

CNET NETWORKS INC  
Form 10-Q  
May 03, 2007  
Table of Contents

---

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

Washington, D.C. 20549

---

**FORM 10-Q**

---

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the Quarterly Period Ended March 31, 2007

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 0-20939

---

**CNET Networks, Inc.**

(Exact name of registrant as specified in its charter)

---

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**13-3696170**  
(I.R.S. Employer  
Identification Number)

235 Second Street, San Francisco, CA 94105

(Address of principal executive offices including zip code)

Telephone Number (415) 344-2000

Edgar Filing: CNET NETWORKS INC - Form 10-Q

(Registrant's telephone number, including area code)

---

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of April 30, 2007 there were 151,216,779 shares of the registrant's common stock outstanding.

---

**Table of Contents**

**Table of Contents**

<b><u>PART I.</u></b>	<b><u>FINANCIAL INFORMATION</u></b>	3
ITEM 1.	<u>Condensed Consolidated Financial Statements</u>	3
ITEM 2.	<u>Managements Discussion and Analysis of Financial Condition and Results of Operations</u>	14
ITEM 3.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	21
ITEM 4.	<u>Controls and Procedures</u>	22
<b><u>PART II.</u></b>	<b><u>OTHER INFORMATION</u></b>	22
ITEM 1.	<u>Legal Proceedings</u>	22
ITEM 1A.	<u>Risk Factors</u>	23
ITEM 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	34
ITEM 3.	<u>Defaults Upon Senior Securities</u>	34
ITEM 4.	<u>Submission of Matters to a Vote of Security Holders</u>	34
ITEM 5.	<u>Other Information</u>	34
ITEM 6.	<u>Exhibits</u>	35
	<u>SIGNATURES</u>	35
	<u>EXHIBIT INDEX</u>	36
	<u>EX-31.1</u>	
	<u>EX-31.2</u>	
	<u>EX-32.1</u>	
	<u>EX-32.2</u>	

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1.****CNET NETWORKS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(UNAUDITED)****(in thousands, except per share data)**

	<b>Three Months Ended</b>	
	<b>March 31, 2007</b>	<b>2006</b>
Revenues	\$ 92,097	\$ 83,650
Operating expenses:		
Cost of revenues (1)	43,482	41,419
Sales and marketing (1)	25,926	22,963
General and administrative (1)	16,080	14,029
Stock option investigation and related matters	4,429	
Depreciation	7,489	4,822
Amortization of intangible assets	3,220	2,739
<b>Total operating expenses</b>	<b>100,626</b>	<b>85,972</b>
Operating loss	(8,529)	(2,322)
Non-operating income (expense):		
Realized gains on investments		500
Interest income	638	1,152
Interest expense	(1,346)	(659)
Other, net	301	140
<b>Total non-operating income (expense)</b>	<b>(407)</b>	<b>1,133</b>
<b>Loss from continuing operations before income taxes</b>	<b>(8,936)</b>	<b>(1,189)</b>
Income tax expense	182	76
<b>Loss from continuing operations</b>	<b>(9,118)</b>	<b>(1,265)</b>
Loss from discontinued operations		(37)
<b>Net loss</b>	<b>\$ (9,118)</b>	<b>\$ (1,302)</b>
Basic and diluted net loss per share	\$ (0.06)	\$ (0.01)
Shares used in calculating basic and diluted net loss per share	150,386	148,733

## Edgar Filing: CNET NETWORKS INC - Form 10-Q

(1) Includes stock compensation expense, which was allocated as follows:

Cost of revenues	\$ 1,765	\$ 1,964
Sales and marketing	843	896
General and administrative	2,555	1,896
	\$ 5,163	\$ 4,756

See accompanying Notes to Condensed Consolidated Financial Statements.

**Table of Contents****CNET NETWORKS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(UNAUDITED)****(in thousands, except per share data)**

	<b>March 31,</b>	<b>December 31,</b>
	<b>2007</b>	<b>2006</b>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 45,282	\$ 31,327
Investments in marketable debt securities	24,881	30,372
Accounts receivable, net of allowance for doubtful accounts of \$6,995 and \$6,918 at March 31, 2007 and December 31, 2006, respectively	76,190	89,265
Other current assets	12,740	10,512
<b>Total current assets</b>	<b>159,093</b>	<b>161,476</b>
Investments in marketable debt securities	2,500	13,915
Restricted cash	2,216	2,200
Property and equipment, net	75,719	72,625
Other assets	15,685	15,554
Intangible assets, net	35,981	34,978
Goodwill	140,888	133,059
<b>Total assets</b>	<b>\$ 432,082</b>	<b>\$ 433,807</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 7,831	\$ 10,055
Accrued liabilities	51,989	80,335
Revolving credit facility	60,000	60,000
Current portion of long-term debt	11,521	13,850
<b>Total current liabilities</b>	<b>131,341</b>	<b>164,240</b>
Non-current liabilities:		
Long-term debt	5,483	4,498
Other liabilities	4,325	726
<b>Total liabilities</b>	<b>141,149</b>	<b>169,464</b>
Commitments and contingencies		
Stockholders' equity:		
Common stock; \$0.0001 par value; 400,000 shares authorized; 152,546 and 151,315 outstanding at March 31, 2007 and December 31, 2006, respectively	15	15
Additional paid-in-capital	2,892,237	2,857,238
Accumulated other comprehensive loss	(10,909)	(11,357)
Treasury stock, at cost; 1,510 shares at March 31, 2007 and December 31, 2006	(30,453)	(30,453)
Cumulative effect on retained earnings due to change in accounting principle	261	

Edgar Filing: CNET NETWORKS INC - Form 10-Q

Accumulated deficit	(2,560,218)	(2,551,100)
Total stockholders' equity	290,933	264,343
Total liabilities and stockholders' equity	\$ 432,082	\$ 433,807

See accompanying Notes to Condensed Consolidated Financial Statements.

**Table of Contents****CNET NETWORKS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(UNAUDITED)****(in thousands)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (9,118)	\$ (1,302)
<b>Adjustments to reconcile net loss to net cash provided by operating activities:</b>		
Depreciation and amortization	10,709	7,561
Noncash stock compensation expense	5,163	4,756
Asset disposals		52
Noncash interest expense	(59)	(126)
Provision for doubtful accounts	363	837
Gain on sale of business, net		(778)
Gains on sales of marketable securities and privately held investments		(500)
<b>Changes in operating assets and liabilities, net of acquisitions:</b>		
Accounts receivable	13,611	19,727
Other assets	(2,992)	3,211
Accounts payable	(2,573)	(217)
Accrued liabilities	(3,298)	(4,010)
Other long-term liabilities	(770)	(33)
<b>Net cash provided by operating activities</b>	<b>11,036</b>	<b>29,178</b>
<b>Cash flows from investing activities:</b>		
Purchase of marketable debt securities	(6,372)	(18,043)
Proceeds from sales of marketable debt securities	24,161	10,070
Proceeds from sales of investments in privately held companies		2,562
Investments in privately held companies		(31)
Purchases of other intangible assets	(181)	
Cash paid for acquisitions, net of cash acquired	(14,108)	(840)
Sale of leasehold improvements	2,349	
Purchases of property and equipment	(9,540)	(8,711)
<b>Net cash used in investing activities</b>	<b>(3,691)</b>	<b>(14,993)</b>
<b>Cash flows from financing activities:</b>		
Net proceeds from issuance of stock	6,454	4,293
<b>Net cash provided by financing activities</b>	<b>6,454</b>	<b>4,293</b>
<b>Net increase in cash and cash equivalents</b>	<b>13,799</b>	<b>18,478</b>
Effect of exchange rate changes on cash and cash equivalents	156	(215)
Cash and cash equivalents at the beginning of the period	31,327	55,895
Cash and cash equivalents at the end of the period	\$ 45,282	\$ 74,158



**Supplemental disclosure of cash flow information:**

Interest paid	\$ 1,369	\$ 318
Taxes paid	\$ 260	\$ 489
Issuance of note payable for acquisition	\$ 896	\$

See accompanying Notes to Condensed Consolidated Financial Statements.

**Table of Contents**

**CNET NETWORKS, INC.**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2007**

**(1) BASIS OF FINANCIAL STATEMENTS**

***BUSINESS AND BASIS OF PRESENTATION***

CNET Networks, Inc. (CNET Networks or the Company) is an interactive media company that builds brands for people and the things they are passionate about, such as gaming, music, entertainment, technology, business, food and parenting. The Company's leading brands include CNET, GameSpot, TV.com, MP3.com, ZDNet, TechRepublic, CHOW and UrbanBaby. CNET Networks has a strong presence in the United States, Asia and Europe. CNET Networks was incorporated in the state of Delaware in December 1992.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, except as otherwise indicated, considered necessary for a fair presentation of the financial condition, results of operations and cash flows for the periods presented. These condensed financial statements should be read in conjunction with the audited consolidated financial statements included in CNET Networks' Annual Report on Form 10-K for the year ended December 31, 2006, as filed with the Securities and Exchange Commission, which contains additional financial and operating information and information concerning the significant accounting policies followed by CNET Networks.

The condensed consolidated results of operations for the three months ended March 31, 2007 are not necessarily indicative of the results to be expected for the year ending December 31, 2007 or any other future period.

***SIGNIFICANT ACCOUNTING POLICIES***

There have been no significant changes in CNET Networks' significant accounting policies during the three months ended March 31, 2007 as compared to what was previously disclosed in CNET Networks' Annual Report on 10-K for the year ended December 31, 2006.

***CONCENTRATION OF CREDIT RISK***

Financial instruments potentially subjecting CNET Networks to concentrations of credit risk consist primarily of cash equivalents, marketable debt securities and trade accounts receivable. CNET Networks invests excess cash in low risk, liquid instruments. The majority of CNET Networks' accounts receivable is derived from sales to advertising agencies, located in the United States. CNET Networks closely monitors its outstanding receivable balances on an ongoing basis.

Revenues from one customer, Google, Inc., approximated 12% and 10% of total revenues for the three months ended March 31, 2007 and 2006, respectively.

***RECENT ACCOUNTING PRONOUNCEMENTS***

In June 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS 109, *Accounting for Income Taxes*. FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. This interpretation is effective for fiscal years beginning after December 15, 2006.

CNET Networks files federal income tax returns in the U.S., and also files returns in various state and foreign jurisdictions. CNET Networks is no longer subject to U.S. state, or non-U.S. income tax examinations by tax authorities for years before 2001. Certain U.S. Federal returns for years 1995 and following are not closed by relevant statutes of limitation due to unused net operating losses reported on those returns.

CNET Networks adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized a \$261,000 decrease in the liability for unrecognized tax benefits, which was accounted for as an increase to the January 1, 2007 balance of retained earnings. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Edgar Filing: CNET NETWORKS INC - Form 10-Q

(in thousands)

Balance as of December 31, 2006	\$ 261
Additions based on tax positions related to the current year	
Additions for tax positions of prior years	23,645
Reductions for tax positions of prior years	(261)
Balance as of March 31, 2007	\$ 23,645

**Table of Contents**

Included in the balance at March 31, 2007 is \$23.6 million of tax positions for which the ultimate impact resulted in an adjustment to net operating loss carryforwards. The Company currently maintains a full valuation allowance against the deferred tax assets arising from these net operating losses. Accordingly, the recognition of these unrecognized tax benefits would not affect the annual effective tax rate.

CNET Networks recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in other expenses. During the quarter ended March 31, 2007, CNET Networks recognized and accrued approximately \$110,000 of penalties. There were no penalties recognized and accrued during the quarter ended March 31, 2006.

**(2) ACQUISITIONS AND DISCONTINUED OPERATIONS****Acquisitions**

For the three months ended March 31, 2007, purchase consideration for all acquisitions was as follows:

<b>(in thousands)</b>	
Cash	\$ 10,248
Deferred consideration	876
Direct acquisition costs	267
 Net assets acquired	 \$ 11,391

During the three months ended March 31, 2007, CNET Networks acquired Gamekult in France and acquired the assets of ea3w.com and Stor-Age in China. Gamekult is a video game content site, while ea3w.com is a home consumer electronics buying guide, and Stor-Age is an online media site focused on providing information on storage technology. These acquisitions serve to broaden CNET Networks' content coverage and expand its opportunity to reach new categories of advertisers. Under the terms of the agreements, CNET Networks paid an aggregate purchase price, totaling \$11.4 million for these acquisitions, consisting of \$10.2 million paid in cash, \$0.3 million in direct acquisition costs and a \$0.9 million note payable due in July 2008 bearing interest of 4.0% annually.

The purchase consideration of the acquisitions during the three months ended March 31, 2007 has been allocated to the estimated fair values of the assets acquired and liabilities assumed for these acquisitions at the dates of the acquisitions as follows:

<b>(in thousands)</b>	<b>Total</b>	<b>Weighted Average Life</b>
Cash acquired	\$ 202	
Tangible assets acquired	1,104	
Amortizable intangible assets:		4 years
Trade names	1,733	5 years
Existing relationships	689	4 years
Content	1,455	2 years
Noncompete agreements	82	2 years
Goodwill	7,733	
 Total assets acquired	 12,998	
Liabilities assumed	(1,607)	
 Net assets acquired	 \$ 11,391	

**Table of Contents****Discontinued Operations**

On February 2, 2006, CNET Networks sold its Computer Shopper magazine business. The Computer Shopper magazine business was part of the U.S. Media segment. In accordance with the provisions of SFAS 144, CNET Networks has accounted for this disposal as a discontinued operation. CNET Networks recorded a gain of \$0.8 million associated with the sale, which is also included in discontinued operations.

**(3) GOODWILL AND INTANGIBLE ASSETS****Acquired Intangible Assets**

The following table sets forth the amount of intangible assets that are subject to amortization, including the related accumulated amortization:

(in thousands)	March 31, 2007		Net Carrying Amount	December 31, 2006 Net Carrying Amount
	Gross Carrying Amount	Accumulated Amortization		
Amortized intangible assets:				
Tradenames and trademarks	\$ 44,112	\$ (28,215)	\$ 15,897	\$ 15,230
Existing relationships	17,532	(5,980)	11,552	11,506
Developed technology	8,015	(5,251)	2,764	3,427
Content	7,590	(3,364)	4,226	3,398
Other	3,795	(2,253)	1,542	1,417
<b>Total</b>	<b>\$ 81,044</b>	<b>\$ (45,063)</b>	<b>\$ 35,981</b>	<b>\$ 34,978</b>

Intangible assets that are subject to amortization are amortized on a straight-line basis and have original estimated useful lives as follows: tradenames and trademarks, two to fifteen years; existing relationships, three to seven years; developed technology, two to three years; content, one to five years; and other, one to five years. Useful lives are reviewed regularly to ensure that a change in circumstances has not occurred that would result in a change in useful life. Estimated future amortization expense related to other intangible assets at March 31, 2007 was as follows:

(in thousands)	
Remainder of 2007	\$ 8,970
2008	9,140
2009	6,908
2010	6,127
2011	3,675
Thereafter	1,161
	<b>\$ 35,981</b>

**Table of Contents****Goodwill**

The following table sets forth the changes in goodwill by reporting unit for the three months ended March 31, 2007:

(in thousands)	U.S. Media	Channel Services	Asia	Europe	Total
Balances as of December 31, 2006	\$ 97,047	\$ 5,626	\$ 25,985	\$ 4,401	\$ 133,059
Additions				7,733	7,733
Foreign translation adjustments			4	92	96
 Balances as of March 31, 2007	 \$ 97,047	 \$ 5,626	 \$ 25,989	 \$ 12,226	 \$ 140,888

The U.S. Media and Channel Services reporting units operate in the U.S. Media segment. The Asia and Europe reporting units operate in CNET Networks International segment.

**(4) STOCK BASED COMPENSATION****EMPLOYEE STOCK OPTION PLANS***Stock Option Program Description*

As of March 31, 2007, CNET Networks had the following stock option incentive plans:

(in thousands)	Plan Name	Number of Shares Authorized	Number of Shares Outstanding	Number of Shares Available for Grant
Stockholder-approved Plans		41,000	12,475	8,882
Plans not approved by stockholders		8,827	3,398	1,387
Assumed Plans		<i>Not Applicable</i>	1,065	
 Total			 16,938	 10,269

Stock options for the 1994 Stock Option Plan, the CNET 1997 Stock Option Plan, the CNET 2000 Stock Incentive Plan, and the CNET 2004 Incentive Stock Plan were approved by the stockholders. Stock options for the 2001 CNET Networks, Inc. Stock Incentive Plan and the TwoFold Photos, Inc. 2003 Common Stock Incentive Plan were not approved by the stockholders. Assumed plans are stock option plans that CNET Networks assumed in connection with various acquisitions. All stock options have terms of 10 years, except for options issued to employees in Switzerland which have a term of 12 years, and generally vest and become fully exercisable four years from the date of grant. The vesting schedule for stock option grants are generally as follows: 25% of the grant vests upon one year from date of grant with the remainder of the grant vesting in 36 equal monthly installments thereafter.

**Table of Contents***General Option Information*

The following table summarizes stock option activity for the three months ended March 31, 2007:

<i>(in thousands, except per share data)</i>			
<b>Options</b>	<b>Number of Share Options</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term</b>
Outstanding at December 31, 2006	20,217	\$ 9.76	6.97
Granted	396	8.87	
Exercised	(1,231)	5.24	
Forfeited or expired	(2,444)	13.15	
Outstanding at March 31, 2007	16,938	\$ 9.79	7.05

Intrinsic value is calculated as the difference between the market value of stock on a given date and the exercise price of the shares. The aggregate intrinsic value of \$17.1 million and \$92.7 million as of March 31, 2007 and 2006, respectively, is based on CNET Networks' closing stock price of \$8.71 and \$14.21 on those dates, respectively, and represents the total pretax intrinsic value, which would have been received by the option holders had all option holders exercised their options as of that date.

*Valuation Information under SFAS 123(R)*

The weighted-average estimated grant date fair value of employee stock options granted during the three months ended March 31, 2007 and 2006 was \$4.51 and \$6.55 per share, respectively. The fair value of stock options granted under stock-based compensation plans was estimated using the Black-Scholes option pricing model with the following weighted-average assumptions for grants during the three months ended March 31, 2007 and 2006:

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
<b>Stock options:</b>		
Dividend yield	0%	0%
Expected volatility	50.2-59.3%	56.9%-61.8%
Risk-free interest rate	4.7-4.9%	4.4%-4.8%
Expected term (in years)	3.7-4.6	3.7-4.6
<b>Employee Stock Purchase Plan:</b>		
Dividend yield	0%	0%
Expected volatility	40.4%	34.0%
Risk-free interest rate	5.0%	4.0%
Expected term (in years)	0.39	0.25

CNET Networks' computation of expected volatility is based on a combination of historical and implied stock price volatility. The risk-free interest rate assumption is based upon U.S. Treasury bond rates appropriate for the term of CNET Networks' employee stock options. The dividend yield assumption is based on CNET Networks' history and current expectation of no dividend payouts.

The expected option term is estimated by analyzing the historical term period from grant to exercise and also considering the expected term for those options that are still outstanding.

As of March 31, 2007, there was \$32.4 million of unrecognized compensation cost adjusted for estimated forfeitures related to non-vested stock-based payment awards granted under option plans. That cost is expected to be recognized over a weighted-average period of 2.7 years.





**Table of Contents****Modifications of Stock Options**

Under the terms of the CNET Networks option plans, terminated employees who have vested and exercisable stock options have 90 days after the date of termination to exercise the options. The Form S-8 registration statements for shares of common stock issuable under the option plans were not available from August 2006 through January 2007 due to delays in the filing of financial information with the SEC as a result of the stock option investigation and the restatement of the 2005 financial statements. Therefore, terminated employees were precluded from exercising options until January 2007 when CNET Networks was again in compliance with applicable federal securities laws. In 2006, the Compensation Committee of the Board of Directors approved a modification for these individuals by extending the normal 90-day exercise period after termination date to 30 days after the date that CNET Networks became compliant with SEC filings and the registration of the option shares was once again effective, which 30-day period commenced on January 29, 2007. The liability associated with this modification of approximately \$24.0 million was relieved during the first quarter of 2007 either through the exercise of those options or expiration of the remaining unexercised stock options.

**EMPLOYEE STOCK PURCHASE PLAN**

In July 1996, CNET Networks adopted an Employee Stock Purchase Plan (ESPP) that covers substantially all domestic employees, whereby participants may elect to purchase CNET Networks' stock. The purchase price varies each quarter and is 85% of the lower of the closing price at the beginning of the quarter and the closing price at the end of the quarter for the first and third quarters of the year or the lower of the closing price at the beginning of the prior quarter and the closing price at the end of the current quarter for the second and fourth quarters of the year. Employee contributions consist of a percentage of their compensation. The maximum percentage of compensation that an employee may contribute to purchase CNET Networks stock is 15% subject to a limitation of \$25,000 (of total value) in a calendar year. There were not purchases under the ESPP for the three months ended March 31, 2007. The number of shares available for purchase under the ESPP at March 31, 2007 was 4,986,336.

**(5) NET LOSS PER SHARE**

The following table sets forth the computation of net loss per share:

(in thousands, except per share data)	Three Months Ended March 31,	
	2007	2006
Loss from continuing operations	\$ (9,118)	\$ (1,265)
Weighted average shares basic and diluted	150,386	148,733
Basic and diluted loss per common share	\$ (0.06)	\$ (0.01)

Basic net income (loss) per share is computed using the weighted average number of outstanding shares of common stock and diluted net income per share is computed using the weighted average number of outstanding shares of common stock and dilutive potential common shares during the period. Potential common shares that are anti-dilutive are excluded from the computation of diluted net income per share.

Statement of Financial Accounting Standards No. 128, Earnings per Share, requires that employee equity share options, nonvested shares and similar equity instruments granted by CNET Networks be treated as potential common shares outstanding in computing diluted earnings per share. Diluted shares outstanding include the dilutive effect of in-the-money options which is calculated based on the average share price for each period using the treasury stock method. Under the treasury stock method, the amount the employee must pay for exercising stock options, the amount of compensation cost for future service that CNET Networks has not yet recognized, and the amount of benefits that would be recorded in additional paid-in capital when the award becomes deductible are assumed to be used to repurchase shares.

The following table summarizes potential common shares outstanding excluded from the calculation of diluted net loss per share for the three months ended March 31, 2007 and 2006, because their effect is anti-dilutive:

Edgar Filing: CNET NETWORKS INC - Form 10-Q

(in thousands, except per share data)

	Three Months Ended March 31, 2007		Three Months Ended March 31, 2006	
	Weighted Average Shares	Weighted Average Exercise Price	Weighted Average Shares	Weighted Average Exercise Price
Shares issuable under stock options	16,938	\$ 9.79	18,073	\$ 10.16
Shares issuable pursuant to 0.75% Convertible Senior Notes	NA	NA	8,333	\$ 15.00

**Table of Contents****(6) COMPREHENSIVE LOSS**

The components of other comprehensive loss for the three months ended March 31, 2007 and 2006 are as follows:

(in thousands)	Three Months Ended March 31,	
	2007	2006
Net loss	\$ (9,118)	\$ (1,302)
Other comprehensive loss:		
Unrealized holding gains arising during the period, net of tax	47	36
Unrealized holding losses arising during the period, net of tax	(15)	(53)
Foreign currency translation loss	(416)	(135)
Comprehensive loss	\$ (9,502)	\$ (1,454)

**(7) SEGMENTS**

CNET Networks' primary areas of measurement and decision-making include two principal business segments, U.S. Media and International Media. U.S. Media consists of an online media network focused on topics that people are highly interested in such as technology, entertainment, community and business. International Media includes media properties under several of the same brands as our sites in the United States, with additional brands represented in markets such as China and the United Kingdom and several print publications in China.

Summarized information by segment as excerpted from the internal management reports is as follows:

(in thousands)	U.S. Media	Inter- national Media	Other	Total
<b>Three Months Ended March 31, 2007</b>				
Revenues	\$ 74,238	\$ 17,859	\$	\$ 92,097
Operating expenses	59,981	20,344	20,301	100,626
Operating income (loss)	\$ 14,257	\$ (2,485)	\$ (20,301)	\$ (8,529)
<b>Three Months Ended March 31, 2006</b>				
Revenues	\$ 67,763	\$ 15,887	\$	\$ 83,650
Operating expenses	56,519	17,137	12,316	85,972
Operating income (loss)	\$ 11,244	\$ (1,250)	\$ (12,316)	\$ (2,322)

---

## **Table of Contents**

Since operating income (loss) before depreciation, amortization and stock compensation expense is the measure of operating performance that management uses for making decisions and allocating resources, certain operating costs are not allocated across segments. These unallocated operating costs, included in "Other" in the table above, represent all depreciation and amortization expenses, as well as stock compensation expense.

For the three months ended March 31, 2007, "Other" includes depreciation and amortization expenses of \$10.7 million, stock compensation expense of \$5.2 million and stock option investigation and related matters of \$4.4 million. For the three months ended March 31, 2006, "Other" includes \$7.6 million of depreciation and amortization expense and \$4.8 million of stock compensation expense.

Assets are not allocated to segments for internal reporting purposes. Segment operating income (loss) before depreciation, amortization and stock compensation expense should not be considered a substitute for operating income, cash flows or other measures of financial performance prepared in accordance with accounting principles generally accepted in the United States of America.

## **(8) COMMITMENTS AND CONTINGENCIES**

### **Class Action Suits**

Two shareholder class action lawsuits were filed in the United States District Court for the Southern District of New York on August 16, 2001 and September 26, 2001, against Ziff-Davis, Eric Hippeau and Timothy O'Brien, and investment banks that were the underwriters of the initial public offering of ZDNet series of Ziff-Davis stock (the ZDNet Offering). One of the complaints also names CNET Networks as a defendant, as successor in liability to Ziff-Davis. The complaints are similar and allege violations of the Securities Act of 1933, and one of the complaints also alleges violations of the Securities Exchange Act of 1934. The complaints allege the receipt of excessive and undisclosed commissions by the underwriters in connection with the allocation of shares of common stock to certain investors in the ZDNet Offering and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices. Plaintiffs allege that the prospectus for the ZDNet Offering was false and misleading and in violation of the securities laws because it did not disclose the arrangements. A Consolidated Amended Complaint, which is now the operative complaint, was filed in the Southern District of New York on April 19, 2002. For more details on this matter, please see the Company's Annual Report on Form 10-K for the year ended December 31, 2006. Since the filing of the Company's Annual Report on Form 10-K for the year ended December 31, 2006, the Second Circuit denied Plaintiffs' petition for rehearing of the Court's reversal of the district court's order granting class certification. The Second Circuit noted, however, that Plaintiffs could ask the district court to certify a more narrow class than the one that was rejected.

### **Shareholder Derivative Suits**

On June 19, 2006, a purported shareholder derivative complaint was filed in the United States District Court for the Northern District of California by a party identifying itself as a shareholder of CNET Networks purporting to act on behalf of CNET Networks against the directors of CNET Networks and certain present and former officers of CNET Networks. CNET Networks is also named as a nominal defendant. The suit, captioned *Melzer v. Bonnie, et al.*, alleged violations of federal securities law, California securities law, as well as breach of fiduciary duty, unjust enrichment, and insider trading arising from stock options granted between 1997 and 2003. On July 13, 2006, another purported shareholder derivative complaint, captioned *Finn v. Bonnie et al.*, was filed in the same court containing identical allegations. These purported shareholder derivative actions pending before the United States District Court for the Northern District of California were consolidated on August 31, 2006 and the plaintiffs in those cases have subsequently filed a consolidated complaint on September 28, 2006. That consolidated complaint was amended on November 9, 2006. The complaint seeks monetary damages, disgorgement, an accounting and constructive trust, rescission of stock options and other relief against the defendants on behalf of CNET Networks. The amended complaint also seeks an order directing CNET Networks to undertake certain corporate governance procedures. The complaint does not seek monetary damages from, or the imposition of equitable remedies on, CNET Networks.

On April 11, 2007, the District Court granted our motion to dismiss for failure to present a litigation demand, but granted leave for plaintiffs to further amend their complaint in a separate order on April 30, 2007.

---

## **Table of Contents**

Except as disclosed above, there have been no material developments in the legal proceedings disclosed in CNET Networks' Annual Report on Form 10-K for the year ended December 31, 2006. The Company's accounting policy is to accrue a liability for those matters when both probable loss has occurred and the amount of loss is reasonably estimable.

### **(9) SUBSEQUENT EVENT**

#### **Tender Offer to Amend Exercise Prices**

On March 7, 2007, CNET Networks filed a Tender Offer Statement on Schedule TO with the U.S. Securities and Exchange Commission and commenced an offer (the "Offer") to amend certain options that had been granted to employees with exercise prices per share that were less than the fair market value per share used for financial accounting purposes which options are referred to as discount options.

Under the terms of the Offer, individuals eligible to participate in the offer must have been: (i) a U.S.-based employee on April 7, 2007, the date on which the offer expired; and (ii) holding a discount option grant that was unvested as of December 31, 2004 ("Eligible Options"). Officers and Directors of CNET Networks were not eligible to participate in the Offer.

The terms of the Offer provided that employees could elect to have Eligible Options amended to increase their exercise price per share to be equal to the fair market value used for financial reporting purposes and to receive a cash payment with respect to such amended options equal to the difference between the amended exercise price and the original exercise price of each Eligible Option, less applicable withholding taxes.

As of April 4, 2007, the date on which the offer expired, the Company had received election forms from eligible employees agreeing to amend and increase to fair value the exercise price with respect to 897,465 Eligible Options. Under the terms of the Offer, the Company will make cash payments in January 2008 totaling approximately \$2.1 million to the individuals who have amended their Eligible Options. The cost associated with the amendment (the future cash payment) will be recorded in April 2007 as that is when the offer expired.

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

This report contains forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially. Further information about these forward-looking statements and risks associated with our business can be found in Part II, ITEM 1A "Risk Factors."

### **OVERVIEW**

CNET Networks, Inc., or CNET Networks, is an interactive media company that builds brands for people and the things they are passionate about, such as technology, entertainment, business, food and parenting. The Company's leading brands include CNET, GameSpot, TV.com, MP3.com, ZDNet, TechRepublic, CHOW and UrbanBaby. Founded in 1992, CNET Networks has a strong presence in the United States, Asia and Europe.

We have determined that our business segments are U.S. Media and International Media. U.S. Media consists of an online media network focused on topics that people are highly interested in, such as technology, entertainment, community and business. International Media includes media properties under several of the same brands as our sites in the United States, with additional brands represented in markets such as China and the United Kingdom and several print publications in China. Within these business segments, we earn revenues from:

Marketing Services: sales of advertisements on our Internet network through impression-based advertising (fees earned from the number of times an advertisement is viewed by users of our websites) and activity-based advertising (fees earned when our users click on an advertisement or text link to visit the websites of our merchant partners, or download a software application or a whitepaper); and sales of advertisements in our print publications.

---

**Table of Contents**

Licensing, Fees and User: licensing our product database and online content, subscriptions to our online services and print publications, and other paid services.

We had an average of 143.7 million unique users per month in the first quarter of 2007, compared to 116.8 million unique users in the first quarter of 2006, an increase of 23%. The increase in unique user growth was experienced across all of our properties, especially in the Entertainment and Business properties. These users generated over 81.2 million Web page views per day during the first quarter of 2007 compared to 98.7 million in the first quarter of 2006, an 18% decrease. The decline in page views was driven primarily by Webshots, which has experienced increasing competitive pressures. Our focus is on audience development and creating more engaging experiences for our users. With the addition of more video, audio and other emerging media formats to our properties, we expect to see page views grow at a slower rate. While increases or decreases in unique users and daily average page views are not necessarily indicative of increases or decreases in financial results, we believe that these statistics are helpful because they provide insight into the growth of the Internet as an advertising medium resulting from increased user adoption and increased user demand for CNET Networks' properties in particular.

Operating expenses included in our operating income (loss) before depreciation, amortization, and stock compensation expense consist of cost of revenues, sales and marketing, general and administrative costs and stock option and related matters costs, which are primarily cash related expense activities. The majority of our cash related expenses are costs associated with employee compensation, benefits and facilities. Non-cash related expenses consist of depreciation, amortization of intangible assets and stock compensation expense and are included in our operating income (loss).

Cost of revenues includes costs associated with the production and delivery of our Internet sites, print publications and creation of our product database and related technology. The principal elements of cost of revenues for our operations are compensation and associated expenses for the editorial, production and technology staff and related costs for facilities and equipment. A substantial portion of expenses included in our cost of revenues remain consistent from period to period and do not necessarily fluctuate proportionately with fluctuations in revenues.

Sales and marketing expenses consist primarily of compensation and related expenses including associated costs for facilities, consulting fees and advertising expenses.

General and administrative expenses consist of compensation and related expenses for executive, finance, legal and administrative personnel, professional fees and other general corporate expenses and associated costs for facilities and equipment.

We evaluate our financial performance primarily on the following key measurements:

Revenues

Operating income

We evaluate our liquidity primarily on the following key measurements:

Operating income (loss) before depreciation, amortization and stock compensation expense

Net cash provided by (used in) operating activities

Free cash flow

**RESULTS OF OPERATIONS**

**Revenues**

The following table sets forth our revenues for the three months ended March 31, 2007 and 2006;



**Table of Contents**

(in thousands)	Three Months Ended March 31,					
	2007			2006		
	Total	U.S. Media	International Media	Total	U.S. Media	International Media
<b>Revenues:</b>						
Marketing services	\$ 80,445	\$ 64,165	\$ 16,280	\$ 71,233	\$ 56,981	\$ 14,252
Licensing, fees and user	11,652	10,073	1,579	12,417	10,788	1,629
	\$ 92,097	\$ 74,238	\$ 17,859	\$ 83,650	\$ 67,769	\$ 15,881
Increase over prior year	10%	10%	12%	17%	15%	26%
<b>As a Percentage of Revenues:</b>						
Marketing Services	87%	86%	91%	85%	84%	90%
Licensing, fees and user	13%	14%	9%	15%	16%	10%
	100%	100%	100%	100%	100%	100%

*Total Revenues.* Total revenues were \$92.1 million and \$83.7 million for the three months ended March 31, 2007 and 2006, respectively. Total revenues increased 10% for the quarter ended March 31, 2007 as compared to the corresponding period in 2006 due to growth in our marketing services revenues.

For the three months ended March 31, 2007 as compared to prior year, revenues have increased for both the U.S. Media segment and the International Media segment. The increase in revenues for the U.S. Media segment is related to an increase in marketing services revenue. The increase in revenues for the International Media segment is from growth due to the impact of changes in exchange rates on revenues denominated in certain foreign currencies and an increase from acquisitions offset by lower publishing revenues.

For the three-month periods ended March 31, 2007 and 2006, approximately \$3.9 million and \$3.5 million of our revenues were derived from barter transactions, respectively. Barter transactions occur when we deliver marketing services for the marketing services of other companies. These revenues and marketing expenses were recognized at the fair value of the advertisements delivered.

*Marketing Services Revenues.* Marketing services revenues were \$80.4 million and \$71.2 million and represented 87% and 85% of total revenues for the three months ended March 31, 2007 and 2006, respectively. Marketing services revenues increased by \$9.2 million, or 13%, for the three months ended March 31, 2007 compared to the three months ended March 31, 2006. The increase in marketing services revenues was driven by growth in branding advertising in the categories where we have traditionally seen demand, such as consumer electronics, games and computing, and to a lesser extent from increased advertising from new categories, such as automobiles, media and entertainment, reflecting the expansion of our content offerings and broadening user audiences. The growth in branding advertising revenue was partially offset by a decrease in transactional activity among our users, resulting in lower revenue from leads to merchants, as well as a decrease in advertising in our international print publications.

*Licensing, Fees and User.* Licensing, fees and user revenues were \$11.7 million and \$12.4 million and represented 13% and 15% of total revenues for the three-month periods ended March 31, 2007 and 2006, respectively. The \$0.7 million, or 6% decrease in the three months ended March 31, 2007 reflects the discontinuance of the events business in the United States, which held its main event in the first quarter of each year.



**Table of Contents****Operating Expenses**

(in thousands)	Three Months Ended March 31,					
	Operating Expense	2007 Noncash expense	Cash expense	Operating Expense	2006 Noncash expense	Cash expense
Operating expenses:						
Cost of revenues	\$ 43,482	\$ 1,765	\$ 41,717	\$ 41,419	\$ 1,964	\$ 39,455
Sales and marketing	25,926	843	25,083	22,963	896	22,067
General and administrative	16,080	2,555	13,525	14,029	1,896	12,133
Stock option investigation and related matters	4,429		4,429			
Depreciation	7,489	7,489		4,822	4,822	
Amortization	3,220	3,220		2,739	2,739	
Total operating expenses	\$ 100,626	\$ 15,872	\$ 84,754	\$ 85,972	\$ 12,317	\$ 73,655
Increase over prior year		17%		15%	19%	13%

*Cost of Revenues, Sales and Marketing, General and Administrative.* We refer to cost of revenues, sales and marketing, and general and administrative expenses (excluding non-cash stock compensation expense) as cash-related expenses. We incurred cash-related expenses in aggregate of \$84.8 million and \$73.7 million for the three months ended March 31, 2007 and 2006, respectively, representing approximately 92% and 88% of total revenues, respectively. The majority of our cash-related expenses were costs associated with employee compensation, benefits and facilities. Total cash-related expenses increased approximately 15% for the three months ended March 31, 2007 when compared to the prior year. The increase related primarily to higher compensation and benefit costs resulting from an approximate 13% increase in our headcount from first quarter 2006 to first quarter 2007 as we invest in longer-term growth opportunities. We expect cash-related expenses to increase as there were several executive positions open during the first quarter of 2007 which we expect to hire into in the second quarter of 2007.

For the three months ended March 31, 2007, the U.S. Media segment cash-related expenses as a percentage of revenues were relatively flat as compared to the prior year. The International Media segment cash related expenses were 114% of revenues in the three months ended March 31, 2007, compared to 108% of revenues in the three months ended March 31, 2006. The increase in cash related expenses in the International Media segment is primarily due to headcount increases and the impact of foreign exchange.

Noncash stock compensation expense included in our statement of operations was as follows:

(in thousands)	Three Months Ended March 31,	
	2007	2006
Stock compensation expense included in:		
Cost of revenues	\$ 1,765	\$ 1,964
Sales and marketing	843	896
General and administrative	2,555	1,896
Stock compensation expense	\$ 5,163	\$ 4,756

*Stock Option Investigation and Related Matters.* We incurred expenses of \$4.4 million during the first quarter of 2007 related to costs incurred in connection with an internal investigation of our stock option accounting practices and related matters. These expenses represent costs for outside legal counsel and outside accounting experts that were engaged by management in performing the investigation of our stock option accounting and related restatement of our historical financial statements to correct errors found in the investigation and legal fees associated with government inquiries. We expect additional expenses to be recorded in 2007 primarily in connection with the derivative suits and government inquiries, but can not estimate how much these expenses might be. A portion of our legal expenses incurred related to the derivative suits may be subject to reimbursement under our insurance coverage. If and when we do receive reimbursements for our legal expenses incurred, we will record the reimbursement when received.



**Table of Contents**

*Depreciation and Amortization.* Depreciation expense was \$7.5 million and \$4.8 million for the three months ended March 31, 2007 and 2006, respectively. The increase in depreciation expense is due to increased capital expenditure spending related to the launch of new products and to accommodate growth in users and usage.

Intangible asset amortization expense was \$3.2 million and \$2.7 million for the three months ended March 31, 2007 and 2006, respectively. Our amortization expense increased due to the amortization of intangible assets that were acquired in 2006.

**Operating Loss**

Operating loss for the three months ended March 31, 2007 was \$8.5 million compared to an operating loss of \$2.3 million in 2006. Although our revenues increased by \$8.4 million in the first quarter of 2007 as compared to 2006, our operating income decreased due to stock option investigation expenses of \$4.4 million and increased expenses driven by the investment of additional personnel in both our new and existing businesses.

**Nonoperating Income and Expense**

*Realized Gains on Investments.* We recognized gains of \$0.5 million during the three months ended March 31, 2006 from sales of certain privately-held investments to third parties. There were no sales of investments during the quarter ended March 31, 2007.

*Interest Income and Interest Expense.* Interest income is earned on our cash and cash equivalents and investments in marketable debt securities. Interest income decreased by approximately \$0.5 million for the three months ended March 31, 2007 as compared to the three months ended March 31, 2006 due to lower cash and investment balances.

Interest expense increased in the first quarter of 2007 due to a higher interest rate on our outstanding balance on our \$60.0 million line of credit as compared to the interest incurred in the first quarter of 2006 on our \$125.0 million 0.75% Convertible Senior Notes that were repaid in October 2006.

*Other, net.* Other, net included a gain on derivative of \$0.7 million, offset by a net loss on foreign exchange transactions of approximately \$0.2 million and tax penalties of \$0.2 million for the three months ended March 31, 2007. The gain on derivative resulted from a liability recorded in 2006 related to a modification of stock option awards for certain terminated employees which allowed an extension of the normal 90-day exercise period after termination date to 30 days after the date that CNET Networks became compliant with SEC filings and the registration of the option shares was once again effective, which 30-day period commenced on January 29, 2007. As the holders of these options were no longer employees, the liability associated with this modification was accounted for in accordance with Emerging Issues Task Force Issue 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock*. On the dates of modification, the options with the extended exercise terms were initially measured at fair value and subsequent changes in fair value are reported in earnings. The gain on derivative recorded in the first quarter of 2007 represented such a change in fair value. The remaining liability was relieved upon the expiration of the affected options.

Other, net for the three months ended March 31, 2006 primarily represented net gain on foreign exchange transactions of \$0.1 million.

**Liquidity and Capital Resources**

When evaluating our overall cash position for the purpose of assessing our liquidity, we consider our cash and cash equivalents, short-term and long-term investments in marketable debt securities and restricted cash.

(in thousands)	March 31, 2007	December 31, 2006
Cash and cash equivalents	\$ 45,282	\$ 31,327
Short-term marketable debt securities	24,881	30,372
Long-term marketable debt securities	2,500	13,915
 Total cash, cash equivalents and investments	 \$ 72,663	 \$ 75,614



## **Table of Contents**

We evaluate our liquidity primarily on the following key measurements:

Net cash provided by operating activities

Operating income (loss) before depreciation, amortization and stock compensation expense

Free cash flow

Other key factors that impact our liquidity include:

Capital expenditures

Cash used for investments and acquisitions

Debt obligations or debt retirement

Proceeds from sales of our stock through stock option and employee stock purchase plan.

### **Net Cash Provided by Operating Activities**

Net cash provided by operating activities of \$11.0 million for the three months ended March 31, 2007 included a net loss of \$9.1 million and non-cash depreciation and amortization charges totaling \$10.7 million, as well as non-cash stock compensation expense of \$5.2 million. Net cash provided by operating activities also included cash generated from working capital items, primarily \$13.6 million from accounts receivable. Net cash provided by operating activities of \$29.2 million for the three months ended March 31, 2006 included a net loss of \$1.3 million, depreciation and amortization totaling \$7.6 million, non-cash stock compensation expense of \$4.8 million and an increase in working capital primarily from accounts receivable. We may from time-to-time require cash for working capital purposes as our business expands.

### **Net Cash Used in Investing Activities**

Net cash used in investing activities of \$3.7 million for the three months ended March 31, 2007 was primarily due to capital expenditures and cash used for acquisitions, offset by proceeds from the sale of marketable debt securities. The net cash used in investing activities for the three months ended March 31, 2006 of \$15.0 million was primarily due to capital expenditures, purchases of marketable debt securities and acquisitions and investments.

*Acquisitions of property and equipment.* Capital expenditures for the three months ended March 31, 2007 were \$9.5 million. These capital expenditures include improvements made on our new U.K. office space for the benefit of our landlord. The landlord reimbursed us \$2.3 million for certain improvements to the leased facility in a transaction accounted for as a sale-leaseback. Capital expenditures for the full year 2007 are expected to be between \$35.0 million and \$40.0 million, an increase over the prior year due to the continued launch of new products and growth in users.

*Acquisitions and Investments.* Cash used for acquisitions in the first quarter of 2007, represents payment of deferred consideration totaling \$3.8 million for the 2005 TV Tome acquisition and the 2006 XCar acquisition, as well as the acquisition of Gamekult in France and two asset acquisitions in China. We routinely evaluate new business opportunities and ventures, including acquisitions, in a broad range of areas and expect to fund such investments through our existing cash and marketable debt securities, cash generated from operations and available bank borrowings.

## Edgar Filing: CNET NETWORKS INC - Form 10-Q

*Operating income before depreciation, amortization and stock compensation expense.* The following table reconciles operating income before depreciation, amortization and stock compensation expense to operating loss as calculated in accordance with GAAP (accounting principles generally accepted in the United States) for three months ended March 31, 2007 and 2006:

(in thousands)	Three Months Ended March 31,	
	2007	2006
Operating loss	\$ (8,529)	\$ (2,322)
Stock compensation expense	5,163	4,756
Depreciation	7,489	4,822
Amortization	3,220	2,739
Operating income before depreciation, amortization and stock compensation expense	\$ 7,343	\$ 9,995

---

**Table of Contents**

We believe that operating income before depreciation, amortization and stock compensation expense is useful to management and investors as a supplement to our GAAP financial measures for evaluating the ability of the business to generate cash from operations. Depreciation and amortization are noncash items and include within them amounts related to past transactions and expenditures that are not necessarily reflective of the current cash or capital requirements of the business. Stock compensation expense is a noncash item that does not reflect upon the ability of the business to generate cash from operations.

Management refers to operating income before depreciation, amortization and stock compensation expense in making operating decisions and for planning and compensation purposes. A limitation associated with this measure is that it does not reflect the costs of certain capitalized tangible and intangible assets used in generating revenues. Management compensates for these limitations by relying primarily on our GAAP financial measures, such as capital expenditures, and using operating income before depreciation, amortization and stock compensation expense only on a supplemental basis. Although depreciation and amortization are noncash charges, the capitalized assets being depreciated and amortized will often have to be replaced in the future, and operating income before depreciation, amortization and stock compensation expense does not reflect any cash requirements for such replacements. Similarly, our stock compensation reduces deferred compensation expense, a component of our stockholders' equity, which has no impact on current or future cash. This measure also does not take into account interest expense, or the cash requirements necessary to service interest or principal payments on our debt. Nor does the measure reflect changes in, or cash requirements for, our working capital needs. Operating income before depreciation, amortization and stock compensation expense should be considered in addition to, and not as a substitute for, other measures of financial performance prepared in accordance with GAAP.

Excluding noncash charges consisting of depreciation, amortization and stock compensation expense, our operating income was \$7.3 million and \$10.0 million for the three months ended March 31, 2007 and 2006, respectively. The decrease in operating income before depreciation, amortization and stock compensation expense in 2007 as compared to 2006 was due to an increase in revenues offset by increased investment in additional personnel for both our new and existing businesses and costs of our stock option investigation and related matters.

Operating income before depreciation, amortization and stock compensation expense is a key liquidity measurement as it can be the primary driver of the cash provided by operating activities. It is also a measure used by the financial institution with which we have a \$60.0 million credit facility in determining compliance with certain financial covenants required under this borrowing. Operating income before depreciation, amortization and stock compensation expense should be considered in addition to, and not as a substitute for, other measures of financial performance prepared in accordance with GAAP.

**Free cash flow.** Free cash flow is defined as net cash provided by operating activities less capital expenditures. Free cash flow for the three months ended March 31, 2007 was \$1.5 million (cash provided by operating activities of \$11.0 million, less capital expenditures of \$9.5 million, which includes the \$2.3 million reimbursement from the landlord for improvements to our leased space in the United Kingdom that was accounted for as a sale-leaseback). This compares to free cash flow for the three months ended March 31, 2006 of \$20.5 million (cash provided by operating activities of \$29.2 million, less capital expenditures of \$8.7 million). The decrease in free cash flow in the first quarter of 2007 as compared to the same period in 2006 resulted from a greater net loss primarily due to less cash from working capital items including cash resulting from changes in accounts receivable and was also due in part to costs associated with our stock option investigation and related matters.

We believe that free cash flow provides useful information about the ability of our business operations to generate cash after the purchase of property and equipment. A limitation of free cash flow is that it does not represent the total increase or decrease in the cash balance for the period which would include activities such as acquisitions and debt or equity transactions. Free cash flow should be considered in addition to, and not as a substitute for, other measures of financial performance prepared in accordance with GAAP.

**Table of Contents****Net Cash Provided by Financing Activities**

Cash provided by financing activities of \$6.5 million and \$4.3 million for the three months ended March 31, 2007 and 2006, respectively, was due to the issuance of common stock through the exercise of stock options in both quarters and the purchase of stock through our employee stock purchase plan in the three months ended March 31, 2006.

**Debt and Cash Balances**

As of March 31, 2007, we had \$77.0 million of outstanding indebtedness, of which \$71.5 million was classified as current, which included \$60.0 million outstanding on a line of credit due in October 2007. We were in compliance with all debt covenants at March 31, 2007 and expect to remain in compliance with these covenants through the term of the borrowing. As of March 31, 2007, we had long-term borrowings under notes payable totaling \$5.5 million comprised of \$2.7 million of Swiss mortgage notes payable, \$2.2 million in notes payable related to acquisitions and a \$0.6 million note payable.

As of March 31, 2007, we had cash and investments of \$72.7 million. We have prepared a forecast for 2007 which is based on our current expectations regarding revenue growth and associated operating expense and capital spending levels. If our actual results should differ materially from our expectations, our liquidity may be adversely impacted. If that were to occur, we would take steps to adjust our operating costs and capital expenditures to levels necessary to support our anticipated business levels. We may also need to raise additional equity or borrow additional funds to achieve our longer-term business objectives. We cannot assure you, however, that such equity or borrowings will be available or, if available, will be at rates or prices which are acceptable to us. Our ability to raise such additional capital, however, will depend on market conditions at the time. In addition, our \$60.0 million credit facility limits further borrowings which could impact our ability to fund acquisitions, support cash needed to fund our operations or to pay for capital purchases. We believe that our anticipated cash flows from operating activities coupled with existing cash and investment balances will be sufficient to fund our working capital, debt service and purchases of property, plant and equipment through March 31, 2008, including the \$60.0 million outstanding on a one-year credit facility which expires in October 2007. The performance of our business is dependent on many factors and subject to risks and uncertainties as discussed under *Risk Factors that May Affect Future Operating Performance* in Part II, ITEM 1A *Risk Factors* of this Quarterly Report on Form 10-Q.

***CRITICAL ACCOUNTING POLICIES AND ESTIMATES***

There have been no material changes to our critical accounting policies and estimates from the information provided in Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies and Estimates* included in our 2006 Form 10-K.

***RECENT ACCOUNTING PRONOUNCEMENTS***

In February 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 159, *Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS 159 ). SFAS 159 permits companies to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007, although earlier adoption is permitted. We are currently evaluating the impact that SFAS 159 will have on our consolidated financial statements.

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

We are exposed to the impact of interest rate changes and changes in the market values of our investments.

**Interest Rate Risk.** We have interest rate risk with respect to our credit facility under which we can borrow up to \$60.0 million. Interest rates applicable to amounts outstanding under this facility are at variable rates based on the Federal Funds rate plus 0.5% or the LIBOR plus an applicable margin based on our leverage. A change in interest rates on this variable rate debt impacts the interest incurred and cash flows but does not impact the fair value of the instrument.

We also have exposure to market rate risk for changes in interest rates as those rates relate of our investment portfolio. We have not used derivative financial instruments in our investment portfolio. We invest our excess cash in debt instruments of the United States Government and its agencies, and in high-quality corporate issuers that, by policy, limit the amount of credit exposure to any one





---

## **Table of Contents**

issuer. We protect and preserve our invested funds by limiting default, market and reinvestment risk. Investments in both fixed rate and floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Accordingly, our future investment income may fluctuate due to changes in interest rates, or we may suffer losses in principal if forced to sell securities that have declined in market value due to changes in interest rates.

**Investment Risk.** We invest in equity instruments of privately held, information technology companies for business and strategic purposes. These investments are included in other long-term assets and are accounted for under the cost method, as we do not have the ability to exert significant influence over the investee or their operations. For these non-quoted investments, our policy is to regularly review the assumptions underlying the operating performance and cash flow forecasts in assessing the carrying values. We identify and record impairment losses on investments when events and circumstances indicate that such assets might be impaired.

**Foreign Currency Risk.** The revenues and expenses associated with our overseas operations are exposed to foreign currency risk. Changes in value of the U.S. dollar against the currencies in which those operations are conducted causes increases or decreases in the ongoing financing of those operations, and results in an increase or decrease in our recorded revenues and expenses and may impact our operating income. We monitor our foreign currency exposures regularly to assess our risk and to determine if we should hedge our currency positions.

### **ITEM 4. Controls and Procedures**

a) **Evaluation of disclosure controls and procedures.** Our chief executive officer and our chief financial officer, after evaluating the effectiveness of our "disclosure controls and procedures", as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as of the end of the fiscal quarter covered by this Quarterly Report on Form 10-Q to ensure that information we are required to disclose in reports that are filed or submitted under the Securities Exchange Act of 1934, as amended, are recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission rules and forms. Based on this evaluation, our chief executive officer and chief financial officer have concluded that as of March 31, 2007, our disclosure controls and procedures were effective.

b) **Changes in internal controls over financial reporting.** There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Given the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, will be detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Further, the design of a control system must reflect the fact that there are resource constraints, and that benefits of controls must be considered relative to their costs. The design of any system of controls is also based in part on certain assumptions regarding the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

## **PART II. OTHER INFORMATION**

### **ITEM 1. Legal Proceedings.**

#### **United States Attorney and SEC Inquiries**

On June 26, 2006, CNET Networks received a grand jury document subpoena from the United States Attorney for the Northern District of California requesting records pertaining to the granting of stock options. In addition in May 2006, CNET Networks received notice that the Securities and Exchange Commission (SEC) was conducting an informal inquiry into CNET Networks' stock option grants. CNET Networks is cooperating, and will continue to cooperate fully with the United States Attorney for the Northern District of California and the SEC. CNET Networks cannot predict the outcome of these investigations.

#### **Class Action Suits**

## Edgar Filing: CNET NETWORKS INC - Form 10-Q

Two shareholder class action lawsuits were filed in the United States District Court for the Southern District of New York on August 16, 2001 and September 26, 2001, against Ziff-Davis, Eric Hippeau and Timothy O'Brien, and investment banks that were the

## **Table of Contents**

underwriters of the public offering of ZDNet series of Ziff-Davis stock (the ZDNet Offering). One of the complaints also names CNET Networks as a defendant, as successor in liability to Ziff-Davis. The complaints are similar and allege violations of the Securities Act of 1933, and one of the complaints also alleges violations of the Securities Exchange Act of 1934. The complaints allege the receipt of excessive and undisclosed commissions by the underwriters in connection with the allocation of shares of common stock to certain investors in the ZDNet Offering and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices. Plaintiffs allege that the prospectus for the ZDNet Offering was false and misleading and in violation of the securities laws because it did not disclose the arrangements. A Consolidated Amended Complaint, which is now the operative complaint, was filed in the Southern District of New York on April 19, 2002. For more details on this matter, please see the Company's Annual Report on Form 10-K for the year ended December 31, 2006. Since the filing of the Company's Annual Report on Form 10-K for the year ended December 31, 2006, the Second Circuit denied Plaintiffs' petition for rehearing of the Court's reversal of the district court's order granting class certification. The Second Circuit noted, however, that Plaintiffs could ask the district court to certify a more narrow class than the one that was rejected.

### **Shareholder Derivative Suits**

On June 19, 2006, a purported shareholder derivative complaint was filed in the United States District Court for the Northern District of California by a party identifying itself as a shareholder of CNET Networks purporting to act on behalf of CNET Networks against the directors of CNET Networks and certain present and former officers of CNET Networks. CNET Networks is also named as a nominal defendant. The suit, captioned *Melzer v. Bonnie, et al.*, alleged violations of federal securities law, California securities law, as well as breach of fiduciary duty, unjust enrichment, and insider trading arising from stock options granted between 1997 and 2003. On July 13, 2006, another purported shareholder derivative complaint, captioned *Finn v. Bonnie et al.*, was filed in the same court containing identical allegations. These purported shareholder derivative actions pending before the United States District Court for the Northern District of California were consolidated on August 31, 2006 and the plaintiffs in those cases have subsequently filed a consolidated complaint on September 28, 2006. That consolidated complaint was amended on November 9, 2006. The complaint seeks monetary damages, disgorgement, an accounting and constructive trust, rescission of stock options and other relief against the defendants on behalf of CNET Networks. The amended complaint also seeks an order directing us to undertake certain corporate governance procedures. The complaint does not seek monetary damages from, or the imposition of equitable remedies on, CNET Networks.

On April 11, 2007, the District Court granted our motion to dismiss for failure to present a litigation demand, but granted leave for plaintiffs to further amend their complaint in a separate order on April 30, 2007.

Except as disclosed above, there have been no material developments in the legal proceedings disclosed in CNET Networks' Annual Report on Form 10-K for the year ended December 31, 2006.

### **ITEM 1A. Risk Factors**

#### ***SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS AND RISK FACTORS***

This Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are any statements other than statements of historical fact. Examples of forward-looking statements include projections of earnings, revenues or other financial items, statements of the plans and objectives of management for future operations, and statements concerning proposed new products and services, and any statements of assumptions underlying any of the foregoing. In some cases, you can identify forward-looking statements by the use of words such as may, will, expects, should, believes, plans, anticipates, estimates, predicts, potential, or continue, and any other words of similar meaning.

Any or all of our forward-looking statements in this report and in any other public statements we make may turn out to be wrong and may cause our actual results to differ materially from forecasted or historical results. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties, including those outlined below. Consequently, no forward-looking statement can be guaranteed. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosures we make on related subjects in our reports to the Securities and Exchange Commission. Also note that we provide cautionary discussion of risks, uncertainties and possibly inaccurate assumptions relevant to our businesses. These are factors that we think could cause our actual results to differ materially from expected and historical results. Other factors besides those listed here could also adversely affect us. This discussion is provided as permitted by the Private Securities Litigation Reform Act of 1995.



---

**Table of Contents**

You should carefully consider the risks described below before making an investment decision regarding CNET Networks securities. Our business, financial condition or results of operations could be materially adversely affected by any of these risks. The trading price of our common stock could decline due to any of these risks. The risks described below are not the only ones we face. Additional risks not presently known to us or that we currently deem immaterial may also impair our business operations.

***The matters relating to the Special Committee's and Management's review of our past stock option granting practices and the restatement of our consolidated financial statements have resulted in expanded litigation and regulatory proceedings and may result in future litigation and regulatory proceedings which could harm our financial results.***

On May 22, 2006, we announced that our Board of Directors had appointed a Special Committee comprised of independent directors to conduct, with the assistance of legal counsel and outside accounting experts, an internal investigation relating to past option grants, the timing of such grants and related accounting matters. The Special Committee reached a preliminary conclusion in July 2006, concluding that the actual measurement dates for certain stock options granted between 1998 and 2001 differed from the recorded measurement dates. Charges related to the change in these stock option measurement dates were determined to be material and, as a result, on January 29, 2007, we filed restated financial statements for 2005, 2004 and 2003 and the first quarter of 2006.

Our review of our past stock option granting practices has required us to incur substantial expenses for legal, accounting, tax and other professional services, has diverted our management's attention from our business, and could in the future harm our business, financial condition, results of operations and cash flows.

Our past stock option granting practices and the restatement of our prior financial statements have exposed us to greater risks associated with litigation and regulatory proceedings. In June 2006, we received a grand jury document subpoena from the United States Attorney for the Northern District of California requesting records pertaining to the granting of stock options. In addition, in May 2006 we received notice that the Securities and Exchange Commission (SEC) was conducting an informal inquiry into our stock option grants. We are cooperating, and will continue to cooperate fully with the United States Attorney for the Northern District of California and the SEC. We cannot predict the outcome of these investigations. In addition, as described in Part II, Item 3, Legal Proceedings, several derivative complaints have been filed against our directors and certain of our executive officers pertaining to allegations relating to stock option grants. We cannot guarantee that new lawsuits from third parties or regulatory proceedings from additional government agencies, including but not limited to the Internal Revenue Service, related to the investigation or our restatements will not be filed, and we cannot predict the outcome of any current or potential future litigation or regulatory proceeding against CNET Networks or our directors or officers.

While we believe that we have made appropriate judgments in determining the correct measurement dates for option grants, the SEC may disagree with the manner in which we have accounted for and reported, or not reported, the financial impact of past option grant measurement date errors, and there is a risk that any SEC inquiry could lead to circumstances in which we may have to further restate our prior financial statements, amend prior filings with the SEC, or otherwise take other actions not currently contemplated. In addition, the SEC may issue additional guidance on disclosure requirements related to the financial impact of past option grant measurement date errors that may require us to amend this filing or prior filings with the SEC to provide additional disclosures pursuant to this guidance. Any such circumstance could also lead to future delays in filing our subsequent SEC reports and delisting of our common stock from the Nasdaq Global Select Market. Furthermore, if we are subject to adverse findings in any of these matters, we could be required to pay damages or penalties or have other remedies imposed upon us which could harm our business, financial condition, results of operations and cash flows.

***The matters relating to the Special Committee's and Management's review of our past stock option granting practices and the restatement of our consolidated financial statements may otherwise adversely impact our business.***

As a result of our delayed filing of our Quarterly Reports on Form 10-Q for the quarters ended June 30, 2006 and September 30, 2006, we will be ineligible to register our securities on Form S-3 for sale by us or resale by others until November 2007. We may use Form S-1 to raise capital or complete acquisitions, but doing so could increase transaction costs and adversely impact our ability to raise capital or complete acquisitions of other companies in a timely manner.

---

**Table of Contents**

Employees who were awarded options that were granted at a discount from fair market value and were all or partially unvested as of December 31, 2004, which we refer to as discount options, may be subject to income tax liability on the vesting date of those discount options in addition to a 20% excise tax under Internal Revenue Code Section 409A ( Section 409A ) and parallel state taxes. In March 2007, CNET Networks notified the IRS of its intent to participate in the IRS 409A compliance relief program. In March of 2007, the Company also elected to participate in a similar program offered by the California Franchise Tax Board. Under these programs, the Company intends to pay state and federal income taxes incurred under Section 409A on behalf of employees for whom such taxes apply as a result of their exercise of discount options during 2006. The Company intends to make a further tax reimbursement payment to such employees in order to defray the tax consequences of the Company's payment of Section 409A taxes on the employees' behalf. In order to assist current non-executive employees holding discount options to avoid future adverse tax consequences, we launched a tender offer in March. Under the terms of the offer, which closed in early April, employees were given the opportunity to voluntarily increase the exercise price of their option to the appropriate fair value in exchange for a cash payment equal to the amount of the increase, which will be payable in January 2008. There is no guarantee that these actions will effectively address employees' adverse tax consequences as a result of having held discount options. Any unforeseen measures may cause the Company to incur additional cash or noncash compensation expense. Furthermore, such measures, or the failure of such measures, may require the Company to incur substantial expenses for legal, accounting, tax and other professional services and may divert our management's attention from our business, which could in the future harm our business, financial condition, results of operations and cash flows.

***Our revenues might not grow, and they might decrease.***

Several factors, many of which are outside of our control, contribute to our revenue growth. Some scenarios that might impede our revenue growth in the future include:

our failure to maintain existing customers and to attract new marketing customers due to competition from other media outlets, dissatisfaction with our services or reduced advertising budgets;

our loss of advertising and other marketing opportunities to competitors, especially as other media companies increase their online presence in areas where we focus;

our inability to attract advertisers and users for our newer websites;

our inability to respond to ad-blocking technology might decrease the effectiveness of online advertising;

our failure to attract and retain users to our websites where advertising inventory is purchased;

weakness in corporate and consumer spending in the markets in which we operate, including in the United States, the United Kingdom, China, France and Japan, may lead to a decline in advertising, which is the primary source of our revenues;

a decline in general economic conditions, which could occur as a result of currency fluctuations, rising interest rates, or other factors;

disruption of our operations due to technical difficulties, system downtime, Internet brownouts or denial of service or other similar attacks; and

disruption to our operations, employees, partners, customers and facilities caused by natural disasters, international or domestic terrorist attacks or armed conflict.

## Edgar Filing: CNET NETWORKS INC - Form 10-Q

*We may not be able to achieve our targeted profit measures and accordingly we may fail to make expected improvements in our overall profit measures.*

We have identified various profit measures as a useful way to evaluate operating performance. We may fail to achieve our profit measure targets. Some of the factors that could cause us not to achieve these targets include:

greater than expected expenses due to a decision to invest in new products, services or websites;

acquisitions of businesses that cannot immediately achieve these profit measures;

greater than expected compensation expenses due to competition for qualified employees;

a failure to achieve projected revenues growth;

a failure to manage the costs associated with innovation and growth; or

an inability to achieve or to execute on an effective sales strategy.



---

**Table of Contents**

***Competition is intense and we might not compete successfully.***

The media industry is intensely competitive and rapidly evolving. We compete for advertisers, users and business partners with numerous companies throughout the world and expect the market to become increasingly competitive as Internet usage and marketing continues to grow in acceptance. We compete with diversified media companies that provide both online and offline content, including magazines, cable television, network television, radio and newspapers. In addition, as diversified media companies continue to introduce and acquire more interactive media offerings, we will increasingly compete with them for consumers and advertisers. We believe that the Internet offers a competitive advantage over offline media for creating a rich and interactive environment for both users and marketers.

Our brands also compete with sites focused on the same vertical markets on which we focus. For example, our gaming properties compete with other gaming sites such as IGN Entertainment, and our business properties compete with smaller, niche sites such as TechTarget. As Internet media consumption and advertising continues to gain share, we compete with a variety of online properties for users and marketers, including the following: general purpose portals like AOL, MSN and Yahoo!, especially as these properties expand their content offering in our areas of expertise; search engines like Google, Yahoo! and MSN; online comparison shopping and retail properties, including Shopping.com, Amazon.com and eBay; social networking and community properties such as MySpace and Facebook; and emerging platforms such as blogs, podcasts and video properties. We believe our ability to marry content and community in a unique branded environment coupled with expertise in building online brands for people and the things they are passionate about provide us with many advantages over our competitors.

***An inability to attract and retain key personnel could adversely affect our operations.***

Our success depends to a large extent on the continued services of our senior management team and qualified skilled employees. We depend on our ability to identify, attract, develop, retain and motivate personnel in a competitive job environment. We currently have key executive positions open, and we cannot assure you that we will find qualified candidates in a timely manner. Our inability to attract key executives and other employees or to retain and motivate existing executives and employees may adversely affect our ability to operate our business. We do not maintain key person life insurance policies on any of our officers or other employees. As the overall industry for interactive content and Internet advertising grows, our employees are increasingly sought after by competitors. In order to remain competitive in the employment market, we may need to increase compensation to retain or attract qualified employees, which could have an adverse effect on our financial condition or operating results. Our inability to attain shareholder approval of equity compensation plans may affect our ability to attract and retain key employees.

***Our advertising and other operating revenues may be subject to fluctuations, which could have a material adverse effect on our business, operating results and financial condition.***

We believe that advertising spending on the Internet, as in traditional media, fluctuates significantly with economic conditions. Because a majority of our revenues are derived from advertising, fluctuations in advertising spending generally, or with respect to Internet-based spending specifically, could adversely impact our revenues. In addition, marketing spending follows seasonal consumer behavior throughout the calendar year to reflect trends during the calendar year, with spending historically weighted towards the fourth quarter. Consistent with industry trends, our revenues in 2006 were weighted toward the end of the year, with 31% of our revenues being earned in the fourth quarter.

***Most of our revenues are derived from short-term contracts which may not be renewed.***

Our revenues are derived in large part from the sale of advertising and we expect that this will continue to be the case for the foreseeable future. Most of our advertising contracts are short-term and are subject to termination by the customer at any time on thirty-day prior written notice. Advertisers who have longer-term contracts may fail to honor their existing contracts or fail to renew their contracts. If a significant number of advertisers or a few large advertisers decided not to continue advertising on our websites, we could experience a rapid decline in our revenues over a relatively short period of time.

***We depend on, and receive, a significant percentage of our revenues from a relatively small number of advertisers.***

A relatively small number of advertisers contribute a significant percentage of our revenues. Our top one hundred customers in the United States contributed 57% of our revenues in the quarter ended March 31, 2007. These customers may not continue to use our services to the same extent, or at all, in the future. A significant reduction in advertising by one or more of our largest customers could have a material adverse effect on our financial condition and results of operation.



---

**Table of Contents**

*Users may not always accept, or may be drawn away from, our brands, content and services.*

Our future success depends upon the strength of our brands and our ability to deliver original and compelling content and services that attract and retain users. We will endeavor to continue building existing brands and introducing new brands, that resonate with their audiences, but we may not be successful. The specialized nature of certain of our sites may limit those sites' potential user base. Our content and services might not be attractive to a sufficient number of users to generate revenues consistent with our estimates. In addition, we might not develop new content or services in a timely or cost-effective manner. If we are not successful in growing our user base and increasing user interaction on our sites, then our ability to attract the advertisers who seek to market to the demographic represented by our user base may be affected which would in turn impact our revenues. Our ability to successfully develop and produce content and services is subject to numerous uncertainties, including the ability to:

anticipate and successfully respond to rapidly changing consumer tastes and preferences;

fund new program development;

attract and retain qualified editors, producers, writers, and technical personnel; and

successfully expand our content offerings into new platform and delivery mechanisms.

Our business may be impacted by any event that decreases the amount of the time that users spend on our properties, including but not limited to geopolitical events and natural disasters. During these times, our traffic and revenues may decrease.

***Our failure to use third-party technologies or develop and maintain successful relationships with third parties may adversely impact our traffic.***

We depend in part on third parties for Internet traffic to our websites and changes to their operations or our failure to develop and maintain relationships with them or use their technologies successfully could result in decreased traffic. Any reduction in users on our websites could negatively impact our ability to earn revenues. A significant portion of our users visit our websites by conducting a search on a search engine, such as Google, MSN or Yahoo!, and following a link displayed in the search results. Changes in the methodologies used by these search engines to display results or our failure to successfully optimize our sites for search engine ranking could result in our websites receiving less favorable placements, which could reduce the number of users who link to our sites from these search engines. In addition, we rely on the cooperation of owners and operators of other Internet sites with whom we have syndication and other arrangements to generate traffic for our Internet sites. Our ability to maintain these relationships will continue to be critical to the success of our Internet operations. If we are unable to develop and maintain satisfactory relationships with such third parties on acceptable commercial terms, or if our competitors are better able to capitalize on these relationships, we could see a reduction in the numbers of users of our websites, which could adversely impact our revenues.

***A significant percentage of our revenues are derived from activity-based fees generated when our users visit the content of our partners, and we might not be able to attract qualified users for which our partners are willing to pay us activity-based fees.***

We earn fees when users search the content of our partners. There are currently many other businesses that offer similar services. In addition, users may prefer to contact our partners directly rather than return to our sites. If we are unable to continue to attract users to our sites or to maintain the fees we charge our partners for these services, then our business, operating results and financial condition may be adversely affected. Most of our agreements with merchants under which activity-based fees are earned are terminable by either party on ten to thirty days notice.

***We have limited protection of our intellectual property and could be subject to infringement claims that may result in costly litigation, the payment of damages or the need to revise the way we conduct our business.***

Our success and ability to compete are dependent in part on the strength of our proprietary rights, on the goodwill associated with our trademarks, trade names, service marks, and on our ability to use United States and foreign laws to protect them. Our intellectual property includes our original content, our editorial features, logos, brands, domain names, the technology that we use to deliver our products and

## Edgar Filing: CNET NETWORKS INC - Form 10-Q

services, the various databases of information that we maintain and make available through our Internet sites or by license, and the appearance of our Internet sites. We claim common law protection on certain names and marks that we have used in connection with our business activities. While we have applied for and obtained registration of many of our marks in countries outside of the United States where we do business, we have not been able to obtain registration of all of our key marks in such jurisdictions, in some cases due to opposition by people employing similar marks. In addition to laws in the United States and foreign jurisdictions, we rely on confidentiality agreements with our employees and third parties, and protective contractual provisions to protect our intellectual property.

## **Table of Contents**

Worldwide policing of our intellectual property rights is a difficult task and we might not be able to identify infringers. Our content is widely distributed to third parties through licensing arrangements, and we cannot be certain our third party licensees will always take actions to protect the value of our proprietary rights and reputation. Intellectual property laws, our agreements and our patents may not be sufficient to prevent others from copying or otherwise obtaining and using our content or technologies. Others may develop technologies that are similar or superior to ours. In seeking to protect our trademarks, copyrights and other proprietary rights, or defending ourselves against claims of infringement brought by others, with or without merit, we could face costly litigation and the diversion of our management's attention and resources.

Notwithstanding the efforts that we have taken to ensure that we have sufficient rights to the intellectual property that we use, we could still be subject to claims of infringement. For instance, there has been a recent increase in the granting and attempted enforcement of business process patents that cover practices that may be widely employed in the Internet industry. We have, on occasion, been approached by holders of patents alleging that our services infringe on their patents. Many companies that offer services similar to ours have been approached and, in some cases, sued by other patent holders alleging patent infringement. We could be required to enter into costly royalty arrangements with the holders of these patents or to revise our services to ensure non-infringement or to avoid litigation. If we are unsuccessful in avoiding litigation, we would incur significant expenses and could be subject to damage awards, including damages for past infringement and royalties for future use of the patented method or technology. If we are found to violate any such patent, and we are unable to enter into a license agreement on reasonable terms, our ability to offer services could be materially and adversely affected. We do not have insurance for patent infringement.

These claims could result in the need to develop alternative trademarks, content or technology or to enter into costly royalty or licensing agreements, which could have a material adverse effect on our business, results of operations and financial condition.

***Our business involves risks of liability claims for Internet and print content, which could result in significant costs.***

As a publisher and a distributor of content through the Internet and print publications, we may face potential liability for:

defamation/libel;

negligence;

copyright, patent or trademark infringement; or

other claims based on the nature and content of the materials published or distributed.

These types of claims have been brought, sometimes successfully, against online services and publishers of print publications. In addition, we could be exposed to liability in connection with material posted to our Internet sites by third parties. For example, many of our sites offer users an opportunity to post profiles, software, videos, photos, reviews and opinions. Some of this user-generated content, and the content that appears in our indexes and directories, may infringe on third party intellectual property rights or privacy rights or may otherwise be subject to challenge under copyright laws. Although we do not believe that our listing of any such material should expose us to liability, it is possible that such a claim may be successfully brought.

Our insurance may not cover potential claims of defamation, libel, negligence and similar claims, and it may or may not apply to a particular claim or be adequate to reimburse us for all liability that may be imposed. Any imposition of liability that is not covered by insurance or is in excess of insurance coverage could have a material adverse effect on our financial condition.

***Changes in regulations could adversely affect the way that we operate.***

It is possible that new laws and regulations in the United States and elsewhere will be adopted covering issues affecting our business, including:

privacy and use of personally identifiable information;

copyrights, trademarks and domain names;

obscene or indecent communications;

pricing, characteristics and quality of Internet products and services;

**Table of Contents**

marketing practices, such as direct marketing or adware;

the ability of children to access our services;

taxation of Internet usage and transactions; and

securities and tax regulations.

Increased government regulation, or the application of existing laws to online activities, could:

decrease the growth rate of the Internet;

reduce our revenues;

increase our operating expenses; and

expose us to significant liabilities.

We cannot be sure what effect any future material noncompliance by us with these laws and regulations or any material changes in these laws and regulations could have on our business, operating results and financial condition.

***We may have difficulties with our acquisitions, investments and new product developments.***

We intend to continue to pursue new business opportunities and ventures to expand our business, including acquisitions, investments and new product developments in a broad range of content areas and in various domestic and international markets. Our decision to pursue these activities would be accompanied by risks, including, among others:

investment of a substantial amount of capital, which could have a material adverse effect on our financial condition and our ability to execute our existing business strategy;

issuance of additional equity interests, which would be dilutive to current stockholders;

the need to incur borrowings, which would impact future cash flows for the repayment of principal and interest payments, and which borrowing may also have restrictive covenants that could limit certain operating activities including our ability to make acquisitions;

additional burdens on our management personnel and financial and operational systems;

difficulty assimilating the operations, technology, corporate culture and personnel of the newly acquired businesses;

potential disruption to our ongoing business;

possible inability to retain key personnel;

additional operating losses and expenses associated with the activities and expansion of acquired businesses; including expenses associated with amortization of purchased intangible assets,

possible impairment of relationships with existing employees and advertising customers;

the impact of our recently completed stock option investigation and related lawsuits on our ability to attract business partners;

potential undisclosed liabilities associated with new or acquired businesses; and

for foreign acquisitions and investments, additional risks related to the integration of operations across different cultures and languages, currency risks, and the particular economic, political, and regulatory risks associated with specific countries.

In addition, our \$60.0 million credit facility, which expires in October 2007, has significant restrictions on additional further borrowings which could impact our ability to fund acquisitions or to pay for capital purchases.

***We may not innovate at a successful pace.***

Our industry is rapidly adopting new technologies and standards to create and satisfy consumer demand. It is critical that we continue to innovate, anticipate and adapt to these changes to ensure that our content delivery platforms, services and products remain interesting to our users, advertisers and partners. In addition, we may discover that we must make significant expenditures to achieve this goal. If we fail to accomplish these goals, we may lose users and the advertisers that seek to reach those users.



## **Table of Contents**

### ***Changes in our tax rate and the outcomes of routine tax audits could affect our future results.***

Our future effective tax rates could be unfavorably affected by changes in the valuation of our deferred tax assets and liabilities, changes in the mix of earnings in countries with differing statutory tax rates, or by changes in tax laws or their interpretations. In addition, we are subject to the continuous examination of our tax returns by the Internal Revenues Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. The outcomes from examinations may have an adverse effect on our business, operating results and financial condition.

### ***We may be subject to system disruptions and other events that may impact use of our properties, which could adversely affect our revenues.***

Our ability to attract and maintain relationships with users, advertisers, and strategic partners will depend on the satisfactory performance, reliability and availability of our Internet infrastructure. Our Internet advertising revenues relate directly to the number of advertisements and other marketing opportunities delivered to our users. System interruptions or delays that result in the unavailability of Internet sites or slower response times for users would reduce the number of impressions and leads delivered. This could reduce revenues as the attractiveness of our sites to users, strategic partners and advertisers decreases. Our insurance policies provide only limited coverage for service interruptions and may not adequately compensate us for any losses that may occur due to any failures or interruptions in our systems. Further, we do not have multiple site capacity for all of our services in the event of any such occurrence. We may experience service disruptions for the following reasons:

occasional scheduled maintenance;

equipment failure;

an increase in traffic volumes to our sites beyond our infrastructure's capacity;

disruptions in the services provided to us by third parties; and

natural disasters, telecommunications failures, power failures, other system failures, maintenance, viruses, hacking or other events. In addition, our business may be impacted by any event that decreases the amount of the time that users spend on our properties. During these times, our traffic and revenues may decrease. Such events include, but are not limited to, geopolitical events and natural disasters.

There is no guarantee that our disaster recovery plans will be effective in mitigating system disruptions caused by these and other events.

### ***Our networks may be vulnerable to unauthorized persons accessing our systems, which could disrupt our Internet operations and result in the theft of our proprietary information.***

A party who is able to circumvent our security measures could misappropriate either our proprietary information or the personal information of our users, customers and employees or cause interruptions or malfunctions in our Internet operations. We may be required to expend significant capital and resources to protect against the threat of security breaches or to alleviate problems caused by breaches in security. For example, so-called "spiders" have and can be used in efforts to copy our databases, including our database of technology products and prices. Our activities and the activities of third party contractors involve the storage and transmission of proprietary and personal information, such as computer software or credit card numbers. Accordingly, security breaches could expose us to a risk of loss or litigation and possible liability. We cannot assure you that contractual provisions attempting to limit our liability in these areas will be successful or enforceable, or that other parties will accept such contractual provisions as part of our agreements.

### ***There are a number of risks associated with international operations that could adversely affect our business.***

## Edgar Filing: CNET NETWORKS INC - Form 10-Q

We maintain an international presence through a variety of international structures and business operations. We have wholly-owned operations in Australia, France, Germany, Japan, Russia, Singapore, Switzerland and the United Kingdom. We also have license arrangements in various other countries throughout the world. We operate our operations in China through a variety of entities some of which are owned by local employees in order to comply with local ownership and regulatory licensing requirements. We believe our current ownership structure complies with all existing Chinese laws. It is possible; however, that the Chinese government may change the applicable laws or take a different interpretation of existing laws. If we were found to be in violation of any existing or future Chinese laws or regulations, we could be subject to fines and other financial penalties, have our licenses revoked, or be forced to discontinue our business entirely.

**Table of Contents**

There are additional risks inherent in doing business in international markets, such as the following:

weak economic conditions in foreign markets, especially in the business sector;

challenges caused by distance, language and cultural differences and in doing business with foreign entities and governments;

uncertainty of product acceptance in different countries;

longer collection cycles in some countries;

current, and unforeseen changes in, legal and regulatory requirements;

difficulties in staffing and managing multi-national operations;

currency exchange rate fluctuations, which could reduce our revenues as determined under United States GAAP, increase our expenses, and dilute our operating margins;

difficulties in finding appropriate foreign licensees or joint venture partners;

potential adverse tax requirements;

foreign exchange controls that might prevent us from repatriating cash earned in countries outside the United States; and

foreign political and economic uncertainty.

***Our debt obligations are restrictive and expose us to risks that could adversely affect our financial condition and prevent us from fulfilling our obligations.***

We have a substantial level of debt and interest expense. At March 31, 2007 we had \$77.0 million of outstanding indebtedness, of which \$71.5 million was classified as a current liability, including \$60.0 million outstanding on a line of credit due in October 2007. In addition, the terms of our \$60.0 million credit facility limit the circumstances under which we can incur additional debt and require that we achieve minimum levels of earnings before interest, taxes, depreciation and amortization as well as minimum levels of unrestricted liquidity. The level of our indebtedness and the associated covenants, among other things, could:

make it difficult for us to satisfy our obligations with respect to our indebtedness;

make it difficult for us to obtain any necessary financing in the future for working capital, capital expenditures, debt service, acquisitions or general corporate operating purposes;

require us to dedicate a substantial portion of our cash flow from operations to service interest and principal payments on our debt;

limit our flexibility in planning for or reacting to changes in our business;

reduce funds available for use in our operations;

place us at a possible competitive disadvantage relative to less leveraged competitors and competitors that have better access to capital resources;

impair our ability to incur additional debt because of financial and other restrictive covenants; and

make us more vulnerable in the event of a downturn in our business or an increase in interest rates.

As of March 31, 2007, we had cash and investments of \$72.7 million. We have prepared a forecast for 2007 which is based on our current expectations regarding revenue growth and associated operating expense and capital spending levels. If our actual results should differ materially from our expectations, our liquidity may be adversely impacted. If that were to occur, we would take steps to adjust our operating costs and capital expenditures to levels necessary to support our incoming business. We may also need to raise additional equity or borrow additional funds to achieve our longer-term business objectives. In addition if we are unable to extend or refinance our \$60.0 million credit facility before it matures in October 2007, our capital resources will be significantly impacted.

However, if we are unable to generate sufficient cash flow or otherwise obtain funds necessary to make required payments, or if we fail to comply with the various covenants of our \$60.0 million credit facility, we would be in default, which would permit our lender to accelerate the maturity of the indebtedness. Any default under our credit facility could have a material adverse effect on our financial condition and adversely impact our business.

---

## **Table of Contents**

In addition, as a result of our delayed filing of our Quarterly Report on Form 10-Q for the quarters ended June 30, 2006 and September 30, 2006, we will be ineligible to register our securities on Form S-3 for sale by us or resale by others until November 2007. We may use Form S-1 to raise capital or complete acquisitions, but doing so could increase transaction costs and adversely impact our ability to raise capital or complete acquisitions of other companies in a timely manner.

***Our business, operating results and financial condition may be impacted by certain contingencies related to our guarantee of certain lease obligations.***

In conjunction with the ZDNet acquisition in 2000, we assumed a guarantee of the obligations of Ziff Davis Media Inc., an unaffiliated company and primary lessee, under a New York City office lease for a total of 399,773 square feet. This lease expires in 2019. The annual average cost per square foot is approximately thirty dollars over the remaining term of the lease. Ziff Davis Media Inc. currently occupies 144,682 square feet of this space. Ziff Davis Media Inc. subleases 205,951 square feet to The Bank of New York, FOJP Risk Management and Softbank. In addition, we currently sublease and occupy 49,140 square feet of the office space from Ziff Davis Media Inc. These leases and subleases fully cover the current monthly lease payments.

As of March 31, 2007, the total lease payments remaining until the end of the lease term were \$145.7 million, excluding the amounts attributable to our sublease with respect to the floor we occupy. If the financial condition of any of the sublessees or Ziff Davis Media Inc. were to deteriorate and thereby result in their inability to make lease payments, we would be required to make their lease payments under the guarantee. In addition, any expiration of any sublease, the potential resulting vacancy and the inability of Ziff Davis Media Inc. to make the primary lease payments could result in us being required to make lease payments on these vacancies.

In connection with that guarantee, we have a letter of credit for \$15.0 million outstanding as a security deposit. As there is no present obligation to make any payments in connection with this guarantee, we have not recorded any liability for this guarantee in our financial statements.

***We have generated significant losses in the past and cannot assure you that we will report positive net income in the future. If our revenues do not increase, we may not be able to adjust spending in a timely manner to maintain positive net income.***

In the past, we have generated operating losses, as well as net losses, as was the case in the quarter ended March 31, 2007. Although we generated positive net income in 2006, our ability to generate positive net income in 2007 or subsequent periods may be negatively impacted by:

an inability to decrease expenses in a timely manner to offset any revenues shortfalls or expenses associated with cost-reduction measures, such as severance, lease termination payments, contract termination costs or impairment charges;

changes in the valuation of our deferred tax assets and liabilities or an adverse outcome of an examination of our tax returns by tax authorities;

payments associated with contingent liabilities, such as litigation or our guarantee of the New York lease of Ziff Davis Media Inc., as described in more detail in a prior risk factor; or

any unusual transactions such as impairments or losses on investments.

***We will record substantial stock compensation expenses, which may have a material negative impact on our operating results for the foreseeable future.***

Effective January 1, 2006, we adopted the SFAS 123R for stock-based employee compensation. Our stock compensation expense was \$5.2 million in the quarter ended March 31, 2007 and is also expected to be significant in future periods, which will have an adverse impact on our operating income and net income. Our option-pricing model requires the input of highly subjective assumptions, including the option's expected life and the price volatility of the underlying stock. Changes in the subjective input assumptions can materially affect the amount of our stock compensation expense. Our estimated stock compensation expenses may also be greater than expected if the fair value of our stock increases. In addition, an increase in the competitiveness of the market for qualified employees could cause us to issue more stock options or other securities than expected, which would increase our stock compensation expense.



## **Table of Contents**

***Changes in the interpretation of United States generally accepted accounting principles, or GAAP, may affect our reported results.***

We prepare our financial statements in conformity with GAAP, which is subject to interpretation by the SEC and various bodies formed to interpret and create appropriate accounting policies. A change in these principles could have a significant effect on our reported results and may affect the reporting of transactions completed prior to the announcement of a change.

***Accounting rules regarding goodwill could make our reported results more volatile.***

Goodwill is tested for impairment annually or when an event occurs indicating the potential for impairment. The evaluation is prepared based on our current and projected performance for our identified reporting units. The fair value of our reporting units is determined using a combination of the cash flow and market comparable approaches. If we conclude at any time that the carrying value of our goodwill and other intangible assets for any of our reporting units exceeds its implied fair value, we will be required to recognize an impairment, which could materially reduce operating income and net income in the period in which such impairment is recognized.

In the application of these methodologies, we are required to make estimates of future operating trends and judgments on discount rates and other variables. Actual future results and other assumed variables could differ from these estimates, including changes in the economy, the business environment in which we operate, and/or our own relative performance. Any differences in actual results compared to our estimates could result in further future impairments. Accordingly, our future earnings may be subject to significant volatility, particularly on a period-to-period basis.

***A substantial number of shares of common stock may be sold, which could affect the trading price of our common stock.***

We have a substantial number of shares of common stock subject to stock options. As of March 31, 2007, we had 10.3 million shares of common stock available for future grant under our stock option and employee stock purchase plans and 16.9 million issuable upon the future conversion of outstanding stock options. In addition, as of March 31, 2007, we have approximately 250 million shares of authorized but unissued shares of our common stock that are available for future sale. We cannot predict the effect, if any, that future sales of shares of our common stock, or the availability of shares of our common stock for future sale, will have on the market price of our common stock. Sales of substantial amounts of our common stock, including shares issued in connection with acquisitions or upon the exercise of stock options or warrants or the conversion of debt securities, or the perception that such sales could occur, may adversely affect prevailing market prices for our common stock.

***The trading value of our common stock may be volatile and decline substantially.***

The trading price of our common stock is subject to wide fluctuations, which are a result of a number of events and factors, including:

quarterly variations in operating results;

announcements of innovations requiring significant expenditures;

new products, strategic developments or business combinations by us or our competitors;

changes in our financial estimates or that of securities analysts;

announcements relating the appointment or resignation of a member of senior management;

restatements of previously issued financial results;

## Edgar Filing: CNET NETWORKS INC - Form 10-Q

our sale of common stock or other securities in the future;

changes in recommendations of securities analysts;

developments in litigations or other governmental proceedings against us, or new litigations or governmental proceedings;

the operating and securities price performance of other companies that investors may deem comparable to us; and

news reports, including those relating to trends in the Internet.

In addition, the stock market in general, and the market prices for Internet-related companies in particular, have experienced extreme volatility that often has been unrelated to the operating performance of these companies. These broad market and industry fluctuations may adversely affect the trading price of our common stock. These fluctuations may make it more difficult to use stock as currency to make acquisitions that might otherwise be advantageous, or to use stock options as a means to attract and retain employees.

Any shortfall in revenues or earnings compared to our or analysts' or investors' expectations could cause, and has in the past caused an immediate and significant decline in the trading price of our common stock. In addition, we may not learn of such shortfalls or delays until late in the fiscal quarter, which could result in an even more immediate and greater decline in the trading price of our common stock.



## **Table of Contents**

### ***Provisions of our certificate of incorporation, bylaws and Delaware law could deter takeover attempts.***

Some provisions in our certificate of incorporation and bylaws could delay, prevent or make more difficult a merger, tender offer, proxy contest or change of control. Our stockholders might view any transaction of this type as being in their best interest since the transaction could result in a higher stock price than the current market price for our common stock. Among other things, our certificate of incorporation and bylaws:

authorize our Board of Directors to issue preferred stock with the terms of each series to be fixed by our Board of Directors;

divide our Board of Directors into three classes so that only approximately one-third of the total number of directors is elected each year;

permit directors to be removed only for cause; and

specify advance notice requirements for stockholder proposals and director nominations.

In addition, with some exceptions, the Delaware General Corporation Law restricts or delays mergers and other business combinations between us and any stockholder that acquires 15% or more of our voting stock.

### ***Our business could be adversely impacted if we have deficiencies in our disclosure controls and procedures or internal control over financial reporting.***

The design and effectiveness of our disclosure controls and procedures and internal control over financial reporting may not prevent all errors, misstatements or misrepresentations. While management will continue to review the effectiveness of our disclosure controls and procedures and internal control over financial reporting, we cannot assure you that our disclosure controls and procedures or internal control over financial reporting will be effective in accomplishing all control objectives all of the time. Deficiencies, particularly a material weakness in internal control over financial reporting, which may occur in the future, could result in misstatements of our results of operations, restatements of our financial statements, a decline in our stock price, or otherwise materially adversely affect our business, reputation, results of operation, financial condition or liquidity.

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

None.

#### **ITEM 3. Defaults upon Senior Securities.**

None.

#### **ITEM 4. Submission of Matters to a Vote of Security Holders.**

None.

#### **ITEM 5. Other Information.**

None.



**Table of Contents**

**ITEM 6. Exhibits.**

- 31.1 Certificate of Principal Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certificate of Principal Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certificate of Principal Executive Officer pursuant to section 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002
- 32.2 Certificate of Principal Financial Officer pursuant to section 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002

**SIGNATURES**

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

CNET Networks, Inc.

*(Registrant)*

/s/George E. Mazzotta  
George E. Mazzotta

*Chief Financial Officer*

Dated: May 2, 2007

**Table of Contents**

**EXHIBIT INDEX**

**Exhibit**

<b>Number</b>	<b>Description</b>
31.1*	Certificate of Principal Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certificate of Principal Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certificate of Principal Executive Officer pursuant to section 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002
32.2*	Certificate of Principal Financial Officer pursuant to section 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002

---

\* Filed herein.