NEUSTAR INC
Form 10-Q
November 05, 2007

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 September 30, 2007

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 ¨

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 þ Accelerated filer o Non-accelerated filer o.

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 76,900,652 shares of Class A common stock, $0.001 par value, and 4,538 shares of Class B common stock, $0.001 par value, outstanding at October 31, 2007.

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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, 2006	September 30, 2007 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 39,242	$ 118,381
Restricted cash		139
Short-term investments	19,010	27,625
Accounts receivable, net of allowance for doubtful accounts of $1,103 and $1,276, respectively	53,108	71,853
Unbilled receivables	810	247
Notes receivable	1,994	2,116
Prepaid expenses and other current assets	6,945	10,068
Deferred costs	6,032	7,813
Income tax receivable	893	3,081
Deferred tax assets	7,641	15,519
Total current assets	135,675	256,842
Property and equipment, net	42,678	51,727
Goodwill	205,855	203,629
Intangible assets, net	51,196	40,414
Notes receivable, long-term	2,918	1,315
Deferred costs, long-term	4,411	4,105
Deferred tax assets, long-term	4,500	
Other assets	1,026	5,367
Total assets	$ 448,259	$ 563,399

See accompanying notes.

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

	December 31, 2006	September 30, 2007 (unaudited)
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 3,619	$ 6,627
Accrued expenses	49,460	41,494
Deferred revenue	22,923	32,384
Notes payable	768	2,471
Capital lease obligations	4,367	2,577
Accrued restructuring reserve	368	401
Other liabilities	200	100
Total current liabilities	81,705	86,054
Deferred revenue, long-term	17,921	18,023
Notes payable, long-term	174	6,037
Capital lease obligations, long-term	3,751	3,261
Accrued restructuring reserve, long-term	2,206	1,899
Deferred tax liabilities, long-term		1,912
Other liabilities, long-term	1,356	3,301
Total liabilities	107,113	120,487
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.001 par value; 100,000,000 shares authorized; no shares issued or outstanding		
Class A common stock, par value $0.001; 200,000,000 shares authorized; 74,351,200 and 76,822,350 shares issued and outstanding at December 31, 2006 and September 30, 2007, respectively	74	77
Class B common stock, par value $0.001; 100,000,000 shares authorized; 18,330 and 4,538 shares issued and outstanding at December 31, 2006 and September 30, 2007, respectively		
Additional paid-in capital	243,395	285,511
Treasury stock, 756 and 98,509 shares at December 31, 2006 and September 30, 2007, respectively, at cost	(22)	(3,194)
Retained earnings	97,699	160,518
Total stockholders equity	341,146	442,912
Total liabilities and stockholders equity	$ 448,259	$ 563,399

See accompanying notes.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2007**	**2006**	**2007**
Revenue:				
Addressing	$ 28,645	$ 28,451	$ 75,507	$ 82,311
Interoperability	13,550	15,191	40,911	43,153
Infrastructure and other	40,314	67,115	124,517	182,434
Total revenue	82,509	110,757	240,935	307,898
Operating expense:				
Cost of revenue (excluding depreciation and amortization shown separately below)	21,591	24,093	62,422	70,417
Sales and marketing	12,185	16,317	32,754	52,602
Research and development	4,625	5,977	12,782	19,297
General and administrative	9,966	12,978	25,551	35,018
Depreciation and amortization	6,212	9,498	16,493	27,937
	54,579	68,863	150,002	205,271
Income from operations	27,930	41,894	90,933	102,627
Other (expense) income:				
Interest expense	(240)	(504)	(927)	(1,218)
Interest and other income	1,328	1,123	2,729	3,196
Income before minority interest and income taxes	29,018	42,513	92,735	104,605
Minority interest			(95)	
Income before income taxes	29,018	42,513	92,640	104,605
Provision for income taxes	11,914	16,811	37,299	41,786
Net income	$ 17,104	$ 25,702	$ 55,341	$ 62,819
Net income per common share:				
Basic	$ 0.23	$ 0.34	$ 0.77	$ 0.83
Diluted	$ 0.22	$ 0.32	$ 0.71	$ 0.79
Weighted average common shares outstanding:				
Basic	73,042	76,461	71,849	75,664
Diluted	78,399	79,272	78,096	79,120

See accompanying notes.

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

	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2007
Operating activities:		
Net income	$ 55,341	$ 62,819
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	16,493	27,937
Stock-based compensation	8,650	11,589
Amortization of deferred financing costs	5	115
Excess tax benefits from stock-based compensation	(42,419)	(17,997)
Deferred income taxes	2,852	1,737
Provision for doubtful accounts	1,070	1,876
Minority interest	95	
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(15,926)	(22,490)
Unbilled receivables	6,253	563
Notes and securitized notes receivable	(4,311)	1,481
Prepaid expenses and other current assets	731	(519)
Deferred costs	(379)	(1,475)
Income tax receivable	33,873	16,581
Other assets	393	(57)
Other liabilities		48
Accounts payable and accrued expenses	(2,429)	(1,774)
Accrued restructuring reserve	(416)	(274)
Deferred revenue	1,485	8,889
Net cash provided by operating activities	61,361	89,049
Investing activities:		
Purchases of property and equipment	(10,183)	(20,718)
Sales of investments, net	(35,505)	(8,615)
Business acquired, net of cash	(66,925)	(1,569)
Net cash used in investing activities	(112,613)	(30,902)
Financing activities:		
Disbursement of restricted cash	(14)	(139)
Principal repayments on notes payable	(1,126)	(2,522)
Principal repayments on capital lease obligations	(4,535)	(3,705)
Proceeds from exercise of common stock options	14,034	12,533
Excess tax benefits from stock-based compensation	42,419	17,997
Repurchase of restricted stock awards		(3,172)
Net cash provided by financing activities	50,778	20,992

Net (decrease) increase in cash and cash equivalents	(474)	79,139
Cash and cash equivalents at beginning of period	27,529	39,242
Cash and cash equivalents at end of period	$ 27,055	$ 118,381

See accompanying notes.

NEUSTAR, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2007

1. DESCRIPTION OF BUSINESS AND ORGANIZATION

NeuStar, Inc. (the Company) was incorporated as a Delaware corporation in 1998. The Company provides the communications industry with essential clearinghouse services. Its customers use the databases the Company contractually maintains in its clearinghouse to obtain data required to successfully route telephone calls in North America, to exchange information with other communications service providers and to manage technological changes in their own networks. The Company operates the authoritative directories that manage virtually all telephone area codes and numbers, and it enables 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, must access the Company s clearinghouse to properly route virtually all of their customers calls. The Company also provides clearinghouse services to emerging CSPs, including Internet service providers, mobile network operators, cable television operators, and voice over Internet Protocol, or VoIP, service providers. In addition, the Company provides domain name services, including internal and external managed domain name systems (DNS) solutions that play a key role in directing and managing traffic on the Internet, and it also manages the authoritative directories for the .US and .BIZ Internet domains. The Company operates the authoritative directory for U.S. Common Short Codes, part of the short messaging service relied upon by the U.S. wireless industry, and provides solutions used by mobile network operators throughout Europe to enable mobile instant messaging for their end users.

The Company was founded to meet the technical and operational challenges of the communications industry when the U.S. government mandated local number portability in 1996. While the Company remains the provider of the authoritative solution that the communications industry relies upon to meet this mandate, the Company has developed a broad range of innovative services to meet an expanded range of customer needs. The Company provides the communications industry with critical technology services that solve the addressing, interoperability and infrastructure needs of CSPs. These services are now used by CSPs to manage 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 top-level 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 manage their networks more efficiently by centrally managing certain critical data they use to route communications over their own networks.

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 and nine months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the full fiscal year. The consolidated balance sheet as of December 31, 2006 has been derived from the audited consolidated financial statements as of 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, 2006 filed with the Securities and Exchange Commission (SEC).

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

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting periods. Significant estimates and assumptions are inherent in the evaluation of goodwill and intangible assets for potential impairment, including changes in market conditions which could affect the estimated fair values of our reporting units, the analysis and the measurement of deferred tax assets, the identification and quantification of income tax liabilities due to uncertain tax positions, and the determination of the allowance for estimated uncollectible accounts. Actual results could differ from those estimates.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of assets acquired, as well as other definite-lived intangible assets. In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, goodwill and indefinite-lived intangible assets are not amortized, but are reviewed for impairment upon the occurrence of events or changes in circumstances that would reduce the fair value of such assets below their carrying amount. Goodwill is required to be tested for impairment at least annually, or on an interim basis if circumstances change that would indicate the possibility of impairment. For purposes of the Company s annual impairment test, the Company has identified and assigned goodwill to two reporting units, Clearinghouse Services and Next Generation Messaging (NGM) Services.

Goodwill is tested for impairment at the reporting unit level using a two-step approach. The first step is to compare the fair value of a reporting unit s net assets, including assigned goodwill, to the book value of its net assets, including assigned goodwill. Fair value of the reporting unit is determined using both an income and market approach. To assist in the process of determining if a goodwill impairment exists, the Company performs internal valuation analyses and considers other market information that is publicly available, and the Company may obtain appraisals from external advisors. If the fair value of the reporting unit is greater than its net book value, the assigned goodwill is not considered impaired. If the fair value is less than the reporting unit s net book value, we perform a second step to measure the amount of the impairment, if any. The second step would be to compare the book value of the reporting unit s assigned goodwill to the implied fair value of the reporting unit s goodwill, using a theoretical purchase price allocation based on this implied fair value to determine the magnitude of the impairment. If the Company determines that an impairment has occurred, the Company is required to record a write-down of the carrying value and charge the impairment as an operating expense in the period the determination is made. There were no impairment charges recognized during the three and nine months ended September 30, 2006 and 2007.

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 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	3 to 4	Straight-line
Customer lists and relationships	3 to 7	Various
Trade names	3	Straight-line

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

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 indicator 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 using customary valuation techniques, such as a discounted cash flow analysis. There were no impairment charges recognized during the three and nine months ended September 30, 2006 and 2007.

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

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

policies are in accordance with the SEC s 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, directory services for Internet domain names and U.S. Common Short Codes, and internal and external managed domain name services. 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. 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 the event the Company estimates losses on any of its fixed fee contracts, the Company recognizes these losses in the period in which a loss becomes apparent.

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 its 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 through internal and external managed DNS services. This revenue consists of customer set-up fees followed by transaction processing under contracts with terms ranging from one to three years. Customer set-up fees are not considered a separate deliverable and are deferred and recognized on a straight-line basis over the term of the contract. Under the Company s contracts to provide its managed DNS services, customers have contractually established monthly transaction volumes for which they are charged a recurring monthly fee. Transactions processed in excess of the pre-established monthly volume are billed at a contractual per-transaction rate. Each month the Company recognizes the recurring monthly fee and usage in excess of the established monthly volume on a per-transaction basis as services are provided. The Company generates revenue from its U.S. Common Short Code services under short-term contracts ranging from three to twelve months, and the Company recognizes revenue on a straight-line basis over the term of the 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, 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 are not considered separate deliverables; 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 services. The Company generates revenue from network management services under its long-term contracts with North American 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

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

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 equal to 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.

The per-transaction pricing under these contracts prior to 2007 provided for annual volume-based credits that were earned on all transactions in excess of the pre-determined annual volume threshold. For 2006, the maximum aggregate volume-based 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. The pre-determined annual transaction volume threshold under these contracts was exceeded in June 2006, which resulted in the issuance of $2.1 million and $5.4 million of volume-based credits for the three months ended June 30, 2006 and September 30, 2006, respectively.

In September 2006, these contracts were amended such that the expiration dates were extended from May 2011 to June 2015, the per-transaction fee charged to the Company s customers over the term of the contracts was reduced and volume-based credits were eliminated. Pricing for 2006, including volume-based credits, remained unchanged. For 2007, pricing is $0.91 per transaction regardless of transaction volume.

Service Level Standards

Pursuant to certain of the Company s contracts, the Company is subject to service level standards and to corresponding penalties for failure to meet those standards. The Company records a provision for these performance-related penalties when it becomes aware that required service levels that would trigger such a penalty have not been met, which results in a corresponding reduction to revenue.

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 personnel costs associated with service implementation, product maintenance, customer deployment and customer care, including salaries, stock-based compensation and other personnel-related expense. In addition, cost of revenue includes costs relating to maintaining the Company s existing technology and services, as well as royalties paid related to the Company s U.S. Common Short Code services. Cost of revenue also includes the costs incurred by the Company s information technology and systems department, including network costs, data center maintenance, database management, data processing costs, and facilities costs.

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 on a straight-line basis over the contract term. Deferred costs also include royalties paid related to the Company s U.S. Common Short Code services, which are recognized in cost of revenue on a straight-line basis over the contract term. Deferred costs are classified as such on the

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

consolidated balance sheets.

Stock-Based Compensation

The Company accounts for its stock-based compensation plans under the recognition and measurement provisions of SFAS No. 123(R), *Share-Based Payment* (SFAS No. 123(R)). The Company adopted SFAS No. 123(R) on January 1, 2006 using the modified-prospective transition method. Under the modified-prospective transition method, compensation cost recognized includes: (a) compensation cost for all stock-based awards 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, *Accounting for Stock-Based Compensation* (SFAS No. 123) and (b) compensation cost for all stock-based awards granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R).

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 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 nine months ended September 30, 2006 and 2007, the Company presented $42.4 million and $18.0 million, respectively, of excess tax benefits as a financing cash inflow with a corresponding operating cash outflow.

Basic and Diluted Net Income per Common Share

Basic net income per common share excludes dilution for potential common stock issuances and is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted net income 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 temporary differences between the financial reporting bases and the tax bases of assets and liabilities. Deferred tax assets are also recognized for tax net operating loss carryforwards. These deferred tax assets and liabilities are measured using the enacted tax rates and laws that will be in effect when such amounts are expected to be reversed or utilized. The realization of total deferred tax assets is contingent upon the generation of future taxable income. Valuation allowances are provided to reduce such deferred tax assets to amounts more likely than not to be ultimately realized.

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

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109. FIN 48 is effective for fiscal

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

years beginning after December 15, 2006, and was adopted by the Company on January 1, 2007. FIN 48 provides a two-step approach to recognize and measure tax benefits when the realization of the benefits is uncertain. The first step is to determine whether the benefit is to be recognized; the second step is to determine the amount to be recognized. Income tax benefits should be recognized when, based on the technical merits of a tax position, the entity believes that if a dispute arose with the taxing authority and were taken to a court of last resort, it is more likely than not (*i.e.*, a probability of greater than 50 percent) that the tax position would be sustained as filed. If a position is determined to be more likely than not of being sustained, the reporting enterprise should recognize the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority. The cumulative effect of applying the provisions of FIN 48 upon adoption is to be reported as an adjustment to beginning retained earnings. The Company s practice is to recognize interest and penalties related to income tax matters in income tax expense.

Comprehensive Net Income

There were no material differences between net income and comprehensive net income for the three and nine months ended September 30, 2006 and 2007.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 provides enhanced guidance for using fair value to measure assets and liabilities. It clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of SFAS No. 157 on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159), to permit all entities to choose to elect, at specified election dates, to measure eligible financial instruments at fair value. An entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date, and recognize upfront costs and fees related to those items in earnings as incurred and not deferred. SFAS No. 159 applies to fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has also elected to apply the provisions of SFAS No. 157. An entity is prohibited from retrospectively applying SFAS No. 159, unless it chooses early adoption. The Company is currently evaluating the impact of the provisions of SFAS No. 159 on its consolidated financial statements.

3. ACQUISITION

I-View.com, Inc. (d/b/a MetaInfo)

On January 8, 2007, the Company acquired certain assets of I-View.com, Inc. (d/b/a MetaInfo) for cash consideration of $1.7 million. The acquisition of MetaInfo expands the Company s enterprise DNS services. The acquisition was accounted for as a purchase business combination in accordance with SFAS No. 141, *Business Combinations* (SFAS No. 141) and the results of operations of MetaInfo have been included in the accompanying consolidated statement of operations since the date of acquisition. Of the total purchase price, a preliminary estimate of $0.1 million has been allocated to net tangible liabilities assumed, $0.5 million to definite-lived intangible assets and $1.3 million to goodwill. Definite-lived intangible assets consist of customer relationships and acquired technology. The Company is amortizing the value of the customer relationships in proportion to the discounted cash flows over an estimated useful life of 3 years. Acquired technology is being amortized on a straight-line basis over 3 years.

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

The Company has currently not identified any material pre-acquisition contingencies where a liability is probable and the amount of the liability can be reasonably estimated. If information becomes available prior to the end of the purchase price allocation period which would indicate that such a liability is probable and the amounts can be reasonably estimated, such items will be included in the final purchase price allocation.

4. GOODWILL AND INTANGIBLE ASSETS

Goodwill consists of the following (in thousands):

	December 31, 2006	September 30, 2007 (unaudited)
Goodwill	$ 205,855	$ 203,629

Intangible assets consist of the following (in thousands):

	December 31, 2006	September 30, 2007 (unaudited)	Weighted-Average Amortization Period (In Years) (unaudited)
Intangible assets:			
Customer lists and relationships	$ 43,467	$ 43,740	5.7
Accumulated amortization	(5,817)	(13,156)	
Customer lists and relationships, net	37,650	30,584	
Acquired technology	16,808	17,069	3.1
Accumulated amortization	(3,416)	(7,343)	
Acquired technology, net	13,392	9,726	
Trade names	200	200	3.0
Accumulated amortization	(46)	(96)	

