

Answers CORP
Form 10-K
March 09, 2009

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2008

OR

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

For the transition period from _____ to _____ .

Commission file number 001-32255

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

Delaware
(State or other jurisdiction of
incorporation or organization)

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

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

10001
(Zip Code)

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

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

Title of each class	Name of each exchange on which registered
Common Stock	The NASDAQ Capital Market

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

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

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

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

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

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

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/> (do not check if smaller reporting company)	Smaller reporting company <input checked="" type="checkbox"/>
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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes
No

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant, computed by reference to price at which the common equity was sold, or the average bid and asked price of such common stock as of June 30, 2008, was \$23,857,648. For purposes of this computation, the registrant has excluded the market value of all shares of its common stock reported as being beneficially owned by executive officers and directors and holders of more than 10% of the common stock on a fully diluted basis of the registrant; such exclusion shall not, however, be deemed to constitute an admission that any such person is an "affiliate" of the registrant. As of March 6, 2009, there were 7,876,270 issued and outstanding shares of common stock of the registrant.

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References to Web Property Usage Measurements

Throughout this Annual Report, we refer to estimates of traffic. We gauge the progress of our traffic trends and the effectiveness of our monetization efforts by measuring our revenue per thousand page views, or RPM. In our Management's Discussion and Analysis of Financial Condition and Results of Operations prior to our quarterly report on Form 10-Q for the quarterly period ended June 30, 2008, we tracked the traffic on our Answers.com and WikiAnswers.com Web properties using two separate systems:

- (a) Our Answers.com traffic was measured using our internally developed server-side, log-based system ("Internal Data Warehouse"). This system was designed to identify traffic from search engine robots and other known Web robots, commonly referred to as Web spiders or Web crawlers, as well as from suspected automated spidering scripts, and excludes such traffic from the traffic activity measurements.
- (b) WikiAnswers.com traffic was tracked using HBX Analytics, a tag-based web analytics system offered by Omniture, Inc. (formerly offered by WebSideStory). Traffic measurements from this system are generated by our placement of tags on our WikiAnswers.com Web pages. The HBX Analytics system then generates traffic metrics. WikiAnswers community-related statistics, including total number of questions, answers and users, are generated from the WikiAnswers.com Web property.

Beginning with the Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our quarterly report on Form 10-Q for the quarterly period ended June 30, 2008, all traffic measurements (including measurements previously reported in past filings using our Internal Data Warehouse) for Answers.com are also presented based on the HBX Analytics data. We estimate that the historical page views for Answers.com pursuant to HBX Analytics data, as set forth in our quarterly reports beginning with our quarterly report on Form 10-Q for the quarterly period ended June 30, 2008, are approximately 11% lower than the traffic measurements reported in previous filings. Consequently, our Answers.com RPMs, as reported in those quarterly reports, are higher than previous filings.

We also use Google, Inc.'s Google Analytics measurement services and Google AdSense data for various internal analyses. Our breakdown of our traffic sources, noted above, is based on such data. Google Analytics measurements are generated by our placement of tags on our Web properties' pages, which Google Analytics uses to count and report audience metrics independently.

In this Annual Report, statistics gathered from HBX Analytics and Google Analytics are also referred to as "internal estimates".

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

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ANSWERS CORPORATION

PART I

ITEM 1 BUSINESS

Introductory Note

This Annual Report on Form 10-K contains “forward looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These forward looking statements are based on expectations, estimates, goals and projections as of the date of this filing and are subject to significant risks and uncertainties. Actual results may differ materially from those expressed in forward looking statements. See Item 1A of part I – “Risk Factors.”

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

In this Annual Report, “Answers,” “we,” “us” and “our” refer to Answers Corporation and its subsidiary, GuruNet Israel Ltd.

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

Available Information

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

General

As a leading online answer engine, we own and operate Web properties known as WikiAnswers.com and Answers.com, which are dedicated to providing useful answers in thousands of categories. WikiAnswers.com is a community-generated social knowledge Q&A platform, leveraging wiki-based technologies. Through the contributions of WikiAnswers' large and growing community, answers are constantly improved and updated over time. WikiAnswers.com was ranked by comScore, a global Internet information provider, as the fastest growing domain of the top 200 in the U.S. in terms of unique monthly visitors in 2008. The award-winning reference site Answers.com includes content on millions of topics from over 250 licensed sources created by leading publishers, including Houghton Mifflin Company, Barron's and Encyclopedia Britannica.

According to comScore, our combined Web properties –WikiAnswers.com and Answers.com – had approximately 25.6 million unique visitors in January 2009, which ranked Answers Corporation number 33 in the top U.S. Web properties. Our goal is to become the premier online provider of and leading destination for answers to questions.

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According to our internal estimates, our Web properties had approximately 675 million page views during the fourth quarter of 2008. During the same period, approximately 80% of our traffic was generated by search engines; 15% from direct traffic, which consists of traffic resulting from a direct type-in of our URL, a bookmarked Favorite, a direct link from other Web properties, a downloaded toolbar, or other software or utilities we make available; and 5% by the definition link appearing on Google's Website result pages.

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We believe our valuable content and overall user experience drives traffic to our Web properties, which in turn drives advertising revenue. Our revenue is derived from third party ad networks, primarily Google AdSense, which aggregate Web properties looking to monetize their Web traffic and advertisers seeking to advertise on the Internet.

Products & Services

WikiAnswers.com

WikiAnswers.com is a user-generated content (UGC) community-based question and answer site where users ask questions and the community answers them. This question and answer site is currently differentiated from other popular question and answer sites which facilitate a forum where users can ask and answer questions, often repeating the same question in many different ways, but cannot improve upon or edit the questions or answers.

WikiAnswers.com's approach allows the community to transform each question and answer into its own "wiki" page, a collaborative page that can be improved upon by others in the community. In this manner, good answers can potentially become better answers over time; related questions can be merged or physically associated with each other; and ultimately, the community user-experience is enhanced.

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

WikiAnswers.com continued to grow very strongly in 2008. Based on a 31-day average for the month of December 2008 compared to a 31-day average for the month of December 2007, we have seen the following increases in key performance indicators:

- new users registering with WikiAnswers.com every day rose from approximately 1,900 to approximately 5,200;
- questions answered on a daily basis increased from approximately 3,200 to approximately 8,400; and
- daily new questions being added to our system grew from approximately 6,600 to approximately 28,100.

Answers.com

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

Our content includes over 250 licensed titles from leading offline and online publishers. The publishers from which we currently license content include, among many others, All Media Guide, Barron's Educational Series, Encyclopedia Britannica, Houghton Mifflin Company, Oxford University Press and Gale.

We attribute the data source of information on each Web page, enabling our users to make an independent evaluation as to the credibility of the content.

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1-Click Answers; AnswerTips; Web-Based AnswerTips

1-Click Answers is a tool that facilitates access to Answers.com. With 1-Click Answers installed on a computer, a user can click on a word or phrase within virtually any application, such as an e-mail, spreadsheet, document or database, and gain access to Answers.com's online library. Answers.com content related to the word or phrase is displayed in an AnswerTips pop-up information bubble. Available for users of both Microsoft Windows and Apple's Macintosh OS X, 1-Click Answers performs contextual analysis of the words or phrase clicked. For example, when clicking on the word "Ford" appearing in the context of Ford Motor Company, Harrison Ford, or Gerald Ford, 1-Click Answers will process and recognize the context and deliver information on the vehicle manufacturer, the film star, or the U.S. president, respectively.

Since 2007, we began offering other Web properties and blogs the ability to provide their users with the 1-Click functionality through our webmaster tool version of AnswerTips, which does not require a download. The Web version of AnswerTips is triggered when a visitor double-clicks a word or phrase on an "AnswerTips-enabled" site.

Traffic Generation

Our revenues are primarily driven by the traffic generated by our Web properties and our ability to effectively monetize that traffic. Please refer to the preamble of this Annual Report for a full explanation of the manner in which we measure traffic. The average daily page views, RPM and revenues of Answers.com and of WikiAnswers.com for 2008 are as follows:

	Q1	Q2	Q3	Q4
Ad Revenue (\$ - in thousands)				
Answers.com	1,828	1,485	1,579	1,730
WikiAnswers.com	1,185	1,500	1,960	2,879
Total	3,013	2,985	3,539	4,609
Answers.com	61%	50%	45%	38%
WikiAnswers.com	39%	50%	55%	62%
Total	100%	100%	100%	100%
Traffic				
Answers.com	3,225,000	2,641,000	2,666,000	3,027,000
WikiAnswers.com	1,885,000	2,318,000	3,094,000	4,350,000
Total	5,110,000	4,959,000	5,760,000	7,377,000
Answers.com	63%	53%	46%	41%
WikiAnswers.com	37%	47%	54%	59%
Total	100%	100%	100%	100%
RPM				

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Answers.com	\$6.23	\$6.18	\$6.44	\$6.21
WikiAnswers.com	\$6.95	\$7.11	\$6.89	\$7.19

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Our current traffic is primarily generated by search engines, direct users and the Google definition link:

Search engines. Our largest source of traffic is search engines, which represented 80% of our traffic for the fourth quarter of 2008. We continually seek to improve the volume and optimize the monetization of traffic directed to our Web properties by search engines. The industry commonly refers to these efforts as search engine optimization, or SEO. One of our principal strategic initiatives is centered on our understanding that content drives traffic through SEO. We believe that rich, unique content is valued by the user and by the search engines and their content indexing algorithms. Thus, we have historically focused on adding unique content that has not been broadly offered on the Web. Currently, the Q&A-oriented content belonging to WikiAnswers.com is playing an overwhelming role in creating rich and unique information for our Web properties. Our additional SEO efforts involve optimizing our Web properties' coding, presentation and structure, such as incorporating a clear hierarchical site-structure, and structuring the site to facilitate search engine indexing.

Direct users. Answers.com, and to a lesser extent, WikiAnswers.com, also receive traffic from users visiting and returning to our sites directly, as well as other software and utilities. Direct users represented approximately 15% of our traffic for the fourth quarter of 2008.

Google definition link. Our informal, non-contractual relationship with Google, under which Google links to search results related to certain definitional queries to Answers.com, accounted for approximately 5% of our traffic for the fourth quarter of 2008.

Traffic Monetization

Our business runs on the ability to effectively attract and monetize traffic. Our revenue model for monetizing query traffic on our Web properties is advertising.

Third Party Ad Networks. In 2008, we obtained the bulk of our advertisements through third party ad networks. Third party ad networks generally compensate us by paying us a portion of the revenue they earn from advertisers for our provision of promotional space on our Web properties. Of these current third party ad networks, Google AdSense accounted for approximately 82% of our total revenues for 2008.

Direct Ad Sales. In an effort to improve monetization, in the fourth quarter of 2006, we began marketing directly to advertisers and generating additional advertising revenue through an in-house team of direct ads salespeople. However, at the end of the second quarter of 2008 we decided to suspend this business initiative, and by the end of the third quarter of 2008 we no longer employed a direct sales staff. Although we currently employ no direct ad sales staff we do occasionally accept orders from advertisers who approach us directly, however this is not significant to our overall revenues. Further details concerning our suspension of direct ad sales can be found in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operation.

Seasonality

Our results of operations have historically been affected by seasonal patterns in both traffic to our Web properties and advertising demand. Many of our users are students who utilize our Web properties as reference sources. Our traffic fluctuates with the academic school year, rising from January through May, falling to lower levels during the summer months, rising again in September through November, and falling again in December, coinciding with school breaks and the holiday season. We expect traffic to our Web properties to continue to fluctuate seasonally in the future. This seasonal fluctuation in traffic results in a fluctuation in our quarterly revenues, since lower traffic on our Web properties translates into fewer users clicking on or viewing the advertisements on our Web properties.

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Community Development

As part of our effort to continuously grow the WikiAnswers.com community, the focus has been on several site-wide programs designed to increase loyalty, foster repeat visits and build on the “human element” that has fueled the site’s growth.

Mentoring Program

The Mentoring Program is an effort to provide a friendly, fun and worthwhile learning experience for volunteer Supervisors who are looking to pursue a more active role in the WikiAnswers.com community. Through this program experienced Mentors are matched-up with newly-joined volunteer Supervisors, known as Protégés. Mentors are often site veterans who have garnered an array of experience and knowledge – enabling them to provide solid support and guidance to fellow up-and-comers. The program serves as an optional extra level of involvement.

Community Outreach Program

As WikiAnswers.com continues to grow, feelings of belonging and interconnectivity must be nurtured so that participants at all levels can develop a sense of citizenship and community. Through the Outreach Program infrequent visitors are given positive feedback on their contributions and less-active volunteer Supervisors are constantly cheered on to encourage their active return and participation and help them become more involved and engaged. The Outreach Program has a volunteer advisory panel which convenes online and shares experiences in furtherance to the outreach goals. There are currently numerous outreach participants that have voluntarily assumed various roles within the program, including “WikiGuides,” “Talent Scouts” and “Forum Fanatics.” On a day-to-day basis, outreach volunteers welcome and follow-up with new contributors, spread information about group chats and contests, encourage inactive contributors and scout for potential contributors who are interested in volunteering and greater involvement.

Influential Teens Program

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

Vandal Patrol Program

The Vandal Patrol Program was started to address the problem of vandalism, found on many wiki-based sites. As WikiAnswers.com grows in both size and recognition, it continues to attract not only great contributors, but more vandals as well. Through this targeted program, volunteer participants enjoy finding, eliminating and defending against vandalism on the site.

Dispute Resolution Program

With an ever-growing and diverse community spanning across the globe, the need for a Dispute Resolution Program on WikiAnswers.com is apparent. Our Community Development team receives numerous emails in the form of editing conflicts – large and small – which they work to peacefully resolve. With the ability to appeal to this new mediating capacity, contributors enjoy enhanced communication, less discord and better understanding between one another.

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Our Strategy

We believe our valuable content and overall user experience drives traffic to our Web properties, which in turn drives advertising revenue. The key elements of our strategy to increase site usage and revenue include:

Become the Best Place to Get Answers

We believe that the core value proposition of our products is to help people find usable answers quickly. Some users will value our highly specific user-generated content from WikiAnswers.com; others will prefer the licensed Answers.com editorial content. To that end, we intend to better connect our Web properties to drive traffic between them, with the goal of helping users seamlessly discover their answers from whichever source.

Build the WikiAnswers.com Community

The WikiAnswers.com community is a source of continuous content creation. We believe the size of the community drives the quantity of the content, content attracts additional users which in turn grows the community. We believe this cyclical pattern is the major source of growth for WikiAnswers.com. We intend to accelerate this growth by further enhancing WikiAnswers.com, incorporating new features to maximize user experience and promoting the unique nature of this Q&A platform. We intend to continue building the loyal user-base of the site by continuing to focus on all our community programs (see discussion under Community Development above). We also intend to promote the community through more public relations efforts and marketing programs.

Internationalizing WikiAnswers.com

We plan to offer WikiAnswers.com in several languages other than English and enable native speakers to help volunteer supervise country-specific communities forming around foreign sister sites of WikiAnswers.com. Our strategy will capitalize on the needs of users around the globe who are searching for answers online and will leverage our core strengths: community building; Q&A space; and our large and growing database of questions and answers. Efforts in this area are underway and several foreign-language WikiAnswers.com versions are expected to launch in the second and third quarters of 2009.

Expand Content

Content is critical to the success of our business. We plan to continue to offer users relevant, unique content, which is valued by the user and recognized by the search engine algorithms. Our content strategy includes adding new, rich and unique content and having our content continually indexed by the search engines.

Improving User-Generated Content Quality

We are increasingly aware that it is high-quality answers that provide the greatest value to users and, ultimately, the progression and growth of WikiAnswers.com. While the wiki form of content management is an engaging platform, it raises concerns about quality, including, among others, vandalism, bias, plagiarism, and errors. As our WikiAnswers content base expands, we will continue to develop tools and engage in initiatives to assist users in creating and maintaining quality content. Among our primary efforts are the better measurement of the quality of questions and answers on WikiAnswers.com; establishing quality control mechanisms; encouraging the community to eliminate bad content; and enhancing the user interface to facilitate better and easier ways to maintain and increase quality content. Some examples of planned site changes and features that are aimed at improving content quality are set forth below:

- Delete low quality questions;

- Incorporate User generated rankings;
- Create new ways for users to report bad content;
- Increase usage of watch lists & RSS feeds (Rich Site Summary, a format for delivering regularly changing web content); and
 - Develop sub-communities, enabling each category and sub category to develop its own loyal user-base.

Improve Access and Enhance the User Experience

Over time, we plan to enhance the user experience for visitors to our properties and further differentiate them from other online services offering answers, including functionality, usability, performance, and access from various platforms, including mobile access. We continuously invest in improving these enhancements, which we believe lead to increased user stickiness and user retention.

Strengthen the Answers Brand

We are pursuing a brand development strategy that includes public relations, product features that encourage word-of-mouth sharing, and direct marketing to enhance public awareness of our Web properties. Our branding strategy centers on positioning us as a leading online answer engine, showcasing authoritative content on our rich collection of topics, with a platform for the creation of compelling user-generated content. We believe that building our Answers brand will not only increase traffic to our Web properties directly, but will also encourage search engine visitors to select links to us when our topics appear in search engine results pages. The goal of these marketing efforts is to increase direct traffic to our Web properties, as well as search engine traffic and traffic directed from other sources.

Answers.com Content

Scope and Quality of Content

Answers.com's collection of information related to millions of topics is drawn from more than 250 licensed titles from leading publishers. As shown in the taxonomy table below, our services offer users access to a multitude of subjects through the following select content categories:

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Category	Topics		Publishers
Business & Finance	Accounting terms	Finance terms	Barron's Educational Series
	Banking terms	Insurance terms	Dun & Bradstreet
	Business plans	Investment terms	Dow Jones Marketwatch
	Company history	Marketing terms	Gale
	Company news	Real Estate terms	Investopedia
	Currency conversions	US Industry Profiles	
Health & Medical	Alternative medicine	Medical procedures	Elsevier
	Children's health	Medical tests	Gold Standard
	Drug encyclopedia	Neurological encyclopedia	Houghton Mifflin Company
	Genetics encyclopedia	Oncology encyclopedia	Oxford University Press
	Medical dictionary	Public health	Gale
Entertainment/People	Actors	Game info	All Media Guide
	Album reviews	General biographies	Columbia University Press
	American authors	Movie reviews	Houghton Mifflin Company
	Artist discographies	Music glossary	Oxford University Press
	Black biographies	Political biographies	Gale
	Business biographies	Pop artists	Who2
	Classical albums	Scientists	
Science & Technology	Measures & units	How products are made	Computer Language Company
	Animal encyclopedia	Rocks & minerals	Houghton Mifflin Company
	Archaeology dictionary	Science of everyday things	Oxford University Press
	Computer encyclopedia	Sci-tech dictionary	Gale
Legal	Law dictionary	US courts decisions	Oxford University Press
	Legal encyclopedia		Gale
Arts & Literature	African mythology	French literature	Houghton Mifflin Company
	Asian mythology	German literature	Oxford University Press
	Classical literature	Literature study guides	Gale
History	European history	US historical documents	Columbia University Press
	Intelligence & Security	US history	Encyclopaedia Britannica
	Mideast history	US literature chronology	Houghton Mifflin Company
	Russian history	US military history	Oxford University Press
Leisure	Diet information	Local cuisine	Barron's Educational Series

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Fashion encyclopedia	Nutritional values	Houghton Mifflin Company
Food encyclopedia	Recipes	Oxford University Press
		Gale

Reference	Abbreviations	Idioms	Columbia University Press
	Acronyms	New words	Encyclopaedia Britannica
	Dictionary	Quotations	Houghton Mifflin Company
	Encyclopedia	Thesaurus	Oxford University Press
	Family names	Translations	Wikipedia
	Grammar	Word origins	Wizcom

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Content License Agreements

We license content under written agreements with recognized publishers of information. These agreements are generally for fixed periods, mostly ranging from one year and more, renewable by consent of the parties, and entitle us to provide the licensed information to our end users through our services in return for a fixed amount payable over the life of the agreement, either in a lump sum up front or payable over the course of a fixed schedule, either monthly, quarterly or annually.

We also provide content we license at no cost, content publicly available from the Web and content we develop and author independently. We are increasingly looking to license and make available content that is difficult to find elsewhere on the Internet.

Technology

Research and Development

We devote a substantial portion of our resources to developing new products and services, maintaining and enhancing existing products and services, expanding and improving our fundamental technology and strengthening our technological expertise. In fiscal years 2007 and 2008, we spent approximately \$3.0 million and \$3.5 million, respectively, on research and development of our products and services. Our engineering and production teams are located in our Jerusalem, Israel development facility, with additional production support provided from our office in New York City. We have developed our technology internally, acquired it or licensed it from outside vendors.

Hosting Services

We manage our Answers.com and WikiAnswers.com Web operations through our own colocation facility. Our colocation facility, located in New Jersey, is provided by NetAccess Corporation. We plan to add a second colocation site during the first half of 2009 in order to provide redundancy of Web operations at the data center level. Until such time, our operations are centered in one single data center facility. Prior to launching our colocation facility in 2008, we outsourced our Web hosting to Terremark Worldwide, Inc.

Competition

We face significant competition from a wide variety of Web properties. Question and answer sites, such as Yahoo! Answers (owned by Yahoo!), Askville (owned by Amazon), Live QnA (owned by Microsoft), Yedda (owned by AOL), Answerbag.com (owned by Demand Media, Inc.) and Wikia, Inc. compete with WikiAnswers.com. Destination portals and other free online information and/or reference services, such as About.com (owned by the New York Times), Dictionary.com (owned by IAC/InterActiveCorp), TheFreeDictionary.com and Wikipedia.org, compete with Answers.com. Other competitors of Answers.com include vertical industry-specific Web properties, such as Bankrate.com and WebMD.com.

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

Many of our competitors have longer operating histories, more extensive management experience, an employee base with more extensive experience, better geographic coverage, larger consumer bases, greater brand recognition and

significantly greater financial, marketing and other resource than we do. We expect competition to intensify in the future. If our competitors are more successful than we are in developing compelling products or attracting and retaining users, then our competitive position and financial results could be adversely affected.

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Advertising Relationships

We obtain almost all of our advertising revenue through agreements with third party ad networks. Third party ad networks generally compensate us by paying us a portion of the revenue they earn from ads that appear on our Web properties. Our primary ad network partner, Google AdSense, accounted for approximately 82% of our total revenue in 2008.

Google AdSense. In January 2005, we entered into the Google Services Agreement (GSA) governing our participation in Google AdSense. Pursuant to the GSA, we display listings from Google's network of advertisers on our Web properties. There are two methods by which AdSense advertisements are generated on our Web properties:

- AdSense for Search, or AFS; and
- AdSense for Content, or AFC.

In effect, the GSA positions Google AdSense as our most significant third party ad network. In December 2005, we amended the GSA in order to obtain Google's permission to display image ads. In September 2007, we entered into a renewal of the GSA, thereby extending its term through January 2010 and improving our revenue-share percentage. Google may terminate the GSA with no advance notice for any of the following reasons:

- our breach of certain prohibited actions including, among other things:

editing or modifying the order of search results,

redirecting end users, producing or distributing any software which prevents the display of ads by Google,

modifying, adapting or otherwise attempting to obtain source code from Google technology, content, software and documentation or

engaging in any action or practice that reflects poorly on Google or otherwise disparages or devalues Google's reputation or goodwill;

our breach of the grant of a license to us by Google of certain trade names, trademarks, service marks, logos, domain names and other distinctive brand features of Google;

- our breach of the confidentiality provisions of the GSA;
- our breach of the exclusivity provisions of the GSA; or
- our material breach of the GSA more than two times, irrespective of any cure to such breaches.

In addition to the GSA, we also benefit from a non-contractual, informal relationship, described earlier, pursuant to which Google currently links to our Answers.com Web property for definitions of certain words.

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Direct Ad Sales

In an effort to improve monetization, in the fourth quarter of 2006, we began marketing directly to advertisers and generating additional advertising revenue through an in-house team of direct ads salespeople. However, at the end of the second quarter of 2008 we decided to suspend this business initiative, and by the end of the third quarter of 2008 we no longer employed a direct sales staff. We initially saw promise in this area, with the belief that our Web properties would see RPM increases as a result of direct ad sales. In the fourth quarter of 2007, the sales force generated \$575 thousand of direct ad revenue. However, direct ad revenue in 2008 was disappointing, with revenue in the first quarter amounting to \$231 thousand and in the second quarter to \$200 thousand.

At the end of the second quarter of 2008, we came to the belief that the horizontal, educational, reference nature of www.answers.com Answers.com made direct ads less compelling for this Web property. While we viewed WikiAnswers.com as having the potential to successfully implement a direct ad sales strategy, we decided not to pursue that strategy and to instead focus on selling ads through advertising networks, primarily Google AdSense. This decision allowed us to focus on our core competency – growing the WikiAnswers community, growing traffic to our Web properties and monetizing via Google AdSense and other ad networks.

Marketing

To enhance the Answers brands, we are pursuing a brand development strategy that includes direct marketing, word-of-mouth marketing, public relations efforts and licensing arrangements.

Word of Mouth Marketing

We benefit from word of mouth advertising when users share their positive experience using our answer engine services with friends, colleagues, family, and others. We work to encourage the practice by adding features that make it simple to link to our Web properties or send an e-mail with information from our Web properties, by targeting bloggers which may include links from their blogs to our Web properties, and by working with computer user groups and newsletter publishers, all of whom share new technologies with constituents. We provide bloggers, who communicate actively online, with tools and features to enhance their blogs and share Answers.com and WikiAnswers.com services with readers.

Public Relations Efforts

Over the years, we have received multiple favorable reviews from numerous publications including USA Today, The Washington Post, The Wall Street Journal, Forbes and PC Magazine and plan on continuing our public relations efforts with outreach, speaking opportunities, press releases, interviews and briefings.

Employees

At February 28, 2009, we had 70 employees, of which 57 were full-time employees and 13 were part-time employees. As of such date, 56 employees were located in our office in Jerusalem; 14 employees were based in the United States. None of our employees is subject to a collective bargaining agreement, and we consider our employee relations to be satisfactory.

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Intellectual Property

We regard our domain names, patents, trademarks, copyrights, trade dress, trade secrets, proprietary technologies and similar intellectual property as critical to our success, and we rely on patent, trademark and copyright law, trade-secret protection, and confidentiality and/or license agreements with our employees, customers, partners, and others to protect our proprietary rights.

The United States Patent and Trademark Office has granted us four United States patents; the Israeli Patent Office has granted us one patent. We have one patent pending in the United States and a corresponding patent pending under the Patent Cooperation Treaty.

The status of any patent involves complex legal and factual questions, and the breadth of claims allowed is uncertain. Accordingly, we cannot assure you that any patent application filed by us will result in a patent being issued or that our issued patents, and any patents that may be issued in the future, will afford adequate protection against competitors with similar technology. We similarly face the risk that any patents issued to us might be infringed or designed around by others.

While we rely on patent and other intellectual property laws to protect our technology, we also believe that factors such as the technological and creative skills of our personnel, new product developments, frequent product enhancements and reliable product maintenance are essential to establishing and maintaining our market position. We enter into confidentiality agreements, as appropriate, with our employees, consultants and customers, and otherwise seek to control access to, and distribution of, our proprietary information. These measures, however, afford only limited protection. There is no guarantee that these safeguards will protect our technology and other valuable competitive information from being used by competitors.

We have applied for, or have been assigned by third parties, numerous domain names and have filed applications for a number of trademarks by U.S. governmental authorities. Among these are trademark applications for registering "Answers.com," "WikiAnswers.com" and "WikiAnswers." We have been recently granted a Community Trademark ("CTM") by the European Office for Harmonization in the Internal Market for the Answers.com mark.

From time to time in the ordinary course of business, we have been, and we expect to continue to be, subject to claims of alleged infringement of copyrights, trademarks and other intellectual property rights of third parties. These claims and any resultant litigation, should it occur, could subject us to significant liability for damages. In addition, even if we prevail, litigation could be time-consuming and expensive to defend and could result in the diversion of our time and attention. Any claims from third parties may also result in limitations on our ability to use the intellectual property subject to these claims, unless we are able to enter into license agreements with the third parties making these claims.

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Government Regulation

The manner in which existing laws regulating the Internet, in general, and how they relate to our business in particular, is unclear or unsettled in many cases. Such uncertainty arises under existing laws regulating matters, including user privacy, defamation, pricing, advertising, taxation, gambling, sweepstakes, promotions, content regulation, quality of products and services and intellectual property ownership and infringement.

Nevertheless, to resolve some of the current legal uncertainty, we expect the courts to interpret these laws and regulations and such rulings may be applicable to our activities. Such rulings could generally dampen the growth in use of the Internet and could potentially expose us to substantial liability, including significant expenses necessary to comply with applicable laws and regulations.

Several fairly recent U.S. federal laws that could have an impact on our business include, among others:

• The Digital Millennium Copyright Act is intended to reduce the liability of online service providers for listing or linking to third party Web properties that include materials that infringe copyrights or other rights of others.

• Portions of the Communications Decency Act are intended to provide statutory protections to online service providers who distribute third party content.

- The Child's Online Protection Act, or COPA, the Children's Online Privacy Protection Act, or COPPA and the Prosecutorial Remedies and Other Tools to End Exploitation of Children Today Act, are intended to restrict the distribution of certain materials deemed harmful to children and impose additional restrictions on the ability of online services to collect user information from minors.

• The Protection of Children From Sexual Predators Act requires online service providers to report evidence of violations of federal child pornography laws under certain circumstances.

• The CAN-SPAM Act is intended to regulate spam and create criminal penalties for unmarked sexually-oriented material and emails containing fraudulent headers.

Likewise, other laws could have an impact on our business. Under the U.K. Data Protection Act and the European Union Data Protection Directive, a failure to ensure that personal information is accurate and secure or a transfer of personal information to a country without adequate privacy protections could result in criminal or civil penalties. Such legislation may impose significant additional costs on our business or subject us to additional liabilities.

We post our privacy policy and practices concerning the use and disclosure of user data. Any failure by us to comply with our posted privacy policy, U.S. Federal Trade Commission requirements or other domestic or international privacy-related laws and regulations could result in proceedings by governmental or regulatory bodies, that could potentially harm our business, results of operations and financial condition. In this regard, there are a large number of legislative proposals before the European Union, as well as before the United States Congress and various state legislative bodies, regarding privacy issues related to our business. It is not possible to predict whether or when such legislation may be adopted, and certain proposals, if adopted, could harm our business operations. For example, decreases in usage of our services could be caused by, among other possible provisions, the required use of disclaimers or other requirements before users can utilize our services.

Due to the global nature of the Web, it is possible that the governments of other states and foreign countries might attempt to regulate its transmissions or prosecute us for violations of their laws. We might unintentionally violate such laws, such laws may be modified and new laws may be enacted in the future. Any such developments could harm our

business, operating results and financial condition.

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

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Operations in Israel

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

Taxable income of a company derived from an Approved Enterprise is subject to tax at the maximum rate of 25%, rather than the current rate of 27%, for the benefit period (the "Benefit Period"). The Benefit Period is ordinarily 7 years, beginning with the year in which the Approved Enterprise first generates taxable income, and is limited to 12 years from when production begins or 14 years from the date of approval, whichever is earlier. A company owning an Approved Enterprise may elect to receive an alternative package of benefits, which allows the company to receive tax exemptions rather than grants. Under the alternative package, the company’s undistributed income derived from an Approved Enterprise will be exempt from tax for a period of between 2 and 10 years from the first year of taxable income, depending on the geographic location of the Approved Enterprise within Israel, and the company will be eligible for the tax benefits under the Investment Law for the remainder of the Benefit Period, if any.

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

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

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

GuruNet Israel Ltd., currently has two capital investment programs, both of which were granted Approved Enterprise status under the Investment Law prior to the Amendment, ending December 31, 2009 and December 31, 2014, respectively. Qualifying income arising from our Approved Enterprise is tax-free in Israel under the alternative package of benefits described above for a period of 10 years from the first year in which our Israeli subsidiary generates taxable income from such Approved Enterprise, but not later than certain specified periods. We have begun

to generate taxable income for purposes of the Investment Law, and we have utilized these tax benefits beginning in 2000. In addition to our two existing capital investment programs, we intend to elect 2008 as our Year of Election for our second expansion under the Amendment to the Investment Law.

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ITEM 1A. RISK FACTORS

Forward-Looking Statements

This Annual Report contains forward-looking statements within the meaning of the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995. Reference is made in particular to the description of our plans and objectives for future operations, assumptions underlying such plans and objectives and other forward-looking statements included in this section, “Item 1 Business,” “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and in other places in this Annual Report. Such statements may be identified by the use of forward-looking terminology such as “may”, “will”, “expect”, “believe”, “estimate”, “anticipate”, “intend”, “continue”, and similar terms, variations of such terms or the negative of such terms. Such statements are based on management’s current expectations and are subject to a number of factors and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. Factors that could cause such results to differ materially from those described in the forward-looking statements include those set forth below.

Risks Relating to our Business

If search engines alter their algorithms or methods or otherwise restrict the flow of users visiting our Web properties, our business and financial results could suffer.

Search engines serve as the primary Web entry point for most users in search of information, and our topic and answer pages often appear as one of the top links on the pages returned by search engines in response to users’ search queries. As a result, we rely heavily on search engines for the overwhelming share of users visiting our Web properties. According to our internal estimates, traffic to our Web properties originating from search engines during the fourth quarter of 2008, excluding Google-directed definition link traffic, was approximately 80% of the overall traffic to our Web properties, the majority of which originated from Google and, to a lesser but still significant extent, Yahoo!. WikiAnswers.com search engine traffic during the same period was even more significant, amounting to approximately 90% of its overall traffic. If our traffic from search engines declines for any reason, we would suffer a significant decline in overall traffic and revenue. For example, in July 2007, a search engine algorithm adjustment by Google led to a drop in Google directed traffic to Answers.com. This adjustment reduced our overall traffic by approximately 28% based on the average traffic directed to Answers.com from Google for the week prior to the adjustment as compared to the week after. As a result, our revenue declined proportionately. In September 2007, Yahoo! dropped our content from its search index, which led to a drop in our Yahoo! directed traffic. This action was reversed within a week. Search engines, at any time and for any reason, could change their algorithms that direct search queries to our Web properties or could restrict the flow of users visiting our Web properties specifically. In fact, as illustrated above, on occasion our Web properties – which both rely so heavily on search engine traffic – have experienced decreases in traffic, and consequently in revenue, due to these search engine actions. We cannot guarantee that we will successfully react to these actions in the future and recover the lost traffic. Accordingly, a change in algorithms that search engines use to identify Web pages towards which traffic will ultimately be directed, or a restriction on users visiting our Web properties from the search engines, could cause a significant decrease in traffic and revenues, which could adversely affect our business and financial results.

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If the Google Services Agreement (GSA) is terminated by Google, we would have to seek an alternative provider of listings and advertisements, which could adversely affect our business and financial results.

Our business is dependent on the GSA, under which we obtain most of the advertisements displayed on our Web properties and earn most of our ad revenues. Google may terminate the GSA with no advance notice if we:

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

The GSA is scheduled to expire on January 31, 2010, unless renewed upon mutual written consent.

Google's termination of the GSA would result in our need to replace this relationship and obtain listings and advertisements from alternative providers, and we may not succeed in receiving equally favorable terms as those provided in the GSA. Termination of the GSA and our failure to replace it on equally favorable terms could result in a material reduction in our ad revenues and could adversely affect our business and financial results. In addition, a renewal of the GSA in February 2010 on terms less favorable to us than the current terms, including the revenue-share percentage, could result in a material reduction in our ad revenues and could adversely affect our business and financial results.

A downturn in the United States and global economic conditions could adversely affect the profitability of our business.

The U.S. and global economies are currently experiencing a significant contraction, and it is expected that we will see further economic downturn in the immediate and near future. This may result in fewer page views that result in commercial activities by our users, and may cause advertisers to reduce the amount they spend on online advertising, thus having a significant negative impact on the RPMs of both our Web properties in 2009 and beyond. A drop in RPM may result in a material reduction in our ad revenues which would adversely affect our business and financial results.

The failure of WikiAnswers.com to grow in accordance with our expectations could have an adverse impact on our business and financial results.

WikiAnswers.com is currently our primary growth driver, and it exceeds Answers.com in both traffic and revenue. Our projections assume that the 2009 growth of WikiAnswers.com will continue to be greater than that of Answers.com. If, for whatever reason, WikiAnswers.com fails to perform as well as we anticipate, and the growth we

are experiencing decelerates significantly, falters or ceases, our business and financial results could be adversely affected.

If Internet users do not interact with WikiAnswers.com frequently or if we fail to attract new users to the service, our business and financial results will suffer.

The success of WikiAnswers.com is largely dependent upon users constantly visiting the site by asking questions, posting answers and improving upon both. We have seen a very high correlation between growth in questions and answers and growth in the site's page views. We need to attract users to visit the Web property frequently and spend increasing amounts of time on the Web property when they visit. If we are unable to encourage users to interact more frequently with WikiAnswers.com and to increase the amount of user generated content they provide, our ability to attract new users to the Web property and increase the number of loyal users will be diminished and adversely affected. As a result, our business and financial results will suffer, and we will not be able to grow our business as planned.

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If we are unable to improve and maintain the quality of content being contributed to WikiAnswers.com, and if we fail to fight vandalism the site has been experiencing, the Web property will become less valuable to the users, less popular as a destination for obtaining answers to questions and its growth will be negatively affected, which in turn could adversely impact our financial results.

It is critical that we ensure that the quality of content being posted on WikiAnswers.com, both questions and answers, is maintained to as high an extent as reasonable, and improved over time. The better the quality of the content generated on the Web property, the more valuable the Web property will be for users in search of answers, as well as for search engines indexing the content to continue featuring it in their search engine result pages. Improved quality content should lead to stronger growth in the community size and will lessen the risk of a search engine's algorithm and/or policy makers downgrading the rank of WikiAnswers.com. In addition, it is critical that we ward off vandals and eliminate vandalism on the Web property to the greatest extent possible. If we fail to maintain and improve the quality of the Web property's content, the appeal of WikiAnswers.com to users and search engines may diminish and the growth of the Web property may be negatively affected, which in turn could cause our financial results to suffer.

If, in the interest of improving user experience and user satisfaction, we decide to decrease the number of ad elements displayed on our Web properties, our advertising revenues will decline and our financial results will be adversely impacted.

We closely monitor the ratio between ad elements and actual content appearing on our Web pages. In the future we may decide that in order to enhance the user-experience and increase user satisfaction, our pages should display fewer ad elements. Displaying less ad-intensive Web pages is likely to result in faster page-load and offering more content per-page is likely to appeal more to the user. A better user experience may result in more stickiness on our Web properties and a higher rate of user-retention and return visits. However, there is no assurance that reducing advertising on our Web properties will result in better user-retention and return visits and there can be no guarantee that the short term reduction in ad revenues will pay off in the long term in the form of increased traffic. A decrease in the number of ad elements displayed on our Web properties will result in a drop in RPM and advertising revenues which may not be recovered through higher traffic, thus having an adverse impact on our results of operations.

If we are unable to attract and retain dedicated volunteer supervisors for encouraging the community's expansion, our plans for growing WikiAnswers.com may fail and our results of operations may be adversely affected.

We benefit from the heavy involvement of a large group of external volunteer supervisors who are not employed by us and are not compensated for their site activity. The volunteer supervisors, for their own personal motives and enjoyment, are involved in monitoring questions and answers in specific categories in an effort to help questions get answered quickly. Volunteers also help prevent vandalism, improve content consistency, encourage high-quality contributions and identify potential new volunteers. Volunteers are also engaged in various community programs aimed at strengthening the community and contributors' sense of connection to the site and the community at large and help instill a sense of camaraderie among users interested in various categories of WikiAnswers.com. As of December 31, 2008, the community enjoyed the benefit of over 500 such supervisors. If we are not able to attract enough volunteers, WikiAnswers.com may suffer and the Web property may become less attractive to users, which in turn will adversely affect the site's growth, our business and financial results. Alternatively, we may be forced to hire paid employees to engage in many of the initiatives that volunteers currently take upon themselves for their own personal pleasure and gratification, which, in turn, would increase the cost of maintaining and improving WikiAnswers.com and adversely affect our financial results.

We benefit from Google's directing of traffic to Answers.com through its definition link, and the loss of this source of traffic could reduce our ad revenues and adversely affect our business and financial results.

Approximately 5% of our overall traffic during the fourth quarter of 2008 was directed to Answers.com by the definition link appearing on Google's website result pages. This traffic includes secondary pages viewed on Answers.com as a result of visitors arriving at the site via the definition performing additional searches. The definition link traffic is the result of a unilateral decision by Google to link certain definitions to Answers.com, and not any contractual relationship. Google may change these links at any time, in its sole discretion. If Google stops directing traffic to Answers.com through its definition link, we would experience a reduction in our traffic and the corresponding ad revenues, which would adversely affect our business and financial results.

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Components of our business and operations are experiencing rapid growth. If we fail to effectively manage our growth, our business and operating results could be harmed.

We have experienced rapid growth in our operations over the past several years, which has placed, and will continue to place, significant demands on our management, operational and financial infrastructure. If we do not effectively manage our growth, the quality of our products and services could suffer, which could negatively affect our brand and operating results. To effectively manage this growth, we will need to continue to improve our operational, financial and management controls and our reporting systems and procedures. These systems enhancements and improvements will require significant capital expenditures and management resources. Failure to implement these improvements could hurt our ability to manage our growth and our financial position.

We have a short operating history and a relatively new business model in an emerging and rapidly evolving market. This makes it difficult to evaluate our future prospects and may increase the risks that we will not continue to be successful and that our financial results could suffer.

There are two primary categories of Internet advertising, pay-per-performance, or most commonly cost per click, or CPC, and pay-per-impression, or cost per 1,000 impressions, or CPM. In the case of performance-based advertising, the advertiser only pays when a user clicks on an ad, as opposed to viewing the ad, as in impression-based advertising. We first derived advertising revenue in the first quarter of 2005, and we have only a short operating history with our CPC and CPM advertising model. As a result, we have very little operating history to aid in assessing our future prospects. Also, we derive nearly all of our revenues from online advertising, which is an immature industry that has undergone rapid and dramatic changes in its short history. We will encounter risks and difficulties as a growing company in a new and rapidly evolving market. We may not be able to successfully address these risks and difficulties, which could materially harm our business and operating results.

We may not be able to obtain capital when desired on favorable terms, if at all, or without dilution to our stockholders.

We believe we have sufficient cash and cash equivalents to meet our working capital and operating requirements for the next twelve months, based on our current cash and cash equivalent levels and expected cash flow from operations. Further, in estimating our expected cash flow during the next twelve months, we have considered the current general economic downturn and its impact on our future revenue. However, we may need or desire additional financing to execute on our current or future business strategies, including to:

- acquire businesses or technologies;
- improve and expand content on our Web properties;
- otherwise respond to competitive pressures; and
- enhance our operating infrastructure.

If we decide to raise additional funds through the issuance of equity or convertible debt securities, and are successful at raising such capital, the percentage ownership of our stockholders could be significantly diluted, and these newly issued securities may have rights, preferences or privileges senior to those of existing stockholders. We cannot assure you that additional financing will be available on terms favorable to us, or at all, particularly in light of the weakness of the financial markets and the economic crisis. For example, we experienced such financing difficulties during the course of our recent failed attempt to acquire Lexico Publishing Group, LLC and our ultimate abandonment of a follow-on offering. If adequate funds are not available or are not available on acceptable terms, when we desire them, our ability to fund our operations, take advantage of unanticipated opportunities, develop or enhance our services, or

otherwise respond to competitive pressures would be significantly limited.

New technologies could block Internet ads, which could harm our financial results.

Technologies have been developed, and are likely to continue to be developed, that can block the display of Internet ads. Most of our revenues are derived from fees paid to us by advertisers in connection with the display of their ads. Ad-blocking technology may cause a decrease in the number of ads that we can display on our Web properties, which could adversely affect our ad revenues and our financial results.

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We face significant competition from question and answer sites, search engines and other free reference and industry-specific Web properties that could adversely impact our competitive position.

We face significant competition from a wide variety of Web properties. Question and answer sites, such as Yahoo! Answers, Askville (owned by Amazon), Live QnA (owned by Microsoft), Yedda (owned by AOL), Answerbag.com (owned by Demand Media, Inc.) and Wikia, Inc. compete with WikiAnswers.com. Destination portals and other free online information and/or reference services, such as About.com (owned by the New York Times), TheFreeDictionary.com, Dictionary.com (owned by IAC/InterActiveCorp) and Wikipedia.org, compete with Answers.com. Other competitors of Answers.com include vertical industry-specific Web properties, such as Bankrate.com and WebMD.com. Since several companies operating traditional search engines, such as Yahoo!, Microsoft, AOL and Ask.com offer their own question and answer services, they too can be viewed as competitors of our answers-driven products, particularly in light of the fact that some search engines have begun putting snippets of useful answers at the top of many of their pages, in response to queries made by users. Nevertheless, search engines remain the greatest source of traffic arriving at our Web properties.

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

Our failure to generate direct traffic to our Web properties could adversely affect our business and financial results.

In addition to search engine traffic and traffic directed by the Google definition link, our traffic also originates from Internet users arriving at our Web properties directly by typing our website address directly into their Web browser, bookmarking our Web properties, using AnswerTips and visiting sites that direct users to our Web properties. Given the wide availability of free search engines and reference content sites, we may not be able to retain current Internet users or attract new Internet users in this direct fashion. If we are unable to retain our direct Internet users or attract new direct Internet users, our ability to generate revenues would be adversely impacted, which could adversely affect our business and financial results.

Traffic to our Web properties and advertising demand fluctuates significantly on a seasonal basis, which impacts our operations from quarter to quarter.

Many of our users are students that utilize our Web properties as reference sources. Our traffic fluctuates with the academic school year, rising from January through May, falling to lower levels during the summer months, rising again in September through November, and falling again in December, coinciding with school breaks and the holiday season. We expect traffic to our Web properties to continue to fluctuate seasonally in the future. This seasonal fluctuation in traffic results in a fluctuation in our quarterly revenues, since fewer users to our Web properties translates into fewer users clicking on or viewing the advertisements on our Web properties. In addition, the demand for our advertising inventory fluctuates during the year based on the seasonal needs of our advertisers, rising to its highest levels during the fourth quarter and falling to its lowest levels in the first quarter. Accordingly, our revenue fluctuates based on the seasonality of our traffic and advertising demand. The effect of this seasonality makes it difficult to estimate future revenues based on the results of any specific quarter, thus it is difficult to make operating plans relating to hiring and expenses. Additionally, as a result of the difficulty to estimate revenues, we may be unable to meet our revenue or profit and loss forecasts which could have a negative impact on the market price of our common stock.

Our operating results may fluctuate, which makes comparing our operating results on a period-to-period basis difficult and could cause our results to fall short of expectations.

Our operating results may fluctuate as a result of a number of factors, many outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful, and you should not rely on our past results as an indication of our future performance. Our quarterly, year-to-date and annual expenses as a percentage of our revenues may differ significantly from our historical or projected rates. Our operating results in future quarters may fall below expectations. Any of these events could cause our stock price to fall.

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We may not be successful in expanding our business through acquisitions, business combinations and other transactions, and, even if we are successful, our operations may be adversely affected as a result of these transactions.

We may pursue acquisitions, business combinations and joint ventures, which we refer to as extraordinary transactions. Our ability to implement this business strategy depends in large part on our ability to compete successfully with other entities for acquisition candidates and joint venture partners. Factors affecting our ability to compete successfully include:

- our financial condition and resources relative to the financial condition and resources of competitors;
- our ability to issue common stock as potential consideration;
- the attractiveness of our common stock as potential consideration relative to the common stock of competitors;
- our ability to obtain financing; and
- our available cash, which depends upon our results of operations and our cash demands.

In addition, we may not be able to find suitable acquisition candidates and we may not be able to complete acquisitions on favorable terms, if at all. If we do complete acquisitions, we may not ultimately strengthen our competitive position or achieve our goals, or such acquisitions may be viewed negatively by customers, financial markets or investors. In addition, any acquisitions that we make could lead to difficulties in integrating personnel and operations from the acquired businesses and in retaining and motivating key personnel from these businesses. Acquisitions may disrupt our ongoing operations, divert management from day-to-day responsibilities, increase our expenses or adversely affect our business, operating results and financial condition. For example, we experienced such disruption, diversion and increased expenses during the course of our recent failed attempt to acquire Lexico Publishing Group, LLC. Future acquisitions may reduce our cash available for operations and other uses and could result in an increase in amortization expense related to identifiable assets acquired, potentially dilutive issuances of equity securities or the incurrence of debt, which could harm our business, financial condition and operating results.

If we fail to maintain and enhance awareness of our Web properties, our business and financial results could be adversely affected.

We believe that maintaining and enhancing awareness of our Web properties is critical to achieving widespread acceptance of our services and to the success of our business. We also believe that the importance of brand recognition will increase due to the relatively low barriers to entry in our market. Maintaining and enhancing our Web properties may require us to spend increasing amounts of money on, and devote greater resources to, advertising, marketing and other brand-building efforts, and these investments may not be successful. Further, even if these efforts are successful, they may not be cost-effective. If we are unable to continuously maintain and enhance our Web properties, our traffic may decrease and we may fail to attract advertisers, which could in turn result in lost revenues and adversely affect our business and financial results.

Our failure to license compelling content could result in lost revenue, as a result of a loss of users and advertisers.

We believe our future success depends in part upon our ability to deliver valuable content through our Web properties. While our user-generated content continues to grow, we continue to also utilize traditional licensed content. We cannot guarantee that we will be able to enter into new or renew current or future content agreements on commercially acceptable terms or at all. If we are unable to maintain and enhance our existing relationships with content providers or develop new relationships with alternative providers of content, our Answers.com service may become less

attractive to Internet users, resulting in decreased traffic to Answers.com, which could have an adverse effect on our ad revenues and a negative impact on our business.

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If we are unable to maintain and expand our computer and communications systems, then interruptions and failures in our services could result, making our services less attractive to consumers and subjecting us to lost revenue from the loss of users and advertisers.

Our ability to provide high quality user experience depends on the efficient and uninterrupted operation of our computer and communications systems. Over time, our Web properties have experienced significant increases in traffic, and we continuously seek to further increase our user base. Accordingly, our Internet servers must accommodate spikes in demand for our Web pages in addition to potential significant growth in traffic. Delays and interruptions could frustrate users and reduce traffic on our Web properties, adversely affecting our operations and growth prospects. Furthermore, our systems may be vulnerable to damage or interruption from earthquakes, terrorist attacks, floods, fires, power loss, telecommunications failures, computer viruses, computer denial of service attacks or other attempts to harm our systems, which could adversely affect our operations.

We manage our Answers.com and WikiAnswers.com Web operations through our own colocation facility. Our colocation facility, located in New Jersey, is provided by NetAccess Corporation. We plan to add a second colocation site in the first half of 2009 in order to provide redundancy of Web operations at the data center level. Until such time, our operations are centered in one single data center facility. Our single facility could suffer interruptions or failures in service. Our Web operations would be adversely affected, making our services less attractive to consumers and subjecting us to lost revenue. Additionally, if we are unable to recruit and retain skilled employees to manage the Web hosting operations, we may not be able to properly manage the necessary tasks to keep our systems running smoothly and grow the business.

If we were to lose the services of our key personnel, we may not be able to execute our business plan and our business could be adversely affected.

Our ability to execute our business plan depends upon the continued service of our executive officers and other key technology, marketing, sales and support personnel. Our employment agreements with our executive officers and key employees are terminable by either party upon 30-90 days notice. If we lose the services of one or more of our key employees, or if one or more of our executive officers or key employees joined a competitor or otherwise competed with us, our business could be adversely affected. We cannot give assurance that we will be able to retain or replace our key personnel, and the services of key members of our research and development team, in particular, would be difficult to replace. If we do not succeed in retaining or replacing our key personnel, we may be unable to execute our business plan and, as a result, our stock price may decline.

Our business depends on increasing use of the Internet by users searching for information, advertisers marketing products and services and Web properties seeking to earn revenue to support their Web content. If the Internet infrastructure does not grow and is not maintained to support these activities, our business will be harmed.

Our success will depend on the continued growth and maintenance of the Internet infrastructure. This includes maintenance of a reliable network backbone with the necessary speed, data capacity and security for providing reliable Internet services. Internet infrastructure may be unable to support the demands placed on it if the number of Internet users continues to increase, or if existing or future Internet users access the Internet more often or increase their bandwidth requirements. In addition, viruses, worms and similar programs may harm the performance of the Internet. The Internet has experienced a variety of outages and other delays as a result of damage to portions of its infrastructure, and could face outages and delays in the future. These outages and delays could reduce the level of Internet usage as well as our ability to provide our solutions.

Rules established by the Financial Accounting Standards Board, or FASB, require us to expense equity compensation given to our employees and may impact our ability to effectively utilize equity compensation to attract and retain

employees.

The FASB has adopted changes that require companies to record a charge to earnings for employee stock option grants and other equity incentives effective January 1, 2006, which we have adopted. These accounting changes may cause us to reduce the availability and amount of equity incentives provided to employees, which may make it more difficult for us to attract, retain and motivate key personnel. Additionally, it may be difficult for us to estimate the impact of such compensation charges on future operating results because they will be based upon the fair market value of our common stock and other assumptions at future dates.

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We may be subject to liability for online services, which may not be limited by the safe harbors in The Digital Millennium Copyright Act, or DMCA, The Communications Decency Act, or CDA, or the U.S. Children's Online Privacy Protection Act, or COPPA. If we do not meet the safe harbor requirements, or if it is otherwise determined that our Web properties contain actionable content, we could be subject to claims, which could be costly and time-consuming to defend.

We host certain services that enable individuals to generate content and engage in various online activities. The law relating to the liability of providers of these online services for activities of their users is currently unsettled both within the United States and internationally. Claims have been threatened and may in the future be brought against us for defamation, invasion of privacy, negligence, copyright or trademark infringement, unlawful activity, tort, including personal injury, fraud, or other theories based on the nature and content of information to which we provide links, or that may be posted online or generated by the users of our Web properties. Our defense of any of these actions could be costly and involve significant time and attention of our management and other resources.

The DMCA is intended, among other things, to reduce the liability of online service providers for listing or linking to third party Web properties that include materials that infringe copyrights or rights of others. Additionally, portions of the CDA are intended to provide statutory protections to online service providers who distribute third party content. A safe harbor for copyright infringement is also available under the DMCA to certain online service providers that provide specific services, if the providers take certain affirmative steps as set forth in the DMCA. Important questions regarding the safe harbor under the DMCA and the CDA have yet to be litigated, and we can not guarantee that we will meet the safe harbor requirements of the DMCA or of the CDA. If we are not covered by a safe harbor, for any reason, we could be exposed to claims, which could be costly and time-consuming to defend.

In addition, COPPA was enacted in October 1998. COPPA imposes civil and criminal penalties on persons distributing material harmful to minors over the Internet to persons under the age of 17 or collecting personal information from children under the age of 13. We do not knowingly collect and disclose personal information from minors. The manner in which COPPA may be interpreted and enforced cannot yet be determined. Moreover, the applicability to the Internet of existing laws governing issues such as property ownership, copyright, defamation, obscenity and personal privacy is uncertain. We may be subject to claims that our content violates such laws, which could damage our business and cause our stock price to decline.

We also periodically enter into arrangements to offer third party products, services or content under the Answers brand or through our Web properties. We may be subject to claims concerning these products, services or content by virtue of our involvement in marketing, branding, broadcasting or providing access to them, even if we do not ourselves host, operate, provide, or provide access to them.

It is also possible that, if any information provided directly by us contains errors or is otherwise negligently provided to users, third parties could make claims against us. While it is our belief that the Terms of Use governing the use of our Web properties covers us against these types of claims, there are no assurances as to the final determination of these types of claims by any court of law. Furthermore, investigating and defending any of these types of claims is expensive, even to the extent that the claims are without merit or do not ultimately result in liability.

Third parties may claim that we are infringing on their patents, trademarks or copyrights, which could result in substantial costs, diversion of significant managerial resources and significant harm to our reputation.

The industry in which we operate is characterized by the existence of a large number of patents and frequent litigation based on allegations of patent infringement. We expect that Internet technologies, software products and services may be increasingly subject to third party patent infringement claims as the number of competitors in our industry segment grows and the functionality of products in different industry segments overlaps. From time to time, third parties may

assert patent infringement claims against us in various jurisdictions that are important to our business. Additionally, third parties may assert trademark infringement claims with respect to brand names we use from time to time and content we display on our Web properties. For example, a third party may make claims against us over the display of search results triggered by search terms that include trademark terms. Furthermore, we may be faced with copyright infringement claims. We have received, and are likely to continue to receive, “cease and desist” letters demanding that we remove infringing content from our Web properties based on a theory of copyright and trademark infringement.

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A successful patent, trademark or copyright infringement claim against us by any third party, could subject us to:

- substantial liability for damages and litigation costs, including attorneys' fees;

lawsuits that prevent us from further use of intellectual property and require us to permanently cease and desist from selling or marketing products that use the intellectual property;

licensing intellectual property from a third party, which could include significant licensing and royalty fees not presently paid by us, adding materially to our costs of operations;

developing new intellectual property, as a non-infringing alternative, that could delay projects, add materially to our costs of operations and be unacceptable to our users, which in turn could adversely affect our traffic and revenues; and

indemnifying third parties who have entered into agreements with us with respect to losses they incurred as a result of the infringement, which could include consequential and incidental damages that are material in amount.

Regardless of the merit of third party infringement claims, these claims could result in substantial costs, diversion of significant resources and management attention, termination of customer contracts, loss of customers and significant harm to our reputation.

Finally, many of our agreements with advertisers, distribution partners, and other third party partners require us to indemnify these partners for certain third party intellectual property infringement claims, which could increase our costs as a result of defending the claims and may require that we pay damages if there were an adverse ruling in any of the claims. An adverse determination could also prevent us from offering our products and services to others and may require that we procure substitute products or services, which could adversely affect our business and financial results.

Misappropriation of our intellectual property could harm our reputation, adversely affecting our competitive position and financial results.

Our ability to compete depends in part upon the strength of our proprietary rights in our technologies, brands and content. We rely on a combination of U.S. and foreign patents, copyrights, trademark, trade secret laws and license agreements to establish and protect our intellectual property and proprietary rights. The efforts we have taken to protect our intellectual property and proprietary rights may not be sufficient or effective at stopping unauthorized use of our intellectual property. In addition, effective trademark, domain name, patent, copyright and trade secret protection may not be available or cost-effective in every country in which our services are made available through the Internet. There may be instances where we are not able to fully protect or utilize our intellectual property in a manner that maximizes competitive advantage. If we are unable to protect our intellectual property and proprietary rights from unauthorized use, the value of our Web properties may be reduced, which could negatively impact our business. In addition, protecting our intellectual property and other proprietary rights is expensive and diverts critical managerial resources. If any of the foregoing were to occur, or if we are otherwise unable to protect our intellectual property and proprietary rights, our business and financial results could be adversely affected.

We have incurred significant and continuing net losses since our inception and may continue to incur losses.

We incurred net losses of approximately \$12.3 million and \$4.1 million for the years ended December 31, 2008 and 2007, respectively. As of December 31, 2008, we had an accumulated deficit of approximately \$71 million. We cannot assure you that we will be able to achieve net income on a quarterly or annual basis. If our revenues do not increase, or if our operating expenses exceed expectations or cannot be reduced, we will continue to incur substantial

losses, which would materially adversely affect our business and financial results.

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New government regulation and legal uncertainties could require us to incur significant expenses.

The laws and regulations applicable to the Internet, and to our products and services, are evolving and unclear and could damage our business. In addition, we will be subject to any new laws and regulations directly applicable to our products and services. It is possible that laws and regulations may be adopted covering issues such as user privacy, pricing, taxation, content regulation, quality of products and services, and intellectual property ownership and infringement. This legislation could expose us to substantial liability as well as dampen the growth in use of the Internet generally, decrease the acceptance of the Internet as a communications and commercial medium, or require us to incur significant compliance expenses. Compliance with these laws and regulations may also cause us to change or limit our business practices in a manner adverse to our business.

Increased regulation or the imposition of access fees could substantially increase the costs of communicating on the Internet, potentially decreasing the demand for our products. A number of proposals have been made at the federal, state and local level that would impose additional taxes on the sale of goods and services through the Internet. Such proposals, if adopted, could substantially impair the growth of electronic commerce and could adversely affect us.

Due to the global nature of the Internet, it is possible that the governments of other states and foreign countries might attempt to regulate its transmissions or prosecute us for violations of their laws. We might unintentionally violate these laws. Such laws may be modified, or new laws may be enacted, in the future. Our business may be negatively affected by a variety of new or existing laws and regulations, which may expose us to substantial compliance costs and liabilities and may impede the growth in use of the Internet generally.

Risks Related to our Common Stock

Our common stock may be affected by limited trading volume and may fluctuate significantly.

Our common stock is traded on the NASDAQ Capital Market. Although an active trading market has developed for our common stock, there can be no assurance that an active trading market for our common stock will be sustained. Failure to maintain an active trading market for our common stock may adversely affect our shareholders' ability to sell our common stock in short time periods, or at all. Our common stock has experienced, and may experience in the future, significant price and volume fluctuations, which could adversely affect the market price of our common stock.

You may experience dilution in your percentage ownership interest as a result of any additional issuances of our common stock.

We have authorized 100 million shares of our common stock, of which approximately 15.1 million shares were issued and outstanding after giving effect to the assumed exercise of all outstanding warrants and options and assumed conversion of preferred stock as of December 31, 2008. Our board of directors has the authority, without action or vote of our stockholders in many cases, to issue all or a part of any authorized but unissued shares. Such stock issuances may be made at a price that reflects a discount from the then-current trading price of our common stock. In addition, we may need to issue securities that are convertible into or exercisable for a significant amount of our common stock. For example, on June 16, 2008, we sold Series A Convertible Preferred Stock and related warrants for \$6.0 million to Redpoint Ventures. Additionally, Redpoint Ventures is in possession of a warrant entitling the fund to invest a second tranche in the amount of \$7.0 million, in exchange for Series B Convertible Preferred Stock and related warrants. See "Redpoint Financing" discussion in Item 7 below for a description of these transactions and the related securities. These issuances may dilute your percentage ownership interest, which will have the effect of reducing your influence on matters on which our stockholders vote.

You may incur additional dilution if holders of stock options, whether currently outstanding or subsequently granted, exercise their options or if warrant holders exercise their warrants to purchase shares of our common stock. In addition, these issuances, or the perception that such issuances may occur in the future, may have a depressant effect on our stock price and make it more difficult to raise capital in the future on reasonable terms or at all.

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There may be substantial sales of our common stock, which could cause our stock price to fall.

All of our issued and outstanding shares are immediately available for sale in the public market without registration under Rule 144. Sales of a substantial number of shares of our common stock could cause the price of our securities to fall and could impair our ability to raise capital by selling additional securities.

We do not intend to pay dividends on our common stock.

We have never declared or paid any cash dividend on our common stock. We currently intend to retain any future earnings and do not expect to pay any dividends on our common stock in the foreseeable future.

We may incur penalties if the registration statement covering the common stock underlying the Series A Convertible Preferred Stock and the Common Stock Purchase Warrants does not remain effective.

Under the terms of the registration rights agreement we entered into with the holders of our Series A Convertible Preferred Stock, we are obligated to register the common stock underlying the Series A Convertible Preferred Stock and the Common Stock Purchase Warrants. The registration rights carry penalties in the event we do not meet these registration obligations. The registration statement registering the common stock underlying the Series A Convertible Preferred Stock and the Common Stock Purchase Warrants was declared effective by the Securities and Exchange Commission on September 16, 2008. We agreed to use our commercially reasonable best efforts to ensure the continued effectiveness of the registration statement thereafter. In the event sales of any or all of the securities covered by the registration statement cannot be made, whether because of our failure to keep the registration statement effective, or for various other reasons, then we must pay liquidated damages in cash to the holders of our Series A Convertible Preferred Stock in the amount of 1.0% per month, on a daily pro rata basis, up to a maximum of 8.0%, of the aggregate purchase price of \$6,000,000.

We have issued and could issue “blank check” preferred stock without stockholder approval with the effect of diluting then current stockholder interests.

Our certificate of incorporation authorizes the issuance of up to 1,000,000 shares of “blank check” preferred stock with designations, rights and preferences as may be determined from time to time by our board of directors. Accordingly, our board of directors is empowered, without stockholder approval, to issue a series of preferred stock with dividend, liquidation, conversion, voting or other rights, which could dilute the interest of, or impair the voting power of, our stockholders. The issuance of a series of preferred stock could be used as a method of discouraging, delaying or preventing a change in control. Although we do not presently intend to issue any additional shares of preferred stock, we may do so in the future. On June 16, 2008, we issued 60,000 shares of Series A Convertible Preferred Stock to Redpoint Ventures. In the event Redpoint Ventures exercises a warrant we granted it, we will issue shares of Series B Convertible Preferred Stock.

The holders of our Series A Convertible Preferred Stock are entitled to receive liquidation payments in preference to the holders of our common stock.

Pursuant to the terms of the certificate of designation creating the Series A Convertible Preferred Stock, upon a liquidation of our company, the holders of shares of the Series A Convertible Preferred Stock are entitled to receive a liquidation payment prior to the payment of any amount with respect to the shares of our common stock. The amount of this preferential liquidation payment is equal to the greater of (i) \$100 per share of Series A Convertible Preferred Stock, plus the amount of any accrued but unpaid dividends on those shares and any other fees or liquidated damages owing thereon or (ii) such amount per share as would have been payable had all shares of Series A Convertible Preferred Stock been upon any such liquidation converted to common stock immediately prior to such liquidation.

Dividends accrue on the shares of Series A Convertible Preferred Stock at a rate of 6% per annum. In addition, in the event the Unit Warrant is exercised we will issue up to 70,000 shares of Series B Convertible Preferred Stock. If issued, the Series B Convertible Preferred Stock would have pari passu rights with the Series A Convertible Preferred Stock upon a liquidation of our company to receive a liquidation payment prior to the payment of any amount with respect to the shares of our common stock on substantially similar terms as the Series A Convertible Preferred Stock.

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Provisions in our charter documents and under Delaware law could discourage a takeover that stockholders may consider favorable.

Provisions of our Amended and Restated Certificate of Incorporation and Bylaws could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. For example, our board of directors is divided into three classes, with one class being elected each year by our stockholders, which generally makes it more difficult for stockholders to replace a majority of directors and obtain control of our board. In addition, stockholder meetings may be called only by our board of directors, the chairman of the board and the president, advance notice is required prior to stockholder proposals and stockholders may not act by written consent. Furthermore, we have authorized preferred stock that is undesignated, making it possible for our board of directors to issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to change control of our company.

Delaware law also could make it more difficult for a third party to acquire us. Specifically, Section 203 of the Delaware General Corporation Law, to which our company is subject, may have an anti-takeover effect with respect to transactions not approved in advance by our board of directors, including discouraging attempts that might result in a premium over the market price for the shares of common stock held by our stockholders.

We are at risk of securities class action litigation.

Securities class action litigation has often been brought against a company following a decline in the market price of its securities. This risk is especially relevant for us because Internet companies often experience significant stock price volatility. If we faced such litigation, it could result in substantial costs and diversion of management's attention and resources, which could adversely affect our business.

As of December 31, 2007, we determined that we had material weaknesses in our internal control over financial reporting. As a result, current and potential stockholders could lose confidence in our financial reporting, which could harm our business and trading price of our stock.

Section 404 of the Sarbanes-Oxley Act of 2002 and the related rules and regulations of the SEC require annual management assessments of the effectiveness of our internal control over financial reporting. As of December 31, 2007, we were also required to obtain and disclose a report by our independent registered public accounting firm attesting to and reporting on these controls. We dedicated significant amounts of time and resources to ensure compliance with this legislation for the year ended December 31, 2007. Based on their evaluation, our principal executive and principal financial officers concluded that, as of December 31, 2007, our disclosure controls and procedures were not effective due to the material weaknesses in our internal controls over (i) access to, and changes in, our information technology financial applications and underlying financial data; and (ii) the authority of our officers to obligate the Company. Because of these material weaknesses, our management concluded that, as of December 31, 2007, we did not maintain effective internal control over financial reporting based on the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Additionally, our auditors issued an adverse opinion with respect to the effectiveness of our internal controls over financial reporting as of December 31, 2007.

Although we remediated the material weaknesses by removing our controller as the information technology administrator for our enterprise resource management system in March 2008 and by adopting an approval policy that limits the authority of certain officers to obligate us in April 2008, current and potential stockholders could negatively view the abovementioned material weaknesses and lose confidence in our financial reporting which could harm our business and trading price of our common stock.

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Material weaknesses in our internal controls may impede our ability to produce timely and accurate financial statements, which could cause us to fail to file our periodic reports timely, result in inaccurate financial reporting or restatements of our financial statements, subject our stock to delisting and materially harm our business reputation and stock price.

As a public company, we are required to file annual and quarterly periodic reports containing our financial statements with the Securities and Exchange Commission within prescribed time periods. As part of The NASDAQ Capital Market listing requirements, we are also required to provide our periodic reports, or make them available, to our shareholders within prescribed time periods. If we are required to restate our financial statements in the future, any specific adjustment may be adverse and may cause our operating results and financial condition, as restated, on an overall basis to be materially and adversely impacted. As a result, we or members of our management could be the subject of adverse publicity, investigations and sanctions by such regulatory authorities as the Securities and Exchange Commission and subject to shareholder lawsuits. Any of the above consequences could cause our stock price to decline materially and could impose significant unanticipated costs on us.

If we are not able to issue our financial statements in a timely manner, we will not be able to comply with the periodic reporting requirements of the Securities and Exchange Commission and the listing requirements of The NASDAQ Capital Market. If these events occur, our common stock listing on The NASDAQ Capital Market could be suspended or terminated and our stock price could materially suffer. In addition, we or members of our management could be subject to investigation and sanction by the Securities and Exchange Commission and other regulatory authorities and to shareholder lawsuits, which could impose significant additional costs on us, divert management attention and materially harm our operating results, financial condition, business reputation and stock price.

Risks Related to our Location in Israel

Conditions in Israel may limit our ability to produce and sell our product, which would lead to a decrease in revenues.

Because most of our operations are conducted in Israel, our operations are directly affected by economic, political and military conditions affecting Israel. Specifically, we could be adversely affected by:

- any hostilities involving Israel;
- a full or partial mobilization of the reserve forces of the Israeli army;
- the interruption or curtailment of trade between Israel and its present trading partners;
- risks associated with the fact that a certain number of our key employees and one officer reside in what are commonly referred to as occupied territories;
- risks associated with outages and disruptions of communications networks due to any hostilities involving Israel; or
- a significant downturn in the economic or financial conditions in Israel.

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors and a state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Despite negotiations to effect peace between Israel and its Arab neighbors, the future of these peace efforts is uncertain. Since October 2000, there has been a significant increase in violence, civil unrest and hostility, including armed clashes between the State of Israel and the Palestinians, and acts of terror have been committed inside Israel and against Israeli targets in the West Bank and Gaza Strip. In addition, the armed conflict with Hezbollah on the

northern border of Israel during the summer of 2006 and the most recent armed conflict with Hamas on the southern border of Israel negatively affected business conditions in Israel. There is no indication as to how long the current hostilities will last or whether there will be any further escalation. Any further escalation in these hostilities or any future conflict, political instability or violence in the region may have a negative effect on our business, harm our results of operations and adversely affect our share price.

Furthermore, there are a number of countries that restrict business with Israel or with Israeli companies, which may limit our ability to promote our products and services those countries.

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We may not be able to enforce covenants not-to-compete under current Israeli law that might result in added competition for our products.

We have non-competition agreements with all of our employees, almost all of which are governed by Israeli law. These agreements prohibit our employees from competing with or working for our competitors, generally during and for up to 12 months after termination of their employment. However, Israeli courts are reluctant to enforce non-compete undertakings of former employees and tend, if at all, to enforce those provisions for relatively brief periods of time in restricted geographical areas and only when the employee has obtained unique value to the employer specific to that employer's business and not just regarding the professional development of the employee. If we are not able to enforce non-compete covenants, we may be faced with added competition.

The Israeli government tax benefits program in which we currently participate and from which we receive benefits requires us to meet several conditions. These programs or benefits may be terminated or reduced in the future, which may result in an increase in our tax liability.

Our Israeli subsidiary receives tax benefits authorized under Israeli law for capital investments that are designated as "Approved Enterprises." To be eligible for these tax benefits, we must meet certain conditions. If we fail to meet such conditions, these tax benefits could be cancelled, and we could be required to pay increased taxes or refund the amount of tax benefits we received, together with interest and penalties. Israeli governmental authorities have indicated that the government may in the future reduce or eliminate the benefits of such programs. The termination or reduction of these programs and tax benefits could increase our Israeli tax rates, and thereby reduce our net profits or increase our net losses.

U.S. and Israeli tax authorities may interpret tax issues in manners other than those which we have adopted, which may expose us to tax liabilities.

We operate in the U.S. and in Israel and our earnings are subject to taxation in both jurisdictions, at different rates. Relevant tax authorities may disagree with our interpretation and application in practice of tax laws and may dispute various assumptions we make during our tax planning process. Further, the tax authorities in the U.S. and/or Israel may take exception with the transfer price of transactions between Answers Corporation and its wholly owned Israeli subsidiary. If there is a successful tax challenge of our tax position, our interpretation and/or application of tax laws in practice, we may be forced to recognize additional tax liabilities, which may include interest and penalties. This may harm our results of operations and adversely affect our financial condition.

Our business may be impacted by NIS exchange rate fluctuations, which may negatively affect our earnings.

Exchange rate fluctuations between the U.S. dollar and the NIS may negatively affect our earnings. Our revenues are denominated in U.S. dollars. However, a significant portion of our expenses, associated with our Israeli operations, including personnel and facilities-related expenses, are incurred in NIS. Consequently, a devaluation of the U.S. dollar in comparison to the NIS will have the effect of increasing the dollar cost of our operations in Israel. In 2008 and 2007, the average value of the dollar declined 12.7% and 7.8%, respectively, as compared to its value in the years immediately preceding such years. We cannot predict any future trends in the rate of devaluation or appreciation of the NIS against the U.S. dollar or of the U.S. dollar against the NIS. Despite the fact that we often use various hedging tools, including forward contracts and options, to minimize the effect of currency fluctuations on our income, if the U.S. dollar cost of our operations in Israel increases, our dollar-measured consolidated results of operations will be adversely affected.

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our New York office, which serves as our corporate U.S. headquarters for investor relations, sales, marketing, community development and business development operations, is located at 237 West 35th Street, Suite 1101, New York, NY 10001 and occupies a portion of the 11th floor at this location. The lease for these premises commenced in May 2005 and will expire in June 2010, and, according to its terms, the average base rent for the offices during the first year is approximately \$66,000 per annum, gradually increasing to approximately \$74,000 per annum for the final year.

Our research and development facility is located on the entire 7th floor of the Tower (Building 2), Jerusalem Technology Park, P.O. Box 48253, Jerusalem 91481, Israel in approximately 1,000 square meters of space, occupied under a 5-year lease with a current monthly rental rate of \$19,000 based on the Dollar-NIS exchange rate on December 31, 2008. The lease will expire in July 2010, with an option to extend the term for an additional 5 years.

We may require additional space for our expanding operations, both in Israel and New York, before the expiration of these leases. We believe that there is suitable space available in the local markets (although for the New York office, possibly not in our current facilities) at reasonable rates that is available to us if we need expansion space prior to the end of our leases.

ITEM 3. LEGAL PROCEEDINGS

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

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted to a vote of our security holders during the fourth quarter of the fiscal year ended December 31, 2008.

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PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON STOCK, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock has been quoted on the NASDAQ Global Market under the symbol "ANSW" between August 2, 2005 and September 28, 2008 and on the NASDAQ Capital Market, under the same symbol, since September 29, 2008. Prior to August 2, 2005, our common stock was traded on the American Stock Exchange, under the symbol GRU, between October 13, 2004 and August 1, 2005. There was no established market for our shares before October 13, 2004. The following table sets forth the high and low closing sale prices for our common stock as quoted on the NASDAQ Global Market (or the NASDAQ Capital Market, as the case may be) for the fiscal years ended December 31, 2007 and 2008 and the subsequent period indicated.

	High	Low
Year ended December 31, 2007		
First quarter	\$14.84	\$11.24
Second quarter	\$17.12	\$10.14
Third quarter	\$13.20	\$6.20
Fourth quarter	\$9.15	\$5.58
Year ending December 31, 2008		
First quarter	\$6.93	\$3.76
Second quarter	\$5.52	\$3.27
Third quarter	\$5.77	\$2.82
Fourth quarter	\$7.23	\$3.70
Year ending December 31, 2009		
First quarter (through March 6, 2009)	\$9.56	\$5.73

The closing sale price of our common stock as reported by the NASDAQ Capital Market on March 6, 2009 was \$6.00 per share.

As of March 6, 2009, there were approximately 44 holders of record of our common stock (not including beneficial owners holding shares in nominee accounts). We have not paid any cash dividends since formation and we do not expect to pay any cash dividends in the foreseeable future. During 2008 we did not repurchase any shares of our common stock. Except as disclosed in this Annual Report (see Item 7), we have not sold any securities during the past three years which were not registered under the Securities Act. For details concerning securities authorized for issuance under our equity compensation plans, see Item 12 of this Annual Report.

Equity Compensation Plan Information

The following table sets forth certain information at December 31, 2008 with respect to our compensation plans that provide for the issuance of options, warrants or rights to purchase our securities.

No. of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	No. of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
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(c)

Equity compensation plans approved by security holders	2,066,484	\$8.87	424,651
Equity compensation plans not approved by security holders	35,651	\$2.23	—
Total	2,102,135		424,651

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with, and is qualified in its entirety by, our financial statements (and notes related thereto) and other more detailed financial information appearing elsewhere in this report. Consequently, you should read the following discussion and analysis of our financial condition and results of operations together with such financial statements and other financial data included elsewhere in this report. Some of the information contained in this discussion and analysis or set forth elsewhere in this report, including information with respect to our plans and strategy for our business, includes forward-looking statements that involve risks and uncertainties. You should review the "Risk Factors" section of this report for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis. See also "Risk Factors" in Part I, Item 1A, of this report.

Overview

We own and operate two leading Web properties dedicated to providing useful answers in thousands of categories. WikiAnswers.com is a community-based social knowledge Q&A platform, leveraging wiki-based technologies. Through the contributions of WikiAnswers.com's user-community and dedicated volunteer supervisors, answers to the site's growing database of questions are added and improved over time. Our award-winning reference site, Answers.com, includes reference content on millions of topics from over 250 licensed sources. According to comScore, our Web properties had approximately 25.6 million unique visitors in January 2009, ranking Answers Corporation number 33 in the top U.S. Web properties for that month. Our goal is to become the leading online provider of answers about anything and the best place for people to share answers to questions.

On September 29, 2008, the listing of our common stock was transferred from The NASDAQ Global Market to The NASDAQ Capital Market. Our trading symbol was not impacted and remains "ANSW".

Redpoint Financing

On June 16, 2008, pursuant to a private placement of our securities, Redpoint Omega, L.P. and Redpoint Omega Associates, LLC (collectively, "Redpoint") purchased \$6,000,000 of our Series A Convertible Preferred Stock, initially convertible into 1,333,333 shares of common stock at a conversion price of \$4.50 per share, along with Common Stock Purchase Warrants exercisable for 666,667 shares of common stock at an exercise price of \$4.95 per share ("Series A Purchase Warrants"). In conjunction therewith, Redpoint also received a warrant, exercisable until June 16, 2009, to purchase units of up to \$7 million of Series B Convertible Preferred Stock (70,000 shares) and Common Stock Purchase Warrants exercisable for 636,364 shares of common stock ("Series B Purchase Warrants"). The warrant to purchase units of Series B Convertible Preferred Stock and Series B Purchase Warrants is referred to as the "Series B Unit Warrant". The Series B Convertible Preferred Stock is initially convertible into 1,272,727 shares of common stock at a conversion price of \$5.50 per share. The Series B Purchase Warrants have an exercise price of \$6.05 per share. After deducting placement agent fees and legal expenses, our net proceeds from the private placement were \$5,380 thousand. This transaction is collectively referred to as the "Redpoint Financing". The Series A Convertible Preferred Stock, the Series B Convertible Preferred Stock, the Series A Purchase Warrants and the Series B Purchase Warrants are collectively referred to as the "Redpoint Securities".

The Series A Convertible Preferred Stock has the rights and preferences set forth in our Certificate of Designations, Number, Voting Powers, Preferences and Rights of Series A Convertible Preferred Stock, which, as of its date of

filing on June 16, 2008, amended our Amended and Restated Certificate of Incorporation. The Series B Convertible Preferred Stock, if purchased by Redpoint pursuant to the Series B Unit Warrant, will have similar rights and preferences as the Series A Convertible Preferred Stock. For a detailed description of the rights and preferences of the Series A Convertible Preferred Stock, we refer you to the notes to the financial statements included in this annual report.

In connection with the Redpoint Financing, Redpoint received the right to appoint an individual to serve as a voting member of our board of directors. If Redpoint exercises the Series B Unit Warrant and meets certain ownership requirements, it will be entitled to appoint a second member to our board.

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In connection with the private placement, we entered into a registration rights agreement with Redpoint, pursuant to which we agreed to register with the SEC, for resale, the common stock underlying the Redpoint Securities. In connection with the registration rights agreement, we agreed to pay a penalty of 1.0% per month, on a daily pro rata basis, up to a maximum of 8.0%, of the aggregate purchase price, as partial liquidated damages, for certain default events and subject to certain circumstances. The partial liquidated damages will trigger if the registration statement filed with the SEC on July 30, 2008, and declared effective on September 16, 2008, ceases to remain continuously effective.

The accounting for this transaction is discussed in the notes to the accompanying financial statements.

Revenue

Traffic

Our revenue is driven by the traffic generated by our Web properties and our ability to effectively monetize that traffic. Our current sources of traffic include the following:

Search engines: Users submit queries and search engines respond by generating a list of Web pages that they deem likely to offer the most relevant content. When our pages rank high in the algorithmic systems of search engines, our results are more likely to be accessed by users. For the fourth quarter and full year of 2008, according to our internal estimates, this source of traffic represented approximately 80% and 76% of our overall traffic, respectively.

Direct users: Users visiting and returning to our home pages, and to a far lesser extent, arriving from Web properties that send us traffic, or via 1-Click Answers and AnswerTips. For the fourth quarter and full year of 2008, according to our internal estimates, direct users represented approximately 15% and 18% of our overall traffic, respectively.

Google's definition link: We have an informal, non-contractual relationship with Google under which Google links certain search results related to definitional queries to Answers.com. For the fourth quarter and full year of 2008, according to our internal estimates, this source of traffic represented approximately 5% and 6% of our overall traffic, respectively.

Since most of our traffic originates from search engines, we expend considerable resources improving the volume of this traffic. The industry commonly refers to such efforts as search engine optimization, or SEO. Our Web properties have at times experienced decreases in traffic, and consequently decreases in revenue, due to search engine actions, including actions by Google. In July 2007, a search engine algorithm adjustment by Google led to a drop in Google directed traffic to Answers.com. This adjustment reduced our overall traffic by approximately 28% based on the average traffic directed to Answers.com from Google for the week prior to the adjustment as compared to the week after. As a result, our revenue also declined proportionately. The change made by Google did not affect the traffic directed to WikiAnswers.com.

Monetization

Advertising Revenue. We earn practically all of our revenue from advertising. There are two primary categories of Internet advertising: pay-per-performance, also known as cost-per-click, or CPC, and pay-per-impression, also known as display ads or cost per 1,000 impressions, or CPM. In the pay-per-performance model, we earn revenue based on the number of clicks associated with an ad; in the pay-per-impression model, we derive revenue from the display of ads. The overwhelming majority of our advertising revenue is earned from CPC advertising. We obtain CPC and CPM advertisements from third-party ad networks. These ad networks compensate us by paying us a portion of the revenue they earn from advertisers for our provision of promotional space on our Web properties.

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We gauge the effectiveness of our monetization efforts and trends by measuring our revenue per thousand page views, or RPM. Throughout this annual report, we refer to estimates of traffic, or page views. In our Management's Discussion and Analysis of Financial Condition and Results of Operations prior to our quarterly report on Form 10-Q for the quarterly period ended June 30, 2008, we tracked the traffic on our Answers.com and WikiAnswers.com Web properties using two separate systems:

- Answers.com traffic was measured using our internally developed server-side, log-based system ("Internal Data Warehouse"). This system was designed to identify traffic from search engine robots and other known Web robots, commonly referred to as Web spiders or Web crawlers, as well as from suspected automated spidering scripts, and excludes such traffic from the traffic activity measurements.
- WikiAnswers.com traffic was tracked using HBX Analytics, a tag-based web analytics system offered by Omniture, Inc. (formerly offered by WebSideStory). Traffic measurements from this system are generated by our placement of tags on our WikiAnswers.com pages. The HBX Analytics system then independently generates traffic metrics. WikiAnswers.com community-related statistics, including total number of questions, answers and users, are generated from the WikiAnswers.com Web property.

Beginning with the Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our quarterly report on Form 10-Q for the quarterly period ended June 30, 2008, all traffic measurements (including measurements previously reported in past filings using our Internal Data Warehouse) for Answers.com are also presented based on the HBX Analytics data. We estimate that the historical page views for Answers.com pursuant to HBX Analytics data, as set forth in our reports beginning with our quarterly report on Form 10-Q for the quarterly period ended June 30, 2008, are approximately 11% lower than the traffic measurements reported in previous filings. Consequently, our Answers.com RPMs, as reported in those reports, are higher than previous filings.

We also use Google, Inc.'s Google Analytics measurement services and Google AdSense data for various internal analyses. Our breakdown of our traffic sources, noted above, is based on such data. Google Analytics measurements are generated by our placement of tags on our Web properties' pages, which Google Analytics uses to count and report audience metrics independently.

In this Annual Report, statistics gathered from HBX Analytics and Google Analytics are also referred to as "internal estimates".

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

Our primary third party ad network, Google AdSense, accounted for approximately 88% of our total revenue in the fourth quarter of 2008 as compared to approximately 60% of our total revenue in the fourth quarter of 2007. Google AdSense accounted for approximately 82% of our total revenue in 2008 as compared to approximately 64% of our total revenue in 2007. We obtain CPC ads from Google. In addition to Google, we utilize the services of other third party ad networks that provide us with CPM ads. We expect that for at least the next year, CPC ads will continue to generate the overwhelming majority of our revenue, and we have no plans to reduce our reliance on CPC ads. Although there are many companies that provide third party ad networks, the loss of Google as a third party ad network could have a material adverse impact on our financial condition and results of operations, as we may not succeed in receiving terms and ad services as favorable as those provided under our Google Services Agreement (GSA). The GSA was last renewed for an additional two years, through January 31, 2010.

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Direct Ad Sales. In an effort to improve monetization, in the fourth quarter of 2006, we began marketing directly to advertisers and generating additional advertising revenue through an in-house team of direct ads salespeople. However, at the end of the second quarter of 2008 we decided to suspend this business initiative, and by the end of the third quarter of 2008 we no longer employed a sales staff. We initially saw promise in this area, with the belief that our Web properties would see RPM increases as a result of direct ad sales. In the fourth quarter of 2007, the sales force generated \$575 thousand of direct ad revenue. However, direct ad revenue in 2008 was disappointing, with Q1 at \$231 thousand and Q2 at \$200 thousand. At the end of the second quarter we came to believe that the horizontal, educational, reference nature of Answers.com www.answers.com made direct ads less compelling for this Web property, as compared to vertical sites that direct advertisers often prefer. While we viewed WikiAnswers.com as having the potential to successfully implement a direct ad sales strategy, we decided not to pursue that strategy and to instead focus on selling ads through advertising networks, primarily Google AdSense. This decision has allowed us to focus on our core competency – growing the WikiAnswers.com community, growing traffic to our Web properties and monetizing via Google and other ad networks.

Licensing Revenue. We also earn a very minor portion of our revenues from partners that pay us for providing them with our answer-based services that they then use in their own products, via co-branded Web pages. Revenue from these arrangements are based on various formulas, including fees based on the number of user queries and fixed periodic fees.

Costs and Expenses

Cost of Revenue

Cost of revenue consists of fees to third parties to license content, data center costs, including depreciation of information technology assets, compensation, travel and overhead costs relating to personnel who are engaged in content editing, content integration and production operations, Web search service fees, ad serving fees, amortization of the cost of acquired software used in our products, and contractual revenue sharing fees to various Web property operators for visitors directed to our Web properties, or traffic acquisition costs. As revenues increase, we expect our cost of revenue as a percentage of revenue to decrease, since many of its components, such as content licensing, are not directly tied to revenue. Notwithstanding, in the first half of 2009, our cost of revenue, as a percentage of revenue, is expected to increase as we add our second colocation facility.

Research and Development Expenses

Research and development expenses consist of compensation, travel and overhead costs of personnel conducting research and development of our products and services, and consulting costs. Our research and development team works primarily on projects to improve and enhance product functionality, quality, performance, user interface, and monetization. We generally expect that our research and development expenses will decline as a percentage of revenue as we grow our revenue.

Sales, Marketing and Community Development Expenses

Sales, marketing and community development expenses consist of compensation, travel and overhead costs of personnel in-charge of sales and marketing, and developing and encouraging the WikiAnswers.com community of users asking and answering questions and volunteer supervisors; product management; marketing and market information services, public relations and promotional costs. As a result of our termination of direct ad sales in 2008, we expect the primary future growth in this expense line item will be in the area of WikiAnswers.com community development. We generally expect that our sales, marketing and community development expenses will decline as a percentage of revenue as we grow our revenue.

General and Administrative Expenses

General and administrative expenses consist primarily of compensation, travel and overhead costs for financial, legal, human resource, and other administrative personnel, insurance fees, professional services, including investor relations, legal, accounting, payroll and other consulting fees, amortization of domain names, and other general corporate expenses. We generally expect that our general and administrative expenses will decline as a percentage of revenue as we grow our revenue.

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Overhead Costs

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

Stock-Based Compensation

New employees typically receive stock option awards within three months of their start date. From time-to-time, we also grant additional stock option awards to existing employees and directors. We account for stock-based awards under SFAS No. 123 (revised 2004), "Share-Based Payments", or SFAS 123R, which requires measurement of compensation cost for all stock-based awards at fair value on date of grant and recognition of compensation over the service period awards are expected to vest. Costs resulting from stock-based compensation are part of our compensation expense and are included in the operating expense categories in our Statement of Operations.

Impact of Currency Fluctuations

The dollar cost of our operations in Israel is heavily influenced by changes in the value of the dollar in relation to the New Israeli Shekel ("NIS"), mostly due to the NIS-based salaries of our Israel-based employees. In 2008 and 2007, the average value of the dollar declined 12.7% and 7.8%, respectively, as compared to its value in the years immediately preceding such years. In 2008 and 2007, approximately \$6.5 million and \$4.5 million of our expenses, respectively, were NIS-based, thus the devaluation noted above, significantly influenced our operating expenses. While hedging activities somewhat reduced the impact of the devaluation of the dollar during those periods, we absorbed most of the devaluation.

We expect our NIS-based expenses in 2009, to at least remain at the 2008 levels, thus, if the dollar continues to fluctuate as compared to the NIS, we will experience further fluctuation in the dollar amount of our expenses.

Write-off of the Brainboost Answer Engine

In December 2005, we acquired Brainboost Technology, LLC, developer of the Brainboost Answer Engine, or the BAE, an artificial intelligence technology enabling natural language question-and-answer search on the Web. As consideration for the acquisition, we paid \$4.0 million in cash and 439,000 shares of restricted stock, valued at approximately \$5.6 million at the time of the acquisition. In connection with the initial allocation of the purchase price, we recorded an intangible asset, the BAE, with an estimated useful life of six years, of approximately \$5.4 million. Since the acquisition, through the first quarter of 2008, we spent time further developing the BAE and integrating it into our Answers.com Web property.

In November 2006, we acquired a Web property, then known as www.faqfarm.com, and subsequently rebranded as WikiAnswers.com, a dynamic, user-generated, questions and answers website. Although handled in different ways, BAE and WikiAnswers.com are effectively focused on similar areas, answering complex natural language questions. Since its acquisition, WikiAnswers.com has grown significantly, in terms of both traffic and revenue. Conversely, during that period, Answers.com traffic and revenue has been in decline. Detailed information regarding these trends is provided in the revenue discussion in this annual report. As a result of that trend, and the success of user-generated questions and answers as compared to the technology-driven answers presented by the BAE, we made a strategic decision in the second quarter of 2008 to focus our efforts, in the realm of questions-and-answers, on user-generated questions and answers, and effectively abandoned our use of the BAE. This strategic decision was reflected in a change that we made to Answers.com on May 25, 2008. Prior to that date, users asking a question on Answers.com caused the site to access the BAE in an attempt to locate an answer on the Web. The BAE results were then presented on the Answers.com result page. Beginning May 25, 2008, users no longer received BAE-derived result pages, rather they were instead encouraged to post their question to WikiAnswers.com, and in a less pronounced fashion, offered a

link to another page for purposes of accessing BAE should they wish to do so. This user-interface change virtually eliminated the use of the BAE as demonstrated by the elimination of virtually all BAE-derived page views. In November 2008, we eliminated the link to the BAE.

As a result of our decision to effectively abandon our use of the BAE, the net book value of the BAE, as of May 25, 2008, in the amount of \$3,138 thousand, was written off in the three months ended June 30, 2008.

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Termination fees and write-off of cost relating to the terminated Lexico acquisition and abandoned follow-on offering

In the first quarter of 2008, we recorded a charge of \$2,543 thousand consisting of \$1,618 thousand of accounting, legal, banking, consulting and travel costs we incurred in 2007 and in the first quarter of 2008, in connection with the abandoned acquisition of Lexico and follow-on offering of securities, and \$925 thousand relating to termination fees we paid as a result of the termination of the acquisition and a Securities Purchase Agreement with an institutional investor, for the optional purchase and sale of \$8.5 million of our senior secured convertible notes. A summary of the events that led to the termination of the acquisition and financing follows:

On July 13, 2007, we entered into a Purchase Agreement that we subsequently amended on July 31, 2007 and November 12, 2007; and on January 15, 2008 we entered into an Amended and Restated Purchase Agreement, which we subsequently amended on February 8, 2008, to acquire all of the outstanding limited liability interests of Lexico Publishing Group, LLC for an aggregate purchase price of \$100 million in cash, subject to adjustments for closing net working capital. Consummation of the acquisition of Lexico was subject to our ability to secure financing for the acquisition.

On July 17, 2007, we filed a universal shelf registration statement on Form S-3 with the Securities and Exchange Commission which was declared effective on August 6, 2007. The registration statement covers up to an aggregate of \$140 million of common stock, preferred stock, warrants, debt securities, units or any combination thereof. On January 16, 2008, we filed a prospectus supplement for a proposed public offering which we later amended on February 8, 2008. On February 13, 2008 we canceled our proposed public offering due to unfavorable market conditions. On March 1, 2008, the members of Lexico terminated the purchase agreement, due to our inability to finance the acquisition. Additionally, in connection with the Lexico transaction, on January 15, 2008, we entered into a Securities Purchase Agreement with an institutional investor, or the senior notes investor, for the optional purchase and sale of \$8.5 million of our senior secured convertible notes. Our intent was to close the senior secured convertible notes financing in conjunction with our follow-on offering, if we needed such funds to close the Lexico acquisition. Since our purchase agreement with Lexico was terminated, the Securities Purchase Agreement also terminated.

Interest Income (Expense), Net

Interest income (expense), net, is comprised of interest income earned on cash, cash equivalents and investment security balances, and amortization of deferred costs we incurred in connection with the issuance of the Series B Unit Warrant.

Other Income (Expense), Net

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

Loss Resulting from Fair Value Adjustment of Warrant to Purchase Units of Series B Preferred Stock and Warrants

The Series B Unit Warrant is revalued each reporting date. Any change to its fair value is recorded as a loss in the statement of operations.

Income Tax Benefit (Expense), Net

Our effective tax rate differs from the statutory federal rate due to differences between income and expense recognition prescribed by income tax regulations and Generally Accepted Accounting Principles. We utilize different methods and useful lives for depreciating and amortizing property, equipment and intangible assets and different methods and timing for certain expenses. Furthermore, permanent differences arise from certain income and expense

items recorded for financial reporting purposes but not recognizable for income tax purposes. In addition, our income tax expense has been adjusted for the effect of state and local taxes and foreign income from our wholly owned subsidiary. At December 31, 2008, our deferred tax assets are fully offset by a valuation allowance because realization depends on generating future taxable income, which, in our estimation, is not more likely than not to transpire.

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Our Israeli subsidiary had net income in 2008 and 2007, resulting from services we receive from the Israeli subsidiary. The Israeli subsidiary charges us for research & development and certain management services it provides us, plus a profit margin ranging from 6 to 12.5%. However, the subsidiary is an “approved enterprise” under Israeli law, which means that income arising from the subsidiary’s approved research & development activities, is subject to zero tax under the “alternative benefit” path for a period of ten years. Management services are taxable at the Israeli corporate tax rate in effect at the time (27% in 2008). Currently, the subsidiary operates under two separate “approved enterprise” plans, ending December 31, 2009 and December 31, 2014, respectively. In the event of distributions by the subsidiary to the parent, the subsidiary would have to pay a 10% corporate tax on the amount distributed, and the recipient would have to pay a 15% tax to be withheld at source on the amounts of such distribution received. At present, we do not plan on having the subsidiary distribute a dividend to Answers Corporation.

Revenue

	Year Ended December 31,		
	2008	2007	Change
	(\$ - in thousands)		
WikiAnswers.com advertising revenue	7,524	1,302	6,222
Answers.com advertising revenue	6,622	9,449	(2,827)
Answers services licensing revenue	81	219	(138)
Subscription revenue	-	425	(425)
	14,227	11,395	2,832

Revenue increased \$2,832 thousand, or 25%, to \$14,227 thousand for the year ended December 31, 2008 from \$11,395 thousand for the year ended December 31, 2007.

WikiAnswers.com advertising revenue in 2008 increased \$6,222 thousand compared to 2007, due to increases in traffic, and to a lesser extent, due to improvement in RPM. WikiAnswers.com average daily page views in 2008 were 2,916,000, an increase of 360% compared to the average daily page views of 633,000 in 2007. We believe that the dramatic growth that WikiAnswers.com has experienced since we acquired it, in November 2006, is primarily due to the unique dynamics of the site. As our database of questions and answers grows, we draw new traffic, primarily from SEO, which in turn results in the creation of new questions and answers, or new content, which in turn drives additional growth. This is a self-perpetuating growth model. The WikiAnswers.com RPM in 2008 was \$7.07, an increase of 26% compared to the RPM of \$5.63 in 2007. The increase is primarily due to the inclusion of WikiAnswers.com under our Google Services Agreement in November 2007, replacing the standard AdSense terms that governed the site prior to our acquisition of WikiAnswers.com.

Answers.com advertising revenue in 2008 decreased \$2,827 thousand compared to 2007. The decrease was the result of decreased traffic, and to a lesser extent, due to lower RPM. Answers.com average daily page views in 2008 were 2,890,000, a decline of 28% compared to the average daily page views of 4,021,000 in 2007. The decline in traffic is primarily due to the July 2007 Google algorithm change that significantly impacted Answers.com traffic, reducing our overall traffic by approximately 28% based on the average traffic directed to Answers.com from Google for the week prior to the adjustment as compared to the week after. As a result, our revenue also declined proportionately. The Answers.com RPM in 2008 was \$6.28, a decrease of 2%, compared to the RPM of \$6.44, in 2007. We have found that this metric often moves up or down moderately due to many factors including how we are evaluated by our advertising partners.

Historically, we operated on the premise that adding rich unique content to Answers.com positively impacted the site’s traffic growth, guided by the principle that rich unique content was not only appreciated by the human user, but was

also highly valued by the search engines and their content indexing programs. While Answers.com receives significant SEO traffic to its rich content pages, the Google algorithm change caused us to doubt whether licensing additional content would yield a positive return. During the last few months we made certain changes to and ran certain tests on Answers.com that have led us to believe that adding content may, once again, be a viable way to grow traffic, thus, we are planning on licensing new content in order to grow Answers.com. Notwithstanding, given the significance of the opportunity we believe we have with WikiAnswers.com, we do not expect to invest significant amounts of resources, above current levels, to implement a strategy of licensing new content.

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Approximately \$660 thousand and \$990 thousand of our advertising revenue in 2008 and 2007, respectively, resulted from the efforts of our direct ad sales force. In an effort to improve monetization, in the fourth quarter of 2006, we began marketing directly to advertisers and generating additional advertising revenue. However, at the end of the second quarter of 2008 we decided to abandon that effort, and by the end of the third quarter of 2008, all of our direct sales staff left the Company.

Subscription revenue in 2007 of \$425 thousand resulted from the recognition of revenue from the sale of lifetime subscriptions to our GuruNet service prior to December 2003. As of December 31, 2006, we had approximately \$425 thousand of deferred revenue relating to these subscriptions. Prior to 2007, we did not recognize any revenue from the lifetime subscriptions to our GuruNet service because the subscriptions had no defined term. On February 2, 2007, in accordance with our rights under the agreements we entered into with such subscribers, we terminated the GuruNet service and thereby extinguished our service obligations to our subscribers. As a result, we recognized the entire \$425 thousand previously deferred, as revenue, in the first quarter of 2007. After the launch of Answers.com in January 2005, we ceased offering new subscriptions to GuruNet.

Revenue Trends by Web Property

The following table illustrates the historical trends of our two Web properties' average daily traffic, revenues and RPMs, by quarter, beginning the first quarter of 2007:

	2007				2008			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Ad Revenue (\$ - in thousands)								
Answers.com	2,768	2,551	1,861	2,270	1,828	1,485	1,579	1,730
WikiAnswers.com	116	177	304	704	1,185	1,500	1,960	2,879
Total	2,884	2,728	2,165	2,974	3,013	2,985	3,539	4,609
Answers.com	96%	94%	86%	76%	61%	50%	45%	38%
WikiAnswers.com	4%	6%	14%	24%	39%	50%	55%	62%
Total	100%	100%	100%	100%	100%	100%	100%	100%
Traffic								
Answers.com	4,945,000	4,441,000	3,276,000	3,447,000	3,225,000	2,641,000	2,666,000	3,027,000
WikiAnswers.com	293,000	440,000	639,000	1,152,000	1,885,000	2,318,000	3,094,000	4,350,000
Total	5,238,000	4,881,000	3,915,000	4,599,000	5,110,000	4,959,000	5,760,000	7,377,000
Answers.com	94%	91%	84%	75%	63%	53%	46%	41%
WikiAnswers.com	6%	9%	16%	25%	37%	47%	54%	59%
Total	100%	100%	100%	100%	100%	100%	100%	100%
RPM								
Answers.com	\$6.22	\$6.31	\$6.17	\$7.16	\$6.23	\$6.18	\$6.44	\$6.21
WikiAnswers.com	\$4.40	\$4.42	\$5.17	\$6.64	\$6.95	\$7.11	\$6.89	\$7.19

Since we purchased WikiAnswers.com in November 2006, the website has grown significantly, each quarter, both in terms of traffic and revenue. Conversely, in 2007, and especially beginning the third quarter of 2007, when we experienced a drop in our traffic due to a search engine algorithm adjustment by Google, Answers.com's traffic and revenue have been in decline. We expect the aforesaid trends of our individual Web properties to continue in 2009.

The current general economic downturn may result in fewer page views that result in commercial activities by our users, and may cause advertisers to reduce the amount they spend on online advertising. These potential developments could have a significant negative impact on the RPM of both our Web properties. In fact, our RPM has shown some moderate decline in the first quarter of 2009, which we believe is due to both the seasonality of advertising rates as well as the general economic downturn. We believe that, to date, we have been better insulated from the economic downturn than many other content websites due to the fact that the overwhelming majority of our ad revenue is earned from CPC ads, which appear to have been less negatively impacted by the economic downturn than CPM ads. It is still uncertain whether our RPM will be further negatively impacted in 2009.

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Additionally, our CPC revenue, which is earned through Google, is governed by our GSA, which is scheduled to expire on January 31, 2010. Renewal of the GSA in February 2010 on terms less favorable to us than the current terms, including the revenue-share percentage, could result in reduced revenue from CPC ads.

We do not expect the current general economic downturn to affect our expected overall growth in traffic.

Costs and Expenses

Cost of Revenue

	Year Ended December 31,		
	2008	2007	Change
	(\$ - in thousands)		
Cost of revenue	4,641	4,890	(249)

Cost of revenue decreased \$249 thousand, or 5%, to \$4,641, in 2008 from \$4,890 in 2007. The change in cost of revenue was due primarily to the following factors: Amortization expense from intangible technology assets we purchased in connection with the Brainboost acquisition that took place in December 2005 and the WikiAnswers.com acquisition that took place in November 2006 decreased \$593 thousand. Such decrease transpired because we wrote off the Brainboost Answer Engine on May 25, 2008, thus we only recorded \$358 thousand of Brainboost Answer Engine amortization in 2008, as compared the full twelve months of amortization, of \$892 thousand, recorded in 2007. The amortization of the intangible assets related to WikiAnswers.com decreased by \$59 thousand in 2008, as compared to 2007, since we use accelerated depreciation to amortize the database of questions and answers we acquired in conjunction with the acquisition of WikiAnswers. Additionally, there was a decrease in data center costs (including depreciation of information technology assets) of \$93 thousand, due to our moving to our own colocation facility rather than managed hosting. In a colocation facility, many of the tasks that were handled by the managed hosting provider are now handled by our employees, thus the fees we pay are lower. The aforesaid decreases were partially offset by increases in compensation costs of \$307 thousand as a result of staffing additions, salary increases and the weak U.S. dollar as compared to the New Israel Shekel, increases in traffic acquisition costs of \$22 thousand, increases in ad serving fees of \$29 thousand, increases in travel of \$32 thousand, increases in content licensing costs of \$42 thousand, and higher overhead of \$20 thousand.

Research and Development Expenses

	Year Ended December 31,		
	2008	2007	Change
	(\$ - in thousands)		
Research and development	3,482	2,978	504

Research and development expenses increased \$504 thousand, or 17%, to \$3,482 thousand in 2008 from \$2,978 thousand in 2007. The change in research and development expenses was due primarily to an increase of \$463 thousand in compensation, as a result of salary increases, the weak U.S. dollar as compared to the New Israel Shekel, and new hires, and higher overhead of \$44 thousand.

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Sales, Marketing and Community Development Expenses

	Year Ended December 31,		
	2008	2007	Change
	(\$ - in thousands)		
Sales, marketing and Community Development	2,734	3,951	(1,217)

Sales, marketing and community development expenses decreased \$1,217 thousand or 31%, to \$2,734, in 2008, from \$3,951 in 2007. The decrease in sales and marketing expenses is due primarily to the following factors: Compensation related expenses, excluding stock-based compensation, decreased \$737 thousand, mostly due to the termination of our Chief Revenue Officer in the third quarter of 2007, and the termination of our direct ad sales team in the second and third quarters of 2008. Additionally, stock-based compensation decreased \$536 thousand, mostly due to the termination of employment of our Chief Revenue Officer in the third quarter of 2007. The termination of our direct ad sales team also resulted in a reduction of \$31 thousand in allocated overhead expenses, and marketing related expenses decreased \$37 thousand. The aforesaid decreases were partially offset by a charge of \$132 thousand, in the second quarter of 2008, to account for the estimated cost of terminating certain service contracts relating to our abandoned direct ad sales efforts.

General and Administrative Expenses

	Year Ended December 31,		
	2008	2007	Change
	(\$ - in thousands)		
General and administrative	4,799	4,020	779

General and administrative expenses increased \$779 thousand, or 19%, to \$4,799 thousand in 2008 from \$4,020 thousand in 2007. The change in general and administrative expenses was due primarily to the following factors: Compensation costs, excluding stock-based compensation, increased by \$344 thousand as a result of salary increases and the weak U.S. dollar as compared to the New Israel Shekel, and stock-based compensation rose \$98 thousand. Investor relations and stock administration fees increased \$101 thousand, mostly due to our retaining an external investor relations firm in the second quarter of 2008. Additionally, insurance increased \$73 thousand, travel expenses increased \$58 thousand, overhead increased \$33 thousand and accounting and legal fees increased \$20 thousand.

Write-off of the Brainboost Answer Engine

	Year Ended December 31,		
	2008	2007	Change
	(\$ - in thousands)		
Write-off of the Brainboost Answer Engine	3,138	-	3,138

As a result of our decision to effectively abandon our use of the BAE, the net book value of the BAE, as of May 25, 2008, in the amount of \$3,138 thousand, has been written off and the resulting charge is included in our statement of operations for 2008.

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Termination fees and write-off of costs relating to the terminated Lexico acquisition and abandoned follow-on offering

	Year Ended December 31,		
	2008	2007	Change
	(\$ - in thousands)		
Termination fees and write-off of costs relating to the terminated Lexico acquisition and abandoned follow-on offering	2,543	-	2,543

In 2008, we recorded a charge of \$2,543 thousand for various costs and fees we incurred in connection with the terminated acquisition of Lexico and the follow-on offering of securities.

Interest Income (Expense), Net

	Year Ended December 31,		
	2008	2007	Change
	(\$ - in thousands)		
Interest income (expense), net	(55)	385	(440)

Interest income (expense), net decreased \$440 thousand to \$(55) thousand (expense), net, in 2008 from \$385 thousand, income, net, in 2007. The change in interest income (expense), net resulted from certain transaction costs that we incurred in connection with the Series B Unit Warrant, which have been deferred and are being amortized to interest expense over one year. In 2008, \$196 thousand of such deferred costs were amortized and charged to interest expense, while we had no similar charge in 2007. Further, interest earned from our cash balance in 2008 was \$149 thousand, compared to interest earned of \$385 thousand, during 2007. The reduction in interest income earned on our cash balances was the result of lower short-term interest rates.

Loss Resulting from Fair Value Adjustment of Warrant to Purchase Units of Series B Preferred Stock and Warrants

	Year Ended December 31,		
	2008	2007	Change
	(\$ - in thousands)		
Loss Resulting from Fair Value Adjustment of Series B Unit Warrant	(5,187)	-	(5,187)

The Series B Unit Warrant is revalued each reporting date, and any change to its fair value is recorded in the statement of operations. The primary reason for the increase in the value of this liability in 2008 was the increase in the market value of our common stock between the date we issued the Series B Unit Warrant, June 16, 2008, and December 31, 2008, from \$3.92 to \$7.13.

Other Income (Expenses), Net

	Year Ended December		
	31,		
	2008	2007	Change
	(\$ - in thousands)		
Other income (expense), net	19	(11)	30

Other income (expense), net, in 2008 was \$19 thousand, income, net, compared to \$(11) thousand (expense), net, in 2007. Other income (expense), net, results from foreign currency net gains and losses.

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Income Tax Benefit (Expense), Net

We had net operating loss carryforwards, or NOLs, for federal income tax purposes of approximately \$59 million at December 31, 2008, and approximately \$54 million at December 31, 2007. The federal net operating losses will expire if not utilized on various dates from 2019 through 2028. Because we have experienced one or more ownership changes, within the meaning of Section 382 of the Internal Revenue Code of 1986, as amended, an annual limitation is imposed on our ability to use at least \$32 million of these carryforwards. We estimate that the annual limitation on the use of such \$32 million of our NOLs is approximately \$1.8 million per year. Any unused portion of the \$1.8 million annual limitation applicable to our restricted NOLs is available for use in future years until such NOLs are scheduled to expire. The recent Redpoint Financing and other financing events that transpired since October 2004 may further impact our ability to use our NOLs, however, since we have not conducted a Section 382 Study since October 2004 we cannot make that determination. Our Israeli subsidiary has capital loss carryforwards of approximately \$775 thousand that can be applied to future capital gains for an unlimited period of time under current tax rules.

We file U.S. federal, various state & local and foreign income tax returns. Answers Corporation is no longer subject to U.S. federal income tax examinations by tax authorities for years prior to 2005 and state & local income tax examinations for years prior to 2006. In September 2008, the Israeli income tax authorities completed its audit of our Israeli subsidiary for the tax years 2004 through 2006, resulting in no adjustments. As a result of the findings of such audit, we reversed previously accrued tax provisions for uncertain positions, during the third quarter of 2008.

Liquidity and Capital Resources

In 2008 and 2007, our principal sources of liquidity were our cash inflows from revenues and cash and cash equivalents, and investment securities that were raised through various financing events that took place through June 2008. Going forward, we expect that our principal source of liquidity will be cash inflows from operations. We further expect that such cash inflows from operations will be sufficient to fund our capital expenditures. Further, if Redpoint decides to exercise their Series B Unit Warrant, of up to \$7 million, between now and June 16, 2009, that could add to liquidity in 2009.

	Year ended December 31,	
	2008	2007
	(\$ - in thousands)	
Net cash used in operating activities	(299)	(647)
Net cash provided by investing activities	82	2,420
Net cash provided by (used in) financing activities	5,196	(54)

Operating Activities

Despite a net loss of \$12,251 thousand in 2008, net cash used in operations was only \$299 thousand. The adjustments to reconcile the two amounts, including changes to the balances of our various operating assets and liabilities, are noted in detail on the accompanying statement of cash flows. The largest reconciling item is the loss resulting from the fair value adjustment of the Series B Unit Warrant of \$5,187 thousand. The primary factor that caused the fair value of the Series B Unit Warrant, a liability on our balance sheet, to rise, is the rise in our stock price between June 16, 2008, the closing date of the Redpoint transaction, and December 31, 2008. Should Redpoint exercise such warrant, which terminates after June 16, 2009, such investment will add an additional \$7 million of liquidity. Other very large reconciling items were the write-off of the Brainboost Answers Engine of \$3,138 thousand, \$1,719

thousand of operating expenses that were the result of non-cash stock-based compensation to employees and directors, and depreciation and amortization of \$1,329 thousand.

Despite a net loss of \$4,118 thousand in 2007, net cash used by operations was \$647 thousand. The adjustments to reconcile the two amounts, including changes to the balances of our various operating assets and liabilities, are noted in detail on the accompanying statement of cash flows. The largest reconciling items resulted from the fact that we incurred \$2,123 thousand of non-cash, stock-based compensation to employees and directors, depreciation and amortization of \$1,797 thousand, while recognizing \$425 thousand of previously deferred revenue from lifetime subscriptions we sold for our GuruNet service in 2003.

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Investing Activities

Net cash provided by investing activities of \$82 thousand, in 2008, is attributable to the proceeds from the sale of investment securities of \$700 thousand, less cash used to increase long-term deposits of \$60 thousand and cash used for capital expenditures of \$558 thousand.

Net cash provided by investing activities in 2007 is attributable mostly to the proceeds from the sale of investment securities less cash used from purchases of investment securities, and cash used for capital expenditures, long-term deposits and deferred costs relating to the proposed Lexico acquisition, as delineated in our Consolidated Statement of Cash Flows.

Financing Activities

Net cash flow from financing activities in 2008 of \$5,196 thousand was mostly from the Redpoint Financing, which raised \$5,380 thousand after expenses. The other factors impacting net cash flow from financing activities are delineated in the accompanying statement of cash flows.

Cash flow used in financing activities in 2007 stems from deferred costs relating to the proposed Lexico financing, less net proceeds from the exercise of stock options, as delineated our Consolidated Statement of Cash Flows.

Future Operations

As a result of the Redpoint Financing in June 2008, we raised net proceeds of approximately \$5.4 million, significantly improving our cash position. As part of the Redpoint Financing, Redpoint received the Series B Unit Warrant, a warrant to purchase units, exercisable at any time until June 16, 2009, for up to \$7 million of Series B Convertible Preferred Stock (70,000 shares) and Series B Purchase Warrants. The Series A Preferred Stock contains a redemption provision which allows the holder of a majority of the Series A Preferred Stock to request redemption, at any time on or after June 16, 2014, of all or any part of the outstanding Series A Preferred Stock. If issued, the Series B Preferred Stock would have a similar redemption provision.

The 2008 funding we received from Redpoint is important to us because of prior events that decreased our cash position considerably. In connection with the abandoned proposed public offering and the terminated Lexico purchase agreement, we made cash payments of \$1,878 thousand in the first quarter of 2008, in addition to the \$663 thousand we expended in 2007, for termination fees and costs. These payments had a material impact on the balance of our cash and cash equivalents, which were \$5,462 thousand as of March 31, 2008.

Based on our current cash and cash equivalents levels and expected cash flow from operations, we believe we have sufficient cash and cash equivalents to meet our working capital and operating requirements for the next twelve months, irrespective of whether we receive additional funding pursuant to the Series B Unit Warrant. Further, in estimating our expected cash flow during the next twelve months we have considered the current general economic downturn and its impact on our future revenue, as discussed in the earlier revenue discussion.

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

Off-Balance Sheet Arrangements

Except for the Series A Purchase Warrant described in note 9 to the financial statements in Item 8 below, we have not entered into any transactions with unconsolidated entities in which we have financial guarantees, subordinated retained interests, derivative instruments or other contingent arrangements that expose us to material continuing risks, contingent liabilities or any other obligations under a variable interest in an unconsolidated entity that provides us with financing, liquidity, market risk or credit risk support.

Critical Accounting Estimates

While our significant accounting policies are more fully described in the notes to our audited consolidated financial statements for the years ended December 31, 2008 and 2007, we believe the following accounting policies to be the most critical in understanding the judgments and estimates we use in preparing our consolidated financial statements.

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Goodwill, Intangibles and Other Long-Lived Assets

We account for our purchases of acquired companies (for those acquired before December 31, 2008) in accordance with SFAS No. 141, "Business Combinations", or SFAS 141, and for goodwill and other identifiable definite and indefinite-lived acquired intangible assets in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets", or SFAS 142. Additionally, we review our long-lived assets for recoverability in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", or SFAS 144.

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

We evaluate our long-lived tangible and intangible assets for impairment in accordance with SFAS 142, with the annual impairment testing date set at September 30, and in accordance with SFAS 144 whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. While we use available information to prepare our estimates and to perform impairment evaluations, the completion of annual impairment tests requires significant management judgments and estimates.

As of December 31, 2008, we determined that there were no events or changes in circumstances indicating that the carrying amount of an asset may not be recoverable; therefore, there was no need to evaluate the recoverability or compute impairment of our long-lived assets.

In response to the search engine algorithm adjustment by Google in July 2007, we examined what impact this event might have on the recoverability of our long-lived assets in accordance with the guidance contained in SFAS 142 and SFAS 144. As a result of our analysis, we concluded that the carrying value of our assets had not been impaired. However, while we use available information to prepare our estimates and to perform impairment evaluations, our recoverability calculations and impairment tests require significant management judgment and estimates. These estimates included our projections of undiscounted cash flows and assumptions used in calculating projected RPM, page-views, and expenses. In preparing such estimates we considered many factors including historical and seasonal trends, industry and macro-economic trends and specific company initiatives and plans. In addition, a certain degree of judgment was exercised in determining asset groups in accordance with generally accepted accounting principles. Had our estimates and assumptions differed, the accounting treatment might have resulted differently. Future actual results could differ significantly from the anticipated results as reflected in our analysis.

Accounting for Stock-based Compensation

We account for stock-based awards under SFAS No. 123R which requires measurement of compensation cost for all stock-based awards at fair value on date of grant and recognition of compensation over the service period for awards expected to vest, using the modified prospective method. The estimation of stock awards that will ultimately vest requires judgment, and to the extent actual results differ from our estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. We consider various factors when estimating expected forfeitures, including historical experience. Actual results may differ substantially from these estimates.

We determine the fair value of stock options granted to employees and directors using the Black-Scholes valuation model, which considers the exercise price relative to the market value of the underlying stock, the expected stock price volatility, the risk-free interest rate and the dividend yield, and the estimated period of time option grants will be outstanding before they are ultimately exercised. Subsequent to our IPO, through 2006, we did not have sufficient history to predict our volatility and therefore our assumptions about stock price volatility were based on the volatility rates of comparable publicly held companies. These rates may or may not reflect our actual stock price volatility. During 2007, as we accumulated our own volatility history over longer periods of time, our assumptions about our stock price volatility were based on a rate that was derived by taking into consideration the volatility rates of the aforesaid comparable publicly held companies as well as our own historical volatility rates. Beginning 2008, we are estimating our expected stock volatility based solely on our own historical stock volatility rates. Had we made different assumptions about our stock price volatility or the estimated time option and warrant grants will be outstanding before they are ultimately exercised, the related stock based compensation expense and our net loss and net loss per share amounts could have been significantly different, in 2008 and 2007.

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Accounting for Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves management estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not more likely than not, we must establish a valuation allowance. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. At December 31, 2008, we have fully offset our U.S. net deferred tax asset with a valuation allowance. Our lack of earnings history and the uncertainty surrounding our ability to generate US taxable income prior to the expiration of such deferred tax assets were the primary factors considered by management in establishing the valuation allowance.

In July 2006, FASB released FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement 109", or FIN 48, effective for fiscal years beginning after December 15, 2006. FIN 48 prescribes how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. Additionally, for tax positions to qualify for deferred tax benefit recognition under FIN 48, the position must have at least a "more likely than not" chance of being sustained upon challenge by the respective taxing authorities. We adopted the provisions of FIN 48 as of January 1, 2007 and it has not had a material impact on our financial statements.

Redpoint Financing

In accounting for the Redpoint Financing, the proceeds were first allocated to the Series B Unit Warrant, which was classified as a current liability, based on its fair value, and the residual amount was allocated among the Series A Convertible Preferred Stock and the Series A Warrants based on their relative fair values, all in accordance with the guidance in SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity", and EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock". Further, The Series B Unit Warrant is revalued at each reporting date.

We used various valuation models and techniques to determine the individual values of the three components, including Monte Carlo and Black-Scholes. Inputs used in the models include our stock price and risk-free interest rate. Additionally, significant assumptions used in applying these techniques include redemption behavior estimates (including likelihood of forced conversion, and timing of liquidation event if such event transpires) and expected volatility of our stock price. While we believe we have applied appropriate judgment in the aforesaid assumptions, variations in judgment could have a material effect upon the valuation results, and thus, on our financial statements.

The Series A Convertible Preferred Stock issued as part of the Redpoint Financing contains an embedded conversion option which could possibly require separate accounting under SFAS No. 133 – "Accounting for Derivative Instruments and Hedging Activities"(SFAS 133). According to paragraph 12(a) of SFAS 133, in order to determine whether separate accounting is required, one has to evaluate whether the economic characteristics and risks of the conversion option are closely related to the host contract, and the nature of the host contract. We exercised judgment and evaluated this matter in accordance with EITF Topic D-109, "Determining the Nature of a Host Contract Related to a Hybrid Financial Instrument Issued in the Form of a Share under FASB Statement No.133" (Topic D-109). Topic D-109 conveys the SEC staff's views on determining whether the characteristics of a host contract in a hybrid financial instrument issued in the form of a share is more akin to debt or equity. In evaluating an embedded derivative feature for separation under SFAS 133, the consideration of the economic characteristics and risks of the host contract should not ignore the stated or implied substantive terms and features of the hybrid financial instrument. We

considered various factors including, redemption provisions, stated rate, voting rights, whether returns are discretionary or mandatory, collateral requirements, participation in residual earnings and liquidation preferences, in making our determination that the host contract was more akin to equity. The most important factor that led us to the conclusion that the host contract was more akin to equity was the fact that the redemption feature was not mandatory or likely to occur. Had we determined that the host contract was more akin to debt and not equity it would have impacted the accounting for the host contract and the embedded conversion option and could have had a material impact on our financial statements.

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Recently Issued Accounting Pronouncements

In March 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards 161, "Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133" (SFAS 161). SFAS 161 gives financial statement users better information about the reporting entity's hedges by providing for qualitative disclosures about the objectives and strategies for using derivatives, quantitative data about the fair value of and gains and losses on derivative contracts, and details of credit-risk-related contingent features in their hedged positions. SFAS 161 is effective for financial statements issued for fiscal years beginning after November 15, 2008 and interim periods within those years. The adoption of SFAS 161 is not expected to have a material impact on our consolidated financial position, results of operations or cash flows.

In April 2008, the FASB issued FASB Staff Position FAS 142-3, "Determination of the Useful Life of Intangible Assets". FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under Statement 142. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the impact, if any, of adopting FSP FAS 142-3 on our financial position and results of operations.

On May 9, 2008, the FASB issued FASB Staff Position No. APB 14-1(FSP APB 14-1), "Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)". FSP APB 14-1 requires issuers of convertible debt that may be settled wholly or partly in cash when converted to account for the debt and equity components separately. FSP APB 14-1 is effective for fiscal years beginning after December 15, 2008 and must be applied retrospectively to all periods presented. The adoption of FSP APB 14-1 is not expected to have a material impact on our consolidated financial position, results of operations or cash flows.

In June 2008, the FASB ratified the consensus of EITF Issue No. 07-5, "Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock". EITF 07-5 responded to practice questions about whether an instrument or embedded feature is indexed to the reporting company's own stock by establishing a framework for the determinations and by nullifying some previous requirements. The adoption of EITF 07-5's requirements will affect issuers' accounting for warrants and many convertible instruments with provisions that protect holders from declines in the stock price ("down-round" provisions). Warrants with such provisions will no longer be recorded in equity, and many of the convertible instruments with such provisions will have to be bifurcated, with the conversion option separately accounted for as a derivative under SFAS 133. EITF 07-5 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. It will initially be applied by recording a cumulative-effect adjustment to opening retained earnings at the date of adoption for the effect on outstanding instruments. The adoption of EITF 07-5 will have a material impact on our consolidated financial position and results of operations and is discussed in Note 9 to the accompanying financial statements.

Quarterly Results

The following table sets forth our historical unaudited quarterly consolidated statement of operations data and certain non-GAAP financial measures beginning 2007. You should read this information together with our unaudited consolidated financial statements and the related notes appearing elsewhere in our filings. The results of historical periods are not necessarily indicative of the results of operations for a full year or any future period.

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	Quarter Ended							
	Mar. 31, 2007	Jun. 30, 2007	Sep. 30, 2007	Dec. 31, 2007	Mar. 31, 2008	Jun. 30, 2008	Sep. 30, 2008	Dec. 31, 2008
	(in thousands, except page view and RPM data)							
Revenues:								
Advertising revenue	\$ 2,884	\$ 2,728	\$ 2,165	\$ 2,974	\$ 3,013	\$ 2,985	\$ 3,539	\$4,609
Answers services licensing	77	82	43	17	18	18	24	21
Subscriptions	425	—	—	—	—	—	—	—
	3,386	2,810	2,208	2,991	3,031	3,003	3,563	4,630
Costs and expenses:								
Cost of revenue	1,144	1,320	1,179	1,247	1,393	1,416	945	887
Research and development	722	748	769	739	875	929	866	812
Sales and marketing	982	1,072	1,221	676	762	933	563	476
General and administrative	926	1,019	1,058	1,017	1,131	1,198	1,311	1,159
Write-off of the Brainboost Answers Engine	—	—	—	—	—	3,138	—	—
Termination fees and write-off of costs relating to the terminated Lexico acquisition and abandoned follow-on offering	—	—	—	—	2,543	—	—	—
Total operating expenses	3,774	4,159	4,227	3,679	6,704	7,614	3,685	3,334
Operating loss	(388)	(1,349)	(2,019)	(688)	(3,673)	(4,611)	(131)	1,296
Interest income (expense), net	100	112	88	85	55	18	(43)	(86)
Other income (expense), net	(15)	4	—	—	(38)	(11)	11	57
Loss resulting from fair value adjustment of warrant to purchase units of Series B preferred stock and warrants	—	—	—	—	—	—	(2,056)	(3,131)
Loss before income taxes	(303)	(1,233)	(1,931)	(603)	(3,655)	(4,604)	(2,210)	(1,864)
Income tax benefit (expense), net	—	(14)	(19)	(15)	(11)	(15)	91	17

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Net loss	\$(303)	\$(1,247)	\$(1,950)	\$(618)	\$(3,667)	\$(4,619)	\$(2,119)	\$(1,847)
Other Data:								
Adjusted EBITDA(1)	\$160	\$(306)	\$(727)	\$180	\$(181)	\$(670)	\$520	\$1,950
Answers.com average daily page views	4,945,000	4,441,000	3,276,000	3,447,000	3,225,000	2,641,000	2,666,000	3,027,000
WikiAnswers.com average daily page views	293,000	440,000	639,000	1,152,000	1,885,000	2,318,000	3,094,000	4,350,000
Answers.com RPM	\$6.22	\$6.31	\$6.17	\$7.16	\$6.23	\$6.18	\$6.44	\$6.21
WikiAnswers.com RPM	\$4.40	\$4.42	\$5.17	\$6.64	\$6.95	\$7.11	\$6.89	\$7.19

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(1) We define Adjusted EBITDA as net earnings before interest, Loss Resulting from Fair Value Adjustment of Warrant to Purchase Units of Series B Preferred Stock and Warrants, taxes, depreciation, amortization, stock-based compensation, foreign currency exchange rate differences and certain non-recurring revenues and expenses.

We use Adjusted EBITDA as an additional measure of our overall performance for purposes of business decision-making, developing budgets and managing expenditures. It is useful because it removes the impact of our capital structure (interest expense and Loss Resulting from Fair Value Adjustment of Warrant to Purchase Units of Series B Preferred Stock and Warrants), asset base (amortization and depreciation), stock-based compensation expenses, taxes, foreign currency exchange rate differences and certain non-recurring revenues and expenses from our results of operations. We believe that the presentation of Adjusted EBITDA provides useful information to investors in their analysis of our results of operations for reasons similar to the reasons why we find it useful and because these measures enhance their overall understanding of the financial performance and prospects of our ongoing business operations. By reporting Adjusted EBITDA, we provide a basis for comparison of our business operations between current, past and future periods, and peer companies in our industry.

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

- **Amortization of Intangible Assets.** Adjusted EBITDA disregards amortization of intangible assets and other specified costs resulting from acquisitions. Specifically, we exclude (a) amortization, and the write-off, of acquired technology from our acquisition of Brainboost Technology, LLC, or Brainboost, developer of the Brainboost Answer Engine in December 2005; and (b) amortization of intangible assets resulting from the acquisition of WikiAnswers.com and other related assets in November 2006. These acquisitions resulted in operating expenses that would not otherwise have been incurred. We believe that excluding these expenses is helpful to investors, due to the fact that they derive from prior acquisition decisions and are not necessarily indicative of future operating expenses. In addition, we believe that the amount of such expenses in any specific period may not directly correlate to the underlying performance of our core business operations. While we exclude the aforesaid expenses from Adjusted EBITDA we do not exclude revenues derived as a result of such acquisitions. The revenue attributable to WikiAnswers.com in 2008 and 2007 was \$7,524 thousand, and \$1,302 thousand, respectively. The revenue attributable to our acquisition of the Brainboost technology was not quantifiable due to the nature of its integration.
- **Stock-based Compensation Expense.** Adjusted EBITDA disregards expenses associated with stock-based compensation, a non-cash expense arising from the grant of stock-based awards to employees and directors. We believe that, because of the variety of equity awards used by companies, the varying methodologies for determining stock-based compensation expense, and the subjective assumptions involved in those determinations, excluding stock-based compensation from Adjusted EBITDA enhances the ability of management and investors to compare financial results over multiple periods.
- **Depreciation, Interest, Loss Resulting from Fair Value Adjustment of Warrant to Purchase Units of Series B Preferred Stock and Warrants, Taxes and foreign currency gains (losses).** We believe that, excluding these items from the Adjusted EBITDA measure provides investors with additional information to measure our performance, by excluding potential differences caused by variations in capital structures (affecting interest expense), asset composition, and tax positions.
- **Terminated Lexico Acquisition and Follow-On Offering.** Adjusted EBITDA disregards \$2,543 thousand in costs associated with our terminated acquisition of Lexico and the cancellation of our follow-on offering. We believe that, excluding these costs provides investors with additional information to measure our core business performance, by excluding events that are of a non-recurring nature.

- Prior to December 2003, we sold lifetime subscriptions to our GuruNet service, generally for \$40 per subscription. In December 2003, we decided to alter our pricing model and moved to an annual subscription model, for which we generally charged our subscribers \$30 per year. We have not sold subscriptions since our launch of Answers.com in January 2005. In February 2007, we terminated the GuruNet service and recognized \$425 thousand of deferred revenue as revenue during the quarter ended March 31, 2007. We believe that the recognition of the \$425 thousand of revenue is a one-time, non-cash event and is not reflective of our core business and core operating results, and we have therefore excluded this amount from Adjusted EBITDA.

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

- Non-GAAP financial measures are not based on a comprehensive set of accounting rules or principles;
- Many of the adjustments to Adjusted EBITDA reflect the exclusion of items that are recurring and will be reflected in our financial results for the foreseeable future;
- Other companies, including other companies in our industry, may calculate Adjusted EBITDA differently than us, thus limiting its usefulness as a comparative tool;
- Adjusted EBITDA does not reflect the periodic costs of certain tangible and intangible assets used in generating revenues in our business;
 - Adjusted EBITDA does not reflect interest income from our investments in cash and investment securities;
 - Adjusted EBITDA does not reflect interest expense and other cost relating to financing our business, including Loss Resulting from Fair Value Adjustment of Warrant to Purchase Units of Series B Preferred Stock and Warrants;
 - Adjusted EBITDA does not reflect foreign currency gains and losses;
 - Adjusted EBITDA excludes taxes, which is an integral cost of doing business; and
- Because Adjusted EBITDA does not include stock-based compensation, it does not reflect the cost of granting employees equity awards, a key factor in management's ability to hire and retain employees.

We compensate for these limitations by providing specific information in the reconciliation of Adjusted EBITDA to the GAAP net loss, as follows:

	Quarter Ended							
	Mar. 31, 2007	Jun. 30, 2007	Sep. 30, 2007	Dec. 31, 2007	Mar. 31, 2008	Jun. 30, 2008	Sep. 30, 2008	Dec. 31, 2008
Net loss	\$(303)	\$(1,247)	\$(1,950)	\$(618)	\$(3,667)	\$(4,619)	\$(2,119)	\$(1,847)
Interest (income) expense, net	(100)	(112)	(88)	(85)	(55)	(18)	43	86
Foreign currency (gains) losses	15	(4)	—	—	38	11	(11)	(57)
Income tax (benefit) expense, net	—	14	19	15	11	15	(91)	(17)
Depreciation and amortization	448	444	464	442	448	383	250	248
Stock-based compensation	525	599	574	426	501	420	392	406
Write-off of the Brainboost Answers Engine	—	—	—	—	—	3,138	—	—
Termination fees and write-off of costs relating to	—	—	—	—	2,543	—	—	—

the terminated Lexico acquisition and abandoned follow-on offering									
Loss resulting from fair value adjustment of warrant to purchase units of Series B preferred stock and warrants	—	—	—	—	—	—	2,056	3,131	
Cost related to August 2007 layoff	—	—	254	—	—	—	—	—	—
Subscription revenue from lifetime subscriptions	(425)	—	—	—	—	—	—	—	—
Adjusted EBITDA	\$160	\$(306)	\$(727)	\$180	\$(181)	\$(670)	\$520	\$1,950	

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following are the consolidated financial statements and exhibits of Answers Corporation and its consolidated subsidiary, which are filed as part of this Annual Report.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Answers Corporation:

We have audited the accompanying consolidated balance sheets of Answers Corporation and Subsidiary (collectively referred to as “the Company”) as of December 31, 2008 and 2007, and the related consolidated statements of operations, changes in stockholders’ equity and comprehensive loss, and cash flows for each of the years in the two-year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Answers Corporation and Subsidiary as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2008, in conformity with US generally accepted accounting principles.

As discussed in Note 2(o) to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No.157, Fair Value Measurements, as of January 1, 2008, for fair value measurements of all financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis.

/s/ Somekh Chaikin

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

Jerusalem, Israel

March 9, 2009

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Answers Corporation and Subsidiary

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

	December 31 2008 \$	December 31 2007 \$
Assets		
Current assets:		
Cash and cash equivalents	11,739	6,778
Investment securities	-	700
Accounts receivable	1,680	1,448
Prepaid expenses and other current assets	818	487
Total current assets	14,237	9,413
Long-term deposits (restricted)	257	196
Deposits in respect of employee severance obligations	1,337	1,232
Property and equipment, net	1,234	1,012
Other assets:		
Intangible assets, net	994	4,766
Goodwill	437	437
Prepaid expenses, long-term, and other assets	220	275
Deferred charges (Lexico acquisition and public offering)	-	1,267
Total other assets	1,651	6,745
Total assets	18,716	18,598
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	537	968
Accrued expenses	751	1,045
Accrued compensation	628	551
Warrant to purchase units of Series B preferred stock and warrants	8,698	-
Capital lease obligation – current portion	78	-
Deferred revenues	16	16
Total current liabilities	10,708	2,580
Long-term liabilities:		
Liability in respect of employee severance obligations	1,534	1,233
Capital lease obligation, net of current portion	106	-
Deferred tax liability, long-term	26	14
Total long-term liabilities	1,666	1,247
Commitments and contingencies		

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Series A convertible preferred stock: \$0.01 par value; stated value of \$100 per share; aggregate redemption amount and liquidation preference of \$6,000,000; 6% cumulative annual dividend; 60,000 shares authorized, 60,000 and 0 shares issued and outstanding as of December 31, 2008 and 2007, respectively	624	-
Stockholders' equity:		
Preferred stock: \$0.01 par value; 940,000 shares authorized, none issued	-	-
Common stock: \$0.001 par value; 100,000,000 and 30,000,000 shares authorized; 7,870,538 and 7,859,890 shares issued and outstanding as of December 31, 2008 and 2007, respectively	8	8
Additional paid-in capital	77,091	73,893
Accumulated other comprehensive loss	(28)	(28)
Accumulated deficit	(71,353)	(59,102)
Total stockholders' equity	5,718	14,771
Total liabilities and stockholders' equity	18,716	18,598

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

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Answers Corporation and Subsidiary

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

	Year ended December 31	
	2008	2007
	\$	\$
Revenues:		
Advertising revenue	14,146	10,751
Answers service licensing	81	219
Subscriptions	-	425
	14,227	11,395
Costs and expenses:		
Cost of revenue	4,641	4,890
Research and development	3,482	2,978
Sales, marketing and community development	2,734	3,951
General and administrative	4,799	4,020
Write-off of the Brainboost Answer Engine	3,138	-
Termination fees and write-off of costs relating to the terminated Lexico acquisition and abandoned follow-on offering	2,543	-
	21,337	15,839
Total operating expenses	21,337	15,839
Operating loss	(7,110)	(4,444)
Interest income (expense), net	(55)	385
Other income (expense), net	19	(11)
Loss resulting from fair value adjustment of warrant to purchase units of Series B preferred stock and warrants	(5,187)	-
Loss before income taxes		