QUINSTREET, INC
Form 10-Q
May 09, 2013
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

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 No. 001-34628

QuinStreet, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**77-0512121**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**
950 Tower Lane, 6th Floor	
Foster City, California	**94404**
(Address of principal executive offices)	**(Zip Code)**

650-578-7700

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 x 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 x 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.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

Number of shares of common stock outstanding as of April 30, 2013: 42,874,999

Table of Contents

QUINSTREET, INC.

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

QUINSTREET, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

(Unaudited)

	March 31, 2013	June 30, 2012
Assets		
Current assets		
Cash and cash equivalents	$ 75,712	$ 68,531
Marketable securities	38,067	36,736
Accounts receivable, net	44,875	52,830
Deferred tax assets	7,662	7,665
Prepaid expenses and other assets	9,838	7,774
Total current assets	176,154	173,536
Property and equipment, net	7,591	8,755
Goodwill	150,456	243,049
Other intangible assets, net	55,839	72,444
Deferred tax assets, noncurrent	37,363	8,446
Other assets, noncurrent	896	930
Total assets	$ 428,299	$ 507,160
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable	$ 16,785	22,870
Accrued liabilities	28,986	29,462
Deferred revenue	1,695	2,553
Debt	16,082	15,429
Total current liabilities	63,548	70,314
Debt, noncurrent	81,294	92,167
Other liabilities, noncurrent	6,839	6,322
Total liabilities	151,681	168,803
Commitments and contingencies (See Note 8)		
Stockholders equity		
Common stock: $0.001 par value; 100,000,000 shares authorized; 42,817,252 and 43,350,831 shares issued, and 42,817,252 and 43,222,031 shares outstanding at March 31, 2013 and June 30, 2012, respectively	43	43
Additional paid-in capital	223,394	220,552
Treasury stock, at cost (0 and 128,800 shares at March 31, 2013 and June 30, 2012)		(1,178)

Accumulated other comprehensive loss	(1,408)	(1,439)
Retained earnings	54,589	120,379
Total stockholders equity	276,618	338,357
Total liabilities and stockholders equity	$ 428,299	$ 507,160

See notes to condensed consolidated financial statements

Table of Contents

QUINSTREET, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012	Nine Months Ended March 31, 2013	Nine Months Ended March 31, 2012
Net revenue	$ 79,017	$ 93,023	$ 229,394	$ 284,770
Cost of revenue [1]	63,863	72,278	190,765	216,422
Gross profit	15,154	20,745	38,629	68,348
Operating expenses: [1]				
Product development	4,891	5,069	14,288	16,245
Sales and marketing	3,683	3,394	10,870	11,114
General and administrative	4,394	6,239	12,339	16,303
Impairment of goodwill			92,350	
Operating income (loss)	2,186	6,043	(91,218)	24,686
Interest income	28	31	84	105
Interest expense	(1,810)	(1,111)	(4,176)	(3,309)
Other (expense) income, net	(39)	3	3	(121)
Income (loss) before income taxes	365	4,966	(95,307)	21,361
(Provision) benefit for taxes	(2,527)	(2,093)	29,517	(8,561)
Net (loss) income	$ (2,162)	$ 2,873	$ (65,790)	$ 12,800
Net (loss) income per share:				
Basic	$ (0.05)	$ 0.06	$ (1.54)	$ 0.28
Diluted	$ (0.05)	$ 0.06	$ (1.54)	$ 0.27
Weighted average shares used in computing net (loss) income per share				
Basic	42,804	44,870	42,798	46,491
Diluted	42,804	45,794	42,798	47,584

[1] Cost of revenue and operating expenses include stock-based compensation expense as follows:

Cost of revenue	$ 1,010	$ 962	$ 2,896	$ 3,338
Product development	665	637	2,056	1,979
Sales and marketing	780	816	2,403	2,436
General and administrative	558	781	1,457	2,338

See notes to condensed consolidated financial statements

Table of Contents

QUINSTREET, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(In thousands)

(Unaudited)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2013	**2012**	**2013**	**2012**
Net (loss) income	$ (2,162)	$ 2,873	$ (65,790)	$ 12,800
Other comprehensive income (loss)				
Unrealized gain (loss) on investments	7	(10)	(1)	(6)
Foreign currency translation adjustment	23		116	28
Interest rate swap				
Change in unrealized gain (loss)	136	(288)	(77)	(288)
Less: reclassification adjustment for loss (gain) included in net income		30	(8)	30
Net change	136	(258)	(85)	(258)
Other comprehensive income (loss)	166	(268)	30	(236)
Comprehensive (loss) income	$ (1,996)	$ 2,605	$ (65,760)	$ 12,564

See notes to condensed consolidated financial statements

Table of Contents

QUINSTREET, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended March 31, 2013	Nine Months Ended March 31, 2012
Cash Flows from Operating Activities		
Net (loss) income	$ (65,790)	$ 12,800
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	25,666	22,657
Impairment of goodwill	92,350	
Write-off of bank loan upfront fees	680	
Provision for sales returns and doubtful accounts receivable	(575)	1,557
Stock-based compensation	8,813	10,091
Excess tax benefits from stock-based compensation	(60)	(146)
Other non-cash adjustments, net	1,043	1,476
Changes in assets and liabilities, net of effects of acquisitions:		
Accounts receivable	8,619	(656)
Prepaid expenses and other assets	(2,063)	(259)
Other assets, noncurrent	36	(36)
Deferred taxes	(28,914)	
Accounts payable	(5,980)	942
Accrued liabilities	(1,574)	(6,826)
Deferred revenue	(665)	(256)
Other liabilities, noncurrent	290	1,033
Net cash provided by operating activities	31,876	42,377
Cash Flows from Investing Activities		
Capital expenditures	(1,126)	(2,017)
Business acquisitions, net of notes payable and cash acquired		(54,639)
Other intangibles	(2,500)	
Internal software development costs	(1,813)	(1,746)
Purchases of marketable securities	(41,043)	(37,807)
Proceeds from sales and maturities of marketable securities	38,776	34,163
Other investing activities	15	29
Net cash used in investing activities	(7,691)	(62,017)
Cash Flows from Financing Activities		
Proceeds from exercise of common stock options	316	3,526
Proceeds from bank debt		5,884
Principal payments on bank debt	(5,000)	(3,875)
Payment of bank loan upfront fees	(200)	(1,370)
Principal payments on acquisition-related notes payable	(5,848)	(2,190)
Excess tax benefits from stock-based compensation	60	146
Withholding taxes related to restricted stock net share settlement	(191)	(346)
Repurchases of common stock	(6,157)	(36,593)

Net cash used in financing activities	(17,020)	(34,818)
Effect of exchange rate changes on cash and cash equivalents	16	29
Net increase (decrease) in cash and cash equivalents	7,181	(54,429)
Cash and cash equivalents at beginning of period	68,531	132,290
Cash and cash equivalents at end of period	$ 75,712	$ 77,861
Supplemental Disclosure of Cash Flow Information		
Cash paid for interest	3,315	2,781
Cash paid for taxes	1,958	8,642
Supplemental Disclosure of Noncash Investing and Financing Activities		
Notes payable issued in connection with business acquisitions		3,261
Retirement of treasury stock	6,157	44,372
Short term payables	2,500	

See notes to condensed consolidated financial statements

6

Table of Contents

QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. The Company

QuinStreet, Inc. (the Company) is an online performance marketing company. The Company was incorporated in California in April 1999 and reincorporated in Delaware in December 2009. The Company provides customer acquisition programs for clients in various industry verticals such as education and financial services. The corporate headquarters are located in Foster City, California, with additional offices throughout the United States, Brazil and India.

2. Summary of Significant Accounting Policies

Basis of Presentation

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany balances and transactions have been eliminated in consolidation.

Unaudited Interim Financial Information

The accompanying condensed consolidated financial statements and the notes to the condensed consolidated financial statements as of March 31, 2013 and for the three and nine months ended March 31, 2013 and 2012 are unaudited. These unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) and applicable rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Accordingly, these interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2012, as filed with the SEC on August 23, 2012. The condensed consolidated balance sheet at June 30, 2012 included herein was derived from the audited financial statements as of that date, but does not include all disclosures, including notes, required by GAAP.

The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, include all adjustments (consisting only of normal recurring adjustments) necessary for the fair statement of the Company s condensed consolidated balance sheet at March 31, 2013, its condensed consolidated statements of operations for the three and nine months ended March 31, 2013 and 2012, its condensed consolidated statements of comprehensive (loss) income for the three and nine months ended March 31, 2013 and 2012, and its condensed consolidated statements of cash flows for the nine months ended March 31, 2013 and 2012. The results of operations for the nine months ended March 31, 2013 are not necessarily indicative of the results to be expected for the fiscal year ending June 30, 2013, or any other future period.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the period. On an ongoing basis, management evaluates these estimates, judgments and assumptions, including those related to revenue recognition, stock-based compensation, goodwill, intangible assets, long-lived assets, contingencies, and income taxes. The Company bases these estimates on historical and anticipated results and trends and on various other assumptions that the Company believes are reasonable under the circumstances, including assumptions as to future events. These estimates form the basis for making judgments about the carrying values of assets and liabilities and recorded revenue and expenses that are not readily apparent from other sources. Actual results could differ from those estimates, and such differences could affect the results of operations reported in future periods.

Table of Contents

QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Accounting Policies

The significant accounting policies are described in Note 2 to the condensed consolidated financial statements included in the Annual Report on Form 10-K for the fiscal year ended June 30, 2012. There have been no significant changes in the accounting policies subsequent to June 30, 2012.

Concentrations of Credit Risk

No client accounted for 10% or more of net revenue for the three or nine months ended March 31, 2013 or for the same periods in fiscal year 2012. No client accounted for 10% or more of net accounts receivable as of March 31, 2013 or June 30, 2012.

Fair Value of Financial Instruments

The Company s financial instruments consist principally of cash equivalents, marketable securities, accounts receivable, accounts payable, acquisition-related promissory notes, an interest rate swap, short term payables, and a term loan. The fair value of the Company s cash equivalents is determined based on quoted prices in active markets for identical assets for its money market funds; and quoted prices for similar instruments in active markets for its U.S. municipal securities and certificates of deposits that mature within 90 days. The recorded values of the Company s accounts receivable and accounts payable approximate their current fair values due to the relatively short-term nature of these accounts. The fair values of acquisition-related promissory notes and short term payables approximate their recorded amounts as the interest rates on similar financing arrangements available to the Company at March 31, 2013 approximate the interest rates implied when these acquisition-related promissory notes and short term payables were originally issued and recorded. The fair value of the interest rate swap is based upon fair value quotes from the issuing bank and the Company assesses the quotes for reasonableness by comparing them to the present values of expected cash flows. The present value approach is based on observable market interest rate curves that are commensurate with the terms of the interest rate swaps. The carrying value represents the fair value of the swaps, as adjusted for any non-performance risk associated with the Company at March 31, 2013. The Company believes that the fair value of the term loan approximates its recorded amount at March 31, 2013 as the interest rate on the term loan is variable and is based on market interest rates and after consideration of default and credit risk.

Recent Accounting Pronouncements

In September 2011, the FASB issued an update to the accounting standard for goodwill. The revised standard allows entities to use a qualitative approach to test goodwill for impairment. It permits an entity to first perform a qualitative assessment to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the two-step goodwill impairment test. The Company adopted this updated accounting standard during the second quarter of fiscal 2013 as a result of its market capitalization sustaining a significant decline subsequent to the quarterly period ended December 31, 2012. The Company determined that it was more-likely-than-not that the fair value of one of its reporting units was less than the carrying amount. As a result, the two-step impairment test related to goodwill was performed as of December 31, 2012. For additional information about the two-step impairment test related to goodwill, refer to Note 6 to the condensed consolidated financial statements.

In July 2012, the FASB issued an update to the accounting standard for intangibles. The revised standard allows entities to use a qualitative approach to test indefinite-lived intangible assets for impairment. It permits an entity to first perform a qualitative assessment to determine whether it is more-likely-than-not that the fair value of an indefinite-lived intangible asset is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed quantitative impairment test by comparing the fair value of the indefinite-lived intangible asset with its carrying value. Otherwise, the quantitative impairment test is not required. The Company plans to adopt this accounting standard by the fourth quarter of fiscal 2014 and does not believe that the adoption will have a material effect on the Company s consolidated financial statements.

8

Table of Contents

QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

In February 2013, the FASB issued an update to the accounting standard for accumulated other comprehensive income (loss). The revised standard requires entities to present information about significant items reclassified out of accumulated other comprehensive income (loss) by component either on the face of the statement where net income is presented or as a separate disclosure in the notes to the financial statements. This accounting standard will become effective for the Company in the first quarter of fiscal year 2014.

3. Net (Loss) Income Attributable to Common Stockholders and Net (Loss) Income per Share

Basic net (loss) income per share is computed by dividing net (loss) income by the weighted average number of shares of common stock outstanding during the period. Diluted net (loss) income per share is computed by using the weighted-average number of shares of common stock outstanding, including potential dilutive shares of common stock assuming the dilutive effect of outstanding stock options and restricted stock units using the treasury stock method.

The following table presents the calculation of basic and diluted net (loss) income per share:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	**2011**	**2012**	**2011**
	(In thousands, except per share data)		(In thousands, except per share data)	
Numerator:				
Basic and Diluted:				
Net (loss) income	$ (2,162)	$ 2,873	$ (65,790)	$ 12,800
Denominator:				
Basic:				
Weighted average shares of common stock used in computing basic net (loss) income per share	42,804	44,870	42,798	46,491
Diluted:				
Weighted average shares of common stock used in computing basic net (loss) income per share	42,804	44,870	42,798	46,491
Weighted average effect of dilutive securities:				
Stock options		923		1,080
Restricted stock units		1		13
Weighted average shares of common stock used in computing diluted net (loss) income per share	42,804	45,794	42,798	47,584
Net (loss) income per share:				
Basic	$ (0.05)	$ 0.06	$ (1.54)	$ 0.28
Diluted (2)	$ (0.05)	$ 0.06	$ (1.54)	$ 0.27
	10,760	7,347	9,522	6,566

Securities excluded from weighted average shares used in computing diluted net (loss) income per share because the effect would have been anti-dilutive: [(1)]

(1) These weighted shares relate to anti-dilutive stock options and restricted stock units as calculated using the treasury stock method and could be dilutive in the future.

(2) Diluted EPS does not reflect any potential common stock relating to stock options or restricted stock units due to operating loss. The assumed issuance of any additional shares would be anti-dilutive.

Table of Contents

QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. Fair Value Measurements and Marketable Securities

Fair value is defined as the price that would be received on sale of an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants at the measurement date. The FASB has established a fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity s own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3).

The three levels of the fair value hierarchy under the guidance for fair value measurement are described below:

Level 1	Inputs are unadjusted quoted prices in active markets for identical assets or liabilities. Pricing inputs are based upon quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. The valuations are based on quoted prices of the underlying security that are readily and regularly available in an active market, and accordingly, a significant degree of judgment is not required. As of March 31, 2013, the Company used Level 1 assumptions for its money market funds.
Level 2	Pricing inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. As of March 31, 2013, the Company used Level 2 assumptions for its U.S. municipal securities, certificates of deposits, acquisition-related promissory notes, short term payables, term loan, and interest rate swap.
Level 3	Pricing inputs are generally unobservable for the assets or liabilities and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management s judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models, and similar techniques. As of March 31, 2013, the Company did not have any Level 3 financial assets or liabilities.

Table of Contents

QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The Company s financial instruments as of March 31, 2013 and June 30, 2012 were categorized as follows in the fair value hierarchy (in thousands):

	Fair Value Measurements as of March 31, 2013 Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Total
Assets:			
U.S. municipal securities	$	$ 29,352	$ 29,352
Certificates of deposit		12,695	12,695
Money market funds	32,901		32,901
	$ 32,901	$ 42,047	$ 74,948
Liabilities:			
Acquisition-related promissory notes	$	$ 6,163	$ 6,163
Term loan		91,213	91,213
Interest rate swap		1,215	1,215
Short term payable		2,458	2,458
	$	$ 101,049	$ 101,049

	Fair Value Measurements as of June 30, 2012 Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Total
Assets:			
U.S. municipal securities	$	$ 30,861	$ 30,861
Certificates of deposit		11,470	11,470
Money market funds	21,458		21,458
	$ 21,458	$ 42,331	$ 63,789
Liabilities:			
Acquisition-related promissory notes	$	$ 12,215	$ 12,215
Term loan		95,381	95,381
Interest rate swap		1,138	1,138
	$	$ 108,734	$ 108,734

Marketable Securities

All liquid investments with maturities of three months or less at the date of purchase are classified as cash equivalents. Investments with maturities greater than three months at the date of purchase are classified as marketable securities. The Company s marketable securities have been classified and accounted for as available-for-sale. Management determines the appropriate classification of its investments at the time of purchase and reevaluates the available-for-sale designation as of each balance sheet date. Available-for-sale securities are carried at fair value, with unrealized gains and losses, net of tax, reported as a component of stockholders equity.

QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The following table summarizes unrealized gains and losses related to available-for-sale securities held by the Company as of March 31, 2013 and June 30, 2012 (in thousands):

	As of March 31, 2013			
	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. municipal securities	$ 29,343	$ 9		$ 29,352
Certificates of deposit	12,705		10	12,695
Money market funds	32,901			32,901
	$ 74,949	$ 9	$ 10	$ 74,948

	As of June 30, 2012			
	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. municipal securities	$ 30,851	$ 10	$	$ 30,861
Certificates of deposit	11,480		10	11,470
Money market funds	21,458			21,458
	$ 63,789	$ 10	$ 10	$ 63,789

The Company did not realize any gains or losses from sales of its securities in the periods presented. As of March 31, 2013 and June 30, 2012, the Company did not hold securities that had maturity dates greater than one year.

5. Acquisitions

Acquisitions in Fiscal Year 2013

The Company did not complete any acquisitions during the nine months ended March 31, 2013.

Acquisitions in Fiscal Year 2012

In fiscal year 2012, the Company acquired certain assets of Ziff Davis Enterprise from Enterprise Media Group, Inc., a New York-based online media and marketing company in the business-to-business technology market, to broaden its registered user database and brand name in the business-to-business technology market. Additionally, the Company acquired 100% of the outstanding equity interests of NarrowCast Group, LLC, or ITBE, to broaden its registered user database and media access in the business-to-business technology market. The Company also acquired the operations of eleven online publishing businesses. The Company recorded $4.6 million in earn-out payments related to a prior period acquisition as an addition to goodwill.

The total purchase prices recorded were as follows (in thousands):

	Ziff Davis	ITBE	Other	Total
Cash	$ 17,270	$ 23,961	$ 14,620	$ 55,851
Fair value of debt (net of imputed interest)			9,696	$ 9,696
	$ 17,270	$ 23,961	$ 24,316	$ 65,547

Table of Contents

QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The acquisitions were accounted for as business combinations. The Company allocated the purchase price to tangible assets acquired, liabilities assumed and identifiable intangible assets acquired based on their estimated fair values. The excess of the purchase price over the aggregate fair value was recorded as goodwill. The goodwill is deductible for tax purposes. The following table summarizes the allocation of the purchase price and the estimated useful lives of the identifiable intangible assets acquired as of the date of the acquisitions (in thousands):

	Ziff Davis	ITBE	Other	Total	Estimated Useful Life
Tangible assets acquired	$	$ 3,597	$	$ 3,597	
Liabilities assumed	(255)	(1,868)		(2,123)	
Customer/publisher/advertiser relationships	4,120	3,230	435	7,785	3-5 years
Content	500	420	4,541	5,461	2-5 years
Website/trade/domain names	4,630	2,220	1,250	8,100	4-8 years
Registered user database	6,320	4,220		10,540	3 years
Acquired technology and other			560	560	4-5 years
Noncompete agreements		100	87	187	1-3.5 years
Goodwill	1,955	12,042	17,443	31,440	Indefinite
	$ 17,270	$ 23,961	$ 24,316	$ 65,547	

Pro Forma Financial Information

The unaudited pro forma financial information in the table below summarizes the combined results of operations for the Company and other companies that were acquired since the beginning of fiscal year 2012. The pro forma financial information includes the business combination accounting effects resulting from these acquisitions, including amortization charges from acquired intangible assets and the related tax effects, as though the acquisitions were effected as of the beginning of fiscal year 2012. The unaudited pro forma financial information as presented below is for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisitions had taken place at the beginning of fiscal year 2012.

	Three Months Ended March 31, (In thousands)		Nine Months Ended March 31, (In thousands)	
	2013	2012	2013	2012
Net revenue	$ 79,017	$ 94,230	$ 230,962	$ 291,629
Net (loss) income	$ (2,162)	$ 3,094	$ (66,904)	$ 10,414
Basic net (loss) income per share	$ (0.05)	$ 0.07	$ (1.56)	$ 0.22
Diluted net (loss) income per share	$ (0.05)	$ 0.07	$ (1.56)	$ 0.22

Table of Contents

QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

6. Intangible Assets and Goodwill

Intangible assets, net balances, excluding goodwill, consisted of the following (in thousands):

	March 31, 2013			June 30, 2012		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer/publisher/advertiser relationships	$ 37,050	$ (27,543)	$ 9,507	$ 37,045	$ (23,017)	$ 14,028
Content	62,099	(41,014)	21,085	62,076	(34,430)	27,646
Website/trade/domain names	31,624	(16,327)	15,297	31,615	(12,815)	18,800
Acquired technology and others	36,411	(26,461)	9,950	31,477	(19,507)	11,970
	$ 167,184	$ (111,345)	$ 55,839	$ 162,213	$ (89,769)	$ 72,444

Amortization of intangible assets was $5.9 million and $21.6 million in the three and nine months ended March 31, 2013, respectively, and $6.8 million and $18.8 million in the three and nine months ended March 31, 2012, respectively.

The Company licensed certain patents for $4.9 million during the second quarter of fiscal year 2013, and these patents and related short term payables are recorded in other intangible assets, net and accrued liabilities, respectively, on the condensed consolidated balance sheet. Based on the Company s analysis, using a relief from royalty method, the Company determined that a portion of the license fee for these patents represents the cumulative cost relating to prior years. As such, the Company recorded $2.4 million as a charge to cost of revenue during the second quarter of fiscal year 2013. The remaining amount will be amortized over the remaining life of the patents.

Future amortization expense for the Company s intangible assets as of March 31, 2013 was as follows (in thousands):

Year Ending June 30,	Amortization
2013 (remaining three months)	$ 5,290
2014	19,541
2015	12,344
2016	8,780
2017	6,061
Thereafter	3,823
	$ 55,839

The change in the carrying amount of goodwill for the Company s Direct Marketing Services (DMS) and Direct Selling Services (DSS) segments, discussed in Note 11, for the nine months ended March 31, 2013 was as follows (in thousands):

	DMS	DSS	Total
Balance at June 30, 2012	$ 241,818	$ 1,231	$ 243,049

Additions			
Impairment	(92,350)		(92,350)
Other	(243)		(243)
Balance at March 31, 2013	$ 149,225	$ 1,231	$ 150,456

QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

In the nine months ended March 31, 2013, there were no additions to goodwill as the Company did not complete any acquisitions during the period. Any change in goodwill amounts resulting from foreign currency translation are presented as Other in the above table.

The Company tests for goodwill impairment at the reporting unit level on an annual basis during its fourth fiscal quarter or when indicators of impairment arise. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units, and determining the fair value of each reporting unit. Significant judgments required to estimate the fair value of reporting units include estimating future cash flows and determining appropriate discount rates, growth rates, an appropriate control premium and other assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value for each reporting unit which could trigger impairment. The Company has determined that DMS and DSS constitute two separate reporting units. The Company s public market capitalization sustained a decline after December 31, 2012, to a value below the net book carrying value of the Company s equity. As a result, the Company determined that this triggered the necessity to conduct an interim goodwill impairment test.

The Company first tested the long-lived assets related to the DMS reporting unit as of December 31, 2012 and, based on the undiscounted cash flows, determined that these assets were not impaired. Additionally, a two-step process was required to test goodwill impairment. The first step is to determine if there is an indication of impairment by comparing the estimated fair value to its carrying value including goodwill. Goodwill is considered impaired if the carrying value exceeds the estimated fair value. To estimate the fair value for step one, the Company utilized a combination of income and market approaches evenly weighted to estimate the fair value of the reporting units. The income approach involves discounting future estimated cash flows. The discount rate used is the value-weighted average of the reporting unit s estimated cost of equity and debt (cost of capital), derived using both known and estimated customary market metrics. The Company performed sensitivity tests with respect to growth rates and discount rates used in the income approach. In applying the market approach, valuation multiples are derived from historical and projected operating data of selected peer companies; evaluated and adjusted, if necessary, based on the Company s strengths and weaknesses relative to the selected peer companies; and applied to the appropriate historical and/or projected operating data to arrive at a fair value.

The Company completed step one of the impairment analysis for each of its reporting units and concluded that, as of December 31, 2012, the fair value of its DMS reporting unit was below its carrying value, including goodwill. As such, step two of the impairment test was initiated to determine the amount of the impairment by comparing the implied fair value of the reporting unit s goodwill with its carrying value. The Company recorded an estimated goodwill impairment charge of $92.4 million in the second quarter of fiscal year 2013. The Company completed the second step of the goodwill impairment test as described above in the third quarter of fiscal year 2013. The completion of this second step did not result in an adjustment to the goodwill impairment charge previously recorded in the second quarter of fiscal year 2013.

7. Debt

Promissory Notes

During the nine months ended March 31, 2013, the Company issued no promissory notes for the acquisition of businesses. The Company recorded accretion of promissory notes of $50,000 and $0.1 million for the three and nine months ended March 31, 2013, respectively.

During the nine months ended March 31, 2012, the Company issued a total of $3.4 million in promissory notes for the acquisition of businesses, net of imputed interest amounts of $0.1 million. For these notes, interest was imputed such that the notes carry an interest rate commensurate with that available to the Company in the market for similar debt instruments. The Company recorded accretion of promissory notes of $0.1 million and $0.3 million for the three and nine months ended March 31, 2012, respectively. Certain of the promissory notes are secured by the assets acquired in respect to which the notes were issued.

Table of Contents

QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Credit Facility

In November 2011, the Company entered into the Second Amended and Restated Revolving Credit and Term Loan Agreement (Second Loan Agreement) with Comerica Bank (the Bank), the administrative agent and lead arranger. The Second Loan Agreement consists of a $100.0 million five-year term loan, with annual principal amortization of 5%, 10%, 15%, 20% and 50%, and a $200.0 million five-year revolving credit line. On February 15, 2013, the Company entered into the First Amendment to Credit Agreement and Amendment to Guaranty (First Amendment) with the Bank to, among other things: (1) amend the definition of adjusted EBITDA, effective as of December 31, 2012, to exclude extraordinary or non-recurring non-cash expenses of losses including, without limitation, goodwill impairments, and any extraordinary or non-recurring cash expenses in an aggregate amount not to exceed $5.0 million for the life of the Second Loan Agreement; and (2) reduce the $200.0 million five-year revolving credit line portion of the facility to $100.0 million, effective as of February 15, 2013.

Borrowings under the Second Loan Agreement are secured by substantially all of the Company s assets. Interest is payable at specified margins above either the Eurodollar Margin or the Prime Rate. The interest rate varies based upon the ratio of funded debt to adjusted EBITDA and ranges from Eurodollar Margin + 1.625% to 2.375% or Prime + 1.00% for the revolving credit line and from Eurodollar Margin + 2.00% to 2.75% or Prime + 1.00% for the term loan. Adjusted EBITDA is defined as net (loss) income less provision for taxes, depreciation expense, amortization expense, stock-based compensation expense, interest and other income (expense), acquisition costs for business combinations, extraordinary or non-recurring non-cash expenses of losses including, without limitation, goodwill impairments, and any extraordinary or non-recurring cash expenses in an aggregate amount not to exceed $5.0 million for the life of this Second Loan Agreement. The revolving credit line requires an annual facility fee of 0.375% of the revolving credit line capacity.

To reduce the Company s exposure to rising interest rates under the term loan, in February 2012, the Company entered into an interest rate swap encompassing the principal balances scheduled to be outstanding as of January 1, 2014, and, thereafter, such principal amount totaling $85.0 million in January 2014 and amortizing to $35.0 million in November 2016. The interest rate swap effectively fixes the Eurodollar Margin at 0.97%.

The Second Loan Agreement expires in November 2016. The Second Loan Agreement restricts the Company s ability to raise additional debt financing and pay dividends, and also requires the Company to comply with other nonfinancial covenants. In addition, the Company is required to maintain financial ratios computed as follows:

1. A minimum fixed charge coverage ratio of 1.15:1, calculated as the ratio of: (i) trailing twelve months of adjusted EBITDA to (ii) the sum of capital expenditures, net cash interest expense, cash taxes, cash dividends and trailing twelve months payments of indebtedness. Payment of unsecured indebtedness is excluded to the degree that sufficient unused revolving credit line exists such that the relevant debt payment could be made from the credit facility.

2. A maximum funded debt to adjusted EBITDA ratio of 3:1, calculated as the ratio of: (i) the sum of all obligations owed to lending institutions, the face amount of any letters of credit, indebtedness owed in connection with acquisition-related notes and indebtedness owed in connection with capital lease obligations to (ii) trailing twelve months of adjusted EBITDA.

The Company was in compliance with the covenants of the Second Loan Agreement, as amended by the First Amendment, as of March 31, 2013. The Company was in compliance with the covenants of the Second Loan Agreement as of June 30, 2012.

Upfront arrangement fees incurred in connection with the First Amendment totaled $0.2 million and were deferred and will be amortized over the remaining term of the arrangement. In connection with the replacement of the previous credit facility, the Company accelerated amortization of approximately $0.7 million of unamortized deferred upfront costs incurred in connection with the Second Loan Agreement in the three months ending March 31, 2013. The outstanding amount under the term loan at March 31, 2013 and June 30, 2012 was $92.5 million and $97.5 million, respectively. There were no outstanding balances under the revolving credit line at March 31, 2013 or June 30, 2012.

Table of Contents

QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Interest Rate Swap

As discussed above, the Company entered into an interest rate swap to reduce its exposure to the financial impact of changing interest rates under its term loan. The Company does not speculate using derivative instruments. The Company entered into this derivative instrument arrangement solely for the purpose of risk management. The effective date of the swap was April 9, 2012 with a maturity date of November 4, 2016. At March 31, 2013, the Company had approximately $85.0 million of notional amount outstanding under the swap agreement that exchanges a variable interest rate base (Eurodollar margin) for a fixed interest rate of 0.97% over the term of the agreement. This interest rate swap is designated as a cash flow hedge of the interest rate risk attributable to forecasted variable interest payments. The effective portion of the fair value gains or losses on this swap are included as a component of accumulated other comprehensive (loss) income on the condensed consolidated balance sheet. Any hedge ineffectiveness will be immediately recognized in earnings in the current period. At March 31, 2013, the fair value of the interest rate swap was $1.2 million and the hedge effective portion of the interest rate swap was $1.2 million.

Debt Maturities

The maturities of the Company s debt as of March 31, 2013 were as follows (in thousands):

Year Ending June 30,	**Promissory Notes**	**Credit Facility**
2013 (remaining three months)	$ 2,490	$ 2,500
2014	3,364	12,500
2015	560	17,500
2016	50	20,000
2017		40,000
	6,464	92,500
Less: imputed interest and unamortized discounts	(301)	(1,287)
Less: current portion	(5,190)	(10,892)
Noncurrent portion of debt	$ 973	$ 80,321

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