

QUINSTREET, INC  
Form 10-Q  
November 06, 2013  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended September 30, 2013**

**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 No. 001-34628**

**QuinStreet, Inc.**

**(Exact Name of Registrant as Specified in Its Charter)**

**Delaware**  
**(State or Other Jurisdiction of**  
**Incorporation or Organization)**

**77-0512121**  
**(I.R.S. Employer**  
**Identification No.)**

**950 Tower Lane, 6th Floor**  
**Foster City, California**  
**(Address of principal executive offices)**

**94404**  
**(Zip Code)**

**650-578-7700**

**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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) 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

Number of shares of common stock outstanding as of October 31, 2013: 43,394,252

**Table of Contents**

**QUINSTREET, INC.**

**INDEX**

**PART I. FINANCIAL INFORMATION**

|   |    |
|---|----|
| <u>Item 1. Financial Statements</u>   | 3  |
| <u>Condensed Consolidated Balance Sheets at September 30, 2013 and June 30, 2013</u>                                  | 3  |
| <u>Condensed Consolidated Statements of Operations for the Three Months Ended September 30, 2013 and 2012</u>         | 4  |
| <u>Condensed Consolidated Statements of Comprehensive Loss for the Three Months Ended September 30, 2013 and 2012</u> | 5  |
| <u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended September 30, 2013 and 2012</u>         | 6  |
| <u>Notes to Condensed Consolidated Financial Statements</u>   | 7  |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                  | 21 |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>   | 33 |
| <u>Item 4. Controls and Procedures</u>  | 34 |

**PART II. OTHER INFORMATION**

|  |    |
|--|----|
| <u>Item 1. Legal Proceedings</u>   | 34 |
| <u>Item 1A. Risk Factors</u>   | 34 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | 49 |
| <u>Item 3. Defaults Upon Senior Securities</u>                             | 49 |
| <u>Item 4. Mine Safety Disclosures</u>                                     | 49 |
| <u>Item 5. Other Information</u>   | 49 |
| <u>Item 6. Exhibits</u>  | 50 |
| <u>SIGNATURES</u>  | 51 |

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****QUINSTREET, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except share and per share data)****(Unaudited)**

|  | <b>September 30,<br/>2013</b> | <b>June 30,<br/>2013</b> |
|--|-------------------------------|--------------------------|
| <b>Assets</b>                              |                               |                          |
| Current assets                             |                               |                          |
| Cash and cash equivalents                  | \$ 88,295                     | \$ 90,117                |
| Marketable securities                      | 38,363                        | 37,847                   |
| Accounts receivable, net                   | 40,320                        | 38,391                   |
| Deferred tax assets                        | 6,760                         | 6,753                    |
| Prepaid expenses and other assets          | 3,964                         | 4,623                    |
| Total current assets                       | 177,702                       | 177,731                  |
| Property and equipment, net                | 10,946                        | 9,707                    |
| Goodwill                                   | 150,456                       | 150,456                  |
| Other intangible assets, net               | 45,442                        | 50,486                   |
| Deferred tax assets, noncurrent            | 40,260                        | 40,289                   |
| Other assets, noncurrent                   | 963                           | 878                      |
| Total assets                               | \$ 425,769                    | \$ 429,547               |
| <b>Liabilities and Stockholders Equity</b> |                               |                          |
| Current liabilities                        |                               |                          |
| Accounts payable                           | \$ 20,593                     | \$ 18,722                |
| Accrued liabilities                        | 26,976                        | 30,903                   |
| Deferred revenue                           | 1,405                         | 1,638                    |
| Debt                                       | 16,571                        | 15,428                   |
| Total current liabilities                  | 65,545                        | 66,691                   |
| Deferred revenue, noncurrent               | 33                            | 239                      |
| Debt, noncurrent                           | 73,104                        | 77,249                   |
| Other liabilities, noncurrent              | 6,311                         | 6,473                    |
| Total liabilities                          | 144,993                       | 150,652                  |

Commitments and contingencies (See Note 8)

|   |                |                |
|---|----------------|----------------|
| <b>Stockholders' equity</b>   |                |                |
| Common stock: \$0.001 par value; 100,000,000 shares authorized; 43,263,272 and 42,886,884 shares issued, and 43,263,272 and 42,886,884 shares outstanding at September 30, 2013 and June 30, 2013, respectively | 43             | 43             |
| Additional paid-in capital  | 229,882        | 226,857        |
| Accumulated other comprehensive loss  | (1,217)        | (1,012)        |
| Retained earnings   | 52,068         | 53,007         |
| <br>Total stockholders' equity  | <br>280,776    | <br>278,895    |
| <br>Total liabilities and stockholders' equity  | <br>\$ 425,769 | <br>\$ 429,547 |

See notes to condensed consolidated financial statements

Table of Contents**QUINSTREET, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share data)****(Unaudited)**

|  | <b>Three Months Ended<br/>September 30,</b> |             |
|--|---|-------------|
|  | <b>2013</b>                                 | <b>2012</b> |
| Net revenue  | \$ 76,961                                   | \$ 78,626   |
| Cost of revenue <sup>(1)</sup>                               | 63,592                                      | 65,190      |
| Gross profit   | 13,369                                      | 13,436      |
| Operating expenses: <sup>(1)</sup>                           |   |             |
| Product development  | 5,159                                       | 4,893       |
| Sales and marketing  | 4,156                                       | 3,691       |
| General and administrative                                   | 4,134                                       | 3,926       |
| Operating (loss) income                                      | (80)  | 926         |
| Interest income  | 27  | 28          |
| Interest expense   | (1,026)                                     | (1,012)     |
| Other (expense) income, net                                  | (19)  | 46          |
| Loss before income taxes                                     | (1,098)                                     | (12)        |
| Benefit from (provision for) taxes                           | 159   | (125)       |
| Net loss   | \$ (939)                                    | \$ (137)    |
| Net loss per share:  |   |             |
| Basic  | \$ (0.02)                                   | \$ (0.00)   |
| Diluted  | \$ (0.02)                                   | \$ (0.00)   |
| Weighted average shares used in computing net loss per share |   |             |
| Basic  | 43,117                                      | 42,812      |
| Diluted  | 43,117                                      | 42,812      |

<sup>(1)</sup> Cost of revenue and operating expenses include stock-based compensation expense as follows:

|                            |        |        |
|----------------------------|--------|--------|
| Cost of revenue            | \$ 874 | \$ 923 |
| Product development        | 732    | 693    |
| Sales and marketing        | 770    | 765    |
| General and administrative | 659    | 389    |

Edgar Filing: QUINSTREET, INC - Form 10-Q  
See notes to condensed consolidated financial statements

4

Table of Contents**QUINSTREET, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS****(In thousands)****(Unaudited)**

|   | <b>Three Months Ended<br/>September 30,</b> |             |
|---|---|-------------|
|   | <b>2013</b>                                 | <b>2012</b> |
| Net loss  | \$ (939)                                    | \$ (137)    |
| Other comprehensive loss  |   |             |
| Unrealized gain on investments                                  | 6   | 4           |
| Foreign currency translation adjustment                         | (75)  | 253         |
| Interest rate swap  |   |             |
| Change in unrealized loss                                       | (137)                                       | (398)       |
| Less: reclassification adjustment for loss included in net loss |   | (146)       |
| Net change  | (137)                                       | (544)       |
| Other comprehensive loss  | (206)                                       | (287)       |
| Comprehensive loss  | \$ (1,145)                                  | \$ (424)    |

See notes to condensed consolidated financial statements



Table of Contents

## QUINSTREET, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

|   | Three Months<br>Ended<br>September 30, |          |
|---|--|----------|
|   | 2013                                   | 2012     |
| <b>Cash Flows from Operating Activities</b>                                     |  |          |
| Net loss  | \$ (939)                               | \$ (137) |
| Adjustments to reconcile net loss to net cash provided by operating activities: |  |          |
| Depreciation and amortization   | 6,676                                  | 8,279    |
| Provision for sales returns and doubtful accounts receivable                    | (275)                                  | (316)    |
| Stock-based compensation  | 3,035                                  | 2,770    |
| Excess tax benefits from stock-based compensation                               | (96)                                   | (24)     |
| Other non-cash adjustments, net   | 289                                    | 75       |
| Changes in assets and liabilities:  |  |          |
| Accounts receivable   | (1,654)                                | 8,323    |
| Prepaid expenses and other assets   | 659                                    | (9)      |
| Other assets, noncurrent  | (86)                                   | 57       |
| Deferred taxes  | 22                                     |          |
| Accounts payable  | 2,156                                  | (2,754)  |
| Accrued liabilities   | (5,304)                                | (5,926)  |
| Deferred revenue  | (439)                                  | (309)    |
| Other liabilities, noncurrent   | (162)                                  | 342      |
| Net cash provided by operating activities                                       | 3,882                                  | 10,371   |
| <b>Cash Flows from Investing Activities</b>                                     |  |          |
| Capital expenditures  | (1,190)                                | (291)    |
| Other intangibles   | (95)                                   |          |
| Internal software development costs   | (657)                                  | (651)    |
| Purchases of marketable securities  | (12,978)                               | (14,862) |
| Proceeds from sales and maturities of marketable securities                     | 12,218                                 | 12,149   |
| Net cash used in investing activities   | (2,702)                                | (3,655)  |
| <b>Cash Flows from Financing Activities</b>                                     |  |          |
| Proceeds from exercise of common stock options                                  | 993                                    | 236      |
| Principal payments on bank debt   | (2,500)                                | (1,250)  |
| Principal payments on acquisition-related notes payable                         | (523)                                  | (3,568)  |
| Excess tax benefits from stock-based compensation                               | 96                                     | 24       |

|  |           |           |
|--|-----------|-----------|
| Withholding taxes related to restricted stock net share settlement | (1,039)   | (101)     |
| Repurchases of common stock  |           | (6,157)   |
| Net cash used in financing activities                              | (2,973)   | (10,816)  |
| Effect of exchange rate changes on cash and cash equivalents       | (29)      | 17        |
| Net decrease in cash and cash equivalents                          | (1,822)   | (4,083)   |
| Cash and cash equivalents at beginning of period                   | 90,117    | 68,531    |
| Cash and cash equivalents at end of period                         | \$ 88,295 | \$ 64,448 |

**Supplemental Disclosure of Cash Flow Information**

|                        |     |     |
|------------------------|-----|-----|
| Cash paid for interest | 968 | 703 |
| Cash paid for taxes    | 130 | 182 |

**Supplemental Disclosure of Noncash Investing and Financing Activities**

|                              |  |       |
|------------------------------|--|-------|
| Retirement of treasury stock |  | 6,157 |
|------------------------------|--|-------|

See notes to condensed consolidated financial statements

**Table of Contents**

**QUINSTREET, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. The Company**

QuinStreet, Inc. (the Company) is an online performance marketing company. The Company was incorporated in California in April 1999 and reincorporated in Delaware in December 2009. The Company provides customer acquisition programs for clients in various industry verticals such as education and financial services. The corporate headquarters are located in Foster City, California, with additional offices throughout the United States, Brazil and India.

**2. Summary of Significant Accounting Policies**

**Basis of Presentation**

*Principles of Consolidation*

The condensed consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany balances and transactions have been eliminated in consolidation.

*Unaudited Interim Financial Information*

The accompanying condensed consolidated financial statements and the notes to the condensed consolidated financial statements as of September 30, 2013 and for the three months ended September 30, 2013 and 2012 are unaudited. These unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) and applicable rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Accordingly, these interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2013, as filed with the SEC on August 20, 2013. The condensed consolidated balance sheet at June 30, 2013 included herein was derived from the audited financial statements as of that date, but does not include all disclosures, including notes, required by GAAP.

The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, include all adjustments (consisting only of normal recurring adjustments) necessary for the fair statement of the Company's condensed consolidated balance sheet at September 30, 2013, its condensed consolidated statements of operations for the three months ended September 30, 2013 and 2012, its condensed consolidated statements of comprehensive loss for the three months ended September 30, 2013 and 2012, and its condensed consolidated statements of cash flows for the three months ended September 30, 2013 and 2012. The results of operations for the three months ended September 30, 2013 are not necessarily indicative of the results to be expected for the fiscal year ending June 30, 2014, or any other future period.

*Use of Estimates*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the period. On an ongoing basis, management evaluates these estimates, judgments and assumptions, including those related to revenue recognition, stock-based compensation, goodwill, intangible assets, long-lived assets, contingencies, and income taxes. The Company bases these estimates on historical and anticipated results and trends and on various other assumptions that the Company believes are reasonable under the circumstances, including assumptions as to future events. These estimates form the basis for making judgments about the carrying values of assets and liabilities and recorded revenue and expenses that are not readily apparent from other sources. Actual results could differ from those estimates, and such differences could affect the results of operations reported in future periods.

**Table of Contents**

**QUINSTREET, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

***Accounting Policies***

The significant accounting policies are described in Note 2, Summary of Significant Accounting Policies, to the condensed consolidated financial statements included in the Annual Report on Form 10-K for the fiscal year ended June 30, 2013. There have been no significant changes in the accounting policies subsequent to June 30, 2013.

***Concentrations of Credit Risk***

No client accounted for 10% or more of net revenue for the three months ended September 30, 2013 or for the same period in fiscal year 2013. No client accounted for 10% or more of net accounts receivable as of September 30, 2013 or June 30, 2013.

***Fair Value of Financial Instruments***

The Company's financial instruments consist principally of cash equivalents, marketable securities, accounts receivable, accounts payable, acquisition-related promissory notes, an interest rate swap, and a term loan. The fair value of the Company's cash equivalents is determined based on quoted prices in active markets for identical assets for its money market funds; and quoted prices for similar instruments in active markets for its U.S. municipal securities and certificates of deposits that mature within 90 days. The recorded values of the Company's accounts receivable and accounts payable approximate their current fair values due to the relatively short-term nature of these accounts. The fair values of acquisition-related promissory notes approximate their recorded amounts as the interest rates on similar financing arrangements available to the Company at September 30, 2013 approximate the interest rates implied when these acquisition-related promissory notes were originally issued and recorded. The fair value of the interest rate swap is based upon fair value quotes from the issuing bank and the Company assesses the quotes for reasonableness by comparing them to the present values of expected cash flows. The present value approach is based on observable market interest rate curves that are commensurate with the terms of the interest rate swaps. The carrying value represents the fair value of the swaps, as adjusted for any non-performance risk associated with the Company at September 30, 2013. The Company believes that the fair value of the term loan approximates its recorded amount at September 30, 2013 as the interest rate on the term loan is variable and is based on market interest rates and after consideration of default and credit risk.

***Recent Accounting Pronouncements***

In September 2011, the FASB issued an update to the accounting standard for goodwill. The revised standard update allows entities to use a qualitative approach to test goodwill for impairment. It permits an entity to first perform a qualitative assessment to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the two-step goodwill impairment test. The Company adopted this updated accounting standard during the second quarter of fiscal 2013 as a result of its market capitalization sustaining a significant decline subsequent to the quarterly period ended December 31, 2012. The Company determined that it was more-likely-than-not that the fair value of one of its reporting units was less than

the carrying amount. As a result, the two-step impairment test related to goodwill was performed as of December 31, 2012.

In July 2012, the FASB issued an update to the accounting standard for intangibles. The revised standard update allows entities to use a qualitative approach to test indefinite-lived intangible assets for impairment. It permits an entity to first perform a qualitative assessment to determine whether it is more-likely-than-not that the fair value of an indefinite-lived intangible asset is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed quantitative impairment test by comparing the fair value of the indefinite-lived intangible asset with its carrying value. Otherwise, the quantitative impairment test is not required. The Company plans to adopt this accounting standard by the fourth quarter of fiscal 2014 and does not believe that the adoption will have a material effect on the Company's consolidated financial statements.

**Table of Contents**

**QUINSTREET, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

In February 2013, the FASB issued an update to the accounting standard for accumulated other comprehensive loss. The revised standard update requires entities to present information about significant items reclassified out of accumulated other comprehensive loss by component either on the face of the statement where net loss is presented or as a separate disclosure in the notes to the financial statements. The Company's adoption of the new guidance in the first quarter of fiscal year 2014 did not have a material impact on its financial position, results of operations or cash flows.

In July 2013, the FASB issued a new accounting standard update on the financial presentation of unrecognized tax benefits. The new guidance provides that a liability related to an unrecognized tax benefit would be presented as reduction of a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax position is disallowed. The new guidance becomes effective July 1, 2014 for the Company and it should be applied prospectively to unrecognized tax benefits that exist at the effective date, although retrospective application is permitted. The Company does not believe that the adoption will have a material effect on the Company's consolidated financial statements.

**3. Net Loss Attributable to Common Stockholders and Net Loss per Share**

Basic net loss per share is computed by dividing net loss by the weighted average number of shares of common stock outstanding during the period. Diluted net loss per share is computed by using the weighted-average number of shares of common stock outstanding, including potential dilutive shares of common stock assuming the dilutive effect of outstanding stock options and restricted stock units using the treasury stock method.

Table of Contents**QUINSTREET, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The following table presents the calculation of basic and diluted net loss per share:

|  | <b>Three Months Ended<br/>September 30,<br/>2013                  2012</b> |           |
|--|--|-----------|
|  | (In thousands, except<br>per share data)                                   |           |
| <b>Numerator:</b>  |  |           |
| <b>Basic and Diluted:</b>  |  |           |
| Net loss   | \$ (939)   | \$ (137)  |
| <b>Denominator:</b>  |  |           |
| <b>Basic:</b>  |  |           |
| Weighted average shares of common stock used in computing basic net loss per share   | 43,117   | 42,812    |
| <b>Diluted:</b>  |  |           |
| Weighted average shares of common stock used in computing basic net loss per share   | 43,117   | 42,812    |
| <b>Weighted average effect of dilutive securities:</b>   |  |           |
| Stock options  |  |           |
| Restricted stock units   |  |           |
| Weighted average shares of common stock used in computing diluted net loss per share   | 43,117   | 42,812    |
| <b>Net loss per share:</b>   |  |           |
| Basic  | \$ (0.02)  | \$ (0.00) |
| Diluted <sup>(1)</sup>   | \$ (0.02)  | \$ (0.00) |
| Securities excluded from weighted average shares used in computing diluted net loss per share because the effect would have been anti-dilutive: <sup>(2)</sup> | 7,463  | 7,299     |

<sup>(1)</sup> Diluted EPS does not reflect any potential common stock relating to stock options or restricted stock units due to net loss incurred for the quarter ended September 30, 2013 and 2012. The assumed issuance of any additional



shares would be anti-dilutive.

- (2) These weighted shares relate to anti-dilutive stock options and restricted stock units as calculated using the treasury stock method and could be dilutive in the future.

Table of Contents

**QUINSTREET, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**4. Fair Value Measurements and Marketable Securities**

Fair value is defined as the price that would be received on sale of an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants at the measurement date. The FASB has established a fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3).

The three levels of the fair value hierarchy under the guidance for fair value measurement are described below:

- Level 1 Inputs are unadjusted quoted prices in active markets for identical assets or liabilities. Pricing inputs are based upon quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. The valuations are based on quoted prices of the underlying security that are readily and regularly available in an active market, and accordingly, a significant degree of judgment is not required. As of September 30, 2013, the Company used Level 1 assumptions for its money market funds.
- Level 2 Pricing inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. As of September 30, 2013, the Company used Level 2 assumptions for its U.S. municipal securities, certificates of deposit, acquisition-related promissory notes, term loan, and interest rate swap.
- Level 3 Pricing inputs are generally unobservable for the assets or liabilities and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models, and similar techniques. As of September 30, 2013, the Company did not have any Level 3 financial assets or liabilities.

Table of Contents**QUINSTREET, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The Company's financial instruments as of September 30, 2013 and June 30, 2013 were categorized as follows in the fair value hierarchy (in thousands):

|                           | <b>Fair Value Measurements as of September 30, 2013 Using</b>                             |  |              |
|---------------------------|---|--|--------------|
|                           | <b>Quoted<br/>Prices in<br/>Active Markets<br/>for Identical<br/>Assets<br/>(Level 1)</b> | <b>Significant<br/>Other<br/>Observable<br/>Inputs<br/>(Level 2)</b> | <b>Total</b> |
| <b>Assets:</b>            |   |  |              |
| U.S. municipal securities | \$  | \$ 23,421  | \$ 23,421    |
| Certificates of deposit   |   | 19,044   | 19,044       |
| Money market funds        | 38,587  |  | 38,587       |
|                           | \$ 38,587   | \$ 42,465  | \$ 81,052    |

|   |    |           |           |
|---|----|-----------|-----------|
| <b>Liabilities:</b>                                 |    |           |           |
| Acquisition-related promissory notes <sup>(1)</sup> | \$ | \$ 3,283  | \$ 3,283  |
| Term loan <sup>(1)</sup>                            |    | 86,392    | 86,392    |
| Interest rate swap                                  |    | 791       | 791       |
|   | \$ | \$ 90,466 | \$ 90,466 |

|                           | <b>Fair Value Measurements as of June 30, 2013</b>  |  |              |
|---------------------------|---|--|--------------|
|                           | <b>Using<br/>Quoted Prices in<br/>Active<br/>Markets<br/>for Identical Assets<br/>(Level 1)</b> | <b>Significant Other<br/>Observable<br/>Inputs<br/>(Level 2)</b> | <b>Total</b> |
| <b>Assets:</b>            |   |  |              |
| U.S. municipal securities | \$  | \$ 25,544  | \$ 25,544    |
| Certificates of deposit   |   | 16,923   | 16,923       |
| Money market funds        | 38,465  |  | 38,465       |
|                           | \$ 38,465   | \$ 42,467  | \$ 80,932    |

**Liabilities:**

|   |    |    |        |    |        |
|---|----|----|--------|----|--------|
| Acquisition-related promissory notes <sup>(1)</sup> | \$ | \$ | 3,875  | \$ | 3,875  |
| Term loan <sup>(1)</sup>                            |    |    | 88,802 |    | 88,802 |
| Interest rate swap                                  |    |    | 655    |    | 655    |
|   | \$ | \$ | 93,332 | \$ | 93,332 |

<sup>(1)</sup> These liabilities are carried at historical cost on the Company's consolidated balance sheet.

***Marketable Securities***

All liquid investments with maturities of three months or less at the date of purchase are classified as cash equivalents. Investments with maturities greater than three months at the date of purchase are classified as marketable securities. The Company's marketable securities have been classified and accounted for as available-for-sale. Management determines the appropriate classification of its investments at the time of purchase and reevaluates the available-for-sale designation as of each balance sheet date. Available-for-sale securities are carried at fair value, with unrealized gains and losses, net of tax, reported as a component of accumulated other comprehensive loss within stockholders' equity.

Table of Contents**QUINSTREET, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The following table summarizes unrealized gains and losses related to available-for-sale securities held by the Company as of September 30, 2013 and June 30, 2013 (in thousands):

|                           | Gross<br>Amortized<br>Cost | As of September 30, 2013     |                               | Estimated<br>Fair<br>Value |
|---------------------------|----------------------------|------------------------------|-------------------------------|----------------------------|
|                           |                            | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses |                            |
| U.S. municipal securities | \$ 23,415                  | \$ 6                         | \$                            | \$ 23,421                  |
| Certificates of deposit   | 19,060                     |                              | 16                            | 19,044                     |
| Money market funds        | 38,587                     |                              |                               | 38,587                     |
|                           | \$ 81,062                  | \$ 6                         | \$ 16                         | \$ 81,052                  |

  

|                           | Gross<br>Amortized<br>Cost | As of June 30, 2013          |                               | Estimated<br>Fair<br>Value |
|---------------------------|----------------------------|------------------------------|-------------------------------|----------------------------|
|                           |                            | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses |                            |
| U.S. municipal securities | \$ 25,538                  | \$ 6                         | \$                            | \$ 25,544                  |
| Certificates of deposit   | 16,945                     |                              | 22                            | 16,923                     |
| Money market funds        | 38,465                     |                              |                               | 38,465                     |
|                           | \$ 80,948                  | \$ 6                         | \$ 22                         | \$ 80,932                  |

The Company did not realize any gains or losses from sales of its securities in the periods presented. As of September 30, 2013 and June 30, 2013, the Company did not hold securities that had maturity dates greater than one year.

**5. Acquisitions**

The Company did not complete any acquisitions during the three months ended September 30, 2013 or in fiscal year 2013.

Table of Contents**QUINSTREET, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****6. Intangible Assets and Goodwill**

Intangible assets, net balances, excluding goodwill, consisted of the following (in thousands):

|   | September 30, 2013    |                          |                     | June 30, 2013         |                          |                     |
|---|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
|   | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Customer/publisher/advertiser relationships | \$ 37,027             | \$ (29,048)              | \$ 7,979            | \$ 37,035             | \$ (28,321)              | \$ 8,714            |
| Content                                     | 61,985                | (45,054)                 | 16,931              | 62,028                | (43,054)                 | 18,974              |
| Website/trade/domain names                  | 31,582                | (18,439)                 | 13,143              | 31,597                | (17,403)                 | 14,194              |
| Acquired technology and others              | 36,569                | (29,180)                 | 7,389               | 36,425                | (27,821)                 | 8,604               |
|   | \$ 167,163            | \$ (121,721)             | \$ 45,442           | \$ 167,085            | \$ (116,599)             | \$ 50,486           |

Amortization of intangible assets was \$5.1 million and \$6.9 million in the three months ended September 30, 2013 and 2012.

Future amortization expense for the Company's intangible assets as of September 30, 2013 was as follows (in thousands):

| Year Ending June 30,         | Amortization |
|------------------------------|--------------|
| 2014 (remaining nine months) | \$ 14,401    |
| 2015                         | 12,365       |
| 2016                         | 8,800        |
| 2017                         | 6,048        |
| 2018                         | 2,197        |
| Thereafter                   | 1,631        |
|                              | \$ 45,442    |

The change in the carrying amount of goodwill for the Company's Direct Marketing Services ( DMS ) and Direct Selling Services ( DSS ) segments, discussed in Note 10, Segment Information, for the three months ended September 30, 2013 was as follows (in thousands):

|                               | <b>DMS</b> | <b>DSS</b> | <b>Total</b> |
|-------------------------------|------------|------------|--------------|
| Balance at June 30, 2013      | \$ 149,225 | \$ 1,231   | \$ 150,456   |
| Additions                     |            |            |              |
| Balance at September 30, 2013 | \$ 149,225 | \$ 1,231   | \$ 150,456   |

In the three months ended September 30, 2013, there were no additions to goodwill as the Company did not complete any acquisitions during the period.

**Table of Contents**

**QUINSTREET, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**7. Debt**

***Credit Facility***

In November 2011, the Company entered into the Second Amended and Restated Revolving Credit and Term Loan Agreement (the *Second Loan Agreement*) with Comerica Bank (the *Bank*), the administrative agent and lead arranger. The *Second Loan Agreement* consists of a \$100 million five-year term loan, with annual principal amortization of 5%, 10%, 15%, 20% and 50%, and a \$200 million five-year revolving credit line.

On February 15, 2013, the Company entered into the First Amendment to Credit Agreement and Amendment to Guaranty (*First Amendment to the Second Loan Agreement*) with the *Bank* to, among other things: (1) amend the definition of adjusted EBITDA, effective as of December 31, 2012, to exclude extraordinary or non-recurring non-cash expenses of losses including, without limitation, goodwill impairments, and any extraordinary or non-recurring cash expenses in an aggregate amount not to exceed \$5 million for the life of the *Second Loan Agreement*; and (2) reduce the \$200 million five-year revolving credit line portion of the facility to \$100 million, effective as of February 15, 2013.

Borrowings under the *Second Loan Agreement* are secured by substantially all of the Company's assets. Interest is payable at specified margins above either the Eurodollar Margin or the Prime Rate. The interest rate varies based upon the ratio of funded debt to adjusted EBITDA and ranges from Eurodollar Margin + 1.625% to 2.375% or Prime + 1.00% for the revolving credit line and from Eurodollar Margin + 2.00% to 2.75% or Prime + 1.00% for the term loan. Adjusted EBITDA is defined as net (loss) income less benefit from (provision for) taxes, depreciation expense, amortization expense, stock-based compensation expense, interest and other income (expense), acquisition costs for business combinations, extraordinary or non-recurring non-cash expenses of losses including, without limitation, goodwill impairments, and any extraordinary or non-recurring cash expenses in an aggregate amount not to exceed \$5.0 million for the life of this *Second Loan Agreement*. The revolving credit line requires an annual facility fee of 0.375% of the revolving credit line capacity.

The *Second Loan Agreement* expires in November 2016. The credit facility agreement restricts the Company's ability to raise additional debt financing and pay dividends, and also requires the Company to comply with other nonfinancial covenants. In addition, the Company is required to maintain financial ratios computed as follows:

1. A minimum fixed charge coverage ratio of 1.15:1, calculated as the ratio of: (i) trailing twelve months of adjusted EBITDA to (ii) the sum of capital expenditures, net cash interest expense, cash taxes, cash dividends and trailing twelve months payments of indebtedness. Payment of unsecured indebtedness is excluded to the degree that sufficient unused revolving credit line exists such that the relevant debt payment could be made from the credit facility.
2. A maximum funded debt to adjusted EBITDA ratio of 3:1, calculated as the ratio of: (i) the sum of all obligations owed to lending institutions, the face amount of any letters of credit, indebtedness owed in connection with acquisition-related notes and indebtedness owed in connection with capital lease obligations to (ii) trailing twelve



months of adjusted EBITDA.

The Company was in compliance with the covenants of the Second Loan Agreement, as amended by the First Amendment, as of September 30, 2013 and June 30, 2013.

The outstanding amount under the term loan at September 30, 2013 and June 30, 2013 was \$87.5 million and \$90 million. There were no outstanding balances under the revolving credit line at September 30, 2013 or June 30, 2013.

### ***Interest Rate Swap***

To reduce the Company's exposure to rising interest rates under the term loan, in February 2012, the Company entered into an interest rate swap to reduce its exposure to the financial impact of changing interest rates under its term loan. The Company does not speculate using derivative instruments. The Company entered into this derivative instrument arrangement solely for the purpose of

**Table of Contents****QUINSTREET, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

risk management. The swap encompasses the principal balances scheduled to be outstanding as of January 1, 2014 and thereafter, such principal and notional amount totaling \$85 million in January 2014 and amortizing to \$35 million in November 2016. The effective date of the swap was April 9, 2012 with a maturity date of November 4, 2016. At September 30, 2013, the Company had approximately \$85 million of notional amount outstanding in the swap agreement that exchanges a variable interest rate base (Eurodollar margin) for a fixed interest rate of 0.97% over the term of the agreement. This interest rate swap is designated as a cash flow hedge of the interest rate risk attributable to forecasted variable interest payments. The effective portion of the fair value gains or losses on this swap are included as a component of accumulated other comprehensive loss. Any hedge ineffectiveness will be immediately recognized in earnings in the current period.

At September 30, 2013, the fair value of the interest rate swap liability was \$0.8 million and the hedge effective portion of the interest rate swap was \$0.8 million.

***Promissory Notes***

During the three months ended September 30, 2013 and 2012, the Company did not issue any promissory notes for the acquisition of businesses because the Company did not complete any acquisitions. The outstanding amount under the promissory notes at September 30, 2013 and June 30, 2013 was \$3.4 million and \$4.0 million.

***Debt Maturities***

The maturities of the Company's debt as of September 30, 2013 were as follows (in thousands):

| <b>Year Ending June 30,</b>                      | <b>Promissory<br/>Notes</b> | <b>Credit<br/>Facility</b> |
|--|-----------------------------|----------------------------|
| 2014 (remaining nine months)                     | \$ 2,744                    | \$ 10,000                  |
| 2015   | 560                         | 17,500                     |
| 2016   | 50                          | 20,000                     |
| 2017   |                             | 40,000                     |
| 2018   |                             |                            |
| 2019   |                             |                            |
|  | 3,354                       | 87,500                     |
| Less: imputed interest and unamortized discounts | (71)                        | (1,108)                    |
| Less: current portion                            | (3,179)                     | (13,392)                   |
| Noncurrent portion of debt                       | \$ 104                      | \$ 73,000                  |

***Letters of Credit***

The Company has a \$0.4 million letter of credit agreement with a financial institution that is used as collateral for fidelity bonds placed with an insurance company and a \$0.5 million letter of credit agreement with a financial institution that is used as collateral for the Company's corporate headquarters' operating lease. The letters of credit automatically renew annually without amendment unless cancelled by the financial institutions within 30 days of the annual expiration date.

**8. Commitments and Contingencies**

***Leases***

The Company leases office space and equipment under non-cancelable operating leases with various expiration dates through 2019. Rent expense for the three months ended September 30, 2013 and 2012 was \$1.1 million and \$0.8 million. The Company recognizes rent expense on a straight-line basis over the lease period and accrues for rent expense incurred but not paid.

Table of Contents**QUINSTREET, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

Future annual minimum lease payments under noncancelable operating leases as of September 30, 2013 were as follows (in thousands):

| <b>Year Ending June 30,</b>  | <b>Operating<br/>Leases</b> |
|------------------------------|-----------------------------|
| 2014 (remaining nine months) | \$ 2,726                    |
| 2015                         | 3,476                       |
| 2016                         | 3,362                       |
| 2017                         | 2,911                       |
| 2018                         | 2,950                       |
| 2019 and thereafter          | 1,099                       |
|                              | <b>\$ 16,524</b>            |

***Guarantor Arrangements***

The Company has agreements whereby it indemnifies its officers and directors for certain events or occurrences while the officer or director is, or was, serving at the Company's request in such capacity. The term of the indemnification period is for the officer or director's lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, the Company has a director and officer insurance policy that limits its exposure and enables the Company to recover a portion of any future amounts under certain circumstances and subject to deductibles and exclusions. As a result of its insurance policy coverage, the Company believes the estimated fair value of these indemnification agreements is not material. Accordingly, the Company had no liabilities recorded for these agreements as of September 30, 2013 and June 30, 2013.

In the ordinary course of its business, the Company from time to time enters into standard indemnification provisions in its agreements with its clients. Pursuant to these provisions, the Company may be obligated to indemnify its clients for certain losses suffered or incurred, including losses arising from violations of applicable law by the Company or by its third-party website publishers, losses arising from actions or omissions of the Company or its third-party publishers, and for third-party claims that a Company product infringed upon any United States patent, copyright or other intellectual property rights. Where applicable, the Company generally limits its liabilities under such indemnities. With respect to its DSS products, the Company also generally reserves the right to resolve intellectual property infringement claims by providing a non-infringing alternative or by obtaining a license on reasonable terms, and failing that, by terminating its relationship with the client and thus terminating the infringing activity. Subject to these limitations, the term of such indemnity provisions is generally coterminous with the corresponding agreements but in some cases survives for a period of time after termination of the agreement.

The potential amount of future payments to defend lawsuits or settle indemnified claims under these indemnification provisions is generally limited and the Company believes the estimated fair value of these indemnity provisions is not material, and accordingly, the Company had no liabilities recorded for these agreements as of September 30, 2013 and June 30, 2013.

***Litigation***

In December 2012, Internet Patents Corporation ( IPC ) filed a patent infringement lawsuit against the Company in the United States District Court for the Northern District of California, seeking a judgment that the Company has infringed a patent held by IPC. The Company received the related summons and complaint from IPC in March 2013. In September 2013, the court dismissed a related case because it found that the patent is invalid, and on the same date, the court issued IPC an Order to Show Cause that the lawsuit against the Company should not be dismissed. In October 2013, IPC filed a response to the order and the court subsequently dismissed the case against the Company. In November 2013, IPC filed a Notice of Appeal to the United States Court of Appeals for the Federal Circuit. While the Company denies IPC's claims, there can be no assurance that the Company will prevail in this matter

Table of Contents**QUINSTREET, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

and any adverse ruling may have a significant impact on its business and operating results. In addition, regardless of the outcome of the matter, the Company may incur significant legal fees defending the action until it is resolved. The Company has determined that the probability of any loss is remote.

**9. Stock Benefit Plans***Stock Incentive Plans*

The Company may grant incentive stock options ( ISOs ), nonstatutory stock options ( NQSOs ), restricted stock, restricted stock units, stock appreciation rights, performance-based stock awards and other forms of equity compensation, as well as performance cash awards, under its 2010 Equity Incentive Plan (the 2010 Incentive Plan ) as well as NQSOs and restricted stock units to non-employee directors under the 2010 Non-Employee Directors Stock Award Plan (the Directors Plan). To date, the Company has issued only ISOs, NQSOs and restricted stock units under the plans.

As of September 30, 2013, 9,210,527 shares were reserved and 5,401,687 shares were available for issuance under the 2010 Incentive Plan; 1,593,162 shares were reserved and 1,187,035 shares were available for issuance under the Directors Plan.

*Stock-Based Compensation*

The Company estimates the fair value of stock options at the date of grant using the Black-Scholes option-pricing model. Options are granted with an exercise price equal to the fair value of the common stock at the date of grant. The weighted average Black-Scholes model assumptions and the weighted average grant date fair value of employee stock options for the three months ended September 30, 2013 and 2012 were as follows:

|                          | <b>Three Months Ended</b> |             |
|--------------------------|---------------------------|-------------|
|                          | <b>September 30,</b>      |             |
|                          | <b>2013</b>               | <b>2012</b> |
| Expected term (in years) | 4.6                       | 4.6         |
| Expected volatility      | 48%                       | 55%         |
| Expected dividend yield  | 0.0%                      | 0.0%        |
| Risk-free interest rate  | 1.4%                      | 0.7%        |
| Grant date fair value    | \$ 3.93                   | \$ 4.36     |

The fair value of restricted stock units is determined based on the closing price of the Company's common stock on the grant date. Compensation expense is amortized net of estimated forfeitures on a straight-line basis over the requisite service period of the stock-based compensation awards.



**Table of Contents**

**QUINSTREET, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**10. Segment Information**

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The Company's chief operating decision maker is its chief executive officer. The Company's chief executive officer reviews financial information presented on a consolidated basis, accompanied by information about operating segments, including net sales and operating (loss) income before depreciation, amortization and stock-based compensation expense.

The Company determined its reportable operating segments to be DMS, which derives revenue from fees earned through the delivery of qualified leads, clicks, calls, customers and, to a lesser extent, impressions, and DSS, which derives revenue from the sale of direct selling services through a hosted solution. The accounting policies of the two reportable operating segments are the same as those described in Note 2, Summary of Significant Accounting Policies.

The Company evaluates the performance of its operating segments based on operating income before depreciation, amortization and stock-based compensation expense.

The Company does not allocate most of its assets, nor its depreciation and amortization expense, stock-based compensation expense, interest income, interest expense or income tax expense by segment. Accordingly, the Company does not report such information.



Table of Contents**QUINSTREET, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

Summarized information by segment was as follows (in thousands):

|   | <b>Three Months<br/>Ended<br/>September 30,</b> |             |
|---|---|-------------|
|   | <b>2013</b>                                     | <b>2012</b> |
| Net revenue by segment:   |   |             |
| DMS   | \$ 76,696                                       | \$ 78,334   |
| DSS   | 265   | 292         |
| <br>Total net revenue   | <br>76,961                                      | <br>78,626  |
| Segment operating income before depreciation, amortization,<br>and stock-based compensation expense:          |   |             |
| DMS   | 9,461   | 11,824      |
| DSS   | 170   | 151         |
| <br>Total segment operating income before depreciation,<br>amortization, and stock-based compensation expense | <br>9,631                                       | <br>11,975  |
| Depreciation and amortization   | (6,676)   | (8,279)     |
| Stock-based compensation expense  | (3,035)   | (2,770)     |
| <br>Total operating (loss) income   | <br>\$ (80)                                     | <br>\$ 926  |

The following tables set forth net revenue and long-lived assets by geographic area (in thousands):

|                       | <b>Three Months Ended<br/>September 30,</b> |               |
|-----------------------|---|---------------|
|                       | <b>2013</b>                                 | <b>2012</b>   |
| Net revenue:          |   |               |
| United States         | \$ 76,417                                   | \$ 77,909     |
| International         | 544   | 717           |
| <br>Total net revenue | <br>\$ 76,961                               | <br>\$ 78,626 |

|                                    | <b>September 30<br/>2013</b> | <b>June 30,<br/>2013</b> |
|------------------------------------|------------------------------|--------------------------|
| Property and equipment, net:       |                              |                          |
| United States                      | \$ 10,664                    | \$ 9,502                 |
| International                      | 282                          | 205                      |
| Total property and equipment, net: | \$ 10,946                    | \$ 9,707                 |

---

**Table of Contents**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the fiscal year ended June 30, 2013, filed with the Securities and Exchange Commission ( SEC ).*

*This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they do not materialize or if they prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are often identified by the use of words such as, but not limited to, anticipate, believe, can, continue, could, estimate, expect, intend, may, will, plan, project, seek, should, target, will, would, and similar expressions or variations intended to identify forward-looking statements. These statements reflect the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified in Part II Item 1A. Risk Factors below, and those discussed in the sections titled Special Note Regarding Forward-Looking Statements and Risk Factors included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2013, filed with the SEC. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.*

**Management Overview**

QuinStreet is a leader in performance marketing online. We have built a strong set of capabilities to engage Internet visitors with targeted media and to connect our marketing clients with their potential customers online. We focus on serving clients in large, information-intensive industry verticals where relevant, targeted media and offerings help visitors make informed choices, find the products that match their needs, and thus become qualified customer prospects for our clients.

We deliver cost-effective marketing results to our clients most typically in the form of a qualified lead or inquiry, in the form of a qualified click, or in the form of a call. Leads, clicks or calls can then convert into a customer or sale for clients at a rate that results in an acceptable marketing cost to them. We are typically paid by clients when we deliver qualified leads, clicks, calls or customers as defined by our agreements with them. References to the delivery of customers means the sale of completed customer transactions (e.g. bound insurance policies or customer appointments with clients). Because we bear the costs of media, our programs must deliver value to our clients and provide for a media yield, or generation of an acceptable margin on our media costs, that provides a sound financial outcome for us. To deliver leads, clicks, calls, and customers to our clients, generally we:

own or access targeted media;

run advertisements or other forms of marketing messages and programs in that media to create visitor responses in the form most typically of leads (visitor generated contact information and requests), clicks (to further qualification or matching steps, or to online client applications or offerings) or calls (to our owned and operated call centers or that of our clients or their agents);

match these leads, clicks, calls or customers to client offerings or brands that we believe can meet visitor interests or needs, converting visitors into qualified leads, clicks, calls or customers for our clients; and

optimize client matches and media yield such that we achieve desired results for clients and a sound financial outcome for us.

## **Table of Contents**

Our primary financial objective has been and remains creating revenue growth from sustainable sources, at target levels of profitability. Our primary financial objective is not to maximize profits, but rather to achieve target levels of profitability while investing in various growth initiatives, as we continue to believe we are in the early stages of a large, long-term market.

Our Direct Marketing Services ( DMS ) business accounted for substantially all of our net revenue in the three months ended September 30, 2013 and 2012. Our DMS business derives net revenue from fees earned through the delivery of qualified leads, clicks, calls or customers and, to a lesser extent, display advertisements, or impressions. Through a vertical focus, targeted media presence and our technology platform, we are able to deliver targeted, measurable marketing results to our clients.

Our two largest client verticals within our DMS business are education and financial services. Our education client vertical represented 43% and 44% of net revenue in the three months ended September 30, 2013 and 2012. Our financial services client vertical represented 41% and 39% of net revenue in the three months ended September 30, 2013 and 2012. Other DMS client verticals, consisting primarily of business-to-business technology, home services and medical, represented 16% and 17% of net revenue in the three months ended September 30, 2013 and 2012.

In addition, we derived less than 1% of our net revenue in the three months ended September 30, 2013, and for the same period last fiscal year, from the provision of a hosted solution and related services for clients in the direct selling industry, also referred to as our Direct Selling Services ( DSS ) business.

We generated substantially all of our revenue from sales to clients in the United States.

No client accounted for 10% or more of our net revenue in the three months ended September 30, 2013 or 2012.

## **Trends Affecting our Business**

### ***Client Verticals***

To date, we have generated the majority of our revenue from clients in our education and financial services client verticals. We expect that a majority of our revenue for the remainder of fiscal year 2014 will continue to be generated from clients in these two client verticals.

Our education client vertical has been significantly affected by the adoption of regulations affecting for-profit educational institutions over the past several years. The regulations have affected, and are expected to continue to affect, our clients' businesses and marketing practices, including an overall decrease in our clients' external marketing expenditures. The effect of these regulations or any future regulations may continue to result in fluctuations in the volume and mix of our business with these clients.

Our financial services client vertical continued to be negatively affected due to reduced availability of high quality media at acceptable margins caused by changes in search engine algorithms, acquisition of media sources by competitors and increased competition for quality media. These effects may continue to impact our business in the near future.

### ***Acquisitions***

We did not complete any acquisitions in the three months ended September 30, 2013 or in fiscal year 2013.

***Development and Acquisition of Targeted Media***

One of the primary challenges of our business is finding or creating media that is high quality and targeted enough to attract prospects for our clients at costs that work for our business model. In order to grow our business, we must be able to find, develop or retain quality targeted media on a cost-effective basis. Consolidation of media sources, changes in search engine algorithms, and increased competition on available media has, during some periods, limited and may continue to limit our ability to generate revenue at acceptable margins.

## **Table of Contents**

### ***Seasonality***

Our results are subject to significant fluctuation as a result of seasonality. In particular, our quarters ending December 31 (our second fiscal quarter) are typically characterized by seasonal weakness. In our second fiscal quarters, there is lower availability of lead supply from some forms of media during the holiday period on a cost effective basis and some of our clients have lower budgets. In our quarters ending March 31 (our third fiscal quarter), this trend generally reverses with better lead availability and often new budgets at the beginning of the year for our clients with fiscal years ending December 31.

### ***Regulations***

Our revenue has fluctuated as a result of newly-adopted or amended regulations and the increased enforcement of existing regulations. Our business is affected directly because we operate websites and conduct telemarketing and email marketing, and indirectly as our clients adjust their operations as a result of regulatory changes that affect their industries.

One example of a recent regulatory change that may affect our business is the Telephone Consumer Protection Act (the TCPA), which the Federal Communications Commission recently amended to, among other things, impose heightened consent and opt-out requirements that companies conducting telemarketing must follow. Certain provisions of the regulations became effective in July 2012, and additional regulations requiring prior express written consent for telemarketing calls to wireless numbers became effective in October 2013. We generate a significant amount of revenue from calls made by our internal call centers as well as by third-party call centers. Our and our clients efforts to comply with the new regulations may negatively affect media conversion rates and, thus, our revenue or profitability. Our clients purchasing leads may or may not also be affected by these additional regulations.

In addition, our education client vertical has been significantly affected by the adoption of regulations affecting for-profit educational institutions over the past several years, and a higher level of legislative scrutiny is expected to continue. Clients in our financial services vertical have increasingly been affected by laws and regulations as a result of the adoption of new regulations under The Dodd Frank Wall Street Reform and Consumer Protection Act and the increased enforcement of new and pre-existing laws and regulations. The effect of these regulations, or any future regulations, may continue to result in fluctuations in the volume and mix of our business with these clients.

### **Basis of Presentation**

#### ***General***

Our business is composed of two operating segments: DMS and DSS. For further discussion and financial information about our operating segments, see Note 10, Segment Information, to our condensed consolidated financial statements.

#### ***Net Revenue***

**DMS.** Our DMS business generates revenue from fees earned through the delivery of qualified leads, clicks, calls, customers and, to a lesser extent, display advertisements, or impressions. We deliver targeted and measurable results through a vertical focus that we classify into the following client verticals: education, financial services and other (which includes business-to-business technology, home services and medical).

**DSS.** Our DSS business generated less than 1% of net revenue in the three months ended September 30, 2013 and 2012. We expect DSS to continue to represent an immaterial portion of our business.

***Cost of Revenue***

Cost of revenue consists primarily of media costs, personnel costs, amortization of intangible assets, depreciation expense and amortization of internal software development costs relating to revenue-producing technologies. Media costs consist primarily of fees paid to website publishers that are directly related to a revenue-generating event and pay-per-click, or PPC, ad purchases from Internet search companies. We pay these website publishers and Internet search companies on a revenue-share, a cost-per-lead, or CPL, cost-per-click, or CPC, and cost-per-thousand-impressions, or CPM, basis. Personnel costs include salaries, stock-based



## **Table of Contents**

compensation expense, bonuses and employee benefit costs. Personnel costs are primarily related to individuals associated with maintaining our servers and websites, our editorial staff, client management, creative team, content, compliance group and media purchasing analysts. Costs associated with software incurred in the development phase or obtained for internal use are capitalized and amortized in cost of revenue over the software's estimated useful life.

### ***Operating Expenses***

We classify our operating expenses into three categories: product development, sales and marketing, and general and administrative. Our operating expenses consist primarily of personnel costs and, to a lesser extent, professional services fees, rent and other costs. Personnel costs for each category of operating expenses generally include salaries, stock-based compensation expense, bonuses, commissions and employee benefit costs.

*Product Development.* Product development expenses consist primarily of personnel costs and professional services fees associated with the development and maintenance of our technology platforms, development and launching of our websites, product-based quality assurance and testing. In the current period of business challenges, we are constraining expenses generally to the extent practicable. However, if and when we return to growth, we expect product development expenses to increase in absolute dollars for the remainder of fiscal year 2014 as we believe that continued investment in technology is critical to attaining our strategic objectives.

*Sales and Marketing.* Sales and marketing expenses consist primarily of personnel costs and, to a lesser extent, professional services fees, travel costs and advertising. In the current period of business challenges, we are constraining expenses generally to the extent practicable. However, if and when we return to growth, we expect sales and marketing expenses to increase in absolute dollars for the remainder of fiscal year 2014 as we hire additional personnel in sales and marketing to support our offerings.

*General and Administrative.* General and administrative expenses consist primarily of personnel costs of our executive, finance, legal, corporate and business development, employee benefits and compliance, technical support and other administrative personnel, as well as accounting and legal professional services fees, and insurance. In the current period of business challenges, we are constraining expenses generally to the extent practicable. However, we expect general and administrative expenses, including increased legal and accounting costs to increase in absolute dollars for the remainder of fiscal year 2014 as we continue to invest in corporate infrastructure and expand our business internationally.

### ***Interest and Other Income (Expense), Net***

Interest and other income (expense), net, consists primarily of interest expense, other income and expense, net and interest income. Interest expense is related to our credit facility, including the related interest rate swap and promissory notes issued in connection with our acquisitions, and includes imputed interest on non-interest bearing notes. Borrowings under our credit facility, the aggregate principal amount of outstanding promissory notes and related interest expense could increase if we make additional acquisitions through debt financing. Interest income represents interest earned on our cash, cash equivalents and marketable securities, which may increase or decrease depending on market interest rates and the amounts invested.

Other income (expense), net, includes foreign currency exchange gains and losses and other non-operating items.

### ***Income Tax Benefit from (Provision for)***

We are subject to tax in the United States as well as other tax jurisdictions or countries in which we conduct business. Earnings from our limited non-U.S. activities are subject to local country income tax and may be subject to U.S. income tax.

### **Critical Accounting Policies, Estimates and Judgments**

In presenting our consolidated financial statements in conformity with U.S. generally accepting accounting principles, or GAAP, we are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses and related disclosures.

Some of the estimates and assumptions we are required to make relate to matters that are inherently uncertain as they pertain to future events. We base these estimates and assumptions on historical experience or on various other factors that we believe to be reasonable and appropriate under the circumstances. On an ongoing basis, we reconsider and evaluate our estimates and assumptions. Actual results may differ significantly from these estimates.

**Table of Contents**

We believe that the critical accounting policies listed below involve our more significant judgments, assumptions and estimates and, therefore, could have the greatest potential impact on our consolidated financial statements.

Revenue recognition;  
Valuation of goodwill and intangible assets;  
Stock-based compensation;  
Income taxes; and  
Valuation of long-lived assets.

There have been no material changes to our critical accounting policies, estimates and judgments disclosed in our Annual Report on Form 10-K subsequent to June 30, 2013. For further information on our critical and other significant accounting policies and estimates, see Part II, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operation of our Annual Report on Form 10-K for the year ended June 30, 2013, filed with the SEC.

**Recently Issued Accounting Standards**

See Note 2, Summary of Significant Accounting Policies, to our condensed consolidated financial statements.

**Table of Contents****Results of Operations**

The following table sets forth our consolidated statement of operations for the periods indicated:

|                                    | <b>Three Months Ended September 30,</b> |        |             |        |
|------------------------------------|---|--------|-------------|--------|
|                                    | <b>2013</b>                             |        | <b>2012</b> |        |
|                                    | <b>(In thousands)</b>                   |        |             |        |
| Net revenue                        | \$ 76,961                               | 100.0% | \$ 78,626   | 100.0% |
| Cost of revenue <sup>(1)</sup>     | 63,592                                  | 82.6   | 65,190      | 82.9   |
| Gross profit                       | 13,369                                  | 17.4   | 13,436      | 17.1   |
| Operating expenses: <sup>(1)</sup> |   |        |             |        |
| Product development                | 5,159                                   | 6.7    | 4,893       | 6.2    |
| Sales and marketing                | 4,156                                   | 5.4    | 3,691       | 4.7    |
| General and administrative         | 4,134                                   | 5.4    | 3,926       | 5.0    |
| Operating (loss) income            | (80)                                    | (0.1)  | 926         | 1.2    |
| Interest income                    | 27                                      | 0.0    | 28          | 0.0    |
| Interest expense                   | (1,026)                                 | (1.3)  | (1,012)     | (1.3)  |
| Other (expense) income, net        | (19)                                    | (0.0)  | 46          | 0.1    |
| Loss before income taxes           | (1,098)                                 | (1.4)  | (12)        | (0.0)  |
| Benefit from (provision for) taxes | 159                                     | 0.2    | (125)       | (0.2)  |
| Net loss                           | \$ (939)                                | (1.2)% | \$ (137)    | (0.2)% |

<sup>(1)</sup> Cost of revenue and operating expenses include stock-based compensation expense as follows:

|                            |        |      |        |      |
|----------------------------|--------|------|--------|------|
| Cost of revenue            | \$ 874 | 1.1% | \$ 923 | 1.2% |
| Product development        | 732    | 1.0  | 693    | 0.9  |
| Sales and marketing        | 770    | 1.0  | 765    | 1.0  |
| General and administrative | 659    | 0.9  | 389    | 0.5  |

**Net Revenue**

|                 | <b>Three Months Ended</b> |             | <b>Three Months<br/>% Change</b> |
|-----------------|---------------------------|-------------|----------------------------------|
|                 | <b>September 30,</b>      |             |                                  |
|                 | <b>2013</b>               | <b>2012</b> |                                  |
|                 | <b>(in thousands)</b>     |             |                                  |
| Net revenue     | \$ 76,961                 | \$ 78,626   | (2%)                             |
| Cost of revenue | 63,592                    | 65,190      | (2%)                             |

|              |           |           |      |
|--------------|-----------|-----------|------|
| Gross profit | \$ 13,369 | \$ 13,436 | (0%) |
|--------------|-----------|-----------|------|

Net revenue decreased \$1.7 million, or 2%, for the three months ended September 30, 2013, compared to the three months ended September 30, 2012. Our education client vertical revenue decreased \$1.6 million, or 5%, for the three months ended September 30, 2013, compared to the three months ended September 30, 2012, as a result of our education clients' lower budgets, largely due to uncertainty surrounding regulations affecting for-profit educational institutions and their operational adjustment to those regulatory changes. Our financial services client vertical revenue increased \$1.5 million, or 5%, for the three months ended September 30, 2013, compared to the three months ended September 30, 2012, as a result of higher prices and an increase in volume. Our other client

**Table of Contents**

verticals revenue decreased \$1.6 million, or 11%, for the three months ended September 30, 2013, compared to the three months ended September 30, 2012, primarily due to decreased client demand in our business-to-business technology and home services client verticals.

***Cost of Revenue***

Cost of revenue decreased \$1.6 million, or 2%, for the three months ended September 30, 2013, compared to the three months ended September 30, 2012, driven by decreased amortization of intangible assets of \$1.7 million and decreased personnel costs of \$0.5 million, offset by increased media costs of \$0.5 million and other expenses of \$0.1 million. The decreased amortization of intangible assets was attributable to historical acquisitions being fully amortized and a reduced number of acquisitions in recent periods. The decreased personnel costs were attributable to a lower average salary offset by increased average headcount. The increased media costs were attributable to a lower mix of traffic from owned and operated media, lower margins from publisher arrangements and by a higher mix of traffic from third-party publishers. Gross margin, which is the difference between net revenue and cost of revenue as a percentage of net revenue, was 17% for the three months ended September 30, 2013 and 2012.

***Operating Expenses***

|                            | <b>Three Months Ended<br/>September 30,<br/>2013      2012</b> |           | <b>Three<br/>Months<br/>% Change</b> |
|----------------------------|--|-----------|--------------------------------------|
|                            | <b>(in thousands)</b>  |           |                                      |
| Product development        | \$ 5,159   | \$ 4,893  | 5%                                   |
| Sales and marketing        | 4,156  | 3,691     | 13%                                  |
| General and administrative | 4,134  | 3,926     | 5%                                   |
| Operating expenses         | \$ 13,449  | \$ 12,510 | 8%                                   |

***Product Development Expenses***

Product development expenses increased \$0.3 million, or 5%, for the three months ended September 30, 2013, compared to the three months ended September 30, 2012. This was primarily due to increased personnel costs of \$0.2 million due to an increase in average headcount.

***Sales and Marketing Expenses***

Sales and marketing expenses increased \$0.5 million, or 13%, for the three months ended September 30, 2013, compared to the three months ended September 30, 2012. This was primarily due to increased personnel costs of \$0.3 million due to an increase in average headcount.

***General and Administrative Expenses***

General and administrative expenses increased \$0.2 million, or 5%, for the three months ended September 30, 2013, compared to the three months ended September 30, 2012. This was primarily due to increased stock-based compensation of \$0.3 million due to incremental stock grants and an increase in the fair value of our common stock

offset by a decrease in legal expenses of \$0.1 million.

**Table of Contents*****Interest and Other Income (Expense), Net***

|  | <b>Three Months Ended<br/>September 30,<br/>2013      2012<br/>(in thousands)</b> |          | <b>Three<br/>Months<br/>% Change</b> |
|--|---|----------|--------------------------------------|
| Interest income                          | \$ 27   | \$ 28    | (4%)                                 |
| Interest expense                         | (1,026)   | (1,012)  | 1%                                   |
| Other income (expense), net              | (19)  | 46       | (141%)                               |
| Interest and other income (expense), net | \$ (1,018)  | \$ (938) | 9%                                   |

Interest and other income (expense), net increased \$0.1 million, or 9% for the three months ended September 30, 2013, compared to the three months ended September 30, 2012.

***Provision for Taxes***

|                                    | <b>Three Months Ended<br/>September 30,<br/>2013      2012<br/>(in thousands)</b> |          | <b>Three<br/>Months<br/>% Change</b> |
|------------------------------------|---|----------|--------------------------------------|
| Benefit from (provision for) taxes | \$ 159  | \$ (125) | (227%)                               |

We recognized a tax benefit of \$0.2 million for the three months ended September 30, 2013. We estimate our annual effective tax rate to be 53%. This differs from the annual statutory rate of 35% due to various permanent differences most significantly stock based compensation. The current quarter tax benefit was determined based on applying the estimated annual effective rate to the pre-tax book loss and applying the impact of the discrete reporting of stock based compensation incurred during the three months ended September 30, 2013.

**Liquidity and Capital Resources**

As of September 30, 2013, our principal sources of liquidity consisted of cash and cash equivalents of \$88.3 million, short-term marketable securities of \$38.4 million, cash we expect to generate from operations, and our \$100.0 million revolving credit line, which is committed until November 2016, a portion of which is available to be drawn subject to compliance with applicable covenants. Our cash and cash equivalents are maintained in highly liquid investments with remaining maturities of 90 days or less at the time of purchase. We believe our cash equivalents are liquid and accessible.

Our short-term and long-term liquidity requirements primarily arise from our working capital requirements, debt service on our \$87.5 million term loan balance at September 30, 2013, and acquisitions from time to time. Our primary operating cash requirements include the payment of media costs, personnel costs, costs of information technology systems and office facilities. Our ability to fund these requirements will depend on our future cash flows, which are determined, in part, by future operating performance and are, therefore, subject to prevailing global macroeconomic conditions and financial, business and other factors, some of which are beyond





**Table of Contents**

our control, and also our ability to access our credit facility. Even though we may not need additional funds, we may still elect to obtain additional debt or equity securities or draw down on or increase our borrowing capacity under our current credit facility for other reasons.

We believe that our existing cash, cash equivalents, short-term marketable securities, cash generated from operations and our available borrowings under the credit facility will be sufficient to satisfy our currently anticipated cash requirements through at least the next 12 months.

The following table summarizes our cash flows for the periods indicated:

|   | <b>Three Months Ended</b> |             |
|---|---------------------------|-------------|
|   | <b>September 30,</b>      |             |
|   | <b>2013</b>               | <b>2012</b> |
|   | <b>(in thousands)</b>     |             |
| Cash flows provided by operating activities | \$ 3,882                  | \$ 10,371   |
| Cash flows used in investing activities     | (2,702)                   | (3,655)     |
| Cash flows used in financing activities     | (2,973)                   | (10,816)    |

***Operating Activities***

Our net cash provided by operating activities is primarily the result of our net (loss) income adjusted for non-cash expenses such as depreciation and amortization, stock-based compensation expense and changes in working capital components, and is influenced by the timing of cash collections from our clients and cash payments for purchases of media and other expenses.

Net cash flows provided by operating activities were \$3.9 million for the three months ended September 30, 2013, compared to \$10.4 million for the three months ended September 30, 2012.

Net cash flow provided by operating activities for the three months ended September 30, 2013 consisted of non-cash charges of \$9.6 million, partially offset by contributions to working capital of \$4.8 million and net loss of \$0.9 million. The non-cash charges primarily consisted of depreciation and amortization of \$6.7 million and stock-based compensation expense net of tax benefits of \$2.9 million. The contribution to working capital accounts was primarily due to a net decrease in accounts payable and accrued liabilities of \$3.1 million, an increase in accounts receivable of \$1.7 million and a net decrease in deferred revenue and other noncurrent liabilities of \$0.6 million offset by a decrease in prepaid expenses and other assets of \$0.6 million. The increase in accounts receivable, as well as the net decrease in accounts payable and accrued liabilities, are primarily due to timing of payments.

Net cash flow provided by operating activities for the three months ended September 30, 2012 consisted of non-cash charges of \$10.8 million, partially offset by contributions to working capital of \$0.3 million and net loss of \$0.1 million. The non-cash charges primarily consisted of depreciation and amortization of \$8.3 million and stock-based compensation expense net of tax benefits of \$2.7 million. The contribution to working capital accounts was primarily due to a net decrease in accounts payable and accrued liabilities of \$8.7 million and a decrease in accounts receivable of \$8.3 million. The decrease in accounts receivable, as well as the net decrease in accounts payable and accrued liabilities, are primarily due to timing of payments.

***Investing Activities***

Our investing activities include capital expenditures, capitalized internal development costs and net investments in marketable securities.

Net cash flows used in investing activities was \$2.7 million for the three months ended September 30, 2013, compared to net cash flows used in investing activities of \$3.7 million for the three months ended September 30, 2012.

**Table of Contents**

Cash used in investing activities in the three months ended September 30, 2013 was primarily due to capital expenditures and internal software development costs of \$1.8 million. Net investments in marketable securities totaled \$0.8 million in the three months ended September 30, 2013.

Cash used in investing activities in the three months ended September 30, 2012 was primarily due to net investments in marketable securities of \$2.7 million. Capital expenditures and internal software development costs totaled \$0.9 million in the three months ended September 30, 2012.

**Financing Activities**

Our financing activities include proceeds from exercise of stock options, withholding taxes related to restricted stock net of share settlement, excess tax benefits from stock-based compensation, and principle payments on bank debt and acquisition-related notes payable.

Net cash flows used in financing activities was \$3.0 million for the three months ended September 30, 2013, compared to net cash flows used in financing activities of \$10.8 million for the three months ended September 30, 2012.

Cash used in financing activities in the three months ended September 30, 2013 was primarily due to principal payments on acquisition-related notes payable and our term loan of \$3.0 million and withholding taxes related to restricted stock net share settlement of \$1.0 million, partially offset by exercises of stock options of \$1.0 million.

Cash used in financing activities in the three months ended September 30, 2012 was primarily due to repurchases of our common stock of \$6.2 million and principal payments on acquisition-related notes payable and our term loan and related fees of \$4.8 million, partially offset by exercises of stock options of \$0.2 million.

**Off-Balance Sheet Arrangements**

During the periods presented, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

**Contractual Obligations**

Our contractual obligations relate primarily to borrowings under our credit facility, acquisition-related notes payable and operating leases. There have been no significant changes to our contractual obligations from those disclosed in our Annual Report on Form 10-K for the year ended June 30, 2013.

The following table summarizes our contractual obligations for the periods indicated:

| <b>Year Ending June 30,</b>  | <b>Promissory<br/>Notes</b> | <b>Credit<br/>Facility</b> | <b>Operating<br/>Leases</b> | <b>Total</b> |
|------------------------------|-----------------------------|----------------------------|-----------------------------|--------------|
| 2014 (remaining nine months) | \$ 2,744                    | \$ 10,000                  | \$ 2,726                    | \$ 15,470    |
| 2015                         | 560                         | 17,500                     | 3,476                       | 21,536       |
| 2016                         | 50                          | 20,000                     | 3,362                       | 23,412       |
| 2017                         |                             | 40,000                     | 2,911                       | 42,911       |

Edgar Filing: QUINSTREET, INC - Form 10-Q

|                     |    |       |           |           |            |
|---------------------|----|-------|-----------|-----------|------------|
| 2018                |    |       | 2,950     | 2,950     |            |
| 2019 and thereafter |    |       | 1,099     | 1,099     |            |
| Total               | \$ | 3,354 | \$ 87,500 | \$ 16,524 | \$ 107,378 |

---

**Table of Contents****Credit Facility**

In November 2011, we entered into the Second Amended and Restated Revolving Credit and Term Loan Agreement (the Second Loan Agreement ) with Comerica Bank (the Bank ), the administrative agent and lead arranger. The Second Loan Agreement consists of a \$100 million five-year term loan, with annual principal amortization of 5%, 10%, 15%, 20% and 50%, and a \$200 million five-year revolving credit line. On February 15, 2013, we entered into the First Amendment to Credit Agreement and Amendment to Guaranty ( First Amendment to the Second Loan Agreement ) with the Bank to, among other things: (1) amend the definition of adjusted EBITDA, effective as of December 31, 2012, to exclude extraordinary or non-recurring non-cash expenses of losses including, without limitation, goodwill impairments, and any extraordinary or non-recurring cash expenses in an aggregate amount not to exceed \$5 million for the life of the Second Loan Agreement; and (2) reduce the \$200 million five-year revolving credit line portion of the facility to \$100 million, effective as of February 15, 2013.

Borrowings under the Second Loan Agreement are secured by substantially all of our assets. Interest is payable at specified margins above either the Eurodollar Margin or the Prime Rate. The interest rate varies based upon the ratio of funded debt to adjusted EBITDA and ranges from Eurodollar Margin + 1.625% to 2.375% or Prime + 1.00% for the revolving credit line and from Eurodollar Margin + 2.00% to 2.75% or Prime + 1.00% for the term loan. Adjusted EBITDA is defined as net (loss) income less benefit from (provision for) taxes, depreciation expense, amortization expense, stock-based compensation expense, interest and other income (expense), acquisition costs for business combinations, extraordinary or non-recurring non-cash expenses of losses including, without limitation, goodwill impairments, and any extraordinary or non-recurring cash expenses in an aggregate amount not to exceed \$5 million for the life of this Second Loan Agreement. The revolving credit line requires an annual facility fee of 0.375% of the revolving credit line capacity.

The Second Loan Agreement expires in November 2016. The Second Loan Agreement restricts our ability to raise additional debt financing and pay dividends, and also requires us to comply with other nonfinancial covenants. In addition, we are required to maintain financial ratios computed as follows:

1. A minimum fixed charge coverage ratio of 1.15:1, calculated as the ratio of (i) trailing twelve months of adjusted EBITDA to (ii) the sum of capital expenditures, net cash interest expense, cash taxes, cash dividends and trailing twelve months payments of indebtedness. Payment of unsecured indebtedness is excluded to the degree that sufficient unused revolving credit line capacity exists such that the relevant debt payment could be made from the credit facility.
2. A maximum funded debt to adjusted EBITDA ratio of 3:1, calculated as the ratio of (i) the sum of all obligations owed to lending institutions, the face amount of any letters of credit, indebtedness owed in connection with acquisition-related notes and indebtedness owed in connection with capital lease obligations to (ii) trailing twelve months of adjusted EBITDA.

We were in compliance with the covenants of our loan agreements as of September 30, 2013 and June 30, 2013.

**Interest Rate Swap**

To reduce the our exposure to rising interest rates under the term loan, in February 2012, we entered into an interest rate swap to reduce our exposure to the financial impact of changing interest rates under our term loan. We do not speculate using derivative instruments. The swap encompasses the principal balances scheduled to be outstanding as of January 1, 2014 and thereafter, such principal and notional amount totaling \$85 million in January 2014 and amortizing to \$35 million in November 2016. The effective date of the swap was April 9, 2012 with a maturity date of November 4, 2016. At September 30, 2013, we had approximately \$85 million of notional amount outstanding in the

swap agreement that exchanges a variable interest rate base (Eurodollar margin) for a fixed interest rate of 0.97% over the term of the agreement. This interest rate swap is designated as a cash flow hedge of the interest rate risk attributable to forecasted variable interest payments. The effective portion of the fair value gains or losses on this swap are included as a component of accumulated other comprehensive loss.

At September 30, 2013, our interest rate swap qualified as a cash flow hedge. For this qualifying hedge, the effective portion of the change in fair value will be recognized through earnings when the underlying transaction being hedged affects earnings, thereby allowing the swap's gains and losses to offset interest expense from the term loan on the statement of operations. Any hedge ineffectiveness is recognized in earnings in the current period.

**Table of Contents**

**Headquarter Lease**

We entered into a lease agreement in February 2010 for approximately 63,998 square feet of office space located at 950 Tower Lane, Foster City, California. The term of the lease began on November 1, 2010 and expires on October 31, 2018. The monthly base rent was abated for the first 12 calendar months under the lease, and remained at \$0.1 million through the 24th calendar month of the term of the lease. After this 24 month period, monthly base rent increased to \$0.2 million for the subsequent 12 months and then increases approximately 3% after each 12-month anniversary during the remaining term, including any extensions under our options to extend. We have two options to extend the term of the lease for one additional year for each option following the expiration date of the lease or renewal term, as applicable.



---

**Table of Contents**

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to market risks in the ordinary course of our business. These risks include primarily interest rate and foreign currency exchange risks.

**Interest Rate Risk**

We invest our cash equivalents and short-term investments primarily in liquid, highly-rated U.S. government or municipal fixed income securities, certificates of deposit with financial institutions and money market funds. Unrestricted cash, cash equivalents and short-term investments are held for working capital purposes and acquisition financing. We do not enter into investments for trading or speculative purposes. We believe that we do not have material exposure to changes in the fair value of these investments as a result of changes in interest rates due to the short-term nature of our investments. Declines in interest rates may reduce future investment income. However, a hypothetical decline of 1% in the interest rate on our investments would not have a material effect on our consolidated financial statements.

As of September 30, 2013, our credit facility consisted of a \$87.5 million outstanding term loan and a \$100 million revolving line of credit with no amount outstanding. Interest on borrowings under the credit facility is payable quarterly at specified margins above either the Eurodollar Margin or the Prime Rate. Our exposure to interest rate risk under the credit facility will depend on the extent to which we utilize the facility. To reduce our exposure to rising interest rates under the term loan, in February 2012, we entered into an interest rate swap encompassing the principal balances scheduled to be outstanding as of January 1, 2014 and thereafter, such scheduled principal amount totaling \$85 million on January 1, 2014 and amortizing to \$35 million on November 4, 2016. The interest rate swap effectively fixes the Eurodollar Margin at a fixed rate of 0.97%. A hypothetical change of 1% from prevailing interest rates as of September 30, 2013 would affect our interest expense by approximately \$0.1 million.

In addition to the \$85 million of term loans covered by the interest rate swap as of September 30, 2013, we also had variable rate debt outstanding of \$2.5 million.

A hypothetical increase of 1% in the Eurodollar Margin or Prime Rate-based interest rate on our variable rate debt outstanding of \$2.5 million as of September 30, 2013 would result in an increase in our interest expense of \$0.1 million per year, assuming constant borrowing levels.

**Foreign Currency Exchange Risk**

To date, our international client agreements have been predominately denominated in U.S. dollars, and, accordingly, we have limited exposure to foreign currency exchange rate fluctuations related to client agreements, and do not currently engage in foreign currency hedging transactions. As the local accounts for some of our foreign operations are maintained in the local currency of the respective country, we are subject to foreign currency exchange rate fluctuations associated with the remeasurement to U.S. dollars. A hypothetical change of 10% in foreign currency exchange rates would not have a material effect on our consolidated financial condition or results of operations.

**Table of Contents**

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our principal executive and principal financial officers, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2013. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of September 30, 2013, our principal executive and principal financial officers concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

**Changes in Internal Control over Financial Reporting**

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rules 13a-15(d) and 15d-15(d) of the Securities Exchange Act that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

In December 2012, Internet Patents Corporation ( “IPC” ) filed a patent infringement lawsuit against us in the United States District Court for the Northern District of California, seeking a judgment that we had infringed a patent held by IPC. We received the related summons and complaint from IPC in March 2013. In September 2013, the court dismissed a related case because it found that the patent is invalid, and on the same date, the court issued IPC an Order to Show Cause that the lawsuit against us should not be dismissed. In October 2013, IPC filed a response to the order and the court subsequently dismissed the case against us. In November 2013, IPC filed a Notice of Appeal to the United States Court of Appeals for the Federal Circuit. While we deny IPC’s claims, there can be no assurance that we will prevail in this matter and any adverse ruling may have a significant impact on our business and operating results. In addition, regardless of the outcome of the matter, we may incur significant legal fees defending the action until it is resolved. We have determined that the probability of any loss is remote.

From time to time, we may become involved in other legal proceedings and claims arising in the ordinary course of our business.

**ITEM 1A. RISK FACTORS**

*Investing in our common stock involves a high degree of risk. You should carefully consider the risks described below and the other information in this periodic report. If any of such risks actually occur, our business, operating results or financial condition could be adversely affected. In those cases, the trading price of our common stock could decline and you may lose all or part of your investment.*

### **Risks Related to Our Business and Industry**

*We operate in an emerging industry and have a relatively new business model, which makes it difficult to evaluate our business and prospects.*

We derive nearly all of our revenue from the sale of online marketing and media services, which is an emerging industry that has undergone rapid and dramatic changes in its relatively short history and which is characterized by rapidly-changing Internet media, evolving industry standards, regulatory uncertainty, and changing user and client demands. As a result, we face risks and uncertainties such as but not limited to:

our emerging industry and relatively new business model;

**Table of Contents**

changes in the economic condition, market dynamics, regulatory or legislative environment affecting our business or our clients' businesses;

our dependence on Internet search companies to attract Internet visitors;

our ability to accurately forecast our operating results and appropriately plan our expenses;

our ability to compete in our industry;

our ability to successfully challenge regulatory audit, investigations or alleged noncompliance with laws;

our ability to develop new services and enhancements and features to meet new demands from our clients; and

our ability to develop our websites to allow Internet visitors to access our websites through mobile devices.

If we are unable to address these risks, our business, results of operations and prospects could suffer.

***We depend on two market verticals for a majority of our revenue. Negative changes in the economic condition, market dynamics or regulatory environment in these verticals have caused, and may continue to cause, our revenue to decline and our business and growth to suffer.***

To date, we have generated a large majority of our revenue from clients in our education and financial services client verticals. We expect that a majority of our revenue, at least in the near term, will continue to be generated from clients in our education and financial services client verticals. Changes in the market conditions or the regulatory environment in these two highly-regulated client verticals have negatively impacted, and may continue to negatively impact, our clients' businesses, marketing practices and budgets and, therefore, our financial results.

***Our and our clients' businesses are subject to many regulatory requirements. Current or future regulations could have a material adverse effect on our business, results of operations and financial condition.***

Our business is subject to many laws and regulatory requirements, including Federal, state, and local laws and regulations regarding unsolicited commercial email, telemarketing, user privacy, search engines, Internet tracking technologies, direct marketing, data security, data privacy, pricing, sweepstakes, promotions, intellectual property ownership and infringement, trade secrets, export of encryption technology, acceptable content and quality of goods, and taxation, among others. Each of our education, financial services and other client verticals is also subject to various laws and regulations, and our marketing activities on behalf of our clients are regulated. Many of these laws are frequently changing, and keeping our business in compliance with or bringing our business into compliance with new laws may be costly, affect our revenue, and harm our financial results. Violations or alleged violations of laws by us or our third party publishers could result in liability for damages, fines, criminal prosecution, unfavorable publicity, and restrictions on our ability to operate, any of which could have a material adverse effect on our business, results of

operations, and financial condition. In addition, new laws or regulations or changes in enforcement of existing laws or regulations applicable to our clients could affect the activities or strategies of our clients and, therefore, lead to reductions in their level of business with us.

For example, the Federal Communications Commission recently amended the Telephone Consumer Protection Act that affects telemarketing calls. Certain provisions of the regulations became effective in July 2012, and additional regulations requiring prior express written consent for certain types of telephonic communications became effective in October 2013. We generate a significant amount of revenue from calls made by our internal call centers as well as by third-party call centers. Efforts to comply with the new regulations may negatively affect media conversion rates and, thus, our revenue or profitability. We also purchase a portion of our lead data from third-party publishers and cannot guarantee that these third parties will comply with the regulations. Any failure by us or the third-party publishers on which we rely on for telemarketing, email marketing and other lead generation activities to adhere to or successfully implement appropriate processes and procedures in response to changing regulatory requirements could result in legal liability or damage our reputation in the marketplace, either of which could have a material adverse effect on our business, results of operations and financial condition.

---

**Table of Contents**

From time to time, we are subject to audits, inquiries, investigations, claims of non-compliance and lawsuits by Federal and state governmental agencies, regulatory agencies, attorneys general, and other governmental or regulatory bodies, any of whom may allege violations of legal requirements. For example, in June 2012, we entered into an Assurance of Voluntary Compliance agreement following a civil investigation into certain of our marketing practices related to our education client vertical that was conducted by the attorneys general of a number of states. If the results of any future investigations, audits, inquiries, claims or litigation are unfavorable to us, we may be required to pay monetary fines or penalties or have restrictions placed on our business, which could materially adversely affect our business, financial condition, results of operations and cash flows.

***We depend on third-party website publishers for a significant portion of our visitors. Any decline in the supply of media available through these websites or increase in the price of this media could cause our revenue to decline or our cost to reach visitors to increase.***

A significant portion of our revenue is attributable to visitor traffic originating from third-party publishers. In many instances, website publishers can change the media inventory they make available to us at any time and, therefore, impact our revenue. In addition, website publishers may place significant restrictions on our offerings. These restrictions may prohibit advertisements from specific clients or specific industries, or restrict the use of certain creative content or formats. If a website publisher decides not to make media inventory available to us, or decides to demand a higher revenue share or places significant restrictions on the use of such inventory, we may not be able to find media inventory from other websites that satisfy our requirements in a timely and cost-effective manner. In addition, the number of competing online marketing service providers and advertisers that acquire inventory from websites continues to increase. Consolidation of Internet advertising networks and website publishers could eventually lead to a concentration of desirable inventory on websites or networks owned by a small number of individuals or entities, which could limit the supply or pricing of inventory available to us. For example, throughout both fiscal years 2013 and 2012, our revenue declined in our financial services client vertical primarily due to volume declines caused by losses of traffic from third-party publishers acquired by competitors, changes in search engine algorithms which reduced or eliminated traffic from some third-party publishers, and increased competition for quality media. We cannot assure you that we will be able to acquire media inventory that meets our clients' performance, price and quality requirements, in which case our revenue could decline or our operating costs could increase.

***Our operating results have fluctuated in the past and may do so in the future, which makes our results of operations difficult to predict and could cause our operating results to fall short of analysts' and investors' expectations.***

Historically, quarterly and annual operating results have fluctuated due to changes in our business, our industry and the general economic climate. We expect our future operating results to vary significantly from quarter to quarter due to a variety of factors, many of which are beyond our control. Our fluctuating operating results could cause our performance and outlook to be below the expectations of securities analysts and investors, causing the price of our common stock to fall. Our business is changing and evolving, and, as a result, our historical operating results may not be useful to you in predicting our future operating results. Factors that may increase the volatility of our operating results include the following:

changes in client volume;

loss of existing clients;

the availability and price of quality media;

consolidation of media sources;

changes in search engine algorithms that affect our and our publishers' websites; and

regulatory and legislative changes.

***We depend upon Internet search providers to direct a significant portion of the visitors to our and our third-party publishers' websites. Changes in search engine algorithms have in the past and may in the future harm the websites' placements in both paid and organic search result listings, which may cause the number of visitors to our websites, our third-party publishers' websites and our revenue to decline.***

Our success depends on our ability to attract online visitors to our and our third-party publishers' websites and convert them into prospects for our clients in a cost-effective manner. We depend on Internet search providers to direct a substantial share of visitors to

**Table of Contents**

our websites. Search providers offer two types of search results: organic and paid listings. Organic listings are displayed based solely on formulas designed by the search companies. Paid listings are displayed based on a combination of the advertiser's bid price for particular keywords and the search engines' assessment of the website's relevance and quality.

Our ability to maintain or grow the number of visitors to our websites from search providers is not entirely within our control. Search providers frequently revise their algorithms and changes in their algorithms could cause our websites to receive less favorable placements. We have experienced fluctuations in organic rankings for a number of our websites and some of our paid listing campaigns have also been harmed by search engine algorithmic changes. Search providers could determine that our or our third-party publishers websites content is either not relevant or is of poor quality. In addition, we may fail to optimally manage our paid listings, or our proprietary bid management technologies may fail. In any of these cases, our websites may receive less favorable placement in organic or paid listings, which would reduce the number of visitors to our sites and have a detrimental effect on our ability to generate revenue. If visits to our websites decrease, we may need to use more costly sources to replace lost visitors, and such increased expense could adversely affect our business and profitability.

***If we fail to compete effectively against other online marketing and media companies and other competitors, we could lose clients and our revenue may decline.***

The market for online marketing is intensely competitive, and we expect this competition to continue to increase in the future both from existing competitors and, given the relatively low barriers to entry into the market, from new competitors. We compete both for clients and for limited high-quality media. We compete for clients on the basis of a number of factors, including return on investment of client's marketing spending, price and client service.

We compete with Internet and traditional media companies for a share of clients' overall marketing budgets, including:

online marketing or media services providers such as Education Dynamics in the education client vertical and BankRate in the financial services client vertical;

offline and online advertising agencies;

major Internet portals and search engine companies with advertising networks;

other online marketing service providers, including online affiliate advertising networks and industry-specific portals or lead generation companies;

website publishers with their own sales forces that sell their online marketing services directly to clients;

in-house marketing groups and activities at current or potential clients;



offline direct marketing agencies;

mobile and social media; and

television, radio and print companies.

Competition for web traffic among websites and search engines, as well as competition with traditional media companies, has resulted and may continue to result in significant increases in media pricing, declining margins, reductions in revenue and loss of market share. In addition, if we expand the scope of our services, we may compete with a greater number of websites, clients and traditional media companies across an increasing range of different services, including in vertical markets where competitors may have advantages in expertise, brand recognition and other areas. Internet search companies with brand recognition, such as Google, Yahoo!, and Microsoft, have significant numbers of direct sales personnel and substantial proprietary advertising inventory and web traffic that provide a significant competitive advantage and have significant impact on pricing for Internet advertising and web traffic. Some of these companies may offer or develop more vertically targeted products that match consumers with products and services and, thus, compete with us more directly. The trend toward consolidation in online marketing may also affect pricing and availability of media inventory and web traffic. Many of our current and potential competitors also enjoy other competitive advantages over us, such as longer operating histories, greater brand recognition, larger client bases, greater access to advertising inventory on high-traffic websites, and significantly greater financial, technical and marketing resources. As a result, we may not be able to compete

## **Table of Contents**

successfully. Competition from other marketing service providers online and offline offerings has affected and may continue to affect both volume and price, and, thus, revenue, profit margins and profitability. If we fail to deliver results that are superior to those that other online marketing service providers deliver to clients, we could lose clients, and our revenue may decline.

***Federal and state regulations governing clients in our education vertical have negatively affected, and may continue to negatively affect, our clients' businesses, marketing practices and budgets, any or all of which could have a material adverse effect on our financial results.***

Historically, we have generated nearly half of our revenue from our education client vertical, and nearly all of that revenue was generated from post-secondary educational institutions. Post-secondary educational institutions are subject to extensive Federal and state regulations, including the Higher Education Act, Department of Education regulations and individual state higher education regulations. The regulations govern many aspects of these clients' operations, including marketing and recruiting activities, as well as the schools' eligibility to participate in Title IV Federal student financial aid programs, which is the principal source of funding for many of our education clients. There have been significant changes to these regulations in the recent past, and a high level of regulatory activity and heightened legislative scrutiny is expected to continue in the post-secondary education sector. Changes in, or new interpretations of, applicable laws, regulations, standards or policies applicable to these clients could have a material adverse effect on their accreditation, authorization to operate in various states, or receipt of funds under Title IV programs, any of which, in turn, may harm our ability to generate revenue from these clients and our financial results.

***If we fail to continually enhance and adapt our products and services to keep pace with rapidly changing technologies and industry standards, we may not remain competitive and could lose clients or advertising inventory.***

The online media and marketing industry is characterized by rapidly changing standards, changing technologies, frequent new product and service introductions, and changing user and client demands. The introduction of new technologies and services embodying new technologies and the emergence of new industry standards and practices could render our existing technologies and services obsolete and unmarketable or require unanticipated investments in technology. We continually make enhancements and other modifications to our proprietary technologies, and these changes may contain design or performance defects that are not readily apparent. If our proprietary technologies fail to achieve their intended purpose or are less effective than technologies used by our competitors, our business could be harmed.

Our future success will depend in part on our ability to successfully adapt to these rapidly changing online media formats and other technologies. If we fail to adapt successfully, we could lose advertising inventory.

***More people are using mobile devices to access the internet. If we fail to develop our websites to keep pace with this shift in user devices, we may not remain competitive and could lose clients or advertising inventory.***

The number of people who access the Internet through mobile devices such as smart phones and tablets has increased dramatically in the past few years, and the trend is expected to continue. Our online marketing services and content were originally designed for desktop or laptop computers. The shift from desktop or laptop computers to mobile devices could potentially deteriorate the user experience for visitors to our websites and may make it more difficult for visitors to respond to our offerings. It may also require us to develop new offerings specifically designed for mobile devices. Additionally, the monetization of our online marketing services and contents on these mobile devices might not be as lucrative for us compared to those on desktop and laptop computers. If we fail to develop our websites cost effectively and improve our monetization capabilities of our mobile marketing services, we may not remain

competitive and may negatively affect our business and operating results.

***We rely on our management team and other key employees, and the loss of one or more key employees could harm our business.***

Our success and future growth depend upon the continued services of our management team, including Douglas Valenti, Chief Executive Officer, and other key employees in all areas of our organization. From time to time, there may be changes in our key employees resulting from the hiring or departure of executives and employees, which could disrupt our business. Many members of our management team and employees have also become, or will soon become, substantially vested in their equity grants or may have limited retention value in their existing grants. In addition, in fiscal year 2013, we experienced declines in our business and a depressed stock price, making our equity and cash incentive compensation programs less attractive to current and potential key employees. If we lose the services of key employees or if we are unable to attract and retain additional qualified employees, our business and growth could suffer.

**Table of Contents**

***Third-party publishers or vendors may engage in unauthorized or unlawful acts that could subject us to significant liability or cause us to lose clients.***

We generate a significant portion of our web visitors from online media that we purchase from third-party website publishers. We also rely on third-party call centers and email marketers. Some of these third-parties are authorized to use our clients' brands, subject to contractual restrictions. Any activity by third-party publishers or vendors that clients view as potentially damaging to their brands can harm our relationship with the client and cause the client to terminate its relationship with us, resulting in a loss of revenue. In addition, we may also face liability for any failure of our third-party publishers or vendors to comply with regulatory requirements, as further described in the risk factor beginning, "Our business is subject to many regulatory requirements, and current or future regulation could have a material adverse effect on our business, results of operations and financial condition."

The law is unsettled on the extent of liability that an advertiser in our position has for the activities of third-party publishers or vendors. Recent Department of Education regulations impose strict liability on our education clients for misrepresentations made by their marketing service providers. In addition, certain of our contracts impose liability on us for the acts of our third-party publishers or vendors. We could be subject to costly litigation and, if we are unsuccessful in defending ourselves, damages for the unauthorized or unlawful acts of third-party publishers or vendors.

***We gather, transmit and store consumer personally identifiable information and unauthorized access to or accidental disclosure of this information may cause us to incur significant expenses and may negatively affect our reputation and business.***

We gather, transmit and store consumer personally identifiable information. This information may include social security numbers, credit scores, credit card information, and financial and health information, some of which is held and managed by our third-party vendors. As a result, we are subject to certain contractual terms, as well as Federal, state and foreign laws and regulations designed to protect personally identifiable information. Despite our implementation of security measures and controls, our computer systems may be susceptible to electronic or physical computer break-ins, viruses and other disruptions and security breaches. In the past, we have experienced security incidents involving access to our user databases. Although, to our knowledge, no sensitive financial or personal information has been compromised in the past, any future security incidents could result in the compromise of such data and subject us to liability. In addition, the increased use of mobile devices by our employees increases the risk of unintentional disclosure of personally identifiable information. Any perceived or actual unauthorized disclosure of personally identifiable information, whether through breach of our network by an unauthorized party, employee theft, misuse, or error could harm our reputation, impair our ability to attract website visitors and to attract and retain our clients, or subject us to claims or litigation arising from damages suffered by consumers, and thereby harm our business and operating results. In addition, we could incur significant costs in complying with the multitude of state, Federal and foreign laws regarding personally identifiable information.

***A substantial portion of our revenue is generated from a limited number of clients and, if we lose a major client, our revenue will decrease and our business and prospects would be harmed.***

A substantial portion of our revenue is generated from a limited number of clients. None are 10% or more, however we have a few customers that account for a large portion of our net revenue for the quarter ended September 30, 2013. Our clients can generally terminate their contracts with us at any time, with limited prior notice or penalty as these contracts do not contain penalty provisions for cancellations before the end of the contract term. Our clients may also reduce their level of business with us, leading to lower revenue.

In addition, reductions in business by one or more significant clients may trigger price reductions for our other clients for products whose prices are determined in whole or in part by client bidding or competition. Any such price reduction could result in lower revenue. We expect that a limited number of clients will continue to account for a significant percentage of our revenue, and the loss of any one of these clients, or material reduction in their marketing spending with us, could decrease our revenue and harm our business.

***Acquisitions and investments could complicate operations, or could result in dilution and other harmful consequences that may adversely impact our business and results of operations.***

Acquisitions have historically been an important element of our overall corporate strategy and use of capital. Any possible future acquisitions could be material to our financial condition and results of operations. We may evaluate and enter into discussions regarding a wide array of potential strategic transactions. The process of integrating an acquired company, business or technology has created, and will continue to create, unforeseen operating difficulties and expenditures. The areas where we face risks include:

diversion of management time and focus from operating our business to acquisition integration challenges;

**Table of Contents**

failure to successfully further develop the acquired business or technology;

implementation or remediation of controls, procedures and policies at the acquired company;

integration of the acquired company's accounting, human resource, and other administrative systems, and coordination of product, engineering and sales and marketing functions;

transition of operations, users and customers onto our existing platforms;

failure to obtain required approvals on a timely basis, if at all, from governmental authorities, or conditions placed upon approval, under competition and antitrust laws which could, among other things, delay or prevent us from completing a transaction, or otherwise restrict our ability to realize the expected financial or strategic goals of an acquisition;

in the case of foreign acquisitions, the need to integrate operations across different cultures and languages and to address the particular economic, currency, political and regulatory risks associated with specific countries;

cultural challenges associated with integrating employees from the acquired company into our organization, and retention of employees from the businesses we acquire;

liability for activities of the acquired company before the acquisition, including patent and trademark infringement claims, violations of laws, commercial disputes, tax liabilities and other known and unknown liabilities; and

litigation or other claims in connection with the acquired company, including claims from terminated employees, customers, former stockholders or other third-parties.

Our failure to address these risks or other problems encountered in connection with our past or future acquisitions and investments could cause us to fail to realize the anticipated benefits of such acquisitions or investments, incur unanticipated liabilities and harm our business generally.

Future acquisitions could also result in dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities, amortization expenses, impairment of goodwill or restructuring charges, any of which could harm our financial condition or results. Also, the anticipated benefit of many of our acquisitions may not materialize.

***We rely on certain advertising agencies for the purchase of various advertising and marketing services on behalf of their clients. Such agencies may have or develop high-risk credit profiles, which may result in credit risk to us.***

A portion of our client business is sourced through advertising agencies and, in many cases, we contract with these agencies and not directly with the underlying client. Contracting with these agencies subjects us to greater credit risk

than where we contract with clients directly. In many cases, agencies are not required to pay us unless and until they are paid by the underlying client. In addition, many agencies are thinly capitalized and have or may develop high-risk credit profiles. This credit risk may vary depending on the nature of an agency's aggregated client base. If an agency became insolvent, or if an underlying client did not pay the agency, we may be required to write off account receivables as bad debt. Any such write-offs could have a materially negative effect on our results of operations for the periods in which the write-offs occur.

***We have a significant amount of debt, which may limit our ability to fund general corporate requirements and obtain additional financing, limit our flexibility in responding to business opportunities and competitive developments and increase our vulnerability to adverse economic and industry conditions.***

As of September 30, 2013, we had debt with a principal balance of \$87.5 million. As a result of obligations associated with our debt, we may not have sufficient liquidity:

to respond to business opportunities, competitive developments and adverse economic conditions;

to fund all of our costs if our revenue declines or costs increase; and

to repay the principal balance of our debt when due.

## **Table of Contents**

Our debt obligations may also impair our ability to obtain additional financing, if needed. Our indebtedness is secured by substantially all of our assets, leaving us with limited collateral for additional financing. Moreover, the terms of our indebtedness restrict our ability to take certain actions, including the incurrence of additional indebtedness, certain mergers and acquisitions, investments, asset sales, dividends and stock repurchases. In addition, even if we are able to raise needed equity financing, we are required to use a portion of the net proceeds of certain types of equity financings to repay the outstanding balance of our term loan. A failure to pay interest or indebtedness when due could result in a variety of adverse consequences, including the acceleration of our indebtedness. In such a situation, it is unlikely that we would be able to fulfill our obligations under our credit facility or repay the accelerated indebtedness or otherwise cover our costs.

### ***Damage to our reputation could harm our business, financial condition and results of operations.***

Our business is dependent on attracting a large number of visitors to our and our third-party publishers' websites and providing leads, clicks, calls and customers to our clients, which depends in part on our reputation within the industry and with our clients. There are companies within our industry that regularly engage in activities that others may view as unlawful or inappropriate. These activities by third-parties, such as spyware or deceptive promotions, may be seen as characteristic of participants in our industry and, therefore, may harm the reputation of all participants in our industry, including us.

Our ability to attract potential consumers and, thereby, clients also depends in part on consumers receiving competitive levels of customer service, responsiveness and prices from our lead purchasers. If lead purchasers do not provide competitive levels of service to consumers, our reputation and our ability to attract clients and consumers could be harmed.

In addition, from time to time, we may be subject to investigations, inquiries or litigation by various regulators, which may harm our reputation regardless of the outcome of any such action. For example, in 2012, we responded to a civil investigation conducted by the attorneys general of a number of states into certain of our marketing and business practices resulting in us entering into an Assurance of Voluntary Compliance agreement. Negative perceptions of our business may result in additional regulation, enforcement actions by the government and increased litigation, any of which may affect our business and result in lower revenue.

Any damage to our reputation, including from publicity from legal proceedings against us or companies that work within our industry, governmental proceedings, consumer class action litigation, or the disclosure of information security breaches or private information misuse, could adversely affect our business, financial condition and results of operations.

### ***If we do not effectively manage any future growth, our operating performance will suffer and we may lose clients.***

We have historically experienced growth in our operations and operating locations. This growth placed, and any future growth will continue to place, significant demands on our management and our operational and financial infrastructure. Growth, if any, may make it more difficult for us to accomplish the following:

successfully scale our technology to accommodate a larger business and integrate acquisitions;



maintain our standing with key vendors, including Internet search companies and third-party website publishers;

maintain our client service standards; and

develop and improve our operational, financial and management controls and maintain adequate reporting systems and procedures.

Our future success depends in part on the efficient performance of our software and technology infrastructure. As the numbers of websites and Internet users increase, our technology infrastructure may not be able to meet the increased demand. Unexpected constraints on our technology infrastructure could lead to slower website response times or system failures and adversely affect the availability of websites and the level of user responses received, which could result in the loss of clients or revenue or harm to our business and results of operations.

In addition, our personnel, systems, procedures and controls may be inadequate to support our future operations if we return to growth. The improvements required to manage growth may require us to make significant expenditures, expand, train and manage our employee base and reallocate valuable management resources. If we fail to effectively manage future growth, our operating performance will suffer, and we may lose clients, key vendors and key personnel.

**Table of Contents**

***Interruption or failure of our information technology and communications systems could impair our ability to effectively deliver our services, which could cause us to lose clients and harm our operating results.***

Our delivery of marketing and media services depends on the continuing operation of our technology infrastructure and systems. Any damage to or failure of our systems could result in interruptions in our ability to deliver offerings quickly and accurately or process visitors' responses emanating from our various web presences. Interruptions in our service could reduce our revenue and profits, and our reputation could be damaged if people believe our systems are unreliable. Our systems and operations are vulnerable to damage or interruption from earthquakes, terrorist attacks, floods, fires, power loss, break-ins, hardware or software failures, telecommunications failures, computer viruses or other attempts to harm our systems, and similar events. If we or third-party data centers that we utilize were to experience a major power outage, we would have to rely on back-up generators. These back-up generators may not operate properly through a major power outage and their fuel supply could also be inadequate during a major power outage or disruptive event. Furthermore, we do not currently have backup generators at our Foster City, California headquarters. Information systems such as ours may be disrupted by even brief power outages, or by the fluctuations in power resulting from switches to and from back-up generators. This could give rise to obligations to certain of our clients which could have an adverse effect on our results for the period of time in which any disruption of utility services to us occurs.

Our primary data center is at a third-party co-location center in San Francisco, California. All of the critical components of the system are redundant and we have a backup data center in Las Vegas, Nevada. We have implemented these backup systems and redundancies to minimize the risk associated with earthquakes, fire, power loss, telecommunications failure, and other events beyond our control.

Any unscheduled interruption in our service would result in an immediate loss of revenue. If we experience frequent or persistent system failures, the attractiveness of our technologies and services to clients and website publishers could be permanently harmed. The steps we have taken to increase the reliability and redundancy of our systems are expensive, reduce our operating margin and may not be successful in reducing the frequency or duration of unscheduled interruptions.

***We rely on call centers, Internet and data center providers, and other third-parties for key aspects of the process of providing services to our clients, and any failure or interruption in the services and products provided by these third-parties could harm our business.***

We rely on internal and third-party call centers as well as third-party vendors, including data center and Internet providers. Notwithstanding disaster recovery and business continuity plans and precautions instituted to protect our clients and us from events that could interrupt delivery of services, there is no guarantee that such interruptions would not result in a prolonged interruption in our ability to provide services to our clients. Any temporary or permanent interruption in the services provided by our call centers or third-party providers could significantly harm our business.

In addition, any financial or other difficulties our third-party providers face may have negative effects on our business, the nature and extent of which we cannot predict. We exercise little control over our third-party vendors, which increases our vulnerability to problems with the services they provide. We license technology and related databases from third-parties to facilitate analysis and storage of data and delivery of offerings. We have experienced interruptions and delays in service and availability for data centers, bandwidth and other technologies in the past. Any errors, failures, interruptions or delays experienced in connection with these third-party technologies and services could adversely affect our business and could expose us to liabilities to third-parties.

***We may need additional capital in the future to meet our financial obligations and to pursue our business objectives. Additional capital may not be available or may not be available on favorable terms and our business and financial condition could therefore be adversely affected.***

While we anticipate that our existing cash and cash equivalents, together with availability under our credit facility and cash from operations, will be sufficient to fund our operations for at least the next 12 months, we may need to raise additional capital to fund operations in the future or to finance acquisitions. If we seek to raise additional capital in order to meet various objectives, including developing future technologies and services, increasing working capital, acquiring businesses and responding to competitive pressures, capital may not be available on favorable terms or may not be available at all. In addition, pursuant to the terms of our credit facility, we are required to use a portion of the net proceeds of certain equity financings to repay the outstanding balance of our

---

**Table of Contents**

term loan. Lack of sufficient capital resources could significantly limit our ability to take advantage of business and strategic opportunities. Any additional capital raised through the sale of equity or debt securities with an equity component would dilute our stock ownership. If adequate additional funds are not available, we may be required to delay, reduce the scope of, or eliminate material parts of our business strategy, including potential additional acquisitions or development of new technologies.

***Our quarterly revenue and operating results may fluctuate significantly from quarter to quarter due to seasonal fluctuations in advertising spending.***

In addition to other factors that cause our operating results to fluctuate, results are also subject to significant seasonal fluctuation. In particular, our quarters ending December 31 (our second fiscal quarter) are typically characterized by seasonal weakness. In our second fiscal quarters, there is generally lower availability of lead supply from some forms of media during the holiday period on a cost effective basis and some of our clients have lower budgets. In our quarters ending March 31 (our third fiscal quarter), this trend generally reverses with better lead availability and often new budgets at the beginning of the year for our clients with fiscal years ending December 31.

***If the market for online marketing services fails to continue to develop, our success may be limited, and our revenue may decrease.***

The online marketing services market is relatively new and rapidly evolving, and it uses different measurements than traditional media to gauge its effectiveness. Some of our current or potential clients have little or no experience using the Internet for advertising and marketing purposes and have allocated only limited portions of their advertising and marketing budgets to the Internet. The adoption of online marketing, particularly by those entities that have historically relied upon traditional media for advertising, requires the acceptance of a new way of conducting business, exchanging information and evaluating new advertising and marketing technologies and services. In particular, we are dependent on our clients' adoption of new metrics to measure the success of online marketing campaigns. We may also experience resistance from traditional advertising agencies who may be advising our clients. We cannot assure you that the market for online marketing services will continue to grow. If the market for online marketing services fails to continue to develop or develops more slowly than we anticipate, the success of our business may be limited, and our revenue may decrease.

***If we do not adequately protect our intellectual property rights, our competitive position and business may suffer.***

Our ability to compete effectively depends upon our proprietary systems and technology. We rely on patent, trade secret, trademark and copyright law, confidentiality agreements and technical measures to protect our proprietary rights. We enter into confidentiality agreements with our employees, consultants, independent contractors, advisors, client vendors and publishers. These agreements may not effectively prevent unauthorized disclosure of confidential information or unauthorized parties from copying aspects of our services or obtaining and using our proprietary information. Further, these agreements may not provide an adequate remedy in the event of unauthorized disclosures or uses, and we cannot assure you that our rights under such agreements will be enforceable. Effective patent, trade secret, copyright and trademark protection may not be available in all countries where we currently operate or in which we may operate in the future. Some of our systems and technologies are not covered by any copyright, patent or patent application. We cannot guarantee that: (i) our intellectual property rights will provide competitive advantages to us; (ii) our ability to assert our intellectual property rights against potential competitors or to settle current or future disputes will be effective; (iii) our intellectual property rights will be enforced in jurisdictions where competition may be intense or where legal protection may be weak; (iv) any of the patent, trademark, copyright, trade secret or other intellectual property rights that we presently employ in our business will not lapse or be invalidated, circumvented, challenged, or abandoned; (v) competitors will not design around our protected systems and technology; or (vi) that

we will not lose the ability to assert our intellectual property rights against others.

We have from time to time become aware of third-parties who we believe may have infringed our intellectual property rights. Such infringement or infringement of which we are not yet aware could reduce our competitive advantages and cause us to lose clients, third-party website publishers or could otherwise harm our business. Policing unauthorized use of our proprietary rights can be difficult and costly. Litigation, while it may be necessary to enforce or protect our intellectual property rights, could result in substantial costs and diversion of resources and management attention and could adversely affect our business, even if we are successful on the merits. In addition, others may independently discover trade secrets and proprietary information, and in such cases we could not assert any trade secret rights against such parties.

## **Table of Contents**

***Third-parties may sue us for intellectual property infringement, which, even if unsuccessful, could require us to expend significant costs to defend or settle.***

We cannot be certain that our internally developed or acquired systems and technologies do not and will not infringe the intellectual property rights of others. In addition, we license content, software and other intellectual property rights from third-parties and may be subject to claims of infringement if such parties do not possess the necessary intellectual property rights to the products they license to us.

In addition, we have in the past, and may in the future, be subject to legal proceedings and claims that we have infringed the patents or other intellectual property rights of third-parties. These claims sometimes involve patent holding companies or other adverse patent owners who have no relevant product revenue and against whom our own intellectual property rights, if any, may therefore provide little or no deterrence. For example, in December 2012, Internet Patents Corporation ( IPC ) filed a patent infringement lawsuit against us in the Northern District of California alleging that some of our websites infringe a patent held by IPC. IPC is a non-practicing entity that relies on asserting its patents as its primary source of revenue. In addition, third-parties have asserted and may in the future assert intellectual property infringement claims against our clients, and we have agreed in certain circumstances to indemnify and defend against such claims. Any intellectual property-related infringement claims, whether or not meritorious and regardless of the outcome of the litigation, could result in costly litigation and could divert management resources and attention. Should we be found liable for infringement, we may be required to enter into licensing agreements, if available on acceptable terms or at all, pay substantial damages, or limit or curtail our systems and technologies. Moreover, we may need to redesign some of our systems and technologies to avoid future infringement liability. Any of the foregoing could prevent us from competing effectively and increase our costs.

Additionally, the laws relating to use of trademarks on the Internet are unsettled, particularly as they apply to search engine functionality. For example, other Internet marketing and search companies have been sued for trademark infringement and other intellectual property-related claims for displaying ads or search results in response to user queries that include trademarked terms. The outcomes of these lawsuits have differed from jurisdiction to jurisdiction. We may be subject to trademark infringement, unfair competition, misappropriation or other intellectual property-related claims which could be costly to defend and result in substantial damages or otherwise limit or curtail our activities, and therefore adversely affect our business or prospects.

***Limitations on our ability to collect and use data derived from user activities could significantly diminish the value of our services and have an adverse effect on our ability to generate revenue.***

When a user visits our websites, we use technologies, including cookies, to collect information such as the user's IP address and the user's past responses to our offerings. We access and analyze this information in order to determine the effectiveness of a marketing campaign and to determine how to modify the campaign. The use of cookies is the subject of litigation, regulatory scrutiny and industry self-regulatory activities, including the discussion of do-not-track technologies and guidelines.

Additionally, users are able to block or delete cookies from their browser. Periodically, certain of our clients and publishers seek to prohibit or limit our collection or use of this data. Interruptions, failures or defects in our data collection systems, as well as privacy concerns regarding the collection of user data, could also limit our ability to analyze data from our clients' marketing campaigns. This risk is heightened when we deliver marketing services to clients in the financial services client vertical. If our access to data is limited in the future, we may be unable to provide effective technologies and services to clients and we may lose clients and revenue.

***If we fail to maintain proper and effective internal controls, our ability to produce accurate financial statements on a timely basis could be impaired, which would adversely affect our ability to operate our business.***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. We may in the future discover areas of our internal financial and accounting controls and procedures that need improvement. Our internal control over financial reporting will not prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. All control systems have inherent limitations, and, accordingly, no

**Table of Contents**

evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud will be detected. If we are unable to maintain proper and effective internal controls, we may not be able to produce accurate financial statements on a timely basis, which could adversely affect our ability to operate our business and could result in regulatory action.

***As a creator and a distributor of Internet content, we face potential liability and expenses for legal claims based on the nature and content of the materials that we create or distribute. If we are required to pay damages or expenses in connection with these legal claims, our operating results and business may be harmed.***

We display original content and third-party content on our websites and in our marketing messages. As a result, we face potential liability based on a variety of theories, including defamation, negligence, deceptive advertising (including Department of Education regulations regarding misrepresentation in education marketing), copyright or trademark infringement. We are also exposed to risk that content provided by third-parties is inaccurate or misleading, and for material posted to our websites by users and other third-parties. These claims, whether brought in the United States or abroad, could divert management time and attention away from our business and result in significant costs to investigate and defend, regardless of the merit of these claims. In addition, if we become subject to these types of claims and are not successful in our defense, we may be forced to pay substantial damages.

***We face additional risks in conducting business in international markets.***

We have entered into certain international markets and may enter into additional international markets in the future. We have limited experience in marketing, selling and supporting our services outside of the United States, and we may not be successful in introducing or marketing our services abroad. There are risks and challenges inherent in conducting business in international markets, such as:

adapting our technologies and services to foreign clients' preferences and customs;

successfully navigating foreign laws and regulations, including marketing, privacy regulations, employment and labor regulations;

changes in foreign political and economic conditions;

tariffs and other trade barriers, fluctuations in currency exchange rates and potentially adverse tax consequences;

language barriers or cultural differences;

reduced or limited protection for intellectual property rights in foreign jurisdictions;

difficulties and costs in staffing, managing or overseeing foreign operations;



education of potential clients who may not be familiar with online marketing;

challenges in collecting accounts receivables; and

successfully interpreting and complying with the U.S. Foreign Corrupt Practices Act and similar worldwide anti-bribery laws, particularly when operating in countries with varying degrees of governmental corruption.

If we are unable to successfully expand and market our services abroad, our business and future growth may be harmed, and we may incur costs that may not lead to future revenue.

***We recognized an impairment in the carrying value of goodwill. Additional such charges in the future could negatively affect our operating results and financial condition.***

We continue to have a substantial amount of goodwill and purchased intangible assets on our balance sheet as a result of historical acquisitions. The carrying value of goodwill represents the fair value of an acquired business in excess of identifiable assets and liabilities as of the acquisition date. The carrying value of intangible assets with identifiable useful lives represents the fair value of relationships, content, domain names, acquired technology, among others, as of the acquisition date, and are amortized based on their economic lives. Goodwill expected to contribute indefinitely to our cash flows is not amortized, but must be evaluated for impairment

## **Table of Contents**

at least annually. If the carrying value exceeds current fair value as determined based on the discounted future cash flows of the related business, the goodwill or intangible asset is considered impaired and is reduced to fair value via a non-cash charge to earnings. Events and conditions that could result in impairment include adverse changes in the regulatory environment, a reduced market capitalization or other factors leading to reduction in expected long-term growth or profitability.

Goodwill impairment analysis and measurement is a process that requires significant judgment. Our stock price and any estimated control premium are factors affecting the assessment of the fair value of our underlying reporting units for purposes of performing any goodwill impairment assessment. For example, our public market capitalization sustained a decline after December 31, 2012 to a value below the net book carrying value of our equity, triggering the need for a goodwill impairment analysis. As a result of our goodwill impairment analysis, we recorded a goodwill impairment charge of \$92.4 million in the second quarter of fiscal year 2013.

It is possible that another material change could occur in the future. We will continue to conduct impairment analyses of our goodwill on an annual basis, unless indicators of possible impairment arise that would cause a triggering event, and we would be required to take additional impairment charges in the future if any recoverability assessments reflect estimated fair values that are less than our recorded values. Further impairment charges with respect to our goodwill could have a material adverse effect on our results of operations and financial condition.

***We could lose clients if we fail to detect click-through or other fraud on advertisements in a manner that is acceptable to our clients.***

We are exposed to the risk of fraudulent clicks or actions on our websites or our third-party publishers' websites, which could lead the clients to become dissatisfied with our campaigns, and in turn, lead to loss of clients and related revenue. Click-through fraud occurs when an individual clicks on an ad displayed on a website or an automated system is used to create such clicks with the intent of generating the revenue share payment to the publisher rather than to view the underlying content. Action fraud occurs when online forms are completed with false or fictitious information in an effort to increase a publisher's compensable actions. From time to time, we have experienced fraudulent clicks or actions. We do not charge our clients for fraudulent clicks or actions when they are detected, and such fraudulent activities could negatively affect our profitability or harm our reputation. If fraudulent clicks or actions are not detected, the affected clients may experience a reduced return on their investment in our marketing programs, which could lead the clients to become dissatisfied with our campaigns, and in turn, lead to loss of clients and the related revenue. Additionally, we have, from time to time, had to, and in the future may have to, terminate relationships with publishers who we believed to have engaged in fraud. Termination of such relationships entails a loss of revenue associated with the legitimate actions or clicks generated by such publishers.

## **Risks Related to the Ownership of Our Common Stock**

***Our stock price has been volatile, and you may not be able to resell shares of our common stock at or above the price you paid.***

The trading price of our common stock has been volatile since our initial public offering and may continue to be subject to wide fluctuations in response to various factors, some of which are beyond our control. These factors include those discussed in this "Risk Factors" section of this periodic report and others such as:

our ability to return to growth and to manage any such growth effectively;

changes in earnings estimates or recommendations by securities analysts;

announcements about our revenue, earnings or other financial results that are not in line with analyst expectations;

our ability to find, develop or retain high quality targeted media on a cost effective basis;

relatively low trading volume in our stock creates inherent volatility regardless of factors related to our business performance or prospects;

the sale of, or indication of the intent to sell, substantial amounts of our common stock by our directors, officers or substantial shareholders;

announcements by us or our competitors of new services, significant contracts, commercial relationships, acquisitions or capital commitments;

---

**Table of Contents**

our commencement of, or involvement in, litigation; and

negative publicity about us, our industry, our clients or our clients' industries.

In recent years, the stock market in general, and the market for technology and Internet-based companies in particular, has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. Broad market and industry factors may seriously affect the market price of our common stock, regardless of our actual operating performance. In addition, in the past, following periods of volatility in the overall market and the market price of a particular company's securities, securities class action litigation has often been instituted against these companies. Such litigation, if instituted against us, could result in substantial costs and a diversion of our management's attention and resources.

***If securities or industry analysts do not publish research or reports about our business, or if they issue an adverse opinion regarding our stock, our stock price and trading volume could decline.***

The trading market for our common stock is influenced by the research and reports that industry or securities analysts publish about us, our business or the industries or businesses of our clients. If any of the analysts issue an adverse opinion regarding our stock or if our actual results do not meet analyst estimates, our stock price would likely decline. If one or more of these analysts ceases coverage of our company or fails to publish reports on us regularly, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

***Our directors and executive officers and their respective affiliates have substantial control over us and could delay or prevent a change in corporate control.***

As of September 30, 2013, our directors and executive officers, together with their affiliates, beneficially owned approximately 28% of our outstanding common stock. As a result, these stockholders, acting together, have substantial control over the outcome of matters submitted to our stockholders for approval, including the election of directors and any merger, consolidation or sale of all or substantially all of our assets. In addition, these stockholders, acting together, have significant influence over the management and affairs of our company. Accordingly, this concentration of ownership may have the effect of:

delaying, deferring or preventing a change in corporate control;

impeding a merger, consolidation, takeover or other business combination involving us; or

discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of us.

***Provisions in our charter documents under Delaware law and in contractual obligations could discourage a takeover that stockholders may consider favorable and may lead to entrenchment of management.***

Our amended and restated certificate of incorporation and bylaws contain provisions that could have the effect of delaying or preventing changes in control or changes in our management without the consent of our board of directors. These provisions include:

a classified board of directors with three-year staggered terms, which may delay the ability of stockholders to change the membership of a majority of our board of directors;

no cumulative voting in the election of directors, which limits the ability of minority stockholders to elect director candidates;

the exclusive right of our board of directors to elect a director to fill a vacancy created by the expansion of the board of directors or the resignation, death or removal of a director, which prevents stockholders from being able to fill vacancies on our board of directors;

the ability of our board of directors to determine to issue shares of preferred stock and to determine the price and other terms of those shares, including preferences and voting rights, without stockholder approval, which could be used to significantly dilute the ownership of a hostile acquirer;

**Table of Contents**

a prohibition on stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;

the requirement that a special meeting of stockholders may be called only by the chairman of the board of directors, the chief executive officer or the board of directors, which may delay the ability of our stockholders to force consideration of a proposal or to take action, including the removal of directors; and

advance notice procedures that stockholders must comply with in order to nominate candidates to our board of directors or to propose matters to be acted upon at a stockholders meeting, which may discourage or deter a potential acquiror from conducting a solicitation of proxies to elect the acquiror's own slate of directors or otherwise attempting to obtain control of us.

We are also subject to certain anti-takeover provisions under Delaware law. Under Delaware law, a corporation may not, in general, engage in a business combination with any holder of 15% or more of its capital stock unless the holder has held the stock for three years or, among other things, the board of directors has approved the transaction.

***We do not currently intend to pay dividends on our common stock and, consequently, your ability to achieve a return on your investment will depend on appreciation in the price of our common stock.***

We currently have not and do not intend to declare and pay dividends on our common stock for in the near term. We currently intend to invest our future earnings, if any, to fund our growth. Additionally, the terms of our credit facility restrict our ability to pay dividends. Therefore, you are not likely to receive any dividends on your common stock in the near term.

**Table of Contents**

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

**Unregistered Sales of Equity Securities**

None.

**Purchases of Equity Securities by QuinStreet**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not Applicable.

**ITEM 5. OTHER INFORMATION**

None.

**Table of Contents**

**ITEM 6. EXHIBITS**

**Exhibit**

| <b>Number</b>       | <b>Description of Document</b>   |
|---------------------|--|
| 10.1 <sup>(1)</sup> | Transition Agreement dated September 18, 2013 between the Company and Scott Mackley.   |
| 10.2 <sup>(1)</sup> | Transition Agreement dated September 18, 2013 between the Company and Bronwyn Syiek.   |
| 10.3*               | Amendment to Consulting Services Agreement dated October 30, 2013 to the Transition Agreement dated September 18, 2013 between the Company and Bronwyn Syiek.                  |
| 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 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS             | XBRL Instance Document   |
| 101.SCH             | XBRL Taxonomy Extension Schema Document  |
| 101.CAL             | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF             | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB             | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE             | XBRL Taxonomy Extension Presentation Linkbase Document   |

<sup>(1)</sup> Incorporated by reference to the same numbered exhibit to QuinStreet, Inc. s Current Report on Form 8-K (SEC File No. 001-34628) filed on September 19, 2013.

\* Filed herewith.  
Furnished herewith.



**Table of Contents**

**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.

QUINSTREET, INC.

/s/ Gregory Wong

Gregory Wong

Chief Financial Officer and Senior Vice

President

(Principal Financial and Accounting Officer  
and duly authorized signatory)

Date: November 6, 2013

**Table of Contents**

**INDEX TO EXHIBITS**

**Exhibit**

| <b>Number</b>       | <b>Description of Document</b>   |
|---------------------|--|
| 10.1 <sup>(1)</sup> | Transition Agreement dated September 18, 2013 between the Company and Scott Mackley.   |
| 10.2 <sup>(1)</sup> | Transition Agreement dated September 18, 2013 between the Company and Bronwyn Syiek.   |
| 10.3*               | Amendment to Consulting Services Agreement dated October 30, 2013 to the Transition Agreement dated September 18, 2013 between the Company and Bronwyn Syiek.                  |
| 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 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS             | XBRL Instance Document   |
| 101.SCH             | XBRL Taxonomy Extension Schema Document  |
| 101.CAL             | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF             | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB             | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE             | XBRL Taxonomy Extension Presentation Linkbase Document   |
| <sup>(1)</sup>      | Incorporated by reference to the same numbered exhibit to QuinStreet, Inc. s Current Report on Form 8-K (SEC File No. 001-34628) filed on September 19, 2013.                  |
| *                   | Filed herewith.<br>Furnished herewith.   |