

INFOSPACE INC  
Form 10-Q  
August 08, 2011  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended June 30, 2011 June 30, 2011

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: 000-25131

**INFOSPACE, INC.**

(Exact name of registrant as specified in its charter)

# Edgar Filing: INFOSPACE INC - Form 10-Q

<p><b>Delaware</b> (State or other jurisdiction of  incorporation or organization)</p> <p><b>601 108th Avenue NE, Suite 1200</b> <b>Bellevue, Washington</b> (Address of principal executive offices)</p>	<p><b>91-1718107</b> (I.R.S. Employer  Identification No.)</p> <p><b>98004</b> (Zip Code)</p>
<p><b>Registrant's telephone number, including area code: (425) 201-6100</b></p>	

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

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

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

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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

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

Class	Outstanding at <b>July 29, 2011</b>
Common Stock, Par Value \$0.0001	38,149,690

**Table of Contents**

**INFOSPACE, INC.**

**FORM 10-Q**

**TABLE OF CONTENTS**

**PART I FINANCIAL INFORMATION**

Item 1.	<u>Financial Statements</u>	
	<u>Unaudited Condensed Consolidated Balance Sheets as of June 30, 2011 and December 31, 2010</u>	3
	<u>Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) for the Three and Six Months ended June 30, 2011 and 2010</u>	4
	<u>Unaudited Condensed Consolidated Statements of Cash Flows for the Three and Six Months ended June 30, 2011 and 2010</u>	5
	<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	6
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	13
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	23
Item 4.	<u>Controls and Procedures</u>	24

**PART II OTHER INFORMATION**

Item 1.	<u>Legal proceedings</u>	24
Item 1A.	<u>Risk factors</u>	24
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	35
Item 3.	<u>Defaults Upon Senior Securities</u>	35
Item 4.	<u>[Removed and Reserved]</u>	35
Item 5.	<u>Other Information</u>	36
Item 6.	<u>Exhibits</u>	36
	<u>Signature</u>	37

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements****INFOSPACE, INC.****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

(amounts in thousands, except share data)

	June 30, 2011	December 31, 2010
<b><u>ASSETS</u></b>		
Current assets:		
Cash and cash equivalents	\$ 70,698	\$ 155,645
Short-term investments, available-for-sale	192,704	98,091
Accounts receivable, net of allowance of \$10 and \$15	19,758	19,189
Other receivables	4,262	1,185
Prepaid expenses and other current assets	1,577	2,163
Net assets of discontinued operations		16,161
Total current assets	288,999	292,434
Property and equipment, net	6,814	7,304
Goodwill	57,465	57,465
Other intangible assets, net	282	282
Other long-term assets	4,264	4,258
Total assets	\$ 357,824	\$ 361,743
<b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>		
Current liabilities:		
Accounts payable	\$ 12,503	\$ 2,699
Accrued expenses and other current liabilities	20,779	39,518
Liabilities of discontinued operations		7,777
Total current liabilities	33,282	49,994
Other long-term liabilities	757	955
Total liabilities	34,039	50,949
Stockholders' equity:		
Common stock, par value \$0.0001 authorized, 900,000,000 shares; issued and outstanding 37,963,589 and 36,088,646 shares	4	4
Additional paid-in capital	1,337,020	1,322,265
Accumulated deficit	(1,013,248)	(1,011,473)
Accumulated other comprehensive income (loss)	9	(2)
Total stockholders' equity	323,785	310,794
Total liabilities and stockholders' equity	\$ 357,824	\$ 361,743

See accompanying notes to Unaudited Condensed Consolidated Financial Statements.



**Table of Contents****INFOSPACE, INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****AND COMPREHENSIVE INCOME (LOSS)**

(amounts in thousands, except per share data)

	<b>Three months ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Revenues:	\$ 54,292	\$ 52,363	\$ 105,942	\$ 114,136
Cost of sales:	35,807	29,142	67,523	72,701
Gross profit	18,485	23,221	38,419	41,435
Expenses and other income:				
Engineering and technology	1,784	2,540	3,448	4,446
Sales and marketing	4,902	7,314	11,869	13,796
General and administrative	4,970	6,751	10,130	13,506
Depreciation	552	814	1,214	1,634
Other loss (income), net	(107)	3,522	(182)	3,659
Total expenses and other income	12,101	20,941	26,479	37,041
Income from continuing operations before income taxes	6,384	2,280	11,940	4,394
Income tax expense	(1,999)	(850)	(3,788)	(1,420)
Income from continuing operations	4,385	1,430	8,152	2,974
Discontinued operations:				
Loss from discontinued operations, net of taxes	(621)	(760)	(2,253)	(760)
Loss on sale of discontinued operations, net of taxes	(7,674)		(7,674)	
Net income (loss)	\$ (3,910)	\$ 670	\$ (1,775)	\$ 2,214
Income (loss) per share Basic				
Income from continuing operations	\$ 0.12	\$ 0.04	\$ 0.22	\$ 0.08
Loss from discontinued operations	(0.02)	(0.02)	(0.06)	(0.02)
Loss on sale of discontinued operations	(0.20)		(0.21)	
Basic net income (loss) per share	\$ (0.10)	\$ 0.02	\$ (0.05)	\$ 0.06
Weighted average shares outstanding used in computing basic income (loss) per share	37,422	35,751	36,883	35,609
Income (loss) per share Diluted				
Income from continuing operations	\$ 0.12	\$ 0.04	\$ 0.22	\$ 0.08
Loss from discontinued operations	(0.02)	(0.02)	(0.06)	(0.02)
Loss on sale of discontinued operations	(0.20)		(0.21)	
Diluted net income (loss) per share	\$ (0.10)	\$ 0.02	\$ (0.05)	\$ 0.06
Weighted average shares outstanding used in computing diluted income (loss) per share	38,128	37,353	37,609	37,207
Other comprehensive income (loss):				
Net income (loss)	\$ (3,910)	\$ 670	\$ (1,775)	\$ 2,214

## Edgar Filing: INFOSPACE INC - Form 10-Q

Foreign currency translation adjustment		(17)		(188)
Unrealized gain (loss) on investments, available-for-sale, included in net income (loss)	(18)	77	11	140
Other comprehensive income	(18)	60	11	(48)
Comprehensive income (loss)	\$ (3,928)	\$ 730	\$ (1,764)	\$ 2,166

See accompanying notes to Unaudited Condensed Consolidated Financial Statements.

- 4 -

**Table of Contents****INFOSPACE, INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(amounts in thousands)

	Six months ended June 30,	
	2011	2010
Operating activities:		
Net income (loss)	\$ (1,775)	\$ 2,214
Adjustments to reconcile net income (loss) to net cash provided by operating activities of continuing operations:		
Loss from sale of discontinued operations	7,674	
Loss from discontinued operations	2,253	760
Stock-based compensation	3,371	6,070
Depreciation and amortization of intangible assets	2,827	3,477
Earn-out contingent liability adjustments	1,500	
Gain on resolution of contingent liability	(1,500)	
Deferred income taxes	(198)	
Excess tax benefits from stock-based award activity		(1,097)
Amortization of premium on investments, net	240	942
Loss on disposals of assets	5	544
Other	(20)	(7)
Cash provided (used) by changes in operating assets and liabilities:		
Accounts receivable	107	8,831
Notes and other receivables	(3,077)	60
Prepaid expenses and other current assets	586	603
Other long-term assets	(294)	285
Accounts payable	9,825	(2,956)
Accrued expenses and other current and long-term liabilities	(13,018)	(2,984)
Net cash provided by operating activities of continuing operations	8,506	16,742
Investing activities:		
Business acquisitions, net of cash acquired		(8,000)
Purchases of property and equipment	(2,209)	(977)
Other long-term assets	288	
Proceeds from the sales of assets		306
Proceeds from maturities of investments	44,767	115,460
Purchases of investments	(139,611)	(141,841)
Net cash provided by investing activities of continuing operations	(96,765)	(35,052)
Financing activities:		
Proceeds from stock option exercises and issuance of stock through employee stock purchase plan	11,869	1,840
Tax payments from shares withheld upon vesting of restricted stock units	(1,119)	(2,383)
Earn-out payments for business acquisitions	(423)	
Repayment of capital lease obligation	(221)	(291)
Excess tax benefits from stock-based award activity		1,097
Net cash provided by financing activities of continuing operations	10,106	263
Discontinued operations:		
Operating activities	(6,156)	(2,606)



# Edgar Filing: INFOSPACE INC - Form 10-Q

Investing activities	(638)	(7,966)
Net cash used by discontinued operations	(6,794)	(10,572)
Net decrease in cash and cash equivalents	(84,947)	(28,619)
Cash and cash equivalents:		
Beginning of period	155,645	83,750
End of period	\$ 70,698	\$ 55,131
Non-cash items:		
Supplemental disclosure of non-cash investing activities:		
Liabilities assumed in purchase transaction		\$ (8,231)
Supplemental disclosure of non-cash financing activities:		
Contingent earn-out consideration from acquisition		\$ (5,000)

See accompanying notes to Unaudited Condensed Consolidated Financial Statements.

- 5 -

**Table of Contents****INFOSPACE, INC.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****1. The Company and Basis of Presentation**

InfoSpace, Inc. (the *Company* or *InfoSpace*) provides search tools and technologies that assist consumers with finding information, merchants, individuals, products, and other content on the Internet. The Company uses its metasearch technology, which selects search results from several search engine content providers, to power its own branded websites and to provide search services to distribution partners. Distribution partner versions of web offerings are generally private-labeled and delivered with each distribution partner's unique requirements. Some content providers, such as Google and Yahoo!, provides InfoSpace with advertisements in addition to search content, and share the revenue earned from those advertisements, and the Company refers to those providers as search customers.

On June 22, 2011, the Company sold its Mercantila e-commerce business to Zoo Stores, Inc. Prior to the Company's disposition of its Mercantila business, the Company had two reporting segments, Core and E-commerce. As a result of the disposition of the Mercantila e-commerce business, the Company now has one reporting segment, and the operating results of the e-commerce business have been presented as discontinued operations in the accompanying unaudited Condensed Consolidated Financial Statements for all periods presented.

The Company's Chief Executive Officer, who is its chief operating decision maker, reviews financial information presented on a consolidated basis accompanied by disaggregated information for certain measures. This information is used for purposes of allocating resources and evaluating financial performance. The Company's operations are not organized into components below the consolidated unit level and operating results are not reported to the Chief Executive Officer for components below the consolidated unit level. Accordingly, the Company's management considers InfoSpace to have a single reporting segment.

The accompanying Unaudited Condensed Consolidated Financial Statements include all adjustments, consisting of normal recurring adjustments that, in the opinion of management, are necessary to present fairly the financial information set forth herein. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (*GAAP*) have been condensed under the rules and regulations of the U.S. Securities and Exchange Commission (*SEC*). Investors should read these interim Unaudited Condensed Consolidated Financial Statements and related notes in conjunction with the audited financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

Results of operations for the three and six months ended June 30, 2011 are not necessarily indicative of future financial results. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual amounts may differ, perhaps materially, from these financial estimates.

**2. Fair Value Measures**

The Company measures its investments at fair value under GAAP. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy of the Company's financial assets carried at fair value and measured on a recurring basis is as follows (amounts in thousands):

		Fair value measurements at the reporting date using		
		Quoted prices in active markets using identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	June 30, 2011			
Cash equivalents	\$ 52,039	\$ 52,039	\$	\$
Available-for-sale securities	192,704	192,704		
	\$ 244,743	\$ 244,743	\$	\$



**Table of Contents**

Cash equivalents and short-term investments classified as available-for-sale at June 30, 2011 and December 31, 2010 consisted of the following, stated at fair value (amounts in thousands):

	June 30, 2011	December 31, 2010
U.S. government securities	\$ 139,065	\$ 90,850
Corporate notes	98,540	87,902
Taxable municipal bonds	7,066	19,337
Money market funds	72	31
<b>Total cash equivalents and short-term investments available-for-sale</b>	<b>\$ 244,743</b>	<b>\$ 198,120</b>

In the six months ended June 30, 2011 and at December 31, 2010, the Company did not measure the fair value of any of its assets or liabilities other than cash equivalents and available-for-sale investments. The Company's management considers the carrying values of accounts receivable, other receivables, prepaid expenses and other current assets, accounts payable, accrued expenses and other current liabilities to approximate fair values primarily due to their short-term nature.

**3. Stock-Based Compensation**

The Company has included the following amounts for stock-based compensation expense, including the cost related to restricted stock units ( *RSUs* ), market stock units, and stock options granted under the Company's equity award plans including the Company's employee stock purchase plan, in the accompanying Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income for the three and six months ended June 30, 2011 and 2010 (amounts in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Services cost of sales	\$ 53	\$ 145	\$ 197	\$ 253
Engineering and technology	178	651	433	862
Sales and marketing	223	1,059	652	1,538
General and administrative	884	1,935	2,089	3,417
Discontinued operations	(536)	169	(159)	169
<b>Total</b>	<b>\$ 802</b>	<b>\$ 3,959</b>	<b>\$ 3,212</b>	<b>\$ 6,239</b>

The total intrinsic value and net shares issued for RSUs vested, options exercised, and shares purchased pursuant to the employee stock purchase plan during the three and six months ended June 30, 2011 and 2010 is presented below (amounts in thousands):

	Three months ended June 30, 2011		2010		Six months ended June 30, 2011		2010	
	Net shares		Net shares		Net shares		Net shares	
	\$	issued	\$	issued	\$	issued	\$	issued
RSUs vested	\$ 2,858	229	\$ 3,350	221	\$ 3,740	296	\$ 5,470	337
Options exercised	1,057	1,233	158	52	1,486	1,549	356	187
Shares purchased pursuant to ESPP			75		41	30	75	26
<b>Total</b>	<b>\$ 3,915</b>	<b>1,462</b>	<b>\$ 3,583</b>	<b>273</b>	<b>\$ 5,267</b>	<b>1,875</b>	<b>\$ 5,901</b>	<b>550</b>

- 7 -

**Table of Contents**

To determine the stock-based compensation expense that was recognized with respect to RSUs, market stock units, and stock options in the three and six months ended June 30, 2011 and 2010, the Company used the fair value at date of grant for RSUs, the Black-Scholes-Merton option-pricing model for stock option grants, and the Monte Carlo valuation method for the market stock unit grants, with the following weighted-average inputs for stock option grants and market stock unit grants:

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Stock option grants:				
Risk-free interest rate	1.06%	1.38%	1.06%	1.40%
Expected dividend yield	0%	0%	0%	0%
Expected volatility	46%	51%	47%	51%
Expected life	3.0 years	3.0 years	3.0 years	3.0 years
Market stock unit grants:				
Risk-free interest rate	0.15%		0.15%	
InfoSpace expected dividend yield	0%		0%	
iShares Russell 2000 Index expected dividend yield	1.08%		1.08%	
InfoSpace closing stock price	\$8.74		\$8.74	
iShares Russell 2000 Index closing price	\$82.29		\$82.29	
InfoSpace expected volatility	37.4%		37.4%	
iShares Russell 2000 Index expected volatility	20.3%		20.3%	
Measurement period	1.0 years		1.0 years	

**4. Net Income Per Share**

Basic net income per share is computed using the weighted average number of common shares outstanding during the period. Diluted net income per share is computed using the weighted average number of common shares outstanding plus the number of potentially dilutive shares outstanding during the period. Potentially dilutive shares consist of the incremental common shares issuable due to equity award activity by using the treasury stock method. Potentially dilutive shares are excluded from the computation of earnings per share if their effect is antidilutive. The treasury stock method calculates the dilutive effect for equity awards with an exercise price less than the average stock price during the period presented (amounts in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Weighted average common shares outstanding, basic	37,422	35,751	36,883	35,609
Dilutive equity awards	706	1,602	726	1,598
Weighted average common shares outstanding, diluted	38,128	37,353	37,609	37,207
Antidilutive equity awards excluded from dilutive share calculation	794	895	609	492
Outstanding stock options with an exercise price greater than the average price during the quarter not included in dilutive share calculation	2,919	2,482	3,063	2,402

## **Table of Contents**

### **5. Commitments and Contingencies**

The Company's contractual commitments associated with its purchase commitments and capital and operating lease obligations did not change materially from the commitments and obligations disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

#### *Litigation*

From time to time the Company is subject to various legal proceedings or claims that arise in the ordinary course of business. Although the Company cannot predict the outcome of these matters with certainty, the Company's management does not believe that the disposition of these ordinary course matters will have a material adverse effect on the Company's financial position, results of operations, or cash flows.

### **6. Income Taxes**

The Company provides income taxes for the various jurisdictions in which it operates. The income tax expense or benefit reflects the income tax effects of financial reporting income, permanent differences between financial reporting income and taxable income and the effects for the change in the valuation allowance applied to its deferred tax assets. At the end of each quarterly reporting period, the Company estimates the income, permanent differences, changes in the deferred tax assets and the related change to its valuation allowance, and the effective income tax rate that it expects for the full year.

Each quarterly reporting period, the Company applies the expected effective income tax rate to financial reporting income recorded in its financial statements on a year-to-date basis and records the change in expected income taxes as income tax expense or benefit. The Company reflects the tax effect of any tax law changes and certain other discrete events in the period in which they occur.

The expected annual effective tax rate may vary during each quarterly reporting period due to a number of factors, including any changes to the valuation allowance arising from the limitation on forecasting the reversal of deferred tax assets attributable to stock-based compensation prior to the settlement date, increases or decreases in deferred tax assets during a subsequent quarterly reporting period and expectations on realizability of deferred tax assets, enactment of tax legislation in the various jurisdictions in which the Company operates, and certain other discrete events.

As discussed in Note 8 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, the Company has a valuation allowance against substantially the full amount of its net deferred tax asset. The Company currently provides a valuation allowance against deferred tax assets when it is more likely than not that some portion, or all, of its deferred tax assets will not be realized.

The Company recorded income tax expense from continuing operations of \$2.0 million and \$3.8 million in the three and six months ended June 30, 2011, respectively. The Company recorded income tax expense from continuing operations of \$850,000 and \$1.4 million in the three and six months ended June 30, 2010, respectively. In the three and six months ended June 30, 2011, income tax expense differed from the taxes at the statutory rates primarily due to non-deductible permanent differences and relieving a valuation allowance against deferred tax assets reversing during the period.

During the six months ended June 30, 2011, there were no material changes to the unrecognized tax benefits, the total amount of unrecognized tax benefits that would affect the effective tax rate if recognized, the amount of interest and penalties recognized in connection with the unrecognized tax benefits, and the tax years that remain subject to examination. The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease within the next 12 months.

### **7. Acquisitions**

*Make The Web Better.* On April 1, 2010, the Company purchased assets consisting of web properties and licenses for content and technology from Make The Web Better, a search distribution partner and privately-held developer of online products used on social networking sites, for \$13.0 million. The purchase consideration included an initial cash payment of \$8.0 million, with an additional contingent payment depending on financial performance. At the time of the acquisition, that contingent payment was estimated at \$5.0 million. The financial performance of the operation of the Make the Web Better assets has been greater than was expected when the assets were acquired. As a consequence, the Company's estimate of the fair value of the related contingent consideration increased to \$11.5 million as of June 30, 2011 and it recorded a charge of \$1.5 million to other loss (income), net in the six months ended June 30, 2011, and recorded a charge of \$3.5 million to other loss

Edgar Filing: INFOSPACE INC - Form 10-Q

(income), net in the three and six months ended June 30, 2010.

- 9 -



**Table of Contents**

The purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair values at their date of acquisition as follows (in thousands):

License for use of developed core technology	\$ 235
Prepaid hosting services	115
Identifiable assets acquired	\$ 350
Purchase price:	
Cash paid	\$ 8,000
Contingent consideration	5,000
Purchase price	\$ 13,000
Less identifiable assets acquired	(350)
Excess of purchase price over net assets acquired, allocated to goodwill	\$ 12,650

**8. Discontinued Operations**

On June 22, 2011, the Company sold its Mercantila e-commerce business to Zoo Stores, Inc. As consideration for the acquisition of Mercantila, Zoo Stores paid InfoSpace \$250,000 upon completion of the sale, plus the Company received the right to receive additional consideration of up to \$3.0 million contingent on liquidity or other events, which the Company recorded at a fair value of zero as of June 30, 2010. Nikhil Behl, who is currently Chief Executive Officer of Mercantila, and was formerly a Named Executive Officer of InfoSpace, owns a majority interest in Zoo Stores. Mr. Behl will continue to serve as Chief Executive Officer of Mercantila and ceased to be an officer of, or otherwise affiliated with, InfoSpace upon the closing of the transaction.

The results of operations from the business are reflected in the unaudited Condensed Consolidated Financial Statements as discontinued operations for all periods presented. Revenue, loss before taxes, income tax benefit, and loss from discontinued operations, net of taxes, and loss on sale of discontinued operations, net of taxes, for the three and six months ended June 30, 2011 and 2010 are presented below (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Revenue from discontinued operations	\$ 6,915	\$ 7,039	\$ 16,894	\$ 7,039
Loss from discontinued operations before taxes	\$ (1,214)	\$ (926)	\$ (3,506)	\$ (926)
Income tax benefit	593	166	1,253	166
Loss from discontinued operations, net of taxes	\$ (621)	\$ (760)	\$ (2,253)	\$ (760)
Loss on sale of discontinued operations, net of an income tax benefit of \$5,092	\$ (7,674)	\$	\$ (7,674)	\$

Loss from discontinued operations includes previously unallocated depreciation, amortization, stock-based compensation expense, income taxes, and other corporate expenses that were attributable to the e-commerce business.

**Table of Contents**

Assets and liabilities from discontinued operations at December 31, 2010 consist of the following (in thousands):

	December 31, 2010
Accounts receivable	\$ 365
Other receivables	1,101
Prepaid expenses and other current assets	1,015
Property and equipment, net	166
Goodwill	12,413
Other intangible assets	1,101
<b>Assets of discontinued operations</b>	<b>\$ 16,161</b>
Accounts payable	\$ 4,540
Accrued expenses and other current liabilities	3,237
<b>Liabilities of discontinued operations</b>	<b>\$ 7,777</b>

**9. Reclassifications to Unaudited Condensed Consolidated Statements of Operations**

In the three months ended June 30, 2011, the Company revised the presentation of its Consolidated Statements of Operations. The operating results of the Company's recently sold Mercantile e-commerce business have been presented as discontinued operations in the accompanying unaudited Condensed Consolidated Statements of Operations for all periods presented. The Company's management now considers InfoSpace to have a single reporting segment.

The amounts in the Consolidated Statements of Operations for the year ended December 31, 2010 and each of the three months ended March 31, June 30, September 30, and December 31, 2010 and March 31, 2011 have been reclassified as follows (in thousands):

	Three months ended					Three months ended
	March 31 2010	June 30 2010	September 30 2010	December 31 2010	Year ended December 31 2010	March 31 2011
Revenues:	\$ 61,773	\$ 52,363	\$ 50,524	\$ 49,683	\$ 214,343	\$ 51,650
Cost of Sales:	43,559	29,142	28,849	28,422	129,972	31,716
Gross profit	18,214	23,221	21,675	21,261	84,371	19,934
Expenses and other income:						
Engineering and technology	1,906	2,540	2,197	1,828	8,471	1,664
Sales and marketing	6,482	7,314	7,305	7,044	28,145	6,967
General and administrative	6,755	6,751	9,213	10,124	32,843	5,160
Depreciation	820	814	804	700	3,138	662
Other loss (income), net	137	3,522	493	(19,399)	(15,247)	(75)
Total expenses and other income	16,100	20,941	20,012	297	57,350	14,378
Income from continuing operations before income taxes	2,114	2,280	1,663	20,964	27,021	5,556
Income tax expense	(570)	(850)	(81)	(7,224)	(8,725)	(1,789)
Income from continuing operations	1,544	1,430	1,582	13,740	18,296	3,767

# Edgar Filing: INFOSPACE INC - Form 10-Q

Discontinued operations:

Loss from discontinued operations, net of taxes	(760)	(1,684)	(2,149)	(4,593)	(1,632)
---	-------	---------	---------	---------	---------

Net income (loss)	1,544	670	(102)	11,591	13,703	2,135
-------------------	-------	-----	-------	--------	--------	-------

- 11 -

**Table of Contents**

**10. Recent Accounting Pronouncements**

In June 2011, the Financial Accounting Standards Board issued Accounting Standards Update ( ASU ) No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. ASU 2011-05 will require companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. It eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The standard does not change the items which must be reported in other comprehensive income, how such items are measured, or when they must be reclassified to net income. This standard is effective for the Company as of January 1, 2012. Because this ASU impacts presentation only, it will have no effect on the Company's financial condition, results of operations or cash flows.

- 12 -

## **Table of Contents**

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

*This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties. The statements in this report that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements include, but are not limited to: statements regarding projections of our future financial performance; trends in our businesses; our future business plans and growth strategy, including our plans to expand, develop, or acquire particular operations, businesses, or assets; and the sufficiency of our cash balances and cash generated from operating, investing, and financing activities for our future liquidity and capital resource needs.*

*Forward-looking statements are subject to known and unknown risks, uncertainties, and other factors that may cause our results, levels of activity, performance, achievements, prospects, and other characterizations of future events or circumstances, to be materially different from those expressed or implied by such forward-looking statements. These risks, uncertainties, and other factors include, among others, those identified under Part II, Item 1A, Risk Factors and elsewhere in this report. You should not rely on forward-looking statements included herein, which speak only as of the date of this Quarterly Report on Form 10-Q or the date specified herein. We do not undertake any obligation to update publicly any forward-looking statement to reflect new information, events, or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect the occurrence of unanticipated events.*

#### **Overview**

InfoSpace's revenues are primarily generated by our search business. Using our metasearch technology and relationships with major search content providers, we offer web search products both directly to consumers and through our network of distribution partners. Our metasearch technology selects search results from several search engine content providers, including Google, Yahoo!, and Bing, among others, and aggregates, filters, and prioritizes the results. This combination provides a more relevant search results page and utilizes the investments made by our search customers to continually improve the user experience. Revenues from our search business are primarily generated when end users of our services click on paid search results from our own branded websites or those of our distribution partners. These paid search results are provided to us by some of our search content providers, primarily Google and Yahoo!, who share the revenue generated by those paid clicks with us. We refer to those providers as our search customers.

We offer search services directly to consumers through our owned and operated web properties, such as *Dogpile.com*, *WebCrawler.com*, *MetaCrawler.com*, and *WebFetch.com*, which collectively receive millions of unique visitors each month. We use the term "properties" to refer to the methods in which end users access our search services, which typically are websites and downloadable applications belonging to us or our distribution partners. In addition, we provide search services through the web properties of distribution partners. Partner versions of our web offerings are generally private-labeled and delivered with each distribution partner's unique requirements.

We generate revenue when an end user of our services clicks on a paid search link provided by a search customer and displayed on one of our owned and operated web properties or displayed on a distribution partner's web property. The search customer that provided the paid search link receives a fee from the advertiser who paid for the click and the search customer pays us a portion of that fee. If the click originated from one of our distribution partners' web properties, we share a portion of the fee we receive with such partner. Revenue is recognized in the period in which such paid clicks occur and is based on the amounts earned and remitted to us by our search customers for such clicks. Revenues from Google and Yahoo! jointly account for over 95% of our total revenues for the three months ended June 30 in both 2011 and 2010.

Revenues from our search business increased to \$54.3 million for the three months ended June 30, 2011 from \$52.4 million for the three months ended June 30, 2010. This increase was driven primarily by an increase in the revenues from our distribution partners, which increased to \$42.5 million for the three months ended June 30, 2011 from \$32.7 million for the three months ended June 30, 2010. The increase in distribution partner revenue is due in part to increased revenue generated by existing distribution partners (launched during the relevant prior year), which increased by \$8.7 million for the three months ended June 30, 2011 as compared to the same period in 2010. Additionally, revenue from new distribution partners (launched during the current year) increased by \$1.1 million for the three months ended June 30, 2011 as compared to the same period in 2010.

In recent periods, we experienced an overall decline in revenue generated through our owned and operated properties. This trend is a result of fewer retained users on our owned and operated metasearch engine sites and, therefore, fewer paid clicks from these sites. The impact of this trend is partially offset by higher fees earned from our search customers for each of these paid clicks. Our ability to maintain revenue in our metasearch engine sites relies in part on our ability to attract end users to these properties and retain them by providing a satisfying search experience. Revenue from our metasearch engine sites (such as *Dogpile.com*) accounted for 60% of overall owned and operated revenue (excluding revenue from the *Make The Web*



## **Table of Contents**

*Better purchased assets discussed below*) for the three months ended June 30, 2011 and 56% for the three months ended June 30, 2010. The remainder of our owned and operated revenue is generated through our online direct marketing initiatives, which attract users to our owned and operated sites via targeted online advertisements. The success of our online direct marketing initiatives depends on our ability to execute to an expected return on our online direct marketing expenditures. In recent periods, revenue generated through our online direct marketing initiatives has declined, further contributing to the overall negative trend in revenue generated by our owned and operated properties. Revenue from our online direct marketing initiatives accounted for 40% of owned and operated revenue (*excluding revenue from the Make The Web Better purchased assets*) for the three months ended June 31, 2011 and 44% for the three months ended June 30, 2010.

On April 1, 2010, we purchased assets consisting of web properties and licenses for content and technology from Make The Web Better, a former search distribution partner. After this purchase, revenue from the Make The Web Better assets were included in our owned and operated revenues and contributed \$2.2 million (or 19%) to our search revenue generated through our owned and operated properties for the three months ended June 30, 2011. As we anticipated, the revenue generated by the operation of the acquired Make The Web Better assets has steadily declined since we acquired them. We expect that, as the end-user base of those assets continues to decrease, the revenue generated will decline by approximately 25% in each quarter when compared to the prior quarter, and will be between \$7 million and \$8 million for 2011.

On June 22, 2011, we sold our Mercantila e-commerce business to Zoo Stores, Inc. after our management determined that the long-term prospects for the financial performance of Mercantila were not meeting InfoSpace's expectations and that retaining the Mercantila business did not fit within InfoSpace's strategy. As consideration for the acquisition of Mercantila, Zoo Stores paid us \$250,000 upon completion of the sale and the right to receive additional consideration of up to \$3.0 million contingent on liquidity or other events. The results of operations from the Mercantila business are reflected as discontinued operations for all periods presented in this Quarterly Report on Form 10-Q.

The Company is currently focused on the following areas: improving the search services offered to our distribution partners and through our owned and operated properties, maintaining our current distribution partners and adding new distribution partners, and seeking opportunities to use our resources to acquire and integrate new businesses and assets. Within the Company, engineering, operations, and product management personnel remain paramount to our ability to deliver high quality search services, enhance our current technology, and increase our distribution network. The Company has shifted much of the incentive compensation for these personnel to cash-based incentives from stock-based incentives, and this change is reflected in a decline in stock-based compensation expenses. The extent to which this decline is offset by an increase in cash-based incentive compensation expenses in future periods is unknown and depends on Company performance and hiring trends. Additionally, we seek to use our cash and short-term available-for-sale investments to acquire businesses and other assets, including businesses that may not be related to search.

**Table of Contents****Overview of Second Quarter 2011 Operating Results**

The following is an overview of our operating results for the three months ended June 30, 2011 compared to the three months ended June 30, 2010. A more detailed discussion of our operating results, comparing our operating results for the three and six months ended June 30, 2011 and 2010, is included under the heading **Results of Operations for the Three and Six Months Ended June 30, 2011 and 2010** in this Management's Discussion and Analysis of Financial Condition and Results of Operations.

Several of our key operating financial measures for the three months ended June 30, 2011 and 2010 in total dollars (in thousands) and as a percentage of associated revenue are presented below.

	<b>Three months ended June 30,</b>			
	<b>2011</b>		<b>2010</b>	
Revenues	\$ 54,292		\$ 52,363	
		<b>% of</b>		<b>% of</b>
		<b>revenues</b>		<b>revenues</b>
Gross profit	\$ 18,485	34.0%	\$ 23,221	44.3%
Income from continuing operations	\$ 4,385	8.1%	\$ 1,430	2.7%
Net income (loss)	\$ (3,910)	(7.2)%	\$ 670	1.3%
Adjusted EBITDA <sup>(1)</sup>	\$ 8,991	16.6%	\$ 11,306	21.6%
Search Revenue:				
Revenue from distribution partners	\$ 42,462	78%	\$ 32,663	62%
Revenue from existing distribution partners (launched prior to the then-current year)	\$ 40,903	75%	\$ 32,228	62%
Revenue from new distribution partners (launched during the then-current year)	\$ 1,332	2%	\$ 253	0%
Revenue from owned and operated properties	\$ 11,721	22%	\$ 18,503	35%
Revenue from online direct marketing initiatives on owned and operated web properties	\$ 3,821	7%	\$ 4,888	9%
Revenue from Make The Web Better owned and operated	\$ 2,198	4%	\$ 7,411	14%
Revenue from metasearch properties	\$ 5,702	11%	\$ 6,204	12%

<sup>(1)</sup> Adjusted EBITDA is a non-GAAP measure, defined below in **Non-GAAP Financial Measures**.

Search revenue excludes revenue from early-stage business initiatives, which is *de minimis* for the three months ended June 30, 2011. The increase in revenues for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010 was primarily due to an increase in revenue generated through the web properties of our distribution partners, partially offset by a decrease in revenue generated through our owned and operated properties. We generated 46% and 33% of our search revenue through our top five distribution partners for the three months ended June 30, 2011 and 2010, respectively. The web properties of our top five distribution partners for the three months ended June 30, 2011 generated 29% of our search revenue for the three months ended June 30, 2010.

The decrease in gross profit as a percent of search revenue, for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010, was primarily due to an increase in revenue generated through the web properties of our distribution partners, with whom we share our search revenue, and a decrease in revenue generated through our owned and operated properties.

The decrease in operating expenses was primarily due to decreases in stock-based compensation of \$2.4 million, advertising expense associated with our owned and operated properties of \$932,000, and general and administrative professional service fees, including legal fees, of \$865,000.



**Table of Contents****Results of Operations for the Three and Six Months Ended June 30, 2011 and 2010**

**Revenues.** Revenues for the three and six months ended June 30, 2011 and 2010 are presented below (amounts in thousands):

	<b>Three months ended June 30,</b>		<b>Change from</b>	<b>Six months ended June 30,</b>		<b>Change from</b>
	<b>2011</b>	<b>2010</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>	<b>2010</b>
Revenues	\$ 54,292	\$ 52,363	\$ 1,929	\$ 105,942	\$ 114,136	\$ (8,194)

The increase in revenues for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010 is due to an increase in revenue generated through the web properties of our distribution partners. Revenue from existing distribution partners (launched prior to the then-current year) increased for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010 by \$8.7 million. Additionally, revenue from new distribution partners (launched during the then-current year) increased by \$1.1 million for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010.

The decrease of \$6.8 million in revenue generated by our owned and operated properties for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010 was primarily due to decrease of \$5.2 million in revenue generated by the operation of the acquired Make The Web Better assets and a decrease in revenue of \$1.1 million from our online direct marketing initiatives. Also, we continue to experience an overall decline in revenue generated through our owned and operated metasearch engine sites, excluding the revenue from the Make The Web Better purchased assets. This trend is a result of fewer retained users on our metasearch engine sites and, therefore, fewer paid clicks from these sites.

For the three months ended June 30, 2011, 78% of our search revenue was generated through our search distribution partners' web properties, compared to 64% of our search revenue generated through our search distribution partners' web properties in the three months ended June 30, 2010.

The decrease in revenues for the six months ended June 30, 2011 as compared to the six months ended June 30, 2010 is due to a decrease in revenue generated by our owned and operated properties of \$4.2 million, a decrease in revenue from our non-search initiatives of \$2.8 million (due to closing down our Hagggle operations in 2010), and a decrease in revenues from our distribution partners of \$1.2 million. Revenue from existing distribution partners (launched prior to the then-current year) decreased for the six months ended June 30, 2011 as compared to the six months ended June 30, 2010 by \$1.3 million, primarily due to a decline of \$9.4 million from distribution partner Make The Web Better as we acquired its search revenue generating assets on April 1, 2010.

The decrease of \$4.2 million in revenue generated by our owned and operated properties for the six months ended June 30, 2011 as compared to the six months ended June 30, 2010 was primarily due to decrease of \$2.5 million in revenue generated by the operation of the acquired Make The Web Better assets and an overall decline in revenue generated through our other owned and operated metasearch engine sites.

For the six months ended June 30, 2011, 76% of our search revenue was generated through our search distribution partners' web properties, compared to 73% of our search revenue generated through our search distribution partners' web properties in the six months ended June 30, 2010.

During the first half of 2010, we discontinued the syndication of our search results to certain distribution partners who we deemed to be delivering low quality clicks. Those discontinuations had a material negative impact on our revenues for the first half of 2010. We expect that search revenue from searches conducted by end users on sites of our distribution partners will continue to represent a significant proportion of our search revenue for the foreseeable future.

***Seasonality***

Our owned and operated metasearch services are affected by seasonal fluctuations in Internet usage, which generally declines in the summer months.

**Table of Contents**

**Cost of sales.** Cost of sales consists of costs related to revenue sharing arrangements with our distribution partners, certain costs associated with the operation of the data centers that serve our search business, including depreciation, personnel expenses (which include salaries, benefits and other employee related costs, and stock-based compensation expense), amortization of certain intangible assets, usage-based content fees, and bandwidth costs. Cost of sales in total dollars (in thousands) and as a percentage of associated and total revenues for the three and six months ended June 30, 2011 and 2010 are presented below:

	Three months ended June 30,		Change from	Six months ended June 30,		Change from
	2011	2010	2010	2011	2010	2010
Cost of sales	\$ 35,807	\$ 29,142	\$ 6,665	\$ 67,523	\$ 72,701	\$ (5,178)
Percentage of revenues	66.0%	55.7%		63.7%	63.7%	

The dollar increase in cost of sales for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010 is primarily due to the increase in revenue sharing expenses related to increases in revenue generated through the web properties of our distribution partners. The cost of sales for the sixth months ended June 30, 2011 as compared to the sixth months ended June 30, 2010 did not materially vary because the increase in revenue sharing expenses related to increases in revenue generated through the web properties of our distribution partners was offset by the effect of no longer paying distribution expense for revenue generated by Make The Web Better's assets after we acquired them on April 1, 2010.

Our content and distribution expenses consist principally of costs related to revenue sharing arrangements with our content and distribution partners, as well as content and data licenses. For the three months ended June 30, 2011 as compared to the three months ended June 30, 2010, content and distribution expenses increased by \$8.1 million, primarily due to the increase in revenue sharing expenses related to increases in revenue generated through the web properties of our distribution partners. For the sixth months ended June 30, 2011 as compared to the sixth months ended June 30, 2010, content and distribution expenses decreased by \$2.0 million, primarily due to the increases in revenue generated through the web properties of our distribution partners being more than offset by the effect of no longer paying distribution expense for revenue generated by Make The Web Better's assets as of April 1, 2010.

We anticipate that revenue sharing expenses paid to our distribution partners will increase in dollars if revenue increases through growth in existing arrangements with our distribution partners or we add new distribution partners. If search revenue generated through our distribution partners' web properties increases at a greater rate than revenue generated through our owned and operated web properties, revenue sharing expenses with our distribution partners as a percentage of revenues will increase. As a result of our acquisition of assets from Make The Web Better in April 2010, we experienced a decrease in cost of sales as a percentage of revenues, and a corresponding increase in our gross profit percentage on our revenues. That effect has been declining as expected as the revenue has declined from the Make The Web Better assets. We expect that revenue from searches conducted by end users on sites of our distribution partners will continue to be a significant portion of our search revenue.

**Engineering and technology expenses.** Engineering and technology expenses are associated with the research, development, support, and ongoing enhancements of our offerings, including personnel expenses (which include salaries, stock-based compensation expense, and benefits and other employee related costs), costs for temporary help and contractors to augment our staffing, software support and maintenance, and professional service fees. Engineering and technology expenses in total dollars (in thousands) and as a percentage of total revenues for the three months ended June 30, 2011 and 2010 are presented below:

	Three months ended June 30,		Change from	Six months ended June 30,		Change from
	2011	2010	2010	2011	2010	2010
Engineering and technology expenses	\$ 1,784	\$ 2,540	\$ (756)	\$ 3,448	\$ 4,446	\$ (998)
Percentage of revenues	3.3%	4.9%		3.3%	3.9%	

The dollar decrease for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010 was primarily attributable to a decrease in stock-based compensation expense of \$473,000.

The dollar decrease for the six months ended June 30, 2011 as compared to the six months ended June 30, 2010 was primarily attributable to a decrease in stock-based compensation expense of \$429,000 and a decrease in personnel-related expenses, not including stock-based compensation expense and including costs for temporary help and contractors to augment our staffing, of \$398,000, primarily due to an increase in capitalizing internal software development costs.



**Table of Contents**

**Sales and Marketing Expenses.** Sales and marketing expenses consist principally of personnel costs (which include salaries, stock-based compensation expense, and benefits and other employee related costs), the cost of temporary help and contractors to augment our staffing, and marketing expenses associated with our owned and operated websites (which consist of agency fees, brand promotion expense, market research expense, and online direct marketing expense associated with traffic acquisition, including fees paid to search engines). Sales and marketing expenses in total dollars (in thousands) and as a percentage of total revenues for the three months ended June 30, 2011 and 2010 are presented below:

	Three months ended June 30,		Change from	Six months ended June 30,		Change from
	2011	2010	2010	2011	2010	2010
Sales and marketing expenses	\$ 4,902	\$ 7,314	\$ (2,412)	\$ 11,869	\$ 13,796	\$ (1,927)
Percentage of revenues	9.0%	14.0%		11.2%	12.1%	

The dollar decrease for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010 was primarily attributable to a decrease of \$932,000 in advertising expense associated with our owned and operated properties, an decrease in personnel-related costs, not including stock-based compensation expense and including costs for temporary help and contractors to augment our staffing, of \$605,000, and a decrease in stock-based compensation expense of \$836,000.

The dollar decrease for the six months ended June 30, 2011 as compared to the six months ended June 30, 2010 was primarily attributable to a decrease in personnel-related costs, not including stock-based compensation expense and including costs for temporary help and contractors to augment our staffing, of \$809,000, and a decrease in stock-based compensation expense of \$885,000.

We expect to continue to invest in marketing initiatives to promote new services that result from our development initiatives, some of which may not be related to online search, and search services on our branded web properties.

**General and Administrative Expenses.** General and administrative expenses consist primarily of personnel expenses (which include salaries, stock-based compensation expense, and benefits and other employee related costs), professional service fees (which include legal, audit, and tax fees), general business development and management expenses, occupancy and general office expenses, taxes, insurance expenses, and certain legal settlements. General and administrative expenses in total dollars (in thousands) and as a percentage of total revenues for the three months ended June 30, 2011 and 2010 are presented below:

	Three months ended June 30,		Change from	Six months ended June 30,		Change from
	2011	2010	2010	2011	2010	2010
General and administrative expenses	\$ 4,970	\$ 6,751	\$ (1,781)	\$ 10,130	\$ 13,506	\$ (3,376)
Percentage of revenues	9.2%	12.9%		9.6%	11.8%	

The dollar increase for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010 was primarily attributable to decreases in stock-based compensation expense of \$1.1 million, legal fees of \$446,000, and professional service fees of \$419,000. These decreases were partially offset by increases in employee separation costs of \$387,000.

The dollar increase for the six months ended June 30, 2011 as compared to the six months ended June 30, 2010 was primarily attributable to decreases in stock-based compensation expense of \$1.3 million, legal fees of \$1.6 million, and professional service fees of \$370,000. These decreases were partially offset by increases in personnel-related costs, not including stock-based compensation expense and including costs for temporary help and contractors to augment our staffing, not including stock-based compensation expense, of \$331,000.

**Depreciation.** Depreciation of property and equipment includes depreciation of computers, software, office equipment and fixtures, and leasehold improvements that is not reclassified into cost of sales.

	Three months ended June 30,		Change from	Six months ended June 30,		Change from
	2011	2010	2010	2011	2010	2010

## Edgar Filing: INFOSPACE INC - Form 10-Q

Depreciation expense	\$ 552	\$ 814	\$ (262)	\$ 1,214	\$ 1,634	\$ (420)
----------------------	--------	--------	----------	----------	----------	----------

The only material variance in depreciation expense for the periods presented above was a decrease in the depreciation of capitalized internal software development costs for the six months ended June 30, 2011 compared to the six months ended June 30, 2010 of \$328,000.

- 18 -

**Table of Contents**

**Other Loss (Income), Net.** Other income (loss), net for the three months ended June 30, 2011 and 2010 are presented below (in thousands):

	Three months ended June 30,		Change from	Six months ended June 30,		Change from
	2011	2010	2010	2011	2010	2010
Increase in fair value of earn-out contingent liability	\$	\$ 3,500	\$ (3,500)	\$ 1,500	\$ 3,500	\$ (2,000)
Gain on contingency resolution				(1,500)		(1,500)
Interest income	(99)	(95)	(4)	(190)	(160)	(30)
Foreign currency exchange loss	16	32	(16)	7	3	4
Loss on disposal of fixed assets	5	72	(67)	5	296	(291)
Other	(29)	13	(42)	(4)	20	(24)
Other loss (income), net	\$ (107)	\$ 3,522	\$ (3,629)	\$ (182)	\$ 3,659	\$ (3,841)

The expense related to the increase in fair value of earn-out contingent liability for the periods presented above was to adjust the estimated contingent payments to be made related to our acquisition of the Make The Web Better assets and a gain of \$1.5 million related to the resolution of a contingent liability recorded in the six months ended June 30, 2011.

**Income Tax Expense.** We recorded income tax expense from continuing operations of \$2.0 million and \$3.8 million in the three and six months ended June 30, 2011 respectively. We recorded income tax expense from continuing operations of \$850,000 and \$1.4 million in the three and six months ended June 30, 2010 respectively. In the three and six months ended June 30, 2011, income tax expense differed from the taxes at the statutory rates primarily due to non-deductible permanent differences and the reversal of a valuation allowance against deferred tax assets reversing during the period.

**Loss from Discontinued Operations and Loss on Sale of Discontinued operations.**

On June 22, 2011, we sold our Mercantila e-commerce business to Zoo Stores, Inc. As consideration for the acquisition of Mercantila, Zoo Stores paid us \$250,000 upon completion of the sale, plus we received the right to receive additional consideration of up to \$3.0 million contingent on liquidity or other events, which we recorded at a fair value of zero as of June 30, 2010. We recorded a loss of \$7.7 million upon the sale of our Mercantila business, net of a \$5.1 million income tax benefit. Nikhil Behl, who is currently Chief Executive Officer of Mercantila, and was formerly a Named Executive Officer of InfoSpace, owns a majority interest in Zoo Stores. Mr. Behl will continue to serve as Chief Executive Officer of Mercantila and ceased to be an officer of, or otherwise affiliated with, InfoSpace upon the closing of the transaction.

The results of operations from the business are reflected as discontinued operations for all periods presented. Revenue, loss before taxes, income tax benefit, and loss from discontinued operations, net of taxes for the three and six months ended June 30, 2011 and 2010 are presented below (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Revenue from discontinued operations	\$ 6,915	\$ 7,039	\$ 16,894	\$ 7,039
Loss from discontinued operations before taxes	\$ (1,214)	\$ (926)	\$ (3,506)	\$ (926)
Income tax benefit	593	166	1,253	166
Loss from discontinued operations, net of taxes	\$ (621)	\$ (760)	\$ (2,253)	\$ (760)
Loss on sale of discontinued operations, net of an income tax benefit of \$5,092	\$ (7,674)	\$	\$ (7,674)	\$

**Non-GAAP Financial Measures**

## Edgar Filing: INFOSPACE INC - Form 10-Q

We define Adjusted EBITDA as net income (loss), determined in accordance with GAAP, excluding the effects of discontinued operations (including loss from discontinued operations, net of taxes, and loss on sale of discontinued operations, net of taxes), income taxes, depreciation, amortization of intangible assets, stock-based compensation expense, and other loss (income), net (which includes such items as adjustments to the fair values of contingent liabilities related to business combinations, gains on resolution of contingencies, interest income, foreign currency gains or losses, and gains or losses from the disposal of assets).

- 19 -

## Table of Contents

We believe that Adjusted EBITDA provides meaningful supplemental information regarding InfoSpace's performance by excluding certain expenses and gains that we believe are not indicative of our operating results. We use this non-GAAP financial measure for internal management purposes, when publicly providing guidance on possible future results, and as a means to evaluate period-to-period comparisons. We believe that Adjusted EBITDA is a common measure used by investors and analysts to evaluate our performance, that it provides a more complete understanding of the results of operations and trends affecting our business when viewed together with GAAP results, and that management and investors benefit from referring to this non-GAAP financial measure. Items excluded from Adjusted EBITDA are significant and necessary components to the operations of our business, and, therefore, Adjusted EBITDA should be considered as a supplement to, and not as a substitute for or superior to, GAAP net income. Other companies may calculate Adjusted EBITDA differently, and therefore our Adjusted EBITDA may not be comparable to similarly titled measures of other companies. A reconciliation of our Adjusted EBITDA to net income, which we believe to be the most comparable GAAP measure, is presented for the three and six months ended June 30, 2011 and 2010 below (amounts in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Net income (loss)	\$ (3,910)	\$ 670	\$ (1,775)	\$ 2,214
Discontinued operations	8,295	760	9,927	760
Depreciation and amortization of intangible assets	1,376	1,714	2,827	3,477
Stock-based compensation	1,338	3,790	3,371	6,070
Other loss (income), net	(107)	3,522	(182)	3,659
Income tax expense	1,999	850	3,788	1,420
Adjusted EBITDA	\$ 8,991	\$ 11,306	\$ 17,956	\$ 17,600

A reconciliation of our Adjusted EBITDA to net income (loss), for the year ended December 31, 2010 and each of the three months ended March 31, June 30, September 30, and December 31, 2010 and March 31, 2011 and are presented below (amounts in thousands):

	Three months ended					Three months ended
	March 31 2010	June 30 2010	September 30 2010	December 31 2010	Year ended December 31 2010	ended March 31 2011
Net income (loss)	\$ 1,544	\$ 670	\$ (102)	\$ 11,591	\$ 13,703	\$ 2,135
Discontinued operations		760	1,684	2,149	4,593	1,632
Depreciation and amortization of intangible assets	1,763	1,714	1,735	1,558	6,770	1,451
Stock-based compensation	2,280	3,790	2,708	5,140	13,918	2,033
Other loss (income), net	137	3,522	493	(19,399)	(15,247)	(75)
Income tax expense	570	850	81	7,224	8,725	1,789
Adjusted EBITDA	\$ 6,294	\$ 11,306	\$ 6,599	\$ 8,263	\$ 32,462	\$ 8,965

We define non-GAAP income from continuing operations as income from continuing operations, determined in accordance with GAAP, excluding the effect of non-cash income taxes. Non-cash income tax expense represents a reduction to cash taxes payable associated with the utilization of deferred tax assets, which are primarily comprised of U.S. federal net operating losses.



**Table of Contents**

We believe that excluding the non-cash portion of income tax expense from our GAAP income from continuing operations provides meaningful supplemental information to investors and analysts regarding our performance and the valuation of our business because of our ability to offset a substantial portion of our cash tax liabilities by using these deferred tax assets. The majority of these deferred tax assets will expire if unutilized in 2020. Non-GAAP net income should be evaluated in light of our financial results prepared in accordance with GAAP, and should be considered as a supplement to, and not as a substitute for or superior to, GAAP income from continuing operations. A reconciliation of our non-GAAP income from continuing operations to income from continuing operations, which we believe to be the most comparable GAAP measure, is presented for the three months ended June 30, 2011 and 2010 below (amounts in thousands):

	<b>Three months ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Net income (loss)	\$ (3,910)	\$ 670	\$ (1,775)	2,214
Discontinued operations	8,295	760	9,927	760
Income from continuing operations	4,385	1,430	8,152	2,974
Non-cash income tax expense from continuing operations	1,862	774	3,532	1,283
Non-GAAP net income	6,247	2,204	11,684	4,257
Income from continuing operations diluted	\$ 0.12	\$ 0.04	\$ 0.22	\$ 0.08
Non-cash income taxes per share diluted	0.04	0.02	0.09	0.03
Non-GAAP income per share diluted	\$ 0.16	\$ 0.06	\$ 0.31	\$ 0.11

A reconciliation of our non-GAAP income from continuing operations to income from continuing operations, for the year ended December 31, 2010 and each of the three months ended March 31, June 30, September 30, and December 31, 2010 and March 31, 2011 and are presented below (amounts in thousands):

	<b>Three months ended</b>					<b>Three months ended</b>
	<b>March 31 2010</b>	<b>June 30 2010</b>	<b>September 30 2010</b>	<b>December 31 2010</b>	<b>Year ended December 31 2010</b>	<b>March 31 2011</b>
Net income (loss)	\$ 1,544	\$ 670	\$ (102)	\$ 11,591	\$ 13,703	\$ 2,135
Discontinued operations		760	1,684	2,149	4,593	1,632
Income from continuing operations	1,544	1,430	1,582	13,740	18,296	3,767
Non-cash income tax expense from continuing operations	509	774	167	7,079	8,529	1,670
Non-GAAP net income	\$ 2,053	\$ 2,204	\$ 1,749	\$ 20,819	\$ 26,825	\$ 5,437
Income from continuing operations per share diluted	\$ 0.04	\$ 0.04	\$ 0.04	\$ 0.37	\$ 0.50	\$ 0.10
Non-cash income per share diluted	0.02	0.02	0.01	0.19	0.23	0.05
Non-GAAP net income per share diluted	\$ 0.06	\$ 0.06	\$ 0.05	\$ 0.56	\$ 0.73	\$ 0.15

For our non-GAAP measures Adjusted EBITDA and Non-GAAP net income, amounts previously disclosed have been revised to reflect the effect of classifying our Mercantila e-commerce business as discontinued operations.

**Liquidity and Capital Resources**

## Edgar Filing: INFOSPACE INC - Form 10-Q

### *Cash, Cash Equivalents, and Short-Term Investments*

Our principal source of liquidity is our cash and cash equivalents and short-term investments. As of June 30, 2011, we had cash and marketable investments of \$263.4 million, consisting of cash and cash equivalents of \$70.7 million and available-for-sale short-term investments of \$192.7 million. We generally invest our excess cash in high quality marketable investments. These investments include securities issued by U.S. government agencies, commercial paper, certificates of deposit, money market funds, and taxable municipal bonds. All of our financial instrument investments held at June 30, 2011 have minimal default risk and short-term maturities.

We plan to use our cash to fund operations, develop technology, advertise, market and distribute our services, and continue the enhancement of our network infrastructure. An important component of our strategy for future growth is to acquire technologies and businesses, and we plan to use our cash to acquire and integrate acceptable targets that we may identify. These targets may include businesses, products, or technologies unrelated to search. We may use a portion of our cash for special dividends or for common stock repurchases.

We believe that existing cash and cash equivalents, short-term investments, and cash generated from operations will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next 12 months. However, the underlying levels of revenues and expenses that we project may not prove to be accurate. In addition, we evaluate acquisitions of businesses, products, or technologies from time to time. Any such transactions, if completed, may use

**Table of Contents**

a significant portion of our cash balances and marketable investments. If we are unable to liquidate our investments when we need liquidity for acquisitions or business purposes, we may need to change or postpone such acquisitions or business purposes or find alternative financing for such acquisitions or business purposes, if available. We may seek additional funding through public or private financings or other arrangements prior to such time. Our ability to raise funds may be adversely affected by a number of factors, including factors beyond our control, such as economic conditions in markets in which we operate and from which we generate revenues, and increased uncertainty in the financial, capital, and credit markets. Adequate funds may not be available when needed or may not be available on favorable terms. If we raise additional funds by issuing equity securities, dilution to existing stockholders may result. If funding is insufficient at any time in the future, we may be unable, or delayed in our ability, to develop or enhance our services, take advantage of business opportunities, or respond to competitive pressures, any of which could harm our business.

*Contractual Obligations and Commitments*

Our obligations under capital and operating lease agreements and other purchase commitments have not changed materially from those commitments disclosed in *Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources* in Part II, Item 7, of our Annual Report on Form 10-K for the year ended December 31, 2010.

*Cash Flows*

Our net cash flows were comprised of the following for the six months ended June 30, 2011 and 2010 (amounts in thousands):

	Six months ended June 30,	
	2011	2010
Net cash provided by operating activities	\$ 8,506	\$ 16,742
Net cash used by investing activities	(96,765)	(35,052)
Net cash provided by financing activities	10,106	263
Net cash used by discontinued operations	(6,794)	(10,572)
Net decrease in cash and cash equivalents	\$ (84,947)	\$ (28,619)

**Net cash provided by operating activities.** Net cash provided by operating activities consists of net income offset by certain adjustments not affecting current period cash flows and the effect of changes in our operating assets and liabilities.

Net cash provided by operating activities was \$8.5 million for the six months ended June 30, 2011, consisting of our net loss of \$1.8 million, non-cash charges of \$17.9 million (primarily consisting of a loss on discontinued operations and the loss on the sale of discontinued operations, stock-based compensation expense, depreciation and amortization of intangible assets, and earn-out contingent liability adjustments), and changes in our operating assets and liabilities of \$10.5 million (primarily consisting of increases in accounts payable, and a decrease in prepaid expenses and other current assets). These increases were offset by cash provided by changes in our operating assets and liabilities of \$16.4 million (primarily consisting of decreases in accrued expenses and other current and long-term liabilities and increases in other receivables) and a gain on the resolution of a contingency of \$1.5 million.

Net cash provided by operating activities was \$16.7 million for the six months ended June 30, 2010, consisting of our net income of \$2.2 million, non-cash charges of \$11.8 million (primarily consisting of stock-based compensation expense, depreciation and amortization of intangible assets, amortization of premium on investments, a loss on discontinued operations, and loss on disposal of assets), and changes in our operating assets and liabilities of \$9.8 million (primarily consisting of decreases in accounts receivable and prepaid expenses and other current assets). These increases were partially offset by cash used by changes in our operating assets and liabilities of \$5.9 million (consisting of decreases in accounts payable and accrued expenses and other current and long-term liabilities) and presentation of the tax benefit from stock-based award activity in financing activities of \$1.1 million.

**Net cash used by investing activities.** Net cash used by investing activities primarily consists of transactions related to our marketable investments, the business acquisitions, and purchases of property and equipment.

Net cash used by investing activities was \$96.8 million for the six months ended June 30, 2011, primarily consisting of purchases of \$139.6 million of marketable investments and purchases of property and equipment of \$2.2 million. Partially offsetting cash used by investing activities

## Edgar Filing: INFOSPACE INC - Form 10-Q

were proceeds of \$44.8 million from the maturities of our marketable investments.

Net cash used by investing activities was \$35.1 million for the six months ended June 30, 2010, primarily consisting of purchases of \$141.8 million of marketable investments, \$8.0 million for the acquisition of Make The Web Better assets, and purchases of property and equipment of \$977,000. Partially offsetting cash used by investing activities were proceeds of \$115.5 million from the maturities of our marketable investments.

- 22 -

## **Table of Contents**

**Net cash provided by financing activities.** Net cash provided by financing activities consists of proceeds from the issuance of stock through the exercise of stock options and our employee stock purchase plan, tax payments from shares withheld upon vesting of restricted stock units, repayments of capital lease obligations, excess tax benefits generated by stock-based award activity and earn-out payments for business acquisitions.

Net cash provided by financing activities totaled \$10.1 million for the six months ended June 30, 2011 and primarily consisted of cash proceeds of \$11.9 million from the exercise of options and our employee stock purchase plan. Partially offsetting cash provided by financing activities was \$1.1 million in tax payments from shares withheld upon vesting of restricted stock units and \$423,000 in earn-out payments from business acquisitions.

Net cash provided by financing activities totaled \$263,000 for the six months ended June 30, 2010 and primarily consisted of cash proceeds of \$1.8 million from the exercise of options and our employee stock purchase plan and tax benefits of \$1.1 million generated by stock-based award activity. Partially offsetting cash provided by financing activities was \$2.4 million in tax payments from shares withheld upon vesting of restricted stock units.

**Net cash used by discontinued operations.** Net cash used by discontinued operations consists of cash used in operating the Mercantila e-commerce business and the cash used in investing activities primarily related to the purchase and sale of the Mercantila e-commerce business.

Net cash used by operating activities attributable to discontinued operations totaled \$6.2 million for the six months ended June 30, 2011 and consisted of cash used by discontinued operations. Net cash used by the investing activities attributable to discontinued operations totaled \$638,000 for the six months ended June 30, 2011 and primarily consisted of net cash used in the sale of discontinued operations.

Net cash used by operating activities attributable to discontinued operations totaled \$2.6 million for the six months ended June 30, 2010 and consisted of cash used by discontinued operations. Net cash used by the investing activities attributable to discontinued operations totaled \$8.0 million for the six months ended June 30, 2011 and primarily consisted of net cash used to purchase operations that were discontinued.

## **Critical Accounting Policies and Estimates**

The preparation of our financial statements requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. We base our estimates on historical experience and other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates. Our critical accounting policies, estimates, and methodologies for the six months ended June 30, 2011 are consistent with those in *Management's Discussion and Analysis of Financial Condition and Results of Operations* Critical Accounting Policies and Estimates in Part II, Item 7, of our Annual Report on Form 10-K for the year ended December 31, 2010. We do not expect the adoption of recently issued accounting pronouncements to have a significant impact on our results of operations, financial position, or cash flows.

## **Recent Accounting Pronouncements**

In June 2011, the Financial Accounting Standards Board issued ASU No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. ASU 2011-05 will require companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. It eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The standard does not change the items which must be reported in other comprehensive income, how such items are measured, or when they must be reclassified to net income. This standard is effective for the Company as of January 1, 2012. Because this ASU impacts presentation only, it will have no effect on our financial condition, results of operations or cash flows.

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

Our market risks at June 30, 2011 have not changed significantly from those discussed in Part II, Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2010.

## **Table of Contents**

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

*Evaluation of disclosure controls and procedures.* Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of June 30, 2011 to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934, as amended, is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure, and that such information is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms.

*Changes in internal control over financial reporting.* During the second quarter of 2011, we implemented a new accounting system using Dynamics AX at InfoSpace, in order to improve our accounting efficiency. The implementation resulted in changes to our internal control over financial reporting relating to processing our business transactions and reporting our operating results. We believe we have taken the necessary steps to monitor and maintain appropriate internal control over financial reporting around accounting and reporting during this transition.

There were no other changes in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended).

## **PART II OTHER INFORMATION**

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

See the litigation disclosure under the subheading **Litigation** in Note 5 to our Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

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

#### **RISKS RELATED TO OUR BUSINESS**

**Most of our revenue is attributable to Google and Yahoo!, and the loss of, or a payment dispute with, either of these search customers (or any future significant search customer) would harm our business and financial results.**

We rely on our ability to acquire rights to content from third-party content providers, who we refer to as search customers, and our future success in our search business is highly dependent upon our ability to maintain and renew relationships with these search customers. Google and Yahoo! jointly accounted for over 95% of our total revenues in the first quarter of 2011 and in 2010, and we expect that concentration will continue. Google and Yahoo! compete with each other, and the way we do business with one of them may not be acceptable to the other, or to any of their competitors with whom we may also do business. Google and Yahoo! are also our competitors in search, and they have had relationships with some of our current and potential search distribution partners, and may, in the future, contract directly with some of our distribution partners to provide search services.

If Google, Yahoo!, or any future significant search customer were to substantially reduce or eliminate the content it provides to us or to our distribution partners, our business results could materially suffer to the extent we are unable to establish and maintain new search customer relationships, or expand our remaining search customer relationships, to replace the lost or disputed revenue. We recently extended our agreements with Yahoo! and Google. Our agreement with Yahoo! runs through December 31, 2013 and our agreement with Google runs through March 31, 2013, and may be extended until March 31, 2014 in our sole discretion, provided that we have not assigned this agreement to another party. The long-term operational and financial impact of any new and changed provisions in the recently renewed and revised Yahoo! and Google agreements are currently unknown. If these new or changed provisions result in a loss or reduction of our, or our distribution partners', ability to successfully attract Internet users or to display content or advertisements, our operations and financial performance could be materially impacted.

If a third-party content provider, including Yahoo! or Google, is unwilling to pay us amounts that it owes us, or if it dispute amounts it owes us or has previously paid to us for any reason (including for the reasons described in the risk factors below), our business and financial results could materially suffer to the extent we were unable to establish and maintain new



## **Table of Contents**

search customer relationships, or expand our remaining search customer relationships, to replace the lost or disputed revenue. In addition, Yahoo! recently signed an agreement with Bing, under which Bing provides all of Yahoo! 's algorithmic search results and some of its paid search results. If Yahoo! cannot maintain an agreement with Bing on favorable terms, or if Bing is unable to adequately perform its obligations to Yahoo!, then Yahoo! 's ability to provide us with algorithmic and paid search results may be impaired, and our operations and financial performance may be materially impacted as a result.

**Failure by us or our search distribution partners to comply with the guidelines promulgated by Google and Yahoo! relating to the use of content may cause that search customer to temporarily or permanently suspend the use of its content or terminate its agreement with us, or may require us to modify or terminate certain distribution relationships.**

If we or our search distribution partners fail to meet the guidelines promulgated by Google or Yahoo! for the use of their content, we may not be able to continue to use their content or provide the content to such distribution partners. Our agreements with Google and Yahoo! give them the ability to suspend the use and the distribution of their content for non-compliance with their requirements and guidelines and, in the case of breaches of certain other provisions of their agreements, to terminate their agreements with us immediately, regardless of whether such breaches could be cured.

The terms of the search customer agreements with Google and Yahoo! and the related guidelines are subject to differing interpretations by the parties. Google and Yahoo! have in the past suspended, and may in the future, suspend their content provided to our websites or the websites of our distribution partners, without notice, when they believe that we or our distribution partners are not in compliance with their guidelines or are in breach of the terms of their agreements. During such suspension we will not receive any revenue from any property, ours or our distribution partners', affected by the suspended content, and the loss of such revenue could harm our business and financial results.

Additionally, as our business evolves, we expect that the guidelines of Google and Yahoo!, as well as the parties' interpretations of compliance, breach, and sufficient justification for suspension of use of content will change. Both Yahoo! and Google have recently changed their guidelines and requirements as part of our renegotiation of our agreements with them. These changes in the guidelines and any changes in the parties' interpretations of those guidelines may result in restrictions on our use of the Google and Yahoo! search services, and may require us to terminate our agreement with distribution partners or forego entering into agreements with distribution partners. The loss or reduction of content that we can use or make available to our distribution partners as a result of suspension, termination, or modification of distribution or search customer agreements, particularly our Google and Yahoo! agreements, could have a material adverse effect on our business and financial results.

**A substantial portion of our revenues is dependent on our relationships with a small number of distribution partners who distribute our search services, the loss of which could have a material adverse effect on our business and financial results.**

We rely on our relationships with search distribution partners, including Internet service providers, web portals, and software application providers, for distribution of our search services. In the second quarter of 2011, 78% of our total revenues came from searches conducted by end users on the web properties of our search distribution partners. We generated approximately 46% and 41% of our total revenues through relationships with our top five distribution partners in the second quarter of 2011 and first quarter of 2011, respectively. There can be no assurance that these relationships will continue or will result in benefits to us that outweigh their cost. Moreover, as the proportion of our revenue generated by distribution partners has increased in previous quarters, we have experienced, and expect to continue to experience, less control and visibility over performance. One of our challenges is providing our distribution partners with relevant services at competitive prices in rapidly evolving markets. Distribution partners may create their own services or may seek to license services from our competitors or replace the services that we provide. Also, many of our distribution partners have limited operating histories and evolving business models that may prove unsuccessful even if our services are relevant and our prices competitive. If we are unable to maintain relationships with our distribution partners, our business and financial results could be materially adversely affected.

Our agreements with most of our distribution partners come up for renewal in 2011 and 2012. In addition, some of our distributors have the right to immediately terminate their agreements in the event of certain breaches. Such agreements may be terminated, may not be renewed, or may not be renewed on favorable terms, any of which could adversely impact our business and financial results. We anticipate that our distribution costs for our revenue sharing arrangements with our distribution partners will increase as revenue grows, and may increase as a percentage of revenues to the extent that there are changes to existing arrangements or we enter into new arrangements on less favorable terms.

In addition, competition continues for quality consumer traffic in the search market. Recently, we have experienced increased competition from our search customers as they seek to enter into content provider agreements directly with our existing or potential distribution partners, making it increasingly difficult for us to renew agreements with existing major distribution partners or to enter into distribution agreements with new partners on favorable terms. Any difficulties that we experience with maintaining or strengthening our business relationships with our major distribution partners could have an adverse effect on our business and financial results.





## **Table of Contents**

**If advertisers perceive that they are not receiving quality traffic to their sites through their paid-per-click advertisements, they may reduce or eliminate their advertising through the Internet. Further, if Google, Yahoo!, or other search customers perceive that they are not receiving quality traffic from our own websites or the web property of a distribution partner, they may reduce the fees they pay to us. Either of these factors could have a negative material impact on our business and financial results.**

Most of our revenue from our search business is based on the number of paid clicks on commercial search results served on our owned and operated web properties or our distribution partners' web properties. Each time a user clicks on a commercial search result, the search customer that provided the commercial search result receives a fee from the advertiser who paid for the click and the search customer pays us a portion of that fee. If the click originated from one of our distribution partners' web properties, we share a portion of the fee we receive with such partner. If an advertiser receives what it perceives to be poor quality traffic, meaning that the advertiser's objectives are not met for a sufficient percentage of clicks for which it pays, the advertiser may reduce or eliminate its advertisements through the search customer that provided the commercial search result to us. This leads to a loss of revenue for our search customers and consequently fewer fees paid to us. Also, if a search customer perceives that the traffic originating from one of our web properties or the web property of a distribution partner is of poor quality, the search customer may discount the amount it charged all advertisers whose paid click advertisements appeared on such website or web property based on the amount of poor quality traffic the search customer deems to have been generated, and accordingly may reduce the fees it would have otherwise paid us. The search customer may also suspend or terminate our ability to provide its content through such websites or web properties if such activities are not modified to satisfy the search customer's concerns. The payment of fewer fees to us or the inability to provide content through such websites or web properties, particularly the content of Google and Yahoo!, could have a material negative effect on our business and financial results.

Poor quality traffic may be a result of invalid click activity. Such invalid click activity occurs, for example, when a person or automated click generation program clicks on a commercial search result to generate fees for the web property displaying the commercial search result rather than to view the webpage underlying the commercial search result. Some of this invalid click activity is referred to as "click fraud." When such invalid click activity is detected, the search customer may not charge the advertiser or may refund the fee paid by the advertiser for such invalid clicks. If the invalid click activity originated from one of our distribution partners' web properties or our owned and operated properties, such non-charge or refund of the fees paid by the advertisers in turn reduces the amount of fees the search customer pays us. The resulting loss of revenue, particularly with respect to Google or Yahoo! content, could harm our business and financial results.

Initiatives we undertake to improve the quality of the traffic that we send to our search customers may not be successful and, even if successful, may result in loss of revenue in a given reporting period. For example, during the first half of 2010, we removed certain traffic from some distribution partners in an effort to improve traffic quality, and these actions, while successful in improving traffic quality, had a material negative impact on our revenues for the first and second quarters of 2010.

**A significant part of our strategy involves identifying and acquiring businesses or technologies. We may not be successful in executing this strategy, and thus may not be able to use our capital in the way that provides the best possible return to stockholders.**

An important component of our strategy for future growth is to identify and acquire new businesses or technologies. We had cash, cash equivalents, and short-term investments ( "cash" ) of approximately \$263 million as of June 30, 2011 and we had approximately \$788 million of net operating losses as of December 31, 2010 that may provide a tax benefit on our taxable income substantially through 2020. Thus, in addition to operating our current businesses, we have a growth strategy predicated on the expectation that we will deploy a significant portion of our assets, including cash, to acquire businesses or technologies, in an effort to, among other things, use some or all of our tax asset. However, we may be unable to identify acceptable targets for acquisition. Competition for acquisitions, especially acquisitions that will allow us to use our net operating losses, has been intense, and will likely continue to be intense in the future. As a result, even if we are able to identify an acquisition that we would like to complete, we may not be able to complete the acquisition on commercially reasonable terms.

Acquisitions or development of new businesses or technologies may involve the use of cash, dilutive issuances of stock, the incurrence of debt and contingent liabilities, and amortization expenses related to certain intangible assets. If outside financing is needed, we may be unable to obtain it on acceptable terms, or at all, in light of the current capital market conditions or other factors. The cost of development or acquisition, as the case may be, may be greater than anticipated by us or investors.

---

## **Table of Contents**

We believe that our strategy of growth through acquisitions of new businesses and technology is the best way to use our assets. However, this belief may turn out to be incorrect. If we are unable to successfully identify and acquire new businesses or technologies on terms that allow us to operate them profitably, we will be unable to execute our current strategy for growth and use of our assets. As a result, we may be unable to grow to the extent that we currently intend, and we may be unable to use our assets in the way that provides the best possible return to stockholders.

**Our financial and operating results will suffer if we are unsuccessful in integrating our acquisitions. If we are successful in acquiring new businesses or technologies, they may not be complementary to our current operations or leverage our current infrastructure and operational experience.**

The successful integration of newly-acquired or developed businesses or technologies into InfoSpace is critical for our success. If we are successful in identifying and acquiring targets, those targets may not be complementary to our current operations and may not leverage our existing infrastructure or operational experience. In addition, any acquisitions or developments of businesses or technologies may not prove successful. In the past, our financial results have suffered significantly due to impairment charges of goodwill and other intangible assets related to prior acquisitions. Most recently, our May 2010 purchase of the Mercantila business did not meet our expectations and, as a result, we sold that business for a loss in June 2011.

Acquisitions involve numerous other risks that could materially and adversely affect our results of operations or stock price, including:

difficulties in assimilating the operations, products, technology, information systems and management, and other personnel of acquired companies that result in unanticipated costs, delays, or allocation of resources;

the dilutive effect on earnings per share as a result of issuances of stock, as well as, incurring operating losses and the amortization of intangible assets for the acquired business;

stock volatility due to the perceived value of the acquired business by investors;

diverting management's attention from current operations and other business concerns, including potential strain on financial and managerial controls and reporting systems and procedures;

disruption of our ongoing business or the ongoing acquired business, including impairment of existing relationships with our employees, distributors, suppliers, or customers or those of the acquired companies;

diversion of capital from other uses;

failing to achieve the anticipated benefits of the acquisitions in a timely manner, or at all;

difficulties in acquiring foreign companies, including risks related to integrating operations across different cultures and languages, currency risks, and the particular economic, political, and regulatory risks associated with specific countries; and

adverse outcome of litigation matters or other contingent liabilities assumed in or arising out of the acquisitions.

Developing or acquiring a business or technology, and then integrating it into InfoSpace, will be complex, time consuming, and expensive, particularly if we acquire a business or technology that is not in our current industry of search. For example, the successful integration of an acquisition requires, among other things, that we: retain key personnel; maintain and support preexisting supplier, distribution, and customer

relationships; and integrate accounting and support functions. The complexity of the technologies and operations being integrated and, in the case of an acquisition, the disparate corporate cultures and/or industries being combined, may increase the difficulties of integrating an acquired technology or business. If our integration of acquired or internally developed technologies or businesses is not successful, we may experience adverse financial or competitive effects. Moreover, there can be no assurance that the short- or long-term value of any business or technology that we develop or acquire will be equal to the value of the cash and other consideration that we paid or expenses we incurred.

**The value of equity-based awards, including stock options, restricted stock units, and market stock units granted to employees may cease to provide sufficient incentive to retain to our employees and to attract new talent.**

Like many technology companies, we use stock options, restricted stock units, and other equity-based awards (such as market stock units, which are a form of share price performance-based restricted stock unit granted under our 2011 long-term executive compensation plan) to recruit and retain senior level employees. With respect to those employees to whom we issue such equity-based awards, we face a significant challenge in retaining them if the value of equity-based awards in aggregate or individually is either not deemed by the employee to be substantial enough or deemed so substantial that the employee leaves after their equity-based awards vest. If our stock price does not increase significantly above the exercise prices of our options

## **Table of Contents**

or does not increase significantly above the comparative index price for our market stock units, we may need to issue new equity-based awards in order to motivate and retain our executives. We may undertake or seek stockholder approval to undertake other equity-based programs to retain our employees, which may be viewed as dilutive to our stockholders or may increase our compensation costs. Additionally, there can be no assurance that any such programs, or any other incentive programs, we undertake will be successful in motivating and retaining our employees.

### **If we are unable to hire, retain, and motivate highly qualified employees, including our key employees, we may not be able to successfully manage our business.**

Our future success depends on our ability to identify, attract, hire, retain, and motivate highly skilled management, technical, sales and marketing, and corporate development personnel. Qualified personnel with experience relevant to our search business are scarce and competition to recruit them is intense. If we fail to successfully hire and retain a sufficient number of highly qualified employees, we may have difficulties in supporting our search customers or expanding our business. Realignment of resources, reductions in workforce, or other operational decisions have created and could continue to create an unstable work environment and may have a negative effect on our ability to hire, retain, and motivate employees.

Our business and operations are substantially dependent on the performance of our key employees, all of whom are employed on an at-will basis. We have experienced significant changes at our executive management level and we may experience more changes in the future. Changes of management or key employees may cause disruption to our operations, which may materially and adversely affect our business and financial results or delay achievement of our business objectives. In addition, if we lose the services of one or more key employees and are unable to recruit and retain a suitable successor(s), we may not be able to successfully and timely manage our business or achieve our business objectives. For example, the success of our search business is partially dependent on key personnel who have long-term relationships with our search customers and distribution partners. There can be no assurance that any retention program we initiate will be successful at retaining employees, including key employees.

### **Our stock price has been and is likely to continue to be highly volatile.**

The trading price of our common stock has been highly volatile. Between July 1, 2009 and June 30, 2011, our stock price ranged from \$6.62 to \$11.82. On, July 29, 2011, the closing price of our common stock was \$9.53. Our stock price could decline or fluctuate wildly in response to many factors, including the other risks discussed in this Item 1A and the following, among others:

actual or anticipated variations in quarterly and annual results of operations;

announcements of significant acquisitions, dispositions, charges, changes in or loss of material contracts, new search customers, new distribution partner relationships, or other business developments by us, our search customers, distribution partners, or competitors;

conditions or trends in the search services market;

changes in general conditions in the U.S. and global economies or financial markets;

announcements of technological innovations or new services by us or our competitors;

changes in financial estimates or recommendations by securities analysts;

disclosures of any accounting issues, such as restatements or material weaknesses in internal control over financial reporting;

## Edgar Filing: INFOSPACE INC - Form 10-Q

equity offerings resulting in the dilution of stockholders;

the adoption of new regulations or accounting standards; and

announcements or publicity relating to litigation and similar matters.

In addition, the stock market in general, and the NASDAQ Global Select Market and the market for Internet and technology company securities in particular, have experienced extreme price and volume fluctuations. These broad market and industry factors and general economic conditions may materially and adversely affect our stock price. Our stock has been subject to such price and volume fluctuations in the recent past. Often, class action litigation has been instituted against companies after periods of volatility in the overall market and in the price of such companies stock. If such litigation were to be instituted against us, even if we were to prevail, it could result in substantial cost and diversion of management's attention and resources.

**We have a history of incurring net losses, we may incur net losses in the future, and we may not be able to regain or sustain profitability on a quarterly or annual basis.**

- 28 -

## **Table of Contents**

Although we generated net income in our last two years and in the first quarter of 2011, we have incurred net losses on an annual basis for all but five of the years since our inception, and as of June 30, 2011, we had an accumulated deficit of \$1.0 billion. We may incur net losses in the future, including but not limited to losses resulting from our operations, loss on investments, the impairment of goodwill or other intangible assets, losses from acquisitions, restructuring charges, or expense related to stock-based compensation and other equity awards. There can be no assurance that we will be able to achieve and maintain consistent profitability in the future.

### **Our financial results are likely to continue to fluctuate, which could cause our stock price to continue to be volatile or decline.**

Our financial results have varied on a quarterly basis and are likely to continue to fluctuate in the future. These fluctuations could cause our stock price to be volatile or decline. Many factors could cause our quarterly results to fluctuate materially, including but not limited to:

changes or potential changes in our relationships with Google or Yahoo! or future significant search customers, such as effects of changes to their requirements or guidelines or their measurement of the quality of traffic we send to their advertiser networks, and any resulting loss or reduction of content that we can use or make available to our distribution partners;

the loss, termination, or reduction in scope of key distribution relationships in our search business, for example, as a result of distribution partners licensing content directly from content providers, or any suspension by our search customers (particularly Google and Yahoo!) of the right to use or distribute content on the web properties of our distribution partners;

our strategic initiatives and our ability to implement those initiatives in a cost effective manner;

the mix of search revenue generated by our owned and operated web properties versus our distribution partners' web properties (in the impact to our financial results from our acquisition of certain assets including web properties from Make The Web Better, a distribution partner, in April 2010);

the mix of revenues generated by our search business versus other businesses we develop or acquire;

our ability to attract and retain quality traffic;

litigation expenses, including but not limited to settlement costs;

expenses incurred in finding, negotiating, consummating, and integrating acquisitions;

variable demand for our services, rapidly evolving technologies and markets, and consumer preferences;

the effects of acquisitions by us, our search customers, or our distribution partners;

increases in the costs or availability of content for our search services;

## Edgar Filing: INFOSPACE INC - Form 10-Q

additional restructuring charges we may incur in the future;

the continuing impact of the economic downturn, which has in the past led to and may in the future lead to lower online advertising spend by advertisers, resulting in lower revenue per click for paid searches;

new court rulings, or the adoption of new laws, rules, or regulations, that adversely affect our ability to acquire content and distribute our search services, that affect our ability to offer non-search products and services, or that otherwise increase our potential liability;

impairment in the value of long-lived assets or the value of acquired assets, including goodwill, core technology, and acquired contracts and relationships;

the effect of changes in accounting principles or in our accounting treatment of revenues or expenses; and

the adoption of new regulations or accounting standards.

For these reasons, among others, you should not rely on period-to-period comparisons of our financial results to forecast our future performance. Furthermore, our fluctuating operating results may fall below the expectations of securities analysts or investors and financial results volatility could make us less attractive to investors, either of which could cause the trading price of our stock to decline.

**Our search services may expose us to claims relating to how the content was obtained, distributed, or displayed.**

Our search services link users, either directly through our own websites or indirectly through the web properties of our

- 29 -



**Table of Contents**

distribution partners, to third-party webpages and content in response to search queries and other requests. These services could expose us to legal liability from claims relating to such third-party content and sites, the manner in which these services are distributed and displayed by us or our distribution partners, or how the content provided by our search customers was obtained or provided by our search customers. Such claims could include the following: infringement of patent, copyright, trademark, trade secret, or other intellectual property or proprietary rights; violation of privacy and publicity rights; unfair competition; defamation; providing false or misleading information; obscenity; pornography; and illegal gambling. Regardless of the legal merits of any such claims, they could result in costly litigation, be time consuming to defend, and divert management's attention and resources. If there was a determination that we had violated third-party rights or applicable law, we could incur substantial monetary liability, be required to enter into costly royalty or licensing arrangements (if available), or be required to change our business practices. We may also have an obligation to indemnify and hold harmless certain of our search customers or distribution partners from damages they suffer for such violations under our contracts with them. Implementing measures to reduce our exposure to such claims could require us to expend substantial resources and limit the attractiveness of our services. As a result, these claims could result in material harm to our business.

In the past, there have been legal actions brought or threatened against distributors of downloadable applications deemed to be adware or spyware. Additionally, certain bills are pending and some laws have been passed in certain jurisdictions setting forth requirements that must be met before a downloadable application is downloaded to an end user's computer. We provide downloadable applications to promote use of our search services for our owned and operated search services. Such applications may be considered adware. We also partner with some distribution partners that provide adware to their users if the partners adhere to our strict guidelines requiring them, among other things, to disclose to the user what the adware does and to obtain the consent of the user before the application is downloaded. The adware must also be easy to uninstall. We also review the downloadable application the partner proposes to use before we distribute our results to them. We also have the right to audit our partners and, if we find that they are not following our guidelines, we can terminate our agreement with them or cease providing content to that downloadable application. Some partners have not been able to meet the new guidelines imposed by us or some of our search customers, and we no longer provide the applicable content or any content, as the case may be, to such partners or certain of their downloadable applications. We work closely with some of our major search customers to try to identify potential distribution partners that do not meet our guidelines or are in breach of our distribution agreements and we work with our distribution partners to ensure they deliver quality traffic. However, there can be no assurance that the measures we implement to reduce our exposure to claims that certain ways in which the content is distributed violate legal requirements will be successful. Any claims against us as a result of violations of legal requirements or contractual obligations could result in material harm to our business.

**Our website and transaction management software, data center systems, or the systems of the third-party co-location facilities in which they are located could fail or become unavailable, which could harm our reputation, result in a loss of revenues and current or potential customers, and cause us to breach agreements with our partners.**

Any system interruptions that result in the unavailability or unreliability of our websites, transaction processing systems, or network infrastructure could reduce our sales and impair our ability to properly process transactions. We use internally developed and third-party systems for our websites and certain aspects of transaction processing. Some of our systems are relatively new and untested, and thus may be subject to failure or unreliability. Any system unavailability or unreliability may cause unanticipated system disruptions, slower response times, degradation in customer satisfaction, additional expense, or delays in reporting accurate financial information.

We provide our own data center services for our search business from two geographically diverse third-party co-location facilities. Although the two data centers provide some redundancy, not all of our systems and operations have backup redundancy. Our systems and operations could be damaged or interrupted by fire, flood, earthquakes, or other natural disasters, power loss, telecommunications failure, Internet breakdown, break-in, or other events beyond our control. We could face significant damage as a result of these events, and our business interruption insurance may not be adequate to compensate us for all the losses that may occur. In addition, such third-party co-location facilities and data center systems use sophisticated equipment, infrastructure, and software that may contain bugs or suffer outages that could interrupt service. During the period in which service is unavailable, we will be unable or severely limited in our ability to generate revenues, and we may also be exposed to liability from those third parties to whom we provide services through our data centers. For these reasons, our business and financial results could be materially harmed if our systems and operations are damaged or interrupted, including if we are unable to develop, or if we or our third-party co-location facility providers are unable to successfully manage, the infrastructure necessary to meet current or future demands for reliability and scalability of our systems.

If the volume of traffic to our search services infrastructure increases substantially, we must respond in a timely fashion by expanding our systems, which may entail upgrading our technology, transaction processing systems, and network infrastructure. Our ability to support our expansion and upgrade requirements may be constrained due to our business demands or constraints of our third-party co-location facility providers. Due to the number of our customers and the services



---

## **Table of Contents**

that we offer, we could experience periodic capacity constraints which may cause temporary unanticipated system disruptions, slower response times and lower levels of customer service, and limit our ability to develop, offer, or release new or enhanced products and services. Our business could be harmed if we are unable to accurately project the rate or timing of increases, if any, in the use of our search services or we fail to expand and upgrade our systems and infrastructure to accommodate these increases in a timely manner.

**The security measures we have implemented to secure information we collect and store may be breached. Security breaches may pose risks to the uninterrupted operation of our systems and could cause us to breach agreements with our customers and distribution partners, expose us to mitigation costs, litigation, potential investigation and penalties by authorities, potential claims by persons whose information was disclosed, and damage our reputation.**

Our networks or those from third parties that we use may be vulnerable to unauthorized access by hackers, rogue employees or contractors, or other persons, computer viruses, and other disruptive problems. Someone who is able to circumvent security measures could misappropriate our proprietary information or cause interruptions in our operations. We receive, retain, and transmit certain personal information about our website visitors, using technology and networks provided by third parties to provide the security and authentication used to transmit confidential information, including payment information. Subscribers to some of our search services are required to provide information that may be considered to be personally identifiable or private information. Unauthorized access to, and abuse of, this information could result in significant harm to our business.

We take, and we believe our third-party providers take, reasonable steps to protect the security, integrity, and confidentiality of the information that is collected and stored, but there is no guarantee that inadvertent or unauthorized disclosure will not occur or that third parties will not gain unauthorized access despite our efforts. If such unauthorized disclosure or access does occur, we may be required under existing and proposed laws to notify persons whose information was disclosed or accessed. We also may be subject to claims of breach of contract for such disclosure, investigation and penalties by regulatory authorities, and potential claims by persons whose information was disclosed, or other persons or companies who suffer damages as a result of unauthorized disclosure. Any such claims could result in costly litigation or liability, be time consuming to resolve, damage our reputation, and divert the attention and resources of management and other personnel.

We may need to expend significant capital or other resources protecting against the threat of security breaches or alleviating problems caused by breaches. Although we intend to continue to implement and improve our security measures, persons may be able to circumvent the measures that we implement in the future. Eliminating computer viruses and alleviating other security problems may require interruptions, delays, or cessation of service to users accessing our services, any of which could harm our business and financial results.

**We may be subject to liability for our use or distribution of information that we gather or receive from third parties and indemnity protections or insurance coverage may be inadequate to cover such liability.**

We obtain content and commerce information from third parties. When we distribute this information, we may be liable for the data that is contained in that content. This could subject us to legal liability for such things as defamation, negligence, intellectual property infringement, violation of privacy or publicity rights, and product or service liability, among others. Laws or regulations of certain jurisdictions may also deem some content illegal, which may expose us to legal liability as well. We also gather personal information from users in order to provide personalized services. Gathering and processing this personal information may subject us to legal liability for, among other things, negligence, defamation, invasion of privacy, or product or service liability. We are also subject to laws and regulations, both in the United States and abroad, regarding the collection and use of end user information and search related data. If we do not comply with these laws and regulations, we may be exposed to legal liability.

Although the agreements by which we obtain content contain indemnity provisions, these provisions may not cover a particular claim or type of claim or the party giving the indemnity may not have the financial resources to cover the claim. Our insurance coverage may be inadequate to cover fully the amounts or types of claims that might be made against us. Any liability that we incur as a result of content we receive from third parties could harm our financial results.

**If others claim that our services infringe their intellectual property rights, we may be forced to seek expensive licenses, reengineer our services, engage in expensive and time-consuming litigation, or stop marketing and licensing our services.**

Companies and individuals with rights relating to the Internet, software, and application services industries have frequently resorted to litigation regarding intellectual property rights. In some cases, the ownership or scope of an entity's or person's rights is unclear and may also change over time, including through changes in U.S. or international intellectual property laws or regulations or through court decisions or decisions by agencies or regulatory boards that manage such rights.



---

## **Table of Contents**

Third parties have in the past and may in the future make claims against us alleging infringement of copyrights, trademarks, trade secret rights, intellectual property or other proprietary rights, or alleging unfair competition or violations of privacy or publicity rights. Responding to any such claims could be time-consuming, result in costly litigation, divert management's attention, cause product or service release delays, require us to redesign our services, or require us to enter into royalty or licensing agreements. Our technology and intellectual property may not be able to withstand any third-party claims or rights against their use. If a successful claim of infringement were made against us and we could not develop non-infringing technology or license the infringed or similar technology on a timely and cost-effective basis, our business could suffer.

We do not regularly conduct patent searches to determine whether the technology used in our services infringes patents held by third parties. Patent searches may not return every issued patent that may be deemed relevant to a particular product or service. It is therefore difficult to determine, with any level of certainty, whether a particular product or service may be construed as infringing a U.S. or foreign patent. Because patent applications in the United States are not immediately publicly disclosed, applications may have been filed by third parties that relate to our services that may not be discovered in a patent search. In addition, other companies, as well as research and academic institutions, have conducted research for many years in the search technology field, and this research could lead to the filing of further patent applications or affect filed applications.

If we were to discover that our services violated or potentially violated third-party proprietary rights, we might be required to obtain licenses that are costly or contain terms unfavorable to us, or expend substantial resources to reengineer those services so that they would not violate such third-party rights. Any reengineering effort may not be successful, and any such licenses may not be available on commercially reasonable terms, if at all. Any third-party infringement claims against us could result in costly litigation or liability and be time consuming to defend, divert management's attention and resources, cause product and service delays, or require us to enter into royalty and licensing agreements.

**We rely heavily on our technology and intellectual property, but we may be unable to adequately or cost-effectively protect or enforce our intellectual property rights, thus weakening our competitive position and negatively impacting our business and financial results. We may have to litigate to enforce our intellectual property rights, which can be time consuming, expensive, and difficult to predict.**

To protect our rights in our services and technology, we rely on a combination of copyright and trademark laws, patents, trade secrets, confidentiality agreements with employees and third parties, and protective contractual provisions. We also rely on laws pertaining to trademarks and domain names to protect the value of our corporate brands and reputation. Despite our efforts to protect our proprietary rights, unauthorized parties may copy aspects of our services or technology, or obtain and use information, marks, or technology that we regard as proprietary, or otherwise violate or infringe our intellectual property rights. In addition, it is possible that others could independently develop substantially equivalent intellectual property. If we do not effectively protect our intellectual property, or if others independently develop substantially equivalent intellectual property, our competitive position could be weakened.

Effectively policing the unauthorized use of our services and technology is time-consuming and costly, and the steps taken by us may not prevent misappropriation of our technology or other proprietary assets. The efforts we have taken to protect our proprietary rights may not be sufficient or effective, and unauthorized parties may obtain and use information, marks, or technology that we regard as proprietary, copy aspects of our services, or use similar marks or domain names. In some cases, the ownership or scope of an entity's or person's rights is unclear and may also change over time, including through changes in U.S. or international intellectual property laws or regulations or through court decisions or decisions by agencies or regulatory boards that manage such rights. Our intellectual property may be subject to even greater risk in foreign jurisdictions, as protection is not sought or obtained in every country in which our services and technology are available and it is often more difficult and costly to enforce our rights in foreign jurisdictions. Moreover, the laws of many countries do not protect proprietary rights to the same extent as the laws of the United States and intellectual property developed for us by our employees or contractors in foreign jurisdictions may not be as protected as if created in the United States.

We may have to litigate to enforce our intellectual property rights, to protect our trade secrets, or to determine the validity and scope of others' proprietary rights, which are sometimes not clear or may change. Litigation can be time consuming, expensive, and difficult to predict.

**Delaware law and our charter documents may impede or discourage a takeover, which could cause the market price of our shares to decline.**

## **Table of Contents**

We are a Delaware corporation and the anti-takeover provisions of Delaware law impose various impediments to the ability of a third party to acquire us, even if a change of control would be beneficial to our existing stockholders. For example, Section 203 of the Delaware General Corporation Law may discourage, delay, or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a period of three years after the person becomes an interested stockholder. In addition, our certificate of incorporation and bylaws contain provisions that may discourage, delay, or prevent a third party from acquiring us without the consent of our board of directors, even if doing so would be beneficial to our stockholders. Provisions of our charter documents that could have an anti-takeover effect include:

the classification of our board of directors into three groups so that directors serve staggered three-year terms, which may make it difficult for a potential acquirer to gain control of our board of directors;

the requirement for supermajority approval by stockholders for certain business combinations;

the ability of our board of directors to authorize the issuance of shares of undesignated preferred stock without a vote by stockholders;

the ability of our board of directors to amend or repeal the bylaws;

limitations on the removal of directors;

limitations on stockholders' ability to call special stockholder meetings;

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

certain limited transfer restrictions in our charter and stockholder rights plan on our common stock designed to preserve our federal net operating loss carryforwards ( *NOLs* ).

On July 19, 2002, our board of directors adopted a stockholder rights plan, pursuant to which we declared and paid a dividend of one right for each share of common stock held by stockholders of record as of August 9, 2002. Unless redeemed by us prior to the time the rights are exercised, upon the occurrence of certain events, the rights will entitle the holders of common stock (except the acquiring person, together with its affiliates and associates and certain transferees thereof, that becomes the beneficial owner of 15% or more of the common stock, whose rights will be null and void following a trigger event), to receive shares of our preferred stock, or shares of an acquiring entity. The security issuable upon exercise of one right approximates the value and voting rights of one share of common stock.

In addition, at our 2009 annual meeting, our stockholders approved an amendment to our certificate of incorporation that restricts any person or entity from attempting to transfer our stock, without prior permission from the Board of Directors, to the extent that such transfer would (i) create or result in an individual or entity becoming a five-percent stockholder of our stock, or (ii) increase the stock ownership percentage of any existing five-percent stockholder. This amendment provides that any transfer that violates its provisions shall be null and void and would require the purported transferee to, upon demand by the Company, transfer the shares that exceed the five percent limit to an agent designated by the Company for the purpose of conducting a sale of such excess shares. The stockholder rights plan and the amendment to the certificate of incorporation would make the acquisition of the Company more expensive to the acquirer and could significantly delay, discourage, or prevent third parties from acquiring the Company without the approval of our board of directors.

**If there is change in our ownership within the meaning of Section 382 of the Internal Revenue Code, our ability to use our NOLs may be severely limited or potentially eliminated.**

## Edgar Filing: INFOSPACE INC - Form 10-Q

As of December 31, 2010, we had NOLs of approximately \$788 million that will expire over a ten to twenty year period. If we were to have a change of ownership within the meaning of Section 382 of the Internal Revenue Code (defined as a cumulative change of 50 percentage points or more in the ownership positions of certain stockholders owning five percent or more of a company's common stock over a three-year rolling period), then under certain conditions, the amount of NOLs we could use in any one year could be limited to an amount equal to our market capitalization, net of substantial non-business assets, at the time of the ownership change multiplied by the federal long-term tax exempt rate. Our certificate of incorporation imposes certain limited transfer restrictions on our common stock that we expect will assist us in preventing a change of ownership and preserving our NOLs, but there can be no assurance that these restrictions will be sufficient. If we are unable to use our NOLs before they expire, or if the use of this tax benefit is severely limited or eliminated by a change of ownership, there could be a material reduction in the amount of after-tax income and cash flow from operations, and it could have an effect on our ability to engage in certain transactions.

### **Restructuring and streamlining our business, including implementing reductions in workforce, discretionary spending, and other expense reductions, may harm our business.**

We have in the past and may in the future find it advisable to take measures to streamline operations and reduce expenses, including, without limitation, reducing our workforce or discontinuing products or businesses. Such measures may place significant strains on our management and employees, and could impair our development, marketing, sales, and customer support efforts. We may also incur liabilities from these measures, including liabilities from early termination or assignment of contracts, potential failure to meet obligations due to loss of employees or resources, and resulting litigation. Such effects from restructuring and streamlining could have a negative impact on our business and financial results.

## **Table of Contents**

### **RISKS RELATED TO THE INDUSTRIES IN WHICH WE OPERATE**

#### **We may be unable to compete successfully in the search market.**

We face intense competition in the search market, which is extremely competitive and rapidly changing. Many of our competitors or potential competitors have substantially greater financial, technical, and marketing resources, larger customer bases, longer operating histories, more developed infrastructures, greater brand recognition, better access to vendors, or more established relationships in the industry than we have. Our competitors may be able to adopt more aggressive pricing policies, develop and expand their product and service offerings more rapidly, adapt to new or emerging technologies and changes in search customer and distribution partner requirements more quickly, take advantage of acquisitions and other opportunities more readily, achieve greater economies of scale, and devote greater resources to the marketing and sale of their products and services than we can. Some of the companies we compete with in search are currently search customers of ours, the loss of any of which could harm our business. In addition, we may face increasing competition for search market share from new search startups, mobile search providers, and social media sites and applications. If we are unable to match or exceed our competitors marketing reach and customer service experience, our business may not be successful. Because of these competitive factors and due to our relatively small size and financial resources, we may be unable to compete successfully in the search market and, to the extent that these competitive factors apply to other markets that we pursue, in such other markets.

Additionally, our business and financial results could be adversely affected if our search distribution partners create their own services that compete or replace the services we provide or they acquire such services from other sources. We continue to experience increased competition from search customers seeking to enter into agreements directly with our existing or potential distribution partners, making it increasingly difficult for us to renew agreements with existing major distribution partners or to enter into distribution agreements with new partners on favorable terms.

#### **Consolidation in the industries in which we operate could lead to increased competition and loss of customers.**

The Internet search industry has experienced substantial consolidation. This consolidation may continue. These acquisitions could adversely affect our business and results of operations in a number of ways, including the following:

search customers could acquire or be acquired by one of our other search customers, enter into new business relationships with each other, and stop licensing content to us or gain additional negotiating leverage in their relationships with us;

our search distribution partners could acquire or be acquired by one of our competitors and terminate their relationship with us;

our search distribution partners could merge with each other, which could reduce our ability to negotiate favorable terms.

Consolidation in the Internet industry could have a material adverse effect on our business and results of operations.

#### **Governmental regulation and the application of existing laws may slow business growth, increase our costs of doing business, and create potential liability.**

The growth and development of the Internet has led to new laws and regulations, as well as the application of existing laws to the Internet, in both the U.S. and foreign jurisdictions. Application of these laws can be unclear. For example, it is unclear how many existing laws regulating or requiring licenses for certain businesses (such as gambling, online auctions, distribution of pharmaceuticals, alcohol, tobacco, firearms, insurance, securities brokerage, or legal services) apply to search services, online advertising, and our business. The costs of complying or failure to comply with these laws and regulations could limit our ability to operate in our market (including limiting our ability to distribute our services; conduct targeted advertising; collect, use, or transfer user information; or comply with new data security requirements), expose us to compliance costs and substantial liability, and result in costly and time-consuming litigation. It is impossible to predict whether or when any new legislation may be adopted or existing legislation or regulatory requirements will be deemed applicable to us, any of which could materially and adversely affect our business.

Any failure by us to comply with our posted privacy policies, Federal Trade Commission ( *FTC* ) requirements, or other privacy-related laws and regulations could result in proceedings by the FTC or others, including potential class action litigation, which could potentially have an adverse



## Edgar Filing: INFOSPACE INC - Form 10-Q

effect on our business, results of operations, and financial condition. For example, there are a large number of legislative proposals before the U.S. Congress and various state legislative bodies regarding privacy and data protection issues related to our businesses. It is not possible to predict whether or when such legislation may be adopted and certain proposals, if adopted, could materially and adversely affect our business through a decrease in user registrations and revenues. This could be caused by, among other possible provisions, the required use of disclaimers or other requirements before users can utilize our services.

- 34 -

## **Table of Contents**

The FTC has recommended that search engine providers delineate paid-ranking search results from non-paid results. To the extent that we are required to modify presentation of search results as a result of specific regulations or requirements that may be issued in the future by the FTC or other state or federal agencies or legislative bodies with respect to the nature of such delineation or other aspects of advertising in connection with search services, revenue from the affected search engines could be negatively impacted. Addressing these regulations may require us to develop additional technology or otherwise expend significant time and expense.

Due to the nature of the Internet, it is possible that the governments of states and foreign countries might attempt to regulate Internet transmissions, through data protection laws amongst others, or institute proceedings for violations of their laws. We might unintentionally violate such laws, such laws may be modified, and new laws may be enacted in the future. Any such developments (or developments stemming from enactment or modification of other laws) could increase the costs of regulatory compliance for us or force us to change our business practices.

**We rely on the infrastructure of the Internet networks, over which we have no control and the failure of which could substantially undermine our operations.**

Our success depends, in large part, on other companies maintaining the Internet system infrastructure. In particular, we rely on other companies to maintain a reliable network backbone that provides adequate speed, data capacity, and security and to develop services that enable reliable Internet access and services. As the Internet continues to experience growth in the number of users, frequency of use, and amount of data transmitted, the Internet system infrastructure may be unable to support the demands placed on it, and the Internet's performance or reliability may suffer as a result of this continued growth. Some of the companies that we rely upon to maintain network infrastructure may lack sufficient capital to take the necessary steps to support such demands or their long-term operations. The failure of the Internet infrastructure would substantially undermine our operations and may have a material adverse effect on our business and financial results.

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

Not applicable with respect to the current reporting period.

### **Item 3. Defaults Upon Senior Securities**

Not applicable with respect to the current reporting period.

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

---

**Table of Contents**

**Item 5. Other Information**

The Board of Directors of InfoSpace, having considered the results of the voting at the 2011 annual meeting of stockholders (as disclosed in the Current Report on Form 8-K filed by InfoSpace on June 14, 2011), has determined that future advisory votes on the compensation of Named Executive Officers will be held on an annual basis.

The resignation of Chief Financial Officer David Binder, previously disclosed in a Current Report on Form 8-K dated July 21, 2011, has been accepted by the InfoSpace Board of Directors and will be effective on August 19, 2011. On August 4, 2011, the Board of Directors appointed current Chief Accounting Officer Eric Emans as interim Chief Financial Officer and Treasurer, effective upon the effectiveness of Mr. Binder's resignation. In connection with the appointment of Mr. Emans as interim Chief Financial Officer and Treasurer, the Compensation Committee has approved the following changes to Mr. Emans' employment agreement (a copy of which was attached as exhibit 10.4 to the Quarterly Report on Form 10-Q filed on November 10, 2008) effective August 19, 2011:

- (1) An increase in salary to \$230,000;
- (2) An increase in target bonus percentage to 60%;
- (3) A grant of 10,000 Restricted Stock Units (vesting in three substantially equal portions on the first, second and third anniversaries of his appointment); and
- (4) The following provisions that would become effective if Mr. Emans is not named permanent Chief Financial Officer by April 30, 2012:
  - (i) if he is offered and accepts the position of Chief Accounting Officer and Vice President, Finance, then the compensation changes set forth above will become permanent;
  - (ii) if he is offered the position of Chief Accounting Officer and Vice President, Finance, and he rejects that offer and terminates his employment, he will be entitled to a lump sum payment of \$50,000 as additional compensation for the performance of the interim Chief Financial Officer duties; and
  - (iii) if he is not offered the position of, or equivalent to, Chief Accounting Officer and Vice President, Finance by April 30, 2012, and Mr. Emans terminates his employment with the Company, he will be entitled to the severance benefits set forth in Section 6(b) ( "Termination by the Company without Cause" ) of his employment agreement.

The above description is only a summary of the terms, does not purport to be a complete description of the amendment to Mr. Emans' employment agreement, and is qualified in its entirety by reference to that amendment, a copy of which will be attached in full as an exhibit to the Company's Quarterly Report on Form 10-Q for the third fiscal quarter of 2011.

**Item 6. Exhibits**

Exhibits filed or furnished herewith are listed in the accompanying Index to Exhibits.

**Table of Contents**

**SIGNATURE**

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

**INFOSPACE, INC.**

By /s/ David B. Binder  
David B. Binder  
Chief Financial Officer  
(Principal Financial Officer)

Dated: August 8, 2011

- 37 -

**Table of Contents****INDEX TO EXHIBITS**

<b>Exhibit Number</b>	<b>Exhibit Description</b>	<b>Form</b>	<b>Date of First Filing</b>	<b>Exhibit Number</b>	<b>Filed Herewith</b>
2.1	LLC Interest Purchase Agreement dated June 10, 2011 among Zoo Stores, Inc., InfoSpace, Inc., and Mercantila Acquisition, LLC	8-K	June 28, 2011	2.1	
10.1*	Amended and Restated Employment Agreement between William J. Ruckelshaus and InfoSpace, Inc. dated June 15, 2011				X
10.2*	Employment Agreement between Linda A. Schoemaker and InfoSpace, Inc. dated June 13, 2011				X
10.3*	409A Corrective Amendment to Employment Agreement for David B. Binder				X
10.4*	409A Corrective Amendment to Employment Agreement for Eric M. Emans				X
10.5*	409A Corrective Amendment to Employment Agreement for Michael J. Glover				X
10.6*	409A Corrective Amendment to Employment Agreement for Stephen P. Hawthornthwaite				X
10.7*	Termination and Waiver dated June 22, 2011 between InfoSpace, Inc. and Nikhil Behl	8-K	June 28, 2011	10.1	
10.8*	Form of Indemnification Agreement for Directors and Officers	8-K	April 13, 2011	10.1	
10.9*	Restated 1996 Flexible Stock Incentive Plan, as amended and restated effective as of April 21, 2011				X
10.10*	Form of Market Stock Units Agreement				X
10.11*	Amended and Restated InfoSpace Executive Bonus Plan				X
31.1	Certification of Principal Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
31.2	Certification of Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				X
32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				X

**Table of Contents**

Exhibit Number	Exhibit Description	Form	Date of First Filing	Exhibit Number	Filed Herewith
101.1**	The following financial statements from the Company's 10-Q for the fiscal quarter ended June 30, 2011, formatted in XBRL: (i) Unaudited Condensed Consolidated Balance Sheets (ii) Unaudited Condensed Consolidated Statements of Operations, (iii), Unaudited Condensed Consolidated Statements of Cash Flows, and (iv) Notes to Unaudited Condensed Consolidated Financial Statements.				X

\* Indicates a management contract or compensatory plan or arrangement.

\*\* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and are otherwise not subject to liability under those sections.