The Company has currently not identified any material pre-acquisition contingencies where a liability is probable and the amount of the liability can be reasonably estimated. If information becomes available prior to the end of the



purchase price allocation period which would indicate that such a liability is probable and the amount can be reasonably estimated, such items will be included in the purchase price allocation.

## NEUSTAR, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 6. GOODWILL AND INTANGIBLE ASSETS

The change in the carrying amount of goodwill by reportable segment for the three months ended March 31, 2008 is as follows:

|                              | Clearinghouse<br>Services | NGM<br>Services | Total      |
|------------------------------|---------------------------|-----------------|------------|
| Balance at December 31, 2007 | \$ 88,148                 | \$ 115,945      | \$ 204,093 |
| Acquisitions                 | 6,379                     |                 | 6,379      |
| Impairment charge            |                           | (29,021)        | (29,021)   |
| Balance at March 31, 2008    | \$ 94,527                 | \$ 86,924       | \$ 181,451 |

The Company's NGM business segment experienced certain changes in market conditions and customer-related events that caused NGM to revise its financial forecast in March 2008, triggering the Company to perform an interim goodwill impairment test. First, the Company compared the estimated fair value of the NGM reporting unit's net assets, including assigned goodwill, to the book value of these net assets. The estimated fair value for the reporting unit was calculated using a combination of discounted cash flow projections, market values for comparable businesses, and terms, prices and conditions found in sales of comparable businesses. The Company determined that the estimated fair value of the reporting unit was less than its net book value. As such, the Company then performed a theoretical purchase price allocation to compare the carrying value of NGM's assigned goodwill to its implied fair value and recognized an impairment charge of \$29.0 million. The goodwill impairment has been recorded under the caption Impairment of Goodwill in the Unaudited Consolidated Statements of Operations.

Intangible assets consist of the following (in thousands):

|                                       | December<br>31,<br>2007 | March 31,<br>2008<br>(unaudited) | Weighted-<br>Average<br>Amortization<br>Period<br>(In Years)<br>(unaudited) |
|---------------------------------------|-------------------------|----------------------------------|---|
| Intangible assets:                    |                         |                                  |   |
| Customer lists and relationships      | \$ 43,740               | \$ 47,504                        | 5.5   |
| Accumulated amortization              | (15,463)                | (17,853)                         |   |
| Customer lists and relationships, net | 28,277                  | 29,651                           |   |
| Acquired technology                   | 17,068                  | 19,757                           | 3.3   |
| Accumulated amortization              | (8,581)                 | (9,954)                          |   |
| Acquired technology, net              | 8,487                   | 9,803                            |   |
| Trade name                            | 200                     | 200                              | 3.0   |
| Accumulated amortization              | (113)                   | (130)                            |   |
| Trade name, net                       | 87                      | 70                               |   |

|                        |    |        |    |        |
|------------------------|----|--------|----|--------|
| Intangible assets, net | \$ | 36,851 | \$ | 39,524 |
|------------------------|----|--------|----|--------|

Amortization expense related to intangible assets, which is included in depreciation and amortization expense, was approximately \$3.8 million and \$3.8 million for the three months ended March 31, 2007 and 2008, respectively. Amortization expense related to intangible assets for the years ended December 31, 2008, 2009, 2010, 2011, and 2012, is expected to be approximately \$15.2 million, \$12.8 million, \$8.1 million, \$5.5 million, and \$1.5 million, respectively.

**NEUSTAR, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****7. NOTES PAYABLE**

On February 6, 2007, the Company entered into a new credit agreement, which provides for a revolving credit facility in an aggregate principal amount of up to \$100 million (2007 Credit Facility). Borrowings under the 2007 Credit Facility bear interest, at the Company's option, at either a Eurodollar rate plus a spread ranging from 0.625% to 1.25%, or at a base rate plus a spread ranging from 0.0% to 0.25%, with such spread in each case depending on the ratio of the Company's consolidated senior funded indebtedness to consolidated EBITDA. The 2007 Credit Facility expires on February 6, 2012. Borrowings under the 2007 Credit Facility may be used for working capital, capital expenditures, general corporate purposes and to finance acquisitions. There were no borrowings outstanding under the 2007 Credit Facility as of March 31, 2008, but available borrowings were reduced by letters of credit of \$10.1 million outstanding on that date.

The 2007 Credit Facility contains customary representations and warranties, affirmative and negative covenants, and events of default. The 2007 Credit Facility requires the Company to maintain a minimum consolidated EBITDA to consolidated interest charge ratio and a maximum consolidated senior funded indebtedness to consolidated EBITDA ratio. If an event of default occurs and is continuing, the Company may be required to repay all amounts outstanding under the 2007 Credit Facility. Lenders holding more than 50% of the loans and commitments under the 2007 Credit Facility may elect to accelerate the maturity of amounts due thereunder upon the occurrence and during the continuation of an event of default.

In May 2007, the Company entered into a note payable with a vendor for \$9.7 million for the purchase of software and services. The note payable is non-interest bearing and payments of approximately \$810,000 are due quarterly beginning July 1, 2007 over the three year term ending April 2010.

**8. STOCKHOLDERS' EQUITY****Stock-Based Compensation**

The Company has two stock incentive plans: the NeuStar, Inc. 1999 Equity Incentive Plan (the 1999 Plan) and the NeuStar, Inc. 2005 Stock Incentive Plan (the 2005 Plan). The Company may grant to its directors, employees and consultants awards in the form of incentive stock options, nonqualified stock options, stock appreciation rights, shares of restricted stock, restricted stock units, performance vested restricted stock units (PVRsUs), and other stock-based awards. The aggregate number of shares of Class A common stock with respect to which all awards may be granted under the 2005 Plan is 6,044,715, plus any shares that would otherwise be available for issuance under the 1999 Plan. As of March 31, 2008, 2,617,798 shares were available for grant or award under the 2005 Plan.

Stock-based compensation expense recognized under SFAS No. 123(R) for the three months ended March 31, 2007 and 2008 was \$3.6 million and \$4.4 million, respectively. As of March 31, 2008, total unrecognized compensation expense related to non-vested stock options, non-vested restricted stock and non-vested PVRsUs granted prior to that date is estimated at \$40.7 million, which the Company expects to recognize over a weighted average period of approximately 2.2 years. Total unrecognized compensation expense as of March 31, 2008 is estimated based on outstanding non-vested stock options, non-vested restricted stock and non-vested PVRsUs and may be increased or decreased in future periods for subsequent grants or forfeitures.

**Stock Options**

The Company has utilized the Black-Scholes option-pricing model for estimating the fair value of stock options granted during the three months ended March 31, 2007 and 2008, as well as for option grants during all prior periods. The weighted-average fair value of options at the date of grant for options granted during the three months ended March 31, 2007 and 2008 was \$11.62 and \$8.79, respectively.

**NEUSTAR, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following are the weighted-average assumptions used in valuing the stock options granted during the three months ended March 31, 2007 and 2008, and a discussion of the Company's assumptions:

|                                     | <b>Three Months Ended<br/>March 31,</b> |             |
|-------------------------------------|---|-------------|
|                                     | <b>2007</b>                             | <b>2008</b> |
| Dividend yield                      | 0.00%                                   | 0.00%       |
| Expected volatility                 | 33.37%                                  | 35.82%      |
| Risk-free interest rate             | 4.46%                                   | 2.56%       |
| Expected life of options (in years) | 4.61                                    | 4.37        |

**Dividend yield** The Company has never declared or paid dividends on its common stock and does not anticipate paying dividends in the foreseeable future.

**Expected volatility** Volatility is a measure of the amount by which a financial variable such as share price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. Given the Company's limited historical stock data from its initial public offering in June 2005, the Company has used a blended volatility to estimate expected volatility. The blended volatility includes the average of the Company's preceding weekly historical volatility from its initial public offering to the respective grant date, the Company's preceding six-months market implied volatility. Market implied volatility is the volatility implied by the trading prices of publicly available stock options for the Company's common stock. The Company's peer group historical volatility includes the historical volatility of companies that are similar in revenue size, in the same industry or are competitors.

**Risk-free interest rate** This is the average U.S. Treasury rate (with a term that most closely resembles the expected life of the option) for the quarter in which the option was granted.

**Expected life of the options** This is the period of time that the options granted are expected to remain outstanding. Prior to January 1, 2008, this estimate was derived from the average midpoint between the weighted average vesting period and the contractual term as described in the SEC's Staff Accounting Bulletin No. 107, *Share-Based Payment*. After January 1, 2008, the Company utilizes historical exercise information to provide a more reliable estimate of the expected term for plain vanilla share options.

The following table summarizes the Company's stock option activity for the three months ended March 31, 2008:

|                                  | <b>Shares</b> | <b>Weighted-Average<br/>Exercise<br/>Price</b> |
|----------------------------------|---------------|--|
| Outstanding at December 31, 2007 | 5,668,501     | \$ 15.42                                       |
| Options granted                  | 1,119,015     | 26.38  |
| Options exercised                | (325,713)     | 4.66   |
| Options canceled                 | (106,594)     | 28.82  |
| Outstanding March 31, 2008       | 6,355,209     | 17.68  |
| Exercisable at March 31, 2008    | 3,572,701     | 10.31  |

The aggregate intrinsic value of options exercised during the three months ended March 31, 2007 and 2008 was \$29.6 million and \$6.7 million respectively. The aggregate intrinsic value for all options outstanding under the Company's stock plans as of March 31, 2008 was \$67.1 million. The aggregate intrinsic value for options exercisable under the Company's stock plans as of March 31, 2008 was \$61.7 million. The weighted-average remaining

contractual life for all options outstanding under the Company's stock plans as of March 31, 2008 was 5.35 years. The weighted-average remaining contractual life for options exercisable under the Company's stock plans as of March 31, 2008 was 4.60 years.

**NEUSTAR, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Restricted Stock**

The following table summarizes the Company's non-vested restricted stock activity for the three months ended March 31, 2008:

|                              | <b>Shares</b> | <b>Weighted-Average<br/>Grant Date<br/>Fair Value</b> |
|------------------------------|---------------|---|
| Non-vested December 31, 2007 | 75,660        | \$ 31.55  |
| Granted                      | 124,800       | 26.83   |
| Vested                       | (9,960)       | 30.37   |
| Forfeited                    | (4,393)       | 30.08   |
| Non-vested March 31, 2008    | 186,107       | 28.48   |

The aggregate intrinsic value for all non-vested restricted stock outstanding under the Company's stock plans at March 31, 2008 was \$4.9 million. During the three months ended March 31, 2007 and 2008, the Company repurchased 2,709 and 2,493 shares of common stock for an aggregate purchase price of approximately \$139,000 and \$95,000, respectively, pursuant to the participants' rights under the Company's stock incentive plan to elect to use common stock to satisfy their tax withholding obligations.

**Performance Vested Stock Units**

The following table summarizes the Company's non-vested PVRSU activity for the three months ended March 31, 2008:

|                              | <b>Shares</b> | <b>Weighted-Average<br/>Grant Date<br/>Fair Value</b> |
|------------------------------|---------------|---|
| Non-vested December 31, 2007 | 303,080       | \$ 32.59  |
| Granted                      | 286,660       | 26.29   |
| Vested                       |               |   |
| Forfeited                    | (68,460)      | 32.19   |
| Non-vested March 31, 2008    | 521,280       | 29.18   |

The vesting of these stock awards is contingent upon the Company achieving specified financial targets at the end of the specified performance periods and the employees continued employment. The performance conditions affect the number of shares that will ultimately be issued. The range of possible stock-based award vesting is between 0% and 150% of the initial target. Under SFAS No. 123R, compensation expense related to these awards is being recognized over the requisite service period based on the Company's estimate of the achievement of the performance target. The Company has currently estimated that 125% of the target will be achieved. The fair value is measured by the closing market price of the Company's common stock on the date of the grant. Compensation expense is recognized ratably over the requisite service period based on those PVRsUs expected to vest.

The aggregate intrinsic value for all non-vested PVRsUs outstanding under the Company's stock plans at March 31, 2008 was \$13.8 million.

**Restricted Stock Units**

In July 2006, the Compensation Committee of the board of directors issued 27,170 restricted stock units to the Company's non-management directors. The aggregate intrinsic value of the restricted stock units granted totaled \$880,000. For those directors who were elected at the 2006 Annual Meeting of Stockholders, as well as incumbent

directors whose terms did not expire in 2006, these restricted stock units were granted on July 1, 2006. For those directors appointed by the Company's board of directors on July 26, 2006, the date of grant was July 27, 2006. In August and November 2007, the Company's non-management directors were issued 30,828 and 3,342 restricted stock units, respectively, with an aggregate intrinsic value on the grant date of approximately \$900,000 and \$114,000, respectively.



**NEUSTAR, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

These restricted stock units will fully vest on the first anniversary of the date of grant. Upon vesting, each director's restricted stock units will be automatically converted into deferred stock units, which will be delivered to the director in shares of the Company's stock six months following the director's termination of Board service. Following the resignation of two of the Company's directors on July 26, 2006 and April 10, 2007, respectively, a total of 6,518 restricted stock units were forfeited.

The aggregate intrinsic value for these restricted stock units as of March 31, 2008 was approximately \$1.5 million.

**Phantom Stock Units**

In July 2004, the board of directors granted 350,000 phantom stock units to one of the Company's officers. Effective March 1, 2007, the officer was no longer employed with the Company. On that date, 224,383 phantom stock units vested in accordance with the terms of the officer's phantom stock agreement, which had an aggregate intrinsic value of approximately \$7.3 million. Of the 224,383 shares of the Company's common stock issuable to the officer in respect of his vested phantom stock units, the Company repurchased 91,713 shares on March 1, 2007 for an aggregate purchase price of approximately \$3.0 million pursuant to the officer's right under the applicable stock incentive plan to elect to use common stock to satisfy his tax withholding obligations.

**Treasury Stock**

Pursuant to the Company's stock incentive plans, employees may elect to satisfy their tax withholding obligations upon vesting of restricted stock awards by having the Company make such payments and withhold a number of vested shares having a value on the date of vesting equal to their tax withholding obligation. As a result of such employee elections, the Company withheld 94,422 and 2,493 shares during the three months ended March 31, 2007 and 2008 with a total market value of approximately \$3.1 million and \$95,000, respectively, from previously granted restricted stock awards for settlement of employee tax liabilities pursuant to the Company's stock incentive plans as discussed in Note 6, and these shares were accounted for as treasury stock.

On February 14, 2008, a special committee of the board of directors authorized the repurchase of up to \$250 million in shares of the Company's Class A common stock in accordance with applicable rules under the Securities Exchange Act of 1934. As of March 31, 2008, a total of 4,034,678 shares have been repurchased for an aggregate purchase price of approximately \$103.8 million. Subsequent to March 31, 2008, an additional 802,431 shares were repurchased for an aggregate purchase price of \$21.1 million. All repurchased shares are accounted for as treasury shares.

**9. BASIC AND DILUTED NET INCOME (LOSS) PER COMMON SHARE**

The following table reconciles the number of shares used in the basic and diluted net income (loss) per share calculation (in thousands, except per share data):

|  | <b>Three Months Ended<br/>March 31,</b> |             |
|--|---|-------------|
|  | <b>2007</b>                             | <b>2008</b> |
| Computation of basic net income (loss) per common share:   |   |             |
| Net income (loss)  | \$ 17,968                               | \$ (4,460)  |
| Weighted average common shares outstanding - basic         | 74,688                                  | 76,247      |
| Basic net income (loss) per common share                   | \$ 0.24                                 | \$ (0.06)   |
| Computation of diluted net income (loss) per common share: |   |             |
| Net income (loss)  | \$ 17,968                               | \$ (4,460)  |
| Weighted average common shares outstanding - basic         | 74,688                                  | 76,247      |

|   |         |           |
|---|---------|-----------|
| Effect of dilutive securities:                        |         |           |
| Stock-based awards                                    | 4,343   |           |
| Weighted average common shares outstanding    diluted | 79,031  | 76,247    |
| Diluted net income (loss) per common share            | \$ 0.23 | \$ (0.06) |

**NEUSTAR, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Diluted earnings per common share reflects the potential dilution of common stock equivalents such as options and warrants, to the extent the impact is dilutive. Anti-dilutive shares excluded from diluted earnings per common share calculated for the three months ended March 31, 2008 were 2,847,535.

**10. SEGMENT INFORMATION**

The Company has two reportable operating segments: Clearinghouse Services and NGM Services.

Information for the three months ended March 31, 2007 and 2008 regarding the Company's reportable operating segments is as follows (in thousands):

|                                     | <b>Three Months Ended March<br/>31,</b> |             |
|-------------------------------------|---|-------------|
|                                     | <b>2007</b>                             | <b>2008</b> |
| Revenue:                            |   |             |
| Clearinghouse services              | \$ 96,906                               | \$ 113,552  |
| NGM services                        | 542                                     | 3,861       |
| Total revenue                       | \$ 97,448                               | \$ 117,413  |
| Depreciation and amortization:      |   |             |
| Clearinghouse services              | \$ 6,818                                | \$ 7,404    |
| NGM services                        | 2,246                                   | 2,716       |
| Total depreciation and amortization | \$ 9,064                                | \$ 10,120   |
| Income (loss) from operations:      |   |             |
| Clearinghouse services              | \$ 37,828                               | \$ 50,401   |
| NGM services                        | (8,496)                                 | (39,372)    |
| Income (loss) from operations       | \$ 29,332                               | \$ 11,029   |

Information as of December 31, 2007 and March 31, 2008 regarding the Company's reportable operating segments is as follows (in thousands):

|                        | <b>December<br/>31,<br/>2007</b> | <b>March 31,<br/>2008</b> |
|------------------------|----------------------------------|---------------------------|
| Total assets:          |                                  |                           |
| Clearinghouse services | \$ 449,523                       | \$ 377,486                |
| NGM services           | 167,138                          | 134,574                   |
| Total assets           | \$ 616,661                       | \$ 512,060                |
| Goodwill:              |                                  |                           |
| Clearinghouse services | \$ 88,148                        | \$ 94,527                 |
| NGM services           | 115,945                          | 86,924                    |

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|                        |    |         |    |         |
|------------------------|----|---------|----|---------|
| Goodwill               | \$ | 204,093 | \$ | 181,451 |
| Intangible assets:     |    |         |    |         |
| Clearinghouse services | \$ | 14,973  | \$ | 19,462  |
| NGM services           |    | 21,878  |    | 20,062  |
| Intangible assets      | \$ | 36,851  | \$ | 39,524  |

**NEUSTAR, INC.**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**11. INCOME TAXES**

As of December 31, 2007 and March 31, 2008, the Company had unrecognized tax benefits of \$2.0 million and \$2.3 million, respectively, of which \$1.5 million and \$1.8 million, respectively, would affect the Company's effective tax rate if recognized. The Company's annual effective tax rate increased to 136.6% for the three months ended March 31, 2008 from 39.4% for the three months ended March 31, 2007 due primarily to the impact of the \$29.0 million non-cash impairment charge related to a write-down of goodwill, none of which is deductible for tax purposes.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. During the quarter ended March 31, 2008, the Company recognized \$43,000 in interest. As of December 31, 2007 and March 31, 2008, there was approximately \$220,000 and \$263,000 of accrued interest related to uncertain tax positions, respectively. To the extent interest is not assessed with respect to uncertain tax positions, amounts accrued will be reduced and reflected as a reduction of the overall income tax provision.

The Company files income tax returns in the United States Federal jurisdiction and in many state and foreign jurisdictions. The tax years 2004 through 2007 remain open to examination by the major taxing jurisdictions to which the Company is subject.

The Company anticipates that total unrecognized tax benefits will decrease by approximately \$0.9 million over the next 12 months due to the expiration of certain statutes of limitations.

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

### **Forward-Looking Statements**

This quarterly report on Form 10-Q contains forward-looking statements, including, without limitation, statements concerning the conditions in our industry, our operations and economic performance, and our business and growth strategy. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expects, intends, plans, anticipates, believes, estimates, predicts, potential, continue or the negative or other comparable terminology. These statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. Many of these risks are beyond our ability to control or predict. These forward-looking statements are based on estimates and assumptions by our management that, although we believe to be reasonable, are inherently uncertain and subject to a number of risks and uncertainties. These risks and uncertainties include, without limitation, those described in this report, in Part I, Item 1A. Risk Factors and elsewhere in our Annual Report on 10-K for the year ended December 31, 2007 and subsequent filings with the Securities and Exchange Commission. We undertake no obligation to publicly update or revise any forward-looking statement as a result of new information, future events or otherwise, except as otherwise required by law.

### **Overview**

During the first quarter of 2008, we experienced continued growth in our clearinghouse services. Total revenue for the quarter increased 21% as compared to the first quarter of 2007. Under our contracts to provide telephone number portability services in the United States, we processed 87.0 million transactions during this quarter, representing growth of 22% over the first quarter of 2007. We recognized a net loss of \$4.5 million, which was due primarily to an impairment charge of \$29.0 million to write down the value of goodwill related to our NGM business segment.

### **Recent Development**

Our NGM business segment experienced certain changes in market conditions and customer-related events that caused us to revise the NGM business forecast, triggering us to perform an interim goodwill impairment test. First, we compared the fair value of the NGM reporting unit to its carrying value, including assigned goodwill. The estimated fair value for the reporting unit was calculated using a combination of discounted cash flow projections, market values for comparable businesses, and terms, prices and conditions found in sales of comparable businesses. We determined that the fair value of the reporting unit was less than its net book value. As such, we then performed a theoretical purchase price allocation to compare NGM's assigned goodwill to its implied fair value and recognized an impairment charge of \$29.0 million.

### **Critical Accounting Policies and Estimates**

The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles, or U.S. GAAP. The preparation of these financial statements in accordance with U.S. GAAP requires us to utilize accounting policies and make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expense during a fiscal period. The Securities and Exchange Commission considers an accounting policy to be critical if it is important to a company's financial condition and results of operations, and if it requires significant judgment and estimates on the part of management in its application. We have discussed the selection and development of the critical accounting policies with the audit committee of our board of directors, and the audit committee has reviewed our related disclosures in this report. Although we believe that our judgments and estimates are appropriate, actual results may differ from those estimates. See the information in our filings with the Securities and Exchange Commission from time to time, including Part I, Item 1A. Risk Factors, in our Annual Report on Form 10-K for the year ended December 31, 2007, and as updated in our subsequent periodic and current reports, for certain matters that may bear on our future results of operations. We discuss our critical accounting policies and estimates in our Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2007 and in our Notes to Unaudited Consolidated Financial Statements in this Quarterly Report on Form 10-Q. There have been no material changes to our critical accounting policies and

estimates in 2008 except as follows:

**Investments**

We account for investment securities under the provisions of Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, or SFAS No. 115, and related interpretations and staff positions. SFAS No. 115 requires us to record available-for-sale securities at fair value, with unrealized gains and losses being reported as a component of other comprehensive income. When readily determinable fair values are not available, we use judgment to estimate the fair value of our investments based on observable market inputs or, if no observable market inputs are available, unobservable market inputs, or a combination thereof. Our fair value estimates consider, among other factors, the collateral underlying the security investments, creditworthiness of the counterparty, timing of expected future cash flows, and, in the case of auction rate securities, the probability of a successful auction in a future period. Further, we use judgment in evaluating whether a decline in fair value is temporary or other-than-temporary and consider the following indicators: changes in credit ratings or asset quality; changes in the economic environment; length of time and extent to which fair value has been below cost basis; changes in market conditions; changes in expected cash flows; and our ability and intent to hold the investment for a period of time which may be sufficient for anticipated recovery in market value. Temporary declines in fair value are recorded as charges to accumulated other comprehensive income, while other-than-temporary declines in fair value are recorded to earnings.

**Goodwill**

We have made numerous acquisitions, including the 2006 acquisitions of UltraDNS Corporation and Followap Inc., resulting in our recording of goodwill, which represents the excess of the purchase price over the fair value of assets acquired, as well as other definite-lived intangible assets. In accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, or SFAS No. 142, goodwill and indefinite-lived intangible assets are not amortized, but are reviewed for impairment upon the occurrence of events or changes in circumstances that would reduce the fair value of such assets below their carrying amount. Goodwill and indefinite-lived intangible assets are required to be tested for impairment at least annually, or on an interim basis if circumstances change that would indicate the possibility of impairment. For purposes of our annual impairment test, we have identified and assigned goodwill to two reporting units, our Clearinghouse segment and our NGM segment.

Goodwill is tested for impairment at the reporting unit level using a two-step approach. The first step is to compare the fair value of a reporting unit's net assets, including assigned goodwill, to the book value of its net assets, including assigned goodwill. Fair value of the reporting unit is determined using both an income and market approach. To assist in the process of determining if a goodwill impairment exists, we perform internal valuation analyses and consider other market information that is publicly available, and we may obtain appraisals from external advisors. If the fair value of the reporting unit is greater than its net book value, the assigned goodwill is not considered impaired. If the fair value is less than the reporting unit's net book value, we perform a second step to measure the amount of the impairment, if any. The second step would be to compare the book value of the reporting unit's assigned goodwill to the implied fair value of the reporting unit's goodwill, using a theoretical purchase price allocation based on this implied fair value to determine the magnitude of the impairment. If we determine that an impairment has occurred, we are required to record a write-down of the carrying value and charge the impairment as an operating expense in the period the determination is made.

The annual and any required interim goodwill impairment test and the determination of the fair value of intangible assets involve the use of significant estimates and assumptions by management, and are inherently subjective. In particular, for each of our reporting units, the significant assumptions used include market penetration, anticipated growth rates, and risk-adjusted discount rates for the income approach, as well as the selection of comparable companies and comparable transactions for the market approach. Changes in estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. Specifically, for our NGM reporting unit, due to the early stage of its operations and the emerging nature of mobile instant messaging technology, the assumptions and estimates used by management that are incorporated within the NGM valuation have a high degree of subjectivity, and are thus more likely to change over time. In addition, because relatively few carriers control a substantial portion of the end users who will drive the success of mobile instant messaging, the activities of NGM's largest customers can have a significant impact on these assumptions and



estimates. For example, we changed certain of our key assumptions, most notably assumptions relating to end-user adoption rates, to reflect changes in the market and identified customer-related events that occurred late in the first quarter of 2008. The effect of these changes on our projections of future cash flows resulted in a \$29.0 million impairment charge in March 2008. We believe that the assumptions and estimates used to determine the estimated fair values of each of our reporting units, including revised assumptions underlying the valuation of our NGM reporting unit, are reasonable; however, there are a number of factors that could cause actual results to differ from our estimates, including further delays from changes in strategy by participants in the mobile instant messaging market, lack of effective marketing efforts to promote mobile instant messaging to end users and unforeseen changes in the market. Any changes in key assumptions about our businesses and their prospects, or changes in market conditions, could result in an impairment charge. Such a charge could have a material effect on our consolidated financial statements because of the significance of goodwill and intangible assets to our consolidated balance sheet. As of March 31, 2008, we had \$94.5 million and \$86.9 million, respectively, in goodwill for our Clearinghouse reporting unit and our NGM reporting unit subject to future impairment tests.

## **Acquisitions**

### ***I-View.com, Inc. (d/b/a MetaInfo)***

On January 8, 2007, we acquired certain assets of I-View.com, Inc. (d/b/a MetaInfo) for cash consideration of \$1.7 million. The acquisition of MetaInfo expands our enterprise DNS services. The acquisition was accounted for as a purchase business combination in accordance with SFAS No. 141 and the results of operations of MetaInfo have been included in the accompanying consolidated statement of operations since the date of acquisition. Of the total purchase price, we allocated \$0.1 million to net tangible liabilities assumed, \$0.5 million to definite-lived intangible assets and \$1.3 million to goodwill. Definite-lived intangible assets consist of customer intangibles and acquired technology. We are amortizing the value of the customer intangibles in proportion to the discounted cash flows over an estimated useful life of 3 years. Acquired technology is being amortized on a straight-line basis over 3 years.

### ***Webmetrics, Inc.***

On January 10, 2008, we acquired Webmetrics, Inc. (Webmetrics) for cash consideration of \$12.5 million subject to certain purchase price adjustments and contingent cash consideration of up to \$6.0 million, and acquisition costs of approximately \$685,000. The acquisition of Webmetrics, a provider of web and network performance testing, monitoring and measurement services, expands our Internet and infrastructure services. The acquisition was accounted for as a purchase business combination in accordance with SFAS No. 141 and the results of operations of Webmetrics have been included in the accompanying consolidated statement of operations since the date of acquisition. Of the total purchase price, a preliminary estimate of \$0.4 million has been allocated to net tangible assets acquired, \$6.4 million to definite-lived intangible assets and \$6.4 million to goodwill. Definite-lived intangible assets consist of customer relationships and acquired technology. We are amortizing the value of the customer relationships in proportion to the discounted cash flows over an estimated useful life of 3 years. Acquired technology is being amortized on a straight-line basis over 5 years.

**Consolidated Results of Operations*****Three Months Ended March 31, 2007 Compared to Three Months Ended March 31, 2008***

The following table presents an overview of our results of operations for the three months ended March 31, 2007 and 2008.

|  | <b>Three Months Ended<br/>March 31,</b> |             | <b>Three Months Ended<br/>March 31,</b> |             |
|--|---|-------------|---|-------------|
|  | <b>2007</b>                             | <b>2008</b> | <b>2007 vs. 2008</b>                    |             |
|  | \$                                      | \$          | \$<br>Change                            | %<br>Change |
|  | (unaudited)                             |             |   |             |
|  | (in thousands, except per share data)   |             |   |             |
| Revenue:   |   |             |   |             |
| Addressing   | 27,003                                  | 30,161      | 3,158                                   | 11.7        |
| Interoperability   | 14,932                                  | 16,440      | 1,508                                   | 10.1        |
| Infrastructure and other   | 55,513                                  | 70,812      | 15,299                                  | 27.6        |
| Total revenue  | 97,448                                  | 117,413     | 19,965                                  | 20.5        |
| Operating expense:   |   |             |   |             |
| Cost of revenue (excluding depreciation and amortization shown separately below) | 23,078                                  | 24,489      | 1,411                                   | 6.1         |
| Sales and marketing  | 18,636                                  | 18,724      | 88                                      | 0.5         |
| Research and development   | 6,569                                   | 7,548       | 979                                     | 14.9        |
| General and administrative   | 10,769                                  | 16,482      | 5,713                                   | 53.1        |
| Depreciation and amortization  | 9,064                                   | 10,120      | 1,056                                   | 11.7        |
| Impairment of goodwill   |   | 29,021      | 29,021                                  |             |
|  | 68,116                                  | 106,384     | 38,268                                  | 56.2        |
| Income from operations   | 29,332                                  | 11,029      | (18,303)                                | (62.4)      |
| Other (expense) income:  |   |             |   |             |
| Interest expense   | (350)                                   | (442)       | (92)                                    | 26.3        |
| Interest and other income  | 649                                     | 1,592       | 943                                     | 145.3       |
| Income before income taxes   | 29,631                                  | 12,179      | (17,452)                                | (58.9)      |
| Provision for income taxes   | 11,663                                  | 16,639      | 4,976                                   | 42.7        |
| Net income (loss)  | 17,968                                  | (4,460)     | (22,428)                                | (124.8)     |
| Net income (loss) attributable to common stockholders per common share:          |   |             |   |             |
| Basic  | \$ 0.24                                 | \$ (0.06)   |   |             |
| Diluted  | \$ 0.23                                 | \$ (0.06)   |   |             |

Weighted average common shares outstanding:

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|         |        |        |
|---------|--------|--------|
| Basic   | 74,688 | 76,247 |
| Diluted | 79,031 | 76,247 |

## **Revenue**

*Total revenue.* Total revenue increased \$20.0 million due primarily to increases in transactions under our contracts to provide telephone number portability services in the United States.

*Addressing.* Addressing revenue increased \$3.2 million due to the expanded range of DNS services, and the continued increase in the use of U.S. Common Short Codes. Specifically, revenue from DNS services increased \$4.3 million, consisting of a \$2.7 million increase in revenue from increased use of our NeuStar Ultra Services, and a \$1.6 million increase in revenue from an increased number of domain names under management. In addition, revenue from U.S. Common Short Codes increased \$1.4 million due to an increased number of subscribers for U.S. Common Short Codes. These increases were offset by a decrease of \$2.6 million in revenue under our contracts to provide telephone number portability services in the United States.

*Interoperability.* Interoperability revenue increased \$1.5 million due to an increase of \$1.9 million from our NGM business segment, which was offset by a decrease of \$0.4 million from our Clearinghouse business segment. The increase in NGM revenue of \$1.9 million was driven by an increase in the number of carrier customers utilizing our services. The decrease in Clearinghouse revenue was predominantly due to a \$3.1 million reduction in revenue from our contracts to provide number portability services in Canada. This reduction resulted from a return to normal use patterns in the first quarter of 2008 as compared to the elevated transaction levels we experienced in the first quarter of 2007 in advance of the introduction of wireless number portability in Canada. This decrease was offset by an increase in revenue from our order management services of \$2.2 million.

*Infrastructure and other.* Infrastructure and other revenue increased \$15.3 million, of which \$13.9 million was attributable to our Clearinghouse business segment and \$1.4 million was attributable to our NGM business segment. Clearinghouse revenue increased predominantly due to increased demand for our network management services, primarily due to customers making changes to their networks that required actions such as disconnects and modifications to network elements. We believe these changes were driven largely by trends in the industry, including the implementation of new technologies by our customers, such as wireless technology upgrades and network optimization. In addition, the increase in infrastructure revenue from our NGM business segment was driven by an increase in the number of carrier customers utilizing our services.

## **Expense**

*Cost of revenue.* Cost of revenue increased \$1.4 million due to an increase of \$1.7 million attributable to our NGM business segment, which was offset by a decrease of \$0.3 million from our Clearinghouse business segment. The \$1.7 million increase in NGM cost of revenue was due primarily to expanded costs associated with additional deployments for the carrier customers utilizing our services. The \$0.3 million decrease in Clearinghouse cost of revenue was due to a reduction in personnel and personnel-related expense of \$1.3 million, which resulted from increased operating efficiencies in supporting our platforms that allowed us to increase the number of transactions we processed without proportional increases in personnel and personnel-related expense. This decrease was offset by an increase of \$0.9 million in royalty expenses related to U.S. Common Short Code services.

*Sales and marketing.* Sales and marketing expense was generally flat, consisting of a \$0.6 million increase attributable to our NGM business segment to expand our sales force, which was offset by a decrease of \$0.5 million from our Clearinghouse business segment.

*Research and development.* Research and development expense increased \$1.0 million, all of which was attributable to our NGM business segment. The \$1.0 million increase in NGM research and development expense was driven by increased headcount and increased professional fees to support delivery of our NGM services.

*General and administrative.* General and administrative expense increased \$5.7 million, of which \$4.2 million was attributable to our Clearinghouse business segment and \$1.5 million was attributable to our NGM business segment. The increase in Clearinghouse general and administrative expense was due predominantly to a \$1.8 million increase in personnel and personnel-related expense related to increased headcount and a \$1.4 million increase in professional fees to support business growth. In addition, general facility costs for our Clearinghouse segment increased \$0.5 million. The increase in NGM general and administrative expense was due to an increase of \$0.9 million in personnel and personnel-related expense related to increased headcount to support business growth and a \$0.6 million increase in general facility costs.



*Depreciation and amortization.* Depreciation and amortization expense increased \$1.1 million, of which \$0.6 million was attributable to our Clearinghouse business segment and \$0.5 million was attributable to our NGM business segment. These increases in each of our segments were due predominantly to increased depreciation of capital assets.

*Impairment of goodwill.* We recognized an impairment charge of \$29.0 million to write down the value of goodwill from our NGM business segment. There was no corresponding expense in the first quarter of 2007.

*Interest expense.* Interest expense remained relatively constant during the three months ended March 31, 2008 as compared to the three months ended March 31, 2007.

*Interest and other income.* Interest and other income for the three months ended March 31, 2008 increased \$0.9 million as compared to the three months ended March 31, 2007 due primarily to higher yields on average combined cash and short and long-term investment balances.

*Provision for income taxes.* Our annual effective tax rate increased to 136.6% for the three months ended March 31, 2008 from 39.4% for the three months ended March 31, 2007 due primarily to the impact of the \$29.0 million non-cash impairment charge related to a write-down of goodwill, none of which is deductible for tax purposes. Our income tax provision for the three months ended March 31, 2008 increased \$5.0 million as compared to the three months ended March 31, 2007 due primarily to an increase in income from operations excluding the goodwill impairment charge.

### **Liquidity and Capital Resources**

Our principal source of liquidity is cash provided by operating activities. Our principal uses of cash have been to fund acquisitions, facility expansions, capital expenditures, working capital, debt service requirements and stock repurchases. We anticipate that our principal uses of cash in the future will be working capital, capital expenditures, facility expansion, stock repurchases and acquisitions.

Total cash and cash equivalents and short-term investments were \$86.5 million at March 31, 2008, a decrease from \$198.7 million at December 31, 2007. This decrease was due primarily to the repurchase of \$103.9 million of our Class A common stock and the reclassification of \$39.4 million of investments to long-term due to failed auctions for auction rate securities held by us. Of the \$86.5 million included in total cash and cash equivalents and short-term investments, \$32.1 million was invested in a cash reserve fund that has been closed to new investments and immediate redemptions. The fund currently has a projected redemption schedule that will result in approximately 90 percent of the fund being redeemed in 2008.

At March 31, 2008, our long-term investments totaled \$39.4 million and consisted of auction rate securities with AAA ratings whose underlying assets are student loans guaranteed by the federal government. These auction rate securities are intended to provide liquidity via an auction process that resets the applicable interest rate approximately every 30 days and allows investors to either roll over their holdings or gain immediate liquidity by selling such investments at par. The underlying maturities of these investments range from 17 to 39 years. As a result of current negative conditions in the global credit markets, auctions for our \$39.4 million investment in these securities as of March 31, 2008 either have failed or may fail to settle on their respective settlement dates. Consequently, the investments are not currently liquid and we will not be able to access these funds until a future auction of these investments is successful or a buyer is found outside of the auction process. Given our strong liquidity position and expected operating cash flows, we have the ability to execute our business plan and intend to hold these securities until conditions improve.

We believe that our existing cash and cash equivalents, short-term investments, long-term investments and cash from operations will be sufficient to fund our operations for the next twelve months.

### **Discussion of Cash Flows**

#### *Cash flows from operations*

Net cash provided by operating activities for the three months ended March 31, 2008 was \$54.1 million, as compared to cash provided by operating activities of \$9.7 million for the three months ended March 31, 2007. This \$44.4 million increase in net cash provided by operating activities was principally the result of an increase of non-cash adjustments of \$41.4 million, including a goodwill impairment charge of \$29.0 million and a decrease of \$10.2 million relating to excess tax benefits from stock-based compensation.





***Cash flows from investing***

Net cash provided by investing activities for the three months ended March 31, 2008 was \$6.3 million, as compared to net cash used in investing activities of \$4.4 million for the three months ended March 31, 2007. This \$10.8 million increase in net cash provided by investing activities was due to a \$24.1 million increase in net sales of short-term investments offset by an increase of \$11.3 million in cash paid for acquisitions and a \$2.1 million increase in purchases of property and equipment.

***Cash flows from financing***

Net cash used in financing activities was \$104.7 million for the three months ended March 31, 2008 compared to net cash provided by financing activities of \$10.4 million for the three months ended March 31, 2007. This \$115.1 million increase in net cash used in financing activities was principally the result of the \$103.8 million related to the repurchase of our Class A common stock and a \$10.2 million decrease in the excess tax benefits from stock-based compensation.

**Recent Accounting Pronouncements**

In December 2007, the Financial Accounting Standards Board, or FASB, issued SFAS No. 141(R), *Business Combinations* (SFAS No. 141 (R)), which replaces SFAS No. 141. SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non-controlling interest in the acquiree and the goodwill acquired. SFAS No. 141(R) also establishes disclosure requirements which will enable users to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. Early adoption of this standard is prohibited. In the absence of any planned future business combinations, we do not currently expect SFAS No. 141(R) to have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained non-controlling equity investments when a subsidiary is deconsolidated. SFAS No. 160 also establishes reporting requirements that require sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. Early adoption of this standard is prohibited. In the absence of any noncontrolling (minority) interests, we do not currently expect SFAS No. 160 to have a material impact on our consolidated financial statements.

In February 2008, the FASB issued FASB Staff Position (FSP) FAS 157-b, *Effective Date of FASB Statement No. 157*, which delays the effective date of SFAS No. 157, for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The effective date would be delayed by one year to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. We are currently evaluating the impact of FSP FAS 157-b on our consolidated financial statements.

**Off-Balance Sheet Arrangements**

We had no off-balance sheet arrangements as of or for the period ended March 31, 2008.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

For quantitative and qualitative disclosures about market risk affecting NeuStar, see "Quantitative and Qualitative Disclosures About Market Risk" in Item 7A of Part II of our Annual Report on Form 10-K for the fiscal year ended December 31, 2007. Our exposure to market risk has not changed materially since December 31, 2007.

**Item 4. Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As of March 31, 2008, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective and were operating at the reasonable assurance level.

In addition, there were no changes in our internal control over financial reporting that occurred in the first quarter of 2008 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION****Item 1. Legal Proceedings**

From time to time, we are subject to claims in legal proceedings arising in the normal course of our business. We do not believe that we are party to any pending legal action that could reasonably be expected to have a material adverse effect on our business or operating results.

**Item 1A. Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2007 and as updated in our subsequent periodic reports, which could materially affect our business, financial condition or future results. The risks described in our Form 10-K and subsequent reports are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

In February 2008, our Board of Directors authorized a stock repurchase program to acquire up to \$250.0 million of our Class A common stock through open market and privately negotiated transactions, at times and in such amounts as management deems appropriate. The share repurchases are expected to be made over a two-year period, 2nd we are targeting completion of purchases of between \$125.0 million and \$150.0 million before December 31, 2008. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements, capital availability, and other market conditions.

The following table is a summary of our repurchases of common stock during each of the three months in the quarter ended March 31, 2008:

| <b>Month</b>                | <b>Total<br/>Number<br/>of Shares<br/>Purchased<br/>(1)</b> | <b>Average<br/>Price<br/>Paid<br/>per<br/>Share</b> | <b>Total Number<br/>of<br/>Shares<br/>Purchased<br/>as Part of<br/>Publicly<br/>Announced<br/>Plans<br/>or Programs<br/>(2)</b> | <b>Maximum<br/>Number<br/>(or Approximate<br/>Dollar Value) of<br/>Shares that May<br/>Yet Be<br/>Purchased<br/>Under the Plans<br/>or<br/>Programs (3)</b> |
|-----------------------------|---|---|---|---|
| January 1 through 31, 2008  | 744   | \$ 29.01  |   |   |
| February 1 through 29, 2008 | 284,749   | 25.96   | 283,000   | \$ 242,653,235  |
| March 1 through 31, 2008    | 3,751,678   | 25.71   | 3,751,678   | \$ 146,208,186  |
| <b>Total</b>                | <b>4,037,171</b>  | <b>25.73</b>  | <b>4,034,678</b>  | <b>\$ 146,208,186</b>   |

(1) Includes shares of common stock tendered by employees to

satisfy the employees tax withholding obligations arising as a result of vesting of restricted stock grants under our stock incentive plan, which shares were purchased by us based on their fair market value on the vesting date.

- (2) The difference between the total number of shares purchased and the total number of shares purchased as part of publicly announced plans or programs is 2,493 shares, all of which relate to shares surrendered to us to satisfy the employees tax withholding obligations arising as a result of vesting of restricted stock grants under our stock incentive plan.

**Item 3. Defaults upon Senior Securities**

None.

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

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| 3.1                | Restated Certificate of Incorporation, incorporated herein by reference to Exhibit 3.1 to Amendment No. 7 to NeuStar's Registration Statement on Form S-1, filed June 28, 2005 (File No. 333-123635).                         |
| 3.2                | Amended and Restated Bylaws, incorporated herein by reference to Exhibit 3.1 to NeuStar's Current Report on Form 8-K, filed July 13, 2007.  |
| 10.3.2             | Amendment to the National Thousands-Block Pooling Administration agreement awarded to NeuStar, Inc. by the Federal Communications Commission.   |
| 10.5.1             | Amendments to .us Top-Level Domain Registry Management and Coordination agreement awarded to NeuStar, Inc. by the National Institute of Standards and Technology on behalf of the Department of Commerce on October 18, 2007. |
| 10.7.1             | Amendment to Common Short Code License Agreement between the Cellular Telecommunications and Internet Association and NeuStar, Inc.   |
| 10.41              | Form of Agreement Respecting Noncompetition, Nonsolicitation and Confidentiality.   |
| 10.42              | Incentive Stock Option Agreement under the 1999 Plan, made as of December 13, 2003, by and between NeuStar, Inc. and Martin Lowen, as amended as of June 22, 2004 and May 20, 2005.   |
| 10.43              | Nonqualified Stock Option Agreement under the 1999 Plan, made as of December 13, 2003, by and between NeuStar, Inc. and Martin Lowen, as amended as of June 22, 2004 and May 20, 2005.  |
| 10.99.1            | Amendments to .us Top-Level Domain Registry Management and Coordination agreement awarded to NeuStar, Inc. by the National Institute of Standards and Technology on behalf of the Department of Commerce on October 26, 2001. |
| 31.1               | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 31.2               | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 32.1               | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |

Compensation arrangement.

**SIGNATURES**

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

**NeuStar, Inc.**

Date: May 12, 2008

By: /s/ Jeffrey A. Babka  
Jeffrey A. Babka  
Chief Financial Officer  
(Principal Financial and Accounting  
Officer  
and Duly Authorized Officer)

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