

NEUSTAR INC  
Form 10-Q  
July 28, 2010

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

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

**For the quarterly period ended June 30, 2010**

**OR**

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

**For the transition period from to**

**Commission file number 001-32548**

**NeuStar, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**52-2141938**

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

**46000 Center Oak Plaza**

**Sterling, Virginia 20166**

(Address of principal executive offices) (zip code)

**(571) 434-5400**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant 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. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Small reporting company

(Do not check if a smaller  
reporting company)

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

There were 75,025,435 shares of Class A common stock, \$0.001 par value, and 3,082 shares of Class B common stock, \$0.001 par value, outstanding at July 26, 2010.



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

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

	<b>December 31, 2009</b>	<b>June 30, 2010 (unaudited)</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 304,581	\$ 341,170
Restricted cash	512	500
Short-term investments	37,610	21,250
Accounts receivable, net of allowance for doubtful accounts of \$1,425 and \$1,281, respectively	64,019	67,334
Unbilled receivables	2,986	5,363
Prepaid expenses and other current assets	11,171	12,624
Deferred costs	6,916	6,429
Income taxes receivable		2,441
Deferred tax assets	6,973	7,110
Total current assets	434,768	464,221
Property and equipment, net	73,881	76,571
Goodwill	118,417	118,417
Intangible assets, net	8,789	6,437
Deferred costs, long-term	1,731	1,147
Deferred tax assets, long-term	5,124	6,334
Other assets, long-term	5,094	5,136
Total assets	\$ 647,804	\$ 678,263

*See accompanying notes.*

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

	<b>December 31, 2009</b>	<b>June 30, 2010 (unaudited)</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 11,872	\$ 3,612
Accrued expenses	60,180	40,618
Income taxes payable	2,764	
Deferred revenue	26,117	30,884
Notes payable	987	
Capital lease obligations	10,235	9,033
Accrued restructuring reserve	2,459	1,904
Other liabilities	3,891	2,016
 Total current liabilities	 118,505	 88,067
 Deferred revenue, long-term	 8,923	 9,133
Capital lease obligations, long-term	10,766	7,257
Accrued restructuring reserve, long-term	1,111	578
Other liabilities, long-term	4,062	4,434
 Total liabilities	 143,367	 109,469
 Commitments and contingencies		
 Stockholders equity:		
Preferred stock, \$0.001 par value; 100,000,000 shares authorized; no shares issued and outstanding as of December 31, 2009 and June 30, 2010		
Class A common stock, par value \$0.001; 200,000,000 shares authorized; 79,425,095 and 79,998,779 shares issued and outstanding at December 31, 2009 and June 30, 2010, respectively		
	79	80
Class B common stock, par value \$0.001; 100,000,000 shares authorized; 3,082 and 3,082 shares issued and outstanding at December 31, 2009 and June 30, 2010, respectively		
Additional paid-in capital	338,109	349,452
Treasury stock, 4,967,979 and 4,986,412 shares at December 31, 2009 and June 30, 2010, respectively, at cost	(128,757)	(129,183)
Accumulated other comprehensive loss	(463)	(799)
Retained earnings	295,469	349,244
 Total stockholders equity	 504,437	 568,794
 Total liabilities and stockholders equity	 \$ 647,804	 \$ 678,263

*See accompanying notes.*

## NEUSTAR, INC.

## UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2009	2010	2009	2010
Revenue:				
Carrier Services	\$ 89,168	\$ 99,021	\$ 177,211	\$ 198,809
Enterprise Services	26,596	29,971	51,741	59,174
Total revenue	115,764	128,992	228,952	257,983
Operating expense:				
Cost of revenue (excluding depreciation and amortization shown separately below)	28,336	29,844	56,179	58,957
Sales and marketing	19,239	22,028	38,746	44,882
Research and development	4,514	3,278	8,827	7,356
General and administrative	14,301	15,653	27,802	34,102
Depreciation and amortization	9,332	10,006	18,577	20,149
Restructuring charges		1,217		3,566
	75,722	82,026	150,131	169,012
Income from operations	40,042	46,966	78,821	88,971
Other (expense) income:				
Interest and other expense	(849)	(1,234)	(2,073)	(2,982)
Interest and other income	1,146	2,029	3,605	3,419
Income before income taxes	40,339	47,761	80,353	89,408
Provision for income taxes	15,873	19,188	31,534	35,633
Net income	\$ 24,466	\$ 28,573	\$ 48,819	\$ 53,775
Net income per share:				
Basic	\$ 0.33	\$ 0.38	\$ 0.66	\$ 0.72
Diluted	\$ 0.32	\$ 0.37	\$ 0.65	\$ 0.71
Weighted average common shares outstanding:				
Basic	74,314	74,997	74,225	74,805
Diluted	75,427	76,217	75,359	76,079

*See accompanying notes.*

## NEUSTAR, INC.

**UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2009</b>	<b>2010</b>
Operating activities:		
Net income	\$ 48,819	\$ 53,775
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	18,577	20,149
Stock-based compensation	8,241	8,894
Amortization of deferred financing costs	84	84
Excess tax benefits from stock option exercises	(483)	(462)
Deferred income taxes	(68)	(2,423)
Provision for doubtful accounts	1,439	871
Gain on available-for-sale investments	(45)	
Gain on trading securities	(446)	(2,992)
(Gain) loss on auction rate securities rights	(464)	2,877
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	6,049	(4,709)
Unbilled receivables	486	(2,377)
Notes receivable	759	
Prepaid expenses and other current assets	(1,061)	(1,259)
Deferred costs	1,887	1,071
Income taxes receivable	2,966	(2,441)
Other assets	(383)	(288)
Other liabilities	488	(1,503)
Accounts payable and accrued expenses	(6,953)	(27,732)
Income taxes payable		(2,302)
Accrued restructuring reserve	(1,597)	(1,088)
Deferred revenue	3,948	4,977
Net cash provided by operating activities	82,243	43,122
Investing activities:		
Purchases of property and equipment	(12,683)	(18,639)
Sales of investments, net	4,298	16,475
Net cash used in investing activities	(8,385)	(2,164)
Financing activities:		
Reduction of restricted cash	19	12
Principal repayments on notes payable	(1,714)	(987)
Principal repayments on capital lease obligations	(5,217)	(6,319)
Proceeds from exercise of common stock options	1,405	3,259
Excess tax benefits from stock-based compensation	483	462
Repurchase of restricted stock awards	(133)	(426)
Net cash used in financing activities	(5,157)	(3,999)



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Effect of foreign exchange rates on cash and cash equivalents	(337)	(370)
Net increase in cash and cash equivalents	68,364	36,589
Cash and cash equivalents at beginning of period	150,829	304,581
Cash and cash equivalents at end of period	\$ 219,193	\$ 341,170

*See accompanying notes.*

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**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2009 AND 2010**

**1. DESCRIPTION OF BUSINESS AND ORGANIZATION**

NeuStar, Inc. (the Company or Neustar) was incorporated as a Delaware corporation in 1998. The Company provides essential technology and directory services to its customers, which are comprised of communications service providers, or carriers, and non-carrier, commercial businesses, or enterprises. The Company was founded to meet the technical and operational challenges of the communications industry when the U.S. government mandated local number portability in 1996. The Company is the provider of the authoritative solution that the communications industry relies upon to meet this mandate and the Company has also developed a broad range of innovative services to meet an expanded range of its customers' needs.

The Company provides critical technology services that its carrier and enterprise customers rely upon to manage a wide range of technical and operating requirements, including the following:

*Carrier Services.* Through its set of unique databases and system infrastructure in geographically dispersed data centers, the Company manages the increasing complexity in the telecommunications industry and ensures the seamless connection of its carrier customers' numerous networks, while also enhancing the capabilities and performance of their infrastructure. The Company operates the authoritative databases that manage virtually all telephone area codes and numbers, and enables the dynamic routing of calls among numerous competing carriers in North America. All carriers that offer telecommunications services to the public at large must access a copy of the Company's unique database to properly route virtually all of their customers' calls. The Company also facilitates order management and work flow processing among carriers, and allows operators to manage and optimize the addressing and routing of emerging Internet Protocol (IP) communications.

*Enterprise Services.* The Company provides a suite of domain name system (DNS) services to its enterprise customers built on a global directory platform. The Company manages a collection of these directories that maintain addresses to direct, prioritize and manage Internet traffic, and find and resolve Internet queries and top-level domains on behalf of its enterprise customers. The Company serves as the authoritative provider of essential registry services and manages directories of similar resources, or addresses, that its customers use for reliable, fair and secure access and connectivity. Additionally, the Company provides directory services for the 5 and 6-digit number strings used for all U.S. Common Short Codes, which is part of the short messaging service relied upon by the U.S. wireless industry.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Unaudited Interim Financial Information**

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The results of operations for the six months ended June 30, 2010 are not necessarily indicative of the results that may be expected for the full fiscal year. The consolidated balance sheet as of December 31, 2009 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009 filed with the Securities and Exchange Commission (SEC).

**Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of

revenue and expense during the reporting periods. Significant estimates and assumptions are inherent in the analysis and the measurement of deferred tax assets; the identification and quantification of income tax liabilities due to uncertain tax positions; restructuring liabilities;

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**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2009 AND 2010**

valuation of investments; recoverability of intangible assets, other long-lived assets and goodwill; and the determination of the allowance for doubtful accounts. The Company bases its estimates on historical experience and assumptions that it believes are reasonable. Actual results could differ from those estimates.

**Reclassifications**

In the first quarter of 2010, the Company changed its presentation of revenues to conform to its operating segments by customer type (see Note 10). Prior quarter revenues have been reclassified to conform to the current quarter presentation.

**Segment Reporting**

Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker (CODM) in deciding how to allocate resources and in assessing performance. Prior to the first quarter of 2010, the Company reported its results of operations based on two operating segments: Clearinghouse and Next Generation Messaging (NGM). In the first quarter of 2010, the Company realigned its operating structure and internal financial reporting by customer type, reflective of how the CODM allocates resources and assesses performance. This realignment along customer type resulted in two operating segments: Carrier Services and Enterprise Services. The Company's operating segments are the same as its reportable segments.

**Fair Value of Financial Instruments**

The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic Financial Instruments requires disclosures of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value. Due to their short-term nature, the carrying amounts reported in the accompanying consolidated financial statements approximate the fair value for cash and cash equivalents, accounts receivable, accounts payable and accrued expenses.

At June 30, 2010, the Company held auction rate securities (ARS) with a remaining original par value of \$21.3 million that were classified as short-term investments. In November 2008, the Company accepted a settlement offer in the form of a rights offering (ARS Rights) which provided the Company with rights to sell its ARS at par value during a two year period beginning June 30, 2010 to the investment firm that brokered the Company's original purchases. On June 30, 2010, the Company exercised its ARS Rights. The sale of the ARS settled on July 1, 2010 and the Company received \$21.3 million, the remaining par value of the ARS.

As permitted under the FASB ASC Topic Financial Instruments, the Company elected fair value measurement for the ARS Rights. The Company determined the fair value of its ARS using an average of discounted cash flow models (see Note 4). The fair value of the Company's ARS Rights was based on the estimated discounted cash flow of the associated ARS (see Note 4).

The estimated fair values of the Company's financial instruments are as follows (in thousands):

	<b>December 31, 2009</b>		<b>June 30, 2010</b>	
	<b>Carrying Amount</b>	<b>Fair Value</b>	<b>Carrying Amount</b>	<b>Fair Value</b>
Cash and cash equivalents	\$304,581	\$304,581	\$341,170	\$341,170
Restricted cash (current assets)	\$ 512	\$ 512	\$ 500	\$ 500
Short-term investments	\$ 37,610	\$ 37,610	\$ 21,250	\$ 21,250
Marketable securities (long-term other assets)	\$ 1,665	\$ 1,665	\$ 2,831	\$ 2,831
Deferred compensation (long-term other liabilities)	\$ 1,682	\$ 1,682	\$ 2,806	\$ 2,806

**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2009 AND 2010**

**Investments**

The Company periodically evaluates whether any declines in the fair value of its investments are other-than-temporary. This evaluation consists of a review of several factors, including but not limited to: the length of time and extent that a security has been in an unrealized loss position; the existence of an event that would impair the issuer's future earnings potential; the near-term prospects for recovery of the market value of a security; the Company's intent to sell an impaired security; and the probability that the Company will be required to sell the security before the market value recovers. If an investment which the Company does not intend to sell prior to recovery declines in value below its amortized cost basis and it is not more likely than not that the Company will be required to sell the related security before the recovery of its amortized cost basis, the Company recognizes the difference between the present value of the cash flows expected to be collected and the amortized cost basis, or credit loss, as an other-than-temporary charge in interest and other expense. The difference between the estimated fair value and the security's amortized cost basis at the measurement date related to all other factors is reported as a separate component of accumulated other comprehensive loss.

The Company's investments classified as trading are carried at estimated fair value with unrealized gains and losses reported in other (expense) income. At December 31, 2009 and June 30, 2010, the Company classified its ARS as trading pursuant to the Investments—Debt and Equity Securities Topic of the FASB ASC, with changes in the fair value of these securities recorded in earnings (see Note 3). Interest and dividends on these securities were included in interest and other income. On June 30, 2010, the Company exercised its ARS Rights. The sale of the ARS settled on July 1, 2010 and the Company received \$21.3 million, the remaining par value of the ARS.

**Revenue Recognition**

The Company provides essential technology and directory services to carrier and enterprise customers pursuant to various private commercial and government contracts. The Company's revenue recognition policies are in accordance with the Revenue Recognition Topic of the FASB ASC.

**Significant Contracts**

The Company provides number portability administration center services (NPAC Services) which include wireline and wireless number portability, implementation of the allocation of pooled blocks of telephone numbers and network management services in the United States pursuant to seven contracts with North American Portability Management LLC (NAPM), an industry group that represents all telecommunications service providers in the United States. The aggregate fees for transactions processed under these contracts are determined by an annual fixed-fee pricing model under which the annual fixed-fee (Base Fee) was set at \$340.0 million and \$362.1 million in 2009 and 2010, respectively, and is subject to an annual price escalator of 6.5% in subsequent years. These contracts also provide for a fixed credit of \$40.0 million in 2009, \$25.0 million in 2010 and \$5.0 million in 2011, which will be applied to reduce the Base Fee for the applicable year. Additional credits of up to \$15.0 million annually in 2009, 2010 and 2011 may be earned if the customers under these contracts reach certain levels of aggregate telephone number inventories and adopts and implements certain IP fields and functionality. To the extent any available additional credits expire unused at the end of the year, they will be recognized in revenue at that time. The Company determines the fixed and determinable fee under these contracts on an annual basis at the beginning of each year and recognizes this fee on a straight-line basis over twelve months.

For 2009, the Company concluded that the fixed and determinable fee equaled \$285.0 million, which represented the Base Fee of \$340.0 million reduced by the \$40.0 million fixed credit and \$15.0 million of available additional credits. During 2009, the Company's carrier customers adopted and implemented the requisite IP fields and functionality, and as a result earned \$7.5 million of the additional credits for each of 2009, 2010 and 2011. However, the customers did not reach the levels of aggregate telephone number inventories required to earn additional credits and as a result, the Company recognized \$7.5 million of additional revenue in the fourth quarter of 2009. These contracts also enable the Company's customers to earn credits if the volume of transactions in a given year is above or below the contractually established volume range for that year. The determination of credits earned based on

transaction volume is done annually at the end of the year and these credits are applied to the following year's invoices. There were no credits earned in 2009 by the Company's customers for transaction volumes above or below the contractually established volume range for 2009. For 2010, the fixed and determinable fee equals \$322.1 million,

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**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
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which represents the Base Fee of \$362.1 million, reduced by the \$25.0 million fixed credit and \$15.0 million of additional credits. The Company records the fixed and determinable fee as revenue earned in its Carrier Services operating segment.

The amount of revenue derived under the Company's contracts with NAPM was approximately \$74.0 million and \$84.2 million for the three months ended June 30, 2009 and 2010, respectively, and \$148.1 million and \$169.0 million for the six months ended June 30, 2009 and 2010, respectively.

The Company also bills a Revenue Recovery Collections fee equal to a percentage of monthly billings to its customers, which is available to the Company if any customer under the contracts to provide NPAC Services fails to pay its allocable share of total transactions charges.

***Carrier Services***

Under its seven contracts with NAPM, the Company provides NPAC Services. As discussed above under the heading Revenue Recognition Significant Contracts, the Company determines the fixed and determinable fee on an annual basis and recognizes such fee on a straight-line basis over twelve months.

The Company provides NPAC Services in Canada under its long-term contract with the Canadian LNP Consortium Inc. The Company recognizes revenue on a per-transaction fee basis as the services are performed.

The Company generates revenue from its telephone number administration services under two government contracts: North American Numbering Plan Administrator (NANPA) and National Pooling Administrator (NPA). Under its NANPA contract, the Company earns a fixed annual fee and recognizes this fee as revenue on a straight-line basis as services are provided. Under its NPA contract, the Company earns a fixed price associated with administration of the pooling system. The Company recognizes revenue for this contract on a straight-line basis over the term of the contract. In the event the Company estimates losses on these fixed price contracts, the Company recognizes these losses in the period in which a loss becomes apparent.

The Company provides Order Management Services, consisting of customer set-up and implementation followed by transaction processing, under contracts with terms ranging from one to three years. Customer set-up and implementation is not considered a separate deliverable; accordingly, the fees for these services are deferred and recognized as revenue on a straight-line basis over the term of the contract. Per-transaction fees are recognized as the transactions are processed.

The Company generates revenue from its converged messaging services under contracts with global mobile operators that range from one to three years. These contracts consist of fees for set-up and implementation and include either user subscription fees based on the number of subscribers that use mobile instant messaging services, or license fees based on the number of subscribers that use mobile instant messaging services. Customer set-up and implementation is not considered a separate deliverable; accordingly, the fees for these services are deferred and recognized as revenue on a straight-line basis over the remaining term of the contract following delivery of the set-up and implementation services. The Company recognizes user subscription fee revenue on a monthly basis over the term of the contract after completion of customer set-up and implementation. The Company recognizes license fee revenue on a straight-line basis over the term of the contract after completion of customer set-up and implementation.

The Company generates revenue from connection fees and system enhancements under its contracts with NAPM. The Company recognizes connection fee revenue as the service is performed. System enhancements are provided under contracts in which the Company is reimbursed for costs incurred plus a fixed fee, and revenue is recognized based on costs incurred plus a pro rata amount of the fee.

***Enterprise Services***

The Company generates revenue from the management of internal and external DNS services. The Company's revenue from these services consists of customer set-up fees, monthly recurring fees and per-transaction fees for transactions in excess of pre-established monthly minimums under contracts with terms ranging from one to three years. Customer set-up fees are not





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considered a separate deliverable and are deferred and recognized on a straight-line basis over the term of the contract. Under the Company's contracts to provide DNS services, customers have contractually established monthly transaction volumes for which they are charged a recurring monthly fee. Transactions processed in excess of the pre-established monthly volume are billed at a contractual per-transaction rate. Each month, the Company recognizes the recurring monthly fee and usage in excess of the established monthly volume on a per-transaction basis as services are provided.

The Company generates revenue related to its Internet domain name registry services under contracts with terms generally between one and ten years. The Company recognizes revenue on a straight-line basis over the term of the related customer contracts.

The Company generates revenue from its U.S. Common Short Code services under short-term contracts ranging from three to twelve months, and the Company recognizes revenue on a straight-line basis over the term of the customer contracts.

***Service Level Standards***

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

**Income Taxes**

The Company accounts for income taxes in accordance with the Income Taxes Topic of the FASB ASC. Deferred tax assets and liabilities are determined based on temporary differences between the financial reporting bases and the tax bases of assets and liabilities. Deferred tax assets are also recognized for tax net operating loss carryforwards. These deferred tax assets and liabilities are measured using the enacted tax rates and laws that will be in effect when such amounts are expected to be reversed or utilized. Valuation allowances are provided to reduce such deferred tax assets to amounts more likely than not to ultimately be realized.

Income tax provision includes U.S. federal, state, local and foreign income taxes and is based on pre-tax income or loss. In determining the projected annual effective income tax rate, the Company analyzed various factors, including the Company's annual earnings and taxing jurisdictions in which the earnings will be generated, the impact of state and local income taxes and the ability of the Company to use tax credits and net operating loss carryforwards.

The Company assesses uncertain tax positions in accordance with income tax accounting standards. Under these standards, income tax benefits should be recognized when, based on the technical merits of a tax position, the Company believes that if a dispute arose with the taxing authority and were taken to a court of last resort, it is more likely than not (*i.e.*, a probability of greater than 50 percent) that the tax position would be sustained as filed. If a position is determined to be more likely than not of being sustained, the Company recognizes the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority. The Company's practice is to recognize interest and penalties related to income tax matters in income tax expense.

**Recent Accounting Pronouncements**

In September 2009, the FASB ratified Accounting Standard Update (ASU) 2009-13, Revenue Recognition Topic 605 Multiple-Deliverable Revenue Arrangements (ASU 2009-13). When vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, the Company will be required to develop a best estimate of the selling price for separate deliverables and allocate arrangement consideration using the relative selling price method. ASU 2009-13 is effective for revenue arrangements entered into or materially modified beginning January 1, 2011, with earlier application permitted. The Company is currently evaluating the impact of adoption on its consolidated financial statements.

In January 2010, the FASB issued guidance amending the disclosure requirements related to recurring and non-recurring fair value measurements. The guidance requires new disclosures on the transfers of assets and liabilities between Level 1 inputs



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**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
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(quoted prices in active market for identical assets or liabilities) and Level 2 inputs (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires separate disclosure of purchases, sales, issuance and settlements of assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). This standard is effective for all interim and year-end financial statements issued after January 1, 2010, except for the disclosure on the activities for Level 3 fair value measurements, which is effective for all interim and year-end financial statements issued after January 1, 2011. The Company does not currently expect the adoption of this guidance to have a material impact on its consolidated financial statements.

### **3. INVESTMENTS**

#### ***Cash Reserve Fund***

In December 2007, the Company's investment in a cash reserve fund, classified as an available-for-sale investment, was closed to new investments and subject to scheduled redemptions as determined by the cash reserve fund. Unrealized losses on the cash reserve fund represented an other-than-temporary impairment and were charged to earnings. During the year ended December 31, 2009, \$11.3 million was redeemed from this cash reserve fund and the Company recognized gains from redemptions of \$0.5 million. The Company's investment in this fund was completely liquidated as of December 31, 2009.

#### ***Auction Rate Securities and Rights***

As of June 30, 2010, the Company held investments with an original par value of \$21.3 million that consist of auction rate securities (ARS) whose underlying assets are student loans, the majority of which are guaranteed by the federal government. In November 2008, the Company accepted a settlement offer in the form of a rights offering (ARS Rights) by the investment firm that brokered the Company's original purchases of the ARS, which provided the Company with rights to sell these securities at par value to the investment firm during a two year period beginning June 30, 2010. On June 30, 2010, the Company exercised its ARS Rights. The sale of the ARS settled on July 1, 2010 and the Company received the remaining original par value of the ARS of \$21.3 million. At December 31, 2009 and June 30, 2010, the Company's estimated fair values of its ARS and ARS Rights of \$37.6 million and \$21.3 million, respectively, were recorded in short-term investments in the Company's consolidated balance sheets.

The Company elected to measure the ARS Rights at their fair value pursuant to the Financial Instruments Topic of the FASB ASC and to classify the associated ARS as trading securities. During the three and six months ended June 30, 2009, the Company recorded a loss of \$0.4 million and a gain of \$0.5 million, respectively, related to the change in estimated fair value of the ARS Rights. During the three and six months ended June 30, 2010, the Company recorded losses of \$1.8 million and \$2.9 million, respectively, related to the change in estimated fair value of the ARS Rights.

Under the terms of the ARS Rights, if the investment firm was successful in selling any ARS prior to June 30, 2010, the investment firm was obligated to pay the Company par value for the related ARS sold. During the three and six months ended June 30, 2009, the investment firm sold ARS with an original par value of \$150,000 and \$150,000, respectively; the Company received this amount in cash from the investment firm and recognized realized gains of \$51,000 and \$51,000, respectively. During the three and six months ended June 30, 2010, the investment firm sold ARS with an original par value of \$15.8 million and \$16.5 million, respectively, and the Company received this amount in cash from the investment firm and recognized realized gains of \$2.0 million and \$2.1 million respectively.

During the three and six months ended June 30, 2009, the Company recorded \$0.9 million and \$0.4 million, respectively, in income to earnings to recognize gains on the ARS related to the change in estimated fair value of the ARS. During the three and six months ended June 30, 2010, the Company recorded a loss of \$0.1 million and a gain of \$0.9 million, respectively, related to the change in estimated fair value of the ARS.

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**4. FAIR VALUE MEASUREMENTS**

The Fair Value Measurements and Disclosure Topic of the FASB ASC establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value and requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

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

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

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

The Company evaluates assets and liabilities subject to fair value measurements on a recurring and non-recurring basis to determine the appropriate level at which to classify them for each reporting period. This determination requires significant judgments to be made.

**Assets and Liabilities Measured at Fair Value on a Recurring Basis**

The following table sets forth the Company's financial and non-financial assets and liabilities that are measured at fair value on a recurring basis, by level within the fair value hierarchy (in thousands):

	<b>December 31, 2009</b>			<b>Total</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
Auction rate securities – trading securities (short-term investments)	\$	\$	\$ 30,718	\$ 30,718
Auction rate securities rights (short-term investments)	\$	\$	\$ 6,892	\$ 6,892
Marketable securities <sup>(1)</sup>	\$ 1,665	\$	\$	\$ 1,665
Deferred compensation <sup>(2)</sup>	\$ 1,682	\$	\$	\$ 1,682
	<b>June 30, 2010</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Auction rate securities – trading securities (short-term investments)	\$	\$	\$ 17,235	\$ 17,235
Auction rate securities rights (short-term investments)	\$	\$	\$ 4,015	\$ 4,015
Marketable securities <sup>(1)</sup>	\$ 2,831	\$	\$	\$ 2,831
Deferred compensation <sup>(2)</sup>	\$ 2,806	\$	\$	\$ 2,806

(1) The NeuStar, Inc. Deferred Compensation Plan (the Plan) provides directors and certain employees with the ability to defer a portion

of their  
compensation.  
The assets of the  
Plan are  
invested in  
marketable  
securities that  
are held in a  
Rabbi Trust and  
reported at  
market value in  
other assets.

- (2) Obligations to  
pay benefits  
under the Plan  
are included in  
other long-term  
liabilities.

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

	<b>Auction Rate Securities</b>	<b>ARS Rights</b>
Balance on December 31, 2009	\$ 30,718	\$ 6,892
Transfers in and/or (out) of Level 3		
Total gains (losses) realized / unrealized included in earnings	2,992	(2,877)
Total unrealized gains included in accumulated other comprehensive loss		
Purchases, sales, issuances and settlements, net	(16,475)	
Balance on June 30, 2010	\$ 17,235	\$ 4,015

The valuation technique used to measure fair value for the Level 3 ARS was the average of the values obtained using discounted cash flow valuation methods. The discounted cash flow valuation methods involved management's judgment and assumptions regarding discount rates, coupon rates, estimated maturity for each of the ARS and judgment regarding the selection of comparable transactions in a secondary market. The valuation technique used to measure fair value of the ARS Rights was the discounted cash flow valuation method, which involved judgment and assumptions regarding the timing of cash flows, fair value of the underlying ARS and the ability of the investment firm to settle its obligation in accordance with the ARS Rights.

## **5. GOODWILL AND INTANGIBLE ASSETS**

### ***Goodwill***

In the first quarter of 2010, the Company realigned its operations into the following two operating segments: Carrier Services and Enterprise Services. This realignment changed the composition of the Company's reporting units and resulted in the reassignment of goodwill to the reporting units affected. The goodwill attributable to the Company's former NGM reporting unit has been assigned to a single reporting unit. The Company's goodwill attributable to the former Clearinghouse reporting unit has been allocated among the Company's current reporting units using a relative fair value approach.

The Company's historical goodwill disclosures have been recast for comparative purposes to reflect its new operating segments. The carrying amount of goodwill by operating segment as of December 31, 2009 and June 30, 2010 is as follows (in thousands):

	<b>Carrier Services</b>	<b>Enterprise Services</b>	<b>Total</b>
Balance at December 31, 2009:			
Goodwill	\$ 202,055	\$ 9,964	\$ 212,019
Accumulated impairment losses	(93,602)		(93,602)
	\$ 108,453	\$ 9,964	\$ 118,417
Balance at June 30, 2010:			
Goodwill	\$ 202,055	\$ 9,964	\$ 212,019
Accumulated impairment losses	(93,602)		(93,602)
	\$ 108,453	\$ 9,964	\$ 118,417



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**Intangible Assets**

Intangible assets consist of the following (in thousands):

	<b>December</b>	<b>June 30,</b>	<b>Weighted-</b>
	<b>31,</b>	<b>2010</b>	<b>Average</b>
	<b>2009</b>		<b>Amortization</b>
			<b>Period</b>
			<b>(in years)</b>
Intangible assets:			
Customer lists and relationships	\$ 36,659	\$ 36,659	5.6
Accumulated amortization	(29,483)	(31,566)	
Customer lists and relationships, net	7,176	5,093	
Acquired technology	17,744	17,744	3.3
Accumulated amortization	(16,131)	(16,400)	
Acquired technology, net	1,613	1,344	
Trade name	200	200	3.0
Accumulated amortization	(200)	(200)	
Trade name, net			
Intangible assets, net	\$ 8,789	\$ 6,437	

Amortization expense, which is included in depreciation and amortization expense, was approximately \$1.9 million and \$1.2 million for the three months ended June 30, 2009 and 2010, respectively, and \$4.2 million and \$2.4 million for the six months ended June 30, 2009 and 2010, respectively. Amortization expense related to intangible assets for the years ended December 31, 2010, 2011, 2012 and 2013 is expected to be approximately \$4.7 million, \$2.4 million, \$1.5 million and \$0.2 million, respectively. Intangible assets as of June 30, 2010 will be fully amortized during the year ended December 31, 2013.

**6. NOTES PAYABLE**

On February 6, 2007, the Company entered into a credit agreement which provides for a revolving credit facility in an aggregate principal amount of up to \$100 million (the Credit Facility). Borrowings under the Credit Facility bear interest, at the Company's option, at either a Eurodollar rate plus a spread ranging from 0.625% to 1.25%, or at a base rate plus a spread ranging from 0.0% to 0.25%, with the amount of the spread in each case depending on the ratio of the Company's consolidated senior funded indebtedness to consolidated earnings before interest, taxes, depreciation and amortization (EBITDA). The Credit Facility expires on February 6, 2012. Borrowings under the Credit Facility may be used for working capital, capital expenditures, general corporate purposes and to finance acquisitions. There were no borrowings outstanding under the Credit Facility as of December 31, 2009 and June 30, 2010, but available borrowings were reduced by outstanding letters of credit of \$9.0 million and \$8.8 million, respectively.



The Credit Facility contains customary representations and warranties, affirmative and negative covenants, and events of default. The Credit Facility requires the Company to maintain a minimum ratio of consolidated EBITDA to consolidated interest charge and a maximum ratio of consolidated senior funded indebtedness to consolidated EBITDA. If an event of default occurs and is continuing, the Company may be required to repay all amounts outstanding under the Credit Facility. Lenders holding more than 50% of the loans and commitments under the Credit Facility may elect to accelerate the maturity of amounts due under the Credit Facility upon the occurrence and during the continuation of an event of default. As of and for the year ended December 31, 2009, and the six months ended June 30, 2010, the Company was in compliance with these covenants.

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**7. STOCKHOLDERS EQUITY**

**Stock-Based Compensation**

The Company has three stock incentive plans, the NeuStar, Inc. 1999 Equity Incentive Plan (1999 Plan), the NeuStar, Inc. 2005 Stock Incentive Plan (2005 Plan), and the NeuStar, Inc. 2009 Stock Incentive Plan (2009 Plan) (collectively, the Plans). The Company may grant to its directors, employees and consultants awards under the 2009 Plan in the form of incentive stock options, nonqualified stock options, stock appreciation rights, shares of restricted stock, restricted stock units, performance vested restricted stock units (PVRsUs) and other stock-based awards. The aggregate number of shares of Class A common stock with respect to which all awards may be granted under the 2009 Plan is 10,950,000, plus the number of shares underlying awards granted under the 1999 Plan and the 2005 Plan that remain undelivered following any expiration, cancellation or forfeiture of such awards. As of June 30, 2010, 8,682,802 shares were available for grant or award under the 2009 Plan.

The term of any stock option granted under the Plans may not exceed ten years. The exercise price per share for options granted under the Plans may not be less than 100% of the fair market value of the common stock on the option grant date. The board of directors or Compensation Committee of the board of directors determines the vesting schedule of the options, with a maximum vesting period of ten years. Options issued generally vest with respect to 25% of the shares underlying the option on the first anniversary of the grant date and 2.083% of the shares on the last day of each succeeding calendar month thereafter. The options expire seven to ten years from the date of issuance and are forfeitable upon termination of an option holder's service.

The Company has granted and may in the future grant restricted stock to directors, employees and consultants. The board of directors or Compensation Committee of the board of directors determines the vesting schedule of the restricted stock, with a maximum vesting period of ten years. Restricted stock issued generally vests in equal annual installments over a four-year term.

Stock-based compensation expense recognized for the three months ended June 30, 2009 and 2010 was \$4.5 million and \$5.0 million, respectively, and \$8.2 million and \$8.9 million for the six months ended June 30, 2009 and 2010, respectively. As of June 30, 2010, total unrecognized compensation expense related to non-vested stock options, non-vested restricted stock and non-vested PVRsUs granted prior to that date is estimated at \$41.1 million, which the Company expects to recognize over a weighted average period of approximately 1.71 years. Total unrecognized compensation expense as of June 30, 2010 is estimated based on outstanding non-vested stock options, non-vested restricted stock and non-vested PVRsUs, and may be increased or decreased in future periods for subsequent grants or forfeitures.

**Stock Options**

The Company utilizes the Black-Scholes option pricing model for estimating the fair value of stock options granted. The weighted-average grant date fair value of options granted during the three months ended June 30, 2009 and 2010 was \$7.15 and \$8.55, respectively, and for options granted during the six months ended June 30, 2009 and 2010 was \$6.08 and \$8.10, respectively. The following are the weighted-average assumptions used in valuing the stock options granted during the three and six months ended June 30, 2009 and 2010, and a discussion of the Company's assumptions:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>
	%	%	%	%
Dividend yield				
Expected volatility	42.71%	38.53%	44.01%	39.26%
Risk-free interest rate	1.68%	2.27%	1.50%	2.18%
Expected life of options (in years)	4.42	4.42	4.42	4.42

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

**Expected volatility** Volatility is a measure of the amount by which a financial variable such as a share price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. The Company considered the

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implied volatility and historical volatility of its stock price over a term similar to the expected life of the grant in determining its expected volatility.

**Risk-free interest rate** The risk-free interest rate is based on U.S. Treasury bonds issued with similar life terms to the expected life of the grant.

**Expected life of the options** The expected life is the period of time that options granted are expected to remain outstanding. The Company determined the expected life of stock options based on the weighted average of (a) the time-to-settlement from grant of historically settled options and (b) a hypothetical holding period for the outstanding vested options as of the date of fair value estimation. The hypothetical holding period is the amount of time the Company assumes a vested option will be held before the option is exercised. To determine the hypothetical holding period, the Company assumes that a vested option will be exercised at the midpoint of the time between the date of fair value estimation and the remaining contractual life of the unexercised vested option.

The following table summarizes the Company's stock option activity:

	<b>Shares</b>	<b>Weighted-Average Exercise Price</b>	<b>Aggregate Intrinsic Value (in millions)</b>	<b>Weighted-Average Remaining Contractual Life (in years)</b>
Outstanding at December 31, 2009	5,951,258	\$19.37		
Options granted	1,740,925	22.91		
Options exercised	(311,469)	10.46		
Options forfeited	(329,536)	23.89		
Outstanding at June 30, 2010	7,051,178	\$20.43	\$ 25.1	4.89
Exercisable at June 30, 2010	3,485,207	\$19.49	\$ 20.3	3.64

The aggregate intrinsic value of options exercised for the six months ended June 30, 2009 and 2010 was \$3.7 million and \$4.4 million, respectively.

**Restricted Stock**

The following table summarizes the Company's non-vested restricted stock activity for the six months ended June 30, 2010:

	<b>Shares</b>	<b>Weighted-Average Grant Date Fair Value</b>	<b>Aggregate Intrinsic Value (in millions)</b>
Outstanding at December 31, 2009	353,157	\$22.64	
Restricted stock granted	287,890	22.92	
Restricted stock vested	(50,227)	23.90	
Restricted stock forfeited	(25,675)	22.77	

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Outstanding at June 30, 2010	565,145	\$22.83	\$ 11.7
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The total aggregate intrinsic value of restricted stock vested during the six months ended June 30, 2010 was approximately \$1.2 million. During the three and six months ended June 30, 2010, the Company repurchased 5,354 and 18,432 shares of common stock for an aggregate purchase price of \$0.1 million and \$0.4 million, respectively, pursuant to the participants' rights under the Company's stock incentive plans to elect to use common stock to satisfy their tax withholding obligations.

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**Performance Vested Restricted Stock Units**

During the years ended 2008 and 2009, the Company granted 291,083, and 532,943 PVRsUs, respectively, to certain employees with an aggregate fair value of \$7.6 million, and \$8.3 million, respectively. During the three months ended March 31, 2010, the Company granted 265,230 PVRsUs to certain employees with an aggregate fair value of \$6.1 million. No PVRsUs were granted during the three months ended June 30, 2010. The vesting of these stock awards is contingent upon the Company achieving specified financial targets at the end of the specified performance period and an employee's continued employment. The level of achievement of the performance conditions affects the number of shares that will ultimately be issued. The range of possible stock-based award vesting is between 0% and 150% of the initial target. Compensation expense related to these awards is being recognized over the requisite service period based on the Company's estimate of the achievement of the performance target. The Company currently estimates that 0% of the performance target for PVRsUs granted during 2008 will be achieved, 135% of the performance target for PVRsUs granted during 2009 will be achieved and 100% of the performance target for PVRsUs granted during 2010 will be achieved. In the first quarter of 2010, the Company revised its estimate of achievement of the performance target related to the PVRsUs granted during 2008 from 50% of target to 0% of target. In addition, the Company revised its estimate of achievement of the performance target related to the PVRsUs granted during 2009 from 100% of target to 135% of target.

The Company's consolidated net income for the three and six months ended June 30, 2010 was \$28.6 million and \$53.8 million, respectively, and diluted earnings per share was \$0.37 and \$0.71 per share, respectively. If the Company had continued to use the previous estimate of achievement of 50% of the performance target for PVRsUs granted during 2008, the as adjusted net income for the three and six months ended June 30, 2010 would have been approximately \$28.5 million and \$52.7 million, respectively, and the as adjusted diluted earnings per share would have been approximately \$0.37 and \$0.69 per share, respectively. If the Company had continued to use the previous estimate of achievement of 100% of the performance target for its PVRsUs granted during 2009, the as adjusted net income for the three and six months ended June 30, 2010 would have been approximately \$28.7 million and \$54.4 million, respectively, and the as adjusted diluted earnings per share would have been approximately \$0.38 and \$0.72 per share, respectively. If the Company had continued to use the previous estimates of achievement for PVRsUs granted during 2008 and 2009, the as adjusted net income would have been approximately \$28.6 million and \$53.3 million, respectively, and the as adjusted diluted earnings per share would have been approximately \$0.38 and \$0.70 per share, respectively.

The fair value of a PVRsU is measured by reference to the closing market price of the Company's common stock on the date of the grant. Compensation expense is recognized on a straight-line basis over the requisite service period based on the number of PVRsUs expected to vest.

The following table summarizes the Company's non-vested PVRsU activity for the six months ended June 30, 2010:

	<b>Shares</b>	<b>Weighted-Average Grant Date Fair Value</b>	<b>Aggregate Intrinsic Value (in millions)</b>
Non-vested December 31, 2009	839,786	\$21.17	
Granted	265,230	22.82	
Vested			
Forfeited	(196,748)	29.95	

Non-vested June 30, 2010	908,268	\$19.75	\$ 18.7
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**Restricted Stock Units**

The following table summarizes the Company's restricted stock units activity for the six months ended June 30, 2010:

	<b>Shares</b>	<b>Weighted-Average Grant Date Fair Value</b>	<b>Aggregate Intrinsic Value (in millions)</b>
Outstanding at December 31, 2009	163,111	\$25.13	
Granted			
Vested			
Forfeited			
Outstanding at June 30, 2010	163,111	\$25.13	\$ 3.4

These restricted stock units were issued to non-management directors of the Company's board of directors and will fully vest on the first anniversary of the date of grant or the day preceding the date in the following calendar year on which the Company's annual meeting of stockholders is held. Upon vesting, each director's restricted stock units will be automatically converted into deferred stock units, which will be delivered to the director in shares of the Company's stock six months following the director's termination of Board service.

**Share Repurchase Program**

The Company announced on July 28, 2010 that its Board of Directors had authorized a three-year program to acquire up to \$300 million of its outstanding Class A common shares. Share repurchases under this program may be made through 10b5-1 programs, open market purchases, privately negotiated transactions or otherwise as market conditions warrant, at prices the Company deems appropriate, and subject to applicable legal requirements and other factors.

**8. BASIC AND DILUTED NET INCOME PER COMMON SHARE**

The following table provides a reconciliation of the numerators and denominators used in computing basic and diluted net income per common share (in thousands, except per share data):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>
Computation of basic net income per common share:				
Net income	\$ 24,466	\$ 28,573	\$ 48,819	\$ 53,775
Weighted average common shares and participating securities outstanding - basic	74,314	74,997	74,225	74,805
Basic net income per common share	\$ 0.33	\$ 0.38	\$ 0.66	\$ 0.72
Computation of diluted net income per common share:				
Net income	\$ 24,466	\$ 28,573	\$ 48,819	\$ 53,775



Weighted average common shares and participating securities outstanding basic	74,314	74,997	74,225	74,805
Effect of dilutive securities:				
Stock-based awards	1,113	1,220	1,134	1,274
Weighted average common shares outstanding diluted	75,427	76,217	75,359	76,079
Diluted net income per common share	\$ 0.32	\$ 0.37	\$ 0.65	\$ 0.71

Diluted earnings per common share reflects the potential dilution of common stock equivalents such as options and warrants, to the extent the impact is dilutive. The dilutive effect of common stock options to purchase an aggregate of 4,152,194 and 4,505,320 shares were excluded from the calculation of the denominator for diluted net income per common share due to their anti-dilutive effect for the three months ended June 30, 2009 and 2010, respectively. The dilutive effect of common stock options to purchase an aggregate of 4,133,733 and 4,059,395 shares were excluded from the calculation of the denominator for

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diluted net income per common share due to their anti-dilutive effect for the six months ended June 30, 2009 and 2010, respectively.

**9. COMPREHENSIVE INCOME**

Comprehensive income is comprised of net earnings and other comprehensive income, which includes certain changes in equity that are excluded from income.

The following table summarizes the components of total comprehensive income, net of taxes, during the three and six months ended June 30, 2009 and 2010 (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>
Net income	\$ 24,466	\$ 28,573	\$ 48,819	\$ 53,775
Unrealized loss / gain on investments	385	(130)	453	(86)
Accumulated translation adjustments	549	(236)	(41)	(250)
Total comprehensive income	\$ 25,400	\$ 28,207	\$ 49,231	\$ 53,439

The following table summarizes the tax (provision) or benefit for each component of total comprehensive income during the three and six months ended June 30, 2009 and 2010 (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>
Tax (provision) benefit:				
Unrealized loss / gain on investments	\$ (54)	\$ 103	\$ (55)	\$ 75
Accumulated translation adjustments	\$ (326)	\$ 127	\$ 296	\$ 120

**10. SEGMENT INFORMATION**

In the first quarter of 2010, the Company realigned its operating structure and internal financial reporting by customer type: Carrier Services and Enterprise Services, reflective of how the CODM allocates resources and assesses performance. The Company's operating segments are the same as its reportable segments.

The Company's Carrier Services operating segment provides the seamless connection of its carrier customers numerous networks, while also enhancing the capabilities and performance of their customer's infrastructure. The Company enables its carrier customers to use, exchange and share critical resources, such as telephone numbers, facilitate order management and work flow processing among carriers, and allow operators to manage and optimize the addressing and routing of emerging IP communications.

The Company's Enterprise Services operating segment provides services to its enterprise customers to meet their respective directory-related needs. The Company provides a suite of DNS services to its enterprise customers built on a global directory platform. The Company manages a collection of these directories that maintain addresses to direct, prioritize and manage Internet traffic, and find and resolve Internet queries and top-level domains on behalf of its enterprise customers. The Company serves as the authoritative provider of essential registry services and manages directories of similar resources, or addresses, that its customers use for reliable, fair and secure access and connectivity. Additionally, the Company provides directory services for the 5 and 6-digit number strings used for all U.S. Common Short Codes, which is part of the short messaging service relied upon by the U.S. wireless industry.

The Company reports segment information based on the management approach which relies on the internal performance measures used by the CODM to assess the performance of each operating segment in a given period. In connection with that



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assessment, the CODM reviews revenues and segment contribution which excludes certain unallocated costs within the following expense classifications: cost of revenue, sales and marketing, research and development and general and administrative. Depreciation and amortization and restructuring charges are also excluded from segment contribution.

The Company's historical segment disclosures have been recast for comparative purpose to reflect its new reportable segments. Information for the three and six months ending June 30, 2009 and 2010 regarding the Company's reportable segments is as follows (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>
Revenue:				
Carrier Services	\$ 89,168	\$ 99,021	\$ 177,211	\$ 198,809
Enterprise Services	26,596	29,971	51,741	59,174
Total revenue	\$ 115,764	\$ 128,992	\$ 228,952	\$ 257,983
Segment contribution:				
Carrier Services	\$ 72,323	\$ 84,332	\$ 145,685	\$ 170,401
Enterprise Services	11,318	13,261	20,502	26,049
Total segment contribution	83,641	97,593	166,187	196,450
Indirect operating expenses:				
Cost of revenue (excluding depreciation and amortization shown separately below)	15,810	18,306	32,059	37,166
Sales and marketing	3,482	4,084	7,229	8,688
Research and development	2,506	2,688	5,380	6,211
General and administrative	12,469	14,326	24,121	31,699
Depreciation and amortization	9,332	10,006	18,577	20,149
Restructuring charges		1,217		3,566
Consolidated income from operations	\$ 40,042	\$ 46,966	\$ 78,821	\$ 88,971

Assets are not tracked by segment and the CODM does not evaluate segment performance based on asset utilization.

***Enterprise-Wide Disclosures***

Geographic area revenues and service offering revenues from external customers for the three and six months ended June 30, 2009 and 2010, and geographic area long-lived assets as of December 31, 2009 and June 30, 2010 are as follows (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>
Revenues by geographical areas:				
North America	\$ 106,426	\$ 119,543	\$ 210,575	\$ 240,023

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Europe, Middle East and Africa	6,626	5,283	13,547	10,440
Other regions	2,712	4,166	4,830	7,520
Total revenues	\$ 115,764	\$ 128,992	\$ 228,952	\$ 257,983

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	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>
Revenues by service offerings:				
Carrier Services:				
Numbering Services	\$ 79,759	\$ 90,927	\$ 158,228	\$ 181,628
Order Management Services	5,072	4,200	10,036	8,721
IP Services	4,337	3,894	8,947	8,460
<b>Total Carrier Services revenue</b>	<b>89,168</b>	<b>99,021</b>	<b>177,211</b>	<b>198,809</b>
Enterprise Services:				
Internet Infrastructure Services	12,957	15,582	24,802	31,030
Registry Services	13,639	14,389	26,939	28,144
<b>Total Enterprise Services revenue</b>	<b>26,596</b>	<b>29,971</b>	<b>51,741</b>	<b>59,174</b>
<b>Total revenues</b>	<b>\$ 115,764</b>	<b>\$ 128,992</b>	<b>\$ 228,952</b>	<b>\$ 257,983</b>

	<b>December 31,</b>	<b>June 30,</b>
	<b>2009</b>	<b>2010</b>
Long-lived assets, net		
North America	\$ 77,785	\$ 80,420
Europe, Middle East and Africa	4,350	2,541
Other regions	535	47
<b>Total long-lived assets, net</b>	<b>\$ 82,670</b>	<b>\$ 83,008</b>

### **11. RESTRUCTURING CHARGES**

At December 31, 2009 and June 30, 2010, the total accrued liabilities associated with the Company's restructuring and other related charges were \$3.6 million and \$2.5 million, respectively. The accrued restructuring liability is attributable to the following: a 2001 restructuring plan related to reductions in certain leased facilities, reduction in headcount and closure of certain facilities used in the Company's former NGM operating segment and the relocation of certain operations and support functions to Louisville, Kentucky.

At December 31, 2009 and June 30, 2010, the total accrued liability associated with the 2001 restructuring plan related to the reduction in leased facilities was \$1.3 million and \$1.1 million, respectively. The Company paid approximately \$0.2 million and \$0.2 million, net of sublease payments, in each of the six months ended June 30, 2009 and 2010, respectively. Amounts related to lease terminations due to the closure of excess facilities will be paid over the respective lease terms, the longest of which extends through 2011.

In October 2009, the Company adopted a plan to relocate certain operations and support functions to Louisville, Kentucky. The Company estimates it will incur approximately \$3.0 million to \$3.5 million of employee severance and related costs through the third quarter of 2010 under this plan. At June 30, 2010, total restructuring charges recorded

under this plan since inception were \$3.0 million, of which \$2.0 million was recorded in the six months ended June 30, 2010. The Company paid approximately \$1.5 million of severance and severance-related costs in the six months ended June 30, 2010. The accrued restructuring liability relating to this plan was \$0.2 million and \$0.7 million at December 31, 2009 and June 30, 2010, respectively.

During the fourth quarter of 2008, management implemented a restructuring plan for the Company's former NGM operating segment, currently part of the Carrier Services segment, to more appropriately allocate resources to the Company's key mobile instant messaging initiatives. The restructuring plan involved a reduction in headcount and closure of specific leased facilities in

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some of the Company's international locations. In August 2009, the Company announced the extension of the restructuring plan to include further headcount reductions and closure of certain facilities. Total restructuring charges recorded under this plan since inception included \$7.6 million of severance and related costs and \$1.0 million of lease and facility exit costs.

The activity and balance of the restructuring liability related to the Company's former NGM operating segment for the six months ended June 30, 2010 are as follows (in thousands):

	<b>Severance and Related Costs</b>	<b>Lease and Facilities Exit Costs</b>	<b>Total</b>
Balance at December 31, 2009	\$ 1,629	\$ 463	\$ 2,092
Additional restructuring cost	1,585	296	1,881
Adjustments	(285)	(36)	(321)
Cash payments	(2,739)	(150)	(2,889)
Balance at June 30, 2010	\$ 190	\$ 573	\$ 763

Amounts related to the lease and facilities exit costs will be paid over the respective lease terms, the longest of which extends through 2013.

**12. OTHER (EXPENSE) INCOME**

Other (expense) income consists of the following (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>
Interest and other expense:				
Interest expense	\$ 849	\$ (628)	\$ 1,199	\$ (85)
Loss on asset disposals	3	108	206	148
Loss on ARS Rights	422	1,805	422	2,877
Foreign currency transaction (gain) loss	(425)	(51)	(164)	42
ARS trading losses			410	
Total	\$ 849	\$ 1,234	\$ 2,073	\$ 2,982

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>
Interest and other income:				
Interest income	\$ 249	\$ 170	\$ 638	\$ 427
Gain on ARS Rights			886	
ARS trading gains	856	1,859	856	2,992
Gain on indemnification claims			1,180	
Realized gains cash reserve fund	41		45	



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Total	\$ 1,146	\$ 2,029	\$ 3,605	\$ 3,419
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During the three months ended March 31, 2009, the Company received \$1.2 million in payment of indemnification claims related to the acquisition of Followap Inc. in 2006. During the three months ended June 30, 2010, the Company recorded a reduction of \$1.2 million in interest expense related to a decrease in an accrued sales tax liability.

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**13. INCOME TAXES**

As of December 31, 2009 and June 30, 2010, the Company had unrecognized tax benefits of \$1.1 million and \$1.1 million, respectively, of which \$1.1 million and \$1.1 million, respectively, would affect the Company's effective tax rate if recognized. The Company's effective tax rate increased to 39.9% for the six months ended June 30, 2010 from 39.2% for the six months ended June 30, 2009 primarily due to a decrease in income from operations in a certain international location, where such income is taxed at a rate lower than the U.S. federal rate, and an increase in foreign withholding income taxes.

The Company recognizes potential interest and penalties related to uncertain tax positions in income tax expense. The Company recognized potential interest and penalties of \$34,000 and \$1,500 for the three months ended June 30, 2009 and 2010, respectively, and \$61,000 and \$13,000 for the six months ended June 30, 2009 and 2010, respectively. As of December 31, 2009 and June 30, 2010, the Company had established reserves of approximately \$60,000 and \$72,000, respectively, for accrued potential interest and penalties related to uncertain tax positions. To the extent interest and penalties are not assessed with respect to uncertain tax positions, amounts accrued will be reduced and reflected as a reduction of the overall income tax provision.

The Company files income tax returns in the United States Federal jurisdiction and in many state and foreign jurisdictions. The tax years 2005 through 2009 remain open to examination by the major taxing jurisdictions to which the Company is subject. The Internal Revenue Service ( IRS ) has initiated an examination of the Company's federal income tax returns for years 2007 and 2008. While the ultimate outcome of the audit is uncertain, management does not currently believe that the outcome will have a material adverse effect on the Company's financial position, results of operations or cash flows. The IRS completed an examination of the Company's federal income tax returns for the years 2005 and 2006. The audit resulted in no material adjustments.

The Company anticipates that total unrecognized tax benefits will decrease by approximately \$18,000 over the next twelve months due to the expiration of certain statutes of limitations.

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

### **Forward-Looking Statements**

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

### **Overview**

Revenue, profitability and cash generation were strong for the quarter ended June 30, 2010. Our consolidated revenue for the quarter increased 11.4% to \$129.0 million as compared to \$115.8 million from the second quarter of 2009. In the six months ended June 30, 2010, our cash flow provided by operating activities was \$43.1 million. This resulted in a total cash, cash equivalents and short-term investment balance of \$362.4 million as of June 30, 2010, an increase of \$20.2 million from December 31, 2009.

Our revenue increase was primarily driven by an established increase in the fixed fee under our contracts with the North American Portability Management LLC, or NAPM, for our number portability administration center services, or NPAC Services. We recognized \$80.5 million of revenue under our contracts to provide NPAC Services in the second quarter of 2010, a \$9.3 million increase, or 13.0%, from the corresponding period in 2009. Additionally, we continued to experience steady demand from our existing and new customers for our expanded Internet Infrastructure Services. We recognized \$15.6 million of revenue from these domain name system, or DNS, services in the second quarter of 2010, a 20.3% increase over the corresponding period in 2009.

While demand for our services increased, we maintained our focus on positioning the company for future growth by leveraging our operational capabilities and strengthening our management team. We continued to invest in new, early-stage growth opportunities utilizing our core competencies and help create IP-based ecosystems that will rely on seamless interoperability. In the second quarter of 2010, we appointed a media and entertainment executive to lead the development of our service offerings to the media and entertainment industries, the first of which is our partnership with the Digital Entertainment Content Ecosystem, LLC, or DECE. In January 2010, we were selected by the DECE, an industry consortium consisting of leading entertainment, consumer electronics and technology companies and retailers, to provide a new service devoted to creating interoperable solutions for digital and mobile content delivery.

### **Recent Developments**

Consistent with our capital deployment strategy, which focuses on investing in our growth and maximizing shareholder return, we announced on July 28, 2010 that our Board of Directors had authorized a three-year program to acquire up to \$300 million of our outstanding Class A common shares. Share repurchases under this program may be made through 10b5-1 programs, open market purchases, privately negotiated transactions or otherwise as market conditions warrant, at prices we deem appropriate, and subject to applicable legal requirements and other factors.

### **Our Company**

The advent of local number portability, or LNP, the Internet and telecommunications mobility has made the routing of worldwide communications significantly more complex and challenging. We simplify this complexity and help solve these challenges for our customers by providing essential technology and directory services that enable trusted communication across networks, applications, and businesses around the world. We serve two types of customers: carriers and enterprises. As a result, we have aligned our service offerings to the way we sell to a common customer

base. We have a shared operations group that spans across our organization to support our global infrastructure. Our global infrastructure has been designed to provide services that are:

*Reliable.* Our services depend on complex technology that is configured to deliver high reliability consistent with stringent industry and customer standards. We have made a commitment to our customers to deliver high quality

services meeting numerous measured service level requirements, such as system availability, response times for help desk inquiries and billing accuracy.

*Scalable.* The modular design of our infrastructure enables capacity expansion without service interruption or quality of service degradation, and with incremental investment that provides significant economies of scale.

*Neutral.* We provide our services in a competitively neutral way to ensure that no customer is favored over any other. Our databases and capabilities provide competing entities with fair, equal and secure access to essential shared resources. Moreover, it is our commitment to not compete with our customers.

*Trusted.* The data we collect is important and proprietary. Accordingly, we have implemented appropriate procedures and systems to protect the privacy and security of customer data, restrict access to the system and generally protect the integrity of our databases. Our performance with respect to neutrality, privacy and security is independently audited on a regular basis.

In addition to providing the authoritative solution that the communications industry relies upon for LNP, we have developed a broad range of innovative services to meet an expanded range of customer needs. We provide critical technology and directory services that our carrier and enterprise customers rely upon to manage a wide range of technical and operating requirements.

#### ***Carrier Services***

Changes in the structure of the communications industry over the past two decades have presented increasingly complex technical and operating challenges for our carrier customers. Whereas the Bell Operating System once dominated the U.S. telecommunications industry, there are now thousands of carriers with disparate networks. Also, networks have spanned the globe and are now connecting to each other all over the world. Today, while carriers compete with one another in the telephony and Internet Protocol, or IP, areas, they must also cooperate and interconnect their networks to carry each other's traffic to route communications, unlike in the past when a small number of incumbent wireline carriers used established, bilateral relationships. In addition, carriers are delivering a broad set of new services using a diverse array of technologies. These services, which include voice, data and video, are used in combinations that are far more complex than the historically uniform voice services of traditional carriers.

These changes in the communications industry and resulting technological complexities have strained the carriers networks and infrastructure. The in-house network management and back-office systems of traditional carriers were not designed to capture all of the information necessary to provision, authorize, route and invoice these new services. In particular, it has become significantly more difficult for these carrier customers to identify and authenticate the appropriate destination for a given communication across multiple networks and unique addresses, such as wireline, wireless and Voice over Internet Protocol, or VoIP, phone numbers.

Through our set of unique databases and system infrastructure in geographically dispersed data centers, we manage this complexity and ensure the seamless connection of our carrier customers' numerous networks, while enhancing the capabilities and performance of their infrastructure. We enable our carrier customers to use, exchange and share critical resources, such as telephone numbers, facilitate order management and work flow processing among carriers, and allow operators to direct, prioritize and optimize the addressing and routing of emerging IP communications, particularly as they migrate to the mobile environment.

We provide a range of services to our carrier customers, including:

*Numbering Services.* We operate and maintain authoritative databases for telephone number resources utilized by our carrier customers and manage the telephone number lifecycle. Our unique set of databases enables our carrier customers to obtain data to successfully route telephone calls in the United States and Canada. The numbering services we provide to our carrier customers using these databases include NPAC Services, NPAC Services in Canada and LNP services in Taiwan and Brazil, or international LNP solutions, and number inventory and allocation management. Additionally, we enable carriers to more efficiently manage their networks by centrally processing essential changes they use to route communications.

*Order Management Services.* Our Order Management Services permit our carrier customers, through a single interface, to exchange essential operating data with multiple carriers in order to provision services.

*IP Services.* We provide scalable IP services to carriers that allow them to manage access for the routing of IP communications, such as multimedia messaging service, or MMS, traffic, Instant Messaging, or IM, traffic, and presence. Our solutions solve the complexity of mapping a phone number to an IP address for accurate and reliable routing to a carrier's network. We also enable direct network-to-network peering between carriers for voice, video and content services.

### ***Enterprise Services***

Our Enterprise Services segment provides services to our enterprise customers to meet their directory and DNS-related needs. We provide innovative DNS solutions for non-carrier, commercial businesses, and serve as the authoritative provider of essential registry services. We manage a directory of similar resources, or addresses, where customers have reliable, fair and secure access and connectivity to their data. We maintain a collection of these essential directories that maintain addresses to help find and resolve Internet queries and top-level domains on behalf of our enterprise customers. Additionally, we provide directory services for the 5 and 6-digit number strings used for all U.S. Common Short Codes which is part of the short messaging service relied upon by the U.S. wireless industry.

The range of services we offer to our enterprise customers includes:

*Internet Infrastructure Services.* We provide a suite of DNS services to our enterprise customers built on a global directory platform. These services play a key role in directing and managing Internet traffic flow, resolving Internet queries, providing security protection against Internet breaches called Distributed Denial of Service, or DDoS, attacks, and monitoring, testing and measuring the performance of websites and networks.

*Registry Services.* We operate the authoritative registries of Internet domain names for the .biz, .us, .tel and .travel top-level domains. We also provide international registry gateways for China's .cn and Taiwan's .tw country-code top-level domains. All Internet communications routed to any of these domains must query a copy of our directory to ensure that the communication is routed to the appropriate destination. We also operate the authoritative Common Short Codes registry on behalf of the US wireless industry.

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

The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles, or U.S. GAAP. The preparation of these financial statements in accordance with U.S. GAAP requires us to utilize accounting policies and make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingencies as of the date of the financial statements and the reported amounts of revenue and expense during a fiscal period. The Securities and Exchange Commission, or SEC, considers an accounting policy to be critical if it is important to a company's financial condition and results of operations, and if it requires significant judgment and estimates on the part of management in its application. We have discussed the selection and development of the critical accounting policies with the audit committee of our board of directors, and the audit committee has reviewed our related disclosures in this report. Although we believe that our judgments and estimates are appropriate and reasonable, actual results may differ from those estimates. In addition, while we have used our best estimates based on facts and circumstances available to us at the time, different estimates reasonably could have been used in the current period. Changes in the accounting estimates we use are reasonably likely to occur from period to period, which may have a material impact on the presentation of our financial condition and results of operations. If actual results or events differ materially from those contemplated by us in making these estimates, our reported financial condition and results of operation could be materially affected. See the information in our filings with the SEC from time to time, including Part II, Item 1A. Risk Factors of this report, and our subsequent periodic and current reports, for certain matters that may bear on our results of operations.

The following discussion of selected critical accounting policies supplements the information relating to our critical accounting policies described in Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates in our Annual Report on Form 10-K for the year ended December 31, 2009.

### ***Goodwill***

In the first quarter of 2010, we realigned our operating structure and internal financial reporting by customer type, reflective of how our CODM allocates resources and assesses performance. This realignment changed our operating segments and the underlying reporting units.

As a result of this realignment, we reassigned our goodwill to each of our reporting units. The goodwill attributable to our former NGM reporting unit has been assigned to a single reporting unit. Our goodwill attributable to the former Clearinghouse reporting unit has been allocated among each of our reporting units using a relative fair value approach.

We determined the estimated fair value of our reporting units using both an income approach and market approach. To assist in the process of determining fair value, we performed internal valuation analyses and considered other market information that is publicly available. We also obtained appraisals from external advisors. Significant assumptions used in the determination of fair value under the income approach included assumptions regarding market penetration, anticipated growth rates, and risk-adjusted discount rates. Significant assumptions used in the determination of fair value under the market approach included the selection of comparable companies.

The key assumptions we used to determine the fair value of our reporting units included: (a) cash flow projections, which include growth and allocation assumptions for forecasted revenue and expenses; (b) a residual growth rate of 3.0% to 7.0%; (c) a discount rate of 13.5% to 18.0%, which was based upon each respective reporting unit's weighted cost of capital adjusted for the risks associated with the operations at the time of the assessment; (d) selection of comparable companies used in the market approach; and (e) assumptions in weighting the results of the income approach and market approach valuation techniques.

### ***Revenue Recognition***

We provide NPAC Services pursuant to seven contracts with NAPM, an industry group that represents all telecommunications service providers in the United States. The aggregate fees for transactions processed under these contracts was determined by an annual fixed-fee pricing model under which the annual fixed-fee, or Base Fee, is set at \$340.0 million and \$362.1 million in 2009 and 2010, respectively, and is subject to an annual price escalator of 6.5% in subsequent years. These contracts also provide for a fixed credit of \$40.0 million in 2009, \$25.0 million in 2010 and \$5.0 million in 2011, which will be applied to reduce the Base Fee for the applicable year. Additional credits of up to \$15.0 million annually in 2009, 2010 and 2011 may be triggered if the customer reaches certain levels of aggregate telephone number inventories and adopts and implements certain IP fields and functionality. Moreover, these contracts provide for credits in the event that the volume of transactions in a given year is above or below the contractually established volume range for that year. The determination of any volume credits is done annually at the end of the year and such credits are applied to the following year's invoices. We determine the fixed and determinable fee under these contracts on an annual basis and recognize such fee on a straight-line basis over twelve months. For 2009, we concluded that the fixed and determinable fee equals \$285.0 million, which is the Base Fee of \$340.0 million reduced by the \$40.0 million fixed credit and \$15.0 million of additional credits. For 2010, the fixed and determinable fee equals \$322.1 million, which represents the Base Fee of \$362.1 million, reduced by the \$25.0 million fixed credit and \$15.0 million of additional credits.

### ***Restructuring***

At June 30, 2010, the accrued liability associated with our restructuring and other related charges was \$2.5 million. As part of our restructuring costs, we record a liability for the estimated cost of the net lease expense for facilities that are no longer being used. This accrual is equal to the present value of the minimum future lease payments under our contractual lease obligations, offset by the present value of the estimated sublease income. As of June 30, 2010, our accrued restructuring liability related to our net lease expense and other related charges was \$1.7 million. These lease payments will be made over the remaining lives of the leases for facilities that we have vacated, the longest of which extends through 2013. If actual market conditions are different than those we have projected, we will be required to recognize additional restructuring costs or benefits associated with these facilities.



**Investments**

We have approximately \$21.3 million par value in investments related to auction rate securities, or ARS, all of which are classified as current as of June 30, 2010. In November 2008, we accepted a settlement offer in the form of a rights offering, or ARS Rights, from the investment firm that brokered the original purchases of the ARS, which provides us with the right to sell these securities at par value to the investment firm during a period beginning on June 30, 2010. On June 30, 2010, we exercised our ARS Rights and received \$21.3 million in cash from the investment firm when the transaction settled on July 1, 2010. As of June 30, 2010, the ARS and ARS Rights are recorded as short-term investments at fair value of \$21.3 million in our financial statements. The changes in the fair value of the ARS and the ARS Rights were recognized as gains or losses in our earnings until settlement under the rights offering.

For each of our ARS and the associated ARS Rights, we determined the fair value using discounted cash flow methods. The discounted cash flow valuation methods involved management's judgment and assumptions regarding discount rates, coupon rates, estimated maturity for each of the ARS and judgment regarding the selection of comparable securities. We determined the fair value of the ARS Rights using a discounted cash flow method which involves judgment and assumptions regarding the timing of cash flows under the ARS Rights, fair value of the underlying ARS and the ability of the investment firm to disburse the cash anticipated under the terms of the rights offering.

**Stock-Based Compensation**

We recognize share-based compensation expense in accordance with the Compensation—Stock Compensation Topic of the Financial Accounting Standards Board Accounting Standards Codification which requires the measurement and recognition of compensation expense for share-based awards based on estimated fair values on the date of grant. We estimate the fair value of each option-based award on the date of grant using the Black-Scholes option-pricing model. This option pricing model requires that we make several estimates, including the option's expected life and the price volatility of the underlying stock.

Because share-based compensation expense is based on awards that are ultimately expected to vest, the amount of expense takes into account estimated forfeitures at the time of grant which may be revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Changes in these estimates and assumptions can materially affect the measure of estimated fair value of our share-based compensation. See Note 7 to our Unaudited Consolidated Financial Statements in Item 1 of Part I of this report for information regarding our assumptions related to share-based compensation and the amount of share-based compensation expense we incurred for the periods covered in this report. As of June 30, 2010, total unrecognized compensation expense was \$41.1 million, which relates to unvested stock options, unvested restricted stock units, unvested restricted stock and unvested performance vested restricted stock units, or PVRs, and is expected to be recognized over a weighted-average period of 1.71 years.

We estimate the fair value of our restricted stock unit awards based on the fair value of our common stock on the date of grant. Our outstanding restricted stock unit awards are subject to service-based vesting conditions and/or performance-based vesting conditions. We recognize the estimated fair value of service-based awards, net of estimated forfeitures, as share-based expense over the vesting period on a straight-line basis. Awards with performance-based vesting conditions require the achievement of specific financial targets at the end of the specified performance period and the employee's continued employment. We recognize the estimated fair value of performance-based awards, net of estimated forfeitures, as share-based expense over the performance period, which considers each performance period or tranche separately, based upon our determination of whether it is probable that the performance targets will be achieved. At each reporting period, we reassess the probability of achieving the performance targets within the related performance period. Determining whether the performance targets will be achieved involves judgment, and the estimate of stock-based compensation expense may be revised periodically based on changes in the probability of achieving the performance targets. If any performance goals are not met, no compensation cost is ultimately recognized against that goal, and, to the extent previously recognized, compensation cost is reversed. As of June 30, 2010, we estimate achievement of 0%, 135% and 100% of the performance targets related to our performance vested restricted stock units granted during 2008, 2009 and 2010, respectively.

Changes in our assumptions regarding the achievement of specific financial targets could have a material effect on our consolidated financial statements. In the first quarter of 2010, we revised our estimate of the achievement of the performance target related to the PVRsUs granted during 2008 from 50% of target to 0% of target. In addition, we revised our estimate of achievement of the performance target related to the PVRsUs granted during 2009 from 100% of target to 135% of target.

Our consolidated net income for the three and six months ended June 30, 2010 was \$28.6 million and \$53.8 million, respectively, and diluted earnings per share was \$0.37 per share and \$0.71 per share, respectively. If we had continued to use the previous estimate of achievement of 50% of the performance target for our PVRSUs granted during 2008, the as adjusted net income would have been approximately \$28.5 million and \$52.7 million, respectively, and the as adjusted diluted earnings per share would have been approximately \$0.37 per share and \$0.69 per share, respectively. If we had continued to use the previous estimate of achievement of 100% of the performance target for our PVRSUs granted during 2009, the as adjusted net income would have been approximately \$28.7 million and \$54.4 million, respectively, and the as adjusted diluted earnings per share would have been approximately \$0.38 per share and \$0.72 per share, respectively. If we had continued to use the previous estimates of achievement for our PVRSUs granted during 2008 and 2009, the as adjusted net income would have been approximately \$28.6 million and \$53.3 million, respectively, and the as adjusted diluted earnings per share would have been approximately \$0.38 per share and \$0.70 per share, respectively.

**Consolidated Results of Operations****Three Months Ended June 30, 2009 Compared to Three Months Ended June 30, 2010**

The following table presents an overview of our results of operations for the three months ended June 30, 2009 and 2010:

	<b>Three Months Ended June 30,</b>			
	<b>2009</b>	<b>2010</b>	<b>2009 vs. 2010</b>	
	\$	\$	\$ Change	% Change
	(unaudited)			
	(dollars in thousands, except per share data)			
Revenue:				
Carrier Services	\$ 89,168	\$ 99,021	\$ 9,853	11.0%
Enterprise Services	26,596	29,971	3,375	12.7%
Total revenue	115,764	128,992	13,228	11.4%
Operating expense:				
Cost of revenue (excludes depreciation and amortization shown separately below)	28,336	29,844	1,508	5.3%
Sales and marketing	19,239	22,028	2,789	14.5%
Research and development	4,514	3,278	(1,236)	(27.4)%
General and administrative	14,301	15,653	1,352	9.5%
Depreciation and amortization	9,332	10,006	674	7.2%
Restructuring charges		1,217	1,217	100.0%
	75,722	82,026	6,304	8.3%
Income from operations	40,042	46,966	6,924	17.3%
Other (expense) income:				
Interest and other expense	(849)	(1,234)	(385)	45.3%
Interest and other income	1,146	2,029	883	77.1%
Income before income taxes	40,339	47,761	7,422	18.4%
Provision for income taxes	15,873	19,188	3,315	20.9%
Net income	\$ 24,466	\$ 28,573	\$ 4,107	16.8%
Net income per common share:				
Basic	\$ 0.33	\$ 0.38		
Diluted	\$ 0.32	\$ 0.37		
Weighted average common shares outstanding:				
Basic	74,314	74,997		
Diluted	75,427	76,217		

**Revenue**

*Total revenue.* Total revenue increased \$13.2 million due to a \$9.8 million increase in revenue from our Carrier Services operating segment and a \$3.4 million increase in revenue from our Enterprise Services operating segment.

*Carrier Services.* Revenue from our Carrier Services operating segment increased \$9.8 million primarily due to an increase of \$11.2 million in revenue from our Numbering Services. Of this \$11.2 million increase, \$9.3 million resulted from an established increase in the fixed fee under our contracts to provide NPAC Services and \$2.1 million was primarily due to system enhancements and additional functionality requested by our Numbering Services customers. These revenue increases were partially offset by a decrease of \$0.9 million from our Order Management Services.

*Enterprise Services.* Revenue from our Enterprise Services operating segment increased \$3.4 million primarily due to an increase of \$2.6 million in revenue from our Internet Infrastructure Services. This was primarily driven by increased demand from existing and new customers for our expanded service offerings. In addition, Registry Services revenue increased \$0.8 million due to an increase in the number of domain names and common short codes under management.

**Expense**

*Cost of revenue.* Cost of revenue increased \$1.5 million primarily due to an increase of \$0.7 million in general facility costs to support business growth and ongoing operations. Royalty expense in our Registry Services related to common short codes under management increased \$0.6 million. In addition, personnel and personnel-related expense increased \$0.5 million primarily due to increased headcount to support expansion in our new business opportunities.

*Sales and marketing.* Sales and marketing expense increased \$2.8 million primarily due to an increase of \$2.9 million in personnel and personnel-related expense to support our expanded sales and marketing teams as we broaden our geographic presence and increase brand awareness through customer and industry events.

*Research and development.* Research and development expense decreased \$1.2 million due to a \$1.5 million decrease in personnel and personnel-related expense, partially offset by an increase of \$0.3 million in contractor costs. The decrease in personnel and personnel-related expense was a result of headcount reductions in connection with certain restructuring activities, while the increase in contractor costs was related to the development of new directory services.

*General and administrative.* General and administrative expense increased \$1.4 million, due to an increase of \$2.4 million in personnel and personnel-related expense due to increased headcount to support business growth. This increase was partially offset by a \$1.0 million decrease in other general corporate expense.

*Depreciation and amortization.* Depreciation and amortization expense increased \$0.7 million due to an increase of \$1.5 million in depreciation due to an increase in capital assets to build out our infrastructure. This increase was partially offset by a decrease of \$0.8 million in amortization of intangible assets related to acquisitions.

*Restructuring charges.* Restructuring charges increased \$1.2 million due to severance and severance-related expense of \$0.8 million attributable to our plan initiated in the fourth quarter of 2009 to relocate certain operations and support functions to Louisville, Kentucky. In addition, we recorded \$0.4 million in severance and severance-related expense in the second quarter of 2010 attributable to our restructuring plan to reduce headcount and close certain facilities specific to our former NGM operating segment. There was no corresponding expense for the quarter ended June 30, 2009.

*Interest and other expense.* Interest and other expense increased \$0.4 million primarily due to a \$1.3 million increase in losses recorded for our ARS Rights, offset by a decrease of \$1.5 million in interest expense primarily due to a reduction in accrued interest related to a sales tax liability.

*Interest and other income.* Interest and other income increased \$0.9 million primarily due to a \$1.0 million net increase in trading gains recorded for our ARS.

*Provision for income taxes.* Our estimated annual effective tax rate increased to 40.2% for the three months ended June 30, 2010 from 39.3% for the three months ended June 30, 2009 primarily due to a decrease in income from operations in a certain

international location, where such income is taxed at a rate lower than the U.S. federal rate, and an increase in foreign withholding income taxes.

### **Summary of Operating Segments**

The following table presents a summary of our operating segments revenue, contribution and the reconciliation to consolidated income from operations for the three months ended June 30, 2009 and 2010 (unaudited, dollars in thousands):

	<b>Three Months Ended June 30,</b>			
	<b>2009</b>	<b>2010</b>	<b>2009 vs. 2010</b>	
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>%</b>
			<b>Change</b>	<b>Change</b>
Revenue:				
Carrier Services	\$ 89,168	\$ 99,021	\$ 9,853	11.0%
Enterprise Services	26,596	29,971	3,375	12.7%
<b>Total revenue</b>	<b>\$ 115,764</b>	<b>\$ 128,992</b>	<b>\$ 13,228</b>	<b>11.4%</b>
Segment contribution:				
Carrier Services	\$ 72,323	\$ 84,332	\$ 12,009	16.6%
Enterprise Services	11,318	13,261	1,943	17.2%
<b>Total segment contribution</b>	<b>83,641</b>	<b>97,593</b>	<b>13,952</b>	<b>16.7%</b>
Indirect operating expenses:				
Cost of revenue (excluding depreciation and amortization shown separately below)	15,810	18,306	2,496	15.8%
Sales and marketing	3,482	4,084	602	17.3%
Research and development	2,506	2,688	182	7.3%
General and administrative	12,469	14,326	1,857	14.9%
Depreciation and amortization	9,332	10,006	674	7.2%
Restructuring charges		1,217	1,217	100.0%
<b>Consolidated income from operations</b>	<b>\$ 40,042</b>	<b>\$ 46,966</b>	<b>\$ 6,924</b>	<b>17.3%</b>

Segment contribution is determined based on internal performance measures used by the chief operating decision maker, or CODM, to assess the performance of each operating segment in a given period. In connection with this assessment, the CODM reviews revenue and segment contribution, which excludes certain unallocated costs within the following expense classifications: cost of revenue, sales and marketing, research and development and general and administrative. Depreciation and amortization and restructuring charges are also excluded from the segment contribution.

**Six Months Ended June 30, 2009 Compared to Six Months Ended June 30, 2010**

The following table presents an overview of our results of operations for the six months ended June 30, 2009 and 2010:

	<b>Six Months Ended June 30,</b>			
	<b>2009</b>	<b>2010</b>	<b>2009 vs. 2010</b>	
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>%</b>
	<b>Change</b>			
	<b>(unaudited)</b>			
	<b>(dollars in thousands, except per share data)</b>			
Revenue:				
Carrier Services	\$ 177,211	\$ 198,809	\$ 21,598	12.2%
Enterprise Services	51,741	59,174	7,433	14.4%
Total revenue	228,952	257,983	29,031	12.7%
Operating expense:				
Cost of revenue (excludes depreciation and amortization shown separately below)	56,179	58,957	2,778	4.9%
Sales and marketing	38,746	44,882	6,136	15.8%
Research and development	8,827	7,356	(1,471)	(16.7)%
General and administrative	27,802	34,102	6,300	22.7%
Depreciation and amortization	18,577	20,149	1,572	8.5%
Restructuring charges		3,566	3,566	100.0%
	150,131	169,012	18,881	12.6%
Income from operations	78,821	88,971	10,150	12.9%
Other (expense) income:				
Interest and other expense	(2,073)	(2,982)	(909)	43.8%
Interest and other income	3,605	3,419	(186)	(5.2)%
Income before income taxes	80,353	89,408	9,055	11.3%
Provision for income taxes	31,534	35,633	4,099	13.0%
Net income	\$ 48,819	\$ 53,775	\$ 4,956	10.2%
Net income per common share:				
Basic	\$ 0.66	\$ 0.72		
Diluted	\$ 0.65	\$ 0.71		
Weighted average common shares outstanding:				
Basic	74,225	74,805		
Diluted	75,359	76,079		

**Revenue**

*Total revenue.* Total revenue increased \$29.0 million due to a \$21.6 million increase in revenue from our Carrier Services operating segment and a \$7.4 million increase in revenue from our Enterprise Services operating segment.

*Carrier Services.* Revenue from our Carrier Services operating segment increased \$21.6 million primarily due to an increase of \$23.4 million in revenue from our Numbering Services. Of this \$23.4 million increase, \$18.6 million resulted from an established increase in the fixed fee under our contracts to provide NPAC Services and \$4.6 million was primarily due to system enhancements and additional functionality requested by our Numbering Services customers. These revenue increases were partially offset by a decrease of \$1.3 million from our Order Management Services.

*Enterprise Services.* Revenue from our Enterprise Services operating segment increased \$7.4 million primarily due to an increase of \$6.2 million in revenue from our Internet Infrastructure Services. This was primarily driven by increased demand from existing and new customers for our expanded service offerings. In addition, Registry Services revenue increased \$1.2 million due to an increase in the number of domain names and common short codes under management.

**Expense**

*Cost of revenue.* Cost of revenue increased \$2.8 million primarily due to a \$1.1 million increase in general facility costs to support business growth and ongoing operations and an increase of \$1.0 million in royalty expense in our Registry Services related to common short codes under management. In addition, cost of revenue increased \$1.0 million due to an increase in outsourced fees to support our expanded service offerings, including new directory services, and system enhancements for functionality improvements requested by our customers.

*Sales and marketing.* Sales and marketing expense increased \$6.1 million primarily due to an increase of \$5.1 million in personnel and personnel-related expense to support our expanded sales and marketing teams as we broaden our geographic presence and increase brand awareness through customer and industry events. In addition, contractor costs increased \$1.1 million related to branding, product launches and expanded service offerings.

*Research and development.* Research and development expense decreased \$1.5 million due to a \$2.4 million decrease in personnel and personnel-related expense, partially offset by an increase of \$0.9 million in contractor costs. The decrease in personnel and personnel-related expense was a result of headcount reductions in connection with certain restructuring activities, while the increase in contractor costs was related to the development of new directory services.

*General and administrative.* General and administrative expense increased \$6.3 million, primarily due to an increase of \$3.7 million in personnel and personnel-related expense and an increase of \$3.6 million in contractor costs and professional fees incurred to support growth in our existing service offerings, new businesses and corporate initiatives. This increase was partially offset by a decrease of \$1.0 million in other general corporate expense.

*Depreciation and amortization.* Depreciation and amortization expense increased \$1.6 million due to an increase of \$3.4 million in depreciation due to an increase in capital assets to build out our infrastructure. This increase was partially offset by a decrease of \$1.9 million in amortization of intangible assets related to acquisitions.

*Restructuring charges.* Restructuring charges increased \$3.6 million due to severance and severance related expense of \$2.0 million attributable to our plan initiated in the fourth quarter of 2009 to relocate certain operations and support functions to Louisville, Kentucky. In addition, we recorded \$1.6 million in severance and severance-related expense in the six months ended June 30, 2010 attributable to our restructuring plan to reduce headcount and close certain facilities specific to our former NGM operating segment. There was no corresponding expense for the six months ended June 30, 2009.

*Interest and other expense.* Interest and other expense increased \$0.9 million primarily due to a \$2.0 million net increase in losses recorded for our ARS and ARS Rights, partially offset by a decrease of \$1.3 million in interest expense primarily due to a reduction in accrued interest related to a sales tax liability.

*Interest and other income.* Interest and other income decreased \$0.2 million primarily due to the receipt in the first quarter of 2009 of \$1.2 million in payment of indemnification claims made in connection with our 2006 acquisition of Followap, Inc.





There were no corresponding payments received in the six months ended June 30, 2010. This decrease was partially offset by a net increase of \$1.3 million in gains recorded for our ARS and ARS Rights.

*Provision for income taxes.* Our estimated annual effective tax rate increased to 39.9% for the six months ended June 30, 2010 from 39.2% for the six months ended June 30, 2009 due primarily to a decrease in income from operations in a certain international location, where such income is taxed at a rate lower than the U.S. federal rate, and an increase in foreign withholding income taxes.

### **Summary of Operating Segments**

The following table presents a summary our operating segments revenue, contribution and the reconciliation to consolidated income from operations for the six months ended June 30, 2009 and 2010 (unaudited, dollars in thousands):

	2009	Six Months Ended June 30,		
		2010	2009 vs. 2010	
	\$	\$	\$	%
			Change	Change
Revenue:				
Carrier Services	\$ 177,211	\$ 198,809	\$ 21,598	12.2%
Enterprise Services	51,741	59,174	7,433	14.4%
Total revenue	\$ 228,952	\$ 257,983	\$ 29,031	12.7%
Segment contribution:				
Carrier Services	\$ 145,685	\$ 170,401	\$ 24,716	17.0%
Enterprise Services	20,502	26,049	5,547	27.1%
Total segment contribution	166,187	196,450	30,263	18.2%
Indirect operating expenses:				
Cost of revenue (excluding depreciation and amortization shown separately below)	32,059	37,166	5,107	15.9%
Sales and marketing	7,229	8,688	1,459	20.2%
Research and development	5,380	6,211	831	15.4%
General and administrative	24,121	31,699	7,578	31.4%
Depreciation and amortization	18,577	20,149	1,572	8.5%
Restructuring charges		3,566	3,566	100.0%
Consolidated income from operations	\$ 78,821	\$ 88,971	\$ 10,150	12.9%

Segment contribution is determined based on internal performance measures used by the chief operating decision maker, or CODM, to assess the performance of each operating segment in a given period. In connection with this assessment, the CODM reviews revenue and segment contribution, which excludes certain unallocated costs within the following expense classifications: cost of revenue, sales and marketing, research and development and general and administrative. Depreciation and amortization and restructuring charges are also excluded from the segment contribution.

### **Liquidity and Capital Resources**

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

working capital, capital expenditures and facility expansion.

Total cash, cash equivalents and short-term investments were \$362.4 million at June 30, 2010, an increase from \$342.2 million at December 31, 2009. Of the \$362.4 million included in total cash, cash equivalents and short-term investments, \$21.3 million in short-term investments were redeemed at par value on July 1, 2010.

We have a credit facility that is available for cash borrowings up to \$100 million that may be used for working capital, capital expenditures, general corporate purposes and to finance acquisitions. Our credit agreement contains customary representations and warranties, affirmative and negative covenants, and events of default. Our credit agreement requires us to maintain a minimum ratio of consolidated earnings before interest, taxes, depreciation and amortization, or EBITDA, to consolidated interest charges and a maximum ratio of consolidated senior funded indebtedness to consolidated EBITDA. As of and for the six months ended June 30, 2010, we were in compliance with these covenants. As of June 30, 2010, we had no borrowings under the credit facility and we utilized \$8.8 million of the availability under the facility for outstanding letters of credit.

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

#### **Discussion of Cash Flows**

##### ***Cash flows from operations***

Net cash provided by operating activities for the six months ended June 30, 2010 was \$43.1 million, as compared to \$82.2 million for the six months ended June 30, 2009. This \$39.1 million decrease in net cash provided by operating activities was principally the result of a decrease in accounts payable and accrued expenses of \$20.8 million and an increase in accounts receivable of \$10.8 million.

##### ***Cash flows from investing***

Net cash used in investing activities for the six months ended June 30, 2010 was \$2.2 million, as compared to \$8.4 million for the six months ended June 30, 2009. This \$6.2 million decrease in net cash used in investing activities was principally due to an increase of \$12.2 million in cash provided by short-term investment sales, partially offset by an increase of \$6.0 million in cash used for purchases of property and equipment.

##### ***Cash flows from financing***

Net cash used in financing activities was \$4.0 million for the six months ended June 30, 2010, as compared to \$5.2 million for the six months ended June 30, 2009. The \$1.2 million decrease in net cash used in financing activities was principally the result of an increase of \$1.9 million in proceeds from the exercise of stock options and a \$0.7 million decrease in cash used for principal repayments on notes payable. The decrease in net cash used in financing activities was partially offset by an increase of \$1.1 million in principal repayments on capital lease obligations and a \$0.3 million increase in the repurchase of restricted stock awards.

#### **Recent Accounting Pronouncements**

See Note 2 to our Consolidated Financial Statements in Item 1 of Part 1 of this report for a discussion of the effects of recent accounting pronouncements.

#### **Off-Balance Sheet Arrangements**

None.

#### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

For quantitative and qualitative disclosures about our exposure to market risk, see *Quantitative and Qualitative Disclosures About Market Risk* in Item 7A of Part II of our Annual Report on Form 10-K for the fiscal year ended December 31, 2009. Our exposure to market risk has not changed materially since December 31, 2009.

#### **Item 4. Controls and Procedures**

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

As of June 30, 2010, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective and were operating at the reasonable assurance level.

In addition, there were no changes in our internal control over financial reporting that occurred in the second quarter of 2010 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **Item 1. Legal Proceedings**

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

### **Item 1A. Risk Factors**

#### **Cautionary Note Regarding Forward-Looking Statements**

This report contains forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expects, intends, plans, anticipates, believes, estimates, continue or the negative of these terms or other comparable terminology. These statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. Many of these risks are beyond our ability to control or predict. Actual results could differ materially from those projected in the forward-looking statements contained in this Quarterly Report on Form 10-Q as a result of the risk factors discussed below and elsewhere in this Quarterly Report on Form 10-Q and in other filings we make with the Securities and Exchange Commission. These risks and other factors include those listed under "Risk Factors" in Part II, Item 1A of this report and elsewhere in this report and include:

- failures or interruptions of our systems and services;

- security or privacy breaches;

- loss of, or damage to, a data center;

- termination, modification or non-renewal of our contracts to provide telephone number portability and other clearinghouse services;

- adverse changes in statutes or regulations affecting the communications industry;

- our failure to adapt to rapid technological change in the communications industry;



competition from our customers in-house systems or from other providers of addressing, interoperability or infrastructure services;

our failure to achieve or sustain market acceptance at desired pricing levels;

a decline in the volume of transactions we handle;

inability to manage our growth;

economic, political, regulatory and other risks associated with our potential further expansion into international markets;

inability to obtain sufficient capital to fund our operations, capital expenditures and expansion; and

loss of members of senior management, or inability to recruit and retain skilled employees.

### **Risks Related to Our Business**

*The loss of, or damage to, a data center or any other failure or interruption to our network infrastructure could materially harm our revenue and impair our ability to conduct our operations.*

Because virtually all of the services we provide require carriers to query a copy of our continuously updated databases and directories to obtain necessary routing and other essential operational data, the integrity of our data centers, including network elements managed by third-parties throughout the world, and the systems through which we deliver our services are essential to our business. Notably, our data centers and related systems are essential to the orderly operation of the U.S. telecommunications system because they enable carriers to ensure that telephone calls are routed to the appropriate destinations.

Our system architecture is integral to our ability to process a high volume of transactions in a timely and effective manner. Moreover, both we and our customers rely on hardware, software and other equipment developed, supported and maintained by third-party providers. We could experience failures or interruptions of our systems and services, or other problems in connection with our operations, as a result of:

damage to, or failure of, our computer software or hardware or our connections and outsourced service arrangements with third-parties;

failure of, or defects in, the third-party systems, software or equipment on which we or our customers rely to access our data centers and other systems;

errors in the processing of data by our system;

computer viruses or software defects;

physical or electronic break-ins, sabotage, distributed denial of service, or DDoS, attacks, intentional acts of vandalism and similar events;

increased capacity demands or changes in systems requirements of our customers;

power loss, natural disasters, or telecommunications failures; or

errors by our employees or third-party service providers.

We may not have sufficient redundant systems or back-up facilities to allow us to receive and process data if one of the foregoing events occurs. Further, increases in the scope of services that we provide increase the complexity of our network infrastructure. As the scope of services we provide expands or changes in the future, we may be required to

make significant expenditures to establish new data centers from which we may provide services. Moreover, as we add customers, expand our



service offerings and increase our visibility in the market, the likelihood that we will become a target of physical or electronic break-ins, sabotage, DDoS attacks, intentional acts of vandalism and similar events increases. If we cannot adequately protect the ability of our data centers and related systems to perform consistently at a high level and without interruptions, or otherwise fail to meet our customers' expectations:

our reputation may be damaged, which may adversely affect our ability to attract or retain customers for our existing services, and may also make it more difficult for us to market our services;

we may be subject to significant penalties or damages claims, under our contracts or otherwise, including the requirement to pay substantial penalties related to service level requirements in our contracts;

we may be required to make significant expenditures to repair or replace equipment, third-party systems or, in some cases, an entire data center, or to establish new data centers and systems from which we may provide services;

our operating expenses or capital expenditures may increase as a result of corrective efforts that we must perform;

our customers may postpone or cancel subsequently scheduled work or reduce their use of our services; or

one or more of our significant contracts may be terminated early, or may not be renewed.

Any of these consequences would adversely affect our revenue, performance and business prospects.

***Security breaches could result in significant liabilities, interruptions of service or reduced quality of service, which could increase our costs or result in a reduction in the use of our services by our customers.***

Our systems may be vulnerable to physical break-ins, computer viruses, attacks by computer hackers or similar disruptive problems. If unauthorized users gain access to our databases, they may be able to steal, publish, delete or modify sensitive information that is stored or transmitted on our networks and that we are required by our contracts and Federal Communications Commission, or FCC, rules to keep confidential. Such a security or privacy breach could subject us to significant penalties as well as claims for damages under our contracts. Further, a security or privacy breach could result in an interruption of service or reduced quality of service, and we may be required to make significant expenditures in connection with corrective efforts we are required to perform. In addition, a security or privacy breach may harm our reputation and cause our customers to reduce their use of our services, which could harm our revenue and business prospects.

***Our seven contracts with North American Portability Management LLC represent in the aggregate a substantial portion of our revenue, are not exclusive and could be terminated or modified in ways unfavorable to us, and we may be unable to renew these contracts at the end of their term.***

Our seven contracts with North American Portability Management LLC, or NAPM, an industry group that represents all carriers in the United States, to provide NPAC Services are not exclusive and could be terminated or modified in ways unfavorable to us. These seven separate contracts, each of which represented between 6% and 13% of our total revenue in 2009, represented in the aggregate approximately 64% of our total revenue in 2009. NAPM could, at any time, solicit or receive proposals from other providers to provide services that are the same as or similar to ours. In addition, these contracts have finite terms and are currently scheduled to expire in June 2015. Furthermore, any of these contracts could be terminated in advance of its scheduled expiration date in limited circumstances, most notably if we are in default of these agreements. Although these contracts do not contain cross-default provisions, conditions leading to a default by us under one of our contracts could lead to a default under others, or all seven.

We may be unable to renew these contracts on acceptable terms when they are considered for renewal if we fail to meet our customers' expectations, including for performance or other reasons, or if another provider offers to provide the same or similar services at a lower cost. In addition, competitive forces resulting from the possible entrance of a competitive provider could create significant pricing pressure, which could then cause us to reduce the selling price of our services under our contracts. If these contracts are terminated or modified in a manner that is adverse to us, or if

we are unable to renew these contracts on acceptable terms upon their expiration, it would have a material adverse effect on our business, prospects, financial condition and results of operations.

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***Certain of our other contracts may be terminated or we may be unable to renew these contracts, which may reduce the number of services we can offer and damage our reputation.***

In addition to our contracts with NAPM, we rely on other contracts to provide other services that we offer, including the contracts that appoint us to serve as the:

North American Numbering Plan Administrator, under which we maintain the authoritative database of telephone numbering resources in North America;

National Pooling Administrator, under which we perform the administrative functions associated with the administration and management of telephone number inventory and allocation of pooled blocks of unassigned telephone numbers;

provider of NPAC Services in Canada;

operator of the .us registry;

operator of the .biz registry; and

operator of the registry of U.S. Common Short Codes.

Each of these contracts provides for early termination in limited circumstances, most notably if we are in default. In addition, our contracts to serve as the North American Numbering Plan Administrator and as the National Pooling Administrator and to operate the .us registry, each of which is with the U.S. government, may be terminated by the government at will. If we fail to meet the expectations of the FCC, the U.S. Department of Commerce or our customers, as the case may be, for any reason, including for performance-related or other reasons, or if another provider offers to perform the same or similar services for a lower price, we may be unable to extend or renew these contracts. Further, with respect to the renewal or extension of any of our government contracts, we may be subject to bid protests from a competitor, which may require the dedication of substantial company resources, and may result in the loss of the contract. If we were unable to renew or extend any of these contracts, the number of services we are able to offer may be reduced, which would adversely affect our revenue. Further, each of the contracts listed above establishes us as the sole provider of the particular services covered by that contract during its term. If one of these contracts were terminated, or if we were unable to renew or extend the term of any particular contract, we would no longer be able to provide the services covered by that contract and could suffer a loss of prestige that would make it more difficult for us to compete for contracts to provide similar services in the future.

***Failure to comply with neutrality requirements could result in loss of significant contracts.***

Pursuant to orders and regulations of the U.S. government and provisions contained in our material contracts, we must continue to comply with certain neutrality requirements, meaning generally that we cannot favor any particular telecommunications service provider, telecommunications industry segment or technology or group of telecommunications consumers over any other telecommunications service provider, industry segment, technology or group of consumers in the conduct of our business. The FCC oversees our compliance with the neutrality requirements applicable to us in connection with some of the services we provide. We provide to the FCC and the North American Numbering Council, a federal advisory committee established by the FCC to advise and make recommendations on telephone numbering issues, regular certifications relating to our compliance with these requirements. Our ability to comply with the neutrality requirements to which we are subject may be affected by the activities of our stockholders or other parties. For example, if the ownership of our capital stock subjects us to undue influence by parties with a vested interest in the outcome of numbering administration, the FCC could determine that we are not in compliance with our neutrality obligations. Our failure to continue to comply with the neutrality requirements to which we are subject under applicable orders and regulations of the U.S. government and commercial contracts may result in fines, corrective measures or termination of our contracts, any one of which could have a material adverse effect on our results of operations.



***Regulatory and statutory changes that affect us or the communications industry in general may increase our costs or otherwise adversely affect our business.***

The FCC has regulatory authority over certain aspects of our operations, most notably our compliance with our neutrality requirements. We are also affected by business risks specific to the regulated communications industry. Moreover, the business of our customers is subject to regulation that indirectly affects our business. As communications technologies and the communications industry continue to evolve, the statutes governing the communications industry or the regulatory policies of the FCC may change. If this were to occur, the demand for our services could change in ways that we cannot predict and our revenue could decline. These risks include the ability of the federal government, most notably the FCC, to:

increase regulatory oversight over the services we provide;

adopt or modify statutes, regulations, policies, procedures or programs that are disadvantageous to the services we provide, or that are inconsistent with our current or future plans, or that require modification of the terms of our existing contracts, including the manner in which we charge for certain of our services. For example,

In November 2005, BellSouth Corporation filed a petition with the FCC seeking changes in the way our customers are billed for services provided by us under our contracts with North American Portability Management LLC; and

After the amendment of our contracts with North American Portability Management LLC in September 2006, Telcordia Technologies, Inc. filed a petition with the FCC requesting an order that would require North American Portability Management LLC to conduct a new bidding process to appoint a provider of telephone number portability services in the United States, which Telcordia has continued to pursue in response to our amendment of these contracts in January 2009. If successful, this petition could result in the loss of one or more of our contracts with North American Portability Management LLC or otherwise frustrate our strategic plans;

prohibit us from entering into new contracts or extending existing contracts to provide services to the communications industry based on actual or suspected violations of our neutrality requirements, business performance concerns, or other reasons;

adopt or modify statutes, regulations, policies, procedures or programs in a way that could cause changes to our operations or costs or the operations of our customers;

appoint, or cause others to appoint, substitute or add additional parties to perform the services that we currently provide; and

prohibit or restrict the provision or export of new or expanded services under our contracts, or prevent the introduction of other services not under the contracts based upon restrictions within the contracts or in FCC policies.

In addition, we are subject to risks arising out of the delegation of the Department of Commerce's responsibilities for the domain name system to the International Corporation for Assigned Names and Numbers, or ICANN. Changes in the regulations or statutes to which our customers are subject could cause our customers to alter or decrease the services they purchase from us. We cannot predict when, or upon what terms and conditions, further regulation or deregulation might occur or the effect future regulation or deregulation may have on our business.

***If we do not adapt to rapid technological change, we could lose customers or market share.***

Our industry is characterized by rapid technological change and frequent new service offerings. Significant technological changes could make our technology and services obsolete. We must adapt to our rapidly changing market by continually improving the features, functionality, reliability and responsiveness of our services, and by developing new features, services and applications to meet changing customer needs. Our ability to take advantage of opportunities in the market may require us to invest in development and incur other expenses well in advance of our

ability to generate revenue from these services. We cannot guarantee that we will be able to adapt to these challenges or respond successfully or in a cost-effective way, particularly

in the early stages of launching a new service. Further, we may experience delays in the development of one or more features of our solutions, which could materially reduce the potential benefits to us for providing these services. In addition, there can be no assurance that our solutions will be adopted by potential customers, or that we will be able to reach acceptable contract terms with customers to provide these services. Our failure to adapt to meet market demand in a cost-effective manner could adversely affect our ability to compete and retain customers or market share.

***Our customers face implementation and support challenges in introducing IP-based services, which may slow their rate of adoption or implementation of our solutions.***

Historically, carriers have been relatively slow to implement new, complex services such as instant messaging and other IP-based communications. For example, during 2008 and 2009, we witnessed slower than anticipated deployment of our converged messaging solutions by our carrier customers. We have limited or no control over, and cannot accurately predict, the pace at which carriers implement these new IP-based services. Moreover, the launch of new IP-based services by carriers requires significant expenditures by our customers to market and drive adoption by end users. We do not control the decision over whether such expenditures will occur or the timing of such expenditures. In turn, even if carriers attempt to drive adoption of new IP-based services, our future revenue and profits will also depend, in part, on the wide adoption of such services by end users. For instance, we may be required to expend substantial resources to support the efforts of our customers to market and drive the adoption of our converged messaging services by end users. The failure of, or delay by, carriers to introduce and support IP-based services utilizing our solutions in a timely and effective manner, or the failure by end users to adopt such services, could have a material adverse effect on our business and operating results.

***The market for certain of our carrier and enterprise services is competitive, which could result in fewer customer orders, reduced revenue or margins or loss of market share.***

Our services frequently compete against the in-house systems of our customers. In addition, although we are not a carrier, we compete in some areas against carriers, communications software companies and system integrators that provide systems and services used by carriers to manage their networks and internal operations in connection with telephone number portability, instant messaging and other communications transactions. We face competition from large, well-funded providers of carrier and enterprise services. Moreover, we are aware of other companies that are focusing significant resources on developing and marketing services that will compete with us. We anticipate continued growth of competition. Some of our current and potential competitors have significantly more employees and greater financial, technical, marketing and other resources than we have. Our competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements than we can. Also, many of our current and potential competitors have greater name recognition that they can use to their advantage. Increased competition could result in fewer customer orders, reduced revenue, reduced margins or loss of market share, any of which would harm our business.

***If we are unable to protect our intellectual property rights adequately, the value of our services and solutions could be diminished.***

Our success is dependent in part on obtaining, maintaining and enforcing our proprietary rights and our ability to avoid infringing on the proprietary rights of others. While we take precautionary steps to protect our technological advantages and intellectual property and rely in part on patent, trademark, trade secret and copyright laws, we cannot assure that the precautionary steps we have taken will completely protect our intellectual property rights. Because patent applications in the United States are maintained in secrecy until either the patent application is published or a patent is issued, we may not be aware of third-party patents, patent applications and other intellectual property relevant to our services and solutions that may block our use of our intellectual property or may be used by third-parties who compete with our services and solutions.

As we expand our business and introduce new services and solutions, there may be an increased risk of infringement and other intellectual property claims by third-parties. From time to time, we and our customers may receive claims alleging infringement of intellectual property rights, or may become aware of certain third-party patents that may relate to our services and solutions. For example, our converged messaging solutions are designed to conform to Open Mobile Alliance, or OMA, specifications and those of other standards bodies. To the extent that any individual or organization that has contributed intellectual property to OMA or other standards bodies claims that it

has retained its rights relating to such intellectual property, we may be subject to claims of infringement by such individuals or organizations, some of which have greater financial resources and larger intellectual property portfolios than our own.



Additionally, some of our customer agreements require that we indemnify our customers for infringement claims resulting from their use of our intellectual property embedded in their products. Any litigation regarding patents or other intellectual property could be costly and time consuming and could divert our management and key personnel from our business operations. The complexity of the technology involved, and the number of parties holding intellectual property within the communications industry, increase the risks associated with intellectual property litigation. Moreover, the commercial success of our services and solutions may increase the risk that an infringement claim may be made against us. Royalty or licensing arrangements, if required, may not be available on terms acceptable to us, if at all. Any infringement claim successfully asserted against us or against a customer for which we have an obligation to defend could result in costly litigation, the payment of substantial damages, and an injunction that prohibits us from continuing to offer the service or solution in question, any of which could have a material adverse effect on our business, operating results and financial condition.

***Our intellectual property could be misappropriated, which could force us to become involved in expensive and time-consuming litigation.***

Our ability to compete and continue to provide technological innovation is substantially dependent upon internally developed technology. We rely on a combination of patent, copyright, and trade secret laws to protect our intellectual property or proprietary rights in such technology. Despite our efforts to protect our intellectual property and proprietary rights, unauthorized parties may copy or otherwise obtain and use our products, technology or trademarks. Effectively policing our intellectual property is time consuming and costly, and the steps taken by us may not prevent infringement of our intellectual property or proprietary rights in our products, technology and trademarks, particularly in foreign countries where in many instances the local laws or legal systems do not offer the same level of protection as in the United States.

***Our failure to achieve or sustain market acceptance at desired pricing levels could impact our ability to maintain profitability or positive cash flow.***

Our competitors and customers may cause us to reduce the prices we charge for our services and solutions. The primary sources of pricing pressure include:

- competitors offering our customers services at reduced prices, or bundling and pricing services in a manner that makes it difficult for us to compete. For example, a competing provider of interoperability services might offer its services at lower rates than we do, a competing domain name registry provider may reduce its prices for domain name registration or an Internet service provider or a competitor may offer mobile instant messaging solutions at reduced prices or at no cost to the customer;

- customers with a significant volume of transactions may have enhanced leverage in pricing negotiations with us; and

- if our prices are too high, potential customers may find it economically advantageous to handle certain functions internally instead of using our services.

We may not be able to offset the effects of any price reductions by increasing the number of transactions we handle or the number of customers we serve, by generating higher revenue from enhanced services or by reducing our costs.

***A significant decline in the volume of transactions we handle could have a material adverse effect on our results of operations.***

Under our contracts with NAPM, we earn revenue for NPAC Services on an annual, fixed-fee basis. However, in the event that the volume of transactions in a given year is above or below the contractually established volume range for that year, the fixed-fee may be adjusted up or down, respectively, with any such adjustment being applied to the following year's invoices. In addition, under our contract with the Canadian LNP Consortium Inc., we earn revenue on a per transaction basis. As a result, if industry participants in the United States reduce their usage of our services in a particular year to levels below the established volume range for that year or if industry participants in Canada reduce their usage of our services from their current levels, our revenue and results of operations may suffer. For example, consolidation in the industry could result in a decline in transactions if the remaining carriers decide to handle changes to their networks internally rather than use the services that we provide. Moreover, if customer churn among carriers

in the industry stabilizes or declines, or if carriers do not compete vigorously to lure customers away from their competitors, use of our telephone number portability and other services may decline. If carriers

develop internal systems to address their infrastructure needs, or if the cost of such transactions makes it impractical for a given carrier to use our services for these purposes, we may experience a reduction in transaction volumes. Finally, the trends that we believe will drive the future demand for our services, such as the emergence of IP services, growth of wireless services, consolidation in the industry, and pressure on carriers to reduce costs, may not actually result in increased demand for our existing services or for the ancillary directory services that we expect to offer, which would harm our future revenue and growth prospects.

***If we are unable to manage our costs, our profits could be adversely affected.***

Historically, sustaining our growth has placed significant demands on our management as well as on our administrative, operational and financial resources. For us to continue to manage our expanded operations, as well as any future growth, we must continue to improve our operational, financial and management information systems and expand, motivate and manage our workforce. If we are unable to successfully manage our costs without compromising our quality of service, or if new systems that we implement to assist in managing our operations do not produce the expected benefits, we may experience higher turnover in our customer base and our revenue and profits could be adversely affected.

***We may be unable to complete acquisitions, or we may undertake acquisitions that could increase our costs or liabilities or be disruptive to our business.***

We have made a number of acquisitions in the past, and one of our strategies is to pursue acquisitions selectively in the future. We may not be able to locate acquisition candidates at prices that we consider appropriate or on terms that are satisfactory to us. If we do identify an appropriate acquisition candidate, we may not be able to successfully negotiate the terms of the acquisition or, if the acquisition occurs, integrate the acquired business into our existing business. Acquisitions of businesses or other material operations may require additional debt or equity financing, resulting in additional leverage or dilution to our stockholders. Integration of acquired business operations could disrupt our business by diverting management away from day-to-day operations. The difficulties of integration may be increased by the necessity of coordinating geographically dispersed organizations, integrating personnel with disparate business backgrounds and combining different corporate cultures. We also may not realize cost efficiencies or synergies or other benefits that we anticipated when selecting our acquisition candidates, and we may be required to invest significant capital and resources after acquisition to maintain or grow the businesses that we acquire. In addition, we may need to record write-downs from impairments of goodwill, intangible assets, or long-lived assets, or record adjustments to the purchase price that occur after the closing of the transaction, which could reduce our future reported earnings. If we fail to successfully integrate and support the operations of the businesses we acquire, or if anticipated revenue enhancements and cost savings are not realized from these acquired businesses, our business, results of operations and financial condition would be materially adversely affected. Further, at times, acquisition candidates may have liabilities, neutrality-related risks or adverse operating issues that we fail to discover through due diligence prior to the acquisition. The failure to discover such issues prior to such acquisition could have a material adverse effect on our business and results of operations.

***An impairment in the carrying value of goodwill or long-lived assets could negatively impact our consolidated results of operations and net worth.***

Goodwill is initially recorded at fair value and is not amortized, but is reviewed for impairment at least annually or more frequently if impairment indicators are present. In general, long-lived assets are only reviewed for impairment if impairment indicators are present. In assessing goodwill and long-lived assets for impairment, we make significant estimates and assumptions, including estimates and assumptions about market penetration, anticipated growth rates, and risk-adjusted discount rates based on our budgets, business plans, economic projections, anticipated future cash flows and industry data. Some of the estimates and assumptions used by management have a high degree of subjectivity and require significant judgment on the part of management. Changes in estimates and assumptions in the context of our impairment testing may have a material impact, and any potential impairment charges could substantially affect our financial results in the periods of such charges.

***Our expansion into international markets may be subject to uncertainties that could increase our costs to comply with regulatory requirements in foreign jurisdictions, disrupt our operations, and require increased focus from our management.***

Our converged messaging solutions predominantly target international markets. In addition, we are pursuing, and we intend to pursue in the future, other international business opportunities. International operations and business expansion plans are subject to numerous additional risks, including:

economic and political risks in foreign jurisdictions in which we operate or seek to operate;

difficulty of enforcing contracts and collecting receivables through some foreign legal systems;

differences in foreign laws and regulations, including foreign tax, intellectual property, labor and contract law, as well as unexpected changes in legal and regulatory requirements;

differing technology standards and pace of adoption;

export restrictions on encryption and other technologies;

fluctuations in currency exchange rates and any imposition of currency exchange controls;

increased competition by local, regional, or global companies; and

difficulties associated with managing a large organization spread throughout various countries.

If we continue to expand our business globally, our success will depend, in large part, on our ability to anticipate and effectively manage these and other risks associated with our international operations. However, any of these factors could adversely affect our international operations and, consequently, our operating results.

***Our senior management is important to our customer relationships, and the loss of one or more of our senior managers could have a negative impact on our business.***

We believe that our success depends in part on the continued contributions of our senior management. We rely on our executive officers and senior management to generate business and execute programs successfully. In addition, the relationships and reputation that members of our management team have established and maintain with our customers and our regulators contribute to our ability to maintain good customer relations. If we do not retain our senior management, or if we fail to plan adequately for the succession of such individuals, our customer relationships, results of operations and financial condition may be adversely affected.

***We must recruit and retain skilled employees to succeed in our business, and our failure to recruit and retain qualified employees could harm our ability to maintain and grow our business.***

We believe that an integral part of our success is our ability to recruit and retain employees who have advanced skills in the services and solutions that we provide and who work well with our customers in the regulated environment in which we operate. In particular, we must hire and retain employees with the technical expertise and industry knowledge necessary to maintain and continue to develop our operations and must effectively manage our growing sales and marketing organization to ensure the growth of our operations. Our future success depends on the ability of our sales and marketing organization to establish direct sales channels and to develop multiple distribution channels with Internet service providers and other third-parties. The employees with the skills we require are in great demand and are likely to remain a limited resource in the foreseeable future. If we are unable to recruit and retain a sufficient number of these employees at all levels, our ability to maintain and grow our business could be negatively impacted.

***Health epidemics or other events such as wars, acts of terrorism, political unrest or other man-made or natural disasters could severely disrupt our business operations.***

Adverse public health epidemics or pandemics could disrupt business and the economies of the countries in which we do business, including those in Asia. Certain regions in Asia have reported outbreaks of a highly pathogenic flu caused by the H1N1 virus. In the first half of 2003, certain countries in Asia experienced an outbreak of Severe Acute Respiratory Syndrome, or SARS, which seriously interrupted economic activities and caused the demands for goods and services to decrease in the affected regions. A recurrence of SARS or an outbreak of the H1N1 or other influenzas could result in a widespread health crisis that could adversely affect the economies and financial markets of many countries, particularly in Asia. Such events could cause a significant disruption in our operations, services, development of our services, and customer demand for our services. Such significant disruptions could have an adverse impact on our business, financial condition, results of operations and cash flows.

**Risks Related to the Financial Market Conditions**

***The recent financial crisis could negatively affect market utilization of our existing and new services and may harm our financial results.***

Our success depends on our ability to generate revenues from our existing services and our introduction of new services, extensions of existing services and geographic expansion. For some of the services we provide, the market has only recently developed, and the viability and profitability of these services is unproven. Our ability to grow our business will be compromised if we do not develop and market services that achieve broad market acceptance with our current and potential customers. If our service offerings do not gain widespread market acceptance, our financial results could suffer. The global economic disruption experienced during the second half of 2008 and throughout 2009, and any continuing unfavorable changes in economic conditions, may result in lower overall spending by our current and potential customers, and adversely affect our ability to generate revenue from our existing services, introduce new services or extensions of existing services and expand geographically. If the economic downturn is prolonged, we may have difficulty in maintaining and establishing a market for our existing and new services and our financial performance may suffer.

***We may need additional capital in the future and it may not be available on acceptable terms.***

We have historically relied on outside financing and cash flow from operations to fund our operations, capital expenditures and expansion. We may require additional capital in the future to fund our operations, finance investments in equipment or infrastructure, or respond to competitive pressures or strategic opportunities. However, our neutrality requirements may limit or prohibit our ability to obtain debt or equity financing by restricting the ability of certain parties from acquiring our stock or our debt, or the amount that such parties may acquire. In addition, difficulties in the global credit markets have resulted in a substantial decrease in the availability of credit. Some commercial banks are refusing to provide financing, others are imposing more onerous terms on borrowers, including higher interest rates. As a result, additional financing may not be available on terms favorable to us, or at all. Further, the terms of available financing may place limits on our financial and operating flexibility. If we are unable to obtain sufficient capital in the future, we may:

not be able to continue to meet customer demand for service quality, availability and competitive pricing;

be forced to reduce our operations;

not be able to expand or acquire complementary businesses; and

not be able to develop new services or otherwise respond to changing business conditions or competitive pressures.

### **Risks Related to Our Common Stock**

#### ***Our common stock price may be volatile.***

The market price of our Class A common stock may fluctuate widely. Fluctuations in the market price of our Class A common stock could be caused by many things, including:

our perceived prospects and the prospects of the telephone and Internet industries in general;

differences between our actual financial and operating results and those expected by investors and analysts;

changes in analysts' recommendations or projections;

changes in general valuations for communications companies;

adoption or modification of regulations, policies, procedures or programs applicable to our business;

sales of our Class A common stock by our officers, directors or principal stockholders;

sales of significant amounts of our Class A common stock in the public market, or the perception that such sales may occur;

sales of our Class A common stock due to a required divestiture under the terms of our certificate of incorporation; and

changes in general economic or market conditions and broad market fluctuations.

Each of these factors, among others, could have a material adverse effect on the market price of our Class A common stock. Recently, the stock market in general has experienced extreme price fluctuations. This volatility has had a substantial effect on the market prices of securities issued by many companies for reasons unrelated to the operating performance of the specific companies. Some companies that have had volatile market prices for their securities have had securities class action suits filed against them. If a suit were to be filed against us, regardless of the outcome, it could result in substantial costs and a diversion of our management's attention and resources. This could have a material adverse effect on our business, prospects, financial condition and results of operations.

#### ***Delaware law and provisions in our certificate of incorporation and bylaws could make a merger, tender offer or proxy contest difficult, and the market price of our Class A common stock may be lower as a result.***

We are a Delaware corporation, and the anti-takeover provisions of the Delaware General Corporation Law may discourage, delay or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a period of three years after the person becomes an interested stockholder, even if a change of control would be beneficial to our existing stockholders. In addition, our certificate of incorporation and bylaws may discourage, delay or prevent a change in our management or control over us that stockholders may consider favorable. Our certificate of incorporation and bylaws:

authorize the issuance of blank check preferred stock that could be issued by our board of directors to thwart a takeover attempt;

prohibit cumulative voting in the election of directors, which would otherwise enable holders of less than a majority of our voting securities to elect some of our directors;

establish a classified board of directors, as a result of which the successors to the directors whose terms have expired will be elected to serve from the time of election and qualification until the third annual meeting following election;

require that directors only be removed from office for cause;

provide that vacancies on the board of directors, including newly-created directorships, may be filled only by a majority vote of directors then in office;

disqualify any individual from serving on our board if such individual's service as a director would cause us to violate our neutrality requirements;

limit who may call special meetings of stockholders;

prohibit stockholder action by written consent, requiring all actions to be taken at a meeting of the stockholders; and

establish advance notice requirements for nominating candidates for election to the board of directors or for proposing matters that can be acted upon by stockholders at stockholder meetings.

***In order to comply with our neutrality requirements, our certificate of incorporation contains ownership and transfer restrictions relating to telecommunications service providers and their affiliates, which may inhibit potential acquisition bids that our stockholders may consider favorable, and the market price of our Class A common stock may be lower as a result.***

In order to comply with neutrality requirements imposed by the FCC in its orders and rules, no entity that qualifies as a telecommunications service provider or affiliate of a telecommunications service provider, as such terms are defined under the Communications Act of 1934 and FCC rules and orders, may beneficially own 5% or more of our capital stock. As a result, subject to limited exceptions, our certificate of incorporation prohibits any telecommunications service provider or affiliate of a telecommunications service provider from beneficially owning, directly or indirectly, 5% or more of our outstanding capital stock. Among other things, our certificate of incorporation provides that:

if one of our stockholders experiences a change in status or other event that results in the stockholder violating this restriction, or if any transfer of our stock occurs that, if effective, would violate the 5% restriction, we may elect to purchase the excess shares (i.e., the shares that cause the violation of the restriction) or require that the excess shares be sold to a third-party whose ownership will not violate the restriction;

pending a required divestiture of these excess shares, the holder whose beneficial ownership violates the 5% restriction may not vote the shares in excess of the 5% threshold; and

if our board of directors, or its permitted designee, determines that a transfer, attempted transfer or other event violating this restriction has taken place, we must take whatever action we deem advisable to prevent or refuse to give effect to the transfer, including refusal to register the transfer, disregard of any vote of the shares by the prohibited owner, or the institution of proceedings to enjoin the transfer.

Our board of directors has the authority to make determinations as to whether any particular holder of our capital stock is a telecommunications service provider or an affiliate of a telecommunications service provider. Any person who acquires, or attempts or intends to acquire, beneficial ownership of our stock that will or may violate this restriction must notify us as provided in our certificate of incorporation. In addition, any person who becomes the beneficial owner of 5% or more of our stock must notify us and certify that such person is not a telecommunications service provider or an affiliate of a telecommunications service provider. If a 5% stockholder fails to supply the required certification, we are authorized to treat that stockholder as a prohibited owner meaning, among other things, that we may elect to purchase the excess shares or require that the excess shares be sold to a third-party whose ownership will not violate the restriction. We may request additional information from our stockholders to ensure compliance with this restriction. Our board will treat any group, as that term is defined in Section 13(d)(3) of the Securities Exchange Act of 1934, as a single person for purposes of applying the ownership and transfer restrictions in our certificate of incorporation.

Nothing in our certificate of incorporation restricts our ability to purchase shares of our capital stock. If a purchase by us of shares of our capital stock results in a stockholder's percentage interest in our outstanding capital stock increasing to over the 5% threshold, such stockholder must deliver the required certification regarding such stockholder's status as a telecommunications service provider or affiliate of a telecommunications service provider. In addition, to the extent that a repurchase by us of shares of our capital stock causes any stockholder to violate the restrictions on ownership and transfer contained in our certificate of incorporation, that stockholder will be subject to all of the provisions applicable to prohibited owners, including required divestiture and loss of voting rights.





These restrictions and requirements may:

discourage industry participants that might have otherwise been interested in acquiring us from making a tender offer or proposing some other form of transaction that could involve a premium price for our shares or otherwise be in the best interests of our stockholders; and

discourage investment in us by other investors who are telecommunications service providers or who may be deemed to be affiliates of a telecommunications service provider.

The standards for determining whether an entity is a telecommunications service provider are established by the FCC. In general, a telecommunications service provider is an entity that offers telecommunications services to the public at large, and is, therefore, providing telecommunications services on a common carrier basis. Moreover, a party will be deemed to be an affiliate of a telecommunications service provider if that party controls, is controlled by, or is under common control with, a telecommunications service provider. A party is deemed to control another if that party, directly or indirectly:

owns 10% or more of the total outstanding equity of the other party;

has the power to vote 10% or more of the securities having ordinary voting power for the election of the directors or management of the other party; or

has the power to direct or cause the direction of the management and policies of the other party.

The standards for determining whether an entity is a telecommunications service provider or an affiliate of a telecommunications service provider and the rules applicable to telecommunications service providers and their affiliates are complex and may be subject to change. Each stockholder is responsible for notifying us if it is a telecommunications service provider or an affiliate of a telecommunications service provider.

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

The following table is a summary of our repurchases of common stock during each of the three months in the quarter ended June 30, 2010:

Month	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
April 1 through April 30, 2010	1,688	\$ 26.05		\$
May 1 through May 31, 2010	2,185	22.75		
June 1 through June 30, 2010	1,481	20.88		
Total	5,354	\$ 23.27		\$

(1) The number of shares purchased consists of

shares of  
common stock  
tendered by  
employees to us  
to satisfy the  
employees' tax  
withholding  
obligations  
arising as a  
result of vesting  
of restricted  
stock grants  
under our stock  
incentive plan.

We purchased  
these shares for  
their fair market  
value on the  
vesting date.

None of these  
share purchases  
were part of a  
publicly  
announced  
program to  
purchase our  
common stock.

**Item 3. Defaults upon Senior Securities**

None.

**Item 4. [Removed and Reserved]**

**Item 5. Other Information**

None.

**Item 6. Exhibits**

See exhibits listed under the Exhibit Index below.

**SIGNATURES**

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

**NeuStar, Inc.**

Date: July 28, 2010

By: /s/ Paul S. Lalljie  
Paul S. Lalljie  
Chief Financial Officer  
(Principal Financial and Accounting Officer  
and Duly Authorized Officer)

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**EXHIBIT INDEX**

Exhibit No.	Description
3.1	Restated Certificate of Incorporation, incorporated herein by reference to Exhibit 3.1 to Amendment No. 7 to NeuStar's Registration Statement on Form S-1, filed June 28, 2005 (File No. 333-123635).
3.2	Amended and Restated Bylaws, incorporated herein by reference to Exhibit 3.2 to NeuStar's Current Report on Form 8-K, filed September 16, 2008.
10.1.2	Amendment to the contractor services agreement by and between NeuStar, Inc. and North American Portability Management LLC.
10.28	NeuStar, Inc. 2010 Key Employee Severance Pay Plan.
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document**
101.SCH	XBRL Taxonomy Extension Schema**
101.CAL	XBRL Taxonomy Extension Calculation**
101.DEF	XBRL Taxonomy Extension Definition**
101.LAB	XBRL Taxonomy Extension Label**
101.PRE	XBRL Taxonomy Extension Presentation**

Compensation arrangement.

\*\* Pursuant to applicable securities laws and regulations, the Company is deemed to have complied with the reporting obligation relating to the submission of

interactive data files in such exhibits and is not subject to liability under any anti-fraud provisions or other liability provisions of the federal securities laws as long as the Company has made a good faith attempt to comply with the submission requirements and promptly amends the interactive data files after becoming aware that the interactive data files fail to comply with the submission requirements. In addition, users of this data are advised that, pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and

otherwise are  
not subject to  
liability under  
these sections.