

NEUSTAR INC  
Form 10-Q  
October 24, 2011  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended September 30, 2011

OR

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

For the transition period from            to

Commission file number 001-32548

**NeuStar, Inc.**

(Exact name of registrant as specified in its charter)

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

**52-2141938**  
(I.R.S. Employer  
Identification No.)

**21575 Ridgetop Circle**

**Sterling, Virginia 20166**

(Address of principal executive offices) (zip code)

**(571) 434-5400**

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

There were 72,619,461 shares of Class A common stock, \$0.001 par value, and 3,082 shares of Class B common stock, \$0.001 par value, outstanding at October 17, 2011.

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

(in thousands, except share and per share data)

|  | December 31,<br>2010 | September 30,<br>2011<br>(unaudited) |
|--|----------------------|--------------------------------------|
| <b>ASSETS</b>  |                      |                                      |
| Current assets:  |                      |                                      |
| Cash and cash equivalents  | \$ 331,570           | \$ 357,623                           |
| Restricted cash  | 556                  | 10,094                               |
| Short-term investments   | 13,802               | 34,202                               |
| Accounts receivable, net of allowance for doubtful accounts of \$1,435 and \$1,624, respectively | 82,250               | 85,021                               |
| Unbilled receivables   | 7,188                | 3,008                                |
| Notes receivable   | 567                  | 2,744                                |
| Prepaid expenses and other current assets  | 12,797               | 12,376                               |
| Deferred costs   | 5,849                | 7,448                                |
| Income taxes receivable  |                      | 12,076                               |
| Deferred tax assets  | 6,146                | 9,030                                |
| <b>Total current assets</b>  | <b>460,725</b>       | <b>533,622</b>                       |
| Long-term investments  | 37,009               | 18,473                               |
| Property and equipment, net  | 74,296               | 90,206                               |
| Goodwill   | 124,651              | 145,253                              |
| Intangible assets, net   | 18,974               | 36,720                               |
| Notes receivable, long-term  | 1,023                | 4,460                                |
| Deferred costs, long-term  | 1,052                | 775                                  |
| Deferred tax assets, long-term   | 10,137               | 7,895                                |
| Other assets, long-term  | 6,007                | 5,967                                |
| <b>Total assets</b>  | <b>\$ 733,874</b>    | <b>\$ 843,371</b>                    |

*See accompanying notes.*

**Table of Contents****NEUSTAR, INC.****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share data)

|   | December 31,<br>2010 | September 30,<br>2011<br>(unaudited) |
|---|----------------------|--------------------------------------|
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                      |                                      |
| Current liabilities:  |                      |                                      |
| Accounts payable  | \$ 3,882             | \$ 3,995                             |
| Accrued expenses  | 57,808               | 57,698                               |
| Income taxes payable  | 1,590                |                                      |
| Deferred revenue  | 31,751               | 35,546                               |
| Capital lease obligations   | 6,325                | 3,526                                |
| Accrued restructuring   | 4,703                | 2,139                                |
| Other liabilities   | 9,445                | 7,043                                |
| <br>Total current liabilities   | <br>115,504          | <br>109,947                          |
| Deferred revenue, long-term   | 10,578               | 10,733                               |
| Capital lease obligations, long-term  | 4,076                | 2,459                                |
| Accrued restructuring, long-term  | 315                  |                                      |
| Other liabilities, long-term  | 7,289                | 10,332                               |
| <br>Total liabilities   | <br>137,762          | <br>133,471                          |
| Commitments and contingencies   |                      |                                      |
| Stockholders equity:  |                      |                                      |
| Preferred stock, \$0.001 par value; 100,000,000 shares authorized; no shares issued and outstanding as of December 31, 2010 and September 30, 2011  |                      |                                      |
| Class A common stock, par value \$0.001; 200,000,000 shares authorized; 80,294,573 and 81,786,636 shares issued and outstanding at December 31, 2010 and September 30, 2011, respectively | 80                   | 82                                   |
| Class B common stock, par value \$0.001; 100,000,000 shares authorized; 3,082 and 3,082 shares issued and outstanding at December 31, 2010 and September 30, 2011, respectively           |                      |                                      |
| Additional paid-in capital  | 364,346              | 398,536                              |
| Treasury stock, 6,665,228 and 9,077,482 shares at December 31, 2010 and September 30, 2011, respectively, at cost   | (169,848)            | (231,658)                            |
| Accumulated other comprehensive loss  | (144)                | (841)                                |
| Retained earnings   | 401,678              | 543,781                              |
| <br>Total stockholders equity   | <br>596,112          | <br>709,900                          |
| <br>Total liabilities and stockholders equity   | <br>\$ 733,874       | <br>\$ 843,371                       |

*See accompanying notes.*

**Table of Contents****NEUSTAR, INC.****UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS****(in thousands, except per share data)**

|  | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2010</b>                                 | <b>2011</b> | <b>2010</b>                                | <b>2011</b> |
| <b>Revenue:</b>  |   |             |  |             |
| Carrier Services   | \$ 96,657                                   | \$ 114,155  | \$ 292,049                                 | \$ 334,604  |
| Enterprise Services  | 32,781                                      | 38,342      | 91,955                                     | 111,671     |
| Total revenue  | 129,438                                     | 152,497     | 384,004                                    | 446,275     |
| <b>Operating expense:</b>  |   |             |  |             |
| Cost of revenue (excluding depreciation and amortization shown separately below) | 27,574                                      | 34,194      | 81,578                                     | 96,663      |
| Sales and marketing  | 21,322                                      | 25,069      | 64,686                                     | 76,275      |
| Research and development   | 3,519                                       | 3,746       | 10,648                                     | 11,183      |
| General and administrative   | 15,865                                      | 20,960      | 48,084                                     | 63,124      |
| Depreciation and amortization  | 8,255                                       | 10,486      | 23,825                                     | 29,018      |
| Restructuring (recoveries) charges   | (417)                                       | (33)        | 1,589                                      | 387         |
|  | 76,118                                      | 94,422      | 230,410                                    | 276,650     |
| Income from operations   | 53,320                                      | 58,075      | 153,594                                    | 169,625     |
| <b>Other (expense) income:</b>   |   |             |  |             |
| Interest and other expense   | (4,294)                                     | (675)       | (6,842)                                    | (1,148)     |
| Interest and other income  | 4,069                                       | 304         | 7,488                                      | 1,437       |
| Income from continuing operations before income taxes                            | 53,095                                      | 57,704      | 154,240                                    | 169,914     |
| Provision for income taxes, continuing operations                                | 21,275                                      | 19,931      | 61,570                                     | 65,060      |
| Income from continuing operations  | 31,820                                      | 37,773      | 92,670                                     | 104,854     |
| (Loss) income from discontinued operations, net of tax                           | (1,871)                                     |             | (8,946)                                    | 37,249      |
| Net income   | \$ 29,949                                   | \$ 37,773   | \$ 83,724                                  | \$ 142,103  |
| <b>Basic net income (loss) per common share:</b>                                 |   |             |  |             |
| Continuing operations  | \$ 0.43                                     | \$ 0.52     | \$ 1.24                                    | \$ 1.42     |
| Discontinued operations  | (0.03)                                      |             | (0.12)                                     | 0.51        |
| Basic net income per common share  | \$ 0.40                                     | \$ 0.52     | \$ 1.12                                    | \$ 1.93     |
| <b>Diluted net income (loss) per common share:</b>                               |   |             |  |             |
| Continuing operations  | \$ 0.42                                     | \$ 0.51     | \$ 1.22                                    | \$ 1.40     |
| Discontinued operations  | (0.03)                                      |             | (0.12)                                     | 0.49        |
| Diluted net income per common share  | \$ 0.39                                     | \$ 0.51     | \$ 1.10                                    | \$ 1.89     |
| <b>Weighted average common shares outstanding:</b>                               |   |             |  |             |
| Basic  | 74,808                                      | 73,237      | 74,806                                     | 73,658      |

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|         |        |        |        |        |
|---------|--------|--------|--------|--------|
| Diluted | 76,026 | 74,632 | 76,060 | 75,079 |
|---------|--------|--------|--------|--------|

*See accompanying notes.*



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

(in thousands)

|  | <b>Nine Months Ended<br/>September 30,</b> |                 |
|--|--|-----------------|
|  | <b>2010</b>                                | <b>2011</b>     |
| <b>Operating activities:</b>   |  |                 |
| Net income   | \$ 83,724                                  | \$ 142,103      |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |  |                 |
| Depreciation and amortization  | 30,339                                     | 29,647          |
| Stock-based compensation   | 13,949                                     | 19,071          |
| Amortization of deferred financing costs   | 126  | 127             |
| Excess tax benefits from stock option exercises  | (495)                                      | (3,447)         |
| Deferred income taxes  | 3,046                                      | (852)           |
| Provision for doubtful accounts  | 1,664                                      | 2,059           |
| Gain on trading securities   | (7,007)                                    |                 |
| Gain on available-for-sale investments   |  | (683)           |
| Amortization of bond premium (discount), net   |  | 2,357           |
| Loss on auction rate securities rights   | 6,892                                      |                 |
| Loss on asset sale   |  | 1,933           |
| <b>Changes in operating assets and liabilities, net of acquisitions:</b>                 |  |                 |
| Accounts receivable  | (5,867)                                    | (5,632)         |
| Unbilled receivables   | (2,600)                                    | 4,714           |
| Notes receivable   | (1,726)                                    | (5,614)         |
| Prepaid expenses and other current assets  | (616)                                      | 574             |
| Deferred costs   | 1,553                                      | (1,322)         |
| Income taxes receivable  | (6,933)                                    | (12,076)        |
| Other assets   | (587)                                      | (72)            |
| Other liabilities  | (1,064)                                    | (4,321)         |
| Accounts payable and accrued expenses  | (21,207)                                   | (1,096)         |
| Income taxes payable   | (2,269)                                    | 1,857           |
| Accrued restructuring  | (2,201)                                    | (2,879)         |
| Deferred revenue   | 7,019                                      | (461)           |
| <b>Net cash provided by operating activities</b>   | <b>95,740</b>                              | <b>165,987</b>  |
| <b>Investing activities:</b>   |  |                 |
| Purchases of property and equipment  | (28,026)                                   | (35,549)        |
| Sales and maturities of investments  | 37,725                                     | 77,145          |
| Purchases of investments   |  | (81,239)        |
| Business acquired, net of cash acquired  | (1,654)                                    | (39,000)        |
| <b>Net cash provided by (used in) investing activities</b>                               | <b>8,045</b>                               | <b>(78,643)</b> |
| <b>Financing activities:</b>   |  |                 |
| Increase of restricted cash  | (93)                                       | (9,538)         |
| Principal repayments on notes payable  | (987)                                      |                 |
| Principal repayments on capital lease obligations  | (8,991)                                    | (5,695)         |
| Proceeds from exercise of common stock options   | 4,826                                      | 11,962          |
| Excess tax benefits from stock-based compensation  | 495  | 3,447           |
| Repurchase of restricted stock awards  | (509)                                      | (1,496)         |
| Repurchase of common stock   | (25,417)                                   | (59,737)        |
| <b>Net cash used in financing activities</b>   | <b>(30,676)</b>                            | <b>(61,057)</b> |

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|   |            |            |
|---|------------|------------|
| Effect of foreign exchange rates on cash and cash equivalents | (142)      | (234)      |
| Net increase in cash and cash equivalents                     | 72,967     | 26,053     |
| Cash and cash equivalents at beginning of period              | 304,581    | 331,570    |
| Cash and cash equivalents at end of period                    | \$ 377,548 | \$ 357,623 |

*See accompanying notes.*

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**NEUSTAR, INC.**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2011**

**1. DESCRIPTION OF BUSINESS AND ORGANIZATION**

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

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

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

*Enterprise Services.* The Company's enterprise services include Internet infrastructure services and registry services. Through the Company's global directory platform, the Company provides a suite of domain name system (DNS) services to its enterprise customers. The Company manages a collection of directories that maintain addresses in order to direct, prioritize and manage Internet traffic, and to find and resolve Internet queries and top-level domains. The Company is the authoritative provider of essential registry services and manages directories of similar resources, or addresses, that its customers use for reliable, fair and secure access and connectivity. In addition, enterprise customers rely on the Company's services to monitor and load test websites to help identify issues and optimize performance. The Company also provides IP geolocation services that help enterprises identify the location of their consumers for a variety of purposes, such as target marketing and fraud prevention. Additionally, the Company provides directory services for the 5- and 6-digit number strings used for all U.S. Common Short Codes, which is part of the short messaging service relied upon by the U.S. wireless industry.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Unaudited Interim Financial Information**

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The results of operations for the nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the full fiscal year. The consolidated balance sheet as of December 31, 2010 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements. These consolidated financial statements should be read in conjunction with the audited consolidated financial

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statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 (the 2010 Form 10-K) filed with the Securities and Exchange Commission.

### **Reclassification**

During the second quarter of 2011, the Company ceased operations of its Converged Messaging Services business, a component previously presented within the Company's Carrier Services operating segment. The results of operations of its Converged Messaging Services business have been reclassified to discontinued operations for all periods presented.

**Table of Contents****NEUSTAR, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2011****Discontinued Operations**

A business is classified as discontinued operations when (i) the operations and cash flows of the business can be clearly distinguished and have been or will be eliminated from the Company's ongoing operations; (ii) the business has either been disposed of or is classified as held for sale; and (iii) the Company will not have any significant continuing involvement in the operations of the business after the disposal transaction. The results of discontinued operations (as well as the gain or loss on the disposal) are aggregated and separately presented in the Company's consolidated statement of operations, net of income taxes.

**Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting periods. Significant estimates and assumptions are inherent in the analysis and the measurement of deferred tax assets; the identification and quantification of income tax liabilities due to uncertain tax positions; restructuring liabilities; valuation of investments; recoverability of intangible assets, other long-lived assets and goodwill; and the determination of the allowance for doubtful accounts. The Company bases its estimates on historical experience and assumptions that it believes are reasonable. Actual results could differ from those estimates.

**Fair Value of Financial Instruments**

The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic Financial Instruments requires disclosures of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value. Due to their short-term nature, the carrying amounts reported in the accompanying consolidated financial statements approximate the fair value for cash and cash equivalents, accounts receivable, accounts payable and accrued expenses. The Company determined the fair value of its short-term and long-term investments utilizing quoted market prices in active markets (see Note 4). The Company believes the carrying value of its notes receivable approximates fair value as the interest rate approximates a market rate.

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

|  | December 31, 2010  |               | September 30, 2011 |               |
|--|--------------------|---------------|--------------------|---------------|
|  | Carrying<br>Amount | Fair<br>Value | Carrying<br>Amount | Fair<br>Value |
| Cash and cash equivalents                            | \$ 331,570         | \$ 331,570    | \$ 357,623         | \$ 357,623    |
| Restricted cash (current assets)                     | \$ 556             | \$ 556        | \$ 10,094          | \$ 10,094     |
| Short-term investments                               | \$ 13,802          | \$ 13,802     | \$ 34,202          | \$ 34,202     |
| Notes receivable                                     | \$ 1,590           | \$ 1,590      | \$ 7,204           | \$ 7,204      |
| Marketable securities (other assets, long-term)      | \$ 3,681           | \$ 3,681      | \$ 3,953           | \$ 3,953      |
| Long-term investments                                | \$ 37,009          | \$ 37,009     | \$ 18,473          | \$ 18,473     |
| Deferred compensation (other liabilities, long-term) | \$ 3,621           | \$ 3,621      | \$ 3,995           | \$ 3,995      |

**Restricted Cash**

As of December 31, 2010 and September 30, 2011, restricted cash was \$0.6 million and \$10.1 million, respectively. As of September 30, 2011, cash of \$9.9 million was restricted as collateral for the Company's outstanding letters of credit (see Note 7). As of December 31, 2010 and September 30, 2011, cash of \$0.6 million and \$0.2 million, respectively, was restricted for deposits on leased facilities.

**Revenue Recognition**

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

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**NEUSTAR, INC.**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2011**

***Significant Contracts***

As part of its carrier services, the Company provides number portability administration center services (NPAC Services), which include wireline and wireless number portability, implementation of the allocation of pooled blocks of telephone numbers and network management services in the United States pursuant to seven contracts with North American Portability Management LLC (NAPM), an industry group that represents all telecommunications service providers in the United States. The aggregate fees for transactions processed under these contracts are determined by an annual fixed-fee pricing model under which the annual fixed fee (Base Fee) was set at \$362.1 million and \$385.6 million in 2010 and 2011, respectively, and is subject to an annual price escalator of 6.5% in subsequent years. These contracts also provide for fixed credits to customers of \$25.0 million in 2010 and \$5.0 million in 2011, which were applied to reduce the Base Fee for the applicable year. Customers under these contracts may earn additional credits of up to \$15.0 million annually in each of 2010 and 2011 if the customers reach specific levels of aggregate telephone number inventories and adopt and implement certain IP fields and functionality. These contracts also enable the Company's customers to earn credits if the volume of transactions in a given year is above or below the contractually established volume range for that year. The determination of credits earned based on transaction volume is done annually at the end of each year and earned credits are applied to the following year's invoices. To the extent any additional credits expire unused at the end of a year, they will be recognized in revenue at that time.

The Company determines the fixed and determinable fee under these contracts on an annual basis at the beginning of each year and recognizes this fee in its Carrier Services operating segment on a straight-line basis over twelve months. For 2010, the Company concluded that the fixed and determinable fee equaled \$322.1 million, which represented the Base Fee of \$362.1 million, reduced by the \$25.0 million fixed credit and \$15.0 million of additional credits. For 2011, the Company concluded that the fixed and determinable fee equals \$365.6 million, which represents the Base Fee of \$385.6 million, reduced by the \$5.0 million fixed credit and \$15.0 million of additional credits. During the first quarter of 2011, the Company determined that its carrier customers have earned all of the additional credits of \$15.0 million attributable to the adoption and implementation of the requisite IP fields and functionality and the achievement of specific levels of aggregate telephone number inventories.

The total amount of revenue derived under the Company's contracts with NAPM, comprised of NPAC Services, connection service fees related to the Company's NPAC Services and system enhancements, was approximately \$84.0 million and \$93.7 million for the three months ended September 30, 2010 and 2011, respectively, and \$253.0 million and \$280.6 million for the nine months ended September 30, 2010 and 2011, respectively.

Fees under the Company's contracts with NAPM are billed to telecommunications service providers based on their allocable share of the total transaction charges. This allocable share is based on each respective telecommunications service provider's share of the aggregate end-user services revenues of all U.S. telecommunications service providers, as determined by the Federal Communications Commission. The Company also bills a Revenue Recovery Collections fee equal to a percentage of monthly billings to its customers under its NAPM contracts, which is available to the Company if any customer fails to pay its allocable share of total transactions charges under the contracts to provide NPAC Services.

***Carrier Services***

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

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

The Company generates revenue from its telephone number administration services under two government contracts: North American Numbering Plan Administrator (NANPA) and National Pooling Administrator (NPA). Under its NANPA contract, the Company earns a fixed

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annual fee and recognizes this fee as revenue on a straight-line basis as services are provided. Under its NPA contract, the Company earns a fixed fee associated with administration of the pooling system. The Company recognizes revenue for this contract on a straight-line basis over the term of the contract. In the event the Company estimates losses on these fixed price contracts, the Company recognizes these losses in the period in which a loss becomes apparent.

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



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**NEUSTAR, INC.**

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**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2011**

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

The Company generates revenue from its licensed Order Management Services under contracts with terms ranging from three months to two years. The Company generates revenue under these contracts for software licenses, implementation and customization services and post-customer support services (PCS). Under these contracts, revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, collectability is probable and, if applicable, when vendor-specific objective evidence (VSOE) of fair value exists to allocate the arrangement fee to the undelivered elements of a multiple element arrangement. Revenue is allocated to delivered elements of an arrangement using the residual method. Under the residual method, revenue is allocated to the undelivered elements using VSOE of fair value with the remaining contract fee allocated to the delivered elements and recognized as revenue when all other revenue recognition criteria have been met. For software contracts that include customization services that are essential to the functionality of the delivered software, the software license and implementation and customization revenue is recognized under the contract method of accounting using the percentage-of-completion method. The Company estimates the percentage-of-completion for each contract based on the ratio of direct labor hours incurred to total estimated direct labor hours required under such contract and recognizes an amount of revenue equal to the percentage-of-completion multiplied by the contract amount allocated to the software license and implementation and customization services fees. The contract amount allocated to these delivered elements is determined under the residual method approach. The Company determined the VSOE of PCS under the bell-shape curve approach and determined that a substantial majority of its actual PCS renewals are within a narrow range of the median pricing. For arrangements with bundled PCS and there is no stated contractual PCS rate or the rate is less than the established range of VSOE, the Company utilizes the low end of the range for VSOE as fair value of PCS. PCS revenue is recognized on a straight-line basis over the service term of the contract.

***Enterprise Services***

The Company generates revenue from the management of internal and external DNS services. The Company's revenue from these services consists of customer set-up fees, monthly recurring fees and per-transaction fees for transactions in excess of pre-established monthly minimums under contracts with terms ranging from one to three years. Customer set-up fees are not considered a separate deliverable and are deferred and recognized on a straight-line basis over the term of the contract. Under the Company's contracts to provide DNS services, customers have contractually established monthly transaction volumes for which they are charged a recurring monthly fee. Transactions processed in excess of the pre-established monthly volume are billed at a contractual per-transaction rate. Each month, the Company recognizes the recurring monthly fee and usage in excess of the established monthly volume on a per-transaction basis as services are provided.

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

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

***Accounting for Multiple Element Arrangements Entered Into or Materially Modified After January 1, 2011***

In September 2009, the FASB ratified Accounting Standard Update (ASU) 2009-13, Revenue Recognition Topic 605 - Multiple-Deliverable Revenue Arrangements (ASU 2009-13). Under this guidance, when vendor-specific objective evidence or third party evidence for deliverables in a multiple-element arrangement cannot be determined, the Company will be required to develop a best estimate of the selling price for separate deliverables and allocate arrangement consideration using the relative selling price method. The Company adopted ASU 2009-13 on a prospective basis for arrangements entered into or materially modified on or after January 1, 2011.

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During 2010 and the nine months ended September 30, 2011, certain of the Company's arrangements included customer set-up and implementation services, followed by ongoing transaction processing. These customer set-up and implementation services were not considered a separate deliverable that provides stand-alone value to the customer and such fees were deferred and recognized as

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revenue on a straight-line basis over the term of the contract. Accordingly, the adoption of ASU 2009-13 did not have a material effect on the Company's revenue recognized for the nine months ended September 30, 2011. Assuming the adoption of ASU 2009-13 on a prospective basis for arrangements entered into or materially modified on or after January 1, 2010, revenue recognized for the nine months ended September 30, 2010 would not have been materially different.

***Service Level Standards***

Some of the Company's private commercial contracts require the Company to meet service level standards and impose corresponding penalties if the Company fails to meet those standards. The Company records a provision for these performance-related penalties in the period in which it becomes aware that it has failed to meet required service levels, triggering the requirement to pay a penalty, which results in a corresponding reduction to revenue.

**Income Taxes**

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

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

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

**Recent Accounting Pronouncements**

In June 2011, the FASB issued Auditing Standards Update (ASU) 2011-05, Presentation of Comprehensive Income, to improve the comparability, consistency, and transparency of financial reporting and increase the prominence of items reported in other comprehensive income (OCI). The amendments to this standard require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Under either method, adjustments must be displayed for items that are reclassified from OCI to net income, in both net income and OCI. The standard does not change the current option for presenting components of OCI gross or net of the effect of income taxes, provided that such tax effects are presented in the statement in which OCI is presented or disclosed in the notes to the financial statements. Additionally, the standard does not affect the calculation or reporting of earnings per share. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and are to be applied retrospectively, with early adoption permitted. The Company does expect the adoption of this standard to have a material impact on its consolidated financial statements.

In September 2011, the FASB issued ASU 2011-08, Testing Goodwill for Impairment, to simplify how entities test goodwill for impairment. The amendments in the Update permit an entity to first assess qualitative factors to determine whether it is more likely than not (that is, a likelihood of more than 50 percent) that the fair value of a reporting unit is less than its carrying amount. If this is the case, companies will need

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to perform a more detailed two-step goodwill impairment test which is used to identify potential goodwill impairments and to measure the amount of goodwill impairment losses to be recognized, if any. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company plans to adopt this update for its annual goodwill impairment test performed as of October 1, 2011. The Company does not believe the adoption of this update will have a material impact on its financial statements.

**Table of Contents****NEUSTAR, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2011****3. ACQUISITIONS AND DISCONTINUED OPERATIONS***Evolving System Inc. Number Solutions Acquisition*

On July 1, 2011, the Company acquired the assets and certain liabilities of the Numbering Solutions business of Evolving Systems, Inc. for cash consideration of approximately \$39.0 million, subject to certain working capital adjustments. The acquisition of Evolving Systems' Numbering Solutions business expands the Company's Order Management Services portfolio and furthers the Company's long-term initiative to simplify operators' Operations Support Systems architectures by mitigating cost and complexity, while making the evolution to next-generation networks more efficient, manageable, and flexible to meet the increasingly complex needs of end-users.

The acquisition was accounted for under the acquisition method of accounting in accordance with the Business Combinations Topic of the FASB ASC and the results of operations have been included within the Carrier Services segment in the Company's consolidated statement of operations since the date of acquisition. Of the total purchase price, the Company recorded \$20.6 million of goodwill, \$21.7 million of definite-lived intangible assets, and \$3.3 million of net liabilities. The definite-lived intangible assets consist of \$18.9 million of customer relationships and \$2.8 million of acquired technology. The Company is amortizing customer relationships and acquired technology on a straight-line basis over an estimated useful life of 10 years and 5 years, respectively. The total amount of goodwill that is expected to be deductible for tax purposes is \$19.7 million. The allocation of the purchase price is preliminary pending the finalization of the working capital balance sheet and deferred income taxes. The Company does not expect the finalization of these items to materially impact the purchase price allocation.

The application of the acquisition method of accounting for business combinations requires management to make significant estimates and assumptions in the determination of the fair value of the assets acquired and liabilities assumed in order to properly allocate purchase price consideration. These assumptions and estimates include a market participant's expected use of the asset and the appropriate discount rates from a market participant perspective. The Company's estimates are based on historical experience; information obtained from the management of the acquired company and are determined with assistance from an independent third-party appraisal firm. The Company's significant assumptions and estimates include the cash flows that an acquired asset is expected to generate in the future, the weighted-average cost of capital, long-term projected revenues and growth rates, and the estimated royalty rate in the application of the relief from royalty method.

*Discontinued Operations*

During the second quarter of 2011, the Company ceased operations of its Converged Messaging Services business. The results of operations of the Converged Messaging Services business are reflected in the Company's consolidated statements of operations as (Loss) income from discontinued operations, net of tax. All corresponding prior period operating results presented in the Company's consolidated statements of operations and the accompanying notes have been reclassified to reflect the operations of the Converged Messaging Services business as discontinued operations.

Summaries of the results of discontinued operations for the three and nine months ended September 30, 2010 and 2011 are as follows (in thousands):

|  | Three Months Ended<br>September 30, |      | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------|------------------------------------|------------|
|  | 2010                                | 2011 | 2010                               | 2011       |
| Revenue from discontinued operations         | \$ 1,072                            | \$   | \$ 4,488                           | \$ 454     |
| Loss from discontinued operations before tax | \$ (5,682)                          | \$   | \$ (17,418)                        | \$ (8,174) |
| Benefit for income taxes                     | (3,811)                             |      | (8,472)                            | (45,423)   |

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|  |            |    |            |           |
|--|------------|----|------------|-----------|
| (Loss) income from discontinued operations, net of tax | \$ (1,871) | \$ | \$ (8,946) | \$ 37,249 |
|--|------------|----|------------|-----------|

The amounts presented as discontinued operations represent direct revenues and operating costs of the Converged Messaging Services business, which include the pre-tax loss on the sale of certain assets and liabilities of this business of \$1.9 million and an income tax benefit of \$42.7 million attributed to a deduction for the loss on worthless stock of a certain Converged Messaging Services business entity, recorded during the first quarter of 2011. The Company has determined direct costs consistent with the manner in which the Converged Messaging business was structured and managed during the respective periods. Indirect costs such as corporate overhead costs that are not directly attributable to the Converged Messaging business have not been allocated to the discontinued operations.

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As of December 31, 2010 and September 30, 2011, the assets and liabilities of the Converged Messaging Services business are included in their respective balance sheet categories in the Company's consolidated balance sheets. As of December 31, 2010, these assets and liabilities were \$5.8 million and \$6.7 million, respectively. As of September 30, 2011, these assets and liabilities were \$1.6 million and \$2.1 million, respectively. As of September 30, 2011, these assets primarily included cash to fund the residual liabilities of the Converged Messaging Services business. All significant revenue generating and cost producing activities of the discontinued operations have ceased as of June 30, 2011.

**4. INVESTMENTS****Auction Rate Securities and Rights**

In November 2008, the Company accepted a settlement offer in the form of a rights offering (ARS Rights) by the investment firm that brokered the Company's original purchases of auction rate securities (ARS). The ARS Rights provided the Company with rights to sell its ARS at par value to the investment firm during a two year period beginning June 30, 2010. Under the ARS Rights, the investments were completely liquidated on July 1, 2010.

The Company elected to measure the ARS Rights at their fair value pursuant to the Financial Instruments Topic of the FASB ASC and to classify the associated ARS as trading securities. During the three and nine months ended September 30, 2010, the Company recorded losses of \$4.0 million and \$6.9 million, respectively, related to the change in estimated fair value of the ARS Rights. During the three and nine months ended September 30, 2010, the Company recorded gains of \$4.0 million and \$4.9 million, respectively, related to the change in estimated fair value of the ARS.

**Pre-refunded Municipal Bonds and U.S. Agency Debt Securities**

As of December 31, 2010 and September 30, 2011, the Company held approximately \$50.8 million and \$45.8 million, respectively, in pre-refunded municipal bonds, secured by an escrow fund of U.S. Treasury securities. In addition, as of September 30, 2011, the Company held \$6.9 million in U.S. agency debt securities. These investments are accounted for as available-for-sale securities in the Company's consolidated balance sheet pursuant to the Investments - Debt and Equity Securities Topic of the FASB ASC. The Company did not have any sales of these investments during 2010. During the three and nine months ended September 30, 2011, the Company sold approximately \$43.8 million and \$77.1 million, respectively, of available-for-sale securities and recognized net gains of \$10,000 and \$0.1 million, respectively. The Company did not record any impairment charges related to these investments during the three and nine months ended September 30, 2010 and 2011.

The following table summarizes the Company's investments as of December 31, 2010 and September 30, 2011 (in thousands):

|   | \$13,782                 | \$13,782     | \$13,782       | \$13,782         |
|---|--------------------------|--------------|----------------|------------------|
|   | <b>December 31, 2010</b> |              |                |                  |
|   | <b>Gross Unrealized</b>  |              |                | <b>Estimated</b> |
|   | <b>Amortized</b>         | <b>Gains</b> | <b>Losses</b>  | <b>Fair</b>      |
|   | <b>Cost</b>              |              |                | <b>Value</b>     |
| Due within one year:                    |                          |              |                |                  |
| Municipal bonds                         | \$ 13,782                | \$ 23        | \$ (3)         | \$ 13,802        |
| Due after one year through three years: |                          |              |                |                  |
| Municipal bonds                         | 36,968                   | 61           | (20)           | 37,009           |
| <b>Total</b>                            | <b>\$ 50,750</b>         | <b>\$ 84</b> | <b>\$ (23)</b> | <b>\$ 50,811</b> |

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|   | \$13,7820                 | \$13,7820               | \$13,7820     | \$13,7820         |
|---|---------------------------|-------------------------|---------------|-------------------|
|   | <b>September 30, 2011</b> |                         |               |                   |
|   | <b>Amortized</b>          | <b>Gross Unrealized</b> |               | <b>Estimated</b>  |
|   | <b>Cost</b>               | <b>Gains</b>            | <b>Losses</b> | <b>Fair Value</b> |
| Due within one year:                    |                           |                         |               |                   |
| Municipal bonds                         | \$ 28,181                 | \$ 20                   | \$ (2)        | \$ 28,199         |
| U.S. agency debt securities             | 6,004                     |                         | (1)           | 6,003             |
| Due after one year through three years: |                           |                         |               |                   |
| Municipal bonds                         | 17,537                    | 38                      | (4)           | 17,571            |
| U.S. agency debt securities             | 900                       | 2                       |               | 902               |
| <b>Total</b>                            | <b>\$ 52,622</b>          | <b>\$ 60</b>            | <b>\$ (7)</b> | <b>\$ 52,675</b>  |



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Fair value is the price that would be received in the sale of asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Fair Value Measurements and Disclosure Topic of FASB ASC establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value and requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

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

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

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

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

The following table sets forth, as of December 31, 2010 and September 30, 2011, the Company's financial and non-financial assets and liabilities that are measured at fair value on a recurring basis, by level within the fair value hierarchy (in thousands):

|   | December 31, 2010 |         |         | Total     |
|---|-------------------|---------|---------|-----------|
|   | Level 1           | Level 2 | Level 3 |           |
| Municipal bonds (maturities less than one year) | \$ 13,802         | \$      | \$      | \$ 13,802 |
| Municipal bonds (maturities one to three years) | \$ 37,009         | \$      | \$      | \$ 37,009 |
| Marketable securities <sup>(1)</sup>            | \$ 3,681          | \$      | \$      | \$ 3,681  |
| Deferred compensation <sup>(2)</sup>            | \$ 3,621          | \$      | \$      | \$ 3,621  |

|   | September 30, 2011 |         |         | Total     |
|---|--------------------|---------|---------|-----------|
|   | Level 1            | Level 2 | Level 3 |           |
| Municipal bonds (maturities less than one year)             | \$ 28,199          | \$      | \$      | \$ 28,199 |
| Municipal bonds (maturities one to three years)             | \$ 17,571          | \$      | \$      | \$ 17,571 |
| U.S. agency debt securities (maturities less than one year) | \$ 6,003           | \$      | \$      | \$ 6,003  |
| U.S. agency debt securities (maturity one to three years)   | \$ 902             | \$      | \$      | \$ 902    |
| Marketable securities <sup>(1)</sup>                        | \$ 3,953           | \$      | \$      | \$ 3,953  |
| Deferred compensation <sup>(2)</sup>                        | \$ 3,995           | \$      | \$      | \$ 3,995  |

- (1) The NeuStar, Inc. Deferred Compensation Plan (the Plan) provides directors and certain employees with the ability to defer a portion of their compensation. The assets of the Plan are invested in marketable securities held in a Rabbi Trust and reported at market value in other assets. During the three and nine months ended September 30, 2011, the Company recognized gains of \$44,000 and \$0.5 million, respectively, attributed to the sale of securities from the Rabbi Trust.
- (2) Obligations to pay benefits under the Plan are included in other long-term liabilities.



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The Company's goodwill by operating segment as of December 31, 2010 and September 30, 2011 is as follows (in thousands):

|                               | December 31,<br>2010 | Acquisitions | September 30,<br>2011 |
|-------------------------------|----------------------|--------------|-----------------------|
| <b>Carrier Services:</b>      |                      |              |                       |
| Gross goodwill                | \$ 202,055           | \$ 20,602    | \$ 222,657            |
| Accumulated impairment losses | (93,602)             |              | (93,602)              |
| Net goodwill                  | 108,453              | 20,602       | 129,055               |
| <b>Enterprise Services:</b>   |                      |              |                       |
| Gross goodwill                | 16,198               |              | 16,198                |
| Accumulated impairment losses |                      |              |                       |
| Net goodwill                  | 16,198               |              | 16,198                |
| <b>Total:</b>                 |                      |              |                       |
| Gross goodwill                | 218,253              | 20,602       | 238,855               |
| Accumulated impairment losses | (93,602)             |              | (93,602)              |
| Net goodwill                  | \$ 124,651           | \$ 20,602    | \$ 145,253            |

During the third quarter of 2011, the Company recorded \$20.6 million of goodwill related to its acquisition of assets and certain liabilities of the Numbering Solutions business of Evolving Systems, Inc., which is included in the Company's Carrier Services operating segment (see Note 3).

**Intangible Assets**

Intangible assets consist of the following (in thousands):

|                                  | December 31,<br>2010 | September 30,<br>2011 | Weighted-<br>Average<br>Amortization<br>Period<br>(in years) |
|----------------------------------|----------------------|-----------------------|--|
| <b>Intangible assets:</b>        |                      |                       |  |
| Customer lists and relationships | \$ 49,881            | \$ 68,781             | 7.1  |
| Accumulated amortization         | (34,062)             | (36,992)              |  |

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|                                       |           |           |     |
|---------------------------------------|-----------|-----------|-----|
| Customer lists and relationships, net | 15,819    | 31,789    |     |
| Acquired technology                   | 19,554    | 22,354    | 3.6 |
| Accumulated amortization              | (16,805)  | (17,721)  |     |
| Acquired technology, net              | 2,749     | 4,633     |     |
| Trade name                            | 630       | 630       | 3.0 |
| Accumulated amortization              | (224)     | (332)     |     |
| Trade name, net                       | 406       | 298       |     |
| Intangible assets, net                | \$ 18,974 | \$ 36,720 |     |

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**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2011**

During the third quarter of 2011, the Company recorded definite-lived intangible assets of \$21.7 million, consisting of \$18.9 million of customer relationships and \$2.8 million of acquired technology, related to its acquisition of assets and certain liabilities of the Numbering Solutions business of Evolving Systems, Inc. (see Note 3).

Amortization expense related to intangible assets, which is included in depreciation and amortization expense, was approximately \$1.2 million and \$1.8 million for the three months ended September 30, 2010 and 2011, respectively, and \$3.6 million and \$4.0 million for the nine months ended September 30, 2010 and 2011, respectively. Amortization expense related to intangible assets for the years ended December 31, 2011, 2012, 2013, 2014, 2015 and thereafter is expected to be approximately \$5.7 million, \$6.6 million, \$5.2 million, \$4.6 million, \$4.5 million and \$14.2 million, respectively. Intangible assets as of September 30, 2011 will be fully amortized during the year ended December 31, 2021.

**7. NOTES PAYABLE**

On February 6, 2007, the Company entered into a credit agreement which provides for a revolving credit facility in an aggregate principal amount of up to \$100 million (the Credit Facility). Borrowings under the Credit Facility bear interest, at the Company's option, at either a Eurodollar rate plus a spread ranging from 0.625% to 1.25%, or at a base rate plus a spread ranging from 0.0% to 0.25%, with the amount of the spread in each case depending on the ratio of the Company's consolidated senior funded indebtedness to consolidated earnings before interest, taxes, depreciation and amortization (EBITDA). The Credit Facility expires on February 6, 2012. Borrowings under the Credit Facility may be used for working capital, capital expenditures, general corporate purposes and to finance acquisitions. There were no borrowings outstanding under the Credit Facility as of December 31, 2010 and September 30, 2011. As of December 31, 2010, available borrowings were reduced by outstanding letters of credit of \$8.8 million. As of September 30, 2011, the Company's available borrowings under the Credit Facility were \$100 million and the \$9.4 million of outstanding letters of credit were collateralized by \$9.9 million of restricted cash.

The Credit Facility contains customary representations and warranties, affirmative and negative covenants, and events of default. The Credit Facility requires the Company to maintain a minimum ratio of consolidated EBITDA to consolidated interest charges and a maximum ratio of consolidated senior funded indebtedness to consolidated EBITDA. If an event of default occurs and is continuing, the Company may be required to repay all amounts outstanding under the Credit Facility. Lenders holding more than 50% of the loans and commitments under the Credit Facility may elect to accelerate the maturity of amounts due under the Credit Facility upon the occurrence and during the continuation of an event of default. As of and for the year ended December 31, 2010, and the nine months ended September 30, 2011, the Company was in compliance with these covenants.

**8. STOCKHOLDERS' EQUITY**

**Stock-Based Compensation**

The Company has three stock incentive plans: the NeuStar, Inc. 1999 Equity Incentive Plan (1999 Plan); the NeuStar, Inc. 2005 Stock Incentive Plan (2005 Plan); and the NeuStar, Inc. 2009 Stock Incentive Plan (2009 Plan) (collectively, the Plans). The Company may grant to its directors, employees and consultants awards under the 2009 Plan in the form of incentive stock options, nonqualified stock options, stock appreciation rights, shares of restricted stock, restricted stock units, performance vested restricted stock units (PVRsUs) and other stock-based awards. The aggregate number of shares of Class A common stock with respect to which all awards may be granted under the 2009 Plan is 10,950,000, plus the number of shares underlying awards granted under the 1999 Plan and the 2005 Plan that remain undelivered following any expiration, cancellation or forfeiture of such awards. As of September 30, 2011, 6,742,861 shares were available for grant or award under the 2009 Plan.

The term of any stock option granted under the Plans may not exceed ten years. The exercise price per share for options granted under the Plans may not be less than 100% of the fair market value of the common stock on the option grant date. The Board of Directors or Compensation Committee of the Board of Directors determines the vesting schedule of the options, with a maximum vesting period of ten years. Options issued

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generally vest with respect to 25% of the shares underlying the option on the first anniversary of the grant date and 2.083% of the shares on the last day of each succeeding calendar month thereafter. The options expire seven to ten years from the date of issuance and are forfeitable upon termination of an option holder's service.

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

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Stock-based compensation expense recognized for the three months ended September 30, 2010 and 2011 was \$5.1 million and \$6.5 million, respectively, and \$13.9 million and \$19.1 million for the nine months ended September 30, 2010 and 2011, respectively. As of September 30, 2011, total unrecognized compensation expense related to non-vested stock options, non-vested restricted stock awards, non-vested restricted stock units and non-vested PVRsUs granted prior to that date was estimated at \$42.8 million, which the Company expects to recognize over a weighted average period of approximately 1.52 years. Total unrecognized compensation expense as of September 30, 2011 is estimated based on outstanding non-vested stock options, non-vested restricted stock awards, non-vested restricted stock units and non-vested PVRsUs and may be increased or decreased in future periods for subsequent grants or forfeitures, as well as changes in the estimated fair value of non-vested share-based awards granted to consultants.

**Stock Options**

The Company utilizes the Black-Scholes option pricing model for estimating the fair value of stock options granted. The weighted-average grant date fair value of options granted during the three months ended September 30, 2010 and 2011 was \$7.86 and \$7.83, respectively, and for options granted during the nine months ended September 30, 2010 and 2011 was \$8.09 and \$8.64, respectively. The following are the weighted-average assumptions used in valuing the stock options granted during the three and nine months ended September 30, 2010 and 2011, and a discussion of the Company's assumptions:

|                                     | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |         |
|-------------------------------------|-------------------------------------|---------|------------------------------------|---------|
|                                     | 2010                                | 2011    | 2010                               | 2011    |
| Dividend yield                      | %                                   | %       | %                                  | %       |
| Expected volatility                 | 38.55 %                             | 37.90 % | 39.24 %                            | 37.02 % |
| Risk-free interest rate             | 1.54 %                              | 1.00 %  | 2.16 %                             | 1.66 %  |
| Expected life of options (in years) | 4.42                                | 4.37    | 4.42                               | 4.42    |

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

**Expected volatility** Volatility is a measure of the amount by which a financial variable such as a share price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. The Company considered the historical volatility of its stock price over a term similar to the expected life of the grant in determining its expected volatility.

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

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

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

**Shares**

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|  |                  | <b>Weighted-<br/>Average<br/>Exercise<br/>Price</b> | <b>Aggregate<br/>Intrinsic<br/>Value<br/>(in millions)</b> | <b>Weighted-<br/>Average<br/>Remaining<br/>Contractual<br/>Life<br/>(in years)</b> |
|--|------------------|---|--|--|
| Outstanding at December 31, 2010         | 6,715,559        | \$ 20.68  |  |  |
| Options granted                          | 2,165,623        | 26.30   |  |  |
| Options exercised                        | (1,221,728)      | 9.79  |  |  |
| Options forfeited                        | (522,394)        | 24.08   |  |  |
| <b>Outstanding at September 30, 2011</b> | <b>7,137,060</b> | <b>\$ 24.00</b>                                     | <b>\$ 19.5</b>   | <b>4.6</b>   |
| Exercisable at September 30, 2011        | 3,471,390        | \$ 24.03  | \$ 12.6  | 3.2  |



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The aggregate intrinsic value of options exercised for the nine months ended September 30, 2010 and 2011 was \$5.2 million and \$20.1 million, respectively.

**Restricted Stock**

The following table summarizes the Company's non-vested restricted stock activity for the nine months ended September 30, 2011:

|                                   | Shares    | Weighted-Average Grant Date Fair Value | Aggregate Intrinsic Value (in millions) |
|-----------------------------------|-----------|--|---|
| Outstanding at December 31, 2010  | 534,590   | \$ 22.82                               |   |
| Restricted stock granted          | 360,790   | 26.41                                  |   |
| Restricted stock vested           | (171,901) | 25.77                                  |   |
| Restricted stock forfeited        | (90,455)  | 24.79                                  |   |
| Outstanding at September 30, 2011 | 633,024   | \$ 23.78                               | \$ 15.9                                 |

The total aggregate intrinsic value of restricted stock vested during the nine months ended September 30, 2011 was approximately \$4.3 million. During the three and nine months ended September 30, 2011, the Company repurchased 8,033 and 58,065 shares of common stock, respectively, for an aggregate purchase price of \$0.2 million and \$1.5 million, respectively, pursuant to the participants' rights under the Company's stock incentive plans to elect to use common stock to satisfy their tax withholding obligations.

**Performance Vested Restricted Stock Units**

During the year ended December 31, 2010 and the nine months ended September 30, 2011, the Company granted 266,580 and 234,112 PVRsUs, respectively, to certain employees with an aggregate fair value of \$6.1 million and \$6.2 million, respectively. The vesting of these stock awards is contingent upon the Company achieving specified financial targets at the end of the specified performance period and an employee's continued employment through the vesting period. The level of achievement of the performance conditions affects the number of shares that will ultimately be issued. The range of possible stock-based award vesting is between 0% and 150% of the initial target. Compensation expense related to these awards is recognized over the requisite service period based on the Company's estimate of the achievement of the performance target and vesting period. As of September 30, 2011, the Company estimates that it will issue 105% and 131% of the performance target awards for PVRsUs granted during 2010 and 2011, respectively.

In the third quarter of 2011, the Company revised its estimate of achievement of the performance target related to the PVRsUs granted during 2010 from 100% of target to 105% of target. In addition, the Company revised its estimate of achievement of the performance target related to the PVRsUs granted during 2011 from 100% of target to 131% of target. These changes in estimates did not have a material impact on the Company's income from continuing operations and the earnings per diluted share from continuing operations, respectively, for the three and nine months ended September 30, 2011.

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



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The following table summarizes the Company's non-vested PVRSU activity for the nine months ended September 30, 2011:

|                               | Shares    | Weighted-Average<br>Grant Date<br>Fair Value | Aggregate<br>Intrinsic<br>Value<br>(in millions) |
|-------------------------------|-----------|--|--|
| Non-vested December 31, 2010  | 840,923   | \$ 19.53                                     |  |
| Granted                       | 234,112   | 26.45  |  |
| Vested                        |           |  |  |
| Forfeited                     | (229,354) | 24.77  |  |
| Non-vested September 30, 2011 | 845,681   | \$ 20.02                                     | \$ 21.3  |

**Restricted Stock Units**

The following table summarizes the Company's restricted stock units activity for the nine months ended September 30, 2011:

|                                   | Shares  | Weighted-Average<br>Grant Date<br>Fair Value | Aggregate<br>Intrinsic<br>Value<br>(in millions) |
|-----------------------------------|---------|--|--|
| Outstanding at December 31, 2010  | 231,865 | \$ 23.99                                     |  |
| Granted                           | 44,933  | 26.48  |  |
| Vested                            |         |  |  |
| Forfeited                         | (750)   | 25.84  |  |
| Outstanding at September 30, 2011 | 276,048 | \$ 24.39                                     | \$ 6.9   |

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

**Share Repurchase Program**

The Company announced on July 28, 2010 that its Board of Directors had authorized a three-year program under which the Company may acquire up to \$300 million of its outstanding Class A common shares. Share repurchases under this program may be made through Rule 10b5-1 programs, open market purchases, privately negotiated transactions or otherwise as market conditions warrant, at prices the Company deems appropriate, and subject to applicable legal requirements and other factors. During the three and nine months ended September 30, 2010, the Company repurchased 1.1 million shares of its Class A common stock, respectively, for an aggregate purchase price of approximately \$25.4 million. During the three and nine months ended September 30, 2011, the Company repurchased 0.9 million and 2.4 million shares of its Class A common stock, respectively, at an average price of \$25.10 and \$25.62 per share, respectively, for total purchase prices of \$23.6 million and

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\$60.3 million, respectively. As of September 30, 2011, a total of 4.0 million shares at an average price of \$25.04 per share had been repurchased under this program for an aggregate purchase price of \$100.7 million. All repurchased shares are accounted for as treasury shares.

**Table of Contents****NEUSTAR, INC.****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2011****9. BASIC AND DILUTED NET INCOME PER COMMON SHARE**

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

|  | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2010</b>                                 | <b>2011</b> | <b>2010</b>                                | <b>2011</b> |
| <b>Computation of basic net income (loss) per common share:</b>                      |   |             |  |             |
| Income from continuing operations  | \$ 31,820                                   | \$ 37,773   | \$ 92,670                                  | \$ 104,854  |
| (Loss) income from discontinued operations, net of tax                               | (1,871)                                     |             | (8,946)                                    | 37,249      |
| Net income   | \$ 29,949                                   | \$ 37,773   | \$ 83,724                                  | \$ 142,103  |
| <b>Weighted average common shares and participating securities outstanding basic</b> |   |             |  |             |
|  | 74,808                                      | 73,237      | 74,806                                     | 73,658      |
| <b>Basic net income (loss) per common share from:</b>                                |   |             |  |             |
| Continuing operations  | \$ 0.43                                     | \$ 0.52     | \$ 1.24                                    | \$ 1.42     |
| Discontinued operations  | (0.03)                                      |             | (0.12)                                     | 0.51        |
| Basic net income per common share  | \$ 0.40                                     | \$ 0.52     | \$ 1.12                                    | \$ 1.93     |
| <b>Computation of diluted net income (loss) per common share:</b>                    |   |             |  |             |
| <b>Weighted average common shares and participating securities outstanding basic</b> |   |             |  |             |
|  | 74,808                                      | 73,237      | 74,806                                     | 73,658      |
| <b>Effect of dilutive securities:</b>  |   |             |  |             |
| Stock-based awards   | 1,218                                       | 1,395       | 1,254                                      | 1,421       |
| Weighted average common shares outstanding diluted                                   | 76,026                                      | 74,632      | 76,060                                     | 75,079      |
| <b>Diluted net income (loss) per common share from:</b>                              |   |             |  |             |
| Continuing operations  | \$ 0.42                                     | \$ 0.51     | \$ 1.22                                    | \$ 1.40     |
| Discontinued operations  | (0.03)                                      |             | (0.12)                                     | 0.49        |
| Diluted net income per common share  | \$ 0.39                                     | \$ 0.51     | \$ 1.10                                    | \$ 1.89     |

Diluted net income per common share reflects the potential dilution of common stock equivalents such as options and warrants, to the extent the impact is dilutive. The Company used income from continuing operations as the control number in determining whether potential common shares were dilutive or anti-dilutive. The same number of potential common shares used in computing the diluted per-share amount from continuing operations was also used in computing the diluted per-share amounts from discontinued operations even if those amounts were anti-dilutive.

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Common stock options to purchase an aggregate of 4,613,445 and 5,591,797 shares were excluded from the calculation of the denominator for diluted net income per common share for the three months ended September 30, 2010 and 2011, respectively, due to their anti-dilutive effects. Common stock options to purchase an aggregate of 4,176,612 and 5,141,075 shares were excluded from the calculation of the denominator for diluted net income per common share for the nine months ended September 30, 2010 and 2011, respectively, due to their anti-dilutive effects.

### **10. COMPREHENSIVE INCOME**

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

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The following table summarizes the components of total comprehensive income, net of taxes, during the three and nine months ended September 30, 2010 and 2011 (in thousands):

|                                       | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|---------------------------------------|-------------------------------------|-----------|------------------------------------|------------|
|                                       | 2010                                | 2011      | 2010                               | 2011       |
| Net income                            | \$ 29,949                           | \$ 37,773 | \$ 83,724                          | \$ 142,103 |
| Unrealized loss / gain on investments | 155                                 | (55)      | 69                                 | (340)      |
| Accumulated translation adjustments   | 171                                 | (296)     | (79)                               | (357)      |
| Total comprehensive income            | \$ 30,275                           | \$ 37,422 | \$ 83,714                          | \$ 141,406 |

The following table summarizes the tax (provision) or benefit for each component of total comprehensive income during the three and nine months ended September 30, 2010 and 2011 (in thousands):

|                                       | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|---------------------------------------|-------------------------------------|----------|------------------------------------|----------|
|                                       | 2010                                | 2011     | 2010                               | 2011     |
| Tax (provision) benefit:              |                                     |          |                                    |          |
| Unrealized loss / gain on investments | \$ (120)                            | \$ 9     | \$ (45)                            | \$ 203   |
| Accumulated translation adjustments   | \$ (58)                             | \$ (176) | \$ 62                              | \$ (125) |

**11. RESTRUCTURING CHARGES**

The Company recorded restructuring recoveries in continuing operations of \$0.4 million and \$33,000 during the three months ended September 30, 2010 and 2011, respectively. During the nine months ended September 30, 2010 and 2011, the Company recorded restructuring charges in continuing operations of \$1.6 million and \$0.4 million, respectively. The Company's restructuring charges in continuing operations during the nine months ended September 30, 2010 consisted of charges for its 2009 restructuring plan to relocate certain operations and support functions to Louisville, Kentucky, while the restructuring charges in continuing operations during the nine months ended September 30, 2011 consisted of charges incurred under its 2010 management transition restructuring plan.

The Company recorded restructuring recoveries in discontinued operations of \$0.2 million during the three months ended September 30, 2010, and charges of \$1.4 million and \$1.6 million during the nine months ended September 30, 2010 and 2011, respectively. The Company's restructuring charges for discontinued operations consisted of charges incurred under its Converged Messaging Services restructuring plan initiated in the fourth quarter of 2008 and completed in the second quarter of 2011.

**Restructuring Plans*****2010 Management Transition***

In the fourth quarter of 2010, the Company initiated a domestic work-force reduction impacting both of its operating segments and recorded severance and severance-related charges of \$3.8 million. During the three months ended March 31, 2011, the Company recorded additional severance and severance-related charges of \$0.4 million in connection with this restructuring initiative. The Company does not anticipate it will

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incur additional expenses under this plan and expects to pay approximately \$1.0 million in severance and severance-related payments through the third quarter of 2012.

### ***2001 Plan***

At December 31, 2010 and September 30, 2011, the liability related to a reduction in leased facilities incurred in connection with a 2001 restructuring plan was \$0.8 million and \$0.4 million, respectively. Amounts related to lease terminations due to the closure of facilities under this 2001 restructuring plan will be paid over the remainder of the respective lease terms, the longest of which extends through 2011.



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Beginning in the fourth quarter of 2008, management committed to and implemented a restructuring plan for the Company's Converged Messaging Services business, previously known as the Company's Next Generation Messaging business, to more appropriately allocate resources to the Company's key mobile instant messaging initiatives. The restructuring plan involved a reduction in headcount and the closure of specific leased facilities in some of the Company's international locations. In the third quarter of 2009 and the fourth quarter of 2010, the Company extended the restructuring plan to include further headcount reductions and the closure of certain additional facilities. During the nine months ended September 30, 2011, the Company sold certain assets and liabilities of Neustar NGM Services, Inc. and its subsidiaries, and completed the wind-down of the residual operations of its Converged Messaging Services business. Restructuring charges for all periods presented have been reclassified into (Loss) income on discontinued operations, net of tax in the Company's consolidated statements of operations.

Total net restructuring charges recorded under this plan since the fourth quarter of 2008 include approximately \$8.4 million of severance and severance-related costs and \$1.8 million of lease and facility exit costs. Amounts related to lease terminations due to the closure of excess facilities will be paid over the remainder of the respective lease terms, the longest of which extends through 2013.

***Summary of Accrued Restructuring Plans***

The additions and adjustments to the accrued restructuring liability related to the Company's restructuring plans as described above for the nine months ended September 30, 2011 are as follows (in thousands):

|                                      | December 31,<br>2010 | Additional<br>Costs | Cash<br>Payments | Adjustments | September 30,<br>2011 |
|--------------------------------------|----------------------|---------------------|------------------|-------------|-----------------------|
| <b>Converged Messaging Services:</b> |                      |                     |                  |             |                       |
| Severance and related costs          | \$ 656               | \$ 733              | \$ (1,253)       | \$ (136)    | \$                    |
| Lease and facilities exit costs      | 172                  | 313                 | (487)            | 717         | 715                   |
| Total Converged Messaging Services   | 828                  | 1,046               | (1,740)          | 581         | 715                   |
| <b>2010 Management Transition:</b>   |                      |                     |                  |             |                       |
| Severance and related costs          | 3,354                | 447                 | (2,735)          | (60)        | 1,006                 |
| <b>2001 Plan:</b>                    |                      |                     |                  |             |                       |
| Lease and facilities exit costs      | 836                  |                     | (418)            |             | 418                   |
| Total restructuring plans            | \$ 5,018             | \$ 1,493            | \$ (4,893)       | \$ 521      | \$ 2,139              |

**12. OTHER (EXPENSE) INCOME**

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

|                             | Three Months Ended<br>September 30,<br>2010 |  | September 30,<br>2011 |  | Nine Months Ended<br>September 30,<br>2010 |  | September 30,<br>2011 |  |
|-----------------------------|---|--|-----------------------|--|--|--|-----------------------|--|
| Interest and other expense: |   |  |                       |  |  |  |                       |  |

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|  |          |        |          |          |
|--|----------|--------|----------|----------|
| Interest expense                         | \$ 345   | \$ 115 | \$ 95    | \$ 396   |
| (Gain) loss on asset disposals           | (54)     | 418    | (49)     | 482      |
| Loss on ARS Rights                       | 4,015    |        | 6,892    |          |
| Foreign currency transaction (gain) loss | (12)     | 142    | (96)     | 270      |
| Total                                    | \$ 4,294 | \$ 675 | \$ 6,842 | \$ 1,148 |
| <b>Interest and other income:</b>        |          |        |          |          |
| Interest income                          | \$ 54    | \$ 294 | \$ 481   | \$ 754   |
| Available-for sale realized gains        |          | 10     |          | 683      |
| ARS trading gains                        | 4,015    |        | 7,007    |          |
| Total                                    | \$ 4,069 | \$ 304 | \$ 7,488 | \$ 1,437 |

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**NEUSTAR, INC.**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2011**

**13. INCOME TAXES**

The Company's effective tax rate from continuing operations decreased to 38.3% for the nine months ended September 30, 2011 from 39.9% for the nine months ended September 30, 2010 primarily due to a change in estimate of the realizability of acquired Quova, Inc. net operating losses and a discrete benefit for federal research tax credits. Excluding discrete items, the Company's effective tax rate was 39.7% for the nine months ended September 30, 2011.

On February 7, 2011, the Company sold certain business assets and liabilities of Neustar NGM Services, Inc. (NGM Services) and its subsidiaries, a portion of the Converged Messaging Services business. The Company intends to treat the common stock of NGM Services as worthless for U.S. income tax purposes in its 2011 U.S. federal and state income tax returns. As a result, the Company recorded an income tax benefit of \$42.7 million for the three months ended March 31, 2011 within discontinued operations, which primarily represents the book and tax basis differences associated with its investment in NGM Services.

As of December 31, 2010 and September 30, 2011, the Company had unrecognized tax benefits of \$1.2 million and \$1.4 million, respectively, of which \$1.2 million and \$1.4 million, respectively, would affect the Company's effective tax rate if recognized.

The Company recognizes potential interest and penalties related to uncertain tax positions in income tax expense. The Company recognized potential interest and penalties of \$7,300 and \$18,000 for the three months ended September 30, 2010 and 2011, respectively, and \$20,000 and \$66,000 for the nine months ended September 30, 2010 and 2011, respectively. As of December 31, 2010 and September 30, 2011, the Company had established reserves of approximately \$84,000 and \$108,000, respectively, for accrued potential interest and penalties related to uncertain tax positions. To the extent interest and penalties are not assessed with respect to uncertain tax positions, amounts accrued will be reduced and reflected as a reduction of the overall income tax provision. For the nine months ended September 30, 2011, the Company paid approximately \$18,000 of accrued interest and penalties and reflected \$24,000 for reductions of accrued interest and penalties not assessed for tax positions of prior years.

The Company files income tax returns in the United States Federal jurisdiction and in many state and foreign jurisdictions. The tax years 2007 through 2010 remain open to examination by the major taxing jurisdictions to which the Company is subject. The IRS completed an examination of the Company's federal income tax returns for the years 2007 and 2008. The audit resulted in no material effect on the Company's financial position, results of operations or cash flows. The Israeli Taxing Authority has initiated an examination of the Company's income tax returns for years 2007 through 2010. While the outcome of the audit is uncertain, management does not currently believe that the outcome will have a material adverse effect on the Company's financial position, results of operations or cash flows.

The Company anticipates that total unrecognized tax benefits will decrease by approximately \$75,000 over the next twelve months due to the expiration of certain statutes of limitations.

**14. SEGMENT INFORMATION**

The Company has two operating segments, reflective of the manner in which the chief operating decision maker (CODM) allocates resources and assesses performance: Carrier Services and Enterprise Services. The Company's operating segments are the same as its reportable segments.

During the second quarter of 2011, the Company ceased operations of its Converged Messaging Services business and the results of operations of this business have been reclassified as discontinued operations in the Company's consolidated statements of operations for each of the periods presented.

The Company's Carrier Services operating segment provides services that ensure the seamless connection of its carrier customers' numerous networks, while also enhancing the capabilities and performance of their customer's infrastructure. The Company enables its carrier customers to use, exchange and share critical resources, such as telephone numbers, facilitates order management and work flow processing among carriers,

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and allows operators to manage and optimize the addressing and routing of emerging IP communications.

The Company's Enterprise Services operating segment provides services to its enterprise customers to meet their respective directory-related needs, as well as Internet infrastructure services. The Company is the authoritative provider of essential registry services and manages directories of similar resources, or addresses, that its customers use for reliable, fair and secure access and

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connectivity. The Company provides a suite of DNS services to its enterprise customers built on a global directory platform. The Company manages a collection of directories that maintain addresses in order to direct, prioritize and manage Internet traffic, and to find and resolve Internet queries and top-level domains. The Company's services monitor and load-test websites to help identify issues and optimize performance. In addition, the Company provides IP geolocation services that help enterprises identify the location of their consumers used for a variety of purposes, such as target marketing and fraud prevention. Additionally, the Company provides directory services for the 5- and 6-digit number strings used for all U.S. Common Short Codes, which is part of the short messaging service relied upon by the U.S. wireless industry.

The Company reports segment information based on the management approach which relies on the internal performance measures used by the CODM to assess the performance of each operating segment in a given period. In connection with that assessment, the CODM reviews revenues and segment contribution, which excludes certain unallocated costs within the following expense classifications: cost of revenue, sales and marketing, research and development and general and administrative. Depreciation and amortization and restructuring charges are also excluded from segment contribution.

The Company's historical Carrier Services segment disclosures have been recast for comparative purpose to exclude the discontinued operations of its Converged Messaging Services business. Information for the three and nine months ending September 30, 2010 and 2011 regarding the Company's reportable segments from continuing operations is as follows (in thousands):

|  | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2010</b>                                 | <b>2011</b> | <b>2010</b>                                | <b>2011</b> |
| <b>Revenue:</b>  |   |             |  |             |
| Carrier Services   | \$ 96,657                                   | \$ 114,155  | \$ 292,049                                 | \$ 334,604  |
| Enterprise Services  | 32,781                                      | 38,342      | 91,955                                     | 111,671     |
| Total revenue  | \$ 129,438                                  | \$ 152,497  | \$ 384,004                                 | \$ 446,275  |
| <b>Segment contribution:</b>   |   |             |  |             |
| Carrier Services   | \$ 86,561                                   | \$ 99,302   | \$ 261,787                                 | \$ 293,451  |
| Enterprise Services  | 15,733                                      | 16,551      | 41,782                                     | 47,620      |
| Total segment contribution   | 102,294                                     | 115,853     | 303,569                                    | 341,071     |
| <b>Indirect operating expenses:</b>  |   |             |  |             |
| Cost of revenue (excluding depreciation and amortization shown separately below) | 18,724                                      | 20,424      | 55,721                                     | 59,793      |
| Sales and marketing  | 3,736                                       | 3,584       | 12,423                                     | 12,026      |
| Research and development   | 3,119                                       | 3,575       | 9,291                                      | 10,085      |
| General and administrative   | 15,557                                      | 19,742      | 47,126                                     | 60,137      |
| Depreciation and amortization  | 8,255                                       | 10,486      | 23,825                                     | 29,018      |
| Restructuring charges  | (417)                                       | (33)        | 1,589                                      | 387         |
| Income from operations   | \$ 53,320                                   | \$ 58,075   | \$ 153,594                                 | \$ 169,625  |

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



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Geographic area revenues and service offering revenues from external customers for the three and nine months ended September 30, 2010 and 2011, and geographic area long-lived assets as of December 31, 2010 and September 30, 2011 are as follows (in thousands):

|                                 | <b>Three Months Ended<br/>September 30,</b> |                   | <b>Nine Months Ended<br/>September 30,</b> |                   |
|---------------------------------|---|-------------------|--|-------------------|
|                                 | <b>2010</b>                                 | <b>2011</b>       | <b>2010</b>                                | <b>2011</b>       |
| Revenues by geographical areas: |   |                   |  |                   |
| North America                   | \$ 121,431                                  | \$ 142,423        | \$ 361,455                                 | \$ 417,512        |
| Europe and Middle East          | 4,333                                       | 6,343             | 11,744                                     | 18,224            |
| Other regions                   | 3,674                                       | 3,731             | 10,805                                     | 10,539            |
| <b>Total revenues</b>           | <b>\$ 129,438</b>                           | <b>\$ 152,497</b> | <b>\$ 384,004</b>                          | <b>\$ 446,275</b> |

|                                  | <b>Three Months Ended<br/>September 30,</b> |                   | <b>Nine Months Ended<br/>September 30,</b> |                   |
|----------------------------------|---|-------------------|--|-------------------|
|                                  | <b>2010</b>                                 | <b>2011</b>       | <b>2010</b>                                | <b>2011</b>       |
| Revenues by service offerings:   |   |                   |  |                   |
| Carrier Services:                |   |                   |  |                   |
| Numbering Services               | \$ 89,592                                   | \$ 99,924         | \$ 271,220                                 | \$ 298,163        |
| Order Management Services        | 4,620                                       | 10,236            | 13,341                                     | 25,861            |
| IP Services                      | 2,445                                       | 3,995             | 7,488                                      | 10,580            |
| <b>Total Carrier Services</b>    | <b>96,657</b>                               | <b>114,155</b>    | <b>292,049</b>                             | <b>334,604</b>    |
| Enterprise Services:             |   |                   |  |                   |
| Internet Infrastructure Services | 17,260                                      | 20,484            | 48,290                                     | 61,005            |
| Registry Services                | 15,521                                      | 17,858            | 43,665                                     | 50,666            |
| <b>Total Enterprise Services</b> | <b>32,781</b>                               | <b>38,342</b>     | <b>91,955</b>                              | <b>111,671</b>    |
| <b>Total revenues</b>            | <b>\$ 129,438</b>                           | <b>\$ 152,497</b> | <b>\$ 384,004</b>                          | <b>\$ 446,275</b> |

|                                     | <b>December 31,<br/>2010</b> | <b>September 30,<br/>2011</b> |
|-------------------------------------|------------------------------|-------------------------------|
| Long-lived assets, net              |                              |                               |
| North America                       | \$ 91,675                    | \$ 126,895                    |
| Europe and Middle East              | 1,588                        | 30                            |
| Other regions                       | 7                            | 1                             |
| <b>Total long-lived assets, net</b> | <b>\$ 93,270</b>             | <b>\$ 126,926</b>             |





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**NEUSTAR, INC.**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2011**

**15. SUBSEQUENT EVENTS**

**Acquisition**

On October 10, 2011, the Company entered into a definitive agreement to acquire Targus Information Corporation (TARGUSinfo) for cash consideration of approximately \$650.0 million, subject to certain purchase price adjustments. TARGUSinfo is a leading, independent provider of real-time, on-demand information and analytics services including Caller ID. TARGUSinfo's services help its customers identify, verify, score and locate their customers and prospects. This acquisition will combine TARGUSinfo's leadership in Caller ID and online information services, such as lead verification and scoring, with Neustar's strengths in network information services, including address inventory management, network security, and marketing analytics. These capabilities, delivered through a trusted, privacy-controlled environment, will greatly extend Neustar's ability to provide its customers services based on unique, non-replicable datasets. The acquisition is expected to close in the fourth quarter of 2011.

On October 11, 2011, the Company announced that Morgan Stanley Senior Funding, Inc. has committed to provide the Company with a \$600 million senior secured term B loan facility and a \$100 million senior secured revolving credit facility. The proceeds from these facilities will be used, if necessary, to (i) fund a portion of the cash consideration for the acquisition of TARGUSinfo, (ii) repay existing indebtedness of the Company and TARGUSinfo, (iii) pay the fees and expenses incurred in connection with the acquisition of TARGUSinfo and (iv) provide for the ongoing working capital and general corporate needs of the Company. The commitment is subject to customary conditions, including but not limited to the consummation of the acquisition of TARGUSinfo, the absence of a material adverse effect with respect to Neustar and the negotiation of definitive financing documentation.

**Share Repurchase**

On October 11, 2011, the Company announced that, in addition to the \$300 million share repurchase program that it announced in July 2010 (see Note 8), its Board of Directors has authorized the supplemental purchase of up to \$250 million of additional shares of its Class A common stock. The shares may be repurchased at times, at prices and in amounts based on market conditions and other factors, and may be repurchased in market transactions, privately negotiated purchases, block trades or a self-tender.

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**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**Forward-Looking Statements**

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

**Overview**

The growing diversity and complexity of networks, applications and content is driving a crucial need for directory interoperability services. Network operators and those seeking access to Internet Protocol, or IP, end-points require services to meet their authentication, network management and content delivery needs. As a global leader in network addressing, routing and policy management, we offer database services to a community of carriers and enterprises with disparate networks that need to speak to each other in order to allow people and businesses to connect with one another securely and seamlessly around the world.

Our focus encompasses innovation and customer satisfaction by delivering the services our customers need to make those connections. We are aligned with our customers, Carriers and Enterprises; a structure that gives us a better view of our customers' total needs, a keener understanding of the markets in which they operate, and a more efficient way to identify and deliver an array of critical directory and database services. Our Carrier Services serve the telecommunications industry and include: Numbering Services, Order Management Services, and IP Services. Our Enterprise Services serve a wide range of businesses and include: Internet Infrastructure Services, or IIS, and Registry Services.

**Business Highlights and Trends**

In the third quarter of 2011, we experienced increased demand for our Numbering Services, IIS, and Registry Services. Total revenue for the quarter grew 17.8% to \$152.5 million as compared to \$129.4 million in the third quarter of 2010.

Our Carrier Services continue to provide predictable revenue growth and profitability. For the quarter, we recognized \$114.2 million of revenue, an increase of \$17.5 million, or 18.1%, from the corresponding period in 2010. This revenue growth is primarily driven by an established increase in the fixed fee under our contracts with the North American Portability Management LLC, or NAPM, for our number portability administration center services, or NPAC Services. We recognized \$91.4 million of revenue under our contracts to provide NPAC Services in the third quarter of 2011, a \$10.9 million increase, or 13.5%, from the corresponding period in 2010. In addition, we completed the acquisition of certain numbering solutions assets from Evolving Systems, Inc. in the third quarter. These assets have expanded our scope of customers and order management solutions, contributing to total revenue growth and a smaller concentration of revenue from our Numbering Services. Numbering Services revenue made up 65.5% of our total revenues for the three months ended September 30, 2011 and 69.2% of our total revenues for the three months ended September 30, 2010.

Enterprise Services revenue continues to account for approximately 25% of our total revenues while growing to \$38.3 million for the quarter, an increase of \$5.6 million, or 17.0%, from the corresponding period in 2010. We continue to see strong demand for our IIS portfolio, both from new and current customers. For the quarter, we recognized \$20.5 million of revenue from IIS, a \$3.2 million increase, or 18.7%, from the corresponding period in 2010. In addition, Registry Services grew as a result of an increased number of common short codes and domain names under management. For the quarter, we recognized \$17.9 million of revenue from our Registry Services, a \$2.3 million increase, or 15.1% from the corresponding period in 2010.

We continue to focus on technology innovation by leveraging our established assets, pursuing new business opportunities, and attracting and hiring top-talent from the technology industry. During the third quarter, we strengthened our management team by appointing a Chief Technology Officer who will lead product technology strategy and product development efforts. Recently, we launched SiteProtect, a cloud-based service that brings a new level of security to online properties against Distributed Denial of



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Service, or DDoS, attacks and allows customers Web infrastructure to operate normally under attack, avoiding downtime and the associate loss of potential revenue. In addition to our continued investment in innovation and prudent return of capital through our share repurchase program, acquisitions remain an important component of our growth strategy and use of capital.

### **Recent Developments**

#### ***Acquisition***

On October 10, 2011, we entered into a definitive agreement to acquire Targus Information Corporation, or TARGUSinfo, for cash consideration of approximately \$650.0 million, subject to certain purchase price adjustments. TARGUSinfo is a leading, independent provider of real-time, on-demand information and analytics services including Caller ID. TARGUSinfo's services help its customers identify, verify, score and locate their customers and prospects. This acquisition will combine TARGUSinfo's leadership in Caller ID and online information services, such as lead verification and scoring, with our strengths in network information services, including address inventory management, network security, and marketing analytics. These capabilities, delivered through a trusted, privacy-controlled environment, will greatly extend our ability to provide our customers services based on unique, non-replicable datasets. The acquisition is expected to close in the fourth quarter of 2011.

On October 11, 2011, we announced that Morgan Stanley Senior Funding, Inc. has committed to provide us with a \$600 million senior secured term B loan facility and a \$100 million senior secured revolving credit facility. The proceeds from such facilities will be used, if necessary, to (i) fund a portion of the cash consideration for the acquisition of TARGUSinfo, (ii) repay our existing indebtedness and the existing indebtedness of TARGUSinfo, (iii) pay the fees and expenses incurred in connection with the acquisition of TARGUSinfo and (iv) provide for our ongoing working capital and general corporate needs. The commitment is subject to customary conditions, including but not limited to the consummation of the acquisition of TARGUSinfo, the absence of a material adverse effect with respect to us and the negotiation of definitive financing documentation.

#### ***Share Repurchase***

On October 11, 2011, we announced that, in addition to the \$300 million share repurchase program we announced in July 2010, our Board of Directors has authorized the supplemental purchase of up to \$250 million of additional shares of our Class A common stock. The shares may be repurchased at times, at prices and in amounts based on market conditions and other factors, and may be repurchased in market transactions, privately negotiated purchases, block trades or a self-tender.

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

The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles, or U.S. GAAP. The preparation of these financial statements in accordance with U.S. GAAP requires us to utilize accounting policies and make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingencies as of the date of the financial statements and the reported amounts of revenue and expense during a fiscal period. The Securities and Exchange Commission, or SEC, considers an accounting policy to be critical if it is important to a company's financial condition and results of operations, and if it requires significant judgment and estimates on the part of management in its application. We have discussed the selection and development of the critical accounting policies with the Audit Committee of our Board of Directors, and the Audit Committee has reviewed our related disclosures in this report.

Although we believe that our judgments and estimates are appropriate and reasonable, actual results may differ from those estimates. In addition, while we have used our best estimates based on the facts and circumstances available to us at the time, we reasonably could have used different estimates in the current period. Changes in the accounting estimates we use are reasonably likely to occur from period to period, which may have a material impact on the presentation of our financial condition and results of operations. If actual results or events differ materially from those contemplated by us in making these estimates, our reported financial condition and results of operations could be materially affected. See the information in our filings with the SEC from time to time, including Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2010, for certain matters that may bear on our results of operations.

The following discussion of selected critical accounting policies supplements the information relating to our critical accounting policies described in Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates in our Annual Report on Form 10-K for the year ended December 31, 2010.



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**Table of Contents*****Acquisitions***

We record acquisitions using the acquisition method of accounting. All of the assets acquired, liabilities assumed, contractual contingencies and contingent consideration, when applicable, are recognized at their fair value as of the acquisition date. The excess of the purchase price over the estimated fair values of the net tangible and net intangible assets acquired is recorded as goodwill. The application of the acquisition method of accounting for business combinations requires management to make significant estimates and assumptions in the determination of the fair value of assets acquired and liabilities assumed in order to properly allocate purchase price consideration. These assumptions and estimates reflect a market participant's expected use of the asset and the appropriate discount rates from a market participant perspective. Our estimates are based on historical experience; information obtained from the management of the acquired companies and are determined with assistance from an independent third-party appraisal firm. Our significant assumptions and estimates can include, but are not limited to, the cash flows that an acquired asset is expected to generate in the future, the weighted-average cost of capital, long-term projected revenues and growth rates, and the estimated royalty rate in the application of the relief from royalty method. These estimates are inherently uncertain. In addition, unanticipated events and circumstances may occur which may affect the accuracy or validity of such estimates. During the third quarter of 2011, we acquired the assets and certain liabilities of the Numbering Solutions business from Evolving Systems, Inc. and recorded \$20.6 million of goodwill and \$21.7 million of definite-lived intangible assets. See Note 3 to our Unaudited Consolidated Financial Statements in Item 1 of Part I of this report.

***Revenue Recognition***

We provide NPAC Services pursuant to seven contracts with NAPM, an industry group that represents all telecommunications service providers in the United States. The aggregate fees for transactions processed under these contracts are determined by an annual fixed-fee pricing model under which the annual fixed fee, or Base Fee, is set at \$362.1 million and \$385.6 million in 2010 and 2011, respectively, and is subject to an annual price escalator of 6.5% in subsequent years. These contracts also provide for fixed credits to customers of \$25.0 million in 2010 and \$5.0 million in 2011, which were applied to reduce the Base Fee for the applicable year. Additional credits of up to \$15.0 million annually in each of 2010 and 2011 may be triggered if the customer reaches certain levels of aggregate telephone number inventories and adopts and implements certain IP fields and functionality. Moreover, these contracts provide for credits in the event that the volume of transactions in a given year is above or below the contractually established volume range for that year. The determination of whether any volume credits have been earned is done annually at the end of each year and any credits earned are applied to the following year's invoices. To the extent any additional credits expire unused at the end of each year, the credits will be recognized in revenue at that time.

We determine the fixed and determinable fee under these contracts on an annual basis and recognize such fee on a straight-line basis over twelve months. For 2010, we concluded that the fixed and determinable fee equaled \$322.1 million, which represented the Base Fee of \$362.1 million, reduced by the \$25.0 million fixed credit and \$15.0 million of additional credits. For 2011, we concluded that the fixed and determinable fee equals \$365.6 million, which represents the Base Fee of \$385.6 million, reduced by the \$5.0 million fixed credit and \$15.0 million of additional credits. During the first quarter of 2011, we determined that our carrier customers have earned all of the additional credits of \$15.0 million attributable to the adoption and implementation of the requisite IP fields and functionality and to the achievement of specific levels of aggregate telephone number inventories.

***Restructuring***

As of September 30, 2011, the accrued liability associated with our restructuring and other related charges was \$2.1 million. As part of our restructuring costs, we record a liability for the estimated cost of the net lease expense for facilities that are no longer being used. This accrual is equal to the present value of the minimum future lease payments under our contractual lease obligations, offset by the present value of the estimated sublease income. As of September 30, 2011, our accrued restructuring liability related to our net lease expense and other related charges was \$1.1 million. These lease payments will be made over the remaining lives of the leases for facilities that we have vacated, the longest of which extends through 2013. If actual market conditions are different than those we have projected, we will be required to recognize additional restructuring costs or benefits associated with these facilities.

***Investments***

As of September 30, 2011, we have approximately \$52.7 million of investments in pre-refunded municipal bonds and U.S. agency debt securities. These investments are accounted for as available-for-sale securities and unrealized gains or losses on these investments are recorded in other comprehensive income. We are exposed to investment risk as it relates to changes in the market value of our investments. We determined the fair value of our investments using observable inputs such as quoted prices in active markets. As of September 30, 2011, we determined that any declines in the fair value of our investments are not other-than-temporary. Given the significance of these investments to our consolidated balance sheet, declines in the fair value that are considered to be other-than-temporary could have a material effect on our consolidated financial statements.



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***Stock-Based Compensation***

We recognize stock-based compensation expense in accordance with the Compensation – Stock Compensation Topic of the Financial Accounting Standards Board Accounting Standards Codification which requires the measurement and recognition of compensation expense for stock-based awards granted to employees based on estimated fair values on the date of grant. The estimated fair values of non-vested stock-based awards granted to consultants are measured and recognized each reporting period through each vesting date. We estimate the fair value of each option-based award using the Black-Scholes option-pricing model. This option pricing model requires that we make several estimates, including the option's expected life and the price volatility of the underlying stock.

Because stock-based compensation expense is based on awards that are ultimately expected to vest, the amount of expense takes into account estimated forfeitures at the time of grant which may be revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Changes in these estimates and assumptions can materially affect the estimated fair value of our stock-based compensation. See Note 8 to our Unaudited Consolidated Financial Statements in Item 1 of Part I of this report for information regarding our assumptions related to stock-based compensation and the amount of stock-based compensation expense we incurred for the periods covered in this report. As of September 30, 2011, total unrecognized compensation expense was \$42.8 million, which relates to non-vested stock options, non-vested restricted stock units, non-vested restricted stock and non-vested performance vested restricted stock units, or PVRsUs, and is expected to be recognized over a weighted-average period of 1.52 years.

We estimate the fair value of our restricted stock unit awards based on the fair value of our common stock on the date of grant. Our outstanding restricted stock unit awards are subject to service-based vesting conditions and/or performance-based vesting conditions. We recognize the estimated fair value of service-based awards, net of estimated forfeitures, as stock-based expense over the vesting period on a straight-line basis. Awards with performance-based vesting conditions require the achievement of specific financial targets at the end of the specified performance period and the employee's continued employment. We recognize the estimated fair value of performance-based awards, net of estimated forfeitures, as stock-based expense over the performance period, which considers each performance period or tranche separately, based upon our determination of whether it is probable that the performance targets will be achieved. At each reporting period, we reassess the probability of achieving the performance targets within the related performance period. Determining whether the performance targets will be achieved involves judgment, and the estimate of stock-based compensation expense may be revised periodically based on changes in the probability of achieving the performance targets. If any performance goals are not met, no compensation cost is ultimately recognized against that goal, and to the extent previously recognized, compensation cost is reversed. As of September 30, 2011, we estimate that we will issue 105% and 131% of the performance target awards related to our PVRsUs granted during 2010 and 2011, respectively. Changes in our assumptions regarding the achievement of specific financial targets could have a material effect on our consolidated financial statements.

In the third quarter of 2011, we revised our estimate of achievement of the performance target related to the PVRsUs granted during 2010 from 100% of target to 105% of target. In addition, we revised our estimate of achievement of the performance target related to the PVRsUs granted during 2011 from 100% of target to 131% of target. These changes in estimates did not have a material impact on our income from continuing operations and our earnings per diluted share from continuing operations, respectively, for the three and nine months ended September 30, 2011.



**Table of Contents****Consolidated Results of Operations****Three Months Ended September 30, 2010 Compared to Three Months Ended September 30, 2011**

The following table presents an overview of our results of operations for the three months ended September 30, 2010 and 2011:

|   | Three Months Ended September 30, |                  |                 |               |
|---|----------------------------------|------------------|-----------------|---------------|
|   | 2010                             | 2011             | 2010 vs. 2011   |               |
|   | \$                               | \$               | \$ Change       | % Change      |
| (unaudited)   |                                  |                  |                 |               |
| (dollars in thousands, except per share data)                                   |                                  |                  |                 |               |
| <b>Revenue:</b>   |                                  |                  |                 |               |
| Carrier Services  | \$ 96,657                        | \$ 114,155       | \$ 17,498       | 18.1 %        |
| Enterprise Services   | 32,781                           | 38,342           | 5,561           | 17.0 %        |
| <b>Total revenue</b>  | <b>129,438</b>                   | <b>152,497</b>   | <b>23,059</b>   | <b>17.8 %</b> |
| <b>Operating expense:</b>   |                                  |                  |                 |               |
| Cost of revenue (excludes depreciation and amortization shown separately below) | 27,574                           | 34,194           | 6,620           | 24.0 %        |
| Sales and marketing   | 21,322                           | 25,069           | 3,747           | 17.6 %        |
| Research and development  | 3,519                            | 3,746            | 227             | 6.5 %         |
| General and administrative  | 15,865                           | 20,960           | 5,095           | 32.1 %        |
| Depreciation and amortization   | 8,255                            | 10,486           | 2,231           | 27.0 %        |
| Restructuring recoveries  | (417)                            | (33)             | 384             | (92.1)%       |
|   | 76,118                           | 94,422           | 18,304          | 24.0 %        |
| <b>Income from operations</b>   | <b>53,320</b>                    | <b>58,075</b>    | <b>4,755</b>    | <b>8.9 %</b>  |
| <b>Other (expense) income:</b>  |                                  |                  |                 |               |
| Interest and other expense  | (4,294)                          | (675)            | 3,619           | (84.3)%       |
| Interest and other income   | 4,069                            | 304              | (3,765)         | (92.5)%       |
| <b>Income from continuing operations before income taxes</b>                    | <b>53,095</b>                    | <b>57,704</b>    | <b>4,609</b>    | <b>8.7 %</b>  |
| Provision for income taxes, continuing operations                               | 21,275                           | 19,931           | (1,344)         | (6.3)%        |
| <b>Income from continuing operations</b>  | <b>31,820</b>                    | <b>37,773</b>    | <b>5,953</b>    | <b>18.7 %</b> |
| Loss from discontinued operations, net of tax                                   | (1,871)                          |                  | 1,871           | (100.0)%      |
| <b>Net income</b>   | <b>\$ 29,949</b>                 | <b>\$ 37,773</b> | <b>\$ 7,824</b> | <b>26.1 %</b> |
| <b>Basic net income (loss) per common share:</b>                                |                                  |                  |                 |               |
| Continuing operations   | \$ 0.43                          | \$ 0.52          |                 |               |
| Discontinued operations   | (0.03)                           |                  |                 |               |
| <b>Basic net income per common share</b>  | <b>\$ 0.40</b>                   | <b>\$ 0.52</b>   |                 |               |
| <b>Diluted net income (loss) per common share:</b>                              |                                  |                  |                 |               |
| Continuing operations   | \$ 0.42                          | \$ 0.51          |                 |               |
| Discontinued operations   | (0.03)                           |                  |                 |               |
| <b>Diluted net income per common share</b>                                      | <b>\$ 0.39</b>                   | <b>\$ 0.51</b>   |                 |               |

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Weighted average common shares outstanding:

|         |        |        |
|---------|--------|--------|
| Basic   | 74,808 | 73,237 |
| Diluted | 76,026 | 74,632 |

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**Table of Contents****Revenue**

*Carrier Services.* Revenue from our Carrier Services operating segment increased \$17.5 million primarily due to an increase of \$10.3 million in revenue from our Numbering Services, an increase of \$5.6 million in revenue from our Order Management Services, or OMS, and an increase of \$1.6 million from our IP Services. The \$10.3 million increase in revenue from our Numbering Services was the result of an established increase of \$10.9 million in the fixed fee under our contracts to provide NPAC services. The increase in OMS revenue was primarily due to greater demand and usage from existing customers and the addition of new customers and the acquisition of our licensed order management services. The increase in revenue from IP Services was primarily due to growth in revenue from our GSMA PathFinder services and from our Multimedia Interconnect Services revenue.

*Enterprise Services.* Revenue from our Enterprise Services operating segment increased \$5.6 million primarily due to an increase of \$3.2 million in IIS revenue, primarily driven by the addition of new DNS solutions, including IP geolocation services. In addition, Registry Services revenue increased \$2.3 million primarily due to an increase in the number of common short codes under management.

**Expense**

*Cost of revenue.* Cost of revenue increased \$6.6 million primarily due to an increase in contractor costs of \$2.4 million due to increased costs in customer deployments and customer support. In addition, personnel and personnel-related expense increased \$2.0 million primarily due to an increase in headcount for our acquired licensed order management services and IP geolocation services. Furthermore, cost of revenue increased \$1.2 million due to additional telecommunications and maintenance costs primarily resulting from the addition of our IP geolocation services. Royalty expense increased \$1.1 million for our Registry Services primarily due to the increase in revenue from managing a larger number of common short codes

*Sales and marketing.* Sales and marketing expense increased \$3.7 million primarily due to an increase of \$3.7 million in personnel and personnel-related expense related to our expanded sales and marketing teams for our IP geolocation services and new directory services. In addition, contractor costs increased \$0.4 million to support our growth as we broaden our brand awareness and increase our portfolio of services, such as the addition of our IP geolocation services. These increases were partially offset by a decrease of \$0.3 million in general facility costs.

*Research and development.* Research and development expense increased \$0.2 million due to an increase of \$0.4 million in personnel and personnel-related expense, partially offset by a decrease of \$0.1 million in contractor and facilities costs.

*General and administrative.* General and administrative expense increased \$5.1 million primarily due to an increase in consulting costs of \$1.5 million incurred to pursue new business opportunities and \$1.3 million in additional costs to support business growth and strategic planning. In addition, personnel and personnel-related expense increased \$1.2 million, primarily as a result of headcount additions in support of business operations. General facility costs increased \$1.1 million primarily due to office expansion related to the relocation of our corporate headquarters and acquisition of our IP geolocation assets.

*Depreciation and amortization.* Depreciation and amortization expense increased \$2.2 million due to an increase in depreciation expense of \$1.6 million from additions of new property and equipment, including furniture and fixtures and leasehold improvements primarily due to office expansion related to the relocation of our corporate headquarters and the acquisitions of the licensed order management assets and IP geolocation assets. In addition, amortization expense increased \$0.6 million due to the amortization of intangible assets acquired in connection with our acquisitions of the licensed order management assets and IP geolocation assets.

*Restructuring recoveries.* Restructuring recoveries decreased \$0.4 million due to the completion in the third quarter of 2010 of our restructuring plan to relocate certain operations and support functions to Kentucky. Restructuring recoveries recorded in the third quarter of 2011 relate to adjustments of severance and severance related charges previously recorded under our 2010 management transition plan.

*Interest and other expense.* Interest and other expense decreased \$3.6 million primarily due to a decrease in trading losses of \$4.0 million recorded in connection with our auction rate securities rights in 2010. As a result of the settlement of our auction rate securities and associated rights in the third quarter of 2010, there were no associated trading losses recorded in 2011. Losses recorded in connection with asset disposals during the third quarter of 2011 increased \$0.5 million.

*Interest and other income.* Interest and other income decreased \$3.8 million primarily due to a decrease in trading gains of \$4.0 million that were recorded in connection with our auction rate securities settled in 2010, partially offset by \$0.2 million increase in interest income.



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*Provision for income taxes, continuing operations.* Our estimated annual effective tax rate decreased to 34.5% for the three months ended September 30, 2011 from 40.1% for the three months ended September 30, 2010 primarily due to a change in estimate of the realizability of acquired Quova, Inc. net operating losses and a discrete benefit for federal research tax credits.

*Loss from discontinued operations, net of tax.* During the three months ended June 30, 2011, we completed our plan to exit our Converged Messaging Services business. The financial results for the three months ended September 30, 2010 and 2011 reflect the results of operations of Converged Messaging Services, net of tax, as discontinued operations. Loss from discontinued operations, net of tax decreased \$1.9 million due to the completion of the wind down of our Converged Messaging Services business in the second quarter of 2011. See Note 3 in our accompanying unaudited consolidated financial statements for more information regarding these discontinued operations.

**Summary of Operating Segments**

The following table presents a summary our operating segments' revenue, contribution and the reconciliation to income from operations for the three months ended September 30, 2010 and 2011 (in thousands):

|  | Three Months Ended September 30, |                   |                  |               |
|--|----------------------------------|-------------------|------------------|---------------|
|  | 2010                             | 2011              | 2010 vs. 2011    |               |
|  | \$                               | \$                | \$<br>Change     | %<br>Change   |
| <b>Revenue:</b>  |                                  |                   |                  |               |
| Carrier Services   | \$ 96,657                        | \$ 114,155        | \$ 17,498        | 18.1 %        |
| Enterprise Services  | 32,781                           | 38,342            | 5,561            | 17.0 %        |
| <b>Total revenue</b>   | <b>\$ 129,438</b>                | <b>\$ 152,497</b> | <b>\$ 23,059</b> | <b>17.8 %</b> |
| <b>Segment contribution:</b>   |                                  |                   |                  |               |
| Carrier Services   | \$ 86,561                        | \$ 99,302         | \$ 12,741        | 14.7 %        |
| Enterprise Services  | 15,733                           | 16,551            | 818              | 5.2 %         |
| <b>Total segment contribution</b>  | <b>102,294</b>                   | <b>115,853</b>    | <b>13,559</b>    | <b>13.3 %</b> |
| <b>Indirect operating expenses:</b>  |                                  |                   |                  |               |
| Cost of revenue (excluding depreciation and amortization shown separately below) | 18,724                           | 20,424            | 1,700            | 9.1 %         |
| Sales and marketing  | 3,736                            | 3,584             | (152)            | (4.1)%        |
| Research and development   | 3,119                            | 3,575             | 456              | 14.6 %        |
| General and administrative   | 15,557                           | 19,742            | 4,185            | 26.9 %        |
| Depreciation and amortization  | 8,255                            | 10,486            | 2,231            | 27.0 %        |
| Restructuring recoveries   | (417)                            | (33)              | 384              | (92.1)%       |
| <b>Income from operations</b>  | <b>\$ 53,320</b>                 | <b>\$ 58,075</b>  | <b>\$ 4,755</b>  | <b>8.9 %</b>  |

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

**Table of Contents****Consolidated Results of Operations*****Nine Months Ended September 30, 2010 Compared to Nine Months Ended September 30, 2011***

The following table presents an overview of our results of operations for the nine months ended September 30, 2010 and 2011:

|   | Nine Months Ended September 30,               |                   |                  |               |
|---|---|-------------------|------------------|---------------|
|   | 2010  | 2011              | 2010 vs. 2011    |               |
|   | \$  | \$                | \$<br>Change     | % Change      |
|   | (unaudited)                                   |                   |                  |               |
|   | (dollars in thousands, except per share data) |                   |                  |               |
| <b>Revenue:</b>   |   |                   |                  |               |
| Carrier Services  | \$ 292,049                                    | \$ 334,604        | \$ 42,555        | 14.6 %        |
| Enterprise Services   | 91,955  | 111,671           | 19,716           | 21.4 %        |
| <b>Total revenue</b>  | <b>384,004</b>                                | <b>446,275</b>    | <b>62,271</b>    | <b>16.2 %</b> |
| <b>Operating expense:</b>   |   |                   |                  |               |
| Cost of revenue (excludes depreciation and amortization shown separately below) | 81,578  | 96,663            | 15,085           | 18.5 %        |
| Sales and marketing   | 64,686  | 76,275            | 11,589           | 17.9 %        |
| Research and development  | 10,648  | 11,183            | 535              | 5.0 %         |
| General and administrative  | 48,084  | 63,124            | 15,040           | 31.3 %        |
| Depreciation and amortization   | 23,825  | 29,018            | 5,193            | 21.8 %        |
| Restructuring charges   | 1,589   | 387               | (1,202)          | (75.6)%       |
|   | 230,410                                       | 276,650           | 46,240           | 20.1 %        |
| <b>Income from operations</b>   | <b>153,594</b>                                | <b>169,625</b>    | <b>16,031</b>    | <b>10.4 %</b> |
| <b>Other (expense) income:</b>  |   |                   |                  |               |
| Interest and other expense  | (6,842)                                       | (1,148)           | 5,694            | (83.2)%       |
| Interest and other income   | 7,488   | 1,437             | (6,051)          | (80.8)%       |
| <b>Income from continuing operations before income taxes</b>                    | <b>154,240</b>                                | <b>169,914</b>    | <b>15,674</b>    | <b>10.2 %</b> |
| Provision for income taxes, continuing operations                               | 61,570  | 65,060            | 3,490            | 5.7 %         |
| <b>Income from continuing operations</b>  | <b>92,670</b>                                 | <b>104,854</b>    | <b>12,184</b>    | <b>13.1 %</b> |
| (Loss) income from discontinued operations, net of tax                          | (8,946)                                       | 37,249            | 46,195           | (516.4)%      |
| <b>Net income</b>   | <b>\$ 83,724</b>                              | <b>\$ 142,103</b> | <b>\$ 58,379</b> | <b>69.7 %</b> |
| <b>Basic net income (loss) per common share:</b>                                |   |                   |                  |               |
| Continuing operations   | \$ 1.24                                       | \$ 1.42           |                  |               |
| Discontinued operations   | (0.12)  | 0.51              |                  |               |
| <b>Basic net income per common share</b>  | <b>\$ 1.12</b>                                | <b>\$ 1.93</b>    |                  |               |
| <b>Diluted net income (loss) per common share:</b>                              |   |                   |                  |               |
| Continuing operations   | \$ 1.22                                       | \$ 1.40           |                  |               |
| Discontinued operations   | (0.12)  | 0.49              |                  |               |
| <b>Diluted net income per common share</b>                                      | <b>\$ 1.10</b>                                | <b>\$ 1.89</b>    |                  |               |

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Weighted average common shares outstanding:

|         |        |        |
|---------|--------|--------|
| Basic   | 74,806 | 73,658 |
| Diluted | 76,060 | 75,079 |

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**Table of Contents****Revenue**

*Carrier Services.* Revenue from our Carrier Services operating segment increased \$42.6 million primarily due to an increase of \$26.9 million in revenue from our Numbering Services, an increase of \$12.5 million in OMS revenue, and an increase of \$3.1 million from our IP Services. The \$26.9 million increase in revenue from our Numbering Services was the result of an established increase of \$32.7 million in the fixed fee under our contracts to provide NPAC services, partially offset by a decrease of \$1.6 million in system enhancements and functionality requested by our Numbering Services customers and a decrease of \$1.3 million in revenue from our international LNP solutions. The increase in revenue from our OMS revenue was primarily due to greater demand and usage from existing customers, the addition of new customers and the acquisition of our licensed order management services. The increase in revenue from IP Services revenue was primarily due to growth in our GSMA PathFinder services and transition services revenue pursuant to the sale of certain assets and liabilities of our Converged Messaging Services business. These transition services were completed as of June 30, 2011. There was no corresponding transition services revenue in 2010.

*Enterprise Services.* Revenue from our Enterprise Services operating segment increased \$19.7 million primarily due to an increase of \$12.7 million in revenue from our Internet Infrastructure Services, primarily driven by the addition of new DNS solutions, including IP geolocation services. In addition, Registry Services revenue increased \$7.0 million primarily due to an increase in the number of common short codes under management.

**Expense**

*Cost of revenue.* Cost of revenue increased \$15.1 million primarily due to an increase in personnel and personnel-related expense of \$5.9 million primarily related to an increase in headcount for our acquired licensed order management services, IP geolocation services, systems management, and customer support. In addition, contractor costs increased \$3.6 million primarily due to increased costs incurred for customer deployment and customer support. Furthermore, cost of revenue increased \$3.2 million primarily due to additional telecommunications and maintenance costs related to the addition of our IP geolocation services, as well as increased costs for our customer support operations. Royalty expense also increased \$3.0 million for our Registry Services related to the increase in revenue from managing a larger number of common short codes.

*Sales and marketing.* Sales and marketing expense increased \$11.6 million primarily due to an increase of \$10.3 million in personnel and personnel-related expense for our expanded sales and marketing teams for our acquired licensed order management services, IP geolocation services and new directory services. In addition, contractor costs increased \$1.6 million to support our growth as we broaden our brand awareness and increase our portfolio of services, such as the addition of our IP geolocation services.

*Research and development.* Research and development expense increased \$0.5 million due to an increase of \$1.6 million in personnel and personnel-related expense, partially offset by a decrease of \$0.9 million in contractor costs.

*General and administrative.* General and administrative expense increased \$15.0 million primarily due to an increase of \$5.9 million in personnel and personnel-related expense, an increase of \$4.8 million in general facility costs primarily due to office expansions related to the relocation of our corporate headquarters and the acquisition of the IP geolocation assets and an increase of \$4.3 million in consulting costs incurred to support business growth, strategic planning and to pursue new business opportunities. Personnel and personnel-related expense increased \$5.9 million, primarily the result of headcount additions to our teams in support of business operations.

*Depreciation and amortization.* Depreciation and amortization expense increased \$5.2 million due to an increase in depreciation expense of \$4.4 million from additions of new property and equipment, including furniture and fixtures and leasehold improvements primarily due to office expansion related to the relocation of our corporate headquarters and the acquisitions of the licensed order management assets and IP geolocation assets. In addition, amortization expense increased \$0.8 million due to the amortization of intangible assets acquired in connection with our acquisitions of the licensed order management assets and IP geolocation assets.

*Restructuring charges.* Restructuring charges decreased \$1.2 million primarily due to the completion in the third quarter of 2010 of our restructuring plan to relocate certain operations and support functions to Kentucky. In the first nine months of 2010, we recorded severance and severance related expense of \$1.6 million attributable this relocation plan and did not have any corresponding expense in 2011. The decrease in restructuring charges was partially offset by severance and severance related expense of \$0.4 million recorded during the nine months ended September 30, 2011, attributable to our management transition plan initiated in the fourth quarter of 2010.



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*Interest and other expense.* Interest and other expense decreased \$5.7 million primarily due to a decrease in trading losses of \$6.9 million recorded in connection with our auction rate securities rights in 2010. As a result of the settlement of our auction rate securities and associated rights in the third quarter of 2010, there were no associated trading losses recorded in 2011. The interest and other expense decrease was partially offset by an increase of \$0.5 million in losses recorded in connection with asset disposals, an increase of \$0.4 million in foreign currency losses and an increase of \$0.3 million in interest expense.

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*Interest and other income.* Interest and other income decreased \$6.1 million primarily due to a decrease in trading gains of \$7.0 million recorded in connection with our auction rate securities settled in 2010, partially offset by \$0.7 million in realized gains for our available-for-sale securities sold during the nine months ended September 30, 2011.

*Provision for income taxes, continuing operations.* Our estimated annual effective tax rate decreased to 38.3% for the nine months ended September 30, 2011 from 39.9% for the nine months ended September 30, 2010 primarily due to a change in estimate of the realizability of acquired Quova, Inc. net operating losses and a discrete benefit for federal research tax credits partially offset by settlement of our Internal Revenue Service examination.

*(Loss) income from discontinued operations, net of tax.* During the second quarter of 2011, we completed our plan to wind down and cease operations of our Converged Messaging Services business, following the sale in February 2011 of certain assets and liabilities of Neustar NGM Services, Inc., or NGM Services, and its subsidiaries. The financial results for the nine months ended September 30, 2010 and 2011 reflect the results of operations, net of tax, of Converged Messaging Services as discontinued operations. We intend to treat the common stock of NGM Services as worthless for U.S. income tax purposes in our 2011 U.S. federal and state income tax returns. As a result, we recorded a discrete income tax benefit of \$42.7 million in the nine months ended September 30, 2011. See Note 3 in our accompanying unaudited consolidated financial statements for more information regarding these discontinued operations.

**Summary of Operating Segments**

The following table presents a summary our operating segments' revenue, contribution and the reconciliation to income from operations for the nine months ended September 30, 2010 and 2011 (in thousands):

|  | Nine Months Ended September 30, |            |                            |          |
|--|---------------------------------|------------|----------------------------|----------|
|  | 2010<br>\$                      | 2011<br>\$ | 2010 vs. 2011<br>\$ Change | % Change |
| <b>Revenue:</b>  |                                 |            |                            |          |
| Carrier Services   | \$ 292,049                      | \$ 334,604 | \$ 42,555                  | 14.6 %   |
| Enterprise Services  | 91,955                          | 111,671    | 19,716                     | 21.4 %   |
| Total revenue  | \$ 384,004                      | \$ 446,275 | \$ 62,271                  | 16.2 %   |
| <b>Segment contribution:</b>   |                                 |            |                            |          |
| Carrier Services   | \$ 261,787                      | \$ 293,451 | \$ 31,664                  | 12.1 %   |
| Enterprise Services  | 41,782                          | 47,620     | 5,838                      | 14.0 %   |
| Total segment contribution   | 303,569                         | 341,071    | 37,502                     | 12.4 %   |
| <b>Indirect operating expenses:</b>  |                                 |            |                            |          |
| Cost of revenue (excluding depreciation and amortization shown separately below) | 55,721                          | 59,793     | 4,072                      | 7.3 %    |
| Sales and marketing  | 12,423                          | 12,026     | (397)                      | (3.2)%   |
| Research and development   | 9,291                           | 10,085     | 794                        | 8.5 %    |
| General and administrative   | 47,126                          | 60,137     | 13,011                     | 27.6 %   |
| Depreciation and amortization  | 23,825                          | 29,018     | 5,193                      | 21.8 %   |
| Restructuring charges  | 1,589                           | 387        | (1,202)                    | (75.6)%  |
| Income from operations   | \$ 153,594                      | \$ 169,625 | \$ 16,031                  | 10.4 %   |

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



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### **Liquidity and Capital Resources**

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

As of September 30, 2011, our total cash, cash equivalents and short-term investments were \$391.8 million, an increase of \$46.4 million from \$345.4 million at December 31, 2010.

On October 10, 2011, we entered into a definitive agreement to acquire TARGUSinfo for cash consideration of approximately \$650 million, subject to certain purchase price adjustments. We expect to fund this acquisition with a combination of cash on hand and committed financing for a \$600 million senior secured term B loan facility and a \$100 million senior secured revolving credit facility. We expect this acquisition to close in the fourth quarter of 2011; closing is not conditioned on us obtaining any financing. The committed financing is subject to customary conditions, including but not limited to completion of the acquisition of TARGUSinfo and the negotiation of definitive financing agreements.

On October 10, 2011, our Board of Directors authorized the repurchase of up to \$250 million in shares of our Class A common stock. This share repurchase program is in addition to the \$300 million share repurchase program that we announced in July 2010.

We have a credit facility that is available for cash borrowings up to \$100 million that may be used for working capital, capital expenditures, general corporate purposes and to finance acquisitions. Our credit agreement contains customary representations and warranties, affirmative and negative covenants, and events of default. Our credit agreement requires us to maintain a minimum ratio of consolidated earnings before interest, taxes, depreciation and amortization, or EBITDA, to consolidated interest charges and a maximum ratio of consolidated senior funded indebtedness to consolidated EBITDA. The credit facility expires on February 6, 2012. As of and for the nine months ended September 30, 2011, we were in compliance with these covenants. As of September 30, 2011, the Company's available borrowings under the Credit Facility were \$100 million.

We believe that our existing cash and cash equivalents, short-term investments, and cash provided from operations will be sufficient to fund our operations for the next twelve months, excluding the pending acquisition of TARGUSinfo. We expect to fund the pending acquisition of TARGUSinfo with a combination of cash on hand and committed financing.

### **Discussion of Cash Flows**

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

Net cash provided by operating activities for the nine months ended September 30, 2011 was \$166.0 million, as compared to \$95.7 million for the nine months ended September 30, 2010. This \$70.3 million increase in net cash provided by operating activities was the result of an increase in net income of \$58.4 million, an increase in non-cash adjustments of \$1.7 million, and an increase in net changes in operating assets and liabilities of \$10.2 million.

Net income increased \$58.4 million primarily due to the change of \$37.0 million in our income tax benefit for discontinued operations. In the first quarter of 2011, we recorded a tax benefit of \$42.7 million attributed to a worthless stock deduction for the common stock of Neustar NGM Services, Inc.

Non-cash adjustments increased \$1.7 million due to an increase of \$5.1 million in stock-based compensation, an increase of \$2.4 million in amortization of bond premiums, and a \$1.9 million loss-on-sale attributed to the sale of certain assets and liabilities of our Converged Messaging Services business in the first quarter of 2011. These increases in non-cash adjustments were partially offset by a decrease of \$3.9 million in deferred income taxes, a decrease of \$3.0 million in excess tax benefits from stock options and a decrease of \$0.7 million in depreciation and amortization from continuing and discontinued operations.

Net changes in operating assets and liabilities increased \$10.2 million primarily due to a decrease of \$20.1 million in net cash used in the payment of accounts payable and accrued expenses and a net change of \$7.5 million attributable to net decreases in accounts and unbilled receivables during 2011 as compared to increases in 2010. These increases in net changes in operating assets and liabilities were partially offset by an increase in income taxes receivable of \$5.1 million, the result of the tax benefit we recorded in the first quarter of 2011 in connection with a deduction for the loss on worthless stock, and an increase of \$3.9 million in notes receivable. In addition, deferred revenue increased in 2011 as compared to a decrease in 2010, a net change of \$7.5 million.



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

Net cash used in investing activities for the nine months ended September 30, 2011 was \$78.6 million, as compared to \$8.0 million for the nine months ended September 30, 2010. This \$86.6 million increase in net cash used in investing activities was primarily due to investment purchases of \$81.2 million, an increase of \$37.3 million in cash used for acquisitions and an increase of \$7.5 million in cash used for purchases of property and equipment. These increases in net cash used in investing activities were partially offset by the increase of \$39.4 million in cash received from the sales of investments.

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

Net cash used in financing activities was \$61.1 million for the nine months ended September 30, 2011, as compared to \$30.7 million for the nine months ended September 30, 2010. This \$30.4 million increase in net cash used in financing activities was primarily the result of \$34.3 million used to repurchase shares of our Class A common stock under our share repurchase program announced in July 2010 and a net increase of \$9.4 million in restricted cash primarily used to collateralize our outstanding letters of credit. These increases in cash used in financing activities were partially offset by an increase of \$7.1 million in proceeds from the exercise of stock options, an increase of \$3.0 million in excess tax benefits from stock options, and a reduction of \$3.3 million in cash used in principal repayments on capital lease obligations.

### **Recent Accounting Pronouncements**

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

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

None.

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

For quantitative and qualitative disclosures about our market risk, see *Quantitative and Qualitative Disclosures About Market Risk* in Item 7A of Part II of our Annual Report on Form 10-K for the fiscal year ended December 31, 2010. Our exposure to market risk has not changed materially since December 31, 2010.

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

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

As of September 30, 2011, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective and were operating at the reasonable assurance level.

In addition, there were no changes in our internal control over financial reporting that occurred in the third quarter of 2011 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

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

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

The following sets forth risk factors associated with our business. The risk factors marked with an asterisk (\*) contain changes to the description of the risk factors associated with our business previously disclosed in Part 1, Item 1A Risk Factors in our Annual Report on Form 10-K for our fiscal year ended December 31, 2010, filed with the SEC on February 25, 2011. Additional risks and uncertainties that we are unaware of may also become important factors that affect us. If any of the following risks occur, our business, financial condition or results of operations could be materially and adversely affected. In these circumstances, the market price of our common stock could decline.

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

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

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

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

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

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

errors in the processing of data by our systems;

computer viruses, malware or software defects;

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

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

virtual hijacking of traffic destined to our systems; or

power loss, telecommunications failures, pandemics, wars, acts of terrorism, political unrest or other man-made or natural disasters. We may not have sufficient redundant systems or back-up facilities to allow us to receive and process data if one of the foregoing events occurs. Further, increases in the scope of services that we provide increase the complexity of our network infrastructure. As the scope of services we provide expands or changes in the future, we may be required to make significant expenditures to establish new data centers from which we may provide services. Moreover, as we add customers, expand our service offerings and increase our visibility in the market we may become a more likely target of attacks similar to those listed in the bullets above. The number of electronic attacks and viruses grows significantly every year, as



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does the sophistication of these attacks. For example, undetected attackers are able to monitor unencrypted Internet traffic anywhere in the world and modify it before it reaches our destination, and these attackers can harm our customers by stealing identity, Internet email or IP addresses. If we are not able to react to threats and stop attackers from exploiting vulnerabilities, the integrity of our systems and our customers and trading partners may be impacted adversely. If we cannot adequately secure and protect the ability of our data centers, offices, and related systems to perform consistently at a high level and without interruptions, or if we otherwise fail to meet our customers' expectations:

our reputation may be damaged, which may adversely affect our ability to market our services and attract or retain customers;

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

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

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

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

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

***If our security measures are breached and personally identifiable information is obtained by an unauthorized person, our service may be perceived as not being secure and customers may curtail or stop using our services.***

As a number of our products and services are Internet or DNS based, the amount of data we store for our users on our servers (including personal information) has increased. For example, our registry, Ultraviolet™, and mobile service offerings may involve the storage and transmission of consumer information, such as names, addresses, email addresses and other personally identifiable information, and security breaches could expose us to a risk of loss of this information, litigation and possible liability. If our security measures are breached or our systems fail in the future as a result of third-party action, employee error, malfeasance or otherwise, and as a result, someone obtains unauthorized access to consumers' data, our reputation and brands will be damaged, the adoption of our products and services could be severely limited, and we could incur significant liability, any of which may cause our business to suffer. Accordingly, we may need to expend significant resources to protect against security breaches, including encrypting personal information, or remedy breaches after they occur, including notifying each person whose personal data may have been compromised. The risk that these types of events could seriously harm our business is likely to increase as we expand the number of Internet or DNS-based products and services we offer as well as increase the number of countries where we operate. If an actual or perceived breach of our security measures occurs, the market perception of the effectiveness of our security measures and our reputation could be harmed and we could lose sales, existing and future business opportunities and customers, and potentially face costly litigation.

***Our seven contracts with North American Portability Management LLC represent in the aggregate a substantial portion of our revenue, are not exclusive and could be terminated or modified in ways unfavorable to us. These contracts are due to expire in June 2015 and we may not win a competitive procurement.***

Our seven contracts with North American Portability Management LLC, or NAPM, an industry group that represents all carriers in the United States, to provide NPAC Services are not exclusive and could be terminated or modified in ways unfavorable to us. These seven separate contracts, each of which represented between 7% and 13% of our total revenue in 2010, represented in the aggregate approximately 64% of our total revenue in 2010. These contracts have finite terms and are currently scheduled to expire in June 2015. NAPM has publicly announced plans to issue a request for proposal to solicit offers to provide services under a new NPAC Services contract or contracts. We expect that there will be significant competition as a result of this process. Further, we may not win such a competitive procurement if another provider offers to provide the same or similar services at a lower cost. The failure to win the competitive procurement would have a material adverse effect on our business, prospects, financial condition and results of operations. Even if we win the competitive procurement, the new contracts may have different pricing structures or performance requirements than are currently in effect, which could negatively affect our operating performance and may result in additional costs and expenses and possibly lower revenues.

In addition, under the current contracts, NAPM could, at any time, solicit or receive proposals from other providers to provide services that are the same as or similar to ours. These contracts can be terminated or modified in advance of their scheduled expiration date in limited circumstances, most notably if we are in default of these agreements. Although these contracts do not contain cross-default provisions, conditions leading to a default by us under one of our contracts could lead to a default under others, or all seven. If these contracts are terminated or modified in a manner that is adverse to us, it would have a material adverse effect on our business, prospects, financial condition and results of operations.

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

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Under our contracts with NAPM, we earn revenue for NPAC Services on an annual, fixed-fee basis. However, in the event that the volume of transactions in a given year is above or below the contractually established volume range for that year, the fixed-fee

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may be adjusted up or down, respectively, with any such adjustment being applied to the following year's invoices. In addition, under our contract with the Canadian LNP Consortium Inc., we earn revenue on a per transaction basis. As a result, if industry participants in the United States reduce their usage of our services in a particular year to levels below the established volume range for that year or if industry participants in Canada reduce their usage of our services from their current levels, our revenue and results of operations may suffer. For example, consolidation in the industry could result in a decline in transactions if the remaining carriers decide to handle changes to their networks internally rather than use the services that we provide. Moreover, if customer turnover among carriers in the industry stabilizes or declines, or if carriers do not compete vigorously to lure customers away from their competitors, use of our telephone number portability and other services may decline. If carriers develop internal systems to address their infrastructure needs, or if the cost of such transactions makes it impractical for a given carrier to use our services for these purposes, we may experience a reduction in transaction volumes. Finally, the trends that we believe will drive the future demand for our services, such as the emergence of IP services, growth of wireless services, consolidation in the industry, and pressure on carriers to reduce costs, may not actually result in increased demand for our existing services or for the ancillary directory services that we expect to offer, which would harm our future revenue and growth prospects.

***Certain of our other contracts may be terminated or modified at any time prior to their completion, which could lead to an unexpected loss of revenue and damage our reputation.***

In addition to our contracts with NAPM, we provide other carrier services that generate significant revenue and bolster our reputation as a premier solutions provider to communication service providers. Under various contracts, we serve as the provider of NPAC Services in Canada; operator of the .biz registry; and operator of the registry of U.S. Common Short Codes. Each of these contracts provides for early termination in limited circumstances, most notably if we are in default. In addition, our contracts to serve as the North American Numbering Plan Administrator and as the National Pooling Administrator and to operate the .us registry, each of which is with the U.S. government, may be terminated by the government at will. If we fail to meet the expectations of the FCC, the U.S. Department of Commerce or our customers, as the case may be, for any reason, including for performance-related or other reasons, the customer may unilaterally terminate or modify the contracts. A termination arising out of our default could expose us to liability, adversely affect our operating performance and lead to an unexpected loss of revenue. Further, each of the contracts discussed above establishes us as the sole provider of the particular services covered by that contract during its term. If one of these contracts was terminated, we would no longer be able to provide the services covered by that contract and could suffer a loss of prestige that would make it more difficult for us to compete for contracts to provide similar services in the future.

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

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

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

Our domestic operations and those of many of our customers are subject to regulation by the FCC and other federal, state and local agencies. As communications technologies and the communications industry continue to evolve, the statutes governing the communications industry or the regulatory policies of the FCC may change. If this were to occur, the demand for many of our services could change in ways that we cannot predict and our revenue could decline. These risks include the ability of the federal government, most notably the FCC, to:

increase or change regulatory oversight over the services we provide;

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adopt or modify statutes, regulations, policies, procedures or programs that are disadvantageous to the services we provide, or that are inconsistent with our current or future plans, or that require modification of the terms of our existing contracts,

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including the manner in which we charge for certain of our services. For example, in November 2005, BellSouth Corporation filed a petition with the FCC seeking changes in the way our customers are billed for services provided by us under our contracts with North American Portability Management LLC; and

after the amendment of our contracts with North American Portability Management LLC in September 2006, Telcordia Technologies, Inc. filed a petition with the FCC requesting an order that would require North American Portability Management LLC to conduct a new bidding process to appoint a provider of telephone number portability services in the United States. In response to our amendment of these contracts in January 2009, Telcordia filed another petition asking that the FCC abrogate these contracts and initiate a government managed procurement in their place. If successful, either of these petitions could result in the loss of one or more of our contracts with North American Portability Management LLC or otherwise frustrate our strategic plans;

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

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

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

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

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

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

Our success is dependent in part on obtaining, maintaining and enforcing our proprietary rights and our ability to avoid infringing on the proprietary rights of others. While we take precautionary steps to protect our technological advantages and intellectual property and rely in part on patent, trademark, trade secret and copyright laws, we cannot assure that the precautionary steps we have taken will completely protect our intellectual property rights. Effectively policing our intellectual property is time consuming and costly, and the steps taken by us may not prevent infringement of our intellectual property or proprietary rights in our products, technology and trademarks, particularly in foreign countries where in many instances the local laws or legal systems do not offer the same level of protection as in the United States. Further, because patent applications in the United States are maintained in secrecy until either the patent application is published or a patent is issued, we may not be aware of third-party patents, patent applications and other intellectual property relevant to our services and solutions that may block our use of our intellectual property or may be used by third-parties who compete with our services and solutions.

As we expand our business and introduce new services and solutions, there may be an increased risk of infringement and other intellectual property claims by third-parties. From time to time, we and our customers may receive claims alleging infringement of intellectual property rights, or may become aware of certain third-party patents that may relate to our services and solutions.

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

adverse effect on our business, operating results and financial condition.

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***The market for certain of our carrier and enterprise services is competitive, and if we do not adapt to rapid technological change, we could lose customers or market share.***

We compete in some areas against our customers, well-funded providers of carrier and enterprise services, communications software companies and system integrators that provide systems and services used by carriers and enterprises to manage their networks and internal operations in connection with telephone number portability and other communications transactions. In addition, our industry is characterized by rapid technological change and frequent new service offerings. Significant technological changes could make our technology and services obsolete. We must adapt to our rapidly changing market by continually improving the features, functionality, reliability and responsiveness of our services, and by developing new features, services and applications to meet changing customer needs. Our ability to take advantage of opportunities in the market may require us to invest in development and incur other expenses well in advance of our ability to generate revenue from these services. We cannot guarantee that we will be able to adapt to these challenges or respond successfully or in a cost-effective way, particularly in the early stages of launching a new service. Further, we may experience delays in the development of one or more features of our solutions, which could materially reduce the potential benefits to us for providing these services. In addition, there can be no assurance that our solutions will be adopted by potential customers, or that we will be able to reach acceptable contract terms with customers to provide these services. Our failure to adapt to meet market demand in a cost-effective manner could adversely affect our ability to compete and retain customers or market share.

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

Historically, sustaining our growth has placed significant demands on our management as well as on our administrative, operational and financial resources. For example, in 2010, our profits were negatively affected by our business realignment, including a restructuring charge of \$3.8 million related to the reduction of employee headcount, CEO severance costs of \$2.2 million and a long-lived asset impairment charge of \$8.5 million related to our Converged Messaging Services, which has been reclassified to discontinued operations. For us to continue to manage our expanded operations, as well as any future growth, we must continue to improve our operational, financial and management information systems and expand, motivate and manage our workforce. If our quality of service is compromised because we are unable to successfully manage our costs, or if new systems that we implement to assist in managing our operations do not produce the expected benefits, we may experience higher turnover in our customer base and our revenue and profits could be adversely affected.

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

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

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

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

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

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



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

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

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

We currently provide services to customers in Brazil, Taiwan and China. We intend to pursue additional international business opportunities. International operations and business expansion plans are subject to numerous additional risks, including:

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

difficulties in enforcing contracts and collecting receivables through some foreign legal systems;

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

differing technology standards and pace of adoption;

export restrictions on encryption and other technologies;

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

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

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

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

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

We have made a number of acquisitions in the past, and one of our strategies is to pursue acquisitions selectively in the future. We may not be able to locate acquisition candidates at prices that we consider appropriate or on terms that are satisfactory to us. If we do identify an appropriate acquisition candidate, we may not be able to successfully negotiate the terms of the acquisition or, if the acquisition occurs, integrate the acquired business into our existing business. Acquisitions of businesses or other material operations may require additional debt or equity financing, resulting in additional leverage or dilution to our stockholders. Integration of acquired business operations could disrupt our business by diverting management away from day-to-day operations. The difficulties of integration may be increased by the necessity of coordinating geographically dispersed organizations, integrating personnel with disparate business backgrounds and combining different corporate cultures. We also may not realize cost efficiencies or synergies or other benefits that we anticipated when selecting our acquisition candidates, and we may be required to invest significant capital and resources after acquisition to maintain or grow the businesses that we acquire. In addition, we may need to record write-downs from impairments of goodwill, intangible assets, or long-lived assets, or record adjustments to the purchase price that occur after the closing of the transaction, which could reduce our future reported earnings. For example, in the fourth quarter of 2010 we recognized an \$8.5 million non-cash long-lived asset impairment charge related to our Converged Messaging business, which has been reclassified to discontinued operations. If we fail to successfully integrate and support the operations of the businesses we acquire, or if

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anticipated revenue enhancements and cost savings are not realized from these acquired businesses, our business, results of operations and financial condition would be materially adversely affected. Further, at times, acquisition candidates may have liabilities, neutrality-related risks or adverse operating issues that we fail to discover through due diligence prior to the acquisition. The failure to discover such issues prior to such acquisition could have a material adverse effect on our business and results of operations.

***Failure to complete the TARGUSinfo merger could negatively impact our stock price and our future business and financial results.\****

The consummation of the TARGUSinfo merger is subject to customary conditions. If the acquisition is not completed, our ongoing business and financial results may be adversely affected by the following:

we will, under circumstances specified in the merger agreement, be required to pay significant liquidated damages to TARGUSinfo or be compelled to take certain actions to specifically perform our obligation to consummate the acquisition; and

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matters relating to the acquisition (including integration planning) may require substantial commitments of time and resources by our management, which could otherwise have been devoted to other opportunities that may have been beneficial to us. If the acquisition is not completed, these risks may materialize and may adversely affect our business, financial results and stock price.

***We may fail to realize all of the anticipated benefits of the TARGUSinfo merger.\****

The success of the TARGUSinfo merger will depend, in part, on our ability to realize the anticipated benefits from combining our business with TARGUSinfo. To realize these anticipated benefits, we must successfully integrate the businesses of the two companies. If we are not able to achieve these objectives, the anticipated benefits of the acquisition may not be realized fully or at all or may take longer to realize than expected.

We and TARGUSinfo have operated and, until the completion of the acquisition, will continue to operate, independently. It is possible that the integration process could result in the loss of key employees, the disruption of each company's ongoing businesses or inconsistencies in standards, controls, procedures and policies that adversely affect our ability to maintain relationships with customers, suppliers, distributors, creditors, or lessors, or to achieve the anticipated benefits of the acquisition. Integration efforts between the two companies will also divert management attention and resources. These integration matters could have an adverse effect on each of Neustar and TARGUSinfo during such transition period.

We expect to incur a number of non-recurring transaction costs associated with integrating the operations of TARGUSinfo. Additional unanticipated costs may be incurred in the integration of TARGUSinfo's business. Although we expect to realize certain efficiencies related to the integration of the businesses, a net benefit may not be achieved in the near term, or at all.

***Charges to earnings resulting from the application of the acquisition method of accounting may adversely affect the market value of our common stock following the TARGUSinfo merger.\****

In accordance with U.S. GAAP, we will account for the TARGUSinfo merger using the acquisition method of accounting, which will result in charges to our earnings that could adversely affect the market value of our Common Stock following the completion of the merger. Under the acquisition method of accounting, we will allocate the total purchase price to the assets acquired and liabilities assumed from TARGUSinfo based on their fair values as of the date of the completion of the merger, and record any excess of the purchase price over those fair values as goodwill. For certain tangible and intangible assets, reevaluating their fair values as of the completion date of the merger will result in our incurring additional depreciation and/or amortization expense that exceed the combined amounts recorded by Neustar and TARGUSinfo prior to the merger. This increased expense will be recorded by us over the useful lives of the underlying assets. In addition, to the extent the value of goodwill or intangible assets were to become impaired, we may be required to incur charges relating to the impairment of those assets.

**Risks Related to the Financial Market Conditions**

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

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

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

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

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

be forced to reduce our operations;

not be able to expand or acquire complementary businesses; and

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

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

*Our common stock price may be volatile.*

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

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

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

changes in analysts' recommendations or projections;

changes in general valuations for communications companies;

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

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

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

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

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

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

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

We are a Delaware corporation, and the anti-takeover provisions of the Delaware General Corporation Law may discourage, delay or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a

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period of three years after the person becomes an interested stockholder, even if a change of control would be beneficial to our existing stockholders. In addition, our certificate of incorporation and bylaws may discourage, delay or prevent a change in our management or control over us that stockholders may consider favorable. Our certificate of incorporation and bylaws:

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

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

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

require that directors only be removed from office for cause;

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

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

limit who may call special meetings of stockholders;

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

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

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

In order to comply with neutrality requirements imposed by the FCC in its orders and rules, no entity that qualifies as a telecommunications service provider or affiliate of a telecommunications service provider, as defined under the Communications Act of 1934 and FCC rules and orders, may beneficially own 5% or more of our capital stock. In general, a telecommunications service provider is an entity that offers telecommunications services to the public at large, and is, therefore, providing telecommunications services on a common carrier basis. Moreover, a party will be deemed to be an affiliate of a telecommunications service provider if that party controls, is controlled by, or is under common control with, a telecommunications service provider. A party is deemed to control another if that party, directly or indirectly:

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

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

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

As a result of this regulation, subject to limited exceptions, our certificate of incorporation (a) prohibits any telecommunications service provider or affiliate of a telecommunications service provider from beneficially owning, directly or indirectly, 5% or more of our outstanding capital stock and (b) empowers our Board of Directors to determine whether any particular holder of our capital stock is a telecommunications service provider or an affiliate of a telecommunications service provider. Among other things, our certificate of incorporation provides that:

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



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

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

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

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

These restrictions and requirements may:

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

discourage investment in us by other investors who are telecommunications service providers or who may be deemed to be affiliates of a telecommunications service provider, which may decrease the demand for our Class A common stock and cause the market price of our Class A common stock to be lower.

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

The following table is a summary of our repurchases of common stock during each of the three months in the quarter ended September 30, 2011:

| Month                                  | Total Number of Shares Purchased (1) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)(3) | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (3) |
|--|--------------------------------------|------------------------------|---|--|
| July 1 through July 31, 2011           | 255,934                              | \$ 26.42                     | 254,456   | \$ 216,194,872   |
| August 1 through August 31, 2011       | 228,996                              | 24.30                        | 223,684   | 210,751,243  |
| September 1 through September 30, 2011 | 464,482                              | 24.75                        | 463,239   | 199,286,743  |
| Total                                  | 949,412                              | \$ 25.09                     | 941,379   | \$ 199,286,743   |

- (1) The number of shares purchased includes shares of common stock tendered by employees to us to satisfy the employees' tax withholding obligations arising as a result of vesting of restricted stock grants under our stock incentive plan. We purchased these shares for their fair market value on the vesting date.

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- (2) The difference between the total number of shares purchased and the total number of shares purchased as part of publicly announced plans or programs is 8,033 shares, all of which relate to shares surrendered to us by employees to satisfy the employees' tax withholding obligations arising as a result of vesting of restricted stock grants under our incentive stock plans.
- (3) On July 28, 2010, we announced the adoption of a share repurchase program. The program authorizes the repurchase of up to \$300 million of Class A common shares through Rule 10b5-1 programs, open market purchases, privately negotiated transactions or otherwise as market conditions warrant, at prices we deem appropriate. The program will expire in July 2013.

**Item 3. Defaults Upon Senior Securities**

None.

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

**Item 5. Other Information**

None.

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**Item 6. Exhibits**

See exhibits listed under the Exhibit Index below.

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**SIGNATURES**

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

**NeuStar, Inc.**

Date: October 24, 2011

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

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## EXHIBIT INDEX

| Exhibit No. | Description  |
|-------------|--|
| 2.1         | Agreement and Plan of Merger, dated as of October 10, 2011, by and among NeuStar, Inc., Tumi Merger Sub, Inc., Targus Information Corporation and Michael M. Sullivan, as Stockholder Representative, incorporated herein by reference to Exhibit 2.1 to NeuStar's Current Report on Form 8-K, filed October 11, 2011. |
| 3.1         | Restated Certificate of Incorporation, incorporated herein by reference to Exhibit 3.1 to Amendment No. 7 to NeuStar's Registration Statement on Form S-1, filed June 28, 2005 (File No. 333-123635).  |
| 3.2         | Amended and Restated Bylaws, incorporated herein by reference to Exhibit 99.1 to NeuStar's Current Report on Form 8-K, filed December 16, 2010.  |
| 10.2.1      | Amendment to Amended and Restated Common Short Code License Agreement by and between the Cellular Telecommunications and Internet Association and NeuStar, Inc.  |
| 31.1        | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2        | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1        | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 101.INS     | XBRL Instance Document**   |
| 101.SCH     | XBRL Taxonomy Extension Schema**   |
| 101.CAL     | XBRL Taxonomy Extension Calculation**  |
| 101.DEF     | XBRL Taxonomy Extension Definition**   |
| 101.LAB     | XBRL Taxonomy Extension Label**  |
| 101.PRE     | XBRL Taxonomy Extension Presentation**   |

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