NEUSTAR INC
Form 10-Q
May 15, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended March 31, 2006

OR

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

For the transition period from to

Commission file number 001-32548

NeuStar, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**52-2141938**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

46000 Center Oak Plaza
Sterling, Virginia 20166
(Address of principal executive offices) (zip code)
(571) 434-5400
(Registrant s telephone number, including area code)

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

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

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

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

There were 71,930,850 shares of Class A common stock, $0.001 par value, and 27,284 shares of Class B common stock, $0.001 par value, outstanding at May 1, 2006.

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PART I - FINANCIAL INFORMATION
Item 1. Financial Statements

NEUSTAR, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	December 31, 2005	March 31, 2006 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 27,529	$ 16,002
Restricted cash	374	378
Short-term investments	75,946	97,472
Accounts receivable, net of allowance for doubtful accounts of $494 and $594, respectively	30,982	44,444
Unbilled receivables	6,394	7,702
Securitized notes receivable	1,074	434
Prepaid expenses and other current assets	8,054	5,866
Deferred costs	4,819	5,277
Income tax receivable	14,595	34,096
Deferred tax asset	12,216	6,455
Total current assets	181,983	218,126
Property and equipment, net	39,627	38,358
Goodwill	51,495	53,135
Intangible assets, net	2,655	6,449
Deferred costs, long-term	5,454	5,115
Other assets	557	416
Total assets	$ 281,771	$ 321,599

See accompanying notes.

NEUSTAR, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	December 31, 2005	March 31, 2006 (unaudited)
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 4,119	$ 2,149
Accrued expenses	36,880	23,754
Deferred revenue	20,006	21,413
Notes payable	1,232	1,040
Capital lease obligations	5,540	5,375
Accrued restructuring reserve	536	441
Total current liabilities	68,313	54,172
Deferred revenue, long-term	18,463	19,033
Notes payable, long-term	1,019	718
Capital lease obligations, long-term	3,440	2,093
Accrued restructuring reserve, long-term	2,572	2,482
Other liabilities	500	500
Deferred tax liability	1,197	1,116
Total liabilities	95,504	80,114
Minority interest	104	
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.001 par value; 100,000,000 shares authorized; No shares issued or outstanding as of December 31, 2005 and March 31, 2006		
Class A common stock, par value $0.001; 200,000,000 shares authorized; 68,150,690 and 71,467,364 shares issued and outstanding at December 31, 2005 and March 31, 2006, respectively	68	71
Class B common stock, par value $0.001; 100,000,000 shares authorized; 199,152 and 27,284 shares issued and outstanding at December 31, 2005 and March 31, 2006, respectively		
Additional paid-in capital	163,741	199,329
Deferred stock compensation	(1,446)	
Retained earnings	23,800	42,085
Total stockholders equity	186,163	241,485
Total liabilities and stockholders equity	$ 281,771	$ 321,599

See accompanying notes.

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

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2006
Revenue:		
Addressing	$ 19,721	$ 23,414
Interoperability	13,087	14,117
Infrastructure and other	24,984	38,632
Total revenue	57,792	76,163
Operating expense:		
Cost of revenue (excluding depreciation and amortization shown separately below)	13,263	20,875
Sales and marketing	7,018	9,143
Research and development	2,570	4,141
General and administrative	7,590	7,281
Depreciation and amortization	3,582	4,448
Restructuring recoveries	(706)	¾
	33,317	45,888
Income from operations	24,475	30,275
Other (expense) income:		
Interest expense	(626)	(347)
Interest income	475	669
Income before minority interest and income taxes	24,324	30,597
Minority interest		(95)
Income before income taxes	24,324	30,502
Provision for income taxes	9,693	12,217
Net income	14,631	18,285
Dividends on and accretion of preferred stock	(2,143)	¾
Net income attributable to common stockholders	$ 12,488	$ 18,285
Net income attributable to common stockholders per common share:		
Basic	$ 2.08	$ 0.26
Diluted	$ 0.19	$ 0.24
Weighted average common shares outstanding:		

Basic	6,002	70,339
Diluted	75,712	77,657

See accompanying notes.

NEUSTAR, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Three Months Ended March 31,	
	2005	**2006**
Operating activities:		
Net income	$ 14,631	$ 18,285
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,582	4,448
Stock-based compensation	2,322	2,399
Amortization of deferred financing costs	22	5
Excess tax benefits from stock-based compensation		(27,085)
Deferred income taxes	3,411	4,041
Noncash restructuring recoveries	(706)	
Provision for doubtful accounts	300	225
Minority interest		95
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(6,153)	(13,936)
Unbilled receivables	(958)	(1,308)
Notes receivable	1,294	640
Prepaid expenses and other current assets	(366)	2,188
Deferred costs	(2,987)	(120)
Income tax receivable		7,584
Other assets	169	136
Accounts payable and accrued expenses	(3,128)	(14,524)
Income taxes payable	6,103	
Accrued restructuring reserve	(465)	(185)
Customer credits	(3,968)	
Deferred revenue	5,575	1,976
Net cash provided by (used in) operating activities	18,678	(15,136)
Investing activities:		
Purchases of property and equipment	(3,398)	(3,193)
Purchases of investments, net	(7,300)	(21,525)
Business acquired, net of cash	(2,164)	(4,300)
Net cash used in investing activities	(12,862)	(29,018)
Financing activities:		
Release (disbursement) of restricted cash	1,643	(4)
Principal repayments on notes payable	(1,629)	(494)
Principal repayments on capital lease obligations	(1,558)	(1,512)
Proceeds from exercise of common stock options	90	7,552
Excess tax benefits from stock-based compensation		27,085

Net cash (used in) provided by financing activities	(1,454)	32,627
Net increase (decrease) in cash and cash equivalents	4,362	(11,527)
Cash and cash equivalents at beginning of period	19,019	27,529
Cash and cash equivalents at end of period	$ 23,381	$ 16,002

See accompanying notes.

NEUSTAR, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MARCH 31, 2005 AND 2006

1. DESCRIPTION OF BUSINESS AND ORGANIZATION

NeuStar, Inc. (the Company) was incorporated as a Delaware corporation in 1998. The Company provides the North American communications industry with essential clearinghouse services. The Company operates the authoritative directories that manage virtually all telephone area codes and numbers, and enable the dynamic routing of calls among thousands of competing communications service providers, or CSPs, in the United States and Canada. The Company also provides clearinghouse services to emerging CSPs, including Internet service providers, cable television operators, and voice over Internet protocol, or VoIP, service providers. In addition, the Company manages the authoritative directories for the .us and .biz Internet domains, as well as for U.S. Common Short Codes, part of the short messaging service, or SMS, relied on by the U.S. wireless industry.

The Company provides its services from its clearinghouse, which includes unique databases and systems for workflow and transaction processing. These services are used by CSPs to solve a range of their technical and operating requirements, including:

Addressing. The Company enables CSPs to use critical, shared addressing resources, such as telephone numbers, Internet domain names, and U.S. Common Short Codes.

Interoperability. The Company enables CSPs to exchange and share critical operating data so that communications originating on one provider s network can be delivered and received on the network of another CSP. The Company also facilitates order management and work flow processing among CSPs.

Infrastructure and Other. The Company enables CSPs to more efficiently manage changes in their own networks by centrally managing certain critical data they use to route communications over their own networks.

On June 28, 2005, the Company effected a recapitalization, which involved (i) the payment of $6.3 million for all accrued and unpaid dividends on all of the then-outstanding shares of preferred stock, followed by the conversion of such shares into shares of common stock, (ii) the amendment of the Company s certificate of incorporation to provide for Class A common stock and Class B common stock, and (iii) the split of each share of common stock into 1.4 shares and the reclassification of the common stock into shares of Class B common stock (collectively, the Recapitalization). Each share of Class B common stock is convertible at the option of the holder into one share of Class A common stock.

On June 28, 2005, the Company made an initial public offering of 31,625,000 shares of Class A common stock, which included the underwriters over-allotment option exercise of 4,125,000 shares of Class A common stock. All the shares of Class A common stock sold in the initial public offering were sold by selling stockholders and, as such, the Company did not receive any proceeds from that offering. Prior to the Company s initial public offering, holders of 100,000 shares of Series B Voting Convertible Preferred Stock, 28,569,692 shares of Series C Voting Convertible Preferred Stock, and 9,098,525 shares of Series D Voting Convertible Preferred Stock converted their shares into 500,000, 28,569,692, and 9,098,525 shares of the Company s common stock, respectively, after which the split by means of a reclassification, as described in clauses (ii) and (iii) of the previous paragraph, was effected.

The accompanying consolidated financial statements give retroactive effect to the amendment of the Company s certificate of incorporation to provide for Class A common stock and Class B common stock and the split of each share of common stock into 1.4 shares and the reclassification of the common stock into shares of Class B common stock, as though these events occurred at the beginning of the earliest period presented.

NEUSTAR, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Unaudited Interim Financial Information

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The results of operations for the three months ended March 31, 2006 are not necessarily indicative of the results that may be expected for the full fiscal year. The consolidated balance sheet as of December 31, 2005 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements.

These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005 filed with the Securities and Exchange Commission.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting periods. Actual results could differ from those estimates.

Reclassifications

Certain amounts in the prior periods financial statements have been reclassified to conform to the current year presentation.

Goodwill

Goodwill represents the excess of costs over fair value of assets of businesses acquired. Goodwill and intangible assets that are determined to have an indefinite useful life are not amortized, but instead tested for impairment annually in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*.

The Company performs its annual impairment analysis on October 1 of each year or more often if indicators of impairment arise. The impairment review may require an analysis of future projections and assumptions about the Company s operating performance. If such a review indicates that the assets are impaired, an expense would be recorded for the amount of the impairment, and the corresponding impaired assets would be reduced in carrying value.

Identifiable Intangible Assets

Identifiable intangible assets are amortized over their respective estimated useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up and are reviewed for impairment in accordance with SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets* (SFAS No. 144).

The Company s identifiable intangible assets are amortized as follows:

	Years	Method
Acquired technologies	4	Straight-line
Customer lists	3 to 5	Various

Amortization expense related to acquired technologies and customer lists is included in depreciation and amortization expense in the consolidated statements of operations.

NEUSTAR, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Impairment of Long-Lived Assets

In accordance with SFAS No. 144, a review of long-lived assets for impairment is performed when events or changes in circumstances indicate the carrying value of such assets may not be recoverable. If an indication of impairment is present, the Company compares the estimated undiscounted future cash flows to be generated by the asset to its carrying amount. If the undiscounted future cash flows are less than the carrying amount of the asset, the Company records an impairment loss equal to the excess of the asset s carrying amount over its fair value. The fair value is determined based on valuation techniques such as a comparison to fair values of similar assets or using a discounted cash flow analysis. There were no impairment charges recognized during the three months ended March 31, 2005 or 2006.

Revenue Recognition

The Company provides the North American communications industry with essential clearinghouse services that address the industry s addressing, interoperability, and infrastructure needs. The Company s revenue recognition policies are in accordance with the Securities and Exchange Commission Staff Accounting Bulletin No. 104, *Revenue Recognition.*

The Company provides the following services pursuant to various private commercial and government contracts.

Addressing

The Company s addressing services include telephone number administration, implementing the allocation of pooled blocks of telephone numbers, and directory services for Internet domain names and U.S. Common Short Codes. The Company generates revenue from its telephone number administration services under two government contracts. Under its contract to serve as the North American Numbering Plan Administrator, the Company earns a fixed annual fee and recognizes this fee as revenue on a straight-line basis as services are provided. In the event the Company estimates losses on its fixed fee contract, the Company recognizes these losses in the period in which a loss becomes apparent. Under the Company s contract to serve as the National Pooling Administrator, the Company is reimbursed for costs incurred plus a fixed fee associated with administration of the pooling system. The Company recognizes revenue for this contract based on costs incurred plus a pro rata amount of the fixed fee.

In addition to the administrative functions associated with its role as the National Pooling Administrator, the Company also generates revenue from implementing the allocation of pooled blocks of telephone numbers under our long-term contracts with North American Portability Management LLC, and the Company recognizes revenue on a per transaction fee basis as the services are performed. For its Internet domain name services, the Company generates revenue for Internet domain registrations, which generally have contract terms between one and ten years. The Company recognizes revenue on a straight-line basis over the lives of the related customer contracts. The Company generates revenue from its Common Short Code services under short-term contracts ranging from three to twelve months, and the Company recognizes revenue on a straight-line basis over the term of the customer contracts.

Interoperability

The Company s interoperability services consist primarily of wireline and wireless number portability and order management services. The Company generates revenue from number portability under its long-term contracts with North American Portability Management LLC and Canadian LNP Consortium, Inc. The Company recognizes revenue on a per transaction fee basis as the services are performed. The Company provides order management services (OMS), consisting of customer set-up and implementation followed by transaction processing, under contracts with terms ranging from one to three years. Customer set-up and implementation is not considered a separate deliverable; accordingly, the fees are deferred and recognized as revenue on a straight-line basis over the term of the contract. Per-transaction fees are recognized as the transactions are processed.

Infrastructure and Other

The Company s infrastructure services consist primarily of network management and connection fees. The Company generates revenue from network management services under its long-term contracts with North American

NEUSTAR, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Portability Management LLC. The Company recognizes revenue on a per transaction fee basis as the services are performed. In addition, the Company generates revenue from connection fees and system enhancements under its contracts with North American Portability Management LLC. The Company recognizes its connection fee revenue as the service is performed. System enhancements are provided under contracts in which the Company is reimbursed for costs incurred plus a fixed fee, and revenue is recognized based on costs incurred plus a pro rata amount of the fee.

Significant Contracts

The Company provides wireline and wireless number portability, implements the allocation of pooled blocks of telephone numbers and provides network management services pursuant to seven contracts with North American Portability Management LLC, an industry group that represents all telecommunications service providers in the United States. The Company recognizes revenue under its contracts with North American Portability Management LLC primarily on a per-transaction basis. The aggregate fees for transactions processed under these contracts are determined by the total number of transactions, and these fees are billed to telecommunications service providers based on their allocable share of the total transaction charges. This allocable share is based on each respective telecommunications service provider s share of the aggregate end-user services revenues of all U.S. telecommunications service providers as determined by the Federal Communications Commission (FCC). Under the Company s contracts, the Company also bills a Revenue Recovery Collections (RRC) fee of a percentage of monthly billings to its customers, which is available to the Company if any telecommunications service provider fails to pay its allocable share of total transactions charges. In the period in which the RRC fees are billed, the RRC fees are recorded as an accrued expense on the consolidated balance sheet, with a corresponding increase to accounts receivable. If the RRC fee is insufficient for that purpose, these contracts also provide for the recovery of such differences from the remaining telecommunications service providers. On an annual basis, (i) the Company evaluates the RRC fee reserve by comparing cash collections to billings and the RRC percentage is adjusted, and (ii) any excess RRC fee reserve is returned to the telecommunications service providers in accordance with the terms of these contracts.

The per-transaction pricing under these contracts provides for annual volume credits that are earned on all transactions in excess of the pre-determined annual volume threshold. For 2005, the maximum aggregate volume credit was $7.5 million, which was applied via a reduction in per-transaction pricing once the pre-determined annual volume threshold was surpassed. When the aggregate credit was fully satisfied, the per-transaction pricing was restored to the prevailing contractual rate. In August 2005, the pre-determined annual transaction volume threshold under these contracts was exceeded, which resulted in the issuance of $7.5 million of volume credits for the year ended December 31, 2005. The aggregate annual volume credits available in 2006 are $7.5 million.

Cost of Revenue and Deferred Costs

Cost of revenue includes all direct materials, direct labor, and those indirect costs related to generation of revenue such as indirect labor, materials and supplies and facilities cost. The Company s primary cost of revenue is related to our information technology and systems department, including network costs, data center maintenance, database management, data processing costs, and facilities costs. In addition, cost of revenue includes personnel costs associated with service implementation, product maintenance, customer deployment and customer care, including salaries, stock-based compensation and other personnel-related expense. Cost of revenue also includes costs relating to developing modifications and enhancements of the Company s existing technology and services, as well as royalties paid related to the Company s Common Short Code services.

Deferred costs represent direct labor related to professional services incurred for the setup and implementation of contracts. These costs are recognized in cost of revenue ratably over the contract term. Deferred costs also include royalties paid related to the Company s Common Short Code services, which are recognized in cost of revenue ratably over the contract term. Deferred costs are classified as such on the consolidated balance sheet for the periods presented.

NEUSTAR, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock-Based Compensation

Prior to January 1, 2006, the Company accounted for its stock-based compensation plans under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB No. 25), and related interpretations, as permitted by SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123). Effective January 1, 2006, the Company adopted SFAS No. 123(R), *Share-Based Payment* (SFAS No. 123(R)), using the modified-prospective transition method. Under the modified-prospective transition method, compensation cost recognized in fiscal 2006 includes: (a) compensation cost for all stock-based payments granted prior to but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all stock-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). Results for prior periods have not been restated.

In accordance with Financial Accounting Standards Board (FASB) Staff Position No. FAS 123(R)-3, *Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards*, the Company has elected to adopt the alternative method provided in this FASB Staff Position for calculating the tax effects of stock-based compensation pursuant to SFAS No. 123(R). The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of employee stock-based compensation, which is available to absorb tax deficiencies recognized subsequent to the adoption of SFAS No. 123(R). Prior to adoption of SFAS No. 123(R), the Company presented all benefits of tax deductions resulting from the exercise of stock-based compensation as an operating cash flow in the consolidated statements of cash flows. Beginning on January 1, 2006, the Company changed its cash flow presentation in accordance with the SFAS No. 123(R), which requires benefits of tax deductions in excess of the compensation cost recognized (excess tax benefits) to be classified as a financing cash inflow with a corresponding operating cash outflow. For the three months ended March 31, 2006, the Company included $27.1 million of excess tax benefits as a financing cash inflow with a corresponding operating cash outflow.

Basic and Diluted Net Income Attributable to Common Stockholders per Common Share

Basic net income attributable to common stockholders per common share excludes dilution for potential common stock issuances and is computed by dividing net income attributable to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted net income attributable to common stockholders per common share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

Income Taxes

The Company accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS No. 109). Under SFAS No. 109, the liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rate and laws that will be in effect when the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized.

Comprehensive Income

There were no material differences between net income and comprehensive income for the three months ended March 31, 2005 and 2006.

NEUSTAR, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. ACQUISITION

NeuLevel, Inc.

In March 2006, the Company acquired 10% of NeuLevel, Inc. (NeuLevel), from Melbourne IT Limited for cash consideration of $4.3 million, raising the Company s ownership interest from 90% to 100%. The acquisition of the remaining 10% of NeuLevel was accounted for as a purchase. The Company allocated the purchase price principally to customer lists ($4.1 million) based on their estimated fair values on the acquisition date. Customer lists are included in intangible assets and are being amortized on an accelerated basis over five years. In accordance with SFAS No. 109, the Company recorded a deferred tax liability of approximately $1.6 million with an offset to goodwill.

4. GOODWILL AND INTANGIBLE ASSETS

Goodwill consists of the following (in thousands):

	December 31, 2005	March 31, 2006 (unaudited)
Goodwill	$ 51,495	$ 53,135

Intangible assets consist of the following (in thousands):

	December 31, 2005	March 31, 2006 (unaudited)	Weighted-Average Amortization Period (In Years)
Intangible assets:			
Customer lists	$ 3,566	$ 7,667	4.7
Accumulated amortization	(1,441)	(1,668)	
Customer lists, net	2,125	5,999	
Acquired technology	2,208	2,208	4.0
Accumulated amortization	(1,678)	(1,758)	
Acquired technology, net	530	450	
Intangible assets, net	$ 2,655	$ 6,449	

Amortization expense related to intangible assets, which is included in depreciation and amortization expense, was $309,000 and $307,000 for the three months ended March 31, 2005 and 2006. Amortization expense related to intangible assets for the years ended December 31, 2006, 2007, 2008, 2009 and 2010 is expected to be approximately $1.7 million, $1.5 million, $1.3 million, $1.3 million and $0.8 million, respectively.

5. STOCKHOLDERS EQUITY

Stock-Based Compensation

The Company has two stock incentive plans, the NeuStar, Inc. 1999 Equity Incentive Plan (the 1999 Plan) and the NeuStar, Inc. 2005 Stock Incentive Plan (the 2005 Plan). Under the 1999 Plan, the Company had the ability to grant to its directors, employees and consultants stock or stock-based awards in the form of incentive stock options, nonqualified stock options, stock appreciation rights, performance share units, shares of restricted common stock, phantom stock units and other stock-based awards. In May 2005, the Company s board of directors adopted the

NEUSTAR, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2005 Plan, which was approved by the Company s stockholders in June 2005. In connection with the adoption of the 2005 Plan, the Company s board of directors amended the 1999 Plan to provide that no further awards would be granted under the 1999 Plan as of the date stockholder approval of the 2005 Plan was obtained. All shares available for grant as of that date, plus any other shares under the 1999 Plan that again become available due to forfeiture, expiration, settlement in cash or other termination of awards without issuance, will be available for grant under the 2005 Plan.

Under the 2005 Plan, the Company may grant to its directors, employees and consultants awards in the form of incentive stock options, nonqualified stock options, stock appreciation rights, shares of restricted stock, restricted stock units, performance awards and other stock-based awards. The aggregate number of shares of Class A common stock with respect to which all awards may be granted under the 2005 Plan is 6,044,715, plus any shares available for issuance under the 1999 Plan. As of March 31, 2006, 5,042,675 shares were available for grant or award under the 2005 Plan.

The term of any stock option granted under the 1999 Plan or the 2005 Plan may not exceed ten years. The exercise price per share for options granted under these Plans is not less than 100% of the fair market value of the common stock on the option grant date. The board of directors or Compensation Committee of the board of directors determines the vesting of the options, with a maximum vesting period of ten years. Options issued generally vest with respect to 25% of the shares on the first anniversary of the grant date and 2.083% of the shares on the last day of each succeeding calendar month thereafter. The options expire seven to ten years from the date of issuance and are forfeitable upon termination of an optionholder s service.

The board of directors or Compensation Committee of the board of directors has and may in the future grant restricted stock to directors, employees and consultants. The board of directors or Compensation Committee of the board of directors determines the vesting of the restricted stock, with a maximum vesting period of ten years. Restricted stock issued generally vests in equal annual installments over a four year term. In addition, the board of directors granted 350,000 phantom stock units to one of the Company s officers in July 2004. Under the terms of the phantom stock agreement, these phantom stock units will vest in full on December 18, 2008. Upon vesting, this officer will be entitled to receive one share of the Company s Class A common stock for each phantom stock unit. The vesting of these phantom stock units may accelerate if the Company experiences a change of control and certain other conditions are met. The aggregate intrinsic value for these phantom stock units as of March 31, 2006 was $10.9 million.

Prior to January 1, 2006, the Company accounted for its stock-based compensation plans under the recognition and measurement provisions of APB No. 25, and related interpretations, as permitted by SFAS No. 123. Effective January 1, 2006, the Company adopted SFAS No. 123(R), using the modified-prospective transition method. Under the modified-prospective transition method, compensation cost recognized in fiscal 2006 includes: (a) compensation cost for all stock-based payments granted prior to but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all stock-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). Under the modified-prospective transition method, prior periods are not restated for comparative purposes. Stock-based compensation expense recognized under SFAS No. 123(R) for the three months ended March 31, 2006 was $2.4 million. As of March 31, 2006, total unrecognized compensation expense related to non-vested stock options, non-vested restricted stock and non-vested phantom stock units granted prior to that date is estimated at $32.7 million, which the Company expects to recognize over a weighted average period of approximately 2.8 years. Total unrecognized compensation expense at March 31, 2006 is estimated based on outstanding non-vested stock options, restricted stock and phantom stock units, and this amount may be increased or decreased in future periods for subsequent grants or forfeitures.

The following table illustrates the effect on net income attributable to common stockholders and net income attributable to common stockholders per common share if the Company had applied the fair value recognition provisions of SFAS No. 123(R) to stock-based employee compensation for the three months ended March 31, 2005.

The pro forma disclosure for the three months ended March 31, 2005 utilized the Black-Scholes option-pricing

NEUSTAR, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

model to estimate the value of the respective options with such value amortized to compensation expense over the options vesting periods.

	Three Months Ended March 31, 2005 (in thousands, except per share data)
Pro forma basic net income attributable to common stockholders:	
Basic net income attributable to common stockholders, as reported	$ 12,488
Add: stock-based compensation expense included in reported net income attributable to common stockholders	1,402
Deduct: total stock-based compensation expense determined under fair value-based method for all awards	(2,953)
Pro forma basic net income attributable to common stockholders	$ 10,937
Pro forma diluted net income attributable to common stockholders:	
Basic net income attributable to common stockholders, as reported	$ 12,488
Dividends on and accretion of convertible preferred stock	2,143
Diluted net income attributable to common stockholders	14,631
Add: stock-based compensation expense included in reported net income attributable to common stockholders	1,402
Deduct: total stock-based compensation expense determined under fair value-based method for all awards	(2,953)
Pro forma diluted net income attributable to common stockholders	$ 13,080
Net income attributable to common stockholders per common share:	
Basic as reported	$ 2.08
Basic pro forma	$ 1.82
Diluted as reported	$ 0.19
Diluted pro forma	$ 0.17

The Company has utilized the Black-Scholes option-pricing model for estimating the fair value of stock options granted during the three months ended March 31, 2006, as well as for option grants during all prior periods. The weighted-average fair value of options at the date of grant for options granted during the three months ended March 31, 2006 was $11.98. As follows are the weighted-average assumptions used in valuing the stock options granted during the three months ended March 31, 2006, and a discussion of the assumptions.

Dividend yield	0.0%
Expected volatility	39.33%
Risk-free interest rate	4.54%
Expected life of options	4.59

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

Expected volatility Volatility is a measure of the amount by which a financial variable such as a share price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. Given the Company s limited historical stock data from its initial public offering in June 2005, the Company has used a

NEUSTAR, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

blended volatility to estimate expected volatility. The blended volatility includes the average of the Company s preceding seven-month weekly historical volatility, the Company s preceding six-month market implied volatility and an average of the Company s peer group s preceding four-year and six-year weekly historical volatility. Market implied volatility is the volatility implied by the trading prices of publicly available stock options for the Company s common stock. The Company s peer group historical volatility includes the historical volatility of companies that are similar in revenue size, in the same industry or are competitors.

Risk-free interest rate This is the average U.S. Treasury rate (with a term that most closely resembles the expected life of the option) for the quarter in which the option was granted.

Expected life of the options This is the period of time that the options granted are expected to remain outstanding. This estimate is derived from the average midpoint between vesting and the contractual term as described in the SEC s Staff Accounting Bulletin 107, *Share-Based Payment*.

The stock-based compensation expense that has been recognized against income for the Company s stock plans for the three months ended March 31, 2006 was approximately $2.4 million. The total income tax benefit recognized in the consolidated statements of operations for stock-based compensation arrangements was approximately $30,000 for the three months ended March 31, 2006. For stock-based awards subject to graded vesting, the Company has utilized the straight-line method for allocating compensation cost by period.

The following table summarizes the Company s stock option activity for the three months ended March 31, 2006:

	Shares	Weighted-Average Exercise Price
Outstanding at December 31, 2005	12,621,553	$ 4.81
Options granted	1,067,300	30.20
Options exercised	(3,093,316)	2.42
Options forfeited	(140,292)	7.68
Outstanding at March 31, 2006	10,455,245	8.07
Exercisable at March 31, 2006	6,044,524	2.80

The aggregate intrinsic value of options exercised during the three months ended March 31, 2006 was $85.5 million. The aggregate intrinsic value for all options outstanding under the Company s stock plans at March 31, 2006 was $239.8 million. The aggregate intrinsic value for exercisable options outstanding under the Company s stock plans at March 31, 2006 was $170.4 million. The weighted-average remaining contractual life for all options outstanding under the Company s stock plans as of March 31, 2006 was 6.91 years. The weighted-average remaining contractual life for exercisable options under the Company s stock plans as of March 31, 2006 was 5.62 years.

NEUSTAR, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes the Company s non-vested restricted stock activity for the three months ended March 31, 2006:

	Shares	Weighted-Average Grant Date Fair Value
Non-vested December 31, 2005	5,000	31.95
Granted	51,490	30.20
Vested	¾	¾
Forfeited	¾	¾
Non-vested March 31, 2006	56,490	30.35

The aggregate intrinsic value for all non-vested restricted stock outstanding under the Company s stock plans at March 31, 2006 was $1.8 million.

6. BASIC AND DILUTED NET INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS PER COMMON SHARE

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

	Three months Ended March 31,	
	2005	2006
Basic net income attributable to common stockholders:		
Net income	$ 14,631	$ 18,285
Dividends on and accretion of convertible preferred stock	(2,143)	
Basic net income attributable to common stockholders	$ 12,488	$ 18,285
Basic net income attributable to common stockholders per common share	$ 2.08	$ 0.26
Diluted net income attributable to common stockholders:		
Basic net income attributable to common stockholders	$ 12,488	$ 18,285
Dividends on and accretion of convertible preferred stock	2,143	
Diluted net income attributable to common stockholders	$ 14,631	$ 18,285
Diluted net income attributable to common stockholders per common share	$ 0.19	$ 0.24
Weighted average common shares outstanding basic	6,002	70,339
Dilutive effect of:		
Stock options for the purchase of common stock	9,144	7,318
Conversion of preferred stock and accrued dividends payable into common stock	54,244	
Warrants for the purchase of common stock	6,322	

Weighted average common shares outstanding diluted	75,712	77,657

7. SUBSEQUENT EVENT

In April 2006, the Company acquired UltraDNS Corporation (UltraDNS) for cash consideration of $61.8 million. The acquisition of UltraDNS enables the Company to expand its domain name services to include managed domain name systems (DNS) services. These services play a key role in directing and managing Internet traffic for customers of UltraDNS, enabling them to intelligently and securely control and distribute traffic, and ensure security, scalability and reliability of websites and email. The acquisition was accounted for as a purchase. The Company is currently in the process of completing its purchase price allocation.

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

Forward-Looking Statements

This quarterly report on Form 10-Q contains forward-looking statements, including, without limitation, statements concerning the conditions in our industry, our operations and economic performance, and our business and growth strategy. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expects, intends, plans, anticipates, believes, estimates, predicts, potential, continue or the negative o other comparable terminology. These statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. Many of these risks are beyond our ability to control or predict. These forward-looking statements are based on estimates and assumptions by our management that, although we believe to be reasonable, are inherently uncertain and subject to a number of risks and uncertainties. These risks and uncertainties include, without limitation, those described in this report, in Part II, Item 1A. Risk Factors and elsewhere in our Annual Report on Form 10-K for the year ended December 31, 2005, and those described from time to time in our future reports filed with the Securities and Exchange Commission. We undertake no obligation to publicly update or revise any forward-looking statement as a result of new information, future events or otherwise, except as otherwise required by law.

Overview

We provide the North American communications industry with essential clearinghouse services. We operate the authoritative directories that manage virtually all telephone area codes and numbers, and we enable the dynamic routing of calls among thousands of competing communications service providers, or CSPs, in the United States and Canada. All CSPs that offer telecommunications services to the public at large, or telecommunications service providers, such as Verizon Communications Inc., Sprint Nextel Corporation, AT&T Corp. and Cingular Wireless LLC, must access our clearinghouse as one of our customers to properly route virtually all of their customers calls. We also provide clearinghouse services to emerging CSPs, including Internet service providers, cable television operators, and voice over Internet protocol, or VoIP, service providers. In addition, we manage the authoritative directories for the .us and .biz Internet domains, as well as for U.S. Common Short Codes, part of the short messaging service relied upon by the U.S. wireless industry.

During the first quarter of 2006, we continued to experience increased demand for our clearinghouse services. In the first quarter of 2006, total revenue increased 31.8% as compared to the first quarter of 2005. Under our contracts to provide telephone number portability services in the U.S., we processed 54.1 million transactions. We believe that this revenue growth and increased transaction volume during the first quarter of 2006 demonstrates strong demand for our services from numerous sources, including, most significantly, those described below.

We experienced significant growth in transactions in the first quarter from customers who have been upgrading to next generation technologies, such as Internet Protocol, or IP, systems. This type of ongoing and pervasive change drives carriers to evaluate and restructure their network architectures. As IP services have continued to proliferate, VoIP service providers are expanding their operations. This expansion led to an increased need for access to inventories of telephone numbers, which drove increased demand for our addressing services this quarter.

We also saw significant demand for our services during the first quarter of 2006 from wireless carriers, who have continued to expand their networks to facilitate wireless subscriber growth, to deliver new wireless applications, and to compete for market share among the users of wireless services. As CSPs expand and upgrade their networks and technology to enable the delivery of high-speed wireless services, we anticipate that they will increasingly rely on our services, and wireless-related transactions will remain a significant contributor to our transaction volume growth.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles, or

U.S. GAAP. The preparation of these financial statements in accordance with U.S. GAAP requires us to utilize accounting policies and make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingencies as of the date of the financial statements and the reported amounts of revenue and expense during a fiscal period. The Securities and Exchange Commission considers an accounting policy to be critical if it is important to a company s financial condition and results of operations, and if it requires significant judgment and estimates on the part of management in its application. We have discussed the selection and development of the critical accounting policies with the audit committee of our board of directors, and the audit committee has reviewed our related disclosures in this report. Although we believe that our judgments and estimates are appropriate, actual results may differ from those estimates. See Part II, Item 1A. of this report, Risk Factors, for certain matters that may bear on our future results of operations. We discuss our critical accounting policies and estimates in our Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2005 and in our Notes to Unaudited Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards, or SFAS, No. 123(R), *Share-Based Payment*, which requires companies to expense the estimated fair value of employee stock options and similar awards. This statement is a revision to SFAS No. 123, *Accounting for Stock-Based Compensation*, and supersedes Accounting Principles Board Opinion No. 25, or APB No. 25, *Accounting for Stock Issued to Employees*, and amends SFAS No. 95, *Statement of Cash Flows*.

Prior to January 1, 2006, we accounted for our stock-based compensation plans under the recognition and measurement provisions of APB No. 25, and related interpretations, as permitted by SFAS No. 123. Effective January 1, 2006, we adopted SFAS No. 123(R), including the fair value recognition provisions using the modified-prospective transition method. Under the modified-prospective transition method, compensation cost recognized in fiscal 2006 includes: (a) compensation cost for all stock-based payments granted prior to but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all stock-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). Under the modified prospective application, prior periods are not restated for comparative purposes. Stock-based compensation expense recognized under SFAS No. 123(R) for the three months ended March 31, 2006 was $2.4 million. At March 31, 2006, total unrecognized compensation expense related to non-vested stock options, non-vested restricted stock and non-vested phantom stock units granted prior to that date is estimated at $32.7 million, which we expect to recognize over a weighted average period of approximately 2.8 years. Total unrecognized compensation expense at March 31, 2006 is estimated based on outstanding non-vested stock options, restricted stock and phantom stock units, and this amount may be increased or decreased in future periods for subsequent grants or forfeitures.

Both prior and subsequent to the adoption of SFAS No. 123(R), we estimated the value of stock-based awards on the date of grant using the Black-Scholes option-pricing model. Prior to the adoption of SFAS No. 123(R), the value of each stock-based award was estimated on the date of grant using the Black-Scholes option-pricing model for the pro forma information required to be disclosed under SFAS No. 123. The determination of the fair value of stock-based payment awards on the date of grant using the Black-Scholes option-pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include, but are not limited to, our expected stock price volatility over the term of the awards, risk-free interest rate and the expected term of the awards.

If factors change and we employ different assumptions in the application of SFAS No. 123(R) in future periods, the compensation expense that we record under SFAS No. 123(R) may differ significantly from what we have recorded in the current period. Therefore, we believe it is important for investors to be aware of the high degree of subjectivity involved when using option pricing models to estimate stock-based compensation under SFAS No. 123(R). Option-pricing models were developed for use in estimating the value of traded options that have no vesting or hedging restrictions, are fully transferable and do not cause dilution. Because our stock-based payments have characteristics significantly different from those of freely traded options, and because changes in the subjective input assumptions can materially affect our estimates of fair values, in our opinion, existing valuation models, including the Black-Scholes option-pricing model, may not provide reliable measures of the fair values of our stock-based compensation. Consequently, there is a risk that our estimates of the fair values of our stock-based compensation awards on the grant dates may bear little resemblance to the actual values realized upon the exercise, expiration, early termination or forfeiture of those stock-based payments in the future.

Certain stock-based payments, such as employee stock options, may expire worthless or otherwise result in zero intrinsic value as compared to the fair values originally estimated on the grant date and reported in our consolidated financial statements. Alternatively, value may be realized from these instruments that is significantly in excess of the fair values originally estimated on the grant date and reported in our consolidated financial statements. There is currently no market-based mechanism or other practical application to verify the reliability and accuracy of the estimates stemming from these valuation models, nor is there a means to compare and adjust the estimates to actual values. Although the fair value of our stock-based awards is determined in accordance with SFAS No. 123(R) and the Securities and Exchange Commission s Staff Accounting Bulletin No. 107, *Share-Based Payment* (SAB 107) using an option-pricing model, that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction.

Consolidated Results of Operations

Three Months Ended March 31, 2005 Compared to Three Months Ended March 31, 2006

The following table presents an overview of our results of operations for the three months ended March 31, 2005 and 2006.

	Three Months Ended March 31,		Three Months Ended March 31, 2005 vs. 2006	
	2005	2006		
	$	$	$ Change	% Change
	(in thousands, except per share data)			
Revenue:				
Addressing	$ 19,721	$ 23,414	$ 3,693	18.7%
Interoperability	13,087	14,117	1,030	7.9
Infrastructure and other	24,984	38,632	13,648	54.6
Total revenue	57,792	76,163	18,371	31.8
Operating expense:				
Cost of revenue (excluding depreciation and amortization shown separately below)	13,263	20,875	7,612	57.4
Sales and marketing	7,018	9,143	2,125	30.3
Research and development	2,570	4,141	1,571	61.1
General and administrative	7,590	7,281	(309)	(4.1)
Depreciation and amortization	3,582	4,448	866	24.2
Restructuring recoveries	(706)		706	(100.0)
	33,317	45,888	12,571	37.7
Income from operations	24,475	30,275	5,800	23.7
Other (expense) income:				
Interest expense	(626)	(347)	279	(44.6)
Interest income	475	669	194	40.8
Income before minority interest and income taxes	24,324	30,597	6,273	25.8
Minority interest		(95)	(95)	
Income before income taxes	24,324	30,502	6,178	25.4
Provision for income taxes	9,693	12,217	2,524	26.0
Net income	14,631	18,285	3,654	25.0
Dividends on and accretion of preferred stock	(2,143)		2,143	(100.0)
Net income attributable to common stockholders	$ 12,488	$ 18,285	5,797	46.4%

Net income attributable to common stockholders per common share:		
Basic	$ 2.08	$ 0.26
Diluted	$ 0.19	$ 0.24
Weighted average common shares outstanding:		
Basic	6,002	70,339
Diluted	75,712	77,657

Revenue

Total revenue. Total revenue increased $18.4 million due to increases in addressing, interoperability and infrastructure transactions.

Addressing. Addressing revenue increased $3.7 million due primarily to the increase in the number of subscribers for U.S. Common Short Codes, as well as an increase in the number of service providers that carried Common Short Codes across their networks. This increase in addressing revenue was also driven by the continued implementation of, and expansion of carrier networks to facilitate, new communications services, such as Internet telephony. Of the $3.7 million increase in addressing revenue, revenue from U.S. Common Short Codes increased $1.6 million; and revenue from pooling transactions increased $1.0 million, primarily as service providers continued to build inventories of telephone numbers in multiple area codes and rate centers to be able to offer them to Internet and wireless telephony users. Revenue from our domain name services increased $0.7 million due to the increased number of names under management. In addition, fees under our contract to serve as the National Pooling Administrator increased $0.3 million, which resulted from increased activity under our contract during the three months ended March 31, 2006.

Interoperability. Interoperability revenue increased $1.0 million due to an increase in wireline and wireless competition and the associated movement of end users from one CSP to another, carrier consolidation, and broader usage of our expanding service offerings such as enhanced order management services for wireless data and Internet telephony providers. Specifically, revenue from number portability transactions increased $0.5 million.

Infrastructure and other. Infrastructure and other revenue increased $13.6 million due to an increase in the demand for our network management services. Of this amount, $11.7 million was attributable to customers making changes to their networks that required actions such as disconnects and modifications to network elements. We believe these changes were driven largely by trends in the industry, including the implementation of new technologies by our customers, wireless technology upgrades, carrier vendor changes and network optimization. The remaining increase of $1.9 million was principally due to an increase in connection fees.

Expense

Cost of revenue. Cost of revenue increased $7.6 million due to growth in personnel, contractor costs to support higher transaction volumes and royalties related to our Common Short Code services. Of this amount, personnel and personnel-related expense increased $3.5 million due to increased personnel to support our customer deployment, software engineering and operations. Contractor costs increased $1.2 million for software maintenance activities and managing industry changes to our clearinghouse. Additionally, cost of revenue increased by $1.6 million due to royalty expenses related to Common Short Code services and revenue share cost associated with our Internet domain names and registry gateway services. Cost of revenue as a percentage of revenue increased from 22.9% for the three months ended March 31, 2005 to 27.4% for the three months ended March 31, 2006. This increase in cost of revenue as a percentage of revenue is attributable to increased royalty expenses related to Common Short Code services and higher personnel and personnel-related costs related to the expansion of our clearinghouse capabilities to offer additional services.

Sales and marketing. Sales and marketing expense increased $2.1 million due to additions to our sales and marketing team to focus on branding, product launches and new business development opportunities, including international expansion. Of this amount, personnel and personnel-related expense increased $1.9 million, and costs related to industry events increased $0.3 million. Sales and marketing expense as a percentage of revenue decreased from 12.1% for the three months ended March 31, 2005 to 12.0% for the three months ended March 31, 2006.

Research and development. Research and development expense increased $1.6 million due to the development of service features to enhance our offerings to Internet telephony providers. Of this increase, personnel and personnel-related costs increased $0.7 million due to increased headcount, and fees for consultants to augment our internal research and development resources increased $0.8 million. Research and development expense as a percentage of revenue increased from 4.4% for the three months ended March 31, 2005 to 5.4% for the three months ended March 31, 2006.

General and administrative. General and administrative expense decreased $0.3 million primarily due to a reduction in legal and accounting fees of $0.8 million. This decrease was offset by an increase in personnel and personnel-related expenses of $0.8 million to support business growth and costs incurred in complying with our reporting and other requirements as a public company. In addition, general and administrative facility costs decreased $0.3 million. General and administrative expense as a percentage of revenue decreased from 13.1% for the three months ended March 31, 2005 to 9.6% for the three months ended March 31, 2006.

Depreciation and amortization. Depreciation and amortization expense increased $0.9 million due to an increase in capital assets to support increased transaction volume. Depreciation and amortization expense as a percentage of revenue decreased from 6.2% for the three months ended March 31, 2005 to 5.8% for the three months ended March 31, 2006.

Restructuring recoveries. During the three months ended March 31, 2005, we recorded a restructuring recovery of $0.7 million after entering into a sub-lease for our leased property in Chicago with sub-lease rates more favorable than originally assumed when the restructuring liability for the closure of excess facilities was recorded in 2002. There was no similar recovery during the three months ended March 31, 2006.

Interest expense. Interest expense decreased $0.3 million during the three months ended March 31, 2006 as compared to the three months ended March 31, 2005 due predominantly to a decrease in the number of capital leases outstanding during the period. Interest expense as a percentage of revenue decreased from 1.1% for the three months ended March 31, 2005 to 0.5% for the three months ended March 31, 2006.

Interest income. Interest income increased $0.2 million due to higher average cash balances. Interest income as a percentage of revenue increased from 0.8% for the three months ended March 31, 2005 to 0.9% for the three months ended March 31, 2006.

Provision for income taxes. Income tax provision increased $2.5 million due to an increase in net income and an increase to our estimated tax rate for 2006. Our annual effective statutory tax rate increased from 39.8% for the three months ended March 31, 2005 to 40.1% for the three months ended March 31, 2006.

Liquidity and Capital Resources

Historically, our principal source of liquidity has been cash provided by operations. With the adoption of SFAS No. 123(R), benefits of tax deductions in excess of compensation cost recognized for the exercise of common stock options (excess tax benefits) are classified as a financing cash inflow and a corresponding operating cash outflow, rather than as an operating cash flow as required prior to the adoption of SFAS No. 123(R). For the three months ended March 31, 2006, our principal source of liquidity was cash provided from financing activities, specifically $27.1 million of excess tax benefits and $7.6 million of proceeds received from the exercise of common stock options. Our principal uses of cash have been to fund facility expansions, capital expenditures, acquisitions, working capital, dividend payouts on preferred stock, and debt service requirements. We anticipate that our principal uses of cash in the future will be facility expansion, capital expenditures, acquisitions and working capital.

Total cash and cash equivalents and short-term investments were $103.5 million at December 31, 2005, increasing to $113.5 million at March 31, 2006. During April 2006, we paid $61.8 million in cash for our acquisition of UltraDNS.

As of March 31, 2006, we had $5.6 million available under the revolving loan commitment of our bank credit facility, subject to the terms and conditions of that facility.

We believe that our existing cash and cash equivalents, short-term investments and cash from operations will be sufficient to fund our operations for the next twelve months.

Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements as of March 31, 2006.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

For quantitative and qualitative disclosures about market risk affecting NeuStar, see Quantitative and Qualitative Disclosures About Market Risk in Item 7A of Part II of our Annual Report on Form 10-K for the fiscal year ended December 31, 2005. Our exposure to market risk has not changed materially since December 31, 2005.

Item 4. Controls and Procedures

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

As of March 31, 2006, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective and were operating at the reasonable assurance level.

In addition, there were no changes in our internal control over financial reporting that occurred in the first quarter of 2006 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

The following sets forth risk factors associated with our business. The risk factors marked with an asterisk (*) contain changes to the description of the risk factors associated with our business previously disclosed in Item 1A of our 2005 Annual Report on Form 10-K. Additional risks and uncertainties that we are unaware of may also become important factors that affect us. If any of the following risks occur, our business, financial condition or results of operations could be materially and adversely affected. In these circumstances, the market price of our common stock could decline.

Risks Related to Our Business

Failures or interruptions of our clearinghouse could materially harm our revenue and impair our ability to conduct our operations.

We provide addressing, interoperability and infrastructure services that are critical to the operations of our customers. Notably, our clearinghouse is essential to the orderly operation of the national telecommunications system because it enables CSPs to ensure that telephone calls are routed to the appropriate destinations. Our system architecture is integral to our ability to process a high volume of transactions in a timely and effective manner. We could experience failures or interruptions of our systems and services, or other problems in connection with our operations, as a result of:

- damage to, or failure of, our computer software or hardware or our connections and outsourced service arrangements with third parties;
- errors in the processing of data by our system;
- computer viruses or software defects;
- physical or electronic break-ins, sabotage, intentional acts of vandalism and similar events;
- increased capacity demands or changes in systems requirements of our customers; or
- errors by our employees or third-party service providers.

If we cannot adequately protect the ability of our clearinghouse to perform consistently at a high level or otherwise fail to meet our customers expectations:

- we may experience damage to our reputation, which may adversely affect our ability to attract or retain customers for our existing services, and may also make it more difficult for us to market our services;
- we may be subject to significant damages claims, under our contracts or otherwise, including the requirement to pay substantial penalties related to service level requirements in our contracts;
- our operating expenses or capital expenditures may increase as a result of corrective efforts that we must perform;
- our customers may postpone or cancel subsequently scheduled work or reduce their use of our services; or
- one or more of our significant contracts may be terminated early, or may not be renewed.

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

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Security breaches could result in an interruption of service or reduced quality of service, which could increase our costs or result in a reduction in the use of our services by our customers.

Our systems may be vulnerable to physical break-ins, computer viruses, attacks by computer hackers or similar disruptive problems. If unauthorized users gain access to our databases, they may be able to steal, publish, delete or modify sensitive information that is stored or transmitted on our networks and that we are required by our contracts and FCC rules to keep confidential. A security or privacy breach could result in an interruption of service or reduced quality of service and we may be required to make significant expenditures in connection with corrective efforts we are required to perform. In addition, a security or privacy breach may harm our reputation and cause our customers to reduce their use of our services, which could harm our revenue and business prospects.

The loss of, or damage to, a data center could interrupt our operations and materially harm our revenue and growth.

Because telecommunications service providers must query a copy of our continuously updated databases to route virtually every telephone call in North America, the integrity of our data centers is essential to our business. We may not have sufficient redundant systems or back-up facilities to allow us to receive and process data in the event of a loss of, or damage to, a data center. We could lose, or suffer damage to, a data center in the event of power loss; natural disasters such as fires, earthquakes, floods and tornadoes; telecommunications failures, such as transmission cable cuts; or other similar events that could adversely affect our customers ability to access our clearinghouse. We may be required to make significant expenditures to repair or replace a data center. Any interruption to our operations due to the loss of, or damage to, a data center could harm our reputation and cause our customers to reduce their use of our services, which could harm our revenue and business prospects.

The failure of the third-party software and equipment used by our customers or that we use in our clearinghouse could cause interruptions or failures of our systems.

We incorporate hardware, software and equipment developed by third parties in our clearinghouse. Our third-party vendors include, among others, IBM, and Oracle Corporation for database systems and software, and EMC Corporation and Sun Microsystems, Inc. for equipment. Similarly, to access our clearinghouse and utilize our services, many of our customers rely on hardware, software and other equipment developed, supported and maintained by third-party providers. As a result, our ability to provide clearinghouse services depends in part on the continued performance and support of the third-party products on which we and our customers rely. If these products experience failures or have defects and the third parties that supply the products fail to provide adequate support, this could result in or exacerbate an interruption or failure of our systems or services.

Our seven contracts with North American Portability Management LLC represent in the aggregate a substantial portion of our revenue, are not exclusive and could be terminated or modified in ways unfavorable to us, and we may be unable to renew these contracts at the end of their term.

Our seven contracts with North American Portability Management LLC, an industry group that represents all telecommunications service providers in the United States, to provide telephone number portability and other clearinghouse services are not exclusive and could be terminated or modified in ways unfavorable to us. These seven separate contracts, each of which represented between 8.5% and 14.8% of our total revenue in 2005, represented in the aggregate approximately 77.9% of our total revenue in 2005. North American Portability Management LLC could, at any time, solicit or receive proposals from other providers to provide services that are the same as or similar to ours. In addition, these contracts have finite terms and are currently scheduled to expire in May 2011. Furthermore, any of these contracts could be terminated in advance of its scheduled expiration date in limited circumstances, most notably if we are in default of these agreements. Although these contracts do not contain cross-default provisions, conditions leading to a default by us under one of our contracts could lead to a default under others, or all seven.

We may be unable to renew these contracts on acceptable terms when they are being considered for renewal if we fail to meet our customers expectations, including for performance and other reasons, or if another provider offers to provide the same or similar services at a lower cost. In addition, competitive forces resulting from the possible entrance of a competitive provider could create significant pricing pressure, which could then cause us to reduce the selling price of our services under our contracts. If these contracts are terminated or modified in a manner that is adverse to us, or if we are unable to renew these contracts on acceptable terms upon their expiration, it would have a material adverse effect on our business, prospects, financial condition and results of operations.

Our contracts with North American Portability Management LLC contain provisions that may restrict our ability to use data that we administer in our clearinghouse, which may limit our ability to offer services that we currently, or intend to, offer.

In addition to offering telephone number portability and other clearinghouse services under our contracts with North American Portability Management LLC, some of our service offerings not related to these contracts require that we use certain data from our clearinghouse. We have been informed by North American Portability Management LLC that they believe that use of this data, which is unrelated to our performance under these contracts, may not be permissible under the current agreements. If we are subject to burdensome terms of access or are not permitted to use this data, our ability to offer new services requiring the use of this data may be limited.

Certain of our other contracts may be terminated or we may be unable to renew these contracts, which may reduce the number of services we can offer and damage our reputation.

In addition to our contracts with North American Portability Management LLC, we rely on other contracts to provide some of the services that we offer, including the contracts that appoint us to serve as the:

- North American Numbering Plan Administrator, under which we maintain the authoritative database of telephone numbering resources in North America;
- National Pooling Administrator, under which we perform the administrative functions associated with the administration and management of telephone number inventory and allocation of pooled blocks of unassigned telephone numbers;
- provider of number portability services in Canada;
- operator of the .us registry;
- operator of the .biz registry; and
- operator of the registry of U.S. Common Short Codes.

Each of these contracts provides for early termination in limited circumstances, most notably if we are in default. In addition, our contracts to serve as the North American Numbering Plan Administrator and as the National Pooling Administrator and to operate the .us registry, each of which is with the U.S. government, may be terminated by the government at will. If we fail to meet the expectations of the FCC, the U.S. Department of Commerce or our customers, as the case may be, for any reason, including for performance-related or other reasons, or if another provider offers to perform the same or similar services for a lower price, we may be unable to extend or renew these contracts. In that event, the number of services we are able to offer may be reduced, which would adversely affect our revenue from the provision of these services. Each of the contracts listed above establishes us as the sole provider of the particular services covered by that contract during its term. If one of these contracts were terminated, or if we were unable to renew or extend the term of any particular contract, we would no longer be able to provide the services covered by that contract and could suffer a loss of prestige that would make it more difficult for us to compete for contracts to provide similar services in the future.

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

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

Regulatory and statutory changes that affect us or the communications industry in general may increase our costs or impair our growth.

The FCC has regulatory authority over certain aspects of our operations, most notably our compliance with our neutrality requirements. We are also affected by business risks specific to the regulated communications industry. Moreover, the business of our customers is subject to regulation that indirectly affects our business. As communications technologies and the communications industry continue to evolve, the statutes governing the communications industry or the regulatory policies of the FCC may change. If this were to occur, the demand for our clearinghouse services could change in ways that we cannot easily predict and our revenue could decline. These risks include the ability of the federal government, most notably the FCC, to:

- increase regulatory oversight over the services we provide;

- adopt or modify statutes, regulations, policies, procedures or programs that are disadvantageous to the services we provide, or that are inconsistent with our current or future plans, or that require modification of the terms of our existing contracts, including the manner in which we charge for certain of our services. For example, in November 2005, BellSouth Corporation filed a petition with the FCC seeking changes in the way our customers are billed for services provided by us under our contracts with North American Portability Management LLC;

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

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

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

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

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

If we do not adapt to rapid technological change in the communications industry, we could lose customers or market share.

Our industry is characterized by rapid technological change and frequent new service offerings. Significant technological changes could make our technology and services obsolete. We must adapt to our rapidly changing market by continually improving the features, functionality, reliability and responsiveness of our addressing, interoperability and infrastructure services, and by developing new features, services and applications to meet changing customer needs. We cannot guarantee that we will be able to adapt to these challenges or respond successfully or in a cost-effective way. Our failure to do so would adversely affect our ability to compete and retain customers or market share. Although we currently provide our services primarily to traditional telecommunications companies, many existing and emerging companies are providing, or propose to provide, IP-based voice services. Our future revenue and profits will depend, in part, on our ability to provide services to IP-based service providers. For example, we are currently conducting trial tests of SIP-IX, a comprehensive suite of services designed to enable direct network-to-network peering between trading partners for voice, video and content services using Session Initiation Protocol (SIP)-based technologies such as IP multimedia subsystem (IMS) and Voice over Internet Protocol (VoIP). There can be no assurance that IP communications will grow in any meaningful fashion, or that SIP-IX will be adopted by potential customers, nor can we guarantee that we will be able to reach acceptable contract terms with customers to provide this service. In addition, we may experience delays in the development of one or more features of SIP-IX, which could materially reduce the potential benefits to us for providing this service.

The market for certain of our addressing, interoperability, and infrastructure services is competitive, which could result in fewer customer orders, reduced revenue or margins or loss of market share.

Our services most frequently compete against the legacy in-house systems of our customers. In addition, although we are not a telecommunications service provider, we compete in some areas against communications service companies, communications software companies and system integrators that provide systems and services used by CSPs to manage their networks and internal operations in connection with telephone number portability and other telecommunications transactions. We face competition from large, well-funded providers of addressing, interoperability and infrastructure services. Moreover, we are aware of other companies that are focusing significant resources on developing and marketing services that will compete with us. We anticipate continued growth of competition. Some of our current and potential competitors have significantly more employees and greater financial, technical, marketing and other resources than we have. Our competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements than we can. Also, many of our current and potential competitors have greater name recognition that they can use to their advantage. Increased competition could result in fewer customer orders, reduced revenue, reduced gross margins and loss of market share, any of which could harm our business.

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

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

- competitors offering our customers services at reduced prices, or bundling and pricing services in a manner that makes it difficult for us to compete. For example, a competing provider of interoperability services might offer its services at lower rates than we do, or a competing domain name registry provider may reduce its prices for domain name registration;

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

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

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

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

We earn revenue for the vast majority of the services that we provide on a per transaction basis. There are no minimum revenue requirements in our contracts, which means that there is no limit to the potential adverse effect on our revenue from a decrease in our transaction volumes. As a result, if industry participants reduce their usage of our services from their current levels, our revenue and results of operations will suffer. For example, if customer churn between CSPs in the industry stabilizes or declines, or if CSPs do not compete vigorously to lure customers away from their competitors, use of our telephone number portability and other services may decline. In addition, if CSPs develop internal systems to address their infrastructure needs, or if the cost of such transactions makes it impractical for a given carrier to use our services for these purposes, we may experience a reduction in transaction volumes. Finally, the trends that we believe will drive the future demand for our clearinghouse services, such as the emergence of IP services, growth of wireless services, consolidation in the industry, and pressure on carriers to reduce costs, may not actually result in increased demand for our services, which would harm our future revenue and growth prospects.

If we are unable to manage our growth, our revenue and profits could be adversely affected.

Sustaining our growth has placed significant demands on our management as well as on our administrative, operational and financial resources. For us to continue to manage our growth, we must continue to improve our operational, financial and management information systems and expand, motivate and manage our workforce. If we are unable to successfully manage our growth without compromising our quality of service and our profit margins, or if new systems that we implement to assist in managing our growth do not produce the expected benefits, our revenue and profits could be adversely affected.

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

We have made a number of acquisitions in the past, and one of our strategies is to pursue acquisitions selectively in the future. We may not be able to locate suitable acquisition candidates at prices that we consider appropriate or to finance acquisitions on terms that are satisfactory to us. If we do identify an appropriate acquisition candidate, we may not be able to successfully negotiate the terms of an acquisition, finance the acquisition or, if the acquisition occurs, integrate the acquired business into our existing business. Acquisitions of businesses or other material operations may require additional debt or equity financing, resulting in additional leverage or dilution to our stockholders. Integration of acquired business operations could disrupt our business by diverting management away from day-to-day operations. The difficulties of integration may be increased by the necessity of coordinating geographically dispersed organizations, integrating personnel with disparate business backgrounds and combining different corporate cultures. We also may not realize cost efficiencies or synergies or other benefits that we anticipated when selecting our acquisition candidates. In addition, we may need to record write-downs from future impairments of intangible assets, which could reduce our future reported earnings. For example, we recently acquired UltraDNS Corporation. If we fail to successfully integrate the operations of UltraDNS, or if anticipated revenue enhancements and cost savings are not realized, our business, results of operations and financial condition would be materially adversely affected. Further, at times, acquisition candidates may have liabilities, neutrality-related risks or adverse operating issues that we fail to discover through due diligence prior to the acquisition. The failure to discover such issues prior to such acquisition could have a material adverse effect on our business and results of operations.

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

We intend to pursue international business opportunities, which could involve the growth of our operations in foreign jurisdictions. International operations and business expansion plans are subject to numerous additional risks, including economic and political risks in foreign jurisdictions in which we operate or seek to operate, the difficulty of enforcing contracts and collecting receivables through some foreign legal systems, unexpected changes in regulatory requirements and the difficulties associated with managing a large organization spread throughout various countries. If we continue to expand our business globally, our success will depend, in large part, on our ability to anticipate and effectively manage these and other risks associated with our international operations. However, any of these factors could adversely affect our international operations and, consequently, our operating results.

Our senior management is important to our customer relationships, and the loss of one or more of our senior managers could have a negative impact on our business.

We believe that our success depends in part on the continued contributions of our Chief Executive Officer, Jeffrey Ganek, and other members of our senior management. We rely on our executive officers and senior management to generate business and execute programs successfully. In addition, the relationships and reputation that members of our management team have established and maintain with our customers and our regulators contribute to our ability to maintain good customer relations. The loss of Jeffrey Ganek or any other member of senior management could impair our ability to identify and secure new contracts and otherwise to manage our business.

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

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

We will continue to incur increased costs as a public company as a result of recently enacted and proposed changes in laws and regulations.

Recently enacted and proposed changes in the laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act of 2002 and rules of the Securities and Exchange Commission and the New York Stock Exchange, have resulted and will continue to result in increased costs to us, including those related to corporate governance and the costs to operate as a public company. Section 404 of the Sarbanes-Oxley Act of 2002 requires companies to perform a comprehensive and costly evaluation and obtain an audit of their internal controls. The new rules could also make it more difficult or more costly for us to maintain certain types of insurance, including directors and officers liability insurance. The impact of these events could make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as executive officers.

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

We have historically relied on outside financing and cash flow from operations to fund our operations, capital expenditures and expansion. However, we may require additional capital in the future to fund our operations, finance investments in equipment or infrastructure, or respond to competitive pressures or strategic opportunities. Additional financing may not be available on terms favorable to us, or at all. In addition, the terms of available financing may place limits on our financial and operating flexibility. If we are unable to obtain sufficient capital in the future, we may:

- not be able to continue to meet customer demand for service quality, availability and competitive pricing;
- be forced to reduce our operations;
- not be able to expand or acquire complementary businesses; and
- not be able to develop new services or otherwise respond to changing business conditions or competitive pressures.

Risks Related to Our Common Stock

Our common stock price may be volatile.

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

- our perceived prospects and the prospects of the telephone and Internet industries in general;
- differences between our actual financial and operating results and those expected by investors and analysts;
- changes in analysts recommendations or projections;
- changes in general valuations for communications companies;
- adoption or modification of regulations, policies, procedures or programs applicable to our business;
- sales of our Class A common stock by our officers, directors or principal stockholders;
- sales of significant amounts of our Class A common stock in the public market, or the perception that such sales may occur;
- sales of our Class A common stock due to a required divestiture under the terms of our certificate of incorporation; and
- changes in general economic or market conditions and broad market fluctuations.

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

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

We are a Delaware corporation, and the anti-takeover provisions of the Delaware General Corporation Law may discourage, delay or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a period of three years after the person becomes an interested stockholder, even if a change of control would be beneficial to our existing stockholders. In addition, our certificate of incorporation and bylaws may discourage, delay or prevent a change in our management or control over us that stockholders may consider favorable. Our certificate of incorporation and bylaws:

- authorize the issuance of blank check preferred stock that could be issued by our board of directors to thwart a takeover attempt;
- prohibit cumulative voting in the election of directors, which would otherwise enable holders of less than a majority of our voting securities to elect some of our directors;

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

require that directors only be removed from office for cause;

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

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

limit who may call special meetings of stockholders;

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

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

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

In order to comply with neutrality requirements imposed by the FCC in its orders and rules, no entity that qualifies as a telecommunications service provider or affiliate of a telecommunications service provider, as such terms are defined under the Communications Act of 1934 and FCC rules and orders, may beneficially own 5% or more of our capital stock. As a result, subject to limited exceptions, our certificate of incorporation prohibits any telecommunications service provider or affiliate of a telecommunications service provider from beneficially owning, directly or indirectly, 5% or more of our outstanding capital stock. Among other things, our certificate of incorporation provides that:

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

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

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

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

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

These restrictions and requirements may:

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

- discourage investment in us by other investors who are telecommunications service providers or who may be deemed to be affiliates of a telecommunications service provider.

The standards for determining whether an entity is a telecommunications service provider are established by the FCC. In general, a telecommunications service provider is an entity that offers telecommunications services to the public at large, and is, therefore, providing telecommunications services on a common carrier basis. Moreover, a party will be deemed to be an affiliate of a telecommunications service provider if that party controls, is controlled by, or is under common control with, a telecommunications service provider. A party is deemed to control another if that party, directly or indirectly:

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

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

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

The standards for determining whether an entity is a telecommunications service provider or an affiliate of a telecommunications service provider and the rules applicable to telecommunications service providers and their affiliates are complex and may be subject to change. Each stockholder is responsible for notifying us if it is a telecommunications service provider or an affiliate of a telecommunications service provider.

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

None.

Item 3. Defaults upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit No.	Description
2.1	Agreement and Plan of Merger, dated as of April 19, 2006, by and among NeuStar, Inc., UDNS Merger Sub, Inc., UltraDNS Corporation, and Ron Lachman as the Holder Representative.#
3.1	Restated Certificate of Incorporation.*
3.2	Amended and Restated Bylaws.*
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.^
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.^
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.^
^	Filed or furnished herewith.
#	Incorporated by reference to NeuStar, Inc. s report on Form 8-K, filed on April 25, 2006.
*	Incorporated by reference to NeuStar, Inc. s registration statement on Form S-1 (File No. 333-123635).

SIGNATURES

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

NeuStar, Inc.

Date: May 15, 2006

By: /s/ Jeffrey A. Babka

Jeffrey A. Babka
Chief Financial Officer
(Principal Financial and Accounting Officer
and Duly Authorized Officer)