Steel Excel Inc.
Form 10-K
March 11, 2016

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2015 or

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

For the transition period from to

Commission file number 0-15071

Steel Excel Inc.
(Exact name of Registrant as specified in its charter)

DELAWARE (State or other jurisdiction of incorporation or organization)	94-2748530 (I.R.S. Employer Identification No.)
1133 WESTCHESTER AVENUE, SUITE N222 WHITE PLAINS, NEW YORK (Address of principal executive offices)	10604 (Zip Code)

Registrant's telephone number, including area code (914) 461-1300

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.001 per share	Nasdaq Capital Market
Preferred Stock Purchase Rights	Nasdaq Capital Market

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

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

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

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 ý 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 ý No ¨

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

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

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

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

The aggregate market value of the Registrant's common stock held by non-affiliates of the Registrant as of June 30, 2015, the last business day of the Registrant's most recently completed second fiscal quarter, was approximately $96.8 million.

As of February 29, 2016, there were 11,347,038 shares of Steel Excel’s common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Items 10, 11, 12, 13 and 14 of Part III will be incorporated by reference to certain portions of a definitive proxy statement, which is expected to be filed by the Registrant within 120 days after the close of its fiscal year.

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Certain statements contained in this annual report on Form 10-K that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Such statements involve known and unknown risks, uncertainties, and other factors that may cause actual results, performance, or achievements of the Company to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Although the Company believes that the expectations reflected in such forward-looking statements are based upon reasonable assumptions, the Company’s actual results could differ materially from those set forth in the forward-looking statements. See “Risk Factors” in Item I Part 1A of this annual report on Form 10-K for a description of certain factors that might cause such differences.

PART I

Item 1. Business

General

Steel Excel Inc. and its subsidiaries (“Steel Excel”, the “Company”, “we”, “us”, “our”) currently operate in two reporting segments - Energy and Sports. Through its wholly-owned subsidiary Steel Energy Services Ltd. ("Steel Energy Services"), the Company’s Energy business provides drilling and production services to the oil and gas industry. Through its wholly-owned subsidiary Steel Sports Inc., the Company’s Sports business is a social impact organization that strives to provide a first-class youth sports experience emphasizing positive experiences and instilling the core values of discipline, teamwork, safety, respect, and integrity. The Company also makes significant non-controlling investments in entities in industries related to its reporting segments as well as entities in other unrelated industries. The Company continues to identify business acquisition opportunities in both the Energy and Sports industries as well as in other unrelated industries. Steel Partners Holdings L.P. (“Steel Partners”), an affiliate, beneficially owned approximately 58.3% of the Company’s outstanding common stock as of December 31, 2015.

Through September 2010, the Company provided enterprise-class external storage products and software to original equipment manufacturers, at which time the Company wound down its remaining business operations. At such time the Company focused on capital redeployment and identification of new business opportunities in which it could utilize existing working capital and maximize the use of net operating losses.

The Company began its Energy business in December 2011 with the acquisition of the business and assets of Rogue Pressure Services, LLC (“Rogue”). The Company expanded the business with the acquisition of the business and assets of Eagle Well Services, Inc., in February 2012 and the acquisition of Sun Well Service, Inc. ("Sun Well") in May 2012, both of which operate as Sun Well Service as a combined business. In December 2013, the Company further expanded its Energy business with the acquisition of the business and assets of Black Hawk Energy Services, Inc. (“Black Hawk”).

The Company began its Sports business in June 2011 with the acquisition of the assets of Baseball Heaven LLC (“Baseball Heaven”), a provider of a wide variety of baseball services, including tournaments, training, teams, and camps. In August 2011, the Company acquired a 75% membership in The Show, LLC (“The Show”), a provider of baseball uniforms to Little League and softball players and coaches. The Company expanded the business in November 2012 with the acquisition of a 50% interest in two Crossfit® facilities located in Torrance, CA, and Hermosa Beach, CA, and in 2014 the Company increased its ownership interest in the Torrance Crossfit® facility to approximately 86%. In January 2013, the Company acquired a 20% membership interest in Ruckus Sports LLC (“Ruckus”), an obstacle course and mass-participation events company that was controlled by the Company through its majority representation on the Ruckus board. The Company increased its membership interest in Ruckus to 45% during 2013. Also in January 2013, the Company acquired a 40% membership interest in Again Faster LLC, a fitness equipment company that is accounted for as an equity-method investment. In June 2013, the Company further expanded its Sports business with the acquisition of 80% of UK Elite Soccer, Inc. (“UK Elite”), a provider of youth soccer programs, coaching services, tournaments, tours, and camps.

In July 2012 and November 2013 the Company shut down The Show and Ruckus, respectively, after they did not meet operational and financial expectations. The Show and Ruckus are each reported as discontinued operations in the

Company’s consolidated financial statements. In September 2015, the Company fully impaired its investment in Again Faster based on the state of the business and the available strategic alternatives. In January 2016, the Company exchanged its 50% interest in the Hermosa Crossfit® facility for the remaining 14% interest in the Torrance Crossfit® facility.

The Company's effected a 1-for-500 reverse stock split (the "Reverse Split") in June 2014, immediately followed by a 500-for-1 forward stock split (the "Forward Split", and together with the Reverse Split, the "Reverse/Forward Split"), of its common stock. As a result of the Reverse Split, stockholders holding fewer than 500 shares received a cash payment for all of their outstanding shares based on a per share price equal to the closing price of the Company's common stock on June 18, 2014, the effective date of the Reverse/Forward Split. Stockholders holding 500 or more shares as of the effective date of the Reverse/Forward Split did not receive any payments for fractional shares resulting from the Reverse Split, and therefore the total number of shares held by such holders did not change as a result of the Reverse/Forward Split.

In December 2010, we changed our fiscal year-end date from March 31 to December 31. Accordingly, we had a nine-month transition period from April 1, 2010, to December 31, 2010.

The Company was incorporated in California in 1981 under the name "Adaptec, Inc.", and reincorporated in Delaware in March 1998. The Company subsequently changed its name to "ADPT Corporation" in June 2010 and to "Steel Excel Inc." in October 2011. Our website is http://www.steelexcel.com. All reports we file electronically with the Securities and Exchange Commission, including annual reports on Forms 10-K, quarterly reports on Forms 10-Q, current reports on Forms 8-K, and proxy statements along with any amendments to those reports are available, free of charge, on or through our website as soon as reasonably practicable after we file such reports with the Securities and Exchange Commission.

Segment Information

See Note 21 to the Company's consolidated financial statements for information regarding segments.

Services

Energy business. The Energy business provides various services to exploration and production companies in the oil and gas business. The services provided include well completion and recompletion, well maintenance and workover, snubbing, flow testing, down hole pumping, plug and abatement, and rental of auxiliary equipment. Prior to the acquisition of the Black Hawk business in December 2013, the Energy business primarily provided its services to customers' extraction and production operations in North Dakota and Montana in the Bakken basin, and to a lesser extent serviced customers in Colorado and Wyoming in the Niobrara basin. The acquisition of the Black Hawk business increased the Energy business' heavy concentration in the Bakken basin, and expanded the business into Texas in the Permian basin and New Mexico in the San Juan basin.

Well completion services involve prepping the well for production, including running frac strings, setting production tubing, installing down hole equipment, drilling out vertical and horizontal plugs, cleaning out the wellbore, and starting production flow. Well recompletion services involve assisting in the re-stimulation of an existing well or plug-back to shut off the flow in the well from points before the plug. Well maintenance and workover services include pulling rods or tubing, installing submersible pumping equipment, repairing casing, and swabbing. Snubbing services involve installing or removing tubes to enable the customer to continue to work on a well and perform many tasks without having to stop production. Flow testing services involve separating the elements - oil, water, gas, and solids - so that the customer can maximize the quality and quantity of their product. Down hole pumping services involve pumping the necessary fluids into the wellbore. Plug and abatement services involve sealing the well and cleaning the site to reduce the potential for any pollution.

Sports business. The Sports business is focused on providing a first-class experience for all families that participate in our programs through the implementation of the Steel Coaching System. Our baseball business is focused on teams, tournaments, camps, lessons, and showcases. Baseball Heaven is equipped with four full-sized outdoor fields, three smaller youth-sized outdoor fields, and an indoor facility. Our soccer business covers a wide variety of programs, including teams, coaching services, tournaments, tours, and camps. Soccer programs are run at facilities owned by municipalities or schools and are run either in conjunction with local youth soccer leagues or as a stand-alone offering. Strength and conditioning services as well as yoga, pilates, and spin were provided at the Torrance and Hermosa Crossfit® facilities through January 2016, and are provided solely at the Torrance facility subsequently.

Customers

Our Energy business client base consists of exploration and production companies in the oil and gas industry. For the year ended December 31, 2015, revenues from Oasis Petroleum, XTO Energy, Continental Resources, and Whiting Petroleum represented 16.3%, 12.1%, 11.5%, and 10.5%, respectively, of the Company's consolidated revenues; for the year ended December 31, 2014, revenues from Oasis Petroleum and Continental Resources represented 20.7% and 20.3%, respectively, of the Company's consolidated revenues; and for the year ended December 31, 2013, revenues from Continental Resources and XTO Energy represented 17.0% and 10.5%, respectively, of the Company's consolidated revenues. For the years ended December 31, 2015, 2014, and 2013, revenues from the Energy business' five largest customers represented 55.7%, 61.2%, and 51.3%, respectively, of the Company's consolidated revenues. For the years ended December 31, 2015, 2014, and 2013, the Energy business' five largest customers represented 66.3%, 67.1%, and 56.1%, respectively, of the segment's revenues and the fifteen largest customers represented 90.4%, 89.0%, and 88.2%, respectively, of the segment's revenues. The loss of a significant customer could have a material adverse effect on the Energy business and Steel Excel.

Our Sports business client base consists of numerous municipalities, youth sports leagues and organizations, and individuals, none of which provide a significant percentage of the Company's consolidated revenues. The loss of a customer would not have a material adverse effect on the Sports business or Steel Excel.

Sales and Marketing

We rely primarily on our local operations to sell and market our services. Because they have conducted business together over several years, the members of our local operations have established strong working relationships with certain of our clients. These strong client relationships provide a better understanding of region-specific issues and enable us to better address customer needs.

Competition

Energy business. The Energy business operates in a highly competitive industry that is influenced by price, capacity, reputation, and experience. When oil and natural gas prices and drilling activities are at high levels, service companies are ordering new equipment to expand their capacity as they are seeing increased demand for their services and attractive returns on investment. When oil and natural gas prices are declining, service companies may be willing to provide their services at reduced prices to be able to cover their equipment and other fixed costs. To be successful, we must provide quality services that meet the specific needs of oil and gas exploration and production companies at competitive prices. In addition, we need to maintain a safe work environment and a well-trained work force to remain competitive.

Our Energy services are affected by seasonal factors, such as inclement weather, fewer daylight hours, and holidays during the winter months. Heavy snow, ice, wind, or rain can make it difficult to operate and to move equipment between work sites, which can reduce our ability to provide services and generate revenues. These seasonal factors affect our competitors as well. Demand for services in the industry as a whole fluctuates with the supply and demand for oil and natural gas. In general, the need for our services increases when demand exceeds supply. The oil and gas exploration and production companies attempt to take advantage of a higher-priced environment when demand exceeds supply, which leads to an increased need for our services. Conversely, as supply equals or exceeds demand, the oil and gas exploration and production companies will cut back on their production resulting in a decline in their well servicing needs or seek pricing concessions from us and other service providers when the price of oil declines.

Sports business. The market for the Sports business' baseball and soccer service offerings is very fragmented, and its competitors are primarily small local or regional operations. The market for its strength and conditioning services is fragmented, and its competitors vary from large national providers of such services to local providers of comparable or other niche services.

The baseball business and the soccer business are affected by seasonal factors, with business volume declining from late autumn through early spring as a result of colder temperatures and fewer daylight hours. In addition, inclement weather during peak seasons can have an adverse effect on the business since fields may not be available to reschedule any canceled events. In 2013, we completed the construction of an indoor baseball facility to enable us to provide year-round baseball services to partially mitigate the revenue declines experienced in non-peak months and during periods of inclement weather. In 2015, we also increased our focus on providing indoor soccer services during the non-peak months.

Government and Environmental Regulation

Our businesses are subject to multiple federal, state, and local laws and regulations pertaining to worker safety, the handling of hazardous materials, transportation standards, and the environment.

Among the various environmental laws we are subject to, the Clean Water Act established the basic structure for regulating discharges of pollutants into the waters of the United States and quality standards for surface waters. Our businesses could be required to obtain permits for the discharge of wastewater or stormwater. In addition, the Oil Pollution Act of 1990 imposed a multitude of requirements on responsible parties related to the prevention of oil spills and liability for damages resulting from such spills in the waters of the United States. These and comparable state laws provide for administrative, civil, and criminal penalties for unauthorized discharges and impose stringent requirements for spill prevention and response planning, as well as considerable potential liability for the costs of removal and damages in connection with unauthorized discharges.

The Comprehensive Environmental Response, Compensation and Liability Act, as amended, and comparable state laws (“CERCLA” or “Superfund”) impose liability without regard to fault or the legality of the original conduct on certain defined parties, including current and prior owners or operators of a site where a release of hazardous substances occurred and entities that disposed or arranged for the disposition of the hazardous substances found at the site. Under CERCLA, these parties may be subject to joint and several liability for the costs of cleaning up the hazardous substances that were released into the environment and for damages to natural resources. Further, claims may be filed for personal injury and property damages allegedly caused by the release of hazardous substances and other pollutants. We may encounter materials that are considered hazardous substances in the course of our operations. As a result, we may incur CERCLA liability for cleanup costs and be subject to related third-party claims. We also may be subject to the requirements of the Resource Conservation and Recovery Act, as amended, and comparable state statutes (“RCRA”) related to solid wastes. Under CERCLA or RCRA, we could be required to clean up contaminated property (including contaminated groundwater) or to perform remedial activities to prevent future contamination.

Our businesses are also subject to the Clean Air Act, as amended, and comparable state laws and regulations that restrict the emission of air pollutants and impose various monitoring and reporting requirements. These laws and regulations may require us to obtain approvals or permits for construction, modification, or operation of certain projects or facilities and may require use of emission controls. Various scientific studies suggest that emissions of greenhouse gases, including, among others, carbon dioxide and methane, contribute to global warming. While it is not possible to predict how legislation or new regulations that may be adopted to address greenhouse gas emissions would impact our business, any new restrictions on emissions that are imposed could result in increased compliance costs for, or additional operating restrictions on, our customers and, which could have an adverse effect on our business.

We are also subject to the Occupational Safety and Health Act, as amended, (“OSHA”) and comparable state laws that regulate the protection of employee health and safety. OSHA’s hazard communication standard requires that information about hazardous materials used or produced in our operations be maintained and provided to employees and state and local government authorities. We believe we are in substantial compliance with OSHA and comparable state law requirements, including general industry standards, record keeping requirements, and monitoring of occupational exposure to regulated substances.

We cannot predict the level of enforcement or the interpretation of existing laws and regulations by enforcement agencies in the future, or the substance of future court rulings or permitting requirements. In addition, we cannot predict what additional laws and regulations may be put in place in the future, or the effect of those laws and regulations on our business and financial condition. We believe we are in substantial compliance with applicable environmental laws and regulations. While we do not believe that the cost of compliance is material to our business or financial condition, it is possible that substantial costs for compliance or penalties for non-compliance may be incurred in the future.

Employees

As of December 31, 2015, we had 763 employees, of which 658 were full-time employees and 105 were part-time employees. All of our employees are located in the United States. We also hire additional full-time and part-time employees during peak seasonal periods. None of our employees are covered by collective bargaining agreements. We consider our employee relations to be satisfactory.

Item 1A. Risk Factors

Our business faces significant risks, including those described is this Item 1A. If any of the events or circumstances described below as possible risk factors actually occur, our business, financial condition, or results of operations could be adversely affected and could result in a decline in the trading price of our common stock. Additional risks that we are not aware of or that we currently think are immaterial may also ultimately have an adverse effect on our results of operations and financial condition.

Our Energy business is susceptible to the impact of fluctuations in energy prices, which could have an adverse effect on our results of operations. High oil and natural gas prices result in an increase in drilling activity, increasing the demand for oilfield services. Oilfield service companies invest in new equipment in such an environment to expand their capacity to take advantage of this increased activity, which could result in an increasingly competitive environment. Declining oil and natural gas prices can result in our customers reducing their drilling and work over activities, which can result in a reduced demand for our services and requests for price concessions. Oilfield service companies may be willing to provide their services at reduced prices in such an environment to be able to cover their equipment and other fixed costs. The increased competition, reduced demand, or competitive pricing pressure could lead to declines in our prices and utilization, which would have an adverse effect on our results of operations.

We are heavily dependent on the oil and gas industry in North America. Several factors affect our customers' willingness to continue to undertake exploration and production activities, the adverse effects of any of which could have a significant adverse effect on our results of operations. Our Energy business is dependent on our customers' willingness to continue to explore for and produce oil and natural gas in North America, primarily in the Bakken and Permian basins. Factors affecting our customers' willingness to continue to undertake exploration and production activities include the following:

- the prices for oil and natural gas and our customers' perceptions of such prices in the future;
- the supply and demand for oil and natural gas;
- the cost for our customers to conduct the necessary exploration and production activities;
- the discovery of new oil and gas reserves;
- the availability of pipelines and other means of transportation;
- increased regulation of the means of transporting oil out of the Bakken basin by rail or road;
- the availability and cost of capital;
- production levels and geopolitical factors in other oil and gas producing countries;
- the price and availability of alternative sources of energy; and
- weather conditions.

The adverse effects of any of these factors could result in a reduction in our customers' exploration efforts, which could have a significant adverse effect on our results of operations.

We are exposed to potential litigation and unrecoverable losses that could have an adverse effect on our results of operations and financial condition. Our Energy business is subject to many hazards inherent in the industry, including blowouts, cratering, explosions, fires, loss of well control, loss of or damage to the wellbore or underground reservoir, damaged or lost drilling equipment, and damage or loss from inclement weather or natural disasters. Any of these hazards could result in personal injury or death, damage to or destruction of equipment and facilities, suspension of operations, environmental and natural resources damage, and damage to the property of others. In addition, we may be subject to litigation as a result of any of these hazards or in the normal course of business. We may be unable to obtain desired contractual indemnities for such hazards, and our insurance may not provide adequate coverage in certain instances. The occurrence of an event not fully indemnified or insured, or the failure or inability of a customer or insurer to meet its financial obligations, and resulting claims and litigation could result in substantial losses and have a significant adverse effect on our results of operations and financial condition.

Increased regulation of hydraulic fracturing could have an adverse impact on our customers. Many of our customers utilize hydraulic fracturing services, which is the process of creating or expanding cracks, or fractures, in formations underground where water, sand, and other additives are pumped under high pressure into the formation. Although we are not a provider of hydraulic fracturing services, many of our services complement the hydraulic fracturing process. Legislation for broader federal regulation of hydraulic fracturing operations and the reporting and public disclosure of chemicals used in the fracturing process could be enacted. Additionally, the United States Environmental Protection Agency has asserted federal regulatory authority over certain hydraulic fracturing activities involving diesel fuel under the Safe Drinking Water Act and is completing the process of drafting guidance documents related to this asserted regulatory authority. Our customers' operations could be adversely affected if additional regulation or permitting requirements were to be required for hydraulic fracturing activities, which could have an adverse effect on our results of operations.

Severe weather conditions could have an adverse effect on our customers and our ability to provide our services. Our Energy business is heavily concentrated in North Dakota and Montana, where severe weather conditions could result in a curtailment of our customers' service requirements, damage to our facilities and equipment resulting in increased repair costs and a suspension of our operations, our inability to deliver services, and an overall decline in productivity, all of which could result in an adverse effect on our results of operations. In addition, inclement weather could result in the cancellation of events and tournaments in our Sports business during peak seasons, which would have an adverse effect on our results of operations.

We may not be able to attract and retain qualified workers, which could have a significant adverse effect on our Energy business. Our Energy business operations require personnel with specialized skills and experience who can perform physically demanding work, and there is intense competition for these workers in the Bakken basin where our Energy business is concentrated. As a result workers may choose to pursue employment in fields that offer a more desirable work environment or better pay. Our inability to attract and retain such qualified workers could have an adverse effect on our productivity, the quality of our service offerings, and our ability to expand our operations, all of which could have an adverse effect on our results of operations.

We may sustain losses in our investment portfolio, which could have an adverse effect on our results of operations, financial condition, and liquidity. A substantial portion of our assets consists of investments in marketable securities that we classify as available-for-sale securities, which are adjusted to fair value each period. An adverse change in global economic conditions may result in a decline in the value of our marketable securities. Declines in the value of marketable securities may not be recognized if such unrealized losses are deemed to be temporary. However, any such declines in value will be recognized as losses upon the sale of such securities or if such declines are deemed to be other than temporary. For the year ended December 31, 2015, the Company incurred impairment charges related to its marketable securities totaling $59.8 million. Any adverse changes in the financial markets and resulting declines in value of our marketable securities may result in additional impairment charges and could have an adverse effect on our results of operations, financial condition, and liquidity.

Certain of our investments may subject us to greater risk and be less liquid than other investments in our portfolio. Our investments include significant interests in equity-method investees, participation in corporate term loans, and promissory notes. We have also entered into short sale transactions on certain financial instruments and have sold call and put options. We may continue to engage in similar investing activities in the future. Such investments may be subject to greater price fluctuations, may be more difficult to sell, and may be sold at prices that do not reflect their intrinsic value.

We may be unable to identify and acquire new businesses, which could have an adverse effect on our long term growth. Acquisitions are a key element of our business strategy. We may not be able to identify and acquire acquisition candidates on acceptable terms. Our inability to identify and acquire new businesses on acceptable terms could have an adverse effect on our long-term growth.

We may be unable to integrate new businesses, which could have an adverse effect on our results of operations, financial condition, and long-term growth. We may not be able to properly integrate acquired businesses, which could result in such businesses not performing as expected when the acquisition was consummated and possibly being dilutive to our overall operating results. Our inability to properly integrate acquired businesses could result from, among other things, the following:

- our failure to retain and attract key employees;
- our failure to retain and attract new customers;
- our failure to develop effective sales and marketing capabilities; and
- our failure to properly operate new lines of business.

Our inability to integrate new businesses could have an adverse effect on our results of operations, financial condition, and our long-term growth.

We may issue shares of our common stock in the future, which could result in dilution to existing stockholders and have an adverse effect on the price of our common stock. As part of our strategy to grow through acquisitions we may issue additional shares of common stock as consideration for such acquisitions and also may issue common stock to employees and contractors as compensation. Any such issuances of common stock will result in our existing stockholders' equity interest being diluted. Such issuances of common stock will also increase the number of outstanding shares of common stock that will be available for sale in the open market, and those individuals receiving shares of our common stock may be more likely to sell, which could have an adverse effect on the price of our common stock.

Restrictions on the transfer of our common stock could inhibit certain transactions that may be beneficial to shareholders. In order to preserve our tax benefit carryforwards, our Certificate of Incorporation generally prohibits the transfer of our common stock and other corporate securities if such a transfer would result in (i) a party having an ownership interest of 4.9% or greater in the Company or (ii) an increased ownership interest of a party that already has an ownership interest of 4.9% or greater in the Company. This restriction, which is in effect until July 2018, could inhibit or prevent certain transactions that would otherwise be beneficial to stockholders.

We may be deemed an investment company, which could impose on us burdensome compliance requirements and restrict our activities. The Investment Company Act of 1940, as amended (the "Investment Company Act"), requires companies to register as an investment company if they are engaged primarily in the business of investing, reinvesting, owning, holding, or trading securities. Generally, companies may be deemed investment companies under the Investment Company Act if they are viewed as engaging in the business of investing in securities or they own investment securities having a value exceeding 40% of certain assets. Depending on our future activities and operations, we may become subject to the Investment Company Act. Although the Investment Company Act provides certain exemptions, we may not qualify for any of these exemptions. If we are deemed to be an investment company we may be subject to certain restrictions that may make it difficult for us to complete business combinations, including restrictions on the nature of and custodial requirements for holding our investments and restrictions on our issuance of securities, which we may use as consideration in a business combination. In addition, if we are deemed to be an investing company we may have imposed upon us additional burdensome requirements, including the following:

- having to register as an investment company;
- adopting a specific form of corporate structure; and
- having to comply with certain reporting, record keeping, voting, proxy, and disclosure requirements.

Such additional requirements would require us to incur additional costs and have an adverse effect on our results of operations and our ability to effectively carry out our business plan.

Our cash balances could be adversely affected by the instability of financial institutions. We maintain our cash, cash equivalents, and marketable securities with certain financial institutions at which our balances exceed the limits that are insured by the Federal Deposit Insurance Corporation. There could be an impact on our cash balances if financial institutions at which we maintain our cash and investments experience financial difficulties, which would have an adverse effect on our results of operations and financial condition.

We may not be able to fully utilize our tax benefits, which could result in increased cash payments for taxes in future periods. Net operating losses (“NOLs”) may be carried forward to offset federal and state taxable income in future years and reduce the amount of cash paid for income taxes otherwise payable on such taxable income, subject to certain limits and adjustments. If fully utilized, our NOLs and other carry-forwards could provide us with significant tax savings in future periods. Our ability to utilize these tax benefits in future years will depend upon our ability to generate sufficient taxable income and to comply with the rules relating to the preservation and use of NOLs. The potential benefit of the NOLs and other carry-forwards may be limited or permanently lost as a result of the following:

- our inability to generate sufficient taxable income in future years to use such benefits before they expire;
- a change in control of the Company that would trigger limitations on the amount taxable income in future years that may be offset by NOLs and other carry-forwards that existed prior to the change in control; and
- examinations and audits by the Internal Revenue Service and other taxing authorities could reduce the amount of NOLs and other credit carry-forwards that are available for future years.

We maintain a full valuation allowance against our NOLs and other carry-forwards due to uncertainty regarding our ability to generate sufficient taxable income in future periods. Our inability to utilize the NOLs and other carry-forwards could result in increased cash payments for taxes in future periods.

We may be liable for additional income taxes upon examination or audit by the taxing authorities. We are subject to income and other taxes in the United States and certain foreign jurisdictions in which we formerly operated. Our tax provision reflects judgments and estimates, including settlements, that are subject to audit and redetermination by the various taxing authorities. Although we believe our estimates are reasonable, the ultimate outcome of these tax matters may differ materially from the amounts recorded in our consolidated financial statements, which could have an adverse effect on our results of operations and financial position.

Internal controls weaknesses that are currently immaterial may become material in future periods. We have identified certain deficiencies in internal controls over financial reporting as immaterial and therefore not requiring disclosure in our public filings with the Securities and Exchange Commission. Changes in circumstances could result in such deficiencies becoming material, which could result in material misstatements in our financial statements and required public disclosure if the appropriate remediation action is not undertaken.

A significant disruption in, or breach in security of, our information technology systems could adversely affect our business. We rely on information technology systems, some of which are managed by third parties, to process, transmit and store electronic information, and to manage or support a variety of critical business processes and activities. We also collect and store sensitive data, including confidential business information and personal data. These systems may be susceptible to damage, disruptions, or shutdowns due to attacks by computer hackers, computer viruses, employee error or malfeasance, power outages, hardware failures, telecommunication or utility failures, catastrophes, or other unforeseen events. In addition, security breaches of our systems could result in the misappropriation or unauthorized disclosure of confidential information or personal data belonging to us or to our employees, partners, customers, or suppliers. Any such events could disrupt our operations, inhibit our ability to produce financial information, damage customer relationships and our reputation, and result in legal claims or proceedings, liability, or penalties under privacy laws, each of which could adversely affect our business and our financial statements.

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