

Answers CORP  
Form 10-K  
March 17, 2011

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 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 001-32255

ANSWERS CORPORATION  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

98-0202855  
(I.R.S. Employer  
Identification No.)

237 West 35th Street, Suite 1101, New York,  
N.Y.  
(Address of principal executive offices)

10001  
(Zip Code)

Registrant's telephone number, including area code: (646) 502-4777

Securities registered pursuant to Section 12(b) of the Act:

Title of each class  
Common Stock

Name of each exchange on which registered  
The NASDAQ Capital Market

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Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

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 definition 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   
(do not check if smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). 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

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant, computed by reference to price at which the common equity was sold, or the average bid and asked price of such common stock as of June 30, 2010, was \$55,567,035. For purposes of this computation, the registrant has excluded the market value of all shares of its common stock reported as being beneficially owned by executive officers and directors and holders of more than 10% of the common stock on a fully diluted basis of the registrant; such exclusion shall not, however, be deemed to constitute an admission that any such person is an "affiliate" of the registrant. As of March 15, 2011, there were 8,134,602 issued and outstanding shares of common stock of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

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Pursuant to General Instruction G(3) to Form 10-K, the information required by Part III of this Annual Report on Form 10-K will be filed by amendment or included in the 2011 Proxy Statement, each filed with the Securities and Exchange Commission within 120 days of the end of the Registrant's year ended December 31, 2010.

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### INTRODUCTORY NOTES

As used herein, “Answers.com,” “the company,” “we,” “us,” “our,” and similar terms refer to, and include, Answers Corporation and its subsidiary, GuruNet Israel Ltd., unless the context indicates otherwise.

We use various trademarks and trade names in our business, including without limitation “Answers.com,” “WikiAnswers,” “WikiAnswers.comTM,” “AnswerthonTM,” “AnswerTips,” “blufr” and “1-Click AnswersTM”. This Annual Report also contains trademarks and trade names of other businesses that are the property of their respective holders.

### Merger with AFCV

On February 2, 2011, the company entered into a merger agreement with AFCV Holdings, LLC, a Delaware corporation. Under the terms of the merger agreement, a subsidiary of AFCV will be merged with and into Answers.com, with Answers.com continuing as the surviving corporation and a wholly-owned subsidiary of AFCV. If the merger is completed, at the effective time of the merger, holders of Answers.com common stock, other than holders who properly exercise appraisal rights, will be entitled to receive \$10.50 in cash, without interest, less any applicable withholding taxes, for each share of Answers.com common stock owned at the effective time of the merger. Holders of the company’s Series A convertible preferred stock will receive an amount in cash, without interest, for each share of Series A stock owned equal to \$10.50 multiplied by (A) the stated value of \$101.76 plus accrued but unpaid dividends thereon accrued daily at the rate of 6% per annum calculated from the date on which the last regular quarterly dividend is paid in respect of the Series A stock to the effective time of the merger, divided by (B) \$4.50. Holders of the company’s Series B convertible preferred stock will receive an amount in cash without interest for each share of Series B stock owned equal to \$10.50 multiplied by (A) the stated value of \$100.00 plus accrued but unpaid dividends thereon accrued daily at the rate of 6% per annum calculated from the date on which the last regularly quarterly dividend is paid in respect of the Series B stock to the effective time of the merger, divided by (B) \$5.50. The merger is subject to various conditions, including the adoption of the merger agreement by the company’s stockholders. A special meeting of stockholders of the company has been called for April 12, 2011 to vote on adoption of the merger agreement. The company has distributed to stockholders and filed with the Securities and Exchange Commission a proxy statement in connection with the special meeting, which contains information concerning the merger agreement and the merger. Reference is made to the proxy statement for this information.

### Forward Looking Statements

This Annual Report on Form 10-K contains “forward looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These include, among other things, our expectations relating to the growth of our business and revenue, future traffic trends and patterns, future RPM trends and seasonality; our plans to continue investing resources in our core platform in areas such as content quality, maintaining and improving search engine optimization, performance, scalability, and usability; our plans for mobile Answers.com access; and our belief in the adequacy of our cash and cash equivalent to fund our working capital and operating requirements. These forward looking statements are based on expectations, estimates, goals and projections as of the date of this filing and are subject to significant risks and uncertainties. Actual results may differ materially from those expressed in forward looking statements.

In addition, our actual results could be affected by matters relating to merger agreement, including disruptions to our operations, strategic programs and partner relationships resulting from the announcement of or the preparation for the merger; operational restrictions under the merger agreement; costs, fees, expenses and charges related to the merger; and actual and potential litigation relating to the merger.

### References to Web Property Usage Measurements

We gauge the effectiveness of our monetization efforts and trends by measuring our revenue per thousand page views, or RPM. Throughout this Annual Report, we refer to estimates of traffic, or page views, whose source is HBX Analytics, a tag-based Web analytics system offered by Omniture, Inc., a subsidiary of Adobe, Inc. (“Omniture”). Traffic measurements from this system are generated by our placement of tags on our Web pages. The Omniture system then independently generates traffic metrics. We also use Google, Inc.’s Google Analytics measurement services to estimate the breakdown of our traffic sources. Google Analytics measurements are generated by our placement of tags on our Web properties’ pages, which Google Analytics uses to count and report audience metrics independently. In this annual report, statistics gathered from Omniture and Google Analytics are also referred to as “internal estimates”.

We also follow and report certain measurements performed by comScore, Inc., a global leader in measuring the digital world and one of the preferred sources of digital marketing intelligence. comScore’s “unique visitors” data to which we subscribe, is based on a solution introduced by comScore in mid-2009, Media Metrix 360, a ‘panel-centric hybrid’ approach to digital audience measurement, currently referred to by comScore as a Unified Digital Measurement solution. comScore’s unified methodology combines person-level measurement from its proprietary global panel with Web site server metrics. Our focus on comScore’s unique visitors metric – in the U.S. and worldwide – helps us understand and analyze our progress vis-à-vis other Web properties and competitors. Direct comparison of a ranking post implementation of comScore’s Media Metrix 360 solution, versus a ranking preceding the implementation of this relatively new solution, may not reflect the actual change in a site’s ranking or audience size over time.

Third party services measuring traffic audiences may provide different estimates than the estimates reported by other similar services and our internal estimates. These discrepancies may result from differences in methodologies applied or the sampling approaches used by each measuring service.

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ANSWERS CORPORATION

PART I

Item 1. Business

We were incorporated as a Texas corporation in December 1998 and reorganized as a Delaware corporation in April 1999. In October 2005, we changed our name from GuruNet Corporation to Answers Corporation. Our principal executive offices are located in New York, NY. In addition, we have an office in Jerusalem, Israel. We completed our initial public offering in October 2004 and our common stock is listed on The NASDAQ Capital Market under the symbol “ANSW.”

Available Information

We make available free of charge at [www.answers.com](http://www.answers.com) (in the “Investor Relations” section) copies of materials we file with, or furnish to, the Securities and Exchange Commission, or SEC, including our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports, as soon as reasonably practicable after we electronically file such materials with, or furnish them to, the SEC.

Mission

Our mission is to become the dominant and recognized market leader for answers online.

Answers.com is committed to bringing people the best possible answers covering all topics in thousands of categories by leveraging a growing community of contributors and an editorial library of authoritative content licensed from leading publishers.

We intend to build the best online:

- Answer experience
- Answer database
- Q&A community

Overview

Answers.com is a leading Q&A site catering to the growing need of online consumers to locate answers to their questions. By integrating our two popular properties - WikiAnswers and ReferenceAnswers –we have combined the power of community-driven content with hundreds of expert resources from licensed content. People can ask anything and automatically receive the best available answer, which could be user-generated or from an editorial resource. Our community-generated social knowledge Q&A platform, WikiAnswers, leverages wiki-based technologies; through the contributions of a large and growing community, answers can be edited and improved over time. The award-winning reference site ReferenceAnswers includes content on millions of topics from over 250 licensed sources created by leading publishers, including Houghton Mifflin Company, Barron's and Encyclopedia Britannica.

According to comScore data for the month of February 2011, Answers.com had 54.6 million unique visitors, which ranked us number 17 in the top U.S. Web properties. Worldwide, Answers.com had approximately 94.5 million monthly unique visitors, ranking us number 31 in the world's top properties in January 2011.

According to our internal estimates, during 2010, Answers.com yielded approximately 4.3 billion page views.



Our business runs on the ability to attract and monetize traffic to Answers.com. Monetization of Answers.com is achieved by displaying online advertisements, mostly pay-per-performance ads which require people viewing them to actually click on them in order for us to generate revenue. We earn substantially all of our revenue from online advertising.

We believe our valuable content and overall user experience drives traffic to Answers.com, which in turn drives advertising revenue.

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### Company History

Prior to January 2005, we were primarily in the business of selling subscriptions for access to an answer-based product which benefited from intelligent aggregation of multiple sources of content.

In January 2005, we announced the release of the original version of Answers.com, a free-access Web site that had been launched in August 2004 in beta version. The answer-based service offered content from brand-name publishers licensed by us. In conjunction with the original Answers.com, we also released 1-Click Answers, our free downloadable software application that facilitates more efficient access for Windows users to the original Answers.com.

In November 2006, we acquired a questions and answers Web site, collaboratively written and edited by its community of users, which we later re-branded “WikiAnswers”. Our objective for WikiAnswers was twofold: First, we aimed to turn our platform into a dynamic, multi-disciplinary resource for users to share knowledge on similar areas of interest, thus adding a compelling facet to our overall offering. Second, we strived to leverage the potential of the network effect discussed in more detail below (the WikiAnswers Component) and strategically use WikiAnswers as a content creation source.

Over the course of 2007, 2008 and 2009, our focus on user-generated content grew considerably and became the primary driver of our business.

We began to integrate Answers.com and WikiAnswers towards the end of 2008. The product strategy guiding the integration was our desire to give users the best answers to all types of questions – be they community-generated from WikiAnswers, or editorially licensed from Answers.com, which we rebranded as ReferenceAnswers.

In September 2009 we announced the launch of the new Answers.com, in recognition of our completing the integration of our two Web properties. Thus, Answers.com is now our umbrella brand and is comprised of two properties or sub-brands, WikiAnswers and ReferenceAnswers.

### Products & Services

#### The New Answers.com

We own and operate Answers.com, a leading Q&A site, dedicated to providing useful answers to questions about anything. Answers.com includes two Web properties, or components: WikiAnswers and ReferenceAnswers. WikiAnswers is a community-generated social knowledge Q&A platform, leveraging wiki-based technologies. Through the contributions of the community, our questions and answers are continuously growing, improving and being updated, to form the world’s best Q&A database. ReferenceAnswers provides trusted editorial content on millions of topics licensed from the world’s top reference publishers.

#### Integration of WikiAnswers and ReferenceAnswers

The first stages of the integration were minor - creating a similar “look and feel” for, and cross-linking between, the two Web properties. Thus, for example, a user looking up “Michael Jackson” in ReferenceAnswers, arrived at a page displaying reference content covering the specific query, in addition to being asked to answer WikiAnswers unanswered questions relating to Michael Jackson. The result page also resembled a WikiAnswers page by way of including the standard “Ask” and “Answer” bar in the header of the page, as opposed to the original “Search” button displayed adjacent to the query bar. Subsequently, we added an “All” radio button adjacent to the query bar on both properties, allowing users, should they choose, to find a result by searching both properties. In the second quarter of

2009, we took an important additional step in integrating both Web properties by making the “All” radio button the default setting above the query box of both properties. As a result of this user-interface change, users typing in queries into either of our properties are automatically directed to the Web page our algorithms deem most appropriate as a response. For example, a user typing the query, “When did WWII start?” in ReferenceAnswers, lands on a Web page belonging to WikiAnswers with an answer to that question. A user typing the query “Who is Oprah Winfrey?” in WikiAnswers, arrives at a ReferenceAnswers page displaying the Oprah Winfrey topic. In September 2009, we took our final step in integrating the two Web properties by creating a new unified Answers.com home page and login, integrating features from both properties, and making other changes in our user interface to strengthen our positioning as having one dominant product and brand, Answers.com, comprised of the two properties, WikiAnswers and ReferenceAnswers.

During 2010, Answers.com also began featuring many licensed videos. We believe that our users will value and be attracted to the videos covering thousands of topics in numerous categories.

#### The WikiAnswers Component

WikiAnswers is a user-generated content (UGC), community-based, Q&A platform where people ask questions and the community answers them. WikiAnswers is currently differentiated from other popular question and answer sites which facilitate a forum where users can ask and answer questions, often repeating the same question in many different ways, but cannot improve upon or edit the questions or answers. WikiAnswers’ approach allows the community to transform each question and answer into its own “wiki” page, a collaborative page that can be improved upon by others in the community. In this manner, good answers can potentially become better answers over time; related questions can be merged or physically associated with each other; and ultimately, the community user-experience is enhanced.

Content generation is the core of WikiAnswers. The dynamics of UGC make WikiAnswers highly scalable. We believe the size of the community helps drive the quantity of the content, content attracts additional users which in turn grows the community. We believe this cyclical pattern is the major source of growth for WikiAnswers. We have seen a very high correlation between growth in questions and answers and growth in page views. This is the self reinforcing, self sustaining growth engine driving WikiAnswers. We intend to focus on continuing this trend and enhance WikiAnswers to grow the overall community, which in turn should heavily contribute to the overall growth of Answers.com’s content and traffic.

#### The ReferenceAnswers Component

ReferenceAnswers, launched in January 2005 as the original Answers.com, aggregates millions of topics in categories including health and medical, legal, business and finance, science and technology, history, reference, translation and language from brand-name publishers and other sources. Our technology combines and presents targeted information from disparate sources and delivers answers to users’ questions in a single consolidated view.

Our ReferenceAnswers content includes over 250 licensed titles from leading offline and online publishers. The publishers from which we currently license content include, among many others, All Media Guide, Barron’s Educational Series, Encyclopedia Britannica, Houghton Mifflin Company, McGraw-Hill, Oxford University Press and Gale. We attribute the data source of information on each Web page, enabling our users to make an independent evaluation as to the credibility of the content.

Licensing agreements with our publishers are generally for fixed periods, mostly ranging from one year to four years, renewable by consent of the parties. A licensing agreement will typically entitle us to provide the licensed information to our end users through ReferenceAnswers in return for a fixed amount payable over the life of the agreement, either in a lump sum up front or payable over the course of a fixed schedule, either monthly, quarterly or annually. We also provide content we license at no cost, for example, from Wikipedia. We favor content that is difficult to find elsewhere on the Internet.

Access to ReferenceAnswers is also enabled through 1-Click Answers, a downloadable application which, when installed on a computer, enables a user to click on a word or phrase within virtually any program, such as an e-mail, spreadsheet, document or database, and gain access to ReferenceAnswers' online library. Since 2007, we began offering other Web properties and blogs the ability to provide their users with the 1-Click functionality through our webmaster tool version of 1-Click Answers, known as "AnswerTips", which does not require a download.

#### Mobile Access to Answers.com

In mid-2010, the Company introduced its newly-designed mobile version for iPhone, Android and other handheld devices. With mobile Web usage and apps becoming more prevalent, and Facebook's announcement in 2010 that it has surpassed 100 million monthly mobile users, connecting Answers.com with the ever-increasing proportion of users on the go has become an important strategic element. Mobile access constitutes an opportunity to expand Answers.com's user-base, data-base and brand recognition. The mobile site can be accessed by entering <http://m.answers.com> or [www.answers.com](http://www.answers.com) into the mobile browser of any Web-enabled handheld device.

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## Content Quality

Content quality plays a crucial role in our search engine rankings, as well as user experience. Particularly in light of the enormous amount of user-generated content offered on Answers.com via the WikiAnswers component, in the event the perceived quality of content on Answers.com pages does not improve and/or if it deteriorates, our pages may rank lower in the algorithmic systems of search engines. Lower ranking content could cause Answers.com's results to be less likely to be accessed by users, resulting in traffic declines. In an effort to recognize the opportunities and risks noted above, we are currently developing our Reputation Management System, or "RMS". The goal of RMS will be to measure and rate the trustworthiness of each contributor, each question and each answer. Using this data, RMS will serve as a quality watchdog, mitigating poor quality contributions and encouraging high quality contributors. We view RMS as potentially being a key factor in driving future traffic, growth and revenue, in addition to helping protect our search engine rankings.

## Internationalization

In the third quarter of 2009 we launched French, Italian, German and Spanish language versions of WikiAnswers, which we refer to as "FIGS". The Q&A platform also supports Tagalog (Filipino). Our strategy will capitalize on the needs of users around the globe who are searching for answers online and will leverage our core strengths: community building and Q&A space. During the three consecutive quarters ending June 30, 2010, we created a database of approximately 300,000 questions and answers in FIGS languages by translating our English-language Q&A content, at a total cost of approximately \$470 thousand, in an effort to quickly grow those foreign-language versions of WikiAnswers. Beginning the third quarter of 2010, we have not translated any additional English-language Q&A into the FIGS languages. While the international market represents a large market opportunity for us, and we continue to employ personnel responsible for managing FIGS sites, we have currently suspended our translation efforts because of our desire to focus our resources on other initiatives.

## Traffic Generation

Our revenues are primarily driven by the traffic generated by Answers.com and our ability to effectively monetize that traffic. Please refer to the Introductory Notes of this Annual Report for an explanation of the manner in which we measure traffic. The 2010 average daily page views and RPMs (revenue per thousand page views) of Answers.com, by quarter, broken down by component, are as follows:

|  | Q1         | Q2         | Q3         | Q4         |
|--|------------|------------|------------|------------|
| Traffic<br>(page views)                  |            |            |            |            |
| WikiAnswers                              | 8,995,000  | 8,578,000  | 8,279,000  | 11,110,000 |
| ReferenceAnswers                         | 2,737,000  | 2,399,000  | 2,405,000  | 2,801,000  |
| Total                                    | 11,732,000 | 10,977,000 | 10,684,000 | 13,911,000 |
| WikiAnswers                              | 77%        | 78%        | 77%        | 80%        |
| ReferenceAnswers                         | 23%        | 22%        | 23%        | 20%        |
| Total                                    | 100%       | 100%       | 100%       | 100%       |
| RPM<br>(Revenue per thousand page views) |            |            |            |            |
| WikiAnswers                              | \$5.55     | \$5.11     | \$4.35     | \$4.63     |

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|                  |        |        |        |        |
|------------------|--------|--------|--------|--------|
| ReferenceAnswers | \$4.94 | \$4.64 | \$5.09 | \$5.94 |
|------------------|--------|--------|--------|--------|

Search engines. Answers.com's largest source of traffic is search engines, which represented approximately 90% of our traffic for the fourth quarter of 2010. Among search engines, Google is by far our largest provider of search engine traffic, providing approximately 85% of overall search engine traffic in the fourth quarter of 2010.

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We continually seek to improve the volume and optimize the monetization of traffic directed to our Web properties by search engines. The industry commonly refers to these efforts as search engine optimization, or SEO. One of our principal strategic initiatives is centered on our understanding that content drives traffic through SEO. We believe that rich, unique content is valued by the user and by the search engines and their content indexing algorithms. Thus, we have historically focused on adding unique content that has not been broadly offered on the Web. Currently, the Q&A-oriented content belonging to the WikiAnswers component is playing an overwhelming role in creating rich and unique information for Answers.com. Our additional SEO efforts involve optimizing Answers.com's coding, presentation and structure, such as incorporating a clear hierarchical site-structure, and structuring the site to facilitate search engine indexing.

Direct users. Answers.com also receives traffic from users visiting and returning to our sites directly. Direct users represented approximately 10% of our traffic for the fourth quarter of 2010.

## Traffic Monetization

We earn practically all of our revenue from advertising. There are two primary categories of Internet advertising: pay-per-performance, also known as cost-per-click ("CPC"), and pay-per-impression display ads or cost per 1,000 impressions ("CPM"). In the CPC model, we earn revenue based on the number of clicks associated with an ad; in the CPM model, we derive revenue from the sole display of ads on pages that are visited by our audience. Beginning the fourth quarter of 2010, we added a third category of advertising to Answers.com, namely, in-text advertising, a form of contextual advertising where specific keywords within the text of a web-page are matched with advertising units. Those specific keywords become hyperlinks that populate an advertising "bubble" when users hover over the keywords using their cursor. We earn revenue each time a hyperlink within such "bubble" is clicked. 77%, 20% and 3% of our advertising revenue in 2010 was earned from CPC advertising, CPM advertising, and in-text advertising, respectively. We obtain advertisements from third-party ad networks. These ad networks compensate us by paying us a portion of the revenue they earn from advertisers for our provision of promotional space on Answers.com.

Our primary third party ad network, Google AdSense, provided Answers.com with almost all of the site's CPC ads and accounted for approximately 77% of our total advertising revenue in 2010.

Google AdSense. Google AdSense refers to the online program through which Google distributes advertisers' "AdWords" ads, for display on the web sites of its Google Network members. Answers.com is a member of such network. Google's AdSense program includes, amongst others, "AdSense for search" and "AdSense for content", both of which are utilized on Answers.com.

AdSense for search ("AFS") is Google's online service for distributing relevant ads from advertisers for display with search results. Google's AdSense for search ads are targeted to match user search queries. For example, if a user has typed into the Answers.com search box a query with the words "going green initiatives," the search result page may include ads relating to environmentally-friendly products. Answers.com displays Google's AdSense for search ads in textual format. Most of the ads served on the ReferenceAnswers component of Answers.com are delivered by AdSense for search.

AdSense for content ("AFC") is Google's online service for distributing ads from its network of advertisers that are relevant to content appearing on Answers.com. Google's technology analyzes the meaning of the content on Answers.com web pages and serves relevant ads based on the meaning of such content. For example, a web page with a question and an answer about finding a job might display ads for job placement agencies or higher education programs. While AdSense for content allows a variety of ad types to be shown, including text ads, image ads, Google Video Ads and more, Answers.com utilizes text ads, almost exclusively. The vast majority of ads displayed on the WikiAnswers component of Answers.com are drawn from AdSense for content.

Advertisers in Google's network pay Google a fee each time an Answers.com user clicks on their advertisement which Google served to our site. Google shares the revenue associated with these clicks, with us.

Google Contract. In January 2005, we entered into the Google Services Agreement (GSA) governing our participation in Google AdSense. In effect, the GSA positions Google AdSense as our most significant third party ad network. The GSA, extended for an additional two years pursuant to an October 2009 amendment, is scheduled to expire on January 31, 2012. Google may terminate the GSA with no advance notice for any of the following reasons:



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- our breach of certain prohibited actions including, among other things:
  - o editing or modifying the order of search results,
  - o redirecting end users, producing or distributing any software which prevents the display of ads by Google,
  - o modifying, adapting or otherwise attempting to obtain source code from Google technology, content, software and documentation, or
  - o engaging in any action or practice that reflects poorly on Google or otherwise disparages or devalues Google's reputation or goodwill;
- our breach of the grant of a license to us by Google of certain trade names, trademarks, service marks, logos, domain names and other distinctive brand features of Google;
  - our breach of the confidentiality provisions of the GSA;
  - our breach of the exclusivity provisions of the GSA; or
- our material breach of the GSA more than two times, irrespective of any cure to such breaches.

Licensing Revenue. We earn a negligible portion of our revenues from partners that pay us for providing them with our answer-based services that they then use in their own products, via co-branded Web pages.

Direct Ad Sales. Our plan is to launch our own direct ad sales department, in an effort to diversify our revenue sources and improve RPMs. We have recently decided to postpone those plans until the second half of 2011 due to the developments concerning the planned merger with AFCV Holdings, LLC.

Site Redesign. we are in the process of redesigning Answers.com and will begin testing certain site elements beginning the second quarter of 2011. One of the elements of the redesign will allow for different size ad units and changing the location of ads on the page, in an effort to combat "ad-blindness," the term we use to describe our belief that users click on advertisements less, the more they get accustomed to viewing them. Additionally, the site redesign is intended to give expression to the inherent vertical nature of our content, thus, we believe, supporting our efforts to improve monetization.

#### Seasonality

Our results of operations have historically been affected by seasonal patterns in both traffic to Answers.com and advertising demand. For example, many of our users are students that utilize Answers.com as reference sources. Our traffic fluctuates with the academic school year, rising from January through May, falling to lower levels during the summer months, rising again in September through November, and falling again in December, coinciding with school breaks and the holiday season. We expect traffic to Answers.com to continue to fluctuate seasonally in the future. This seasonal fluctuation contributes to the fluctuation in our quarterly revenues.

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### Community Development

As part of our continuous effort to support our growing community, 2010 has seen a broadening of the multi-site, community-oriented and content curation programs designed to foster loyalty, increase repeat visits, maintain quality while providing the “human element” that has fueled Answers.com’s growth.

**Volunteer Premier Answerers.** Volunteer Premier Answerers are a group of dedicated contributors recognized for the time and effort they spend researching and providing consistent improvement to answers. Typically, they are experts in a certain field or on a particular topic and possess the knowledge to answer complex or detailed questions. By empowering these special contributors to focus on what they know best, the overall quality and utility of Answers.com improves.

**Volunteer WikiReviewers.** Volunteer WikiReviewers are registered users dedicated to taking on an organized approach to improving site quality. These members review flagged questions to fix general spelling and grammar, rewrite answers to ensure neutrality and original content, and generally improve answers to make them more applicable to the question being asked. Some volunteer WikiReviewers research difficult questions that are unanswered for a prolonged period of time. By improving the quality of the content in these areas, the site becomes more user-friendly and improves site credibility.

**Volunteer Supervisors.** Supervisors are trusted contributors who have access to specific tools and permissions to perform tasks beyond what regular contributors can do. These volunteers focus on the areas of work they enjoy most, answering and editing, merging similar questions, splitting out dissimilar questions, and organizing questions into categories. Some focus on specific topic areas and others participate as generalists tending to any question and answer that comes their way.

**Mentoring Program.** The Mentoring Program is an effort to provide a friendly, fun and worthwhile learning experience for newly appointed volunteer Supervisors who are looking to pursue a more active role in the community. Experienced volunteer Mentors are matched-up with new volunteer Supervisors. Mentors are site veterans who have garnered considerable experience and knowledge, enabling them to provide solid support and guidance to up-and-coming contributors.

**Community Outreach Program.** Volunteer WikiGuides enhance the community environment by creating a sense of citizenship and interconnectedness among Answers.com participants. Through the Outreach Program, new contributors are greeted with a warm welcome, infrequent visitors are given positive feedback on their contributions, and less-active volunteer Supervisors are encouraged to return to active participation. WikiGuides also deliver invitations to participate in site-wide events and congratulations on special occasions and for participation achievements. The welcoming atmosphere created by our Outreach Program improves member retention and draws back site contributors when their motivation lags.

**Influential Teens Program.** The Influential Teen Program, also known as WIT (WikiAnswers Influential Teens), builds on the growing community of teen contributors on the site. The aim of the program is to provide a constructive and safe online locale for teens to “hang out” and ask and answer questions. WIT is about empowering teens through specially created individual projects. Through WIT, these future trailblazers develop their leadership abilities while learning how to use the site and its features correctly.

**Vandal Patrol Program.** The Vandal Patrol Program addresses the problem of damaging or abusive edits to content, a common problem on wiki-based sites. As user-generated content on Answers.com grows in both size and recognition, it continues to attract not only great contributors, but more vandals as well. Through this targeted program, volunteer participants enjoy finding, eliminating, and defending against vandalism on the site.

Dispute Resolution Program. With an ever-growing and diverse community spanning across the globe, the need for a Dispute Resolution Program on Answers.com is apparent. Our Community Development team receives reports regarding editing conflicts – large and small – that they work to resolve amicably. Through appealing to this mediating service, contributors enjoy improved communication, less discord, and better understanding of their fellow contributors.

Moving toward the future, Community Development intends to further strengthen our ability to support a growing population of people asking, answering, and organizing questions through clear community oriented policies and community influenced projects that embrace the ability for large crowds to collaborate at a pace with the site's expected growth.

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### Our Strategy

We believe our valuable content and overall user experience drives traffic to Answers.com, which in turn drives the creation of more content and more traffic. Our traffic is monetized through advertising. As we view our business consisting of the core Answers.com platform with several possible product extensions, the key elements of our strategy to increase revenue will include:

1. Investment in, and development of, our core Answers.com service, by:

- Growing our Q&A database;
- Improving content quality;
- Building and empowering our user community;
- Improving overall user-experience and core user functionality;
  - Enhancing our search engine optimization (SEO) efforts;
  - Improving the relevance of internal text search; and
  - Introducing newly-licensed content

2. Enabling mobile access to Answers.com via smart-phones

3. Connecting more aggressively to social media platforms, by:

- More tightly integrating the question and answering process with popular social networks, such as Facebook and Twitter; and
- Leveraging our community towards greater social engagement

4. Further penetrating the video space, by:

- Continuing to syndicate video from third-party video aggregators and potentially adding a video creation platform to Answers.com

### Technology

#### Research and Development

We devote a substantial portion of our resources to enhancing and improving our existing core product, Answers.com, developing new product extensions and strengthening our technological expertise. In fiscal years 2009 and 2010, we spent approximately \$3.6 million and \$4.6 million, respectively, on research and development of our products and services. Our engineering and production teams are located in our Jerusalem, Israel development facility, with additional production support provided from our office in New York City. We have developed our technology internally, acquired it or licensed it from outside vendors.

#### Hosting Services

We manage our Web operations through our two independently-managed data centers, which we refer to as colocation facilities. Our facility located in New Jersey is supported by Net Access Corporation (the “First Facility”) and our facility located in Utah is supported by C7 Data Centers, Inc. (the “Second Facility”). Our agreements with Net Access Corporation and C7 Data Centers provide us with the right to use space, equipment, Internet bandwidth, electrical power, cooling and other facility functionalities, enabling us to monitor and manage our applications, databases, servers, routers, IT devices and other networkable assets. Continuous maintenance and operation of the colocation

facilities are critical to the stability and growth of Answers.com and our ancillary Web operations. The advantages of managing our operations out of two separate colocation facilities include, among others:

- Near-to-complete redundancy and load balancing;
- Greater ability to handle traffic spikes, Internet attacks and Internet brownouts;
  - Much faster recovery from single-site issues or disasters; and
- Built-in backup by virtue of maintaining a copy of all data in both locations.

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**Net Access Contract.** On April 19, 2008, we entered into a Network Access and Data Center Services Agreement with Net Access with respect to the First Facility (the “NetAccess Agreement”). The term of the NetAccess Agreement is thirty six months and is scheduled to expire in April 2011. We are currently in active negotiations to renew the Net Access Agreement. Specific services are provided by NetAccess pursuant to service-specific Service Orders entered into by the parties from time to time. We have also entered into a service level agreement pursuant to which Net Access has guaranteed certain standards of service level and operational specifications (the “NetAccess SLA”). We believe that the NetAccess SLA sufficiently addresses our operational needs. Termination of our relationship with Net Access, for whatever reason, would result in our need to replace this relationship and obtain colocation facility services from alternative providers. We believe we would successfully locate and engage such alternative providers; however, there is no assurance we would receive equally favorable terms as those provided in the NetAccess Agreement and NetAccess SLA.

**C7 Contract.** On March 31, 2009, we entered into a Master Services Agreement with C7 with respect to the Second Facility (the “C7 Agreement”). The term of the C7 Agreement is thirty six months from the date of installation and is scheduled to expire in April 2012. Specific services are provided by C7 pursuant to service-specific Statements of Work entered into by the parties from time to time. Each statement of work automatically renews unless cancelled by us ninety days prior to its scheduled expiration. C7 is afforded the right to terminate its services upon the failure by us to cure a breach of the C7 Agreement on our part, following a twenty day cure period. The C7 Agreement includes a service level agreement pursuant to which C7 has guaranteed certain standards of service level and operational specifications (the “C7 SLA”). We believe that the C7 SLA sufficiently addresses our operational needs. Termination of our relationship with C7, for whatever reason, would result in our need to replace this relationship and obtain colocation facility services from alternative providers. We believe we would successfully locate and engage such alternative providers; however, there is no assurance we would receive equally favorable terms as those provided in the C7 Agreement and C7 SLA.

## Competition

Competition in the questions and answers space has greatly intensified over the past several years, and Answers.com faces significant competition from a wide variety of Web properties. Question and answer sites, such as Yahoo! Answers (owned by Yahoo!), Quora, Yedda (owned by AOL), Answerbag.com (owned by Demand Media, Inc.), Aardvark (owned by Google), Wikia, Inc., Askville (owned by Amazon), Ask.com (owned by IAC/InterActiveCorp), StackOverflow, ChaCha, Mahalo Answers, Hunch and many other properties, all compete with our community-driven component of Answers.com. Content sites that compete for the same users searching for information include destination portals and other free online information and/or reference services, such as e-How (owned by Demand Media), Seed.com (owned by AOL), About.com (owned by the New York Times), Dictionary.com (owned by IAC/InterActiveCorp), HowStuffWorks (owned by Discovery Communication), WikiHow, TheFreeDictionary.com and Wikipedia.org. These sites also compete with Answers.com.

During 2010, Facebook launched a product feature known as Facebook Questions. According to Facebook’s description of this feature on its site, Facebook users are encouraged to “Use Facebook Questions to ask and answer questions from your friends and other experts. Since everyone can see your question, you’ll get answers from people who know the most about that topic. Your friends will also see your questions in News Feed, so you’ll also get tailored answers from people who know the most about you”. Facebook Questions is yet another feature that competes with Answers.com.

Since several companies operating traditional search engines, such as Google, Yahoo!, Microsoft and AOL offer answers within their search services, these companies too can be viewed as competitors of our answers-driven products, particularly in light of the fact that some search engines have begun putting snippets of useful answers at the top of many of their pages, in response to queries made by users. Nevertheless, search engines remain the greatest

source of traffic arriving at our Web properties.

Many of our competitors have longer operating histories, more extensive management experience, an employee base with more extensive experience, better geographic coverage, larger consumer bases, greater brand recognition and significantly greater financial, marketing and other resource than we do. We expect competition to further intensify in the future. If our competitors are more successful than we are in developing compelling products or attracting and retaining users, our competitive position and financial results could be adversely affected.

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### Marketing

To enhance the Answers.com brand, we are pursuing a brand development strategy that includes word-of-mouth marketing, direct marketing, spreading the word via social media networks, blogging and public relations efforts.

**Word of Mouth Marketing.** We benefit from word of mouth advertising when users share their positive experience using Answers.com with friends, colleagues, family, and others. We work to encourage the practice by adding features that make it simple to link to Answers.com, or post information from, or send an e-mail with information from Answers.com.

**Direct Marketing.** We aim to annually produce several events for directly reaching our community audience in an interactive manner. We have institutionalized the Answerthon™ weekend contests on Answers.com, occurring from time-to-time throughout the year, in which users attempt to answer as many questions as they can and compete for prizes. We have also established an Answers.com Scholarship Fund in order to better connect with our student demographic, by offering \$20,000 in scholarships for answering questions in any categories of interest. This initiative took place in 2009 and 2010 and is recurring in 2011.

**Social Media Networks.** Answers.com includes features that enable users to share a question or an answer with their friends and contacts via Facebook, or Twitter. Our site also facilitates interaction by users with the brand via becoming a fan of Answers.com on Facebook, subscribing to the Answers.com channel on YouTube or following Answers.com on Twitter. We also have a retained consultant focused on attracting Twitter users to feeds concerning Answers.com in an effort to raise awareness of and create mass linking to the site by way of “Tweets”.

**Blogging.** We maintain a blog at [www.nostupidanswers.com](http://www.nostupidanswers.com) which we use to share news about the community, acquaint users with our top contributors and volunteer supervisors, update the community about the company and recent product features and developments, as well as engage the community by sharing stories, tips and trivia about a wide variety of topics of interest.

**Public Relations Efforts.** Over the years, we have received multiple favorable reviews from numerous publications and we plan on continuing our public relations efforts with outreach, speaking opportunities and sponsorships at conferences, press releases, interviews and briefings.

### Employees

At December 31, 2010, we had 90 employees, of which 79 were full-time employees and 11 were part-time employees. As of such date, 64 employees were located in our office in Jerusalem and 26 employees were based in the United States. None of our employees is subject to a collective bargaining agreement, and we consider our employee relations to be satisfactory.

### Intellectual Property

We regard our domain names, patents, trademarks, copyrights, trade dress, trade secrets, proprietary technologies and similar intellectual property as critical to our success, and we rely on patent, trademark and copyright law, trade-secret protection, and confidentiality and/or license agreements with our employees, customers, partners, and others to protect our proprietary rights. The United States Patent and Trademark Office has granted us four United States patents; the Israeli Patent Office has granted us one patent.

The status of any patent involves complex legal and factual questions, and the breadth of claims allowed is uncertain. Accordingly, we cannot assure you that any patent application filed by us will result in a patent being issued or that



our issued patents, and any patents that may be issued in the future, will afford adequate protection against competitors with similar technology. We similarly face the risk that any patents issued to us might be infringed or designed around by others. While we rely on patent and other intellectual property laws to protect our technology, we also believe that factors such as the technological and creative skills of our personnel, new product developments, frequent product enhancements and reliable product maintenance are essential to establishing and maintaining our market position. We enter into confidentiality agreements, as appropriate, with our employees, consultants and customers, and otherwise seek to control access to, and distribution of, our proprietary information. These measures, however, afford only limited protection. There is no guarantee that these safeguards will protect our technology and other valuable competitive information from being used by competitors.

We have applied for, or have been assigned by third parties, numerous domain names and have filed applications for a number of trademarks. To date, we have been granted a registered U.S., and a Community Trademark (“CTM”) by the European Office for Harmonization in the Internal Market, for the Answers.com mark. We have also been granted a registered U.S. mark and a CTM for the word WikiAnswers, and a registered U.S. mark for the word AnswerTips.

Companies in the Internet, technology, and media industries own large numbers of patents, copyrights, and trademarks and frequently enter into litigation based on allegations of infringement or other violations of intellectual property rights. As we face increasing competition, the possibility of intellectual property claims against us grows. Answers.com has been, and from time to time we expect to continue to be, subject to claims of alleged infringement of copyrights, trademarks and other intellectual property rights of third parties. These claims and any resultant litigation, should it occur, could subject us to significant liability for damages. Our technologies may not be able to withstand any third-party claims or rights against their use. In addition, even if we prevail, litigation could be time-consuming and expensive to defend and could result in the diversion of our time and attention. Any claims from third parties may also result in limitations on our ability to use the intellectual property subject to these claims, unless we are able to enter into license agreements with the third parties making these claims.

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### Government Regulation

We are subject to a number of domestic and foreign laws and regulations that affect corporations using the Internet as their business platform. The interpretation of laws and regulations pertaining to the privacy of users, freedom of expression, content, advertising and intellectual property rights in the United States and in foreign jurisdictions may at times be unclear or unsettled. Additionally, rules and regulations in these areas are being debated and considered for adoption in other countries, and we face risks from proposed legislation that may be adopted in the future.

In the U.S., laws governing the liability of Internet companies offering online services for the activity of Website users and/or other third parties, are currently being tested by a number of claims. Cases include actions for libel, slander, invasion of privacy and other tort claims, unlawful activity, trademark and copyright infringement, as well as other theories based on the nature and content of the materials searched, the ads posted, or the content generated by users. Certain foreign jurisdictions are also testing the liability of providers of online services for activities of their users and other third parties. Any court ruling that will impose liability on providers of online services for activities of their users and other third parties could harm our business.

Nevertheless, to resolve some of the current legal uncertainty, we expect the courts to interpret these laws and regulations and such rulings may be applicable to our activities. Such rulings could generally dampen the growth in use of the Internet and could potentially expose us to substantial liability, including significant expenses necessary to comply with applicable laws and regulations. Several U.S. federal laws that could have an impact on our business include, among others:

- The Digital Millennium Copyright Act (“DMCA”), intended to reduce the liability of online service providers for listing or linking to third party Web properties that include materials that infringe copyrights of others. The DMCA is intended to limit, but does not necessarily eliminate, our liability for listing, linking, or hosting third-party content that includes materials that infringe copyrights.
- Portions of the Communications Decency Act, intended to provide statutory protections to online service providers who distribute third party content.
  - The Child’s Online Protection Act, or COPA, the Children’s Online Privacy Protection Act, or COPPA and the Prosecutorial Remedies and Other Tools to End Exploitation of Children Today Act, are intended to restrict the distribution of certain materials deemed harmful to children and impose additional restrictions on the ability of online services to collect user information from minors.
- The CAN-SPAM Act is intended to regulate spam and create criminal penalties for unmarked sexually-oriented material and emails containing fraudulent headers.

A range of other laws and new interpretations of existing laws could have an impact on our business. For example, in the area of data protection, many states have passed laws requiring notification to users when there is a security breach for personal data, such as California’s Information Practices Act. The costs of compliance with these laws may increase in the future as a result of changes in interpretation. Furthermore, any failure on our part to comply with these laws may subject us to significant liabilities.

We post our privacy policy and practices concerning the use and disclosure of user data. Any failure by us to comply with our posted privacy policy, U.S. Federal Trade Commission requirements or other domestic or international privacy-related laws and regulations could result in proceedings by governmental or regulatory bodies, that could potentially harm our business, results of operations and financial condition. In this regard, there are a large number of legislative proposals before the European Union, as well as before the United States Congress and various state

legislative bodies, regarding privacy issues related to our business. It is not possible to predict whether or when such legislation may be adopted, and certain proposals, if adopted, could harm our business operations. For example, decreases in usage of Answers.com could be caused by, among other provisions, the required use of disclaimers or other requirements before users can utilize our services.

In addition, because our services are accessible worldwide, and particularly in light of our recent launch of several international versions of WikiAnswers, certain foreign jurisdictions may claim that we are required to comply with their laws, including laws relating to labor arrangements, taxes, media and content, among others, even where we have no local entity, employees, or infrastructure. We might unintentionally violate such laws, such laws may be modified or interpreted to our detriment, and new laws may be enacted in the future. Any such developments could harm our business, operating results and financial condition.

We may be subject to legal liability for specific types of online services we provide. We direct users to a wide variety of services that enable individuals to exchange information, conduct business and engage in various online activities on an international basis. The law relating to the liability of providers of these online services for activities of their users is currently unsettled both within the United States and abroad. Claims may be threatened against us for aiding and abetting defamation, negligence, copyright or trademark infringement, or other theories based on the nature and content of information to which we provide links or that may be posted online.

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### Operations in Israel

The Law for the Encouragement of Capital Investments, 5719 – 1959 (the “Investment Law”), provides that upon application to the Investment Center of the Ministry of Industry, Commerce and Employment of the State of Israel (the “Investment Center”), a proposed capital investment in eligible capital expenditures may be designated as an Approved Enterprise. Each certificate of approval for an Approved Enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, such as the equipment to be purchased and utilized under the program. The tax benefits derived from any certificate of approval relate only to taxable income derived from growth in manufacturing revenues attributable to the specific Approved Enterprise. If a company has more than one approval or only a portion of its capital investments are approved, its effective tax rate is the result of a weighted combination of the applicable rates.

Taxable income of a company derived from an Approved Enterprise is subject to tax at the maximum rate of 25% for the benefit period. This period is ordinarily 7 years, beginning with the year in which the Approved Enterprise first generates taxable income, and is limited to 12 years from when production begins or 14 years from the date of approval, whichever is earlier. A company owning an Approved Enterprise may elect to receive an alternative package of benefits, which allows the company to receive tax exemptions. Under the alternative package, the company’s undistributed income derived from an Approved Enterprise will be exempt from tax for a period of between 2 and 10 years from the first year of taxable income, depending on the geographic location of the Approved Enterprise within Israel, and the company will be eligible for the tax benefits under the Investment Law for the remainder of the benefit period.

The benefits available to an Approved Enterprise are conditional upon compliance with the conditions stipulated in the Investment Law and related regulations and the criteria described in the specific certificate of approval. If a company violates these conditions, in whole or in part, it would be required to refund the amount of tax benefits and any grants received plus an amount linked to the Israeli consumer price index and interest.

On April 1, 2005, amendment No. 60 to the Investment Law became effective (“Amendment No. 60”) and has changed several provisions of the Investment Law, mainly in respect of the alternative package. Amendment No. 60 sets forth the scope of enterprises which may qualify as a Beneficiary Enterprise - under Amendment No. 60, the designation is Beneficiary Enterprise rather than Approved Enterprise - by setting forth criteria for qualification of a company. Additionally, Amendment No. 60 determined that companies operating under the alternative package no longer require Investment Center approval in order to qualify for tax benefits. Instead, this position will be incorporated as part of the regular tax audits of the Israeli Tax Authorities (the “ITA”).

Under Amendment No. 60, the year in which a company elects to commence its tax benefits is designated as the year of election (“Year of Election”). A company may choose its Year of Election by notifying the ITA in its annual tax return or within twelve months after the end of the Year of Election, whichever is earlier, or by requesting a pre-ruling from the ITA no later than six months after the end of the Year of Election. However, the Investment Law provides that terms and benefits included in any letter of approval which was granted prior to the effective date of Amendment No. 60, will remain subject to the provisions of the law as they were on the date of such approval. Therefore, our Israeli subsidiary’s (GuruNet Israel Ltd.) existing Approved Enterprise status will generally not be subject to the provisions of Amendment No. 60, while in order to receive further benefits, it will have to meet Amendment No. 60’s requirements. During 2009, GuruNet Israel Ltd. elected 2008 as the Year of Election under Amendment No. 60, for its second expansion.

GuruNet Israel Ltd. currently has three capital investment programs, two of which were granted Approved Enterprise status under the Investment Law prior to Amendment No. 60, ending December 31, 2009 and December 31, 2014, respectively, and one Beneficiary Enterprise pursuant to Amendment No. 60, ending December 31, 2017. Qualifying

income arising from our Approved Enterprise is tax-free in Israel under the alternative package of benefits described above for a period of 10 years from the first year in which our Israeli subsidiary generates taxable income from such Approved Enterprise, but not later than certain specified periods. We have begun to generate taxable income for purposes of the Investment Law, and we have utilized these tax benefits beginning in 2000. The Investment Law also provides that an Approved Enterprise is entitled to accelerated depreciation on its property and equipment that are included in an approved investment program.

On December 29, 2010 the Israeli parliament approved the Economic Policy Law for 2011-2012, which includes an amendment to the Investment Law (hereinafter – “the Recent Amendment to the Law”). The Recent Amendment to the Law is effective from January 1, 2011 and its provisions will apply to preferred income derived or accrued in 2011 and thereafter by a preferred company, per the definition of these terms in the Recent Amendment to the Law. Companies can choose to not be included in the scope of the Recent Amendment to the Law and to stay in the scope of the law before its amendment until the end of the benefits period. The 2012 tax year is the last year companies can choose as the Year of Election under Amendment No. 60, providing that the minimum qualifying investment, as defined under such amendment, began in 2010.

The Recent Amendment to the Law eliminates the existing tax benefit tracks and introduces two new tax tracks in their place, a preferred enterprise and a special preferred enterprise, which mainly provide a uniform and reduced tax rate for all the company’s income entitled to benefits, such as: for a preferred enterprise – in the 2011-2012 tax years – a tax rate of 10% for Development Area A and of 15% for the rest of the country, in the 2013-2014 tax years – a tax rate of 7% for Development Area A and of 12.5% for the rest of the country, and as from the 2015 tax year – 6% for Development Area A and 12% for the rest of the country. Furthermore, an enterprise that meets the definition of a special preferred enterprise is entitled to benefits for a period of 10 consecutive years and a reduced tax rate of 5% if it is located in Development Area A or of 8% if it is located in a different area.

The Recent Amendment to the Law also provides that no tax will apply to a dividend distributed out of preferred income to a stockholder that is a company, for both the distributing company and the stockholder. A tax rate of 15% shall continue to apply to a dividend distributed out of preferred income to an individual stockholder or foreign resident, subject to double taxation prevention treaties, which means that there is no change from the existing law. Furthermore, the Recent Amendment to the Law provides relief with respect to tax paid on a dividend received by an Israeli company from profits of an approved/alternative/beneficiary enterprise that accrued in the benefits period according to the version of the law before its amendment, if the company distributing the dividend notifies the tax authorities by June 30, 2015 that it is applying the provisions of the Recent Amendment to the Law and the dividend is distributed after the date of the notice. We are currently evaluating the impact of the Recent Amendment to the Law.

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Item 2. Properties

Our New York office, which serves as our corporate U.S. headquarters for community development, investor relations, sales and parts of production operations, is located at 237 West 35th Street, Suites 1101 and 1103, New York, NY 10001 and occupies a portion of the 11th floor at this location. The current per annum rent for this office space is approximately \$164,000. The lease for these premises expires in June 2012.

Our research and development facility is located on the entire 7th floor of the Tower (Building 2), Jerusalem Technology Park, P.O. Box 48253, Jerusalem 91481, Israel in approximately 1,000 square meters of space, occupied under a 3-year lease with a current monthly rental rate of approximately \$28,000 based on the Dollar-NIS exchange rate on December 31, 2010. The lease will expire in July 2013, with an option to extend the term for an additional 3 years.

Item 3. Legal Proceedings

Legal Proceedings Regarding the Merger

The Company and its directors have been named as defendants in eight purported class actions filed on behalf of the public stockholders of the Company challenging the proposed merger transaction pursuant to which the Company will be merged with a subsidiary of AFCV Holdings, LLC (“AFCV”) and will become a wholly-owned subsidiary of AFCV.

On February 4, 2011, a purported class action complaint was filed in the Supreme Court of New York in New York County, State of New York, Mathason v. Rosenschein, et. al., Index No. 650311/2011 on behalf of a putative class of Answers.com stockholders and naming as defendants Answers.com, all the members of the Answers.com board of directors, Summit Partners (“Summit”) and AFCV. The plaintiffs generally allege that, in connection with the approval of the merger agreement, the members of the Answers.com board of directors breached their fiduciary duties owed to Answers.com stockholders by, among other things, (i) failing to take steps to maximize the value of Answers.com to its stockholders because the merger price of \$10.50 per share of common stock allegedly does not reflect the true value of Answers.com stock, and (ii) purportedly failing to comply with their disclosure obligations. The plaintiffs further assert that Summit and AFCV aided and abetted the members of the Answers.com board of directors in the alleged breaches of their fiduciary duties. The plaintiffs seek among other things a declaration that the members of the Answers.com board of directors have breached their fiduciary duties, an injunction barring consummation of the merger or rescinding, to the extent already implemented, the merger agreement, and an award of fees, expenses and costs to plaintiffs and their attorneys. In addition, the plaintiffs have served a request for production of documents. On March 7, 2011, plaintiffs filed an amended complaint, adding additional alleged disclosure violations and a claim against Answers.com for aiding and abetting the members of the Answers.com board's alleged breach of fiduciary duty and subsequently moved for expedited discovery. On March 9, 2011, Answers.com and the members of the Answers.com board of directors moved by Order to Show Cause to stay or dismiss this action in favor of the Delaware actions. The court adjourned all pending motions to a status conference on May 3, 2011.

On February 7, 2011, another purported class action complaint was filed in the Court of Chancery in the State of Delaware, Lewis v. Answers Corporation, et.al., Case No. 6170-VCN, naming as defendants Answers.com, all the members of the Answers.com board of directors, AFCV, A-Team Acquisition Sub, LLC (“Merger Sub”) and Summit. The plaintiffs generally allege that, in connection with the approval of the merger agreement, the members of the Answers.com board of directors breached their fiduciary duties owed to Answers.com stockholders by, among other things, (i) failing to take steps to maximize the value of Answers.com to its stockholders because the merger price of \$10.50 per share of common stock allegedly does not reflect the true value of Answers.com stock, and (ii) creating supposedly preclusive deal protection devices in the merger agreement. The plaintiffs further allege that AFCV,

Summit and Merger Sub aided and abetted the members of the Answers.com board of directors in the alleged breaches of their fiduciary duties. The plaintiffs seek among other things an order enjoining the defendants from consummating the transactions contemplated by the merger agreement unless and until Answers.com adopts and implements a procedure or process to obtain a merger agreement providing the best possible terms for stockholders, and damages and attorneys' fees. In addition, the plaintiffs have served a request for production of documents.

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On February 9, 2011, a third purported class action complaint was filed in the Court of Chancery in the State of Delaware, Wilhelm v. Answers Corporation, et.al., Case No. 6177-VCN, naming as defendants Answers.com, all the members of the board of directors, AFCV, and Merger Sub. The plaintiffs generally allege that, in connection with the approval of the merger agreement, the members of the Answers.com board of directors breached their fiduciary duties owed to Answers.com stockholders by, among other things, (i) failing to take steps to maximize the value of Answers.com to its stockholders because the merger price of \$10.50 per share of common stock allegedly does not reflect the true value of Answers.com stock, and (ii) creating allegedly preclusive deal protection devices in the merger agreement. The plaintiffs further allege that Answers.com, AFCV, and Merger Sub aided and abetted the members of the Answers.com board of directors in the alleged breaches of their fiduciary duties. The plaintiffs seek among other things an order enjoining the defendants from consummating the transactions contemplated by the merger agreement unless and until Answers.com adopts and implements a procedure or process to obtain a merger agreement providing the best possible terms for stockholders, and damages and attorneys' fees.

On February 11, 2011, a fourth purported class action complaint was filed in the Court of Chancery in the State of Delaware, Iroquois Master Fund Ltd. v. Answers Corporation, et. al., Case No. 6183-VCN, naming as defendants Answers.com, all the members of the Answers.com board of directors, AFCV, Merger Sub and Summit. The plaintiffs generally allege that, in connection with the approval of the merger agreement, the members of the Answers.com board of directors breached their fiduciary duties owed to Answers.com stockholders by, among other things, (i) failing to take steps to maximize the value of Answers.com to its stockholders because the merger price of \$10.50 per share of common stock allegedly does not reflect the true value of Answers.com stock, (ii) failing to shop Answers.com properly, and (iii) creating allegedly preclusive deal protection devices in the merger agreement. The plaintiffs further allege that AFCV, Summit and Merger Sub aided and abetted the members of the Answers.com board of directors in the alleged breaches of their fiduciary duties. On March 3, 2011, plaintiffs in this action filed an amended complaint, adding additional allegations that, among other things, (i) the members of the Board were allegedly acting to advance their own interests at the expense of Company shareholders; (ii) the members of the Board purportedly failed to comply with their disclosure obligations in the final proxy statement filed on February 28, 2011; and (iii) the investment banking advisor, UBS Securities, LLC, was purportedly conflicted, and its opinion stating that the transaction was fair was purportedly based on flawed information. The plaintiffs seek among other things an injunction barring consummation of the merger or rescinding, to the extent already implemented, the merger, and damages and attorneys' fees.

On February 11, 2011, a fifth purported class action complaint was filed in the Court of Chancery in the State of Delaware, Teitelbaum v. Rosenschein, et.al., Case No. 6186-VCN, naming as defendants Answers.com, all the members of the Answers.com board of directors, AFCV, Merger Sub and Summit. The plaintiffs generally allege that, in connection with the approval of the merger agreement, the members of the Answers.com board of directors breached their fiduciary duties owed to Answers.com stockholders by, among other things, (i) failing to take steps to maximize the value of Answers.com to its stockholders because the merger price of \$10.50 per share of common stock allegedly does not reflect the true value of Answers.com stock, and (ii) creating allegedly preclusive deal protection devices in the merger agreement. The plaintiffs further allege that AFCV, Summit and Merger Sub aided and abetted the members of the Answers.com board of directors in the alleged breaches of their fiduciary duties. The plaintiffs seek among other things an injunction barring consummation of the merger, an order imposing a constructive trust, in favor of the putative class upon any benefits improperly received by the defendants as a result of their allegedly wrongful conduct, and damages and attorneys' fees.

On February 11, 2011, a sixth purported class action complaint was filed in the Court of Chancery in the State of Delaware, Dressler v. Answers Corporation, et.al., Case No. 6189-VCN, naming as defendants Answers.com, all the members of the Answers.com board of directors, AFCV, the Merger Sub and Summit. The plaintiffs generally allege that, in connection with the approval of the merger agreement, the members of the Answers.com board of directors breached their fiduciary duties owed to Answers.com stockholders by, among other things, (i) failing to take steps to



maximize the value of Answers.com to its stockholders because the merger price of \$10.50 per share of common stock allegedly does not reflect the true value of Answers.com stock, (ii) acting to advance their own interests at the expense of Answers.com stockholders, and (iii) creating allegedly preclusive deal protection devices in the merger agreement. The plaintiffs further allege that AFC and Summit aided and abetted the members of the Answers.com board of directors in the alleged breaches of their fiduciary duties. The plaintiffs seek among other things an injunction barring consummation of the merger or rescinding, to the extent already implemented, the merger, and damages and attorneys' fees.

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On February 25, 2011, a seventh purported class action complaint was filed in the Supreme Court of New York in New York County, State of New York, Fruchter v. Answers Corporation, et. al., Index No. 650532/2011, naming as defendants Answers.com, all the members of the Answers.com board of directors, AFCV, Merger Sub, Summit and Redpoint. The plaintiffs generally allege that, in connection with the approval of the merger agreement, the members of the Answers.com board of directors and Answers.com breached their fiduciary duties owed to Answers.com stockholders by, among other things, (i) failing to take steps to maximize the value of Answers.com to its stockholders because the merger price of \$10.50 per share allegedly does not reflect the true value of Answers.com stock, (ii) acting to advance their own interests at the expense of Answers.com stockholders, (iii) purportedly failing to comply with their disclosure obligations; and (iv) creating supposedly preclusive deal protection devices in the merger agreement. The plaintiffs further allege that AFCV, Summit, Merger Sub and Redpoint aided and abetted the members of the Answers.com board of directors in the alleged breaches of their fiduciary duties. The plaintiffs seek among other things a declaration that the members of the Answers.com board of directors have breached their fiduciary duties, an injunction barring consummation of the merger or rescinding, to the extent already implemented, the merger, an order directing the members of the Answers.com board of directors to exercise their fiduciary duties to fully disclose material facts to Answers.com stockholders necessary for them to make a fully informed decision as to whether to vote in support of the merger, and damages and attorneys' fees.

On March 1, 2011, an eighth purported class action complaint was filed in the Court of Chancery, the State of Delaware, Dooley v. Answers Corporation, et. al., Case No. 6236, naming as defendants Answers.com, all the members of the Answers.com board of directors, AFCV, and Merger Sub. The plaintiffs generally allege that, in connection with the approval of the merger agreement, the members of the Answers.com board of directors and Answers.com breached their fiduciary duties owed to Answers.com stockholders by, among other things, (i) failing to take steps to maximize the value of Answers.com to its stockholders because the merger price of \$10.50 per share allegedly does not reflect the true value of Answers.com stock, (ii) acting to advance their own interests at the expense of Answers.com stockholders, (iii) purportedly failing to comply with their disclosure obligations in the definitive proxy statement filed on February 28, 2011 with the Securities and Exchange Commission (the "SEC"); and (iv) creating supposedly preclusive deal protection devices in the merger agreement. The plaintiffs further allege that AFCV and Merger Sub aided and abetted the members of the Answers.com board of directors in the alleged breaches of their fiduciary duties. The plaintiffs seek among other things, an injunction barring consummation of the merger or rescinding, to the extent already implemented, the merger, and damages and attorneys' fees.

On March 4, 2011, the Delaware Court of Chancery consolidated all six Delaware actions and scheduled a preliminary injunction hearing for April 5, 2011.

The defendants in each of these actions are actively contesting these claims. Even if the company is successful in defending the lawsuits, we may incur substantial costs and diversion of management time and resources to defend the litigation.

Aside from legal proceedings which relate specifically to the merger, from time to time, we may be subject to legal proceedings and claims arising in the ordinary course of business.

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## PART II

## Item 5. Market for the Registrant's Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock has been quoted on The NASDAQ Global Market under the symbol "ANSW" between August 2, 2005 and September 28, 2008 and on The NASDAQ Capital Market, under the same symbol, since September 29, 2008. The following table sets forth the high and low closing sale prices for our common stock as quoted on The NASDAQ Capital Market for the fiscal years ended December 31, 2009 and 2010 and the subsequent period indicated.

|  | High    | Low    |
|--|---------|--------|
| Year ended December 31, 2009           |         |        |
| First quarter                          | \$9.56  | \$5.62 |
| Second quarter                         | \$8.88  | \$6.05 |
| Third quarter                          | \$9.11  | \$7.73 |
| Fourth quarter                         | \$10.86 | \$7.40 |
| Year ended December 31, 2010           |         |        |
| First quarter                          | \$9.53  | \$7.46 |
| Second quarter                         | \$9.09  | \$7.00 |
| Third quarter                          | \$8.05  | \$4.58 |
| Fourth quarter                         | \$8.43  | \$5.87 |
| Year ending December 31, 2011          |         |        |
| First quarter (through March 16, 2011) | \$10.74 | \$7.83 |

The closing sale price of our common stock as reported by The NASDAQ Capital Market on March 16, 2011 was \$10.41 per share.

As of March 16, 2011, there were approximately 39 holders of record of our common stock (not including beneficial owners holding shares in nominee accounts). We have not paid any common stock cash dividends since formation and we do not expect to pay any common stock cash dividends in the foreseeable future. During 2010 we did not repurchase any shares of our common stock.

## Equity Compensation Plan Information

The following table sets forth certain information at December 31, 2010 with respect to our compensation plans that provide for the issuance of options, warrants or rights to purchase our securities.

|  | No. of securities to be issued upon exercise of outstanding options, warrants and rights<br>(a) | Weighted-average exercise price of outstanding options, warrants and rights<br>(b) | No. of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))<br>(c) |
|--|---|--|---|
| Equity compensation plans approved by security holders | 2,550,220   | \$8.57   | 379,255   |

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|  |           |   |         |
|--|-----------|---|---------|
| Equity compensation plans not approved by security holders | —         | — | —       |
| Total  | 2,550,220 |   | 379,255 |

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation.

Introduction

This Management Discussion and Analysis, or MD&A, is divided into sections entitled "General," "Results of Operations," "Liquidity and Capital Resources," "Off Balance Sheet Arrangements," "Critical Accounting Estimates," and "Quarterly Results". The "General" section contains information regarding our business and recent events as well as background and commentary regarding the revenue and expense captions that comprise our Statement of Income. The "Results of Operations" section is our commentary on our results of operations compared to the preceding year. All of the sections herein should help provide a better understanding of our performance in 2010 as compared to 2009.

General

We own and operate Answers.com, a leading Q&A site, dedicated to providing useful answers to questions about anything. Answers.com includes WikiAnswers and ReferenceAnswers. WikiAnswers is a community-generated social knowledge Q&A platform, leveraging wiki-based technologies. Through the contributions of the community, our questions and answers are continuously growing and being updated. ReferenceAnswers provides trusted editorial content on millions of topics licensed from what we believe to be the world's top reference publishers. ReferenceAnswers provides the best results for simple questions of the who-is, what-is variety. More complex questions are better handled by WikiAnswers. Our goal is to become the dominant and recognized market leader for answers on the Internet.

According to our internal estimates, Answers.com generated 11.8 million average daily page views in 2010 compared to 9.4 million average daily page views in 2009. According to comScore, under its unified audience measurement methodology, Answers.com had 54.6 million monthly unique visitors in the U.S. in February 2011, ranking the site number 17 among the top U.S. Web properties for that month. Worldwide, Answers.com had 94.5 million monthly unique visitors, ranking the site number 31 in the world's top properties in January 2011.

Agreement and Plan of Merger with AFCV Holdings, LLC

On February 2, 2011, we entered into an Agreement and Plan of Merger (the "Merger Agreement") with AFCV Holdings, LLC, a Delaware limited liability company ("AFCV"), and A-Team Acquisition Sub, Inc., an indirect wholly owned subsidiary of AFCV and a Delaware corporation ("Merger Sub"). The Merger Agreement provides that, upon the terms and subject to the conditions set forth in the Merger Agreement, Merger Sub will merge with and into Answers.com (the "Merger"), with Answers.com continuing as the surviving corporation and a wholly owned subsidiary of AFCV. In connection with, and concurrently with, the execution and delivery of the Merger Agreement, Robert Rosenschein, Answers.com's Chief Executive Officer, and affiliates of Redpoint Ventures, principal stockholders of Answers.com, entered into voting agreements with Answers.com and AFCV pursuant to which they committed to vote all of their shares of Answers.com stock in favor of the Merger,

If the Merger is completed, at the effective time of the Merger, holders of Answers.com common stock, other than holders who properly exercise appraisal rights, will be entitled to receive \$10.50 in cash, without interest, less any applicable withholding taxes, for each share of Answers.com common stock owned at the effective time of the Merger. Holders of the company's Series A convertible preferred stock will receive an amount in cash, without interest, for each share of Series A stock owned equal to \$10.50 multiplied by (A) the stated value of \$101.76 plus accrued but unpaid dividends thereon accrued daily at the rate of 6% per annum calculated from the date on which the last regular quarterly dividend is paid in respect of the Series A stock to the effective time of the merger, divided by (B) \$4.50. Holders of the company's Series B convertible preferred stock will receive an amount in cash without interest for each share of Series B stock owned equal to \$10.50 multiplied by (A) the stated value of \$100.00 plus

accrued but unpaid dividends thereon accrued daily at the rate of 6% per annum calculated from the date on which the last regularly quarterly dividend is paid in respect of the Series B stock to the effective time of the merger, divided by (B) \$5.50.

Holders of options to purchase Answers.com common stock that are vested or become vested as a result of the Merger will receive an amount in cash equal to the excess, if any, of (A) \$10.50 multiplied by the number of shares underlying such options, over (B) the aggregate exercise price of such options, without interest and less any deductions and required withholding taxes, as applicable. Unvested options to acquire Answers.com common stock held by our employees who continue to be employed by the surviving corporation in the Merger on the date or dates that such options would otherwise have vested will receive a similar amount in cash, based on the options vesting on the respective dates. Holders of warrants to purchase shares of Answers.com common stock outstanding immediately prior to the effective time of the Merger will be entitled to receive an amount in cash equal to the product of (A) the number of shares issuable upon exercise of such warrant, multiplied by (B) an amount equal to the excess, if any, of \$10.50 less the per share exercise price for such warrant, without interest, subject to withholding taxes.

A special meeting of the company's stockholders has been called for April 12, 2011 to vote on adoption of the Merger Agreement. Completion of the Merger is subject to adoption of the Merger Agreement by the Answers.com stockholders, and various other conditions set forth in the Merger Agreement.

For further information related to the Merger, see our Definitive Proxy Statement on Schedule 14A filed with the SEC on February 28, 2011, including the Merger Agreement which is attached to that document. Any discussion of the Merger and the Merger Agreement in this Annual Report is qualified in its entirety by reference to these documents.

#### New Answers.com: Integration of WikiAnswers and ReferenceAnswers

In September 2009 we announced the launch of the new Answers.com, in recognition of the integration of our two Web properties, reaching a peak in a process that began several quarters earlier. At such time, we created a new unified Answers.com home page and login, integrated features from both properties, and made other changes in our user interface to strengthen our positioning as having one dominant product and brand, Answers.com, comprised by two properties, WikiAnswers and ReferenceAnswers. Since that time, Answers.com is the name we use for our combined site, as well as our umbrella brand, and is comprised of two properties or sub-brands, WikiAnswers and ReferenceAnswers. The product strategy guiding the integration was our desire to give users one address for the best answers to all types of questions – be they community-generated from WikiAnswers or editorially licensed from ReferenceAnswers.

Despite positioning our website with a single product and brand, Answers.com, we continue to present traffic and revenue metrics of our two Web properties individually, as well as in aggregate. It is our belief that since the Web properties have different characteristics, information broken out by property affords investors greater insight into our business. For example, WikiAnswers is monetized primarily via AFC ads, while ReferenceAnswers is monetized primarily through AFS ads. As a result, changes by Google to the two advertising systems affect each property differently. Furthermore, content growth works differently for each property. ReferenceAnswers grows as a result of editorial licensed content being integrated into the non-editable reference pages, while WikiAnswers grows through the regular addition of user generated content. Also, search engines, chiefly Google, are the primary source of Answers.com traffic. These engines may value, treat and index the content of the properties differently, which may disparately impact their traffic.

While we continue to present revenue metrics of our two Web properties separately, traffic and monetization trends of the individual properties may be different than before their integration took place, and before the implementation of additional changes made to our combined site, since launching the new Answers.com. For example, users accustomed to the editorially-vetted information, from recognized publishers displayed in ReferenceAnswers, may not be attracted to a unified product that includes user-generated content. Conversely, users who are, or have the potential of being,

community active, by asking and answering questions in WikiAnswers, may choose not to do so, since they may prefer sites that are strictly user-generated, or they may not be aware that they are on a site that encourages user-generated contributions. Additionally, while we believe that providing metrics of our two individual Web properties is still useful, particularly since we receive so much of our traffic from search engines, we view the individual property information, since the integration, as not directly comparable to the individual property information, prior to such integration.

#### FIGS Language Versions of WikiAnswers

In the third quarter of 2009 we launched French, Italian, German and Spanish (“FIGS”) language versions of WikiAnswers. Our strategy is to capitalize on the needs of users around the globe who are searching for answers online and will leverage our core strengths: community building and Q&A space. During the three consecutive quarters ending June 30, 2010, we created a database of approximately 300,000 questions and answers in FIGS languages by translating our English-language Q&A content, at a total cost of approximately \$470 thousand, in an effort to quickly grow those foreign-language versions of WikiAnswers. Beginning the third quarter of 2010, we have not translated any additional English-language Q&A into the FIGS languages. We have currently suspended our translation efforts because of our desire to focus our resources on other initiatives.

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### How We Generate Revenue

#### Traffic

Our revenue is driven by the traffic generated by Answers.com and our ability to effectively monetize such traffic. Search engines, primarily Google, are responsible for most of the traffic to Answers.com. Users submit queries and search engines respond by generating a list of Web pages that they deem likely to offer the most relevant content. When an Answers.com page ranks high in the algorithmic systems of search engines, our results are more likely to be accessed by users. This source of traffic represented approximately 86% and 91% of Answers.com's traffic in 2009 and 2010, respectively. The balance of the traffic arriving at Answers.com during such years originated from direct usage, and additionally, in 2009, from users who clicked on Google's Definition Link feature, which has since been discontinued.

Search engines could change their algorithms that direct search queries to Answers.com or other web properties. We have previously experienced increases and decreases in traffic, and consequently in revenue, in response to such search engine action. Further, we experienced such an algorithm change on or about February 24, 2011 and our commentary on that change appears in the Traffic and Revenue Discussion below. Our efforts to maintain and increase the volume of this traffic are commonly referred to by the industry as search engine optimization, or SEO. We often refer to traffic from search engines as "SEO traffic". In particular, we see content quality as a critical SEO opportunity and challenge of WikiAnswers.

The essential driving force behind the growth of our traffic has been the expansion of our database of questions and answers, and the rankings that those questions and answers receive from search engines. Content quality plays a crucial role in our search engine rankings, as well as user experience. Particularly in light of the enormous amount of user-generated content offered on Answers.com via the WikiAnswers component, in the event the perceived quality of content on Answers.com pages does not improve and/or if it deteriorates, our pages may rank lower in the algorithmic systems of search engines. Lower ranking content could cause Answers.com's results to be less likely to be accessed by users, resulting in traffic declines. In an effort to recognize the opportunities and risks noted above, we are currently developing our Reputation Management System, or "RMS". The goal of RMS will be to measure and rate the trustworthiness of each contributor, and the quality of each contribution and edit, and the overall quality of each question and answer. Using this data, RMS will serve as a quality watchdog, mitigating poor quality contributions and encouraging high quality contributors. We view RMS as potentially being a key factor in driving future traffic, growth and revenue, in addition to helping protect our search engine rankings.

#### Seasonality

Our results of operations have historically been affected by seasonal traffic patterns and advertising demand. Many of our users are students who utilize Answers.com as a reference source. Our traffic fluctuates with the academic school year, rising from January through May, falling to lower levels during the summer months, rising again in September through November, and falling again in December, coinciding with school breaks and the holiday season. We expect traffic to Answers.com to continue to fluctuate seasonally in the future. Irrespective of other factors that may influence traffic and revenue, this seasonal fluctuation in traffic impacts our quarterly revenues, since lower or higher traffic to Answers.com translates into fewer or more users clicking on or viewing the advertisements we display. Our current seasonal patterns may become more pronounced or may change as Answers.com grows.

#### Monetization

**Advertising Revenue.** We earn practically all of our revenue from advertising. In 2009 and the first three quarters of 2010, we earned our advertising revenue from two categories of Internet advertising: pay-per-performance, also



known as cost-per-click (“CPC”), and pay-per-impression display ads or cost per 1,000 impressions (“CPM”). In the CPC model, we earn revenue based on the number of clicks associated with an ad; in the CPM model, we derive revenue from the display of ads. Beginning the fourth quarter of 2010, we added a third category of advertising to Answers.com, in-text advertising, a form of contextual advertising where specific keywords within the text of a web-page are matched with advertising units. Those specific keywords become hyperlinks that open an advertising “bubble” when users hover on the keywords. We earn revenue each time a user clicks on a hyperlink displayed within such “bubble”.

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The majority of our advertising revenue is earned from CPC ads, and practically all of such ads are earned through Google. Similarly, all of our in-text ads, and the vast majority of our CPM ads are earned through third-party ad networks. Ad networks compensate us by paying us a portion of the revenue they earn from advertisers for our provision of promotional space on our Web properties. CPM advertisements not earned via networks, but rather, directly by us, are obtained by inbound inquiries, as we do not currently employ any direct ad salespersons. Our revenue earned per 1,000 page views (“RPM”) is calculated based on the aggregation of CPC-based RPM, CPM-based RPM and in-text-based RPM.

**Google AdSense.** Google accounted for approximately 88% and 77% of our total revenue in 2009 and 2010, respectively. Our relationship with Google is governed by our Google Services Agreement, or GSA, which currently extends through January 31, 2012. We participate in two Google AdSense programs, “AdSense for Search”, or “AFS”, and “AdSense for Content”, or “AFC”. AFS is the online service for distributing relevant ads from Google’s advertisers for search results on Google Network members’ sites. AFC, on the other hand, is Google’s online service for distributing ads from its advertisers that are relevant to content on its Network members’ web sites. Under this program, Google uses automated technology to analyze the meaning of the content on the web page and serve relevant ads based on the meaning of such content.

**Licensing Revenue.** We earn a negligible portion of our revenues from partners that pay us for providing them with our answer-based services that they then use in their own products, via co-branded Web pages.

### Costs and Expenses

#### Cost of Revenue

Cost of revenue consists of compensation, travel and overhead costs relating to personnel who are engaged in data center and production operations, and direct content creation, editing and integration. Additionally, this expense line includes fees to third parties to license and translate content, data center costs, including depreciation of data center technology assets, Web search service fees, ad serving fees, amortization of the cost of acquired software used in our products, and contractual revenue sharing fees to various Web property operators for visitors directed to our Web properties, or traffic acquisition costs.

#### Research and Development Expenses

Research and development expenses consist of compensation, travel and overhead costs of personnel conducting research and development of our products and services, and consulting costs. Our research and development team works primarily on projects to improve and enhance product functionality, quality, performance, scalability, user interface, and monetization.

#### Community Development and Marketing Expenses

Community development and marketing expenses consist of compensation, travel and overhead costs of personnel in charge of developing and encouraging the Answers.com community of users asking and answering questions, product management and marketing. Additionally, this expense line includes fees for marketing and market information services, public relations and promotional costs.

#### General and Administrative Expenses

General and administrative expenses consist primarily of compensation, travel and overhead costs for general executive, financial, legal, human resources, and other administrative personnel, professional services, including

investor relations, legal, accounting, payroll and other consulting services, insurance fees, amortization of domain names, and other general corporate expenses.

Overhead Costs

Overhead costs consist primarily of rent, telecommunications, utilities and depreciation expenses.

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### Stock-Based Compensation

New employees typically receive stock option awards within three months of their employment date. We also grant additional stock option awards to existing employees and directors. We account for stock-based awards under Accounting Standards Codification (“ASC”) 718, “Compensation – Stock Compensation,” which requires measurement of compensation cost for all stock-based awards at fair value on date of grant and recognition of compensation over the service period awards are expected to vest. Costs resulting from stock-based compensation are part of our compensation expense and are included in the operating expense categories in our Statements of Operations.

### Impact of Foreign Currency Fluctuations

The dollar cost of our operations is heavily influenced by changes in the value of the dollar in relation to the New Israeli Shekel (“NIS”), mostly due to the NIS-based salaries of our Israel-based employees. Close to half of our operating expenses, excluding stock-based compensation, are denominated in New Israel Shekels. We enter into forward contracts to hedge much of the near-term impact of our NIS-based expenses. Prior to May 2009, these derivatives were not designated as hedging instruments, and therefore, the net gains (losses) arising from these derivatives were recognized in operating expenses as they occurred. Starting May 2009, we designated all of our currency hedging activities as cash flow hedges as they were all eligible. Thus, the changes in those hedges are recorded as other comprehensive income (loss), and are reflected in earnings as the forward contracts mature or if, and to the extent, that the hedging relationship is deemed ineffective.

In 2010, compensation, excluding stock-based compensation, to employees amounted to \$8,443 thousand compared to \$7,134 thousand in 2009, a net increase of \$1,309 thousand or 18%. Approximately \$1,139 thousand of such increase was due to increases in headcount and raises, while approximately \$170 thousand resulted from the weakening of the dollar as compared to the NIS. Our year-over-year discussion regarding operating expenses includes the impact of foreign currency on such expenses. If the dollar continues to fluctuate as compared to the NIS, we will experience fluctuation in the dollar amount of our NIS-based expenses.

### Interest Income (Expense), Net

Interest income (expense), net, is comprised of interest income earned on cash, cash equivalents and marketable securities, and interest expense on capital leases, transaction costs we incurred in connection with the issuance of the Series B Warrants in June 2009 and amortization of deferred costs we incurred in connection with the issuance of the Series B Unit Warrant, in June 2008.

### Other Income (Expense), Net

Other income (expense), net, is comprised of foreign currency gains and losses.

### Gain (Loss) Resulting from Fair Value Adjustment of Warrants

The Series A Warrants, the Series B Warrants and the Series B Unit Warrant (prior to its exercise in June 2009), which are components of transactions with Redpoint Omega, L.P. and Redpoint Omega Associates, LLC (collectively, “Redpoint”) are revalued each reporting date. Any change to their fair value is recorded as a gain or loss in the Statement of Income. Background regarding the transaction with Redpoint follows.

### Redpoint Financings

On June 16, 2008, pursuant to a private placement of our securities, Redpoint purchased \$6 million of our Series A Convertible Preferred Stock (60,000 shares), initially convertible into 1,333,333 shares of common stock at a conversion price of \$4.50 per share, along with Common Stock Purchase Warrants exercisable for 666,667 shares of common stock at an exercise price of \$4.95 per share (“Series A Warrants”). In conjunction therewith, Redpoint also received a warrant, referred to as the “Series B Unit Warrant”, exercisable until June 16, 2009, to purchase units of up to \$7 million of Series B Convertible Preferred Stock (70,000 shares) and Common Stock Purchase Warrants exercisable for 636,364 shares of common stock (“Series B Warrants”). The Series B Convertible Preferred Stock is initially convertible into 1,272,727 shares of common stock at an initial conversion price of \$5.50 per share. The Series B Warrants have an exercise price of \$6.05 per share. On June 10, 2009, Redpoint exercised the Series B Unit Warrant, in full.

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After deducting placement agent fees and legal expenses, our net proceeds from the private placement, in June 2008, were \$5.38 million, while our net proceeds from the exercise of the Series B Unit warrant, in June 2009, were \$6.48 million. The transaction that took place on June 16, 2008 is referred to as the “Series A Financing”. The transaction that took place on June 10, 2009 is referred to as the “Series B Financing”. The two transactions, in aggregate, are collectively referred to as the “Redpoint Financings”. The Series A Convertible Preferred Stock and the Series B Convertible Preferred Stock are collectively referred to as the “Preferred Stock”; the Preferred Stock, together with the Series A Warrants and the Series B Warrants, are collectively referred to as the “Redpoint Securities”.

The Series A Convertible Preferred Stock has the rights and preferences set forth in our Certificate of Designations, Number, Voting Powers, Preferences and Rights of Series A Convertible Preferred Stock, which, amended our Amended and Restated Certificate of Incorporation on June 16, 2008. The Series B Convertible Preferred Stock has the rights and preferences set forth in the company’s Certificate of Designations, Number, Voting Powers, Preferences and Rights of Series B Convertible Preferred Stock which amended the company’s Amended and Restated Certificate of Incorporation on June 9, 2009. For a detailed description of the rights and preferences of the Series A Convertible Preferred Stock and the Series B Convertible Preferred Stock, we refer you to the notes to the financial statements contained in our 2010 annual report.

In connection with the Redpoint Financings, Redpoint received and exercised their right to appoint two individuals to serve as voting members of our board of directors.

Income Tax Benefit (Expense), Net

Our effective tax rate differs from the statutory federal rate primarily due to differences between income and expense recognition prescribed by income tax regulations and Generally Accepted Accounting Principles. We utilize different methods and useful lives for depreciating and amortizing certain property, equipment and intangible assets and different methods and timing for certain expenses. Furthermore, permanent differences arise from certain income and expense items recorded for financial reporting purposes but not recognizable for income tax purposes, and from certain income and expense items recorded for income tax purposes but not recognizable for financial reporting purposes. In addition, our income tax expense has been adjusted for the effect of state and local taxes and foreign income from our wholly owned subsidiary. At December 31, 2009, our deferred tax assets were almost entirely offset by a valuation allowance. While we had taxable income in 2009, we had experienced a cumulative loss in recent years and our revenue model continued to be subject to fluctuations and volatility that impacted our ability to accurately forecast our future expected profitability. We viewed these factors as significant pieces of negative evidence that made it difficult to support a conclusion that expected taxable income from future operations justifies recognition of deferred tax assets. At December 31, 2010, we examined all available evidence, both positive and negative, and determined that it is more likely than not that a portion of the deferred tax asset relating to the reversal of certain federal and state and local NOL’s will be realized. We, therefore, released our valuation allowance to the extent the company expected to utilize NOLs in 2011. However, due to continued volatility and significant uncertainties with respect to our revenue model, we are unable to reliably forecast future pre-tax income beyond 2011 which would be necessary to utilize all of the deferred tax assets resulting from the accumulated net operating losses and therefore it is difficult to support a conclusion that expected taxable income from future operations beyond 2011 justifies recognition of deferred tax assets for such periods. Increases in estimated future taxable income may require us to release all or a portion of the valuation allowance against our deferred tax assets and result in a deferred tax benefit for the period and could have a significant impact on our future earnings. A valuation allowance has not been established for the deferred tax assets of our GuruNet subsidiary of approximately \$51 thousand because we believe that it is more likely than not that the results of future operations will generate sufficient taxable income to realize those deferred tax assets.

Our Israeli subsidiary, GuruNet Israel Ltd. (“GuruNet”), had net income in 2009 and 2010, resulting from services it provided us. GuruNet charges us for research and development services it provides us, plus a profit margin, currently 4.8%. However, GuruNet operates primarily through plans recognized as “approved enterprises” under Israeli law (and a “beneficiary enterprise” as later amended in amendment No. 60 to the Israeli Law for Encouragement of Capital Investments - 1959), which means that income arising from its approved research & development activities, is subject to zero percent tax under the “alternative benefit” path for a period of ten years. Currently, GuruNet operates or operated under two separate “approved enterprise” plans, the first of which ended on December 31, 2009 and the second ending December 31, 2014, and a “beneficiary enterprise” plan ending December 31, 2017. Currently, GuruNet pays taxes at the regular corporate income tax rate on the relative proportion of taxable income attributable to the first approved enterprise plan.

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Additionally, GuruNet provides us with certain management services which it charges at cost plus a profit margin, currently 9.2%. Income derived from such services is taxable at the Israeli corporate tax rate in effect at the time (26% and 25% in 2009 and 2010, respectively).

In the event of dividend or other cash distributions to us by GuruNet, GuruNet would have to pay a 10% corporate tax on the amount distributed, and we would have to pay a 15% tax to be withheld at source on the amounts of such distributions received. Furthermore, we would be subject to a 35% federal tax on dividends received, before applying any credits possibly allowed for NOL carryforwards or by the income tax treaty between the United States and Israel. At present, we do not plan on having GuruNet distribute any dividends.

On December 29, 2010 the Israeli parliament approved the Economic Policy Law for 2011-2012, which includes an amendment to the Investment Law (hereinafter – “the Recent Amendment to the Law”). The Recent Amendment to the Law is effective from January 1, 2011 and its provisions will apply to preferred income derived or accrued in 2011 and thereafter by a preferred company, per the definition of these terms in the Recent Amendment to the Law. Companies can choose to not be included in the scope of the Recent Amendment to the Law and to stay in the scope of the law before its amendment until the end of the benefits period. The 2012 tax year is the last year companies can choose as the Year of Election under Amendment No. 60, providing that the minimum qualifying investment, as defined under such amendment, began in 2010.

The Recent Amendment to the law eliminates the existing tax benefit tracks and introduces two new tax tracks in their place, a preferred enterprise and a special preferred enterprise, which mainly provide a uniform and reduced tax rate for all the company’s income entitled to benefits, such as: for a preferred enterprise – in the 2011-2012 tax years – a tax rate of 10% for Development Area A and of 15% for the rest of the country, in the 2013-2014 tax years – a tax rate of 7% for Development Area A and of 12.5% for the rest of the country, and as from the 2015 tax year – 6% for Development Area A and 12% for the rest of the country. Furthermore, an enterprise that meets the definition of a special preferred enterprise is entitled to benefits for a period of 10 consecutive years and a reduced tax rate of 5% if it is located in Development Area A or of 8% if it is located in a different area.

The Recent Amendment to the Law also provides that no tax will apply to a dividend distributed out of preferred income to a stockholder that is a company, for both the distributing company and the stockholder. A tax rate of 15% shall continue to apply to a dividend distributed out of preferred income to an individual stockholder or foreign resident, subject to double taxation prevention treaties, which means that there is no change from the existing law. Furthermore, the Recent Amendment to the Law provides relief (“the relief”) with respect to tax paid on a dividend received by an Israeli company from profits of an approved/alternative/beneficiary enterprise that accrued in the benefits period according to the version of the law before its amendment, if the company distributing the dividend notifies the tax authorities by June 30, 2015 that it is applying the provisions of the Recent Amendment to the Law and the dividend is distributed after the date of the notice. We are currently evaluating the impact of the Recent Amendment to the Law.



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## Results of Operations

## Revenue

|                                      | Year ended December 31, |        |         |
|--------------------------------------|-------------------------|--------|---------|
|                                      | 2009                    | 2010   | Change  |
|                                      | (\$ - in thousands)     |        |         |
| WikiAnswers advertising revenue      | 14,454                  | 16,529 | 2,075   |
| ReferenceAnswers advertising revenue | 6,230                   | 4,888  | (1,342) |
| Licensing revenue                    | 71                      | 54     | (17)    |
|                                      | 20,755                  | 21,471 | 716     |

Revenue increased \$716 thousand, or 3%, from \$20,755 thousand in 2009, to \$21,471 in 2010.

## WikiAnswers

WikiAnswers' advertising revenue in 2010 increased \$2,075 thousand, or 14%, compared to 2009, due to increased traffic offset, to some extent, by lower RPM.

Traffic. WikiAnswers' average daily page views in 2010 were 9,244,000, an increase of 42% compared to average daily page views of 6,496,000 in 2009.

RPM. The average WikiAnswers RPM in 2010 was \$4.90, a decrease of 20% compared to the average RPM of \$6.10 in 2009. The decrease in WikiAnswers RPM resulted from a decrease in our RPM from Google ads, offset, to some extent, by higher RPM from non-Google ads. Most of the decline in RPM from Google ads is attributable to reduced click-through rates, offset, to some extent by higher CPC ad rates. Factors that, we believe, may have influenced click through rates and CPC rates include changes we made to the site, changes that Google may have made to the AdSense algorithm that connects advertisers and publishers, users becoming so accustomed to the site's layout and the positioning of the ads that they are avoiding them, changes in the percent of clicks on CPC ads on our site that result in users making a purchase (also known as "conversion rates"), changes in how advertisers may have managed their advertising costs in different periods, and the increasing percentage of our traffic that comes from mobile devices. A very minor portion of the decline in the RPM from Google ads is attributable to the terms of our renewed GSA, which became effective in February 2010.

## ReferenceAnswers

ReferenceAnswers' advertising revenue in 2010 decreased \$1,342 thousand, or 22%, compared to 2009, due to lower ReferenceAnswers traffic and RPM.

Traffic. ReferenceAnswers average daily page views in 2010 were 2,585,000, 10% less than average daily page views of 2,884,000 in 2009. We believe the loss of the Google definition link in the fourth quarter of 2009 is the primary cause of that decline.

RPM. The average ReferenceAnswers RPM in 2010 was \$5.18, a decrease of 12%, compared to the RPM of \$5.92, in 2009. The decrease in ReferenceAnswers RPM resulted from a decrease in our RPM from Google ads, offset, to some extent, by higher RPM from non-Google ads. We attribute the decline in RPM from Google ads, to changes in the terms of our renewed GSA with Google as well as reduced click-through rates and lower CPC ad rates. In contrast to

WikiAnswers' revenue, ReferenceAnswers' revenue is earned principally via AFS rather than AFC, so that it was more heavily impacted by the changes in the contract terms with Google than WikiAnswers. Factors that, we believe, may have influenced click-through rates and CPC rates for ReferenceAnswers are the same as those noted above for WikiAnswers.

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## Other Revenue and Traffic Information

- In September 2009, we created a new unified Answers.com home page and login, in connection with the launch of the new Answers.com, which integrated WikiAnswers and ReferenceAnswers. Since the new unified Answers.com home page was designed to give prominence to WikiAnswers and to encourage users to enter their questions into the site's query bar, beginning September 2009, visits to that page, which at such time averaged approximately 175,000 per day, are recorded as WikiAnswers page-views rather than ReferenceAnswers page-views, contrary to the previous practice.
- The percentage of overall Answers.com traffic from mobile devices in 2010 was approximately 7%. We did not track mobile traffic throughout 2009; however, based on limited data, we believe it was under 3%.
- WikiAnswers' FIGS language versions accounted for \$32 thousand and 153 thousand, of our WikiAnswers revenue and average daily page views, respectively, in 2010.

## Traffic and Revenue Discussion

The following table illustrates the historical results of our two Web properties' revenues, average daily page views and RPM, by quarter, beginning the first quarter of 2009.

|                          | 2009      |           |           |            | 2010       |            |            |            |
|--------------------------|-----------|-----------|-----------|------------|------------|------------|------------|------------|
|                          | Q1        | Q2        | Q3        | Q4         | Q1         | Q2         | Q3         | Q4         |
| <b>Ad Revenue</b>        |           |           |           |            |            |            |            |            |
| (\$ - in thousands)      |           |           |           |            |            |            |            |            |
| WikiAnswers              | 3,162     | 3,400     | 3,422     | 4,470      | 4,489      | 3,992      | 3,314      | 4,734      |
| ReferenceAnswers         | 1,567     | 1,585     | 1,548     | 1,530      | 1,218      | 1,012      | 1,127      | 1,531      |
| Total                    | 4,729     | 4,985     | 4,970     | 6,000      | 5,707      | 5,004      | 4,441      | 6,265      |
| WikiAnswers              | 67%       | 68%       | 69%       | 75%        | 79%        | 80%        | 75%        | 76%        |
| ReferenceAnswers         | 33%       | 32%       | 31%       | 25%        | 21%        | 20%        | 25%        | 24%        |
| Total                    | 100%      | 100%      | 100%      | 100%       | 100%       | 100%       | 100%       | 100%       |
| <b>Traffic</b>           |           |           |           |            |            |            |            |            |
| Average Daily Page Views |           |           |           |            |            |            |            |            |
| WikiAnswers              | 5,337,000 | 6,082,000 | 6,336,000 | 8,199,000  | 8,995,000  | 8,578,000  | 8,279,000  | 11,110,000 |
| ReferenceAnswers         | 2,982,000 | 2,965,000 | 2,857,000 | 2,737,000  | 2,737,000  | 2,399,000  | 2,405,000  | 2,801,000  |
| Total                    | 8,319,000 | 9,047,000 | 9,193,000 | 10,936,000 | 11,732,000 | 10,977,000 | 10,684,000 | 13,911,000 |
| WikiAnswers              | 64%       | 67%       | 69%       | 75%        | 77%        | 78%        | 77%        | 80%        |
| ReferenceAnswers         | 36%       | 33%       | 31%       | 25%        | 23%        | 22%        | 23%        | 20%        |
| Total                    | 100%      | 100%      | 100%      | 100%       | 100%       | 100%       | 100%       | 100%       |
| <b>RPM (\$)</b>          |           |           |           |            |            |            |            |            |
| WikiAnswers              | 6.58      | 6.14      | 5.87      | 5.93       | 5.55       | 5.11       | 4.35       | 4.63       |
| ReferenceAnswers         | 5.84      | 5.87      | 5.89      | 6.08       | 4.94       | 4.64       | 5.09       | 5.94       |

The traffic and RPM trend discussion that follows pertains to our Answers.com English site.

WikiAnswers

Since we purchased WikiAnswers in November 2006, the Web property's traffic has experienced significant growth. In fact, with the exception of the second and third quarter of 2010, we experienced sequential traffic growth in every quarter since we acquired WikiAnswers. We believe that the growth that WikiAnswers experienced was primarily due to the dynamics of the property. As our database of questions and answers grew, we drew new traffic, primarily from SEO, which in turn resulted in the creation of new questions and answers, or new content, which drove additional growth. More specifically, we attribute our strong quarterly sequential traffic growth, of 34%, in the fourth quarter of 2010 to heightened traffic we started receiving from Google to unanswered pages, in addition to the favorable seasonality we normally experience in such quarter.

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Most of WikiAnswers' revenue in 2010, and in every quarter since we acquired WikiAnswers, was generated by our use of ads from Google. Further, the RPM declines that WikiAnswers has generally experienced since the beginning of 2009, have been the result of declines in our RPM from Google ads. In an effort to reduce our dependence on Google, in October 2010, we added in-text hyperlink ads to our Web properties, adding a new ad provider to our mix of monetization partners.

In addition, we are in the process of redesigning Answers.com and will begin testing certain site elements beginning the second quarter of 2011. One of the elements of the redesign will allow for different size ad units and changing the location of ads on the page, in an effort to combat "ad-blindness," the term we use to describe our belief that users click on advertisements less, the more they get accustomed to viewing them. Additionally, the site redesign is intended to give expression to the inherent vertical nature of our content, thus, we believe, supporting our efforts to improve monetization.

Finally, in the past few months, we had planned to launch our own direct ad sales department in the first quarter of 2011, in an effort to diversify our revenue sources and improve RPMs. We have recently decided to postpone those plans until later in the year due to the developments concerning the Merger.

### ReferenceAnswers

Loss of Google Definition Link in 2009. Since 2005, we benefited from an informal, non-contractual relationship with Google under which Google linked certain search results related to definitional queries to ReferenceAnswers. This link (or links, in the case of multiple-phrase queries) appeared at the right end of the blue header bar for Google Search Results. In October 2009, Google informed us that beginning sometime during the fourth quarter of 2009, they will no longer be sending us traffic from the Google Definition Link. By the end of 2009, all Google definition link traffic had been discontinued. We believe that the traffic decline that ReferenceAnswers experienced in 2010 as compared to 2009, is attributable to such loss of the Google definition link.

As noted above, we attribute the declines we have seen in ReferenceAnswers RPM in 2010, as compared to the prior year, to the terms of our renewed GSA as well as declines in our click-through rates and CPC rates. While ReferenceAnswers has not suffered RPM declines as prominent as WikiAnswers, the same initiatives that are intended to improve WikiAnswers' RPM, discussed above, are also intended to improve ReferenceAnswers' RPM.

### Recent Google Algorithm Change

On or about February 24, 2011, Google rolled out a significant algorithmic change which, according to the Official Google Blog, "noticeably impacts 11.8% of Google queries" (the "Recent Google Algorithm Change"). According to Google, "this update is designed to reduce rankings for low-quality sites—sites which are low-value add for users, copy content from other websites or sites that are just not very useful. At the same time, it will provide better rankings for high-quality sites—sites with original content and information such as research, in-depth reports, thoughtful analysis and so on". Overall, we believe the Recent Google Algorithm Change, did not adversely impact Answers.com. ReferenceAnswers suffered a detrimental impact, while WikiAnswers benefited from a traffic increase, slightly outweighing the decrease on ReferenceAnswers. Notwithstanding, in an effort to reduce the likelihood of a negative consequence from future Google algorithm changes, we may decide to proactively take measures that could be detrimental to our traffic in the short term. For example, we could potentially decide to un-index web pages that may be viewed as displaying inferior content, and are currently being indexed.

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## Costs and Expenses

## Cost of Revenue

|                 | Year Ended December 31, |       |        |
|-----------------|-------------------------|-------|--------|
|                 | 2009                    | 2010  | Change |
|                 | (\$ - in thousands)     |       |        |
| Cost of revenue | 4,796                   | 5,424 | 628    |

Cost of revenue increased \$628 thousand, or 13%, from \$4,796 thousand in 2009, to \$5,424 thousand in 2010. The change in cost of revenue was due primarily to the following factors: compensation costs, excluding stock based compensation, increased \$193 thousand due to headcount changes and raises; translation expenses increased \$180 thousand; data center costs increased \$270 thousand; overhead expenses increased \$105 thousand; licensing fees relating to third-party software we use in our product increased \$60 thousand; and fees for web search we license increased \$51 thousand. The aforesaid increases were partially offset by decreases in recruiting fees, use taxes, amortization, ad serving fees and traffic acquisition costs, which, in aggregate, decreased by \$209 thousand and a decrease of \$30 thousand in stock-based compensation.

## Research and Development Expenses

|                          | Year Ended December 31, |       |        |
|--------------------------|-------------------------|-------|--------|
|                          | 2009                    | 2010  | Change |
|                          | (\$ - in thousands)     |       |        |
| Research and development | 3,608                   | 4,608 | 1,000  |

Research and development expenses increased \$1,000 thousand, or 28%, from \$3,608 thousand in 2009, to \$4,608 thousand in 2010. The change in research and development expenses was due primarily to the following factors: compensation related expenses increased \$733 thousand, excluding stock based compensation, due to increased headcount and raises; consulting expenses increased \$206 thousand; and overhead expenses increased \$141 thousand. The aforesaid increases were partially offset by a decrease of \$80 thousand in stock-based compensation. Our consulting expenses rose primarily due to development projects in the area of mobile and blufr, a social trivia game based on information from Answers.com.

## Community Development and Marketing Expenses

|                                     | Year Ended December 31, |       |        |
|-------------------------------------|-------------------------|-------|--------|
|                                     | 2009                    | 2010  | Change |
|                                     | (\$ - in thousands)     |       |        |
| Community development and marketing | 2,459                   | 2,777 | 318    |

Community development and marketing expenses increased \$318 thousand, or 13%, from \$2,459 thousand in 2009, to \$2,777 thousand, in 2010. The primary factors that caused this increase were a \$302 thousand increase in compensation related expenses, excluding stock based compensation, due to increased headcount and raises; increased stock based compensation of \$20 thousand; and increased consulting expenses a \$66 thousand, offset, to some extent, by a decrease of \$86 thousand in promotional and marketing costs.



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## General and Administrative Expenses

|                            | Year Ended December 31, |       |        |
|----------------------------|-------------------------|-------|--------|
|                            | 2009                    | 2010  | Change |
|                            | (\$ - in thousands)     |       |        |
| General and administrative | 4,899                   | 4,793 | (106)  |

General and administrative expenses decreased \$106 thousand, or 2%, from \$4,899 thousand in 2009, to \$4,793 thousand in 2010. The change in general and administrative expenses was due primarily to the following factors: stock-based compensation decreased \$273 thousand; travel unrelated to the AFCV transaction decreased \$72 thousand; investor-related expenses decreased \$26 thousand; insurance decreased \$26 thousand; and amortization of intangible assets decreased \$75 thousand, since a WikiAnswers covenant not to compete was fully amortized in October 2009. The aforesaid decreases were partially offset by increases of \$54 thousand in compensation expense, excluding stock-based compensation; non-income related taxes of \$75 thousand; and costs, mostly legal, we incurred in connection with the Merger, amounting to approximately \$250 thousand.

## Interest Income (Expense), Net

|                                | Year Ended December 31, |      |        |
|--------------------------------|-------------------------|------|--------|
|                                | 2009                    | 2010 | Change |
|                                | (\$ - in thousands)     |      |        |
| Interest income (expense), net | (440)                   | 61   | 501    |

Interest income (expense), net, changed by \$501 thousand from \$(440) thousand expense, net, in 2009 to \$61 thousand income, net in 2010. The change in interest income (expense), net, resulted mostly from the following two matters: In 2009, we recorded \$166 thousand of amortization relating to \$363 thousand of transaction costs that we incurred in connection with the issuance of the Series B Unit Warrant in June 2008, and which were fully amortized by the end of the second quarter of 2009. Secondly, in the second quarter of 2009 we recorded \$290 thousand transaction costs that we incurred in connection with the issuance of the Series B Warrants in June 2009.

## Other Income (Expense), Net

|                             | Year Ended December 31, |      |        |
|-----------------------------|-------------------------|------|--------|
|                             | 2009                    | 2010 | Change |
|                             | (\$ - in thousands)     |      |        |
| Other income (expense), net | 6                       | (35) | (41)   |

Other income (expense), net, changed by \$41 thousand, from \$6 thousand net income in 2009, to \$(35) thousand net expense in 2010. Other income (expense), net, results from foreign currency net gains and losses.

## Gain (Loss) Resulting from Fair Value Adjustment of Warrants

|  | Year Ended December 31, |       |        |
|--|-------------------------|-------|--------|
|  | 2009                    | 2010  | Change |
|  | (\$ - in thousands)     |       |        |
| Gain (loss) resulting from fair value adjustment of warrants | (2,634)                 | 1,750 | 4,384  |





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The Series A Warrants and Series B Warrants are revalued each reporting date, and any change to their fair value is recorded in the Statement of Income. The Warrant to Purchase Units of Series B Preferred Stock and Warrants was, up to its exercise in June 2009, also revalued each reporting period and the change in its fair value was recorded in the Statement of Income.

The Series A Warrants and Series B Warrants are classified as a long-term liability and the primary reason for the change in their value is the market price of our common stock on the reporting dates. An increase in the price of our common stock on the reporting date, as compared to its price on the preceding reporting date, increases the value of the warrants and thus results in a loss on our Statement of Income. Conversely, a decline in the price of our common stock decreases the value of the warrants and thus results in a gain on our Statement of Income.

## Income Tax Benefit (Expense), Net

|                                   | Year Ended December 31, |       |        |
|-----------------------------------|-------------------------|-------|--------|
|                                   | 2009                    | 2010  | Change |
|                                   | (\$ - in thousands)     |       |        |
| Income tax benefit (expense), net | (165)                   | 1,443 | 1,608  |

Income tax expense, net, changed by \$1,608 thousand, from \$(165) thousand income tax expense in 2009 to an income tax benefit of \$1,443 thousand in 2010.

The change in tax expense was primarily the result of a release of the valuation allowance established against our U.S. deferred tax assets in the amount of approximately \$1,751. The aforesaid tax benefit was offset, to some extent, by an increase in unrecognized tax benefits of approximately \$132 thousand recorded by our Israeli subsidiary.

We had net operating loss (“NOL”) carryforwards for federal income tax purposes of approximately \$48 million at December 31, 2010. The federal NOLs will expire if not utilized on various dates from 2021 through 2030. Section 382 of the Internal Revenue Code of 1986 (“Section 382”) generally imposes an annual limitation on the amount of NOL carryforwards that may be used to offset taxable income where a corporation has undergone significant changes in its stock ownership. We estimate two ownership changes, as defined under Section 382, have occurred, that would trigger this limitation. Based on our current estimates and assumptions, as of December 31, 2010, we may use approximately \$33 million of our accumulated NOLs. The remaining approximate \$15 million NOL is available to offset taxable income in an amount of approximately \$1.4 million per year. Any unused portion of the \$1.4 million is available for use in future years until such NOL is scheduled to expire. An additional ownership change will take place on the effective date of the Merger Agreement; the effects of the new ownership change on the company’s NOL limitations has not been determined.

Our GuruNet subsidiary has capital loss carryforwards of approximately \$795 thousand, which can be applied to future capital gains resulted in our subsidiary for an unlimited period of time under current tax rules.

We file income tax returns in the U.S., as well as in various state, local and foreign jurisdictions. We are no longer subject to U.S. federal income tax examinations by tax authorities for years prior to 2007. GuruNet is no longer subject to foreign income tax examinations by tax authorities for years prior to 2007 but is currently undergoing an audit by the Israeli tax authorities for the tax years 2007 and 2008. While we have accrued certain amounts in reference to those periods, as a settlement has not been reached there is no certainty that amounts accrued will be the final amounts paid.



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## LIQUIDITY AND CAPITAL RESOURCES

Our principal ongoing source of operating liquidity is the cash generated by our advertising revenue. We had \$25.8 million in cash, cash equivalents and marketable securities at December 31, 2010, including the \$11.9 million we raised from the Redpoint Financings.

|   | Year Ended<br>December 31, |         |
|---|----------------------------|---------|
|   | 2009                       | 2010    |
|   | (\$ - in thousands)        |         |
| Net cash provided by operating activities           | 6,780                      | 4,627   |
| Net cash used in investing activities               | (2,314)                    | (4,737) |
| Net cash provided by (used in) financing activities | 6,047                      | (616)   |

## Operating Activities

Although net income was \$1,760 thousand in 2009, the net cash provided by operations was \$6,780 thousand. The adjustments to reconcile the two amounts, including changes to the balances of our various operating assets and liabilities, are noted in detail on the statement of cash flows included in Item 8 of this annual report. The largest reconciling items are the loss resulting from the fair value adjustment of the warrants of \$2,634 thousand, stock-based compensation of \$1,553 thousand, and depreciation and amortization of \$1,185 thousand.

Net income in 2010 was \$7,088 thousand, and net cash provided by operations was \$4,627 thousand. The adjustments to reconcile the two amounts, including changes to the balances of our various operating assets and liabilities, are noted in detail on the statement of cash flows included in Item 8 of this annual report. The largest reconciling items are the non-cash gain resulting from the fair value adjustment of the warrants of \$1,750 thousand, increase in the deferred tax asset, net, of \$1,753 thousand, stock-based compensation of \$1,190 thousand, depreciation and amortization of \$1,255 thousand, and an increase in accounts receivable and prepaid expenses and other current assets of \$1,103 thousand. The main reason for the increase in accounts receivable and prepaid expenses and other current assets is the fact that our non-Google monetization partners, whose payment terms are less favorable to us than Google's terms, now represent a larger portion of our revenue than in the past.

## Investing Activities

Net cash used in investing activities of \$2,314 thousand, in 2009, is attributable to cash used for capital expenditures of \$1,515 thousand and cash used to purchase marketable securities of \$799 thousand. Most of our capital expenditures resulted from the establishment of our second colocation facility.

Net cash used in investing activities of \$4,737 thousand, in 2010, is attributable to cash used to purchase marketable securities of \$3,515 thousand and capital expenditures of \$1,222 thousand.

## Financing Activities

Net cash flow from financing activities in 2009 was mostly the result of the Redpoint Financings, less dividends paid to Redpoint.

Net cash flow used in financing activities of \$616 thousand, in 2010, stems from \$786 thousand of dividend payments to Redpoint and an \$83 thousand repayment of a capital lease obligation, less \$253 thousand of proceeds from the

exercise of stock options.

#### Future Operations

Based on our current cash and cash equivalents, marketable securities and expected cash flow from operations, we believe we have sufficient cash and cash equivalents to meet our working capital and operating requirements for at least the next twelve months.

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We assess acquisition opportunities as they arise. Financing in excess of our current cash and cash equivalents may be required if we decide to make additional acquisitions. There can be no assurance, however, that any such opportunities may arise, or that any such acquisitions may be consummated. Additional financing may not be available on satisfactory terms when required. To the extent that we raise additional funds by issuing equity securities, our stockholders may experience significant dilution.

As of December 31, 2010, \$3,340 thousand of the company's consolidated cash, and \$2,730 thousand of its consolidated working capital, are assets of GuruNet. Such assets are primarily the result of the accumulation of earnings from GuruNet's "cost plus" relationship with Answers Corporation, since the two companies were formed. A full discussion of the nature of the relationship is contained in the tax discussions above. In the event that we decide to transfer GuruNet's funds to us, such transfer would be deemed a dividend and would cause certain taxes to be incurred, as noted in the earlier tax discussion. At present, we do not plan on having GuruNet distribute any dividends.

The Preferred Stock contain redemption provisions which allow the holders of a majority of the Preferred Stock to request redemption, at any time on or after June 16, 2014, of all or any part of their stock. If the Merger is completed, the Preferred Stock will be exchanged for cash as provided in the Merger Agreement.

### OFF-BALANCE SHEET ARRANGEMENTS

As of December 31, 2010, there were no off-balance sheet arrangements.

### CRITICAL ACCOUNTING ESTIMATES

While our significant accounting policies are more fully described in the notes to our audited consolidated financial statements for the years ended December 31, 2009 and 2010, we believe the following accounting policies to be the most critical in understanding the judgments and estimates we use in preparing our consolidated financial statements.

#### Goodwill, Intangibles and Other Long-Lived Assets

We account for our purchases of acquired companies in accordance with ASC 805, "Business Combinations" (formerly SFAS 141), and for goodwill and other identifiable definite and indefinite-lived acquired intangible assets in accordance with ASC 350, "Intangibles – Goodwill and Other". Additionally, we review our long-lived assets for recoverability in accordance with ASC 360, "Property, Plant and Equipment".

The identification and valuation of intangible assets and the determination of the estimated useful lives at the time of acquisition are based on various valuation methodologies including reviews of projected future cash flows. The use of alternative estimates and assumptions could have increased or decreased the estimated fair value of our goodwill and other intangible assets, and potentially resulted in a different impact to our results of operations. Further, changes in business strategy and/or market conditions may significantly impact these judgments thereby impacting the fair value of these assets, which could result in an impairment of the goodwill and acquired intangible assets.

We evaluate our long-lived tangible and intangible assets for impairment in accordance with ASC 350, with the annual goodwill impairment testing date set at September 30. Further, in accordance with ASC 360 and ASC 350, we also evaluate our long-lived tangible and intangible assets, respectively, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. While we use available information to prepare our estimates and to perform impairment evaluations, the completion of annual impairment tests requires significant management judgments and estimates.

As of December 31, 2010, we determined that there was no impairment of goodwill and there were no events or changes in circumstances indicating that the carrying amount of our intangible and other long-lived assets may not be recoverable; therefore, there was no need to evaluate the recoverability or compute impairment of any of the aforesaid assets.

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### Accounting for Stock-based Compensation

We account for stock-based awards under ASC 718, “Compensation – Stock Compensation”, which requires measurement of compensation cost for stock-based awards at fair value on date of grant and recognition of compensation over the service period awards are expected to vest. The estimation of stock-based awards that will ultimately vest requires judgment, and to the extent actual results differ from our estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. We consider various factors when estimating expected forfeitures, including historical experience. Actual results may differ substantially from these estimates.

We determine the fair value of stock options granted to employees and directors using the Black-Scholes valuation model, which requires significant assumptions regarding the expected stock price volatility, the risk-free interest rate and the dividend yield, and the estimated period of time option grants will be outstanding before they are ultimately exercised. We estimate our expected stock volatility based on our own historical stock volatility rates. Had we made different assumptions about our stock price volatility or the estimated time option and warrant grants will be outstanding before they are ultimately exercised, the related stock based compensation expense, and our net income and net earnings (loss) per share amounts could have been significantly different than reported amounts.

### Accounting for Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves management estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not more likely than not, we must establish a valuation allowance. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. At December 31, 2010, we examined all available evidence, both positive and negative, and determined that it is more likely than not that a portion of the deferred tax asset relating to the reversal of certain federal and state and local NOL's will be realized. We, therefore, released our valuation allowance to the extent the company expected to utilize NOLs in 2011. However, due to continued volatility and significant uncertainties with respect to our revenue model, we are unable to reliably forecast future pre-tax income beyond 2011 which would be necessary to utilize all of the deferred tax assets resulting from the accumulated net operating losses and therefore it is difficult to support a conclusion that expected taxable income from future operations beyond 2011 justifies recognition of deferred tax assets for such periods. Increases in estimated future taxable income may require us to release all or a portion of the valuation allowance against our deferred tax assets and result in a deferred tax benefit for the period and could have a significant impact on our future earnings. A valuation allowance has not been established for the deferred tax assets of our GuruNet subsidiary of approximately \$51 thousand because we believe that it is more likely than not that the results of future operations will generate sufficient taxable income to realize those deferred tax assets.

ASC 740, “Income Taxes”, prescribes how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. Additionally, for tax positions to qualify for deferred tax benefit recognition under ASC 740, the position must have at least a “more likely than not” chance of being sustained upon challenge by the respective taxing authorities, and whether or not it means that criteria is a matter of significant judgment.

We have not provided U.S. and Israeli income taxes and withholding taxes on the undistributed earnings of GuruNet as of December 31, 2010 because we intend to permanently reinvest such earnings outside the U.S. As of December 31, 2010, the cumulative amount of earnings upon which income taxes have not been provided is approximately \$3.7



million. We make an evaluation at the end of each reporting period as to whether or not the undistributed earnings of our foreign subsidiary are permanently reinvested. While, to date, we have concluded that such undistributed earnings are permanently reinvested, facts and circumstances may change in the future. Changes in facts and circumstances may include a change in the estimated capital needs of our foreign subsidiaries, or a change in our corporate liquidity requirements. Such changes could result in our management determining that some or all of such undistributed earnings are no longer permanently reinvested. In that event, we would be required to recognize income tax liabilities on the assumption that GuruNet's foreign undistributed earnings will be distributed to us.

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Accounting for Redpoint Financings

In accounting for the Series A Financing, the proceeds were first allocated to the Series B Unit Warrant, which was classified as a current liability, based on its fair value, and the residual amount was allocated among the Series A Convertible Preferred Stock and the Series A Warrants based on their relative fair values, all in accordance with the guidance in ASC 480, “Distinguishing Liabilities from Equity”, ASC 815, “Derivatives and Hedging” and ASC 815–40, “Derivatives and hedging – Contracts in Entity’s Own Equity”. The Series B Unit Warrant was revalued at each reporting date, since its inception until it was exercised on June 10, 2009. The Series A Convertible Preferred Stock has been classified as temporary equity, in accordance with the guidance in ASC 480-10-S99A, and, prior to January 1, 2009, the Series A Warrants were classified in permanent equity.

As a result of EITF 07-5, “Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity’s Own Stock” (incorporated in ASC 815–40), effective January 1, 2009, and due to the Down-Round Protection of the Series A Warrants, such warrants were, effective January 1, 2009, separately accounted for as a derivative under ASC 815 and were no longer recorded in equity but rather as a liability to be revalued at each reporting date.

On June 10, 2009, Redpoint exercised, in full, the Series B Unit Warrant, which was valued at approximately \$10.8 million on such date, thus extinguishing this liability from our balance sheet through a corresponding increase to additional paid-in capital. In accounting for the Series B Financing, the proceeds were first allocated to the Series B Warrants which were classified as a liability, based on their fair value, and the residual amount was allocated to the Series B Convertible Preferred Stock, all in accordance with the guidance in ASC 480, ASC 815 and ASC 815-40. The Series B Convertible Preferred Stock has been classified as temporary equity, in accordance with the guidance in ASC 480-10-S99A.

We used various valuation models and techniques to determine the individual values of the various components in the Redpoint Financings, including Monte Carlo and Black-Scholes. Inputs used in the models include our stock price and risk-free interest rate. Additionally, significant assumptions used in applying these techniques included redemption behavior estimates (including likelihood of forced conversion, and timing of liquidation event if such event transpires) and expected volatility of our stock price. While we believe we applied appropriate judgment in the aforesaid assumptions, variations in judgment could have materially affected the valuation results, and thus, our financial statements. We continue to use the Black-Scholes valuation model in our periodic fair value adjustments.

The Preferred Stock contain an embedded conversion option which could potentially require separate accounting under ASC 815. According to ASC 815-15, in order to determine whether separate accounting is required, one has to evaluate whether the economic characteristics and risks of the conversion option are closely related to the host contract, and the nature of the host contract. We exercised judgment and evaluated this matter in accordance with ASC 815-10. ASC 815-10 provides guidance on determining whether the characteristics of a host contract in a hybrid financial instrument issued in the form of a share is more akin to debt or equity. In evaluating an embedded derivative feature for separation under ASC 815, the consideration of the economic characteristics and risks of the host contract should not ignore the stated or implied substantive terms and features of the hybrid financial instrument. We considered various factors including redemption provisions, stated rate, voting rights, whether returns are discretionary or mandatory, collateral requirements, participation in residual earnings and liquidation preferences, in making our determination that the host contract was more akin to equity. The most important factor that led us to the conclusion that the host contract was more akin to equity was the fact that the redemption feature was not mandatory or likely to occur. Had we determined that the host contract was more akin to debt and not equity it would have impacted the accounting for the host contract and the embedded conversion option and could have had a material impact on our financial statements.



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## QUARTERLY RESULTS

The following table sets forth our historical quarterly consolidated statement of income (loss) data and certain non-GAAP financial measures beginning with the first quarter of 2009. You should read this information together with our consolidated financial statements and the related notes appearing elsewhere in our filings. The results of historical periods are not necessarily indicative of the results of operations for a full year or any future period.

|   | Quarter Ended                                  |                  |                  |                  |                  |                  |                  |                  |
|---|--|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
|   | Mar. 31,<br>2009                               | Jun. 30,<br>2009 | Sep. 30,<br>2009 | Dec. 31,<br>2009 | Mar. 31,<br>2010 | Jun. 30,<br>2010 | Sep. 30,<br>2010 | Dec. 31,<br>2010 |
|   | (in thousands, except page views and RPM data) |                  |                  |                  |                  |                  |                  |                  |
| Revenues:   |  |                  |                  |                  |                  |                  |                  |                  |
| Advertising revenue   | \$4,729  | \$4,985          | 4,970            | \$6,000          | \$5,707          | \$5,004          | \$4,441          | \$6,265          |
| Answers services licensing  | 18   | 19               | 17               | 17               | 19               | 16               | 11               | 8                |
|   | 4,747  | 5,004            | 4,987            | 6,017            | 5,726            | 5,020            | 4,452            | 6,273            |
| Costs and expenses:   |  |                  |                  |                  |                  |                  |                  |                  |
| Cost of revenue   | 1,059  | 1,166            | 1,264            | 1,307            | 1,437            | 1,315            | 1,303            | 1,369            |
| Research and development  | 873  | 817              | 921              | 997              | 1,061            | 1,140            | 1,202            | 1,205            |
| Community development and marketing                               | 499  | 558              | 621              | 781              | 744              | 660              | 568              | 805              |
| General and administrative  | 1,219  | 1,248            | 1,201            | 1,231            | 1,257            | 1,115            | 1,000            | 1,421            |
| Total operating expenses  | 3,650  | 3,789            | 4,007            | 4,316            | 4,499            | 4,230            | 4,073            | 4,800            |
| Operating income  | 1,097  | 1,215            | 980              | 1,701            | 1,227            | 790              | 379              | 1,473            |
| Interest income (expense), net                                    | (87)   | (362)            | 4                | 5                | 11               | 13               | 19               | 18               |
| Other income (expense), net                                       | 15   | (9)              | (5)              | 5                | (8)              | 12               | (15)             | (24)             |
| Gain (loss) resulting from fair value adjustment of warrants, net | 2,010  | (4,385)          | (999)            | 740              | 615              | 1,468            | 1,321            | (1,654)          |
| Income (loss) before income taxes                                 | 3,035  | (3,541)          | (20)             | 2,451            | 1,845            | 2,283            | 1,704            | (187)            |

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|                                   |           |           |           |           |           |           |           |            |
|-----------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|------------|
| Income tax benefit (expense), net | 6         | (78)      | (50)      | (43)      | (91)      | (160)     | (45)      | 1,739      |
| Net income (loss)                 | \$3,041   | \$(3,619) | \$(70)    | \$2,408   | 1,754     | 2,123     | 1,659     | 1,552      |
| Other Data:                       |           |           |           |           |           |           |           |            |
| Adjusted EBITDA(1)                | \$1,744   | \$1,895   | \$1,708   | \$2,389   | \$1,840   | \$1,381   | \$964     | \$2,382    |
| WikiAnswers                       |           |           |           |           |           |           |           |            |
| average daily page views          | 5,337,000 | 6,082,000 | 6,336,000 | 8,199,000 | 8,995,000 | 8,578,000 | 8,279,000 | 11,110,000 |
| ReferenceAnswers                  |           |           |           |           |           |           |           |            |
| average daily page views          | 2,982,000 | 2,965,000 | 2,857,000 | 2,737,000 | 2,737,000 | 2,399,000 | 2,405,000 | 2,801,000  |
| WikiAnswers                       |           |           |           |           |           |           |           |            |
| RPM                               | \$6.58    | \$6.14    | \$5.87    | \$5.93    | \$5.55    | \$5.11    | \$4.35    | \$4.63     |
| ReferenceAnswers                  |           |           |           |           |           |           |           |            |
| RPM                               | \$5.84    | \$5.87    | \$5.89    | \$6.08    | \$4.94    | \$4.64    | \$5.09    | \$5.94     |

(1) We define Adjusted EBITDA as net earnings before interest, taxes, depreciation, amortization, gain (loss) resulting from fair value adjustment of warrants, stock-based compensation and foreign currency exchange rate differences, and expenses relating to the Merger.

We use Adjusted EBITDA as an additional measure of our overall performance for purposes of business decision-making, developing budgets and managing expenditures. It is useful because it removes the impact of our capital structure (interest expense and gain (loss) resulting from fair value adjustment of warrants), asset base (amortization and depreciation), stock-based compensation expenses, taxes, foreign currency exchange rate differences and expenses relating to the Merger from our results of operations. We believe that the presentation of Adjusted EBITDA provides useful information to investors in their analysis of our results of operations for reasons similar to the reasons why we find it useful and because these measures enhance their overall understanding of the financial performance and prospects of our ongoing business operations. By reporting Adjusted EBITDA, we provide a basis for comparison of our business operations between current, past and future periods, and peer companies in our industry.

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More specifically, we believe that removing these impacts is important for several reasons:

- Amortization of Intangible Assets. Adjusted EBITDA disregards amortization of intangible assets. Specifically, we exclude the amortization of intangible assets resulting from the acquisition of WikiAnswers and other related assets in November 2006. This acquisition resulted in operating expenses that would not otherwise have been incurred. We believe that excluding such expenses is significant to investors, due to the fact that they derive from prior acquisition decisions and are not necessarily indicative of future cash operating costs. In addition, we believe that the amount of such expenses in any specific period may not directly correlate to the underlying performance of our business operations. While we exclude the aforesaid expenses from Adjusted EBITDA we do not exclude revenues generated by the acquired operations.
- Stock-based Compensation Expense. Adjusted EBITDA disregards expenses associated with stock-based compensation, a non-cash expense arising from the grant of stock-based awards to employees and directors. We believe that, because of the variety of equity awards used by companies, the varying methodologies for determining stock-based compensation expense, and the subjective assumptions involved in those determinations, excluding stock-based compensation from Adjusted EBITDA enhances the ability of management and investors to compare financial results over multiple periods.
- Depreciation, Interest, Gain (Loss) Resulting from Fair Value Adjustment of Warrants, Taxes and Foreign Currency Exchange Rate Differences. We believe that, excluding these items from the Adjusted EBITDA measure provides investors with additional information to measure our performance, by excluding potential differences caused by variations in capital structures (affecting interest expense), asset composition, and tax positions.
- Expenses related to the Merger. Adjusted EBITDA disregards costs associated with the Merger, as these costs are not related to the intrinsic operation of our business.

Adjusted EBITDA is not a measure of liquidity or financial performance under generally accepted accounting principles, or GAAP, and should not be considered in isolation from, or as a substitute for, a measure of financial performance prepared in accordance with GAAP. Investors are cautioned that there are inherent limitations associated with the use of Adjusted EBITDA as an analytical tool. Some of these limitations are:

- Non-GAAP financial measures are not based on a comprehensive set of accounting rules or principles;
- Many of the adjustments to Adjusted EBITDA reflect the exclusion of items that are recurring and will be reflected in our financial results for the foreseeable future;
- Other companies, including other companies in our industry, may calculate Adjusted EBITDA differently than us, thus limiting its usefulness as a comparative tool;
- Adjusted EBITDA does not reflect the periodic costs of certain tangible and intangible assets used in generating revenues in our business;
  - Adjusted EBITDA does not reflect interest income from our investments in cash and investment securities;
  - Adjusted EBITDA does not reflect gains and losses from foreign currency exchange rate differences;
  - Adjusted EBITDA does not reflect the costs incurred in connection with the Merger;

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Adjusted EBITDA does not reflect interest expense and other cost relating to financing our business, including gains and losses resulting from fair value adjustment of Redpoint Venture's warrants;

- Adjusted EBITDA excludes taxes, which are an integral cost of doing business; and
- Because Adjusted EBITDA does not include stock-based compensation, it does not reflect the cost of granting employees equity awards, a key factor in management's ability to hire and retain employees.

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We compensate for these limitations by providing specific information in the reconciliation to the GAAP amounts excluded from Adjusted EBITDA, as follows:

|  | Quarter Ended       |                  |                  |                  |                  |                  |                  |                  |
|--|---------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
|  | Mar. 31,<br>2009    | Jun. 30,<br>2009 | Sep. 30,<br>2009 | Dec. 31,<br>2009 | Mar. 31,<br>2010 | Jun. 30,<br>2010 | Sep. 30,<br>2010 | Dec. 31,<br>2010 |
|  | (\$ - in thousands) |                  |                  |                  |                  |                  |                  |                  |
| Net income<br>(loss)   | \$3,041             | \$(3,619)        | \$(70)           | \$2,408          | \$1,754          | \$2,123          | \$1,659          | \$1,552          |
| Interest (income)<br>expense, net  | 87                  | 362              | (4)              | (5)              | (11)             | (13)             | (19)             | (18)             |
| Foreign currency<br>(gains) losses                                       | (15)                | 9                | 5                | (5)              | 8                | (12)             | 15               | 24               |
| Income tax<br>(benefit)<br>expense, net                                  | (6)                 | 78               | 50               | 43               | 91               | 160              | 45               | (1,739)          |
| Depreciation and<br>amortization   | 261                 | 299              | 328              | 302              | 300              | 311              | 322              | 322              |
| Stock-based<br>compensation  | 386                 | 381              | 400              | 386              | 313              | 280              | 263              | 334              |
| (Gain) loss<br>resulting from<br>fair value<br>adjustment of<br>warrants | (2,010)             | 4,385            | 999              | (740)            | (615)            | (1,468)          | (1,321)          | 1,654            |
| Costs related to<br>the Merger   | -                   | -                | -                | -                | -                | -                | -                | 253              |
| Adjusted<br>EBITDA   | \$1,744             | \$1,895          | \$1,708          | \$2,389          | \$1,840          | \$1,381          | \$964            | \$2,382          |



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Item 8. Financial Statements and Supplemental data.

The following are our consolidated financial statements and notes to financial statements, and of our consolidated subsidiary, which are filed as part of this Annual Report.

Answers Corporation  
Index to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

Financial Statements:

Consolidated Balance Sheets

Consolidated Statements of Income

Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders  
of Answers Corporation:

We have audited the accompanying consolidated balance sheets of Answers Corporation and Subsidiary (collectively referred to as “the Company”) as of December 31, 2010 and 2009, and the related consolidated statements of income, changes in stockholders’ equity and comprehensive income, and cash flows for each of the years in the two-year period ended December 31, 2010. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Answers Corporation and Subsidiary as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 10 to the consolidated financial statements, the Company changed its method of accounting for its Redpoint warrants due to the adoption of new accounting requirements issued by the FASB, as of January 1, 2009.

/s/ Somekh Chaikin

Somekh Chaikin  
Certified Public Accountants (Israel)  
A member firm of KPMG International

Jerusalem, Israel  
March 17, 2011

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Answers Corporation and Subsidiary

Consolidated Balance Sheets (in thousands except share and per share data)

|  | December<br>31<br>2009<br>\$ | December<br>31<br>2010<br>\$ |
|--|------------------------------|------------------------------|
| Assets   |                              |                              |
| Current assets:  |                              |                              |
| Cash and cash equivalents                              | 22,234                       | 21,503                       |
| Marketable securities                                  | 795                          | 4,331                        |
| Short-term deposits (restricted)                       | -                            | 200                          |
| Accounts receivable                                    | 2,350                        | 3,191                        |
| Prepaid expenses and other current assets              | 907                          | 1,235                        |
| Deferred tax asset                                     | 34                           | 1,780                        |
| Total current assets                                   | 26,320                       | 32,240                       |
| Long-term deposits (restricted)                        | 276                          | 327                          |
| Deposits in respect of employee severance obligations  | 1,756                        | 2,208                        |
| Property and equipment, net                            | 1,858                        | 1,732                        |
| Other assets:  |                              |                              |
| Intangible assets, net                                 | 797                          | 719                          |
| Goodwill   | 437                          | 437                          |
| Prepaid expenses, long-term                            | 167                          | 555                          |
| Deferred tax asset, long-term                          | 14                           | 22                           |
| Total other assets                                     | 1,415                        | 1,733                        |
| Total assets   | 31,625                       | 38,240                       |
| Liabilities and stockholders' equity                   |                              |                              |
| Current liabilities:                                   |                              |                              |
| Accounts payable                                       | 403                          | 578                          |
| Accrued expenses and other current liabilities         | 774                          | 758                          |
| Accrued compensation                                   | 1,009                        | 972                          |
| Capital lease obligations – current portion            | 82                           | 23                           |
| Total current liabilities                              | 2,268                        | 2,331                        |
| Long-term liabilities:                                 |                              |                              |
| Liability in respect of employee severance obligations | 1,838                        | 2,333                        |
| Capital lease obligations, net of current portion      | 24                           | -                            |
| Deferred tax liability                                 | 38                           | 44                           |
| Series A and Series B Warrants                         | 8,008                        | 6,258                        |

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|   |          |          |
|---|----------|----------|
| Total long-term liabilities   | 9,908    | 8,635    |
| Commitments and contingencies   |          |          |
| Series A and Series B convertible preferred stock: \$0.01 par value; stated value and liquidation preference of \$101.76 per share for the Series A and \$100 per share for the Series B Convertible Preferred Stock; 6% cumulative annual dividend; 130,000 shares authorized, issued and outstanding as of December 31, 2009 and 2010 |          |          |
|   | 2,381    | 4,724    |
| Stockholders' equity:   |          |          |
| Preferred stock: \$0.01 par value; 870,000 shares authorized as of December 31, 2009 and 2010, none issued  | -        | -        |
| Common stock: \$0.001 par value; 100,000,000 shares authorized; 7,951,329 and 8,005,780 shares issued and outstanding as of December 31, 2009 and 2010, respectively  | 8        | 8        |
| Additional paid-in capital  | 88,539   | 86,853   |
| Accumulated other comprehensive income  | 28       | 108      |
| Accumulated deficit   | (71,507) | (64,419) |
| Total stockholders' equity  | 17,068   | 22,550   |
| Total liabilities and stockholders' equity  | 31,625   | 38,240   |

The accompanying notes are an integral part of these consolidated financial statements.

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Answers Corporation and Subsidiary

Consolidated Statements of Income (in thousands except share and per share data)

|  | Year ended December 31 |         |
|--|------------------------|---------|
|  | 2009                   | 2010    |
|  | \$                     | \$      |
| Revenues:  |                        |         |
| Advertising revenue -  |                        |         |
| WikiAnswers  | 14,454                 | 16,529  |
| ReferenceAnswers   | 6,230                  | 4,888   |
| Answers service licensing  | 71                     | 54      |
|  | 20,755                 | 21,471  |
| Costs and expenses:  |                        |         |
| Cost of revenue  | 4,796                  | 5,424   |
| Research and development   | 3,608                  | 4,608   |
| Community development, sales and marketing                         | 2,459                  | 2,777   |
| General and administrative   | 4,899                  | 4,793   |
| Total operating expenses   | 15,762                 | 17,602  |
| Operating income   | 4,993                  | 3,869   |
| Interest income (expense), net                                     | (440)                  | 61      |
| Other income (expense), net  | 6                      | (35)    |
| Gain (loss) resulting from fair value adjustments of warrants, net | (2,634)                | 1,750   |
| Income before income taxes   | 1,925                  | 5,645   |
| Income tax benefit (expense), net                                  | (165)                  | 1,443   |
| Net income   | 1,760                  | 7,088   |
| Net income (loss) attributable to common shares:                   |                        |         |
| Basic  | \$(582)                | \$2,978 |
| Diluted  | \$(582)                | \$1,690 |
| Net income (loss) per common share:                                |                        |         |
| Basic  | \$(0.07)               | \$0.37  |
| Diluted  | \$(0.07)               | \$0.20  |

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Number of shares used in computing net income (loss) per common share:

|         |           |           |
|---------|-----------|-----------|
|         |           |           |
| Basic   | 7,909,353 | 7,971,445 |
| Diluted | 7,909,353 | 8,559,353 |

The accompanying notes are an integral part of these consolidated financial statements.

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Answers Corporation and Subsidiary

Consolidated Statement of Changes in Stockholders' Equity and Comprehensive Income (in thousands except shares)

|   | Common<br>Shares | stock<br>Amount<br>(\$) | Additional<br>paid-in<br>capital<br>\$ | Accumulated<br>other<br>comprehensive<br>income<br>\$ | Accumulated<br>deficit<br>\$ | Total<br>stockholders'<br>equity<br>\$ | Comprehensive<br>income<br>\$ |
|---|------------------|-------------------------|--|---|------------------------------|--|-------------------------------|
| Balance as of<br>December 31, 2008  | 7,870,538        | 8                       | 77,091                                 | (28)  | (71,353)                     | 5,718                                  |                               |
| Cumulative effect of<br>change in accounting<br>principle (see note 10)   | -                | -                       | (1,657)                                | -   | (1,914)                      | (3,571)                                | -                             |
| Issuance of common<br>stock in connection<br>with exercise of<br>vested stock options   | 80,791           | -                       | 247                                    | -   | -                            | 247                                    | -                             |
| Stock-based<br>compensation to<br>employees and<br>directors  | -                | -                       | 1,553                                  | -   | -                            | 1,553                                  | -                             |
| Dividends on Series A<br>Convertible Preferred<br>Stock, \$6.10 per share   | -                | -                       | (366)                                  | -   | -                            | (366)                                  | -                             |
| Dividends on Series B<br>Convertible Preferred<br>Stock, \$3.37 per share   | -                | -                       | (236)                                  | -   | -                            | (236)                                  | -                             |
| Amortization of<br>discounts resulting<br>from Redpoint<br>Financing  | -                | -                       | (1,740)                                | -   | -                            | (1,740)                                | -                             |
| Discount to temporary<br>equity resulting from<br>beneficial<br>conversion feature in<br>the Redpoint<br>Financing (Series B) | -                | -                       | 2,867                                  | -   | -                            | 2,867                                  | -                             |
| Exercise of the Series<br>B Unit Warrant  | -                | -                       | 10,780                                 | -   | -                            | 10,780                                 | -                             |
| Unrealized gains on<br>derivative and<br>hedging activity   | -                | -                       | -                                      | 60  | -                            | 60                                     | 60                            |
| Unrealized loss on<br>marketable securities   | -                | -                       | -                                      | (4)   | -                            | (4)                                    | (4)                           |
| Net income for year   | -                | -                       | -                                      | -   | 1,760                        | 1,760                                  | 1,760                         |

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|  |           |   |         |      |          |         |       |
|--|-----------|---|---------|------|----------|---------|-------|
| Comprehensive income   |           |   |         |      |          |         | 1,816 |
| Balance as of December 31, 2009  | 7,951,329 | 8 | 88,539  | 28   | (71,507) | 17,068  |       |
| Issuance of common stock in connection with exercise of vested stock options | 54,451    | - | 253     | -    | -        | 253     | -     |
| Stock-based compensation to employees and directors                          | -         | - | 1,190   | -    | -        | 1,190   | -     |
| Dividends on Series A Convertible Preferred Stock, \$6.10 per share          | -         | - | (366)   | -    | -        | (366)   | -     |
| Dividends on Series B Convertible Preferred Stock, \$6.00 per share          | -         | - | (420)   | -    | -        | (420)   | -     |
| Amortization of discounts resulting from Redpoint Financing                  | -         | - | (2,343) | -    | -        | (2,343) | -     |
| Realized gains on derivative and hedging activity                            | -         | - | -       | (60) | -        | (60)    | (60)  |
| Unrealized gains on derivative and hedging activity                          | -         | - | -       | 119  | -        | 119     | 119   |
| Unrealized gain on marketable securities                                     | -         | - | -       | 21   | -        | 21      | 21    |
| Net income for year  | -         | - | -       | -    | 7,088    | 7,088   | 7,088 |
| Comprehensive income   |           |   |         |      |          |         | 7,168 |
| Balance as of December 31, 2010  | 8,005,780 | 8 | 86,853  | 108  | (64,419) | 22,550  |       |

The accompanying notes are an integral part of these consolidated financial statements.



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Answers Corporation and Subsidiary

## Consolidated Statements of Cash Flows (in thousands)

|   | Year ended December 31 |         |
|---|------------------------|---------|
|   | 2009                   | 2010    |
|   | \$                     | \$      |
| Cash flows from operating activities:   |                        |         |
| Net income  | 1,760                  | 7,088   |
| Adjustments to reconcile net income to net cash provided by operating activities:           |                        |         |
| Depreciation and amortization   | 1,185                  | 1,255   |
| Increase in deposits in respect of employee severance obligations                           | (407)                  | (322)   |
| Increase in liability in respect of employee severance obligations                          | 288                    | 359     |
| Stock-based compensation to employees and directors   | 1,553                  | 1,190   |
| Increase in deferred tax asset  | (48)                   | (1,753) |
| Increase in deferred tax liability  | 12                     | 6       |
| Fair value adjustments of warrants, net   | 2,634                  | (1,750) |
| Loss on disposal of property and equipment  | 73                     | 24      |
| Increase in short-term deposits (restricted)  | -                      | (200)   |
| Increase in long-term deposits (restricted)   | (19)                   | (51)    |
| Loss from exchange rate differences   | 6                      | 35      |
| Changes in operating assets and liabilities:  |                        |         |
| Increase in accounts receivable, and prepaid expenses and other current assets              | (410)                  | (1,103) |
| Decrease (increase) in prepaid expenses, long-term  | 49                     | (389)   |
| Increase (decrease) in accounts payable   | (307)                  | 314     |
| Increase (decrease) in accrued expenses, accrued compensation and other current liabilities | 411                    | (76)    |
| Net cash provided by operating activities   | 6,780                  | 4,627   |
| Cash flows from investing activities:   |                        |         |
| Capital expenditures  | (1,515)                | (1,222) |
| Purchases of marketable securities  | (799)                  | (3,515) |
| Net cash used in investing activities   | (2,314)                | (4,737) |
| Cash flows from financing activities:   |                        |         |
| Repayment of capital lease obligation   | (78)                   | (83)    |
| Redpoint financing, net of issuance cost  | 6,480                  | -       |
| Dividends paid  | (602)                  | (786)   |
| Exercise of common stock options and warrants   | 247                    | 253     |
| Net cash provided by (used in) financing activities   | 6,047                  | (616)   |
| Effect of exchange rate changes on cash and cash equivalents                                | (18)                   | (5)     |
| Net increase (decrease) in cash and cash equivalents  | 10,495                 | (731)   |
| Cash and cash equivalents at beginning of year  | 11,739                 | 22,234  |

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|  |        |        |
|--|--------|--------|
| Cash and cash equivalents at end of year           | 22,234 | 21,503 |
| Supplemental disclosures of cash flow information: |        |        |
| Income taxes paid                                  | 171    | 60     |
| Interest paid on capital lease obligations         | 9      | 4      |
| Non-cash investing activities:                     |        |        |
| Capital expenditures on account                    | 170    | 23     |
| Exchange of property and equipment                 | -      | 50     |

The accompanying notes are an integral part of these consolidated financial statements.

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ANSWERS CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Planned Acquisition by AFCV Holdings LLC

On February 2, 2011, Answers Corporation, a Delaware corporation (“Answers.com”), AFCV Holdings, LLC, a Delaware limited liability company (“AFCV”), and A-Team Acquisition Sub, Inc., an indirect wholly owned subsidiary of AFCV and a Delaware corporation (“Merger Sub”) entered into an Agreement and Plan of Merger (the “Merger Agreement”). The Merger Agreement was filed with the Securities and Exchange Commission (the “SEC”) on February 7, 2011 as an exhibit to Answers.com’s current report on Form 8-K. The Merger Agreement provides that, upon the terms and subject to the conditions set forth in the Merger Agreement, Merger Sub will merge with and into Answers.com (the “Merger”), with Answers.com continuing as the surviving corporation and a wholly owned subsidiary of AFCV.

A special meeting of Answers.com stockholders has been called for April 12, 2011 to vote on adoption of the merger agreement. The Merger is subject to adoption of the Merger Agreement by the Answers.com stockholders, and various other conditions set forth in the Merger Agreement.

On the effective date of the Merger, the capital stock and other securities of Answers.com will be treated as follows:

- Answers.com common stockholders other than stockholders who properly exercise appraisal rights, will receive \$10.50 in cash, without interest, and less any applicable withholding taxes, in exchange for each share of Answers.com common stock owned and outstanding on the effective date of the Merger.
- Holders of Series A convertible preferred stock of Answers.com (the “Series A stock”) will receive an amount in cash, without interest, in exchange for each share of Series A stock owned and outstanding on the effective date of the Merger equal to \$10.50 multiplied by (A) the stated value of \$101.76 plus accrued but unpaid dividends thereon accrued daily at the rate of six percent (6%) per annum, calculated from the date on which the last regular quarterly dividend is paid in respect of the Series A stock to the effective date of the Merger divided by (B) \$4.50, and less any applicable withholding taxes.
- Holders of Series B convertible preferred stock of Answers.com (the “Series B stock”) will receive an amount in cash, without interest, in exchange for each share of Series B stock owned and outstanding on the effective date of the Merger equal to \$10.50 multiplied by (A) the stated value of \$100.00 plus accrued but unpaid dividends thereon accrued daily at the rate of six percent (6%) per annum, calculated from the date on which the last regular quarterly dividend is paid in respect of the Series B stock to the effective date of the Merger divided by (B) \$5.50, and less any applicable withholding taxes.
- The holders of vested options to purchase Answers.com common stock will receive an amount in cash equal to the excess, if any, of (A) \$10.50 multiplied by the number of shares underlying such options, over (B) the aggregate exercise price of such options, without interest and less any deductions and required withholding taxes, as applicable. All unvested options to acquire Answers.com common stock outstanding immediately prior to the effective date of the Merger will no longer constitute the right to acquire Answers.com common stock. Instead, with respect to unvested options held by our employees, on each date on which a portion of such unvested stock options would have become vested and exercisable, provided that such holder is still employed by the surviving corporation under the Merger on such date, such holder will receive an amount in cash equal to the excess, if any, of \$10.50 multiplied by the number of shares underlying such stock options which become vested on such date over the aggregate exercise price of such vested stock options, without interest and less any deductions and required withholding taxes, as applicable. Each unvested option outstanding immediately prior to the effective date of the

Merger which is held by one of our non-employee directors will be accelerated and treated as a vested option in the Merger. In addition, fifty percent of each of our executive officers' respective unvested options will accelerate upon consummation of the Merger, and if any such executive officer is terminated within 12 months following the Merger, his remaining unvested options, at the time of termination, will become immediately vested.

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ANSWERS CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Planned Acquisition by AFCV Holdings LLC (cont'd)

· Each warrant to purchase shares of Answers.com common stock that is issued and outstanding immediately prior to the effective date of the Merger will be fully exercised prior to the effective date or terminated at the effective date. Following the closing, the holder of any such terminated warrant will be entitled to receive an amount in cash equal to the product of (A) the number of shares issuable upon exercise of such warrant, multiplied by (B) an amount equal to the excess, if any, of \$10.50 less the per share exercise price for such warrant, without interest, subject to withholding taxes.

On February 28, 2011, Answers.com filed its definitive proxy statement on schedule 14A with the SEC in connection with the Merger.

Note 2 - Business

Answers.com, and GuruNet Israel Ltd., its wholly-owned Israeli subsidiary (“the Subsidiary”) that provides primarily research and development to Answers.com, are collectively referred to as “the Company.” Answers.com is a public company and trades on the NASDAQ Capital Market under the symbol “ANSW”.

The Company provides answer-based search services to users through its website Answers.com® and earns practically all of its revenue from advertising on its website.

As of December 31, 2010, approximately \$790 thousand of the Company’s net assets were located outside of the United States.

Note 3 - Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements include the accounts of Answers Corporation and its Subsidiary and are presented in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). All significant intercompany balances and transactions have been eliminated in consolidation.

Foreign Currency Translation

The currency of the primary economic environment in which the operations of the Company are conducted is the U.S. dollar (“dollar”); therefore, the dollar has been determined to be the Company’s functional currency. Transactions in foreign currency (substantially all in New Israeli Shekels – “NIS”) are recorded at the exchange rate as of the transaction date. Monetary assets and liabilities denominated in foreign currency are translated on the basis of the representative rate of exchange at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currency are stated at historical exchange rates. All exchange gains and losses from remeasurement of monetary balance sheet items denominated in non-dollar currencies are reflected in the statement of income as they arise.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent

assets and liabilities at the date of the consolidated financial statements and the reported results of operations during the reporting periods. Significant items subject to such estimates and assumptions include the useful life of fixed assets, allowance for doubtful accounts, the valuation of derivatives, deferred tax assets, investments, share-based compensation, income tax uncertainties and other contingencies. Actual results could differ from those estimates.

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ANSWERS CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Continued)

Note 3 - Summary of Significant Accounting Policies (cont'd)

Cash and Cash Equivalents, and Marketable Securities

All highly liquid investments with stated maturities of three months or less from date of purchase are classified as cash equivalents.

All highly liquid investments with stated maturities of greater than three months are classified as marketable securities. The Company determines the appropriate classification of its investments in marketable securities at the time of purchase. The Company's marketable securities have been classified and accounted for as available-for-sale. After consideration of its risk versus reward objectives, as well as its liquidity requirements, the Company may sell these securities prior to their stated maturities. As these securities are viewed by the Company as available to support current operations, securities with maturities beyond 12 months are classified as current assets under the caption marketable securities in the accompanying consolidated balance sheets. These securities are carried at fair value, with the unrealized gains and losses reported as a component of stockholders' equity, except for unrealized losses determined to be other than temporary which are recorded as other income (expense), net. Any realized gains or losses on the sale of marketable securities are determined on a specific identification method, and such gains and losses are reflected as a component of other income (expense), net.

The Company considers all available information relevant to the collectability of the security, including, past events, current conditions, and reasonable and supportable forecasts to develop estimates of cash flows expected to be collected. Evidence considered in this assessment includes the reasons for the impairment, the severity and duration of the impairment and changes in value subsequent to period-end.

Accounts Receivable

Accounts receivable are recorded when earned and do not bear interest. If necessary, the Company records an allowance for doubtful accounts to reflect the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. As of the balance sheet dates such allowances were not significant.

Property and Equipment

Property and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets. Annual depreciation rates are as follows:

|                        | %       |
|------------------------|---------|
| Computer equipment     | 20 - 33 |
| Furniture and fixtures | 7 - 20  |

Leasehold improvements are amortized over the shorter of the estimated useful life or the expected life of the lease.

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ANSWERS CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Continued)

Note 3 - Summary of Significant Accounting Policies (cont'd)

Revenue Recognition

In 2009 and through the third quarter of 2010, the Company, through its website Answers.com, generated revenues via advertising in the form of pay-per-performance ads and paid-for-impression advertising. In the pay-per-performance model, the Company earns revenue based on the number of clicks associated with such ads. In the paid-for-impression model, the Company's revenue is derived from the display of ads. Beginning the fourth quarter of 2010, the Company added a third category of advertising to Answers.com, in-text advertising, a form of contextual advertising where specific keywords within the text of a web-page are matched with advertising units. Those specific keywords become hyperlinks that open an advertising "bubble" when users hover on the keywords. The Company earns revenue each time a user clicks on the hyperlink in the "bubble".

Almost all of the Company's advertising revenue is obtained through the efforts of third parties rather than through direct contracts with advertisers. The third party is obligated to pay the Company a portion of the revenue it earns from advertisers, as compensation for the Company's sale of promotional space on its Internet properties. Amounts received from such third parties are reflected as revenue in the period in which such advertising services are provided.

The Company also earns an immaterial amount of revenue from partners that pay the Company for providing them with answer-based services that they then use in their own products, via co-branded web pages.

Research and Development

The Company expenses research and development costs as incurred. Certain internal use software and website development costs are capitalized in accordance with the FASB's authoritative guidance on accounting for intangibles and website costs.

Stock-Based Compensation

The fair value of stock options granted to employees and directors, is estimated at the date of grant using the Black-Scholes option-pricing model, which takes into consideration the share price at the date of grant, the exercise price of the option, the expected life of the option, expected interest rates and the expected volatility. The value of stock options, as noted, is recognized as compensation expense on a straight-line basis, over the requisite service period of the entire award, net of estimated forfeitures.

Beginning in 2008, as the Company accumulated its own volatility history, estimates of its expected stock volatility are based on the Company's own historical stock volatility rates.

The fair value for each stock option granted to employees and directors during the years ended December 31, 2009 and 2010 was estimated at the date of grant using the Black-Scholes option-pricing model, assuming no dividends and the following average assumptions:

| Year ended December 31 |      |
|------------------------|------|
| 2009                   | 2010 |



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|                                  |        |        |
|----------------------------------|--------|--------|
| Expected risk-free interest rate | 1.97%  | 0.98%  |
| Expected life (in years)         | 4.08   | 4.05   |
| Expected volatility              | 72.70% | 73.07% |

The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option.

The expected life represents the average period of time that options granted are expected to be outstanding. The Company estimates the expected life of outstanding options by taking the average of the vesting term and the contractual term of the option, in accordance with the SEC's non-authoritative guidance (the "Simplified Method"). The Company uses the Simplified Method as adequate historical experience is not available to provide a reasonable estimate of the expected life for stock option grants, and it will continue to apply the Simplified Method until enough historical experience is available.

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ANSWERS CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Continued)

Note 3 - Summary of Significant Accounting Policies (cont'd)

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

In assessing the need for a valuation allowance, the Company looks at cumulative losses in recent years, estimates of future taxable earnings, feasibility of on-going tax planning strategies, the realizability of tax benefit carryforwards, and other relevant information. Valuation allowances related to deferred tax assets can be impacted by changes to tax laws, changes to statutory tax rates and future taxable earnings. Ultimately, the actual tax benefits to be realized will be based upon future taxable earnings levels, which are very difficult to predict. In the event that actual results differ from these estimates in future periods, the Company will be required to adjust the valuation allowance.

Significant judgment is required in evaluating the Company's federal, state and foreign tax positions and in the determination of its tax provision. Despite management's belief that the Company's liability for unrecognized tax benefits is adequate, it is often difficult to predict the final outcome or the timing of the resolution of any particular tax matters. The Company may adjust these reserves as relevant circumstances evolve, such as guidance from the relevant tax authority, its tax advisors, or resolution of issues in the courts. The Company's tax expense includes the impact of reserve provisions and changes to reserves that it considers appropriate, as well as related interest and penalties. These adjustments are recognized as a component of income tax expense entirely in the period in which they are identified.

Impairment of Property and Equipment, Goodwill and Intangible Assets

The Company reviews property and equipment and intangible assets, excluding goodwill, for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of these assets is measured by comparison of carrying amounts to the future undiscounted cash flows the assets are expected to generate. If property and equipment and intangible assets are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the asset exceeds its fair market value.

Additionally, the Company tests its goodwill for impairment at least annually, in accordance with the provisions of FASB ASC Topic 350, "Intangibles - Goodwill and Other", with the annual impairment testing date set at September 30, or more frequently if events or changes in circumstances indicate that this asset may be impaired. There was no impairment in any of the years presented.

Comprehensive Income

Comprehensive income represents net income plus any revenue, expenses, gains and losses that are specifically excluded from net income and recognized directly as a component of stockholders' equity.

Net Income (Loss) per Common Share

Basic net income (loss) per share is computed by dividing the net income for the period by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing the net income for the period, adjusted for the Redpoint dividends and amortizations of discounts, by the weighted average number of shares of common stock and potentially dilutive common stock outstanding during the period. The dilutive effect of outstanding options and warrants is reflected in diluted net income (loss) per share by application of the treasury stock method. The dilutive effect of the issued and outstanding Series A Convertible Preferred Stock and Series B Convertible Preferred Stock (collectively, the “Series A and Series B Convertible Preferred Stock”) is reflected in diluted net income (loss) per share by application of the if-converted method. The calculation of diluted net income (loss) per share excludes all anti-dilutive shares.

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ANSWERS CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Continued)

## Note 3 - Summary of Significant Accounting Policies (cont'd)

## Derivatives and Hedging

To mitigate the potential adverse impact on cash flows resulting from fluctuations in the exchange rate of the new Israeli shekels (NIS), the Subsidiary hedges portions of its forecasted expenses denominated in NIS with currency forwards. The Subsidiary does not speculate in these hedging instruments in order to profit from foreign currency exchanges, nor does it enter into trades for which there are no underlying exposures.

The Company recognizes all derivatives on the balance sheet at fair value. If the derivatives meet the definition of a hedge and are so designated, depending on the nature of the hedge, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of a derivative's change in fair value, if any, is recognized in earnings. Gains (losses) from a derivative's change in fair value that are not designated as hedges are recognized in earnings.

Through April 2009, the Subsidiary's currency forwards and options were not designated as hedging instruments and, therefore, the net gains (losses) that resulted from such derivatives were recognized in earnings as they occurred.

Starting May 2009, the Subsidiary designated all of its currency hedging activity as cash flow hedges, as they were all eligible. The Company documents all relationships between the hedging instruments and hedged items, as well as its risk management objective for undertaking these hedging transactions. The Company also formally assesses, both at the inception of the hedge and on an ongoing basis, whether or not each derivative is highly effective in offsetting changes in fair value of the hedged items.

Net gains from forward and option contracts are included in operating expenses, as follows:

|                            | Year ended December 31 |      |
|----------------------------|------------------------|------|
|                            | 2009                   | 2010 |
|                            | \$ (in thousands)      |      |
| Cost of revenue            | -                      | 13   |
| Research and development   | 15                     | 61   |
| Sales and marketing        | 1                      | 12   |
| General and administrative | 4                      | 28   |
|                            | 20                     | 114  |

The net gain for the year ended December 31, 2009 of \$20 thousand, is comprised of \$110 thousand of gains from contracts that were designated as hedging instruments, less \$90 thousand of losses from contracts that were not designated as hedging instruments. The net gain for the year ended December 31, 2010, resulted from contracts that were designated as hedging instruments.

As of December 31, 2010, the notional amount of the Subsidiary's outstanding forward contracts was approximately \$1.68 million, constituting assets with a fair value of \$119 thousand (December 31, 2009 - \$60 thousand). Such assets

are included in prepaid expenses and other current assets as the foreign exchange forward contracts mature through May 31, 2011, and the change in fair value has been recorded as other comprehensive income. The amounts recorded as other comprehensive income will be reclassified to earnings as the forward contracts mature or if, and to the extent that the hedging relationship is deemed ineffective.

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ANSWERS CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Continued)

## Note 3 - Summary of Significant Accounting Policies (cont'd)

## Fair Value Measurements

On January 1, 2008, the Company adopted the provisions of FASB Statement No. 157, "Fair Value Measurements", included in ASC Topic 820, "Fair Value Measurements and Disclosures", for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis.

On January 1, 2009, the Company adopted the provisions of ASC Topic 820 (Statement 157) to fair value measurements of nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis.

Statement 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Statement 157 also establishes a framework for measuring fair value and expands disclosures about fair value measurements (see Note 11).

## Note 4 - Cash and Cash Equivalents

Cash and cash equivalents consist of the following (in thousands):

|                                       | 2009   | 2010   |
|---------------------------------------|--------|--------|
|                                       | \$     | \$     |
| In US dollars:                        |        |        |
| Cash                                  | 890    | 820    |
| Cash equivalents (money market funds) | 20,885 | 20,224 |
| In New Israeli Shekels:               |        |        |
| Cash                                  | 57     | 348    |
| Cash equivalents                      | 402    | 111    |
|                                       | 22,234 | 21,503 |

## Note 5 – Marketable Securities

The Company's marketable securities are invested in debt instruments of the U.S. government, and mature between 9 and 14 months subsequent to December 31, 2010.

Gross unrealized gains (losses) on marketable securities, for which other than temporary impairments have not been recognized, and the fair value of those securities, were as follows (in thousands):

| Aggregate<br>cost basis | Other than<br>temporary<br>impairment | Unrealized<br>gain (loss) | Fair value |
|-------------------------|---------------------------------------|---------------------------|------------|
| \$                      | \$                                    | \$                        | \$         |

Available for sale - U.S. government securities

|                   |       |   |     |       |
|-------------------|-------|---|-----|-------|
| December 31, 2009 | 799   | - | (4) | 795   |
| December 31, 2010 | 4,310 | - | 21  | 4,331 |

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ANSWERS CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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## Note 6 - Long-term Deposits (Restricted)

Long-term deposits are comprised of a restricted deposit with a bank in the amount of \$140 thousand to secure a bank guarantee and other long-term deposits with vendors and credit card companies. During 2009 and 2010, the long-term deposits earned immaterial amounts of interest.

## Note 7 - Property and Equipment, Net

Property and equipment as of December 31, 2009 and 2010 consisted of the following (in thousands):

|  | 2009    | 2010    |
|--|---------|---------|
|  | \$      | \$      |
| Computer equipment(1)                              | 3,951   | 4,154   |
| Furniture and fixtures                             | 186     | 190     |
| Leasehold improvements                             | 185     | 252     |
|  | 4,322   | 4,596   |
| Less: accumulated depreciation and amortization(1) | (2,464) | (2,864) |
|  | 1,858   | 1,732   |

(1) Includes leased equipment of \$239 thousand, less accumulated depreciation of \$138 thousand and \$215 thousand as of December 31, 2009 and 2010, respectively.

As of December 31, 2009 and 2010, approximately \$285 thousand and \$296 thousand of the aggregate value of the Company's net book value of property and equipment, respectively, were located in Israel.

During the years 2009 and 2010, the Company recorded \$968 thousand, and \$1,131 thousand of depreciation expense, respectively.



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ANSWERS CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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## Note 8 – Intangible Assets, Net

The following table summarizes the Company's intangible assets as of December 31, 2009 and 2010 (in thousands):

|               | December 31, 2009           |                                |           | December 31, 2010           |                                |           |
|---------------|-----------------------------|--------------------------------|-----------|-----------------------------|--------------------------------|-----------|
|               | Gross carrying amount<br>\$ | Accumulated amortization<br>\$ | Net<br>\$ | Gross carrying amount<br>\$ | Accumulated amortization<br>\$ | Net<br>\$ |
| WikiAnswers   |                             |                                |           |                             |                                |           |
| Technology    | 30                          | (19)                           | 11        | 30                          | (25)                           | 5         |
| Q&A Database  | 207                         | (207)                          | -         | 207                         | (207)                          | -         |
| Domain Names  | 1,068                       | (338)                          | 730       | 1,068                       | (445)                          | 623       |
| Domain names  | 100                         | (44)                           | 56        | 130                         | (55)                           | 75        |
| Video content | -                           | -                              | -         | 16                          | -                              | 16        |
|               | 1,405                       | (608)                          | 797       | 1,451                       | (732)                          | 719       |

During the years 2009 and 2010, the Company recorded \$217 thousand and \$124 thousand of amortization expense of intangible assets, respectively.

Amortization of intangible assets, net, in each of the succeeding five years and thereafter is estimated as follows (in thousands):

|                         |     |
|-------------------------|-----|
| Year ending December 31 | \$  |
| 2011                    | 130 |
| 2012                    | 125 |
| 2013                    | 125 |
| 2014                    | 116 |
| 2015                    | 112 |
| Thereafter              | 111 |
|                         | 719 |

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Note 8 – Intangible Assets, Net (cont'd)

All assets related to the WikiAnswers acquisition, except for the goodwill, are being amortized over their estimated useful lives as follows: Technology – 5 years; Database of questions and answers – 3 years; Domain Names – 10 years. Technology and Database of questions and answers are being amortized to cost of revenue, and Domain Names to general and administrative. In 2009, the Company recorded \$23 thousand and \$184 thousand of such amortization to cost of revenue and general and administrative expenses, respectively. In 2010, the Company recorded \$6 thousand and \$107 thousand of such amortization to cost of revenue and general and administrative expenses, respectively. The goodwill, although not amortized for accounting purposes, and all other assets relating to the WikiAnswers acquisition, are deductible for tax purposes over a fifteen year period.

Note 9 – Deposits and Liability in Respect of Employee Severance Obligations

The Subsidiary's liability for severance pay for most employees is calculated pursuant to Israeli Severance Pay Law based on its employees' most recent monthly salaries, multiplied by the number of years of their employment, or a portion thereof, as of the balance sheet date. As of December 31, 2009 and 2010, this liability is fully provided for by monthly deposits in insurance policies and by an accrual. The deposited funds may be withdrawn by the Company only upon the fulfillment of the obligation pursuant to Israeli Severance Pay Law or labor agreements.

Beginning November 2008, the Subsidiary's agreements with newly hired employees are generally in accordance with section 14 of the Israeli Severance Pay Law, whereby the Company's contributions for severance pay shall fulfill its severance liability. Upon a monthly contribution of an amount equal to 8.33% of the employee's monthly salary, and release of the policy to the employee, no additional payments shall be made by the Company to the employee upon the employee's termination. Further, the related obligation and amounts deposited on behalf of such obligation are not stated on the balance sheet, as the Subsidiary is legally released from obligation to employees once the deposited amounts have been deposited in insurance policies.

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Note 10 – Redpoint Financing

On June 16, 2008, pursuant to a private placement of the Company's securities, Redpoint Omega, L.P. and Redpoint Omega Associates, LLC (collectively "Redpoint") purchased \$6 million of the Company's Series A Convertible Preferred Stock (the "Series A Financing"), initially convertible into 1,333,333 shares of common stock at a conversion price of \$4.50 per share (the "Series A Convertible Preferred Stock"), and common stock purchase warrants exercisable for 666,667 shares of common stock at an exercise price of \$4.95 per share (the "Series A Warrants"). Redpoint also received a warrant (the "Series B Unit Warrant"), exercisable until June 16, 2009, to purchase units of up to \$7 million of Series B Convertible Preferred Stock and common stock purchase warrants. After deducting placement agent fees and legal expenses, the Company's net proceeds from the aforesaid transaction were approximately \$5.38 million.

On June 10, 2009, Redpoint exercised its Series B Unit Warrant and purchased \$7 million of the Company's Series B Convertible Preferred Stock (the "Series B Financing"), initially convertible into 1,272,727 shares of common stock at a conversion price of \$5.50 per share (the "Series B Convertible Preferred Stock"), and common stock purchase warrants exercisable for 636,364 shares of common stock at an exercise price of \$6.05 per share (the "Series B Warrants"). After deducting placement agent fees and legal expenses, the Company's net proceeds from the exercise of the Series B Unit Warrant were approximately \$6.48 million. The change in value of the Series B Unit Warrant from January 1, 2009 through its exercise on June 10, 2009, has been included in the statement of income as loss resulting from fair value adjustment of warrants, and amounted to approximately \$2.08 million in 2009.

The Series A Convertible Preferred Stock, the Series B Convertible Preferred Stock, the Series A Warrants and the Series B Warrants are collectively referred to as the "Redpoint Securities". The two transactions, in aggregate, are collectively referred to as the "Redpoint Financings".

The Series A Convertible Preferred Stock has the rights and preferences set forth in the Certificate of Designations, Number, Voting Powers, Preferences and Rights for the Series A Convertible Preferred Stock, which amended the Company's Amended and Restated Certificate of Incorporation on June 16, 2008. The Series B Convertible Preferred Stock has the rights and preferences set forth in the Certificate of Designations, Number, Voting Powers, Preferences and Rights for the Series B Convertible Preferred Stock, which amended the Company's Amended and Restated Certificate of Incorporation on June 9, 2009.

In connection with the Redpoint Financings, Redpoint received and exercised their right to appoint two individuals to serve as voting members of the Company's board of directors.

Accounting for Series A Financing

The \$6 million of proceeds from the Series A Financing, were first allocated to the Series B Unit Warrant, which was classified as a liability, based on its fair value, and the residual amount was allocated among the Series A Convertible Preferred Stock and the Series A Warrants based on their relative fair values, all in accordance with the guidance in ASC 480, "Distinguishing Liabilities from Equity" (formerly SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity"), and ASC 815-40, "Derivatives and hedging – Contracts in Entity's Own Equity" (formerly EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"). The Series A Convertible Preferred Stock has been classified as temporary equity, in accordance with the guidance in ASC 480-10-S99A (formerly EITF D-98, "Classification and Measurement

of Redeemable Securities”). The Series A Warrants were initially classified in permanent equity but as a result of the adoption of EITF 07-5 (incorporated in ASC 815–40), effective January 1, 2009, and due to their provisions that protect holders from declines in the stock price, such warrants are separately accounted for as a derivative under ASC 815 and are no longer recorded in equity but rather as a liability, initially valued at fair value to be revalued at each reporting date at fair value.

ASC 815–40 was initially applied by recording a cumulative-effect adjustment to opening retained earnings as of January 1, 2009, to effect the accounting for the Series A Warrants as a liability.

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Note 10 – Redpoint Financing (cont'd)

Accounting for Series B Financing

The Series B Unit Warrant that was issued on June 16, 2008, was recorded as a liability, with a corresponding discount to the Series A Convertible Preferred Stock, and was revalued at each reporting date. The change in value of the Series B Unit Warrant from January 1, 2009 through June 10, 2009, has been included in the 2009 statement of income as loss resulting from fair value adjustment of warrant to purchase units of Series B preferred stock and warrants, and amounted to \$2.08 million. On June 10, 2009, Redpoint exercised, in full, the Series B Unit Warrant, which was valued at approximately \$10.8 million on such date, thus extinguishing this liability from the Company's balance sheet through a corresponding increase to additional paid-in capital.

The \$7 million of proceeds from the Series B Financing, were first allocated to the Series B Warrants which were classified as a liability, recorded at fair value, and the residual amount was allocated to the Series B Convertible Preferred Stock, all in accordance with the guidance in ASC 815 (formerly SFAS 133), ASC 480 (formerly SFAS 150) and ASC 815-40 (formerly EITF Issue No. 07-5). The Series B Convertible Preferred Stock has been classified as temporary equity, in accordance with the guidance in ASC 480-10-S99A (formerly EITF D-98).

Resulting from the allocation of the proceeds as described above, and in comparison to the fair market value of the Company's common stock on the date of issuance, the effective conversion rate of the Series B Convertible Preferred Stock, represented an additional beneficial conversion value. Thus, the Company recorded an additional discount to the Series B Convertible Preferred Stock, with a corresponding increase in paid-in capital, of \$2,868,000, reducing the Series B Convertible Preferred Stock to zero. In accordance with ASC 470-20, "Debt with Conversion and Other Options" (formerly EITF 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments"), the aforesaid discount is amortized to paid-in capital over five years from the date of issuance, the earliest redemption date of the stock.

The Series A and the Series B Convertible Preferred Stock are classified as temporary equity.

On December 31, 2009, the Company assessed the fair value of the Series A Warrants as compared to their value as of January 1, 2009, and also assessed the fair value of the Series B Warrants as compared to their value as of June 10, 2009. The change in fair value has been included in the statement of income as loss resulting from fair value adjustments of warrants, and amounted \$552 thousand for the year ended December 31, 2009.

On December 31, 2010, the Company assessed the fair value of the Series A and Series B Warrants as compared to their value as of December 31, 2009. The change in fair value has been included in the statement of income as gain resulting from fair value adjustments of warrants, and amounted \$1,750 thousand for the year ended December 31, 2010.

The fair value of the Series A and Series B Warrants during the years ended December 31, 2009 and 2010 was estimated using the Black-Scholes valuation model, assuming no dividends and the following average assumptions:

|                   | Year ended December 31 |      |
|-------------------|------------------------|------|
|                   | 2009                   | 2010 |
| Series A Warrants |                        |      |

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|                                  |        |        |
|----------------------------------|--------|--------|
| Expected risk-free interest rate | 2.30%  | 1.36%  |
| Expected life (in years)         | 4.83   | 3.84   |
| Expected volatility              | 78.23% | 72.35% |

Series B Warrants

|                                  |        |        |
|----------------------------------|--------|--------|
| Expected risk-free interest rate | 2.86%  | 1.78%  |
| Expected life (in years)         | 5.77   | 4.82   |
| Expected volatility              | 78.60% | 71.16% |

The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the date of measurement for periods corresponding with the expected life of the option. The expected life represents the remaining contractual life of the warrants.

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Note 11 – Fair Value Measurements

The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. The Company determines fair value based on assumptions that market participants would use in pricing an asset or liability in the principal market. When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels:

Level 1 – Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 - Other inputs that are directly or indirectly observable in the marketplace, for substantially the full term of the asset or liability, and are not included in Level 1.

Level 3 - Unobservable inputs that are supported by little or no market activities

The Company measures its cash equivalents, marketable securities, foreign currency derivative contracts and Series A and B Warrants at fair value. In accordance with ASC 820-10, the Company's cash equivalents and marketable securities are classified within Level 1. This is because the cash equivalents and the marketable securities are valued using quoted active market prices. The Company's foreign currency derivative contracts are classified within Level 2, because they are valued utilizing market observable inputs. The Series A and B Warrants are classified within Level 3 because they are valued using the Black-Scholes model which utilizes significant inputs that are unobservable in the market such as expected stock price volatility, risk-free interest rate and the dividend yield, and remaining period of time the warrants will be outstanding before they expire.

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## Note 11 – Fair Value Measurements (cont'd)

The following table presents the Company's assets and liabilities measured at fair value on a recurring basis as of December 31, 2009 and 2010, aggregated by the level in the fair-value hierarchy within which those measurements fall:

## Fair value measurement at reporting date using

| Description                           | December 31, 2009 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---------------------------------------|-------------------|--|---|---|
| <b>Assets</b>                         |                   |  |   |   |
| Cash Equivalents                      | 21,287            | 21,287   | -   | -   |
| Marketable Securities                 | 795               | 795  | -   | -   |
| Foreign currency derivative contracts | 60                | -  | 60  | -   |
| <b>Total Assets</b>                   | <b>22,142</b>     | <b>22,082</b>  | <b>60</b>                                     | <b>-</b>                                  |
| <b>Liabilities</b>                    |                   |  |   |   |
| Series A Warrants                     | 4,000             | -  | -   | 4,000                                     |
| Series B Warrants                     | 4,008             | -  | -   | 4,008                                     |
| <b>Total Liabilities</b>              | <b>8,008</b>      | <b>-</b>   | <b>-</b>                                      | <b>8,008</b>                              |

## Fair value measurement at reporting date using

| Description                           | December 31, 2010 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---------------------------------------|-------------------|--|---|---|
| <b>Assets</b>                         |                   |  |   |   |
| Cash Equivalents                      | 20,335            | 20,335   | -   | -   |
| Marketable Securities                 | 4,331             | 4,331  | -   | -   |
| Foreign currency derivative contracts | 119               | -  | 119   | -   |
| <b>Total Assets</b>                   | <b>24,785</b>     | <b>24,666</b>  | <b>119</b>                                    | <b>-</b>                                  |
| <b>Liabilities</b>                    |                   |  |   |   |
| Series A Warrants                     | 3,200             | -  | -   | 3,200                                     |
| Series B Warrants                     | 3,058             | -  | -   | 3,058                                     |
| <b>Total Liabilities</b>              | <b>6,258</b>      | <b>-</b>   | <b>-</b>                                      | <b>6,258</b>                              |



In addition to the above, the Company's financial instruments at December 31, 2009 and 2010, consisted of cash, accounts receivable, long term deposits, accrued expenses, accrued compensation and related liabilities. The carrying amounts of all the aforementioned financial instruments, approximate fair value.

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## Note 11 – Fair Value Measurements (cont'd)

The following table summarizes the changes in the Company's liabilities measured at fair value using significant unobservable inputs (Level 3), during the years ended December 31, 2009 and 2010:

|   | Series B<br>Unit<br>Warrant | Level 3<br>\$ (in thousands)<br>Series A<br>and B<br>Warrants | Total    |
|---|-----------------------------|---|----------|
| Balance at December 31, 2008  | 8,698                       | -   | 8,698    |
| Cumulative effect of change in accounting principle –<br>adoption of EITF 07-5 (incorporated in ASC 815 – 40) | -                           | 3,554   | 3,554    |
| Fair value adjustments included in statement of<br>income   | 2,082                       | 552   | 2,634    |
| Exercise of the Series B Unit Warrant   | (10,780)                    | -   | (10,780) |
| Issuance of series B warrants   | -                           | 3,902   | 3,902    |
| December 31, 2009   | -                           | 8,008   | 8,008    |
| Fair value adjustments included in statement of<br>income   | -                           | (1,750)   | (1,750)  |
| December 31, 2010   | -                           | 6,258   | 6,258    |

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## Note 12 - Series A and Series B Convertible Preferred Stock

The following table summarizes the changes in Series A and Series B Convertible Preferred Stock during the years ending December 31, 2009 and 2010:

|  | Series A<br>Convertible<br>Preferred<br>Stock | Series B<br>Convertible<br>Preferred<br>Stock<br>\$ (in thousands) | Total   |
|--|---|--|---------|
| December 31, 2008  | 624   | -  | 624     |
| Cumulative effect of change in accounting principle – adoption of EITF 07-5 (incorporated in ASC 815-40) | 17  | -  | 17      |
| Issuance of Series B Convertible Preferred Stock   | -   | 7,000  | 7,000   |
| Issuance costs   | -   | (230)  | (230)   |
| Discount resulting from the issuance of the Series B Warrants  | -   | (3,902)  | (3,902) |
| Discount resulting from the Beneficial Conversion Feature  | -   | (2,868)  | (2,868) |
| Amortizations of discounts during the period   | 989   | 751  | 1,740   |
| December 31, 2009  | 1,630   | 751  | 2,381   |
| Amortizations of discounts during the period   | 989   | 1,354  | 2,343   |
| December 31, 2010  | 2,619   | 2,105  | 4,724   |

The Series A and Series B Convertible Preferred Stock accrue cumulative dividends at a rate of 6% per annum whether or not dividends have been declared by the Company's Board of Directors and whether or not there are profits, surplus or other funds available for the payment of such dividends. Due to the Company's decision to pay Series A Convertible Preferred Stock dividends accrued through September 30, 2008, in the form of additional shares of Series A Convertible Preferred Stock, the dividend accrual through such date is reflected as an increase in the stated value of the Series A Convertible Preferred Stock from \$100 per share to \$101.76 per share, with a corresponding decrease in the additional paid-in capital. All dividends on Series A and Series B Convertible Preferred Stock subsequent to September 30, 2008, were paid in cash.

As a result of the Redpoint Financings (see Note 10), the Company's Amended and Restated Certificate of Incorporation has been amended to provide for the issuance of up to 60,000 shares of Series A Convertible Preferred Stock and 70,000 shares of Series B Convertible Preferred Stock, with a stated value of \$100 per share (the "Stated Value") pursuant to the Certificate of Designations, Number, Voting Powers, Preferences and Rights of Series A Convertible Preferred Stock filed with the State of Delaware on June 16, 2008 and the Certificate of Designations, Number, Voting Powers, Preferences and Rights Series B Convertible Preferred Stock filed with the State of Delaware on July 28, 2009 (the "Certificates of Designations").



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Note 12 - Series A and Series B Convertible Preferred Stock (cont'd)

Rights and Preferences

The Certificates of Designations provide for the following rights and preferences:

**Dividends** -The Series A and Series B Convertible Preferred Stock will accrue cumulative dividends at a rate of 6% per annum whether or not dividends have been declared by the Board of Directors and whether or not there are profits, surplus or other funds available for the payment of such dividends. Dividends may be payable in kind at the option of the Company upon satisfaction of certain conditions.

**Voting Rights** -The Series A and Series B Convertible Preferred Stock shall vote on an as converted basis with the Company's common stock. So long as any shares of Series A Convertible Preferred Stock or Series B Convertible Preferred Stock are outstanding, the Company shall not, without the affirmative vote of the holders of a majority of the shares of the Series A and Series B Convertible Preferred Stock then outstanding (each holder of Series A and Series B Convertible Preferred Stock, a "Holder" and collectively, the "Holders"), (a) alter or change adversely the powers, preferences or rights given to the Series A and Series B Convertible Preferred Stock or alter or amend the Certificate of Designations (whether by merger, consolidation or otherwise), (b) authorize or create any class of stock ranking as to dividends, redemption or distribution of assets upon a Liquidation senior to or otherwise pari passu with the Series A and Series B Convertible Preferred Stock, except for any series of Preferred Stock issued to the Holders, (c) amend its certificate of incorporation or other charter documents (whether by merger, consolidation or otherwise) so as to affect adversely any rights of the Holders, (d) increase or decrease the authorized number of shares of Series A and Series B Convertible Preferred Stock, or (e) enter into any agreement with respect to the foregoing.

**Liquidation** - Upon an event of liquidation, as defined in the Certificate of Designations (a "Liquidation"), the Holders shall be entitled to receive out of the assets of the Company, whether such assets are capital or surplus, for each share of Series A and Series B Convertible Preferred Stock an amount equal to greater of (i) the Stated Value per share plus any accrued and unpaid dividends thereon and any other fees or liquidated damages owing thereon before any distribution or payment shall be made to the holders of any junior securities or (ii) such amount per share as would have been payable had all shares of Series A and Series B Convertible Preferred Stock been upon any such Liquidation converted to common stock immediately prior to such Liquidation, in any case, and if the assets of the Company shall be insufficient to pay in full such amounts, then the entire assets to be distributed to the Holders shall be distributed among the Holders ratably in accordance with the respective amounts that would be payable on such shares if all amounts payable thereon were paid in full.

**Conversion at Option of Holder** - Each share of Series A Convertible Preferred Stock shall be convertible into that number of shares of common stock determined by dividing the Stated Value plus any accrued but unpaid dividends thereon (to the extent not already included in the Stated Value) of such share of Series A Convertible Preferred Stock by \$4.50 (the "Series A Conversion Price"), at the option of the Holder, at any time and from time to time.

Each share of Series B Convertible Preferred Stock shall be convertible into that number of shares of common stock determined by dividing the Stated Value plus any accrued but unpaid dividends thereon (to the extent not already included in the Stated Value) of such share of Series B Convertible Preferred Stock by \$5.50 (the "Series B Conversion Price"), at the option of the Holder, at any time and from time to time.



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Note 12 - Series A and Series B Convertible Preferred Stock (cont'd)

**Mandatory Conversion** - With respect to the Series A Convertible Preferred Stock, beginning December 16, 2009, provided certain conditions are satisfied, if the closing price of the common stock equals an average of \$13.50 (subject to adjustment for stock splits, reclassifications, combinations and similar adjustments) per share for the 45 consecutive trading days immediately prior to the Automatic Conversion Notice Date (as defined below), and average daily volume of the common stock on The NASDAQ Capital Market averages at least \$1 million during such measurement period, unless the Holder is prohibited from converting the Series A Convertible Preferred Stock pursuant to certain limitations set forth in the Certificate of Designations, the Company shall have the right to deliver a notice to the Series A Holder (a Series A Automatic Conversion Notice), to convert any portion of the shares of Series A Convertible Preferred Stock then held by the holder into shares of common stock at the then-effective Conversion Price.

With respect to the Series B Convertible Preferred Stock, beginning December 10, 2010, provided the certain conditions are satisfied, if the closing price of the common stock equals an average of \$16.50 (subject to adjustment for stock splits, reclassifications, combinations and similar adjustments) per share for the 45 consecutive trading days immediately prior to the Automatic Conversion Notice Date (as defined below), and average daily volume of the common stock on The NASDAQ Capital Market averages at least \$1 million during such measurement period, unless the Holder is prohibited from converting the Series B Convertible Preferred Stock pursuant to certain limitations set forth in the Certificate of Designations, the Company shall have the right to deliver a notice to the Series B Holder (a Series B Automatic Conversion Notice), to convert any portion of the shares of Series B Convertible Preferred Stock then held by the holder into shares of common stock at the then-effective Conversion Price.

**Redemption** - At anytime on or after June 16, 2014, upon written request by the majority of the Holders, the Company shall redeem all or any portion of the then outstanding Series A and Series B Convertible Preferred Stock, for an amount in cash equal to the sum of (i) 100% of the aggregate Stated Value then outstanding, (ii) accrued but unpaid dividends (to the extent not already included in Stated Value) and (iii) all liquidated damages and other amounts due in respect of the Series A and Series B Convertible Preferred Stock. Upon redemption, approximately \$13.1 million plus accrued dividends, if any, will be redeemable. The Series A and Series B Convertible Preferred Stock were initially recorded at fair value and have not been adjusted to their maximum redemption amount. If the Merger is completed, the Preferred Stock will be exchanged for cash as provided in the Merger Agreement.

**Subsequent Equity Sales** - If the Company, at any time while the Series A and the Series B Convertible Preferred Stock are outstanding, shall sell or grant any option to purchase or otherwise dispose of or issue any common stock or common stock equivalents entitling any person to acquire shares of common stock, at an effective price per share less than the then effective Conversion Price, then, the Conversion Price shall be adjusted on a broad weighted average basis, as defined in the Redpoint Financings agreement.

**Participation Rights** - At any time while Series A and or Series B Convertible Preferred Stock are outstanding (or the common stock issuable or issued upon conversion thereof) and the Holders or their affiliates collectively hold a majority of the outstanding Series A and or Series B Convertible Preferred Stock (or the common stock issuable or issued upon conversion thereof) purchased by the Holders, each Holder shall have a right to participate pro rata with respect to the issuance or possible issuance by the Company of any future equity or equity-linked securities or debt which is convertible into or exercisable or exchangeable for equity or in which there is an equity component on the same terms and conditions as offered by the Company to the other purchasers of such securities.





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Note 13 – Stockholders' Equity

Common Stock

During 2009, the Company issued a total of 80,791 shares of common stock due to the exercise of stock options, for a total consideration of \$247 thousand.

During 2010, the Company issued a total of 54,451 shares of common stock due to the exercise stock options, for a total consideration of \$253 thousand.

Stock Warrants

As of December 31, 2009, there were 1,155,591 outstanding non-Redpoint stock warrants with a weighted average exercise price of \$16.17. In February, 2010, 1,029,488 warrants with an exercise price of \$17.27 per warrant expired.

As of December 31, 2010, there were 126,103 outstanding stock warrants with an exercise price of \$7.20. These stock warrants were exercised on January 27, 2011, for a total consideration of \$908 thousand.

Redpoint Warrants

In connection with the Redpoint Financings (see Note 10), the Company issued to Redpoint Series A Warrants, exercisable for 666,667 shares of common stock at an exercise price of \$4.95 per share, and Series B Warrants, exercisable for 636,364 shares of common stock at an exercise price of \$6.05 per share. The Series A and the Series B Warrants are exercisable immediately and, if not exercised, they will expire on June 16, 2014 and June 10, 2015, respectively. If the Merger is completed, the Series A Warrants and the Series B Warrants will be exchanged for cash as provided in the Merger Agreement.

Stock Compensation Plans

The Company provides for direct grants or sales of common stock, and common stock options to employees and non-employees through the following: the 1999 Stock Option Plan (the 1999 Plan), the 2000 Stock Option Plan (the 2000 Plan) and the 2003 Stock Option Plan (the 2003 Plan) (thereafter collectively "Prior Option Plans"), the 2004 Stock Option Plan (the 2004 Plan) and the 2005 Incentive Compensation Plan (the 2005 Plan). In addition, prior to 2005, the Company had granted stock options outside of its stock options plans, to certain individuals and entities.

The 2005 Plan was approved by the Company's stockholders in July 2005, following the earlier adoption by the Company's board of directors. The terms of the 2005 Plan provide for grants of stock options, stock appreciation rights or SARs, restricted stock, deferred stock, other stock-related awards and performance awards that may be settled in cash, stock or other property, to officers, directors, employees, consultants and other persons who provide services to the Company. The total number of Company shares of common stock allowed for under the 2005 Plan was set at 850,000, upon its adoption, and was increased by 250,000 on each of the dates June 21, 2006, September 9, 2008 and September 9, 2009, and by additional 150,000 on September 15, 2010, following the approval of the Company's stockholders.

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Under all of the Company's option plans, options generally vest 25%, with respect to the number granted, upon the first anniversary date of the option grant, and the remainder vest in equal monthly installments over the 36 months thereafter. Vested options are exercisable immediately.

The options generally expire between six to ten years after grant date. Except for grants to certain executives, employee options are generally forfeited, if not exercised, within three months of termination of employment or service to the Company.

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## Note 13 – Stockholders' Equity (cont'd)

## Stock Options

During 2010, the Company granted a total of 338,417 stock options under its 2005 and 2004 Plans.

The following table summarizes the Company's stock option activity during 2010:

|                                     | Number of<br>stock<br>options | Weighted<br>average<br>exercise<br>price |
|-------------------------------------|-------------------------------|--|
| Balance as of December 31, 2009     | 2,316,088                     | \$8.80                                   |
| Granted                             | 338,417                       | \$3.57                                   |
| Exercised                           | (54,451)                      | \$4.65                                   |
| Expired                             | (12,036)                      | \$9.69                                   |
| Forfeited                           | (37,798)                      | \$9.44                                   |
| Outstanding as of December 31, 2010 | 2,550,220                     | \$8.57                                   |

The weighted average grant date fair value of options granted during 2009 and 2010 was \$4.42 and \$3.57, respectively. The aggregate intrinsic value of options exercised during 2009 and 2010, was approximately \$362 thousand, and \$84 thousand, respectively, at the date of exercise.

As of December 31, 2009, 379,255 options were available for grant under the 2005 and 2004 Plans. As of December 31, 2010, 228,636 options were available for grant under the 2005 and 2004 Plans. All Prior Option Plans are closed for future grants.

The following table summarizes information about stock options outstanding as of December 31, 2010:

| Range of<br>exercise price | Number<br>outstanding | Options outstanding  |  | Number<br>outstanding | Options exercisable  |  |
|----------------------------|-----------------------|--|--|-----------------------|--|--|
|                            |                       | Weighted<br>average<br>remaining<br>contractual<br>life<br>(years) | Weighted<br>average<br>exercise<br>price |                       | Weighted<br>average<br>remaining<br>contractual<br>life<br>(years) | Weighted<br>average<br>exercise<br>price |
| \$2.76 – \$5.00            | 266,363               | 3.43   | \$3.31                                   | 180,480               | 3.38   | \$2.66                                   |
| \$5.06 – \$9.65            | 1,385,047             | 4.21   | \$6.55                                   | 731,617               | 3.44   | \$6.18                                   |
| \$10.54 – \$14.49          | 770,110               | 1.63   | \$12.77                                  | 751,270               | 1.61   | \$12.79                                  |
| \$15.35 – \$16.93          | 128,700               | 4.48   | \$15.97                                  | 128,700               | 4.48   | \$15.97                                  |

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|           |      |        |           |      |        |
|-----------|------|--------|-----------|------|--------|
| 2,550,220 | 3.36 | \$8.57 | 1,792,067 | 2.74 | \$9.30 |
|-----------|------|--------|-----------|------|--------|

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## Note 13 – Stockholders' Equity (cont'd)

## Stock Options (cont'd)

The aggregate intrinsic value of stock options outstanding as of December 31, 2010, was \$3.07 million of which \$2.08 million relates to vested awards. Intrinsic value for stock options is calculated based on the exercise price of the underlying awards and the quoted price of the Company's common stock as of the reporting date.

The total fair value of stock options that vested during 2009 and 2010 amounts to \$1.55 million and \$1.19 million, respectively, and was recorded as stock-based compensation expense.

As of December 31, 2010, there was \$2.70 million of unrecognized compensation cost, net of estimated forfeitures of \$5 thousand, related to unvested stock options granted under the Company's 2005 and 2004 stock option plans. If the Merger does not transpire, that cost is expected to be recognized as follows (in thousands):

| Year ending December<br>31 | \$    |
|----------------------------|-------|
| 2011                       | 1,050 |
| 2012                       | 865   |
| 2013                       | 569   |
| 2014                       | 217   |
|                            | 2,701 |

If the Merger is completed (see note 1), stock options that are vested, or become vested as a result of the Merger, will be exchanged for cash equal to the excess of \$10.50, if any, over the aggregate exercise price of such vested stock options, multiplied by the number of shares underlying such stock options. Stock options that are unvested at the time of the Merger will continue to vest provided the holder is employed by the surviving corporation in the Merger on the vesting date. On each date on which a portion of such unvested stock options would vest, the holder will receive an amount in cash equal to the excess of \$10.50, if any, over the aggregate exercise price of such vested stock options, multiplied by the number of shares underlying such stock options.

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## Note 14 - Income Taxes

The components of income before income taxes were (in thousands):

|          | Years ended December 31 |       |
|----------|-------------------------|-------|
|          | 2009                    | 2010  |
|          | \$                      | \$    |
| U.S.     | 1,383                   | 5,235 |
| Non-U.S. | 542                     | 410   |
|          | 1,925                   | 5,645 |

Income tax expense (benefit) attributable to income from continuing operations consists of the following (in thousands):

|                               | Current<br>\$ | Deferred<br>\$ | Total<br>\$ |
|-------------------------------|---------------|----------------|-------------|
| Year ended December 31, 2009: |               |                |             |
| U.S.                          | 177           | 12             | 189         |
| Non-U.S.                      | 19            | (43)           | (24)        |
|                               | 196           | (31)           | 165         |
| Year ended December 31, 2010: |               |                |             |
| U.S.                          | 148           | (1,744)        | (1,596)     |
| Non-U.S.                      | 155           | (2)            | 153         |
|                               | 303           | (1,746)        | (1,443)     |

As of December 31, 2010, income tax refunds receivable from U.S. federal, foreign, state and local jurisdictions amounted to approximately \$223 thousand. As of that same date, income taxes payable to such jurisdictions amounted to approximately \$6 thousand.

The income tax expense (benefit) for the years ended December 31, 2009 and 2010, differed from the amounts computed by applying the U.S. federal income tax rate of 34% to pretax income as a result of the following (in thousands):

|  | Years ended December 31 |       |
|--|-------------------------|-------|
|  | 2009                    | 2010  |
|  | \$                      | \$    |
| Computed "expected" tax benefit                    | 654                     | 1,919 |
| Effect of State and Local taxes                    | 161                     | 147   |
| Income tax rate adjustment for State & Local taxes | 62                      | (6)   |
| Foreign tax rate differential                      | (38)                    | (37)  |

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|   |         |         |
|---|---------|---------|
| Tax benefit of “Approved Enterprise”/“Beneficiary Enterprise” tax holiday | (170)   | (82)    |
| Change in valuation allowance   | (3,380) | (3,345) |
| Tax exempt other income   | -       | (595)   |
| Uncertain tax positions   | -       | 132     |
| Non-deductible expenses   | 1,509   | 422     |
| Adjustment to prior year’s NOLs and other items                           | 1,367   | 2       |
| Actual income tax expense (benefit)                                       | 165     | (1,443) |

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## Note 14 - Income Taxes (cont'd)

The types of temporary differences that give rise to significant portions of the Company's deferred tax assets and liabilities are set out below (in thousands):

|                                    | Years ended December 31 |          |
|------------------------------------|-------------------------|----------|
|                                    | 2009                    | 2010     |
|                                    | \$                      | \$       |
| Deferred tax assets:               |                         |          |
| Miscellaneous accrued expenses     | 170                     | 190      |
| Intangible assets                  | 188                     | 194      |
| Property and equipment             | 54                      | 74       |
| Deferred stock compensation        | 358                     | 399      |
| Foreign capital loss carryforwards | 197                     | 198      |
| Other                              | 4                       | 2        |
| Net operating loss                 | 19,517                  | 17,840   |
| Total gross deferred tax assets    | 20,488                  | 18,897   |
| Less: Valuation allowance          | (20,440)                | (17,095) |
| Net deferred tax assets            | 48                      | 1,802    |
| Deferred tax liability:            |                         |          |
| Goodwill                           | (38)                    | (44)     |
| Net deferred tax asset (liability) | 10                      | 1,758    |

The net change in the total valuation allowance for the years ended December 31, 2009 and 2010 was a decrease of \$3,374 thousand and \$3,345 thousand, respectively.

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The determination of the realizability of the deferred tax assets is highly subjective and dependent upon judgment concerning our evaluation of both positive and negative evidence. Evidence includes consideration of cumulative income or losses in recent years, management's ability to forecast future income, the probability that taxable income will be generated in future periods, and general business and economic trends.

At December 31, 2009, the Company's deferred tax assets were almost entirely offset by a valuation allowance. While the Company had taxable income in 2009, it experienced a cumulative loss over the years and its revenue model continued to be subject to fluctuations and volatility that impacted its ability to accurately forecast future expected profitability. The Company viewed these factors as significant pieces of negative evidence that made it difficult to support a conclusion that expected taxable income from future operations justifies recognition of deferred tax assets. At December 31, 2010, the Company examined all available evidence, both positive and negative, and determined that it is more likely than not that a portion of the deferred tax asset relating to the reversal of certain federal and state and



local NOL's will be realized. The Company, therefore, released its valuation allowance to the extent it expected to utilize NOLs in 2011. However, due to continued volatility and significant uncertainties with respect to the Company's revenue model, the Company is unable to reliably forecast future pre-tax income beyond 2011 which would be necessary to utilize all of the deferred tax assets resulting from the accumulated net operating losses and therefore it is difficult to support a conclusion that expected taxable income from future operations beyond 2011 justifies recognition of deferred tax assets for such periods. Increases in estimated future taxable income may require to release all or a portion of the valuation allowance against the deferred tax assets and result in a deferred tax benefit for the period and could have a significant impact on the Company's future earnings. A valuation allowance has not been established for the deferred tax assets of the Subsidiary of approximately \$51 thousand because the Company believes that it is more likely than not that the results of future operations will generate sufficient taxable income to realize those deferred tax assets.

Subsequently recognized tax benefits related to the valuation allowance for deferred tax assets as of December 31, 2010 will be allocated as follows (in thousands):

|  | \$       |
|--|----------|
| Income tax benefits that would be reported in the consolidated statement of earnings | (16,995) |
| Non-current intangible assets  | -        |
| Additional Paid in Capital   | (100)    |
|  | (17,095) |

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Note 14 - Income Taxes (cont'd)

The Company has net operating loss ("NOL") carryforwards for federal income tax purposes of approximately \$48 million at December 31, 2010. The federal NOLs will expire if not utilized on various dates from 2021 through 2030. Section 382 of the Internal Revenue Code of 1986 ("Section 382") generally imposes an annual limitation on the amount of NOL carryforwards that may be used to offset taxable income where a corporation has undergone significant changes in its stock ownership. The Company estimates two ownership changes, as defined under Section 382, have occurred, that would trigger this limitation. Based on current analyses, the Company may currently use approximately \$33 million of its accumulated NOLs. The remaining approximate \$15 million NOL is available to offset taxable income in an amount of approximately \$1.4 million per year. Any unused portion of the \$1.4 million annual limitation applicable to the Company's restricted NOL is available for use in future years until such NOL is scheduled to expire. As mentioned in note 1, the Company entered into a Merger Agreement with AFCV. An additional ownership change, if approved by Answers.com stockholders as detailed in note 1, will take place on the effective date of the Merger Agreement; the effects of the new ownership change on the Company's NOL limitations has not been determined. The Subsidiary has capital loss carryforwards of approximately \$795 thousand, which can be applied to future capital gains for an unlimited period of time under current tax rules.

During the year 2000, the Subsidiary was granted "Approved Enterprise" status under the Israeli Law for the Encouragement of Capital Investments - 1959 (the "Investment Law") under the "alternative benefits" path. As an "Approved Enterprise" the Subsidiary is entitled to receive future tax benefits, which are limited to a period of ten years from the first year that taxable income is generated from the approved assets. In addition, the benefits must be utilized within: the earlier of 12 years of the year of implementation (as defined) of the investment program or 14 years of the year that approval is granted. The Subsidiary began claiming benefits in the 2000 tax year. The effect of the tax holiday on the basic and diluted net income (loss) per common share is \$0.04 and \$0.01, for the years ended December 31, 2009 and 2010, respectively.

Under its "Approved Enterprise" status, income arising from the Subsidiary's approved activities is subject to zero tax under the "alternative benefits" path for a period of ten years. In the event of distributions by the Subsidiary to Answers.com, the Subsidiary would have to pay a 10% corporate tax on the amount distributed, and the recipient would have to pay a 15% tax (to be withheld at source) on the amounts of such distribution received. Should the Subsidiary derive income from sources other than the Approved Enterprise during the relevant period of benefits, such income would be taxable in Israel at the tax rate in effect at that time (25% being the rate in effect during 2010).

As of December 31, 2010, the Company has not provided for deferred income taxes on the undistributed earnings of approximately \$3.7 million of its Subsidiary since these earnings are intended to be reinvested indefinitely. A deferred tax liability will be recognized when the Company no longer demonstrates that it plans to permanently reinvest the undistributed earnings.

During 2003, the Subsidiary filed a completion report on its first investment program. Final approval of the program was received from the Investment Center in March 2004. In December 2006, the Subsidiary filed a completion report on its second (expansion) investment program and final approval of the program was received from the Investment Center in October 2008. Under its Approved Enterprise status, the Subsidiary must maintain certain conditions. Failure to comply with the conditions of the Approved Enterprise status could cause the Subsidiary to lose previously accumulated tax benefits.



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Note 14 - Income Taxes (cont'd)

On April 1, 2005, amendment No. 60 to the Investment Law came into effect (the "Amendment") and has changed several provisions of the Investment Law, mainly in respect of the "alternative benefits" track. The Amendment sets forth the scope of enterprises which may qualify as a "Beneficiary Enterprise" - under the Amendment, the designation is "Beneficiary Enterprise" rather than "Approved Enterprise" - by setting forth criteria for qualification of a company. Additionally, the Amendment enacted that companies operating under the "alternative benefits" track no longer require Investment Center approval in order to qualify for tax benefits. Instead, this position will be incorporated as part of the regular tax audits of the Israeli Tax Authorities (the "ITA").

Under the Amendment, the year in which a company elects to commence its tax benefits is designated as the year of election ("Year of Election"). A company may choose its Year of Election by notifying the ITA in its annual tax return or within twelve months after the end of the Year of Election, whichever is earlier, or by requesting a pre-ruling from the ITA no later than six months after the end of the Year of Election. However, the Investment Law provides that terms and benefits included in any letter of approval which was granted prior to the effective date of the Amendment, will remain subject to the provisions of the law as they were on the date of such approval. Therefore, the Subsidiary's existing Approved Enterprise status will generally not be subject to the provisions of the Amendment, while in order to receive further benefits, the Subsidiary will have to meet the Amendment's requirements. The Company elected 2008 as its Year of Election for its second expansion under the Amendment to the Investment Law.

The Subsidiary currently has three capital investment programs, two of which were granted Approved Enterprise status under the Investment Law prior to the Amendment, ending December 31, 2009 and December 31, 2014, respectively, and one Beneficiary Enterprise pursuant to the Amendment, ending December 31, 2017. As of the balance sheet dates, the Subsidiary believes that it is in compliance with both, the conditions of the Approved Enterprise and Beneficiary Enterprise programs.

On December 29, 2010 the Israeli parliament approved the Economic Policy Law for 2011-2012, which includes an amendment to the Investment Law (hereinafter - "the Recent Amendment to the Law"). The Recent Amendment to the Law is effective from January 1, 2011 and its provisions will apply to preferred income derived or accrued in 2011 and thereafter by a preferred company, per the definition of these terms in the Recent Amendment to the Law. Companies can choose to not be included in the scope of the Recent Amendment to the Law and to stay in the scope of the law before its amendment until the end of the benefits period. The 2012 tax year is the last year companies can choose as the Year of Election under Amendment No. 60, providing that the minimum qualifying investment, as defined under such amendment, began in 2010.

The Recent Amendment to the Law eliminates the existing tax benefit tracks and introduces two new tax tracks in their place, a preferred enterprise and a special preferred enterprise, which mainly provide a uniform and reduced tax rate for all the company's income entitled to benefits, such as: for a preferred enterprise - in the 2011-2012 tax years - a tax rate of 10% for Development Area A and of 15% for the rest of the country, in the 2013-2014 tax years - a tax rate of 7% for Development Area A and of 12.5% for the rest of the country, and as from the 2015 tax year - 6% for Development Area A and 12% for the rest of the country. Furthermore, an enterprise that meets the definition of a special preferred enterprise is entitled to benefits for a period of 10 consecutive years and a reduced tax rate of 5% if it is located in Development Area A or of 8% if it is located in a different area.

The Recent Amendment to the Law also provides that no tax will apply to a dividend distributed out of preferred income to a stockholder that is a company, for both the distributing company and the stockholder. A tax rate of 15% shall continue to apply to a dividend distributed out of preferred income to an individual stockholder or foreign resident, subject to double taxation prevention treaties, which means that there is no change from the existing law. Furthermore, the Recent Amendment to the Law provides relief (“the relief”) with respect to tax paid on a dividend received by an Israeli company from profits of an approved/alternative/beneficiary enterprise that accrued in the benefits period according to the version of the law before its amendment, if the company distributing the dividend notifies the tax authorities by June 30, 2015 that it is applying the provisions of the Recent Amendment to the Law and the dividend is distributed after the date of the notice. The Subsidiary is currently evaluating the impact of the Recent Amendment to the Law on its existing approved plans.

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## Note 14 - Income Taxes (cont'd)

The Company accounts for its income tax uncertainties in accordance with ASC Subtopic 740-10 which clarifies the accounting for uncertainties in income taxes recognized in a company's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Interest and penalties related to unrecognized tax benefits are recognized as a component of income tax expense.

The Company did not record any unrecognized tax benefits in 2009 and recorded \$132 thousand in 2010. This amount may change significantly within the next twelve months as a result of tax audit settlements. The Company has not received enough information from the taxing authorities to estimate a range of such a change, if any, and, therefore, is not able to estimate a range of such change. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

|  | \$  |
|--|-----|
| Balance at December 31, 2009                                   | -   |
| Additions based upon tax positions related to the current year | 7   |
| Additions for tax positions of prior years                     | 125 |
| Balance at December 31, 2010                                   | 132 |

Of the total unrecognized tax benefits at December 31, 2010, approximately \$132 thousand, if recognized, would have impacted the effective tax rate in 2010.

Answers.com and its Subsidiary, collectively, file income tax returns in the U.S. federal jurisdiction, various state & local and foreign jurisdictions. Answers.com is no longer subject to U.S. federal and state & local income tax examinations by tax authorities for years prior to 2006. The Subsidiary is no longer subject to foreign income tax examinations by tax authorities for years prior to 2007 but is currently undergoing an audit by the Israeli tax authorities for the tax years 2007 and 2008.

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## Note 15 - Net Income (Loss) per Common Share

The table below presents the computation of basic and diluted net income (loss) per common share:

|   | Year ended December 31                             |           |
|---|--|-----------|
|   | 2009   | 2010      |
|   | (in thousands, except share<br>and per share data) |           |
| Basic net income (loss) per common share computation                        |  |           |
| Numerator:  |  |           |
| Net income  | \$1,760  | \$7,088   |
| Series A and Series B Convertible Preferred Stock dividends                 | (602)  | (786)     |
| Amortization of Series A and Series B Convertible Preferred Stock discounts | (1,740)  | (2,343)   |
| Income attributable to Series A and Series B Convertible Preferred Stock    | -  | (981)     |
| Net income (loss) attributable to common shares - basic                     | \$(582)  | \$2,978   |
| Denominator:  |  |           |
| Weighted average number of common shares outstanding during the period      | 7,909,353  | 7,971,445 |
| Basic net income (loss) per common share                                    | \$(0.07)   | \$0.37    |
| Diluted net income (loss) per common share computation                      |  |           |
| Numerator:  |  |           |
| Net income  | \$1,760  | \$7,088   |
| Series A and Series B Convertible Preferred Stock dividends                 | (602)  | (786)     |
| Amortization of Series A and Series B Convertible Preferred Stock discounts | (1,740)  | (2,343)   |
| Gain resulting from fair value adjustment of Series A and Series B Warrants | -  | (1,750)   |
| Income attributable to Series A and Series B Convertible Preferred Stock    | -  | (519)     |
| Net income (loss) attributable to common shares - diluted                   | \$(582)  | \$1,690   |
| Denominator:  |  |           |
| Weighted average number of common shares outstanding during the period      | 7,909,353  | 7,971,445 |
| Dilutive shares related to Series A and Series B Warrants                   | -  | 331,197   |
| Dilutive shares related to options and non-Redpoint warrants                | -  | 256,711   |
| Diluted common shares outstanding   | 7,909,353  | 8,559,353 |

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|  |           |           |
|--|-----------|-----------|
| Diluted net income (loss) per common share   | \$(0.07)  | \$0.20    |
| Common stock equivalents excluded because their effect would have been anti-dilutive | 2,912,635 | 2,629,513 |

The diluted net loss per share for the year ended December 31, 2009 is the same as basic net loss per share, as the inclusion of the Company's common stock equivalents would be anti-dilutive.



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## Note 16 - Commitments and Contingencies

(a) Answers.com rents its offices under operating lease agreements through June 30, 2012. The Subsidiary rents its offices under an operating lease agreement through July 31, 2013, with an option to extend the term for additional 3 years.

The minimum lease payments under the aforesaid non-cancelable operating leases, as of December 31, 2010, are as follows (in thousands):

| Year ending December<br>31 | \$    |
|----------------------------|-------|
| 2011                       | 500   |
| 2012                       | 419   |
| 2013                       | 196   |
|                            | 1,115 |

Rent expense for the office space operating leases for the years ended December 31, 2009, and 2010 were approximately \$399 thousand, and \$487 thousand, respectively.

(b) The Subsidiary leases motor vehicles for certain employees under operating lease agreements. Lease payment commitments under operating leases for motor vehicles, as of December 31, 2010, are as follows (in thousands):

| Year ending December<br>31 | \$  |
|----------------------------|-----|
| 2011                       | 171 |
| 2012                       | 96  |
| 2013                       | 19  |
|                            | 286 |

As of December 31, 2010, the payment upon cancellation of these lease agreements amounted to \$33 thousand.

Lease expenses for motor vehicle operating leases for the years ended December 31, 2009, and 2010 were approximately \$173 thousand, and \$192 thousand, respectively.

(c) Future minimum lease payments under non-cancelable capital leases for computer equipment, as of December 31, 2010, amounted to \$23 thousand.

(d) A bank guarantee given to the Subsidiary's landlord, is secured by a lien on some of the Subsidiary's bank deposits. As of December 31, 2010, such deposits amounted to \$661 thousand, including a restricted long-term deposit of \$140 thousand.

(e) The Subsidiary's hedging activity is secured by a lien on one of its bank deposits in an amount of up to \$200 thousand.

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Note 16 - Commitments and Contingencies (cont'd)

(f) In connection with the Redpoint Financings the Company entered into registration rights agreements with Redpoint, pursuant to which the Company agreed to register with the SEC for resale the common stock underlying the Redpoint Securities. In connection with the registration rights agreements, the Company agreed to pay a penalty of 1.0% per month, on a daily pro rata basis, up to a maximum of 8.0%, of the aggregate purchase price, as partial liquidated damages, for certain default events and subject to certain circumstances. The partial liquidated damages may trigger if the registration statements, which the Company filed on July 30, 2008 and June 15, 2009, and which were declared effective by the SEC on September 16, 2008 and July 28, 2009, respectively, cease to remain continuously effective.

(g) In the ordinary course of business, the Company enters into various arrangements with vendors and other business partners, principally for content, web-hosting, marketing and various consulting arrangements. As of December 31, 2010, the total future commitments under these arrangements amounted to approximately \$1.7 million.

(h) In the ordinary course of business, the Company may provide indemnifications of varying scope and terms to customers, vendors, lessors, business partners, and other parties with respect to certain matters, including, but not limited to, losses arising out of its breach of agreements, services to be provided by it, or from intellectual property infringement claims made by third parties. Additionally, the Company has indemnified its board members, officers, employees, and agents serving at the request of the Company to the fullest extent permitted by applicable law. It is not possible to determine the maximum potential amount of liability under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Such indemnification agreements may not be subject to maximum loss clauses. To date, the Company has not incurred costs as a result of obligations under these agreements and has not accrued any liabilities related to such indemnification obligations in its accompanying financial statements.

(i) From time to time, the Company receives various legal claims incidental to its normal business activities, such as intellectual property infringement claims and claims of defamation and invasion of privacy. Although the results of claims cannot be predicted with certainty, the Company believes the final outcome of such matters will not have a material adverse effect on its financial position, results of operations, or cash flows.

(j) In connection with the consummation of the Merger, the Company expects to incur, in 2011, up to approximately \$5 million related to banking fees, legal costs and other expenses.

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Note 16 - Commitments and Contingencies (cont'd)

(k) Between February 4, 2011 and the date of this filing, eight separate and substantially identical purported stockholder class action complaints were filed in the Supreme Court of New York in New York County, State of New York and the Court of Chancery in the State of Delaware. The six actions filed in Delaware have been consolidated by the Court. The complaints name as defendants Answers.com, all the members of the Answers.com board of directors, AFCV, and certain other defendants. The plaintiffs generally allege that, in connection with the approval of the Merger Agreement, the members of Answers.com board of directors breached their fiduciary duties owed to Answers.com stockholders by, among other things, failing to take steps to maximize the Company's value to its stockholders and because the merger price of \$10.50 per share allegedly does not reflect the true value of Answers.com stock. The plaintiffs further allege that AFCV and certain of the other defendants, aided and abetted the members of the Answers.com board of directors in the alleged breaches of their fiduciary duties. The plaintiffs seek among other things an order enjoining the members of the Answers.com board of directors from consummating the transactions contemplated by the Merger Agreement, and, in the case of some of the actions, damages and attorneys' fees. Answers.com and the other defendant parties intend to defend these lawsuits vigorously and believe them to have no merit, but the Company cannot predict the outcome of these matters. Even if successful in defending the lawsuits, the Company may incur substantial costs and diversion of management time and resources to defend the litigation.

Note 17 – Interest Income (Expense), Net

Interest expense, net, in 2009 is comprised of the amortization of the transaction costs relating to the Series B Unit Warrant in the amount of \$166 thousand, transaction costs relating to the issuance of the Series B Warrants in the amount of \$290 thousand and \$9 thousand of interest expenses paid in connection with assets acquired under several capital lease agreements. Such amounts have been reduced by interest income earned from cash and cash equivalents in the amount of \$25 thousand.

Interest income, net, in 2010 is comprised of interest income earned from cash and cash equivalents in the amount of \$76 thousand, reduced by \$4 thousand of interest expenses paid in connection with assets acquired under several capital lease agreements.

Note 18 – Other Income (Expense), Net

Other income, net, is comprised of foreign currency exchange gains and losses.

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Note 19 – Risks and Uncertainties

(a) Most of the Company's revenue was generated through the efforts of third party suppliers (the "Monetization Partners"). In 2009 and 2010, the Company earned approximately 88% and 77% of its revenue, respectively, through one of its Monetization Partners, Google Inc. ("Google"). The Company's relationship with Google is governed by its Google Services Agreement, which was renewed in the fourth quarter of 2009 for a two-year period ending January 31, 2012.

(b) Search engines serve as origination Web properties for users in search of information, and the Company's Websites' topic pages often appear as one of the top links on the pages returned by search engines in response to users' search queries. Thus, in addition to the ads the Company receives through Google, its traffic is mostly driven by search engine traffic, predominantly from the Google search engine. In 2009 and 2010, according to the Company's internal estimates, search engine traffic represented approximately 86% and 91% of traffic, respectively. Search engines, at any time and for any reason, could change their algorithms that direct queries to the Company's Web properties or could specifically restrict the flow of users visiting the Company's Web properties. On occasion the Company's Web properties have experienced decreases in traffic, and consequently in revenue, due to these search engine actions. The Company cannot guarantee that it will successfully react to these actions in the future and recover lost traffic. Accordingly, a change in algorithms that search engines use to identify Web pages towards which traffic will ultimately be directed, or a restriction on the flow of users visiting the Company's Web properties from search engines, could cause a significant decrease in traffic and revenues.

(c) Close to half of the Company's operating expenses, excluding non-cash items such as stock-based compensation, are denominated in New Israel Shekels (NIS). The Company expects the amount of such NIS expenses to grow in the foreseeable future. In recent years, the U.S. dollar-NIS exchange rate has been volatile. If the value of the U.S. dollar weakens against the value of NIS, there will be a negative impact on the Company's operating costs. In addition, to the extent the Company holds monetary assets and liabilities that are denominated in currencies other than the U.S. dollar, the Company will be subject to the risk of exchange rate fluctuations. The Company uses forward contracts, to lessen the effect of currency fluctuations on its results of operations.

(d) The Series A Warrants and Series B Warrants are revalued each reporting date, and any change in their fair value is recorded in the Consolidated Statements of Income. The Company uses the Black-Scholes valuation model to determine the values of the warrants. Inputs used in this model include our stock price and risk-free interest rate. The primary reason for the change in value of the aforesaid warrants in the accompanying financial statements has been the change in the market value of our common stock on the measurement dates. To the extent that the market value of our common stock rises or declines in future periods, the Company may continue to experience significant gains or losses resulting from the fair value adjustments of Series A Warrants and Series B Warrants.

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Our management has evaluated, with the participation of our principal executive and principal financial officers, the effectiveness of our disclosure controls and procedures and of our internal control over financial reporting, as of December 31, 2010. Based on their evaluation, our principal executive and principal financial officers have concluded that, as of December 31, 2010, our disclosure controls and procedures were effective.

Disclosure controls and procedures are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Management's Annual Report on Internal Control over Financial Reporting

Management of Answers Corporation (the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed by our principal executive and principal financial officers, under the supervision of our board, and effected by our management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect our transactions and dispositions of assets, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

The Company's internal control over financial reporting was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management of the Company assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2010. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on our assessment, management concluded that, as of December 31, 2010, the Company's internal control over financial reporting is effective based on those criteria.

Changes in Internal Control over Financial Reporting

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There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the fourth quarter of the year ended December 31, 2010 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information.

None.

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## PART III

## Item 10. Directors, Executive Officers and Corporate Governance.

The following table sets forth certain information regarding our executive officers and directors as of December 31, 2010:

| Name                  | Age | Position  |
|-----------------------|-----|---|
| Executive Officers    |     |   |
| Robert S. Rosenschein | 57  | CEO, President and Chairman of the Board                |
| Steven Steinberg      | 50  | Chief Financial Officer                                 |
| Jeff Schneiderman     | 47  | Chief Technical Officer                                 |
| Bruce D. Smith        | 49  | Chief Strategic Officer                                 |
| Caleb A. Chill        | 36  | Vice President, General Counsel and Corporate Secretary |
| Directors             |     |   |
| Mark A. Tebbe         | 50  | Vice Chairman and Lead Director                         |
| Yehuda Sternlicht     | 56  | Director  |
| Mark B. Segall        | 48  | Director  |
| Lawrence S. Kramer    | 60  | Director  |
| W. Allen Beasley      | 43  | Director  |
| R. Thomas Dyal        | 45  | Director  |

## Executive Officers:

Robert S. Rosenschein has been Chairman of our Board and President since he founded Answers Corporation in December 1998. From December 1998 to April 2000 and since May 2001, Mr. Rosenschein has served as our Chief Executive Officer. Prior to founding Answers, he was the Chief Executive Officer of Accent Software International Ltd. (formerly Kivun), a company that developed multi-lingual software tools, and from 1988 to 1997 and from 1997 to 1998, he was the Chief Technical Officer. Mr. Rosenschein previously served as a software developer for Data General, American Management Systems, the World Bank and Ashton Tate. Mr. Rosenschein graduated with a B.Sc. in Computer Science from the Massachusetts Institute of Technology and received the Prime Minister of Israel's Award for Software Achievement in 1997.

Steven Steinberg has been our Chief Financial Officer since January 2004. From December 2002 to December 2003, Mr. Steinberg was our Vice President of Finance. From January 2001 to November 2002, he was the Vice President of Finance at Percite Information Technologies, Ltd., a supply-chain software company. From November 1998 to December 2000, he was the Controller at Albar Mimunit Services Ltd., a finance and leasing company. From October 1993 to July 1998, he held various positions with Health Partners, Inc. culminating with Chief Financial Officer of the New York Operations. From August 1983 to October 1993, he held various positions with Coopers and Lybrand, an accounting firm, culminating with audit manager at the New York offices. Mr. Steinberg graduated with a B.B.A. from Florida International University.

Jeff Schneiderman has been our Chief Technical Officer since March 2003. From January 1999 to February 2003, Mr. Schneiderman was our Vice President of Research and Development. Prior to joining Answers, he worked at



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Accent Software International Ltd., from November 1991 to December 1998 during which time he served as Vice President of Engineering from October 1996 to March 1998 and Vice President of Product Development from March 1998 to December 1998. From June 1986 to June 1991, Mr. Schneiderman held various development positions at AT&T Bell Labs, a global telecommunication organization, and the Whitewater Group, a firm specializing in object oriented technologies. Mr. Schneiderman graduated with a B.S. in Computer Science from the University of Illinois at Urbana-Champaign and a M.S. in Computer Science from the Illinois Institute of Technology.

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Bruce D. Smith has been our Chief Strategic Officer since June 2007. From July 2005 to June 2007, Mr. Smith was our Vice President of Investor Relations and Strategic Development. In 2008 Mr. Smith assumed the additional role of leader of the WikiAnswers Community Development Team. Prior to joining Answers, he was a Managing Director at Archery Capital, a New York based investment firm from July 1999 to July 2005. From June 1998 to July 1999, he was a sell side analyst at Jefferies & Company, where he was responsible for coverage of the Internet industry as well as individual companies. From November 1995 to March 1998, Mr. Smith maintained coverage of the Internet industry at Merrill Lynch & Co. From April 1994 to October 1995, he was a Security Analyst at Morgan Stanley Asset Management, a division of Morgan Stanley & Co. Mr. Smith graduated with a B.B.A., Magna Cum Laude, from Bernard M. Baruch College, City University of New York. He is a Chartered Financial Analyst and member of the New York Society of Security Analysts.

Caleb A. Chill has been our Vice President, General Counsel and Corporate Secretary since January 2007. From January 2005 to January 2007, Mr. Chill was our In-House Counsel. From August 2002 to November 2004, he was an associate in the Corporate Department of Sills Cummis & Gross P.C., based out of the firm's New York office. His practice concentrated on the structuring and negotiating of corporate transactions in high-tech and other industries. From August 1999 to August 2001, Mr. Chill was an associate in the international department of Baratz, Horn & Co., an Israeli corporate law firm. Mr. Chill holds an LL.B. from Bar-Ilan University of Israel, has earned an M.B.A. from the same institution, and is admitted to practice law in Israel and New York.

Board of Directors:

The following provides certain qualifications, attributes, skills and other biographical information with respect to our six non-management directors currently serving on our board of directors:

Mark A. Tebbe has served as a director since December 1998 and as Vice Chairman and Lead Director since April 2007. Mr. Tebbe currently serves as the chairman of our Compensation Committee and as a member of our Audit Committee. Since February 2002, Mr. Tebbe has been Chairman of Techra Networks LLC, a technology-oriented consulting firm. From August 1984 to January 2002, Mr. Tebbe served as Chairman of Lante Corporation, a technology consulting firm he founded. Mr. Tebbe is also a board member of SBI Group, Elexos Corp. and Selective Search, Inc. and several non-profit and civic organizations. Mr. Tebbe graduated with a B.S. in Computer Science from the University of Illinois at Urbana/Champaign. As a co-founder of the Company, Mr. Tebbe was originally selected to serve as a director due to his deep familiarity with our business, his extensive entrepreneurial background and many years of senior management experience in the technology sector.

Yehuda Sternlicht has served as a director since June 2004 and currently serves as the chairman of our Audit Committee and since July 2005 has also served as a member of our Financing Committee. Since 2004, Mr. Sternlicht has been an independent financial consultant. Between 2004 and 2008, he served as the Chief Financial Officer of NanoVibronix Inc., a medical device company. From 1992 to 2003, he was the Chief Financial Officer of Savient Pharmaceuticals, Inc. Prior to 1992, he served in several financial and accounting positions in public and private companies and in a large CPA firm in Israel and in the United States. Mr. Sternlicht served as a member of the board of directors of Ubank Provident fund management (2005) Ltd. Between June 2006 and January 2008. Mr. Sternlicht graduated with a B.A. in Accounting and Economy from The Hebrew University. He is qualified as a Certified Public Accountant in the State of Israel. Mr. Sternlicht brings to the board substantial financial and accounting experience due to the professional positions he has held over the course of his career. Mr. Sternlicht qualifies as an "audit committee financial expert" under SEC guidelines.

Mark B. Segall has served as a director since December 2004 and currently serves as the chairman of our Finance Committee and as a member of our Audit Committee. Mr. Segall has been the Senior Managing Director of Kidron Corporate Advisors, LLC, a New York based mergers and acquisitions corporate advisory boutique serving emerging

growth companies primarily in the technology, consumer goods and financial services sectors, which he founded in 2003. He is the founder and CEO of Kidron Capital Advisors LLC, a U.S. registered broker dealer since June 2010. He is also a founder and managing member of Kidron's private equity fund, Kidron Opportunity Fund I, LLC. From 2001 to 2003, Mr. Segall was the Co-Chief Executive Officer of Investec, Inc., the U.S. investment banking operations of the Investec Group, a South African based specialist bank. He served as head of investment banking and general counsel at Investec Inc. between 1999 and 2001. From 1996 to 1999, he was a partner at the law firm of Kramer, Levin, Naftalis & Frankel LLP, specializing in cross-border mergers and acquisitions and capital markets activities and between 1991 and 1995 he was an associate at the same firm. Mr. Segall currently serves as a director of Integrated Asset Management plc, an alternative asset management company, and Ronson Europe N.V., a Polish residential real estate development company. Mr. Segall was recently appointed to the board of Temco Services, Inc., a facilities management business. Mr. Segall served as director of the Spectrum Group (formerly Escala) from 1999 to 2007 and of Cogo (formerly the Comtech Group) from 2000 to 2006. Mr. Segall graduated with an A.B. from Columbia University and a J.D. from New York University Law School. Mr. Segall brings significant business finance experience as well as his extensive management expertise to the Company from his background as a chief executive officer in the corporate advisory and investment banking industries, board member of several corporations and counsel to numerous technology company clients.

Lawrence S. Kramer has served as a director since May 2005 and currently serves as the chairman of our Nominating/Corporate Governance Committee and as a member of our Financing Committee. Mr. Kramer is Adjunct Professor of Media Management at the Newhouse School at Syracuse University. He was a senior advisor to Polaris Venture Partners from July 2007 until January 2010. From November 2006 until May 2007, he was an advisor to CBS. From March 2005 to November 2006, he served as the first President of CBS Digital Media. From October 1997 to January 2005, Mr. Kramer was the Chairman and CEO of MarketWatch, Inc., a media company he founded. From February 1994 to October 1997, he served as Vice President of News, Sports and Marketing at Data Broadcasting Corporation. For 20 years prior to that, Mr. Kramer had a distinguished career in journalism as a reporter and top editor at the San Francisco Examiner and the Washington Post. In 2009, Mr. Kramer joined the board of directors of American Media, Inc., a privately-held publishing company in the celebrity journalism and health & fitness categories. In 2008, Mr. Kramer became a board member of Discovery Communications Inc. (NASDAQ: DISCA). Mr. Kramer has been awarded a National Press Club Award, Gerald E. Loeb Award and Associated Press Awards for reporting. Mr. Kramer graduated with a B.S. in Journalism and Political Science from Syracuse University and an M.B.A. from Harvard University and has been a Guest Lecturer at the Harvard Business School for 10 years. Mr. Kramer's many years of experience creating and managing content, along with his strong background of service in the media industry and his past experience as a chairman and chief executive officer of a public company, make him a valuable member of our board of directors who can assist in the development of our growth strategy and business plans.

W. Allen Beasley has served as a director since June 2008, as a designee of the holders of the Company's Series A Convertible Preferred Stock and currently serves as a member of our Compensation Committee and our Financing Committee. Since October 1999, Mr. Beasley has been a partner with Redpoint Ventures. From June 1998 to September 1999, Mr. Beasley was an associate with Institutional Venture Partners (IVP). Before joining IVP, Allen worked in marketing and product management for Ipsilon Networks, a developer of IP switching technology founded in 1994 and acquired by Nokia in 1997. Mr. Beasley focuses on infrastructure and media investments and currently serves on the Boards of Directors of Buzz Media, Inc. and Obopay, Inc. Mr. Beasley holds a B.A. in Economics from Stanford University and an M.B.A. from the Stanford Graduate School of Business. Because of his strong background of investment activity in growth-stage companies and his focus on opportunities in the Internet sector, we believe that Mr. Beasley provides a unique perspective and useful insight to our board as we strive to deliver on our growth strategy and strategic initiatives.

R. Thomas Dyal has served as a director since June 2009, as a designee of the holders of the Company's Series B Convertible Preferred Stock, and currently serves as a member of our Nominating/Corporate Governance Committee. Since October 1999, Mr. Dyal has been a partner with Redpoint Ventures. From June 1997 to September 1999, Mr.

Dyal was a partner and associate with Institutional Venture Partners (IVP). Before joining IVP, Mr. Dyal spent ten years in operating roles in the communications and networking industry, most recently at Bay Networks, Inc. At Bay Networks, he ran product management for its network management software business. Mr. Dyal began his career as a systems engineer with AT&T Bell Laboratories. Mr. Dyal focuses on a wide range of technology investment areas, including infrastructure and application software, services and systems targeting the Internet, mobile and enterprise segments. Currently, he is leading the firm's investments in Clearwell Systems, Inc. and NextG Networks, Inc. Mr. Dyal holds a B.S. in Electrical Engineering from the Georgia Institute of Technology and a M.S. in Electrical Engineering from Stanford University. Mr. Dyal's background, which includes investment activity in companies focused on opportunities in the Internet, software and mobile industries, is complementary to the oversight of our business, and his past operating roles in the communications and networking industry bring additional value to our board.

There are no family relationships among directors, executive officers, or persons nominated or chosen to become directors or executive officers.

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## Board Classes

Our Amended and Restated Certificate of Incorporation provides that the number of directors shall be not less than five or no more than nine directors. Our board of directors is divided into three classes with only one class of directors being elected in each year and each class serving a three-year term. We currently have no Class II board members. The following chart sets forth the term of office of each class of directors and which directors are assigned to each class:

| Class     | Term                             | Members   |
|-----------|----------------------------------|---|
| Class I   | Expires upon 2011 annual meeting | Mark A. Tebbe and Lawrence S. Kramer                  |
| Class II  | Expires upon 2012 annual meeting | N/A   |
| Class III | Expires upon 2013 annual meeting | Robert Rosenschein, Yehuda Sternlicht and Mark Segall |

W. Allen Beasley, the director designee of the holders of a majority of the Company's outstanding Series A Convertible Preferred Stock, is not a member of a class. If the Merger is not consummated, Mr. Beasley's term as a director will expire at the 2011 annual meeting of stockholders, at which time he will be nominated to be reelected as a director provided that the holders of a majority of the Company's outstanding Series A Convertible Preferred Stock meet certain ownership requirements as set forth in the Certificate of Designations, Number, Voting Powers, Preferences and Rights of Series A Preferred Stock.

R. Thomas Dyal, the director designee of the holders of a majority of outstanding Series B Convertible Preferred Stock, is not a member of a class. If the Merger is not consummated, Mr. Dyal's term as a director will expire at the 2011 annual meeting of stockholders, at which time he will be nominated to be reelected as a director provided that the holders of a majority of the Company's outstanding Series B Convertible Preferred Stock meet certain ownership requirements as set forth in the Certificate of Designations, Number, Voting Powers, Preferences and Rights of Series B Preferred Stock.

## Director Independence

The NASDAQ listing standards require that a majority of our board must be composed of "independent directors," which is defined generally as a person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship, which, in the opinion of the company's board of directors would interfere with the director's exercise of independent judgment in carrying out the responsibilities of a director. Our board of directors has determined that its members are currently "independent" in accordance with the applicable listing standards of NASDAQ as currently in effect, with the exception of Mr. Rosenschein.

## Committees of the Board

The Company's board of directors has adopted a written charter for each of the Audit Committee, Compensation Committee and Nominations/ Corporate Governance Committee. Each charter is available on the Company's website.

**Audit Committee.** In May 2004, the Company established an Audit Committee of the board of directors. The Audit Committee consists of Mr. Sternlicht, Chairman, Mr. Segall and Mr. Tebbe, each of whom satisfy the current independence standards as promulgated by the SEC and NASDAQ, as such standards apply specifically to members of audit committees. The Audit Committee's scope of authority, which is specified in our Audit Committee Charter, includes, but is not limited to:

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- Reviewing and discussing with management and the independent accountants our annual and quarterly financial statements and discussing with management any earnings guidance provided to the market;
  - Directly appointing, compensating, retaining, and overseeing the work of the independent auditor;
- Approving, in advance, the provision by the independent auditor of all audit and permissible non-audit services;
- Establishing procedures for the receipt, retention, and treatment of complaints received by the Company regarding accounting, internal accounting controls, or auditing matters and the confidential, anonymous submissions by the Company's employees of concerns regarding questionable accounting or auditing matters;
  - Retaining independent legal and other advisors as the Audit Committee deems necessary or appropriate;
- Determining and receiving from the Company appropriate funding to compensate the independent accountants and any outside advisors engaged by the Audit Committee; and
  - Reviewing reports and disclosure of insider and affiliated party transactions.

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The NASDAQ listing standards require the Audit Committee to be composed of members who are “financially literate.” The NASDAQ listing standards define “financially literate” as being able to read and understand fundamental financial statements, including a company’s balance sheet, income statement and cash flow statement. In addition, NASDAQ requires that the committee have, at least one member who has past employment experience in finance or accounting, requisite professional certification in accounting, or other comparable experience that results in the individual’s financial sophistication. The board of directors has determined that all members of the Audit Committee are financially literate, as defined, and that Mr. Sternlicht satisfies NASDAQ’s definition of financial sophistication and also qualifies as an “audit committee financial expert,” as defined under rules and regulations of the SEC.

Compensation Committee. In May 2004, the Company established a Compensation Committee of the board of directors. The Compensation Committee consists of Mr. Tebbe, Chairman, Mr. Kramer and Mr. Beasley. The board of directors has determined that each of the Compensation Committee members is an independent director under the current definition promulgated by NASDAQ. The Compensation Committee reviews and approves the Company’s salary and benefits policies, including the compensation of executive officers. The Compensation Committee also administers the Company’s stock option plans and recommends and approves grants of stock options and/or other stock-based awards under the plans.

Nominations/Corporate Governance Committee. In May 2004, the Company established a Nominating/Corporate Governance Committee (“Nominating Committee”) of the board of directors. The Nominating Committee consists of Mr. Kramer, Chairman, Mr. Tebbe and Mr. Dyal. The board of directors has determined that each of the Nominating Committee members is an independent director under the current definition promulgated by NASDAQ. The purpose of the Nominating Committee is to select, or recommend for the entire board’s selection, the individuals to stand for election as directors at the annual meeting of stockholders and to oversee the selection and composition of committees of the board. The committee’s duties, which are specified in the Nominating Committee Charter, include, but are not limited to:

- Establishing criteria for the selection of new directors;
- Recommending directors to serve on the committees of the board;
- Considering the adequacy of the Company’s corporate governance and proposing amendments accordingly;
- Overseeing and approving management continuity planning process; and
- Reporting regularly to the board matters relating to the committee’s duties.

Financing Committee. In July 2005, the Company established a Financing Committee of the board of directors. The Financing Committee consists of Mr. Segall, Chairman, Mr. Sternlicht and Mr. Beasley. Each of the Finance Committee members is an independent director under the current definition promulgated by NASDAQ. The purpose of the Financing Committee is to review and discuss with management financing opportunities that the Company is considering, to evaluate the business merits of all potential mergers and acquisitions and to provide the board of directors with a recommendation as to the terms and conditions of any extraordinary transactions, in consultation with the management team, legal advisors and financial consultants.

Vice-Chairman of the Board of Directors and Lead Director. On April 12, 2007, Mark A. Tebbe was appointed Vice-Chairman of the board of directors and Lead Director. In this capacity, Mr. Tebbe is authorized to call meetings of the board, in consultation with the non-employee directors, advise the Chairman as to scheduling board meetings and provide the Chairman with input regarding the agendas for the board meetings, preside at all meetings at which the Chairman is not present including executive sessions of the non-employee directors and apprise the Chairman of

the issues considered, be available for consultation and direct communication with the Company's major stockholders and perform such other duties as the board may from time to time delegate.

#### Code of Ethics

In May 2004, we adopted a Code of Ethics and Business Conduct that applies to all of our executive officers, directors and employees. The Code of Ethics and Business Conduct codifies the business and ethical principles that govern all aspects of our business. A copy of the Code of Ethics and Business Conduct may be found on our website at <http://ir.answers.com>.



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Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires our officers and directors, and persons who own more than ten percent of a registered class of our equity securities, to file reports of ownership and changes in ownership with the Securities and Exchange Commission. Officers, directors and greater than ten percent stockholders are required by SEC regulation to furnish us with copies of all Section 16(a) forms they file. Based on a review of the copies of such forms received, we believe that during 2010, all filing requirements applicable to our officers, directors and greater than ten percent beneficial owners were complied with.

Item 11. Executive Compensation

The information required by this item will be included under the captions “Director Compensation,” “Executive Compensation” and “Directors, Executive Officers and Corporate Governance—Corporate Governance and Board Matters—Compensation Committee Interlocks and Insider Participation” in either an amendment to this Annual Report on Form 10-K or the 2011 Proxy Statement and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item will be included under the captions “Common Stock Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information” in either an amendment to this Annual Report on Form 10-K or the 2011 Proxy Statement and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions and Director Independence

The information required by this item will be included under the captions “Certain Relationships and Related Transactions” and “Directors, Executive Officers and Corporate Governance—Corporate Governance and Board Matters—Director Independence” in either an amendment to this Annual Report on Form 10-K or the 2011 Proxy Statement and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information required by this item will be included under the caption “Independent Registered Public Accounting Firm” in either an amendment to this Annual Report on Form 10-K or the 2011 Proxy Statement and is incorporated herein by reference.

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PART IV

ITEM 15. Exhibits and Financial Statement Schedules

1. Financial Statements.

See Index to Financial Statements on page 37.

2. Financial Statement Schedule.

None.

3. Exhibits.

See exhibits Index immediately below.

| Exhibit No. | Description |
|-------------|-------------|
|-------------|-------------|

|       |  |
|-------|--|
| 2.1   | Agreement and Plan of Merger dated February 2, 2011, with AFCV Holdings, LLC, (“AFCV”) and A-Team Acquisition Sub, Inc. (Previously filed as Exhibit 2.1 to the Registrant’s Current Report on Form 8-K (File No. 001-32255) filed February 7, 2011, and incorporated herein by reference)           |
| 3.1   | Amended and Restated Certificate of Incorporation, as amended (Previously filed as Exhibit 3.1 to the Registrant’s Annual Report on Form 10-K (File No. 001-32255) filed March 9, 2009, and incorporated herein by reference)  |
| 3.2   | Certificate of Designations, Number, Voting Powers, Preferences and Rights of Series A Convertible Preferred Stock of the Registrant (Previously filed as Exhibit 3.1 to the Registrant’s Current Report on Form 8-K (File No. 001-32255) filed June 17, 2008, and incorporated herein by reference) |
| 3.3   | Certificate of Designations, Number, Voting Powers, Preferences and Rights of Series B Convertible Preferred Stock of the Registrant (Previously filed as Exhibit 3.1 to the Registrant’s Current Report on Form 8-K (File No. 001-32255) filed June 15, 2009, and incorporated herein by reference) |
| 3.4   | Amended and Restated By-laws of Registrant (Previously filed as Exhibit 3.2 to the Registration Statement on Form SB-2 (File No. 333-115424) filed May 12, 2004, and incorporated herein by reference)   |
| 4.1   | Specimen Common Stock Certificate of the Registrant (Previously filed as Exhibit 4.1 to the Registration Statement on Form SB-2 (File No. 333-115424) filed July 16, 2004, and incorporated herein by reference)   |
| 10.1« | 2000 Stock Plan of Registrant and form of Option Agreement thereunder (Previously filed as Exhibits 4.4B and 4.4A, respectively, to the Registration Statement on Form S-8 (File No. 333-123185) filed March 8, 2005, and incorporated herein by reference)  |
| 10.2« | 2003 Stock Plan (Previously filed as Exhibit 10.1 to the Registration Statement on Form SB-2 (File No. 333-115424) filed May 12, 2004,   |

- and incorporated herein by reference)
- 10.3« Forms of Stock Option Agreement under the 2003 Stock Plan covering (i) employees of Registrant, and (ii) officers of Registrant (Previously filed as Exhibits 4.3A and 4.3B, respectively, to the Registration Statement on Form S-8 (File No. 333-123185) filed March 8, 2005, and incorporated herein by reference)
- 10.4« 2004 Stock Plan (Previously filed as Exhibit 10.2 to the Registration Statement on Form SB-2 (File No. 333-115424) filed May 12, 2004, and incorporated herein by reference)
- 10.5« Forms of Stock Option Agreement under the 2004 Stock Plan covering (i) employees of Registrant, and (ii) officers of Registrant (Previously filed as Exhibits 4.2A and 4.2B, respectively, to the Registration Statement on Form S-8 (File No. 333-123185) filed March 8, 2005, and incorporated herein by reference)
- 10.6« 2005 Incentive Compensation Plan (Previously filed as Annex B to the Registrant's Definitive Proxy Statement filed May 31, 2005, and incorporated herein by reference)
- 10.7« Amendment to 2005 Incentive Compensation Plan approved by the Registrant's stockholders on June 21, 2006 (Previously filed within the Registrant's Definitive Proxy Statement filed May 1, 2006, and incorporated herein by reference)
- 10.8« Amendment to 2005 Incentive Compensation Plan approved by the Registrant's stockholders on September 9, 2008 (Previously filed within the Registrant's Definitive Proxy Statement filed July 28, 2008, and incorporated herein by reference)
- 10.9 Amendment to 2005 Incentive Compensation Plan approved by the Registrant's stockholders on September 9, 2009 (Previously filed within the Registrant's Definitive Proxy Statement filed July 22, 2009, and incorporated herein by reference)
- 10.10« Amendment to 2005 Incentive Compensation Plan approved by the Registrant's stockholders on September 15, 2010 (Previously filed within the Registrant's Definitive Proxy Statement filed July 27, 2010, and incorporated herein by reference)
- 10.11« Forms of Stock Option Agreement under the 2005 Incentive Compensation Plan covering (i) Israel-based employees, and (ii) U.S.-based employees (Previously filed as Exhibits 10.5A and 10.5B, respectively, to the Registrant's Annual Report on Form 10-KSB (File No. 001-32255) filed March 20, 2006, and incorporated herein by reference)
- 10.12« Robert S. Rosenschein Employment Agreement (Previously filed as Exhibit 10.6 to the Registration Statement on Form SB-2 (File No. 333-115424) filed May 12, 2004, and incorporated herein by reference)
- 10.13« Amendment to Robert S. Rosenschein's Amended and Restated Employment Agreement, dated as of November 27, 2006 (Previously filed as Exhibit 10.1 to the Current Report on Form 8-K (File No. 001-32255) filed November 29, 2006, and incorporated herein by reference)
- 10.14« Amendment to Robert S. Rosenschein's Amended and Restated Employment Agreement, dated as of November 6, 2007 (Previously filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q (File No. 001-32255) filed November 9, 2007, and incorporated herein by

reference)

- 10.15« Amendment to Robert S. Rosenschein's Amended and Restated Employment Agreement, dated as of July 30, 2008 (Previously filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q (File No. 001-32255) filed August 4, 2008, and incorporated herein by reference)
- 10.16« Steven Steinberg Employment Agreement (Previously filed as Exhibit 10.7 to the Registration Statement on Form SB-2 (File No. 333-115424) filed May 12, 2004, and incorporated here by reference)
- 10.17« Amendment to Steve Steinberg's Employment Agreement, dated as of November 6, 2007 (Previously filed as Exhibit 10.2 to the Quarterly Report on Form 10-Q (File No. 001-32255) filed November 9, 2007, and incorporated herein by reference)
- 10.18« Jeff Schneiderman Employment Agreement (Previously filed as Exhibit 10.8 to the Registration Statement on Form SB-2 (File No. 333-115424) filed May 12, 2004, and incorporated herein by reference)
- 10.19« Amendment to Jeff Schneiderman's Employment Agreement, dated as of November 6, 2007 (Previously filed as Exhibit 10.3 to the Quarterly Report on Form 10-Q (File No. 001-32255) filed November 9, 2007, and incorporated herein by reference)
- 10.20« Bruce D. Smith Employment Agreement (Previously filed as Exhibit 10.10 to the annual report on Form 10-KSB (File No. 001-32255) filed March 20, 2006, and incorporated herein by reference)
- 10.21« Amendment to Bruce Smith's Employment Agreement, dated as of November 6, 2007 (Previously filed as Exhibit 10.4 to the Quarterly Report on Form 10-Q (File No. 001-32255) filed November 9, 2007, and incorporated herein by reference)
- 10.22+ Google Services Agreement (“GSA”), GSA Order Form and GSA Order Form Terms and Conditions, all dated January 28, 2005 (Previously filed as Exhibit 10.19 to the Registrant's Annual Report on Amendment No. 3 to Form 10-KSB (File No. 001-32255) filed June 7, 2006, and incorporated herein by reference)
- 10.23+ Amendment No. 1 to Google Order Form and GSA, dated December 20, 2005 (Previously filed as Exhibit 10.20 to the Registrant's Annual Report on Amendment No. 2 to Form 10-KSB (File No. 001-32255) filed May 19, 2006, and incorporated herein by reference)
- 10.24+ Amendment No. 2 to Google Order Form, dated January 31, 2006 (Previously filed as Exhibit 10.21 to the Registrant's Annual Report on Amendment No. 2 to Form 10-KSB (File No. 001-32255) filed May 19, 2006, and incorporated herein by reference)
- 10.25+ Amendment No. 5 to Google Order Form, dated September 21, 2007 (Previously filed as Exhibit 10.5 to the Quarterly Report on Form 10-Q (File No. 001-32255) filed November 9, 2007, and incorporated herein by reference)
- 10.26+ Amendment No. 7 to Google Order Form and Google Services Agreement, dated October 13, 2009 (Previously filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q (File No. 001-32255) filed November 9, 2009, and incorporated herein by reference)
- 10.27+ API Agreement with Shopping.com, Inc. dated May 2, 2005 (Previously filed as Exhibit 10.22 to the Registrant's Annual Report on Form 10-KSB (File No. 001-32255) filed March 20, 2006, and incorporated herein by reference)

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- 10.28 Lease Agreement with 35th Street Associates to lease office space in the building known as 237 West 35th Street in New York, NY, dated April 29, 2005 (Previously filed as Exhibit 10.1 to the Current Report on Form 8-K (File No. 001-32255) filed May 4, 2005, and incorporated herein by reference)
- 10.29\* Extension and Modification of Lease Agreement with 35th Street Associates to lease office space in the building known as 237 West 35th Street in New York, NY, dated April 30, 2010
- 10.30 Supplemental agreement to operating lease agreement between GuruNet Israel Ltd., Answers Corporation's wholly-owned subsidiary ("Subsidiary") and Jerusalem Technology Park Ltd. ("JTP") dated July 26, 2005 in connection with Subsidiary's relocation to new office space (a summary of the principal terms of this lease was previously filed as Exhibit 10.1 to the Current Report on Form 8-K (File No. 001-32255) filed July 28, 2005, and incorporated herein by reference)
- 10.31\* Supplemental agreement to operating lease agreement between Subsidiary and JTP dated July 25, 2010 in connection with Subsidiary's renewal of its Jerusalem office space lease (a summary of the principal terms is filed with this annual report)
- 10.32 Securities Purchase Agreement dated June 16, 2008 between Answers Corporation and Redpoint Omega, L.P. and Redpoint Omega Associates, LLC (Previously filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 001-32255) filed June 17, 2008, and incorporated herein by reference)
- 10.33 Form of Common Stock Purchase Warrant granted to Redpoint Omega, L.P. and Redpoint Omega Associates, LLC on June 16, 2008 (Previously filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K (File No. 001-32255) filed June 17, 2008, and incorporated herein by reference)
- 10.34 Warrant Agreement dated as of June 16, 2008 between Answers Corporation and Redpoint Omega, L.P. and Redpoint Omega Associates, LLC (Previously filed as Exhibit 10.3 to the Registrant's Current Report on Form 8-K (File No. 001-32255) filed June 17, 2008, and incorporated herein by reference)
- 10.35 Registration Rights Agreement dated as of June 16, 2008 between Answers Corporation and Redpoint Omega, L.P. and Redpoint Omega Associates, LLC (Previously filed as Exhibit 10.3 to the Registrant's Current Report on Form 8-K (File No. 001-32255) filed June 17, 2008, and incorporated herein by reference)
- 10.36+ Master Services Agreement and Statement of Work with C7 Data Centers, Inc. dated March 31, 2009
- 10.37+ Network Access and Data Center Services Agreement, Service Order, Network SLA and Facility Availability SLA with Net Access Corporation, Inc. dated April 9, 2008
- 10.38 Voting Agreement dated February 2, 2011, with AFCV and Robert Rosenschein (Previously filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 001-32255) filed February 7, 2011, and incorporated herein by reference)
- 10.39 Voting Agreement dated February 2, 2011, with AFCV, Redpoint Omega, L.P. and Redpoint Omega Associates, LLC (Previously filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K (File No.

- 001-32255) filed February 7, 2011, and incorporated herein by reference)
- 14.1 Code of Ethics and Business Conduct (Previously filed as Exhibit 14.1 to the Registration Statement on Form SB-2 (File No. 333-115424) filed May 12, 2004, and incorporated herein by reference)
- 21.1\* List of Subsidiaries
- 23.1\* Consent of KPMG Somekh Chaikin, Independent Registered Public Accounting Firm
- 31.1\* Certification of Principal Executive Officer required under Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934, as amended
- 31.2\* Certification of Principal Financial Officer required under Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934, as amended
- 32.1\*^ Certification of Principal Executive Officer required under Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350
- 32.2\*^ Certification of Principal Financial Officer required under Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350

\* Filed herewith.

+ Portions of this exhibit were omitted and filed separately with the U.S. Securities and Exchange Commission pursuant to a request for confidential treatment.

^ The certifications attached as Exhibit 32 accompany this Annual Report on Form 10-K pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed "filed" by Answers Corporation for purposes of Section 18 of the Exchange Act.

« Indicates a management contract or compensatory plan or arrangement.

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## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Answers Corporation

By: /s/ Robert S. Rosenschein  
Robert S. Rosenschein  
Chief Executive Officer

Date: March 17, 2011

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

Each person whose signature appears below hereby authorizes Robert S. Rosenschein and Steve Steinberg, or any of them, as attorneys-in-fact to sign on his behalf, individually, and in each capacity stated below, and to file all amendments and/or supplements to this Annual Report on Form 10-K.

| Signature  | Capacity  | Date           |
|--|---|----------------|
| /s/ Robert S. Rosenschein<br>Robert S. Rosenschein | Chairman of the Board and Chief Executive Officer<br>(Principal Executive Officer)        | March 17, 2011 |
| /s/ Steven Steinberg<br>Steven Steinberg           | Chief Financial Officer<br>(Principal Financial Officer and Principal Accounting Officer) | March 17, 2011 |
| /s/ Mark A. Tebbe<br>Mark A. Tebbe                 | Director  | March 17, 2011 |
| /s/ Yehuda Sternlicht<br>Yehuda Sternlicht         | Director  | March 17, 2011 |
| /s/ Mark B. Segall<br>Mark B. Segall               | Director  | March 17, 2011 |
| /s/ Lawrence S. Kramer<br>Lawrence S. Kramer       | Director  | March 17, 2011 |
| /s/ W. Allen Beasley                               | Director  | March 17, 2011 |

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W. Allen Beasley

/s/ R. Thomas Dyal

Director

March 17, 2011

R. Thomas Dyal