

NEUSTAR INC  
Form 10-Q  
April 27, 2011

**Table of Contents**

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

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

**For the quarterly period ended March 31, 2011**

**OR**

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

**For the transition period from**

**to**

**Commission file number 001-32548**

**NeuStar, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**52-2141938**

(I.R.S. Employer  
Identification No.)

**21575 Ridgetop Circle**

**Sterling, Virginia 20166**

(Address of principal executive offices) (zip code)

**(571) 434-5400**

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Small reporting company

(Do not check if a smaller

reporting company)

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

There were 73,715,630 shares of Class A common stock, \$0.001 par value, and 3,082 shares of Class B common stock, \$0.001 par value, outstanding at April 25, 2011.

**NEUSTAR, INC.  
INDEX**

**PART I FINANCIAL INFORMATION**

<u>Item 1. Financial Statements</u>	3
<u>Consolidated Balance Sheets as of December 31, 2010 and March 31, 2011 (unaudited)</u>	3
<u>Unaudited Consolidated Statements of Operations for the three months ended March 31, 2010 and 2011</u>	5
<u>Unaudited Consolidated Statements of Cash Flows for the three months ended March 31, 2010 and 2011</u>	6
<u>Notes to Unaudited Consolidated Financial Statements</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	23
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	30
<u>Item 4. Controls and Procedures</u>	30

**PART II OTHER INFORMATION**

<u>Item 1. Legal Proceedings</u>	30
<u>Item 1A. Risk Factors</u>	30
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	30
<u>Item 3. Defaults Upon Senior Securities</u>	31
<u>Item 4. [Removed and Reserved]</u>	31
<u>Item 5. Other Information</u>	31
<u>Item 6. Exhibits</u>	32

Signatures

<u>EX-10.1.1</u>	
<u>EX-10.46</u>	
<u>EX-10.47</u>	
<u>EX-10.48</u>	
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	
<u>EX-101 INSTANCE DOCUMENT</u>	
<u>EX-101 SCHEMA DOCUMENT</u>	
<u>EX-101 CALCULATION LINKBASE DOCUMENT</u>	
<u>EX-101 LABELS LINKBASE DOCUMENT</u>	
<u>EX-101 PRESENTATION LINKBASE DOCUMENT</u>	

EX-101 DEFINITION LINKBASE DOCUMENT

EX 31.1

EX 31.2

EX 32.1

EX 101 INSTANCE DOCUMENT

EX 101 SCHEMA DOCUMENT

EX 101 CALCULATION LINKBASE DOCUMENT

EX 101 LABELS LINKBASE DOCUMENT

EX 101 PRESENTATION LINKBASE DOCUMENT

EX 101 DEFINITION LINKBASE DOCUMENT

---

**Table of Contents****PART I - FINANCIAL INFORMATION****Item 1. Financial Statements**

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

	<b>December 31, 2010</b>	<b>March 31, 2011 (unaudited)</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 331,570	\$ 296,684
Restricted cash	556	9,791
Short-term investments	13,802	29,536
Accounts receivable, net of allowance for doubtful accounts of \$1,435 and \$1,850, respectively	82,250	83,520
Unbilled receivables	7,188	7,336
Notes receivable	567	575
Prepaid expenses and other current assets	12,797	11,061
Deferred costs	5,849	6,441
Income taxes receivable		29,706
Deferred tax assets	6,146	5,929
Total current assets	460,725	480,579
Long-term investments	37,009	65,996
Property and equipment, net	74,296	82,883
Goodwill	124,651	124,651
Intangible assets, net	18,974	17,846
Notes receivable, long-term	1,023	876
Deferred costs, long-term	1,052	947
Deferred tax assets, long-term	10,137	5,488
Other assets, long-term	6,007	5,777
Total assets	\$ 733,874	\$ 785,043

*See accompanying notes.*

**Table of Contents**

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

	<b>December 31, 2010</b>	<b>March 31, 2011 (unaudited)</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 3,882	\$ 4,219
Accrued expenses	57,808	42,943
Income taxes payable	1,590	
Deferred revenue	31,751	31,228
Capital lease obligations	6,325	5,552
Accrued restructuring	4,703	2,717
Other liabilities	9,445	9,777
 Total current liabilities	 115,504	 96,436
 Deferred revenue, long-term	 10,578	 11,025
Capital lease obligations, long-term	4,076	3,099
Accrued restructuring, long-term	315	741
Other liabilities, long-term	7,289	10,021
 Total liabilities	 137,762	 121,322
 Commitments and contingencies		
 Stockholders' equity:		
Preferred stock, \$0.001 par value; 100,000,000 shares authorized; no shares issued and outstanding as of December 31, 2010 and March 31, 2011		
Class A common stock, par value \$0.001; 200,000,000 shares authorized; 80,294,573 and 81,341,752 shares issued and outstanding at December 31, 2010 and March 31, 2011, respectively		
	80	81
Class B common stock, par value \$0.001; 100,000,000 shares authorized; 3,082 and 3,082 shares issued and outstanding at December 31, 2010 and March 31, 2011, respectively		
Additional paid-in capital	364,346	379,084
Treasury stock, 6,665,228 and 7,404,789 shares at December 31, 2010 and March 31, 2011, respectively, at cost	(169,848)	(189,039)
Accumulated other comprehensive loss	(144)	(58)
Retained earnings	401,678	473,653
 Total stockholders' equity	 596,112	 663,721
 Total liabilities and stockholders' equity	 \$ 733,874	 \$ 785,043

*See accompanying notes.*



**Table of Contents**

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

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2010</b>	<b>2011</b>
Revenue:		
Carrier Services	\$ 99,788	\$ 110,015
Enterprise Services	29,203	36,480
Total revenue	128,991	146,495
Operating expense:		
Cost of revenue (excluding depreciation and amortization shown separately below)	29,113	31,683
Sales and marketing	22,854	25,999
Research and development	4,078	4,038
General and administrative	18,449	21,183
Depreciation and amortization	10,143	9,516
Restructuring charges	2,349	1,718
	86,986	94,137
Income from operations	42,005	52,358
Other (expense) income:		
Interest and other expense	(1,748)	(2,513)
Interest and other income	1,390	203
Income before income taxes	41,647	50,048
Provision (benefit) for income taxes	16,445	(21,927)
Net income	\$ 25,202	\$ 71,975
Net income per share:		
Basic	\$ 0.34	\$ 0.97
Diluted	\$ 0.33	\$ 0.96
Weighted average common shares outstanding:		
Basic	74,613	73,938
Diluted	75,944	75,285

*See accompanying notes.*



**Table of Contents**

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

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2010</b>	<b>2011</b>
Operating activities:		
Net income	\$ 25,202	\$ 71,975
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,143	9,516
Stock-based compensation	3,866	6,296
Amortization of deferred financing costs	42	42
Excess tax benefits from stock option exercises	(350)	(1,914)
Deferred income taxes	(1,388)	4,785
Provision for doubtful accounts	266	1,009
Gain on trading securities	(61)	
Amortization of bond premium (discount), net		449
Loss on asset sale		1,933
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(3,444)	(3,164)
Unbilled receivables	(1,152)	(334)
Notes receivable		139
Prepaid expenses and other current assets	359	1,736
Deferred costs	402	(487)
Income taxes receivable		(29,706)
Other assets	(619)	334
Other liabilities	714	(636)
Accounts payable and accrued expenses	(27,309)	(15,006)
Income taxes payable	13,490	(248)
Accrued restructuring	(706)	(1,560)
Deferred revenue	2,449	85
Net cash provided by operating activities	21,904	45,244
Investing activities:		
Purchases of property and equipment	(7,191)	(13,248)
Sales of investments	650	257
Purchases of investments		(45,428)
Net cash used in investing activities	(6,541)	(58,419)
Financing activities:		
Increase of restricted cash	(12)	(9,235)
Principal repayments on notes payable	(987)	
Principal repayments on capital lease obligations	(3,545)	(1,750)
Proceeds from exercise of common stock options	2,443	6,570
Excess tax benefits from stock-based compensation	350	1,914
Repurchase of restricted stock awards	(300)	(713)
Repurchase of common stock		(18,478)

Edgar Filing: NEUSTAR INC - Form 10-Q

Net cash used in financing activities	(2,051)	(21,692)
Effect of foreign exchange rates on cash and cash equivalents	(7)	(19)
Net increase (decrease) in cash and cash equivalents	13,305	(34,886)
Cash and cash equivalents at beginning of period	304,581	331,570
Cash and cash equivalents at end of period	\$ 317,886	\$ 296,684

*See accompanying notes.*

6

---

**Table of Contents**

**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2011**

**1. DESCRIPTION OF BUSINESS AND ORGANIZATION**

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

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

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

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

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Unaudited Interim Financial Information**

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

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

**Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting periods. Significant estimates and assumptions are inherent in the analysis and the measurement of deferred tax assets; the identification and

**Table of Contents**

**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2011**

quantification of income tax liabilities due to uncertain tax positions; restructuring liabilities; valuation of investments; recoverability of intangible assets, other long-lived assets and goodwill; and the determination of the allowance for doubtful accounts. The Company bases its estimates on historical experience and assumptions that it believes are reasonable. Actual results could differ from those estimates.

**Fair Value of Financial Instruments**

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

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

	December 31, 2010		March 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 331,570	\$ 331,570	\$ 296,684	\$ 296,684
Restricted cash (current assets)	\$ 556	\$ 556	\$ 9,791	\$ 9,791
Short-term investments	\$ 13,802	\$ 13,802	\$ 29,536	\$ 29,536
Notes receivable	\$ 1,590	\$ 1,590	\$ 575	\$ 575
Marketable securities (other assets, long-term)	\$ 3,681	\$ 3,681	\$ 4,358	\$ 4,358
Long-term investments	\$ 37,009	\$ 37,009	\$ 65,996	\$ 65,996
Deferred compensation (other liabilities, long-term)	\$ 3,621	\$ 3,621	\$ 4,332	\$ 4,332

**Restricted Cash**

As of December 31, 2010 and March 31, 2011, restricted cash was \$0.6 million and \$9.8 million, respectively. As of March 31, 2011, cash of \$9.3 million was restricted as collateral for the Company's outstanding letters of credit (see Note 6). As of December 31, 2010 and March 31, 2011, cash of \$0.6 million and \$0.5 million, respectively, was restricted for deposits on leased facilities.

**Revenue Recognition**

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

**Significant Contracts**

As part of its carrier services, the Company provides number portability administration center services (NPAC Services), which include wireline and wireless number portability, implementation of the allocation of pooled blocks of telephone numbers and network management services in the United States pursuant to seven contracts with North American Portability Management LLC (NAPM), an industry group that represents all telecommunications service providers in the United States. The aggregate fees for transactions processed under these contracts are determined by an annual fixed-fee pricing model under which the annual fixed fee (Base Fee) was set at \$362.1 million and \$385.6 million in 2010 and 2011, respectively, and is subject to an annual price escalator of 6.5% in subsequent years. These contracts also provide for fixed credits to customers of \$25.0 million in 2010 and \$5.0 million in 2011, which were applied to reduce the Base Fee for the applicable year. Customers under these contracts may earn additional credits of up to \$15.0 million annually in each of 2010 and 2011 if the customers reach specific levels of aggregate telephone number inventories and adopts and implements certain IP fields and functionality. These contracts also

enable the Company's customers to earn credits if the volume of transactions in a given year is above or below the contractually established volume range for that year. The determination of credits earned based on transaction volume is done annually at the end of each year and earned credits are applied to the following year's invoices. To the extent any additional credits expire unused at the end of a year, they will be recognized in revenue at that time.

**Table of Contents**

**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2011**

The Company determines the fixed and determinable fee under these contracts on an annual basis at the beginning of each year and recognizes this fee in its Carrier Services operating segment on a straight-line basis over twelve months. For 2010, the Company concluded that the fixed and determinable fee equaled \$322.1 million, which represented the Base Fee of \$362.1 million, reduced by the \$25.0 million fixed credit and \$15.0 million of additional credits. For 2011, the Company concluded that the fixed and determinable fee equals \$365.6 million, which represents the Base Fee of \$385.6 million, reduced by the \$5.0 million fixed credit and \$15.0 million of additional credits. As of March 31, 2011, the Company has determined that its carrier customers have earned all of the additional credits of \$15.0 million attributable to the adoption and implementation of the requisite IP fields and functionality and the achievement of specific levels of aggregate telephone number inventories.

The total amount of revenue derived under the Company's contracts with NAPM, comprised of NPAC Services, connection service fees related to the Company's NPAC Services and system enhancements, was approximately \$84.8 million and \$93.8 million for the three months ended March 31, 2010 and 2011, respectively.

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

***Carrier Services***

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

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

The Company generates revenue from its telephone number administration services under two government contracts: North American Numbering Plan Administrator (NANPA) and National Pooling Administrator (NPA). Under its NANPA contract, the Company earns a fixed annual fee and recognizes this fee as revenue on a straight-line basis as services are provided. Under its NPA contract, the Company earns a fixed fee associated with administration of the pooling system. The Company recognizes revenue for this contract on a straight-line basis over the term of the contract. In the event the Company estimates losses on these fixed price contracts, the Company recognizes these losses in the period in which a loss becomes apparent.

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

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 is not considered a separate deliverable; accordingly, the fees for these services are deferred and recognized as revenue on a straight-line basis over the term of the contract. Per-transaction fees are recognized as the transactions are processed.

***Enterprise Services***

The Company generates revenue from the management of internal and external DNS services. The Company's revenue from these services consists of customer set-up fees, monthly recurring fees and per-transaction fees for transactions in excess of pre-established monthly minimums under contracts with terms ranging from one to three years. Customer set-up fees are not considered a separate deliverable and are deferred and recognized on a

straight-line basis over the term of the contract. Under the Company's contracts to provide DNS services, customers have contractually established monthly transaction volumes for which they are charged a recurring monthly fee. Transactions processed in excess of the pre-established monthly volume are billed at a contractual per-transaction rate. Each month, the Company recognizes the recurring monthly fee and usage in excess of the established monthly volume on a per-transaction basis as services are provided.



**Table of Contents**

**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2011**

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

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

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

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

During 2010 and the three months ended March 31, 2011, certain of the Company's arrangements included customer set-up and implementation services, followed by ongoing transaction processing. These customer set-up and implementation services were not considered a separate deliverable that provides stand-alone value to the customer and such fees were deferred and recognized as revenue on a straight-line basis over the term of the contract. Accordingly, the adoption of ASU 2009-13 did not have a material effect on the Company's revenue recognized for the three months ended March 31, 2011. Assuming the adoption of ASU 2009-13 on a prospective basis for arrangements entered into or materially modified on or after January 1, 2010, the effect on revenue recognized for the three months ended March 31, 2010 would not have been materially different.

***Service Level Standards***

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

**Income Taxes**

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

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

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

**Recent Accounting Pronouncements**

There have been no developments to recently issued accounting standards, including the expected dates of adoption and estimated effects on the Company's consolidated financial statements, from those disclosed in the 2010 Form 10-K.

Table of Contents

**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2011**

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

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

The Company elected to measure the ARS Rights at their fair value pursuant to the Financial Instruments Topic of the FASB ASC and to classify the associated ARS as trading securities. During the three months ended March 31, 2010, the Company recorded a loss of \$1.1 million, related to the change in estimated fair value of the ARS Rights and a gain of \$1.0 million, related to the change in estimated fair value of the ARS.

Under the terms of the ARS Rights, if the investment firm was successful in selling any ARS prior to June 30, 2010, the investment firm was obligated to pay the Company par value for any ARS sold. During the three months ended March 31, 2010, the investment firm sold ARS with an original par value of \$0.7 million. The Company received this amount in cash from the investment firm and recognized realized gains of \$0.1 million.

**Pre-refunded Municipal Bonds and U.S. Treasury Notes**

As of December 31, 2010 and March 31, 2011, the Company held approximately \$50.8 million and \$75.4 million, respectively, in pre-refunded municipal bonds, secured by an escrow fund of U.S. Treasury securities. In addition, as of March 31, 2011, the Company held approximately \$20.1 million in U.S. Treasury notes. These investments are accounted for as available-for-sale securities in the Company's consolidated balance sheet pursuant to the Investments Debt and Equity Securities Topic of the FASB ASC. The Company did not have any sales or record any impairment charges related to these investments during 2010. During the three months ended March 31, 2011, the Company sold approximately \$0.3 million of pre-refunded municipal bonds, classified as short-term investments. The following table summarizes the Company's investment in these investments as of December 31, 2010 and March 31, 2011 (in thousands):

	Amortized Cost	December 31, 2010		Estimated Fair Value
		Gross Unrealized Gains	Losses	
Due within one year:				
Municipal bonds	\$ 13,782	\$ 23	\$ (3)	\$ 13,802
Due after one year through three years:				
Municipal bonds	36,968	61	(20)	37,009
Total	\$ 50,750	\$ 84	\$ (23)	\$ 50,811
	Amortized Cost	March 31, 2011		Estimated Fair Value
		Gross Unrealized Gains	Losses	
Due within one year:				
Municipal bonds	\$ 29,525	\$ 17	\$ (6)	\$ 29,536
Due after one year through three years:				
Municipal bonds	45,832	63	(28)	45,867
U.S. Treasury notes	20,115	14		20,129
Total	\$ 95,472	\$ 94	\$ (34)	\$ 95,532



**Table of Contents**

**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2011**

**4. FAIR VALUE MEASUREMENTS**

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

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

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

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

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

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

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

	<b>March 31, 2011</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Municipal bonds (maturities less than one year)	\$ 29,536	\$	\$	\$ 29,536
Municipal bonds (maturities one to three years)	\$ 45,867	\$	\$	\$ 45,867
U.S. Treasury notes (maturity one to three years)	\$ 20,129	\$	\$	\$ 20,129
Marketable securities <sup>(1)</sup>	\$ 4,358	\$	\$	\$ 4,358
Deferred compensation <sup>(2)</sup>	\$ 4,332	\$	\$	\$ 4,332

(1) The NeuStar, Inc. Deferred Compensation Plan (the Plan) provides directors and certain employees with the ability to defer a portion of their compensation. The assets of the Plan are invested in marketable securities held in a Rabbi Trust and reported at market value in other assets.

(2) Obligations to pay benefits under the Plan are included in other long-term liabilities.

**Table of Contents**

**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2011**

**5. GOODWILL AND INTANGIBLE ASSETS****Goodwill**

There were no changes in the carrying amount of goodwill by operating segment during the three months ended March 31, 2011. The Company's goodwill by operating segment as of December 31, 2010 and March 31, 2011 is as follows (in thousands):

	<b>December 31, 2010</b>	<b>March 31, 2011</b>
Carrier Services:		
Gross goodwill	\$ 202,055	\$ 202,055
Accumulated impairment losses	(93,602)	(93,602)
Net goodwill	108,453	108,453
Enterprise Services:		
Gross goodwill	16,198	16,198
Accumulated impairment losses		
Net goodwill	16,198	16,198
Total:		
Gross goodwill	218,253	218,253
Accumulated impairment losses	(93,602)	(93,602)
Net goodwill	\$ 124,651	\$ 124,651

**Intangible Assets**

Intangible assets consist of the following (in thousands):

	<b>December 31, 2010</b>	<b>March 31, 2011</b>	<b>Weighted- Average Amortization Period (in years)</b>
Intangible assets:			
Customer lists and relationships	\$ 49,881	\$ 49,881	6.0
Accumulated amortization	(34,062)	(34,897)	
Customer lists and relationships, net	15,819	14,984	
Acquired technology	19,554	19,554	3.4

Edgar Filing: NEUSTAR INC - Form 10-Q

Accumulated amortization	(16,805)	(17,064)	
Acquired technology, net	2,749	2,490	
Trade name	630	630	3.0
Accumulated amortization	(224)	(258)	
Trade name, net	406	372	
Intangible assets, net	\$ 18,974	\$ 17,846	

Amortization expense related to intangible assets, which is included in depreciation and amortization expense, was approximately \$1.2 million and \$1.1 million for the three months ended March 31, 2010 and 2011, respectively. Amortization expense related to intangible assets for the years ended December 31, 2011, 2012, 2013, 2014, 2015 and thereafter is expected to be approximately \$4.4 million, \$4.1 million, \$2.7 million, \$2.1 million, \$2.0 million and \$3.6 million, respectively. Intangible assets as of March 31, 2011 will be fully amortized during the year ended December 31, 2017.

**Table of Contents**

**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2011**

**6. NOTES PAYABLE**

On February 6, 2007, the Company entered into a credit agreement which provides for a revolving credit facility in an aggregate principal amount of up to \$100 million (the Credit Facility). Borrowings under the Credit Facility bear interest, at the Company's option, at either a Eurodollar rate plus a spread ranging from 0.625% to 1.25%, or at a base rate plus a spread ranging from 0.0% to 0.25%, with the amount of the spread in each case depending on the ratio of the Company's consolidated senior funded indebtedness to consolidated earnings before interest, taxes, depreciation and amortization (EBITDA). The Credit Facility expires on February 6, 2012. Borrowings under the Credit Facility may be used for working capital, capital expenditures, general corporate purposes and to finance acquisitions. There were no borrowings outstanding under the Credit Facility as of December 31, 2010 and March 31, 2011. As of December 31, 2010, available borrowings were reduced by outstanding letters of credit of \$8.8 million. As of March 31, 2011, the Company's available borrowings under the Credit Facility were \$100 million and the \$8.8 million of outstanding letters of credit were collateralized by \$9.3 million of restricted cash.

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

**7. STOCKHOLDERS' EQUITY****Stock-Based Compensation**

The Company has three stock incentive plans: the NeuStar, Inc. 1999 Equity Incentive Plan (1999 Plan); the NeuStar, Inc. 2005 Stock Incentive Plan (2005 Plan); and the NeuStar, Inc. 2009 Stock Incentive Plan (2009 Plan) (collectively, the Plans). The Company may grant to its directors, employees and consultants awards under the 2009 Plan in the form of incentive stock options, nonqualified stock options, stock appreciation rights, shares of restricted stock, restricted stock units, performance vested restricted stock units (PVRSUs) and other stock-based awards. The aggregate number of shares of Class A common stock with respect to which all awards may be granted under the 2009 Plan is 10,950,000, plus the number of shares underlying awards granted under the 1999 Plan and the 2005 Plan that remain undelivered following any expiration, cancellation or forfeiture of such awards. As of March 31, 2011, 7,073,592 shares were available for grant or award under the 2009 Plan.

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

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

Stock-based compensation expense recognized for the three months ended March 31, 2010 and 2011 was \$3.9 million and \$6.3 million, respectively. As of March 31, 2011, total unrecognized compensation expense related to non-vested stock options, non-vested restricted stock awards, non-vested restricted stock units and non-vested PVRSUs granted prior to that date was estimated at \$48.2 million, which the Company expects to recognize over a



weighted average period of approximately 1.73 years. Total unrecognized compensation expense as of March 31, 2011 is estimated based on outstanding non-vested stock options, non-vested restricted stock awards, non-vested restricted stock units and non-vested PVRsUs and may be increased or decreased in future periods for subsequent grants or forfeitures, as well as changes in the estimated fair value of non-vested share-based awards granted to consultants.

Table of Contents

**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2011**

**Stock Options**

The Company utilizes the Black-Scholes option pricing model for estimating the fair value of stock options granted. The weighted-average grant date fair value of options granted during the three months ended March 31, 2010 and 2011 was \$8.07 and \$8.70, respectively. The following are the weighted-average assumptions used in valuing the stock options granted during the three months ended March 31, 2010 and 2011, and a discussion of the Company's assumptions:

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2011</b>
Dividend yield	%	%
Expected volatility	39.30%	36.98%
Risk-free interest rate	2.17%	1.70%
Expected life of options (in years)	4.42	4.42

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

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

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

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

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

	<b>Shares</b>	<b>Weighted- Average Exercise Price</b>	<b>Aggregate Intrinsic Value (in millions)</b>	<b>Weighted- Average Remaining Contractual Life (in years)</b>
Outstanding at December 31, 2010	6,715,559	\$ 20.68		
Options granted	1,772,973	26.45		
Options exercised	(790,929)	8.31		
Options forfeited	(138,156)	22.26		
Outstanding at March 31, 2011	7,559,447	\$ 23.30	\$ 27.0	4.84
Exercisable at March 31, 2011	3,412,707	\$ 23.05	\$ 16.6	3.28

The aggregate intrinsic value of options exercised for the three months ended March 31, 2010 and 2011 was \$1.9 million and \$14.3 million, respectively.

**Table of Contents**

**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2011**

**Restricted Stock**

The following table summarizes the Company's non-vested restricted stock activity for the three months ended March 31, 2011:

	<b>Shares</b>	<b>Weighted- Average Grant Date Fair Value</b>	<b>Aggregate Intrinsic Value (in millions)</b>
Outstanding at December 31, 2010	534,590	\$ 22.82	
Restricted stock granted	284,615	26.45	
Restricted stock vested	(78,869)	22.74	
Restricted stock forfeited	(28,365)	24.55	
Outstanding at March 31, 2011	711,971	\$ 24.21	\$ 18.2

The total aggregate intrinsic value of restricted stock vested during the three months ended March 31, 2011 was approximately \$2.0 million. During the three months ended March 31, 2011, the Company repurchased 27,618 shares of common stock for an aggregate purchase price of \$0.7 million, pursuant to the participants' rights under the Company's stock incentive plans to elect to use common stock to satisfy their tax withholding obligations.

**Performance Vested Restricted Stock Units**

During the year ended December 31, 2010 and the three months ended March 31, 2011, the Company granted 266,580 and 232,537 PVRsUs, respectively, to certain employees with an aggregate fair value of \$6.1 million and \$6.2 million, respectively. The vesting of these stock awards is contingent upon the Company achieving specified financial targets at the end of the specified performance period and an employee's continued employment through the vesting period. The level of achievement of the performance conditions affects the number of shares that will ultimately be issued. The range of possible stock-based award vesting is between 0% and 150% of the initial target. Compensation expense related to these awards is recognized over the requisite service period based on the Company's estimate of the achievement of the performance target and vesting period. As of March 31, 2011, the Company estimates that 100% of the performance target for PVRsUs granted during each of 2010 and 2011, respectively, will be achieved.

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

The following table summarizes the Company's non-vested PVRsU activity for the three months ended March 31, 2011:

	<b>Shares</b>	<b>Weighted- Average Grant Date Fair Value</b>	<b>Aggregate Intrinsic Value (in millions)</b>
Non-vested December 31, 2010	840,923	\$ 19.53	
Granted	232,537	26.45	

Edgar Filing: NEUSTAR INC - Form 10-Q

Vested				
Forfeited	(199,090)		25.15	
Non-vested March 31, 2011	874,370	\$	20.09	\$ 22.4

**Table of Contents**

**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2011**

**Restricted Stock Units**

The following table summarizes the Company's restricted stock units activity for the three months ended March 31, 2011:

	<b>Shares</b>	<b>Weighted-Average Grant Date Fair Value</b>	<b>Aggregate Intrinsic Value (in millions)</b>
Outstanding at December 31, 2010	231,865	\$ 23.99	
Granted			
Vested			
Forfeited	(750)	25.84	
Outstanding at March 31, 2011	231,115	\$ 23.99	\$ 5.9

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

**Share Repurchase Program**

The Company announced on July 28, 2010 that its Board of Directors had authorized a three-year program under which the Company may acquire up to \$300 million of its outstanding Class A common shares. Share repurchases under this program may be made through Rule 10b5-1 programs, open market purchases, privately negotiated transactions or otherwise as market conditions warrant, at prices the Company deems appropriate, and subject to applicable legal requirements and other factors. During the first quarter of 2011, the Company repurchased 0.7 million shares of its Class A common stock at an average price of \$25.95 per share, for a total purchase price of \$18.5 million. As of March 31, 2011, a total of 2.4 million shares at an average price of \$24.74 per share had been repurchased under this program for an aggregate purchase price of \$58.9 million. All repurchased shares are accounted for as treasury shares.

**8. BASIC AND DILUTED NET INCOME PER COMMON SHARE**

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

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2011</b>
Computation of basic net income per common share:		
Net income	\$ 25,202	\$ 71,975
Weighted average common shares and participating securities outstanding - basic	74,613	73,938

Edgar Filing: NEUSTAR INC - Form 10-Q

Basic net income per common share	\$ 0.34	\$ 0.97
Computation of diluted net income per common share:		
Net income	\$ 25,202	\$ 71,975
Weighted average common shares and participating securities outstanding    basic	74,613	73,938
Effect of dilutive securities:		
Stock-based awards	1,331	1,347
Weighted average common shares outstanding    diluted	75,944	75,285
Diluted net income per common share	\$ 0.33	\$ 0.96

**Table of Contents**

**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2011**

Diluted earnings per common share reflects the potential dilution of common stock equivalents such as options and warrants, to the extent the impact is dilutive. Common stock options to purchase an aggregate of 3,672,553 and 4,340,519 shares were excluded from the calculation of the denominator for diluted net income per common share for the three months ended March 31, 2010 and 2011, respectively, due to their anti-dilutive effects.

**9. COMPREHENSIVE INCOME**

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

The following table summarizes the components of total comprehensive income, net of taxes, during the three months ended March 31, 2010 and 2011 (in thousands):

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2011</b>
Net income	\$ 25,202	\$ 71,975
Unrealized loss / gain on investments	44	79
Accumulated translation adjustments	(14)	7
<b>Total comprehensive income</b>	<b>\$ 25,232</b>	<b>\$ 72,061</b>

The following table summarizes the tax (provision) or benefit for each component of total comprehensive income during the three months ended March 31, 2010 and 2011 (in thousands):

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2011</b>
Tax (provision) benefit:		
Unrealized loss / gain on investments	\$ (28)	\$ (65)
Accumulated translation adjustments	\$ (7)	\$ (25)

**10. RESTRUCTURING CHARGES**

During the three months ended March 31, 2010 and 2011, the Company recorded restructuring charges of \$2.3 million and \$1.7 million, respectively. During the three months ended March 31, 2010, the Company's restructuring charges consisted of charges incurred under its Converged Messaging Services restructuring plan initiated in 2008, and its 2009 restructuring plan to relocate certain operations and support functions to Louisville, Kentucky. The Company completed its 2009 Kentucky relocation plan in the third quarter of 2010. During the three months ended March 31, 2011, the Company's restructuring charges consisted of charges incurred under its Converged Messaging Services and its 2010 Management Transition restructuring plans.

**Restructuring Plans*****Converged Messaging Services***

Beginning in the fourth quarter of 2008, management committed to and implemented a restructuring plan for the Company's Converged Messaging Services business, previously known as the Company's Next Generation Messaging (NGM) business, to more appropriately allocate resources to the Company's key mobile instant messaging initiatives. The restructuring plan involved a reduction in headcount and closure of specific leased facilities in some of the Company's international locations. In the third quarter of 2009 and fourth quarter of 2010, the Company extended the restructuring plan to include further headcount reductions and closure of certain additional facilities. During the first quarter of 2011, the Company sold certain assets and liabilities of Neustar NGM Services, Inc. and its subsidiaries, and initiated the wind-down of the residual operations of its Converged Messaging Services





**Table of Contents**

**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2011**

business. The Company anticipates that it will incur additional restructuring charges related to the wind-down of its Converged Messaging Services business through the third quarter of 2011 of approximately \$0.3 million. Total net restructuring charges recorded since the fourth quarter of 2008 include approximately \$8.4 million of severance and severance-related costs and \$1.5 million of lease and facility exit costs. Amounts related to lease terminations due to the closure of excess facilities will be paid over the remainder of the respective lease terms, the longest of which extends through 2013. The Company's Converged Messaging Services business is included in the Carrier Services operating segment.

**2010 Management Transition**

In the fourth quarter of 2010, the Company initiated a domestic work-force reduction impacting both of its operating segments and recorded severance and severance-related charges of \$3.8 million. During the first quarter of 2011, the Company recorded additional severance and severance-related charges of \$0.4 million in connection with its restructuring initiative. The Company does not anticipate it will incur additional expenses under this plan and expects to pay approximately \$1.4 million in severance and severance-related payments through the third quarter of 2012.

**2001 Plan**

At December 31, 2010 and March 31, 2011, the liability related to a reduction in leased facilities incurred in connection with a 2001 restructuring plan was \$0.8 million and \$0.7 million, respectively. Amounts related to lease terminations due to the closure of facilities under this 2001 restructuring plan will be paid over the remainder of the respective lease terms, the longest of which extends through 2011.

**Summary of Accrued Restructuring Plans**

The additions and adjustments to the accrued restructuring liability related to the Company's restructuring plans as described above for the three months ended March 31, 2011 are as follows (in thousands):

	December 31, 2010	Additional Costs	Cash Payments	Adjustments	March 31, 2011
Converged Messaging Services:					
Severance and related costs	\$ 656	\$ 689	\$ (753)	\$ (120)	\$ 472
Lease and facilities exit costs	172		(91)	717	798
Total Converged Messaging Services	828	689	(844)	597	1,270
2010 Management Transition:					
Severance and related costs	3,354	447	(2,347)	(15)	1,439
2001 Plan:					
Lease and facilities exit costs	836		(87)		749
Total restructuring plans	\$ 5,018	\$ 1,136	\$ (3,278)	\$ 582	\$ 3,458

**11. OTHER (EXPENSE) INCOME**

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

	Three Months Ended March 31,	
	2010	2011
Interest and other expense:		
Interest expense	\$ 543	\$ 353

Loss on asset disposals	40	2,109
Loss on ARS Rights	1,072	
Foreign currency transaction loss	93	51
Total	\$ 1,748	\$ 2,513
Interest and other income:		
Interest income	\$ 257	\$ 203
ARS trading gains	1,133	
Total	\$ 1,390	\$ 203

**Table of Contents**

**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2011**

During the three months ended March 31, 2011, the Company sold certain assets and liabilities of its Converged Messaging Services business and recognized a loss on sale of approximately \$1.9 million.

**12. INCOME TAXES**

On February 7, 2011, the Company sold certain business assets and liabilities of Neustar NGM Services, Inc. (NGM Services) and its subsidiaries. The Company intends to treat the common stock of NGM Services as worthless for U.S. income tax purposes in its 2011 U.S. federal and state income tax returns. As a result, the Company recorded an income tax benefit of \$42.7 million for the three months ended March 31, 2011, which primarily represents the book and tax basis differences associated with its investment in NGM Services. The Company also recognized \$0.8 million income tax provision primarily related to settlement of its Internal Revenue Service (IRS) examination and an increase in uncertain tax positions. The Company's effective tax rate decreased to (43.8)% for the three months ended March 31, 2011 from 39.5% for the three months ended March 31, 2010. Excluding the discrete items discussed above, the Company's effective tax rate was 40.0% for the three months ended March 31, 2011.

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

The Company recognizes potential interest and penalties related to uncertain tax positions in income tax expense. The Company recognized potential interest and penalties of \$11,000 and \$39,000 for the three months ended March 31, 2010 and 2011, respectively. As of December 31, 2010 and March 31, 2011, the Company had established reserves of approximately \$84,000 and \$123,000, respectively, for accrued potential interest and penalties related to uncertain tax positions. To the extent interest and penalties are not assessed with respect to uncertain tax positions, amounts accrued will be reduced and reflected as a reduction of the overall income tax provision.

The Company files income tax returns in the United States Federal jurisdiction and in many state and foreign jurisdictions. The tax years 2006 through 2010 remain open to examination by the major taxing jurisdictions to which the Company is subject. The IRS completed an examination of the Company's federal income tax returns for the years 2007 and 2008. The audit resulted in no material effect on the Company's financial position, results of operations or cash flows. The Israeli Taxing Authority has initiated an examination of the Company's income tax returns for years 2007 through 2010. While the outcome of the audit is uncertain, management does not currently believe that the outcome will have a material adverse effect on the Company's financial position, results of operations or cash flows.

The Company anticipates that total unrecognized tax benefits will decrease by approximately \$509,000 over the next twelve months due to the expiration of certain statutes of limitations.

**13. SEGMENT INFORMATION**

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

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

The Company's Enterprise Services operating segment provides services to its enterprise customers to meet their respective directory-related needs, as well as Internet infrastructure services. The Company is the authoritative provider of essential registry services and manages directories of similar resources, or addresses, that its customers use for reliable, fair and secure access and connectivity. The Company provides a suite of DNS services to its enterprise customers built on a global directory platform. The Company manages a collection of directories that maintain addresses in order to direct, prioritize and manage Internet traffic, and to



**Table of Contents**

**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2011**

find and resolve Internet queries and top-level domains. The Company's services monitor and load-test websites to help identify issues and optimize performance. In addition, the Company provides IP geolocation services that help enterprises identify the location of their consumers used in a variety of purposes, such as target marketing and fraud prevention. Additionally, the Company provides directory services for the 5- and 6-digit number strings used for all U.S. Common Short Codes, which is part of the short messaging service relied upon by the U.S. wireless industry.

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

Information for the three months ended March 31, 2010 and 2011 regarding the Company's reportable segments is as follows (in thousands):

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2010</b>	<b>2011</b>
Revenue:		
Carrier Services	\$ 99,788	\$ 110,015
Enterprise Services	29,203	36,480
Total revenue	\$ 128,991	\$ 146,495
Segment contribution:		
Carrier Services	\$ 86,069	\$ 94,743
Enterprise Services	12,788	15,651
Total segment contribution	98,857	110,394
Indirect operating expenses:		
Cost of revenue (excluding depreciation and amortization shown separately below)	18,860	19,632
Sales and marketing	4,604	3,825
Research and development	3,523	3,619
General and administrative	17,373	19,726
Depreciation and amortization	10,143	9,516
Restructuring charges	2,349	1,718
Consolidated income from operations	\$ 42,005	\$ 52,358

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

**Enterprise-Wide Disclosures**

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

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2010</b>	<b>2011</b>
Revenues by geographical areas:		
North America	\$ 120,480	\$ 137,093
Europe and Middle East	5,157	5,806
Other regions	3,354	3,596
Total revenues	\$ 128,991	\$ 146,495

**Table of Contents**

**NEUSTAR, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2011**

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2011</b>
Revenues by service offerings:		
Carrier Services:		
Numbering Services	\$ 90,701	\$ 99,426
Order Management Services	4,521	7,144
IP Services	4,566	3,445
Total Carrier Services	99,788	110,015
Enterprise Services:		
Internet Infrastructure Services	15,448	20,404
Registry Services	13,755	16,076
Total Enterprise Services	29,203	36,480
Total revenues	\$ 128,991	\$ 146,495
	<b>December 31, 2010</b>	<b>March 31, 2011</b>
Long-lived assets, net		
North America	\$ 91,675	\$ 100,429
Europe and Middle East	1,588	296
Other regions	7	4
Total long-lived assets, net	\$ 93,270	\$ 100,729

**14. SUBSEQUENT EVENT**

On April 21, 2011, the Company entered into a definitive agreement to acquire the assets and certain liabilities of the Numbering Solutions business from Evolving Systems, Inc. for cash consideration of approximately \$39.0 million, subject to certain purchase price adjustments. Evolving Systems' Numbering Solutions business will expand the Company's Carrier Services and further the Company's long-term initiative to simplify operators' Operating Support Systems architectures by mitigating cost and complexity, while making the evolution to next-generation networks more efficient, manageable, and flexible to meet the increasingly complex needs of end-users. The acquisition, which is subject to customary closing conditions including the affirmative vote of a majority of Evolving Systems, Inc. stockholders, is expected to close within 120 days.



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

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

**Overview**

During the first quarter we continued to experience increased demand for our solutions around our Numbering Services, Internet Infrastructure Services, or IIS, and Registry Services. Total revenue for the quarter grew 13.6% to \$146.5 million as compared to \$129.0 million in the first quarter of 2010. This revenue increase was primarily driven by an established increase in the fixed fee under our contracts with the North American Portability Management LLC, or NAPM, for our number portability administration center services, or NPAC Services. We recognized \$91.4 million of revenue under our contracts to provide NPAC Services in the first quarter of 2011, a \$10.9 million increase, or 13.5%, from the corresponding period in 2010. In addition, we continued to see strong demand for our IIS, both from new and current customers. For the quarter, we recognized \$20.4 million of revenue from our IIS, a \$5.0 million increase, or 32.1%, from the corresponding period in 2010.

We continued to focus on positioning our company for future growth by streamlining our business activities, leveraging our operational capabilities in new areas and strengthening our management team by appointing an Executive Vice President of Legal and External Affairs and a Senior Vice President of Business Affairs. We developed new customer relationships by investing modestly in adjacent verticals and nascent growth opportunities that leverage our core competencies, which include managing directories and providing secured access to network services, data and intelligence.

Our revenue growth and discrete investments in new opportunities resulted in continued profitability and positive cash generation during the quarter. Our cash, cash equivalents and investments increased to \$392.2 million as of March 31, 2011 and our cash flow provided by operating activities in the first quarter totaled \$45.2 million. We repurchased approximately 712,000 shares of our Class A common stock at an average price of \$25.95 for a total of \$18.5 million.

**Critical Accounting Policies and Estimates**

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

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

**Table of Contents**

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

***Revenue Recognition***

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

We determine the fixed and determinable fee under these contracts on an annual basis and recognize such fee on a straight-line basis over twelve months. For 2010, we concluded that the fixed and determinable fee equaled \$322.1 million, which represented the Base Fee of \$362.1 million, reduced by the \$25.0 million fixed credit and \$15.0 million of additional credits. For 2011, we concluded that the fixed and determinable fee equals \$365.6 million, which represents the Base Fee of \$385.6 million, reduced by the \$5.0 million fixed credit and \$15.0 million of additional credits. As of March 31, 2011, we have determined that our carrier customers have earned all of the additional credits of \$15.0 million attributable to the adoption and implementation of the requisite IP fields and functionality and the achievement of specific levels of aggregate telephone number inventories.

***Restructuring***

As of March 31, 2011, the accrued liability associated with our restructuring and other related charges was \$3.5 million. As part of our restructuring costs, we record a liability for the estimated cost of the net lease expense for facilities that are no longer being used. This accrual is equal to the present value of the minimum future lease payments under our contractual lease obligations, offset by the present value of the estimated sublease income. As of March 31, 2011, our accrued restructuring liability related to our net lease expense and other related charges was \$1.5 million. These lease payments will be made over the remaining lives of the leases for facilities that we have vacated, the longest of which extends through 2013. If actual market conditions are different than those we have projected, we will be required to recognize additional restructuring costs or benefits associated with these facilities.

***Investments***

As of March 31, 2011, we have approximately \$95.5 million of investments in pre-refunded municipal bonds and U.S. Treasury notes. These investments are accounted for as available-for-sale securities and unrealized gains or losses on these investments are recorded in other comprehensive income. We are exposed to investment risk as it relates to changes in the market value of our investments. We determined the fair value of our investments using observable inputs such as quoted prices in active markets. As of March 31, 2011, we determined that any declines in the fair value of our investments are not other-than-temporary. Given the significance of these investments to our consolidated balance sheet, declines in the fair value that are considered to be other-than-temporary could have a material effect on our consolidated financial statements.

***Stock-Based Compensation***

We recognize share-based compensation expense in accordance with the Compensation – Stock Compensation Topic of the Financial Accounting Standards Board Accounting Standards Codification which requires the measurement and recognition of compensation expense for share-based awards granted to employees based on estimated fair values on the date of grant. The estimated fair values of non-vested share-based awards granted to consultants are measured and recognized each reporting period through each vesting date. We estimate the fair value

of each option-based award using the Black-Scholes option-pricing model. This option pricing model requires that we make several estimates, including the option's expected life and the price volatility of the underlying stock.

Because share-based compensation expense is based on awards that are ultimately expected to vest, the amount of expense takes into account estimated forfeitures at the time of grant which may be revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Changes in these estimates and assumptions can materially affect the estimated fair value of our share-based compensation.

**Table of Contents**

See Note 7 to our Unaudited Consolidated Financial Statements in Item 1 of Part I of this report for information regarding our assumptions related to share-based compensation and the amount of share-based compensation expense we incurred for the periods covered in this report. As of March 31, 2011, total unrecognized compensation expense was \$48.2 million, which relates to non-vested stock options, non-vested restricted stock units, non-vested restricted stock and non-vested performance vested restricted stock units, or PVRSUs, and is expected to be recognized over a weighted-average period of 1.73 years.

We estimate the fair value of our restricted stock unit awards based on the fair value of our common stock on the date of grant. Our outstanding restricted stock unit awards are subject to service-based vesting conditions and/or performance-based vesting conditions. We recognize the estimated fair value of service-based awards, net of estimated forfeitures, as share-based expense over the vesting period on a straight-line basis. Awards with performance-based vesting conditions require the achievement of specific financial targets at the end of the specified performance period and the employee's continued employment. We recognize the estimated fair value of performance-based awards, net of estimated forfeitures, as share-based expense over the performance period, which considers each performance period or tranche separately, based upon our determination of whether it is probable that the performance targets will be achieved. At each reporting period, we reassess the probability of achieving the performance targets within the related performance period. Determining whether the performance targets will be achieved involves judgment, and the estimate of stock-based compensation expense may be revised periodically based on changes in the probability of achieving the performance targets. If any performance goals are not met, no compensation cost is ultimately recognized against that goal, and, to the extent previously recognized, compensation cost is reversed. As of March 31, 2011, we estimate achievement of 100% of the performance targets related to our PVRSUs granted during each of 2010 and 2011, respectively. Changes in our assumptions regarding the achievement of specific financial targets could have a material effect on our consolidated financial statements.

**Table of Contents****Consolidated Results of Operations****Three Months Ended March 31, 2010 Compared to Three Months Ended March 31, 2011**

The following table presents an overview of our results of operations for the three months ended March 31, 2010 and 2011:

	<b>Three Months Ended March 31,</b>			
	<b>2010</b>	<b>2011</b>	<b>2010 vs. 2011</b>	
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>%</b>
			<b>Change</b>	<b>Change</b>
	<b>(unaudited)</b>			
	<b>(dollars in thousands, except per share data)</b>			
Revenue:				
Carrier Services	\$ 99,788	\$ 110,015	\$ 10,227	10.2%
Enterprise Services	29,203	36,480	7,277	24.9%
Total revenue	128,991	146,495	17,504	13.6%
Operating expense:				
Cost of revenue (excludes depreciation and amortization shown separately below)	29,113	31,683	2,570	8.8%
Sales and marketing	22,854	25,999	3,145	13.8%
Research and development	4,078	4,038	(40)	(1.0)%
General and administrative	18,449	21,183	2,734	14.8%
Depreciation and amortization	10,143	9,516	(627)	(6.2)%
Restructuring charges	2,349	1,718	(631)	(26.9)%
	86,986	94,137	7,151	8.2%
Income from operations	42,005	52,358	10,353	24.6%
Other (expense) income:				
Interest and other expense	(1,748)	(2,513)	(765)	43.8%
Interest and other income	1,390	203	(1,187)	(85.4)%
Income before income taxes	41,647	50,048	8,401	20.2%
Provision (benefit) for income taxes	16,445	(21,927)	(38,372)	(233.3)%
Net income	\$ 25,202	\$ 71,975	\$ 46,773	185.6%
Net income per common share:				
Basic	\$ 0.34	\$ 0.97		
Diluted	\$ 0.33	\$ 0.96		
Weighted average common shares outstanding:				
Basic	74,613	73,938		
Diluted	75,944	75,285		

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

*Carrier Services.* Revenue from our Carrier Services operating segment increased \$10.2 million primarily due to an increase of \$8.7 million in revenue from our Numbering Services and an increase of \$2.6 million in revenue from our Order Management Services, partially offset by a decrease of \$1.1 million from our IP Services. The \$8.7 million increase in revenue from our Numbering Services was the result of an established increase of \$10.9 million in the fixed fee under our contracts to provide NPAC services, offset by a decrease of \$1.1 million in system enhancements and functionality requested by our Numbering Services customers. Order Management Services revenue increased primarily due to greater demand and usage from existing customers and the addition of new customers. IP Services revenue decreased due to the sale of certain assets and liabilities and the continued wind down of operations of our Converged Messaging Services.

*Enterprise Services.* Revenue from our Enterprise Services operating segment increased \$7.3 million primarily due to an increase of \$5.0 million in revenue from our Internet Infrastructure Services. This was primarily driven by increased demand from current customers that are realizing sustained growth in Internet traffic and new customers utilizing our expansive DNS solutions, including IP geolocation services, monitoring and external DNS. In addition, Registry Services revenue increased \$2.3 million due to an increase in the number of common short codes and domain names under management.

***Expense***

*Cost of revenue.* Cost of revenue increased \$2.6 million primarily due to an increase of \$1.2 million in ongoing costs to scale our platforms to support our business and operational growth, which includes costs to upgrade our data center operations and related maintenance. In addition, cost of revenue increased \$1.1 million due to personnel and personnel-related expense to support our expanded services offerings, including new directory services, IP geolocation services, and system enhancements for functionality improvements requested by our customers. Royalty expense in our Registry Services related to common short codes under management increased \$0.9 million. These increases were partially offset by a decrease of \$1.0 million in fees for outsourced services, resulting from the sale of certain assets and liabilities and the continued wind down of operations of our Converged Messaging Services.

*Sales and marketing.* Sales and marketing expense increased \$3.1 million primarily due to an increase of \$3.3 million in personnel and personnel-related expense for our expanded sales and marketing teams, primarily due to increased headcount. This increased headcount supports our growth as we broaden our portfolio of services, geographic presence and brand awareness through product initiatives as well as customer and industry events.

*Research and development.* Research and development expense for the three months ended March 31, 2010 was comparable to the expense for the three months ended March 31, 2011.

*General and administrative.* General and administrative expense increased \$2.7 million, primarily due to costs incurred to support business growth and costs incurred in preparation for new business opportunities and corporate initiatives. The increase also resulted from further investments in our core teams in support of business operations. Personnel and personnel-related expense increased \$2.9 million, primarily as a result of headcount additions and an increase of \$1.2 million in stock-based compensation expense resulting from the fair value measurement of stock-based awards attributable to the change in employment status of former executives.

*Depreciation and amortization.* Depreciation and amortization expense decreased \$0.6 million due to a \$7.9 million decrease in our Converged Messaging Service's depreciable property and equipment assets as a result of an impairment charge recorded in the fourth quarter of 2010.

*Restructuring charges.* Restructuring charges decreased \$0.6 million primarily due to the completion of our restructuring plan in the third quarter of 2010 to relocate certain operations and support functions to Kentucky. We recorded severance and severance related expense of \$1.2 million attributable to our 2009 relocation plan in the first quarter of 2010 and did not have any corresponding expense in the first quarter of 2011. The decrease in restructuring charges was partially offset by severance and severance related expense of \$0.4 million recorded in the first quarter of 2011, attributable to our 2010 management transition plan initiated in the fourth quarter of 2010.

*Interest and other expense.* Interest and other expense increased \$0.8 million primarily due to the 2011 sale of certain assets and liabilities of our Converged Messaging Services, resulting in a \$1.9 million loss on sale. The increase in interest and other expense was partially offset by a decrease in trading losses of \$1.1 million recorded for

our auction rate securities rights in 2010. As a result of the settlement of our auction rate securities and associated rights in the third quarter of 2010, there were no associated trading losses recorded in 2011.



**Table of Contents**

*Interest and other income.* Interest and other income decreased \$1.2 million primarily due to trading gains of \$1.1 million recorded for our auction rate securities in 2010. There were no associated trading gains recorded in 2010.

*Provision (benefit) for income taxes.* Our effective tax rate decreased to (43.8)% for the three months ended March 31, 2011 from 39.5% for the three months ended March 31, 2010 primarily as a result of a tax benefit of \$42.7 million attributed to a worthless stock deduction for the common stock of Neustar NGM Services, Inc. recorded in the three months ended March 31, 2011. We also recognized a \$0.8 million income tax provision primarily related to the settlement of our IRS examination and an increase in uncertain tax positions. Excluding the impact of these discrete items, our effective tax rate was 40.0% for the three months ended March 31, 2011.

**Summary of Operating Segments**

The following table presents a summary our operating segments revenue, contribution and the reconciliation to consolidated net income from operations for the three months ended March 31, 2010 and 2011 (in thousands, except per share data):

	<b>Three Months Ended March 31,</b>			
	<b>2010</b>	<b>2011</b>	<b>2010 vs. 2011</b>	
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>%</b>
			<b>Change</b>	<b>Change</b>
Revenue:				
Carrier Services	\$ 99,788	\$ 110,015	\$ 10,227	10.2%
Enterprise Services	29,203	36,480	7,277	24.9%
<b>Total revenue</b>	<b>\$ 128,991</b>	<b>\$ 146,495</b>	<b>\$ 17,504</b>	<b>13.6%</b>
Segment contribution:				
Carrier Services	\$ 86,069	\$ 94,743	\$ 8,674	10.1%
Enterprise Services	12,788	15,651	2,863	22.4%
<b>Total segment contribution</b>	<b>98,857</b>	<b>110,394</b>	<b>11,537</b>	<b>11.7%</b>
Indirect operating expenses:				
Cost of revenue (excluding depreciation and amortization shown separately below)	18,860	19,632	772	4.1%
Sales and marketing	4,604	3,825	(779)	(16.9)%
Research and development	3,523	3,619	96	2.7%
General and administrative	17,373	19,726	2,353	13.5%
Depreciation and amortization	10,143	9,516	(627)	(6.2)%
Restructuring charges	2,349	1,718	(631)	(26.9)%
<b>Consolidated income from operations</b>	<b>\$ 42,005</b>	<b>\$ 52,358</b>	<b>\$ 10,353</b>	<b>24.6%</b>

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

**Liquidity and Capital Resources**

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

Our total cash, cash equivalents and short-term investments of \$326.2 million at March 31, 2011 decreased from \$345.4 million at December 31, 2010.

We have a credit facility that is available for cash borrowings up to \$100 million that may be used for working capital, capital expenditures, general corporate purposes and to finance acquisitions. Our credit agreement contains customary representations and warranties, affirmative and negative covenants, and events of default. Our credit agreement requires us to maintain a minimum ratio of consolidated earnings before interest, taxes, depreciation and amortization, or EBITDA, to consolidated interest charges and a maximum ratio of consolidated senior funded indebtedness to consolidated EBITDA. As of and for the three months ended March 31, 2011, we were in compliance with these covenants. As of March 31, 2011, the Company's available borrowings under the Credit Facility were \$100 million.

**Table of Contents**

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

**Discussion of Cash Flows*****Cash flows from operations***

Net cash provided by operating activities for the three months ended March 31, 2011 was \$45.2 million, as compared to \$21.9 million for the three months ended March 31, 2010. This \$23.3 million increase in net cash provided by operating activities was the result of an increase in net income of \$46.8 million, an increase in non-cash adjustments of \$9.6 million, and a decrease in net changes in operating assets and liabilities of \$33.0 million.

Net income increased \$46.8 million primarily due to the change of \$38.4 million in our income tax provision (benefit). In first quarter of 2011, we recorded a tax benefit of \$42.7 million attributed to a worthless stock deduction for the common stock of Neustar NGM Services, Inc., resulting in a decrease in our estimated annual effective tax rate to (43.8)% in the first quarter of 2011.

Non-cash adjustments increased \$9.6 million due to an increase of \$6.2 million in deferred income taxes, an increase of \$2.4 million in stock-based compensation, a \$1.9 million loss on sale attributed to the sale of certain assets and liabilities of our Converged Messaging Services business in the first quarter of 2011, and a change of \$0.7 million as a result of increases in our provision for doubtful accounts. These increases in non-cash adjustments were partially offset by a decrease of \$1.6 million in excess tax benefits from stock options.

Net changes in operating assets and liabilities decreased \$33.0 million primarily due to an increase in income taxes receivable of \$29.7 million and a decrease in income taxes payable of \$13.7 million, both a result of the Neustar NGM Services, Inc. worthless stock tax benefit recorded in the first quarter of 2011. These increases were partially offset by a decrease of \$12.3 million in cash used in the payment of accounts payable and accrued expenses.

***Cash flows from investing***

Net cash used in investing activities for the three months ended March 31, 2011 was \$58.4 million, as compared to \$6.5 million for the three months ended March 31, 2010. This \$51.9 million increase in net cash used in investing activities was primarily due to investment purchases of \$45.4 million in the first quarter of 2011 and an increase of \$6.1 million in cash used in purchases of property and equipment.

***Cash flows from financing***

Net cash used in financing activities was \$21.7 million for the three months ended March 31, 2011, as compared to \$2.1 million for the three months ended March 31, 2010. This \$19.6 million increase in net cash used in financing activities was primarily the result of \$18.5 million used to repurchase shares of our Class A common stock under our share repurchase program announced in July 2010 and a net increase of \$9.2 million in restricted cash primarily used to collateralize our outstanding letters of credit. These increases in cash used in financing activities were partially offset by an increase of \$4.1 million in proceeds from the exercise of stock options, a reduction of \$1.8 million in cash used in principal repayments on capital lease obligations, and an increase of \$1.6 million in excess tax benefits from stock options.

**Recent Accounting Pronouncements**

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

**Off-Balance Sheet Arrangements**

None.

**Table of Contents****Item 3. Quantitative and Qualitative Disclosures About Market Risk**

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

**Item 4. Controls and Procedures**

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

As of March 31, 2011, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective and were operating at the reasonable assurance level.

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

**PART II OTHER INFORMATION****Item 1. Legal Proceedings**

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

**Item 1A. Risk Factors**

In addition to the other information set forth in this Quarterly Report, you should carefully consider the risks discussed in Part I, Item 1A. **Risk Factors** in our Annual Report on Form 10-K for our fiscal year ended December 31, 2010, filed with the SEC on February 25, 2011. The risks discussed in our Annual Report on Form 10-K could materially affect our business, financial condition and future results. The risks described in our Annual Report on Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition or operating results.

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

The following table is a summary of our repurchases of common stock during each of the three months in the quarter ended March 31, 2011:

Month	Total Number of Shares Purchased		Total Number of Shares Purchased as Part of Publicly Announced Plans	Approximate Dollar Value of Shares that May Be Purchased Under the Plans or Programs (3)
	(1)	Average Price Paid		

Edgar Filing: NEUSTAR INC - Form 10-Q

		<b>per Share</b>	<b>or Programs (2)(3)</b>		
January 1 through January 31, 2011	248,706	\$ 27.10	245,985	\$	252,935,053
February 1 through February 28, 2011	23,794	25.70			252,935,053
March 1 through March 31, 2011	467,061	25.35	465,958		241,122,227
<b>Total</b>	<b>739,561</b>	<b>\$ 25.95</b>	<b>711,943</b>	<b>\$</b>	<b>241,122,227</b>

30

---

**Table of Contents**

- (1) The number of shares purchased includes shares of common stock tendered by employees to us to satisfy the employees' tax withholding obligations arising as a result of vesting of restricted stock grants under our stock incentive plan. We purchased these shares for their fair market value on the vesting date.
- (2) The difference between the total number of shares purchased and the total number of shares purchased as part of publicly announced plans or programs is 27,618 shares, all of which relate to shares surrendered to us by employees to satisfy the employees' tax withholding obligations arising as a result of vesting of restricted stock grants under our incentive stock plans.
- (3) On July 28, 2010, we announced the adoption of a share repurchase program. The program authorizes the repurchase of up to \$300 million of Class A common shares through Rule 10b5-1 programs, open market purchases, privately negotiated transactions or otherwise as market conditions warrant, at prices we deem appropriate. The program will expire in July 2013.

**Item 3. Defaults Upon Senior Securities**

None.

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

**Item 5. Other Information**

None.

**Table of Contents**

**Item 6. Exhibits**

See exhibits listed under the Exhibit Index below.

32

---

**Table of Contents**

**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: April 27, 2011

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

---



**Table of Contents**

## EXHIBIT INDEX

Exhibit No.	Description
3.1	Restated Certificate of Incorporation, incorporated herein by reference to Exhibit 3.1 to Amendment No. 7 to NeuStar's Registration Statement on Form S-1, filed June 28, 2005 (File No. 333-123635).
3.2	Amended and Restated Bylaws, incorporated herein by reference to Exhibit 99.1 to NeuStar's Current Report on Form 8-K, filed December 16, 2010.
10.1.1	Amendment to the contractor services agreement by and between NeuStar, Inc. and North American Portability Management LLC.
10.46	Form of Performance Award Agreement under the NeuStar, Inc. 2009 Stock Incentive Plan.
10.47	Form of Restricted Stock Agreement under the NeuStar, Inc. 2009 Stock Incentive Plan.
10.48	Form of Nonqualified Stock Option Agreement under the NeuStar, Inc. 2009 Stock Incentive Plan.
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document**
101.SCH	XBRL Taxonomy Extension Schema**
101.CAL	XBRL Taxonomy Extension Calculation**
101.DEF	XBRL Taxonomy Extension Definition**
101.LAB	XBRL Taxonomy Extension Label**
101.PRE	XBRL Taxonomy Extension Presentation**

## Compensatory Arrangement

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

