

NEUSTAR INC  
Form 10-K  
February 28, 2008

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

Form 10-K

**b** ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934  
for the fiscal year ended December 31, 2007

Or

**o** TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
for the transition period from to

Commission File No. 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.)*

**46000 Center Oak Plaza  
Sterling, Virginia**

*(Address of principal executive offices)*

**20166**

*(Zip Code)*

**(571) 434-5400**

*(Registrant's telephone number, including area code)*

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

| <b>Title of Each Class</b> | <b>Name of Each Exchange on Which Registered</b> |
|----------------------------|--|
| Class A Common Stock       | New York Stock Exchange                          |

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

None

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

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

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 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 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 <input checked="" type="checkbox"/> | Accelerated filer <input type="checkbox"/> | Non-accelerated filer <input type="checkbox"/><br>(Do not check if a<br>smaller reporting<br>company) | Smaller reporting<br>company <input type="checkbox"/> |
|---|--|---|---|

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

On February 15, 2008, 77,376,970 shares of NeuStar Class A common stock were outstanding and 4,538 shares of NeuStar Class B common stock were outstanding. The aggregate market value of the NeuStar common equity held by non-affiliates as of June 30, 2007 was approximately \$2.19 billion.

**DOCUMENTS INCORPORATED BY REFERENCE:**

Information required by Part III (Items 10, 11, 12, 13 and 14) is incorporated by reference to portions of NeuStar's definitive proxy statement for its 2008 Annual Meeting of Stockholders, which NeuStar intends to file with the Securities and Exchange Commission within 120 days of December 31, 2007.

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Unless the context requires otherwise, references in this report to *NeuStar*, *we*, *us*, *the Company* and *our* refer to *NeuStar, Inc.* and its consolidated subsidiaries.

## PART I

### ITEM 1. BUSINESS

#### Overview

We provide the communications industry with essential clearinghouse services. Our customers use the databases we contractually maintain in our clearinghouse to obtain data required to successfully route telephone calls in North America, to exchange information with other communications service providers and to manage technological changes in their own networks. We operate the authoritative directories that manage virtually all telephone area codes and numbers, and we enable the dynamic routing of calls among thousands of competing communications service providers, or CSPs, in the United States and Canada. All CSPs that offer telecommunications services to the public at large, or telecommunications service providers, such as Verizon Communications Inc., Sprint Nextel Corporation, and AT&T Corp., must access our clearinghouse to properly route virtually all of their customers' calls. We provide clearinghouse services to emerging CSPs, including Internet service providers, mobile network operators, cable television operators, and voice over Internet protocol, or VoIP, service providers. In addition, we provide domain name services, including internal and external managed DNS solutions that play a key role in directing and managing traffic on the Internet, and we manage the authoritative directories for the .us and .biz Internet domains. We operate the authoritative directory for U.S. Common Short Codes, part of the short messaging service relied upon by the U.S. wireless industry, and provide solutions used by mobile network operators worldwide to enable mobile instant messaging for their end users.

We were founded to meet the technical and operational challenges of the communications industry when the U.S. government mandated local number portability in 1996. While we remain the provider of the authoritative solution that the communications industry relies upon to meet this mandate, we have developed a broad range of innovative services to meet an expanded range of customer needs. We provide the communications industry with critical technology services that solve the addressing, interoperability and infrastructure needs of CSPs. These services are used by CSPs to manage a range of their technical and operating requirements, including:

*Addressing.* We enable CSPs to use critical, shared addressing resources, such as telephone numbers, Internet top-level domain names, and U.S. Common Short Codes.

*Interoperability.* We enable CSPs to exchange and share critical operating data so that communications originating on one provider's network can be delivered and received on the network of another CSP. We also facilitate order management and work flow processing among CSPs.

*Infrastructure.* We enable CSPs to more efficiently manage their networks by centrally managing certain critical data they use to route communications over their networks.

#### Company Information and History

We were incorporated in Delaware in 1998 to acquire our business from Lockheed Martin Corporation. This acquisition was completed in November 1999. Our principal executive offices are located at 46000 Center Oak Plaza, Sterling, Virginia, 20166, and our telephone number at that address is (571) 434-5400.

On June 28, 2005, we effected a recapitalization, which involved (i) payment of all accrued and unpaid dividends on all of the then-outstanding shares of preferred stock, followed by the conversion of all such shares into shares of common stock, (ii) the amendment of our certificate of incorporation to provide for Class A common stock and Class B common stock, and (iii) the split of each share of common stock into 1.4 shares and the reclassification of the common stock into shares of Class B common stock. We refer to these transactions collectively as the Recapitalization. Each share of Class B common stock is convertible at the option of the holder into one share of Class A common stock, and we anticipate that all holders of Class B common stock will ultimately convert their shares into shares of Class A common stock.

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On June 28, 2005, we made an initial public offering of 31,625,000 shares of Class A common stock, which included the underwriters' over-allotment option exercise of 4,125,000 shares of Class A common stock. All the shares of Class A common stock sold in the initial public offering were sold by selling stockholders and, as such, we did not receive any proceeds from that offering. In December 2005, we completed an additional offering of 20,000,000 shares of Class A common stock, all of which were sold by selling stockholders. As such, we did not receive any proceeds from that offering.

## Industry Background

Changes in the structure of the communications industry over the past two decades have presented increasingly complex technical and operating challenges. Whereas the Bell Operating System once dominated the U.S. telecommunications industry, there are now thousands of service providers, all with disparate networks. Today these service providers must interconnect their networks and carry each other's traffic to route phone calls, unlike in the past when a small number of incumbent wireline carriers used established, bilateral relationships. In addition, CSPs are delivering a broad set of new services using a diverse array of technologies. These services, which include voice, data and video, are used in combinations that are far more complex than the historical, uniform voice services of traditional carriers.

The increasing complexity of the communications industry has produced operational challenges, as the legacy, in-house network management and back office systems of traditional carriers were not designed to capture all of the information necessary for provisioning, authorizing, routing and billing these new services. In particular, it has become significantly more difficult for service providers to:

*Locate end-users.* Identify the appropriate destination for a given communication among multiple networks and unique addresses, such as wireline and wireless phone numbers as well as IP and e-mail addresses;

*Establish identity.* Authenticate that the users of the communications networks are who they represent themselves to be and that they are authorized to use the services being provided;

*Connect.* Route the communication across disparate networks;

*Provide services.* Authorize and account for the exchange of communications traffic across multiple networks; and

*Process transactions.* Capture, process and clear accounting records for billing, and generate settlement data for inter-provider compensation.

## Our Clearinghouse

We provide our services from a set of unique databases, systems and platforms in geographically dispersed data centers, which we refer to collectively as our clearinghouse. Our clearinghouse has been designed to provide substantial advantages in meeting the challenges facing the communications industry for both traditional voice and IP networks. First, our clearinghouse databases and capabilities provide competing CSPs with fair, equal and secure access to essential shared resources such as telephone numbers and domain names. This sharing of data is critical for locating end-users and establishing their identity. Second, our clearinghouse databases and capabilities serve as an authoritative directory to ensure proper routing of voice, advanced data applications and IP-based communications, such as mobile instant messaging, regardless of originating or terminating technologies. Third, our clearinghouse allows CSPs access through standard interfaces. Our clearinghouse also enables connections to authoritative operating data for CSPs and providers of other service elements, including content, entertainment and financial transactions. As

a result, our clearinghouse facilitates advanced services, such as multi-media content services and mobile instant messaging. Finally, our services facilitate the management of networks and services, including the deployment of new technologies and protocols, the balancing of communications traffic across a CSP's internal networks, network consolidation, and the control of instant messaging services, which promote a CSP's ability to create differentiated and value-added services.



To ensure our role as a provider of essential services to the communications industry, we designed our clearinghouse to be:

*Reliable.* Our clearinghouse services depend on complex technology that is designed to deliver reliability consistent with telecommunications industry standards. Under our contracts, we have committed to our customers to deliver high quality services across numerous measured and audited service levels, such as system availability, response times for help desk inquiries and billing accuracy, consistent with telecommunications industry standards.

*Scalable.* The modular design of our clearinghouse enables capacity expansion without service interruption or quality of service degradation, and with incremental investment that provides significant economies of scale.

*Neutral.* We provide our services in a competitively neutral way to ensure that no one telecommunications service provider, telecommunications industry segment or technology or group of telecommunications customers is favored over any other. Moreover, we have committed not to be a telecommunications service provider in competition with our customers.

*Trusted.* The data we collect are important and proprietary. Accordingly, we have appropriate procedures and systems to protect the privacy and security of customer data, restrict access to the system and generally protect the integrity of our clearinghouse. Our performance with respect to neutrality, privacy and security is independently audited regularly.

## **NeuStar Clearinghouse Services**

### ***Addressing***

Addresses are a shared resource among CSPs. Each communications device must have a unique address so that communications can be routed properly to that device. With the development of new technologies, the number and type of addressing resources increase, and the advent of bundled services, such as voice plus text messaging, may require that multiple addresses be identified for what is intended to be a single, integrated communication to one or more devices used by a single user or a group of users.

For communications to reliably reach the intended users, we believe that the communications industry requires a trusted, authoritative administrator of addressing directories to route communications. Moreover, we believe that CSPs must have fair access to shared addressing resources and must be able to access the administrator's systems to ensure the proper routing of communications. We provide a range of addressing services to meet these needs, including:

*Telephone Number Administration.* As the North American Numbering Plan Administrator, we maintain the authoritative database of telephone numbering resources for North America. We allocate telephone numbers by geographic location and assign telephone numbers to telecommunications service providers. We administer area codes, including area code splits and overlays, and collect and forecast telephone number utilization rates by service providers. As the National Pooling Administrator, we also manage the administration of inventory and allocation of pooled blocks of unassigned telephone numbers by reassigning 1,000-number blocks of assigned but unused telephone numbers to telecommunications service providers requiring additional telephone numbers. We provide these services under fixed-fee contracts with the Federal Communications Commission, or FCC.

*Telephone Number Pooling.* In addition to the administrative functions associated with our role as the National Pooling Administrator, we also implement the administration of the allocation of pooled blocks of unassigned telephone numbers through our clearinghouse, including the reallocation of pooled blocks of telephone numbers to the consolidated network of consolidating carriers following a merger or other business combination. We are paid on a per transaction basis for this service.

*Internet Domain Name Services.*

*Ultra Services.* We provide a suite of services that play a key role in directing and managing Internet traffic and monitoring the performance of websites, enabling thousands of customers to intelligently and securely control and distribute Internet traffic, and ensuring security, scalability and reliability of websites and email. We are paid a recurring monthly fee based on contractually established monthly minimum transaction volumes, and a per transaction fee for transactions processed in excess of these monthly volumes.

*.BIZ and .US Domains.* We operate the authoritative registries of Internet domain names for the .biz and .us top level domains. All Internet communications routing to a .biz or .us address must query a copy of our directory to ensure that the communication is routed to the appropriate destination. We are paid on a subscription basis for each name in the registries, which together currently contain over three and a half million registered domain names.

*Registry Gateway Services.* We are the exclusive provider of wholesale registration services to domain name retailers for the .cn (China) and .tw (Taiwan) Internet domains for all regions outside of the home countries. We are paid on a subscription basis for each name sold through the gateway.

*U.S. Common Short Codes.* We operate the authoritative U.S. Common Short Code registry on behalf of the leading wireless providers in the United States. A Common Short Code is a string of five or six numbers, which serves as the address for text messages that are sent from wireless devices to businesses or organizations on a many-to-one basis. U.S. Common Short Codes are often used by consumer brand companies and organizations to count votes using wireless devices in promotional marketing efforts, such as votes for sporting event MVPs, to register for contests and special offers, to download applications such as ring tones, and used for product awareness campaigns. We are paid on a subscription basis for each code in the registry.

***Interoperability***

To provide communications across multiple networks involving multiple service providers, industry participants must exchange essential operating data. We believe that our clearinghouse is the most efficient, logistically practical and economical means for each CSP to exchange the large volumes of operating data that are required to deliver communications services between networks. Our services include:

*Wireline and Wireless Number Portability.* Our clearinghouse is the master, authoritative directory that allows end users to change their telephone carrier without changing their telephone numbers. In addition, service providers use this service to change the network identification associated with their end users' telephone numbers after a merger or consolidation. We have provided this service for wireline local number portability since 1997, and in 2003 we expanded our service to provide portability of telephone numbers between wireless telecommunications service providers and between wireline and wireless telecommunications service providers. We are paid on a per transaction basis for this service.

*Order Management Services.* We provide centralized clearinghouse services that permit our customers, through a single interface, to exchange essential operating data with multiple CSPs in order to provision services. We are typically paid on a per transaction basis for each order we process.

***Infrastructure and Other***

Constant changes in the communications service industry require providers to make frequent and extensive changes in their own network infrastructure. Our infrastructure services are used by CSPs to efficiently reconfigure their networks and systems in response to changes in the market. Our services include:

*Network Management.* Our customers use our clearinghouse to centrally process changes to essential network elements that are used to route telephone calls. We are paid on a per transaction basis for these services. Our network management services are used by our customers for a variety of different purposes, such as to replace and upgrade technologies, to balance network traffic and to reroute traffic on alternative networks in the event of a service disruption.

*Connection Services.* We provide standard connections for those CSPs that connect directly to our clearinghouse. We are paid an established fee based on the type of connection.

### **NeuStar Next Generation Messaging Services**

*Mobile Instant Messaging.* We provide scalable solutions to mobile network operators worldwide, which allow them to manage instant messaging, or IM, and to create their own branded IM services. We are typically paid a monthly fee on a per-active user basis.

### **Operations**

#### ***Sales Force and Marketing***

As of December 31, 2007, our sales and marketing organization consisted of approximately 245 people who work together to proactively deliver advanced technologies and solutions to serve our customers' needs. Our sales teams work closely with our customers to identify and address their needs, while our marketing team works closely with our sales teams to deliver comprehensive services, develop a clear and consistent corporate image and offer a full customer support system.

We have an experienced sales and marketing staff who offer extensive knowledge in the management of telephone numbers and domain name systems, number portability and IP clearinghouse services. We believe we have close relations with our customers, and we know their systems and operations. We have worked closely with our customers to develop solutions such as national pooling, U.S. Common Short Codes, number translation services, and the provisioning of service requests for VoIP providers. Our sales teams strive to increase the services purchased by existing customers and to expand the range of services we provide to our customers.

#### ***Customer Support***

We provide customer support 24 hours a day, 7 days a week and 365 days a year. Customer support personnel are in charge of implementation of our service offerings from the point at which a contract is signed until the point at which our services are fully operational. Post-delivery, our staff works closely with our customers to ensure that our service level agreements are being met. They continually solicit customer feedback and are in charge of bringing together the proper internal resources to troubleshoot any problems or issues that customers may have. Performance of these individuals is measured by customer satisfaction surveys as well as by their ability to limit service downtime.

#### ***Operational Capabilities***

We operate geographically diverse state-of-the-art data centers that support our services. Our data centers are custom designed for the processing and transmission of high volumes of transaction-related, time-sensitive data in a highly secure environment. We are committed to employing best-of-breed tools and equipment for application development, infrastructure management, operations management, and information security. In general, we subscribe to the highest level of service and responsiveness available from each third party vendor that we use. Further, to protect the integrity of our systems, the major components of our networks are generally designed to eliminate any single point of failure.

We consistently exceed our contractual service level requirements, and our performance results are monitored internally and subjected to independent audits on a regular basis for some of our services.

### **Research and Development**

We maintain a research and development group, the principle functions of which are to develop new services and improvements to existing services, oversee quality control processes and perform application testing. Our processes surrounding the development of new services and improvement to existing services focus on the challenges communicated to us by our customers related to the management of an expanding array of technologies and end-user services across a growing number of CSPs. We employ industry experts in areas of technology that we believe are key to solving these problems. Our quality control and application testing processes focus

predominantly on highly technical support issues, which are identified through both internal and external feedback mechanisms, and continuous testing of our applications and system platforms to ensure uptime commensurate to service level standards we have committed to our customers. As of December 31, 2007, we had approximately 219 employees dedicated to research and development, which consists of software engineers, project managers and documentation specialists. We expense our research and development costs as incurred. Our research and development expense was \$11.9 million, \$17.6 million and \$27.4 million for the years ended December 31, 2005, 2006 and 2007, respectively.

## **Customers**

We serve traditional providers of communications, including local exchange carriers, such as Verizon Communications Inc. and AT&T, Inc.; competitive local exchange carriers, such as XO Holdings, Inc. and Level 3 Communications, Inc.; wireless service providers, such as Verizon Wireless Inc., and Sprint Nextel Corporation; and long distance carriers. We also serve emerging CSPs, including Comcast Corporation, Time Warner Telecom Inc., Cox Communications, Inc. and Cbeyond, Inc., and fast-growing emerging providers of VoIP services, such as Vonage Holdings Corp.

In addition to serving traditional CSPs, we also serve a growing number of customers who are either enablers of Internet services or providers of information and content to Internet and telephone users. For example, customers for our managed DNS services include a wide range of both large and small enterprises, including registry operators, such as Afilias Limited, and e-commerce companies, such as Amazon.com, Inc. All Internet service providers rely on our Internet registry services to route all communications to .biz and .us Internet addresses. Domain name registrars, including Network Solutions, Inc., The Go Daddy Group, Inc., and Register.com, Inc. pay us for each .biz and .us domain name they register on behalf of their customers. Wireless service providers rely on our registry to route all U.S. Common Short Code communications, but the bulk of our customers for U.S. Common Short Codes are the information and entertainment content providers who register codes with us to allow wireless subscribers to communicate with them via text messaging. Mobile network operators throughout Europe, including several country operators affiliated with Vodafone Group Plc, rely on our instant messaging solutions to provide mobile instant messaging to their end users.

Our customers include over 8,700 different entities, each of which is separately billed for the services we provide, regardless of whether it may be affiliated with one or more of our other customers. No single entity accounted for more than 10% of our total revenue in 2007. The amount of our revenue derived from customers inside the United States was \$235.5 million, \$317.3 million and \$387.4 million for the years ended December 31, 2005, 2006 and 2007, respectively. The amount of our revenue derived from customers outside the United States was \$7.0 million, \$15.7 million and \$41.8 million for the years ended December 31, 2005, 2006 and 2007, respectively. The amount of our revenue derived under our contracts with North American Portability Management LLC was \$188.8 million, \$249.3 million and \$301.8 million for the years ended December 31, 2005, 2006 and 2007, respectively.

## **Competition**

Our services most frequently compete against the legacy in-house systems of our customers. We believe our services offer greater reliability and flexibility on a more cost-effective basis than these in-house systems.

In our roles as the North American Numbering Plan Administrator, National Pooling Administrator, administrator of local number portability for the communications industry, operator of the sole authoritative registry for the .us and .biz Internet domain names, and operator of the sole authoritative registry for U.S. Common Short Codes, there are no other providers currently providing the services we offer. However, we were awarded the contracts to administer these services in open and competitive procurement processes where we competed against companies including Accenture

Ltd, Computer Sciences Corporation, Hewlett-Packard Company, International Business Machines Corporation, or IBM, Mitretek Systems, Inc., Nortel Networks Corporation, NCS Pearson, Inc., Perot Systems Corporation, Telcordia Technologies, Inc. and VeriSign, Inc. We have renewed or extended the term of several of these contracts since we first entered into them. As the terms of these contracts expire, we expect that other companies may seek to bid on renewals or new contracts, and we may not be successful in renewing them. In



addition, prior to the expiration of our contracts to provide number portability services, North American Portability Management LLC could solicit, or our competitors may submit, proposals to replace us, in whole or in part, as the provider of the services covered by these contracts. Similarly, with respect to our contracts to act as the North American Number Plan Administrator, the National Pooling Administrator, operator of the authoritative registry for the .us and .biz Internet domain names, and the operator of the authoritative registry for U.S. Common Short Codes, the relevant counterparty could elect not to exercise the extension period under the contract, if applicable, or to terminate the contract in accordance with its terms, in which case we could be forced to compete with other providers to continue providing the services covered by the relevant contract. However, we believe that our position as the incumbent provider of these services will enable us to compete favorably for contract renewals or for new contracts to continue to provide these services.

While we do not face direct competition for the registry of .us and .biz Internet domain names, we compete with other companies that maintain the registries for different domain names, including Afilias Limited, which manages the .org and .info registries, VeriSign, Inc., which manages the .com and .net registries, and a number of managers of country-specific domain name registries (such as .uk for domain names in the United Kingdom).

For the remainder of our services, we compete against a range of providers of interoperability and infrastructure services and/or software, as well as the in-house network management and information technology organizations of our customers. Our competitors, other than in-house network systems, generally fall into three categories:

- companies that develop and sell software solutions to CSPs, such as Evolving Systems, Inc., and NetCracker Technology Corp.;

- systems integrators such as Accenture Ltd, Electronic Data Systems Corporation, Hewlett-Packard Company, IBM, Oracle Corporation and Perot Systems Corporation, which develop customized solutions for CSPs and in some cases operate and manage certain back-office systems for CSPs on an outsourced basis; and

- with respect to our Ultra services, companies such as Akamai Technologies, Inc., VeriSign, Inc., and F5 Networks, Inc., who provide internal and external managed DNS services;

- with respect to mobile instant messaging, companies that develop presence and instant messaging solutions, such as Oz Communications, Inc. and Colibria AS; and

- with respect to order management services, companies such as CGI Group Inc., Synchronoss Technologies, Inc., Syniverse Technologies, Inc., Telcordia Technologies, Inc., VeriSign, Inc. and Wisor Telecom Corporation, which offer communications interoperability services, including inter-CSP order processing and workflow management on an outsourced basis;

Competitive factors in the market for our services include breadth and quality of services offered, reliability, security, cost-efficiency, and customer support. Our ability to compete successfully depends on numerous factors, both within and outside our control, including:

- our responsiveness to customers' needs;

- our ability to support existing and new industry standards and protocols;

- our ability to continue development of technical innovations; and

- the quality, reliability, security and price-competitiveness of our services.

We may not be able to compete successfully against current or future competitors and competitive pressures that we face may materially adversely affect our business. The market for clearinghouse services may not continue to develop, and CSPs may not continue to use clearinghouse services rather than in-house systems and purchased or internally-developed software.

## Employees

As of December 31, 2007, we employed 960 persons worldwide. None of our employees is currently represented by a labor union. We have not experienced any work stoppages and consider our relationship with our employees to be good.

## Contracts

We provide many of our addressing, interoperability and infrastructure services pursuant to private commercial and government contracts. Specifically, we provide wireline and wireless number portability, implement the allocation of pooled blocks of telephone numbers and provide network management services pursuant to seven contracts with North American Portability Management LLC, an industry group that represents all telecommunications service providers in the United States. Although the FCC has plenary authority over the administration of telephone number portability, it is not a party to our contracts with North American Portability Management LLC. The North American Numbering Council, a federal advisory committee to which the FCC has delegated limited oversight responsibilities, reviews and oversees North American Portability Management LLC's management of these contracts. See Regulatory Environment Telephone Numbering. We recognize revenue under our contracts with North American Portability Management LLC primarily on a per transaction basis. The aggregate fees for transactions processed under these contracts are determined by the total number of transactions, and these fees are billed to telecommunications service providers based on their allocable share of the total transaction charges. This allocable share is based on each respective telecommunications service provider's share of the aggregate end-user services revenues of all U.S. telecommunications service providers as determined by the FCC. On November 3, 2005, BellSouth Corporation filed a petition seeking changes in the way our customers are billed for services provided by us under our contracts with North American Portability Management LLC. In response to the BellSouth petition, the FCC requested comments from interested parties. As of February 15, 2008, the FCC had not initiated a formal rulemaking process, and the BellSouth petition remains pending. We do not believe that the proposed change to the manner in which we bill for services under these contracts would have a material impact on our customers' demand for these services. In addition, on June 13, 2007, Telcordia Technologies, Inc. filed a petition with the FCC requesting an order that would require North American Portability Management LLC to conduct a new bidding process to appoint a provider of telephone number portability services in the United States. As of February 15, 2008, the FCC had not initiated a formal rulemaking process, and the Telcordia petition remains pending. If the Telcordia petition is successful, we may lose one or more of our contracts with North American Portability LLC. Under our contracts, we also bill a revenue recovery collections, or RRC, fee of a percentage of monthly billings to our customers, which is available to us if any telecommunications service provider fails to pay its allocable share of total transaction charges. If the RRC fee is insufficient for that purpose, these contracts also provide for the recovery of such differences from the remaining telecommunications service providers. Under these contracts, users of our clearinghouse also pay fees to connect to our data center and additional fees for reports that we generate at the user's request. Our contracts with North American Portability Management LLC continue through June 2015.

We also provide wireline number portability and network management services in Canada pursuant to a contract with the Canadian LNP Consortium Inc., a private corporation composed of telecommunications service providers who participate in number portability in Canada. The Canadian Radio-television and Telecommunications Commission oversees the Canadian LNP Consortium's management of this contract. We bill each telecommunications service provider for our services under this contract primarily on a per transaction basis. This contract continues through December 2011. The services we provide under the contracts with North American Portability Management LLC and the Canadian LNP Consortium are subject to rigorous performance standards, and we are subject to corresponding penalties for failure to meet those standards.

We serve as the North American Numbering Plan Administrator and the National Pooling Administrator pursuant to two separate contracts with the FCC. Under these contracts, we administer the assignment and implementation of new area codes in North America, the allocation of central office codes (which are the prefixes following the area codes) to telecommunications service providers in the United States, and the assignment and allocation of pooled blocks of telephone numbers in the United States in a manner designed to conserve telephone number resources. The North American Numbering Plan Administration contract is a fixed-fee government

contract that was awarded by the FCC in 2003. The contract is structured as a one-year agreement with four one-year options exercisable by the FCC. The FCC has exercised each of these four options, and this contract is due to expire on July 8, 2008. We expect to compete for a renewal of this contract. The National Pooling Administration contract was originally awarded to us by the FCC in 2001. In August 2007, the FCC awarded us a new contract to continue as the National Pooling Administrator. Under this new contract, we will continue to perform the administrative functions associated with the allocation of pooled blocks of telephone numbers in the United States. The terms of this new contract provide for a fixed fee associated with the administration of the pooling system plus reimbursement of select costs. The initial contract term is two years, commencing in August 2007, and provides three one-year extension options that are exercisable at the election of the FCC.

We are the operator of the .biz Internet top-level domain by contract with the Internet Corporation for Assigned Names and Numbers, or ICANN. The .biz contract was originally granted in May 2001. In December 2006, the ICANN awarded to us a renewal of the .biz contract through December 2012. Under the terms of the amended agreement, the .biz contract automatically renews after 2012 unless it has been determined that we have been in fundamental and material breach of certain provisions of the agreement and have failed to cure such breach. Similarly, pursuant to a contract with the U.S. Department of Commerce, we operate the .us Internet domain registry. This contract was originally awarded in October 2001. In October 2007, the government awarded to us a renewal of the .us contract for a period of three years, which may be extended by the government for two additional one-year periods. The Department of Commerce is currently evaluating the procedures it followed in awarding to us the .us contract, in response to a bid protest filed by one of our competitors. Pending resolution of this evaluation, performance under our new .us contract has been stayed, and the terms of our previous .us contract remain in effect. The .biz and .us contracts allow us to provide domain name registration services to domain name registrars, who pay us on a per-name basis.

We have an exclusive contract with the CTIA – The Wireless Association® to serve as the registry operator for the administration of U.S. Common Short Codes. U.S. Common Short Codes are short strings of numbers to which text messages can be addressed – a common addressing scheme that works across all participating wireless networks. We were awarded this contract in October 2003 through an open procurement process by the major wireless carriers. The initial term of the contract continued through April 2006, and was renewed automatically for an additional two-year period pursuant to the terms of the contract. Under the terms of the contract, the term automatically renews for additional two-year periods unless terminated in accordance with its terms. We provide U.S. Common Short Code registration services to wireless content providers, who pay us subscription fees per U.S. Common Short Code registered.

## **Regulatory Environment**

### ***Telephone Numbering***

*Overview.* The Telecommunications Act of 1996 was enacted to remove barriers to entry in the communications market. Among other things, the Telecommunications Act mandates portability of telephone numbers and requires traditional telephone companies to provide non-discriminatory access and interconnection to potential competitors. The FCC has plenary jurisdiction over issues relating to telephone numbers, including telephone number portability and the administration of telephone number resources. Under this authority, the FCC promulgated regulations governing the administration of telephone numbers and telephone number portability. In 1995, the FCC established the North American Numbering Council, a federal advisory committee, to advise and make recommendations to the FCC on telephone numbering issues, including telephone number resources administration and telephone number portability. The members of the North American Numbering Council include representatives from local exchange carriers, interexchange carriers, wireless providers, VoIP providers, manufacturers, state regulators, consumer groups and telecommunications associations.

*Telephone Number Portability.* The Telecommunications Act requires telephone number portability, which is the ability of users of telecommunications services to retain existing telephone numbers without impairment of quality, reliability, or convenience when switching from one telecommunications service provider to another. Through a series of competitive procurements, we were selected by a consortium of service providers representing the telecommunications industry to develop, build and operate a solution to enable telephone number portability in

the United States. We ultimately entered into seven regional contracts to administer the system that we developed, after which the North American Numbering Council recommended to the FCC, and the FCC approved, our selection to serve as a neutral administrator of telephone number portability. The FCC also directed the seven original regional entities, each comprising a consortium of service providers operating in the respective regions, to manage and oversee the administration of telephone number portability in their respective regions, subject to North American Numbering Council oversight. Under the rules and policies adopted by the FCC, North American Portability Management LLC, as successor in interest to the seven regional consortiums, has the power and authority to negotiate master agreements with an administrator of telephone number portability, so long as that administrator is neutral.

*North American Numbering Plan Administrator and National Pooling Administrator.* We have contracts with the FCC to act as the North American Numbering Plan Administrator and the National Pooling Administrator, and we must comply with the rules and regulations of the FCC that govern our operations in each capacity. We are charged with administering numbering resources in an efficient and non-discriminatory manner, in accordance with FCC rules and industry guidelines developed primarily by the Industry Numbering Committee. These guidelines provide governing principles and procedures to be followed in the performance of our duties under these contracts. The communications industry regularly reviews and revises these guidelines to adapt to changed circumstances or as a result of the experience of industry participants in applying the guidelines. A committee of the North American Numbering Council evaluates our performance against these rules and guidelines each year and provides an annual review to the North American Numbering Council and the FCC. If we violate these rules and guidelines, or if we fail to perform at required levels, the FCC may reevaluate our fitness to serve as the North American Numbering Plan Administrator and the National Pooling Administrator and may terminate our contracts or impose fines on us. The division of the North American Numbering Council responsible for reviewing our performance as the North American Numbering Plan Administrator and the National Pooling Administrator has determined that, with respect to our performance in 2006, we exceeded and more than met our performance guidelines under each such respective review. Similar reviews of our performance in 2007 have not yet been completed.

*Neutrality.* Under FCC rules and orders establishing the qualifications and obligations of the North American Numbering Plan Administrator and National Pooling Administrator, and under our contracts with North American Portability Management LLC to provide telephone number portability services, we are required to comply with neutrality regulations and policies. Under these neutrality requirements, we are required to operate our numbering plan, pooling administration and number portability functions in a neutral and impartial manner, which means that we cannot favor any particular telecommunications service provider, telecommunications industry segment or technology or group of telecommunications consumers over any other telecommunications service provider, industry segment, technology or group of consumers in the conduct of those businesses. We are examined periodically on our compliance with these requirements by independent third parties. The combined effect of our contracts and the FCC's regulations and orders requires that we:

not be a telecommunications service provider, which is generally defined by the FCC as an entity that offers telecommunications services to the public at large, and is, therefore, providing telecommunications services on a common carrier basis;

not be an affiliate of a telecommunications service provider, which means, among other things, that we:

must restrict the beneficial ownership of our capital stock by telecommunications service providers or affiliates of a telecommunications service provider; and

may not otherwise, directly or indirectly, control, be controlled by, or be under common control with, a telecommunications service provider;

not derive a majority of our revenue from any single telecommunications service provider; and

not be subject to undue influence by parties with a vested interest in the outcome of numbering administration and activities. Notwithstanding our satisfaction of the other neutrality criteria above, the North American Numbering Council or the FCC could determine that we are subject to such undue influence. The North American Numbering Council may conduct an evaluation to determine whether we meet this undue influence criterion.



We are required to maintain complete confidentiality of competitive customer information obtained during the conduct of our business. In addition, as part of our neutrality framework, we are required to comply with a code of conduct that is designed to ensure our continued neutrality. Among other things, our code of conduct, which was approved by the FCC, requires that:

we never, directly or indirectly, show any preference or provide any special consideration to any telecommunications service provider;

we prohibit access by our stockholders to user data and proprietary information of telecommunications service providers served by us (other than access of employee stockholders that is incident to the performance of our numbering administration duties);

our shareholders take steps to ensure that they do not disclose to us any user data or proprietary information of any telecommunications service provider in which they hold an interest, other than the sharing of information in connection with the performance of our numbering administration duties;

we not share confidential information about our business services and operations with employees of any telecommunications service provider;

we refrain from simultaneously employing, whether full-time or part-time, any individual who is an employee of a telecommunications service provider and that none of our employees hold any interest, financial or otherwise, in any company that would violate these neutrality standards;

we prohibit any individual who serves in the management of any of our stockholders to be involved directly in our day-to-day operations;

we implement certain requirements regarding the composition of our board of directors;

no member of our board of directors simultaneously serve on the board of directors of a telecommunications service provider; and

we hire an independent party to conduct a quarterly neutrality audit to ensure that we and our stockholders comply with all the provisions of our code of conduct.

In connection with the neutrality requirements imposed by our code of conduct and under our contracts, we are subject to a number of neutrality audits that are performed on a quarterly and semi-annual basis. In connection with these audits, all of our employees, directors and officers must sign a neutrality certification that states that they are familiar with our neutrality requirements and have not violated them. Failure to comply with applicable neutrality requirements could result in government fines, corrective measures, curtailment of contracts or even the revocation of contracts. See **Risk Factors** **Risks Related to Our Business** **Failure to comply with neutrality requirements could result in loss of significant contracts** in Item 1A of this report.

In contemplation of the initial public offering of our securities, we sought and obtained FCC approval for a safe harbor from previous orders of the FCC that required us to seek prior approval from the FCC for any change in our overall ownership structure, corporate structure, bylaws, or distribution of equity interests, as well as certain types of transactions, including the issuance of indebtedness by us. Under the safe harbor order, we are required to maintain provisions in our organizational and other corporate documents that require us to comply with all applicable neutrality rules and orders. However, we are no longer required to seek prior approval from the FCC for many of these changes

and transactions, although we are required to provide notice of such changes or transactions. In addition, we are subject to the following requirements:

we may not issue indebtedness to any entity that is a telecommunications service provider or an affiliate of a telecommunications service provider without prior approval of the FCC;

we may not acquire any equity interest in a telecommunications service provider or an affiliate of a telecommunications service provider without prior approval of the FCC;

we must restrict any telecommunications service provider or affiliate of a telecommunications service provider from acquiring or beneficially owning 5% or more of our outstanding capital stock;

we must report to the FCC the names of any telecommunications service providers or telecommunications service provider affiliates that own a 5% or greater interest in our company; and

we must make beneficial ownership records available to our auditors, and must certify upon request that we have no actual knowledge of any ownership of our outstanding capital stock by a telecommunications service provider or telecommunications service provider affiliate other than as previously disclosed.

### ***Internet Domain Name Registrations***

We are also subject to government and industry regulation under our Internet registry contracts with the U.S. government and ICANN, the industry organization responsible for regulation of Internet top-level domains. We are the operator of the .biz Internet domain under a contract with ICANN originally granted to us in May 2001, which currently runs through December 2012 and renews automatically thereafter unless it has been determined that we have been in fundamental and material breach of certain provisions of the agreement and have failed to cure such breach. Similarly, pursuant to a contract with the U.S. Department of Commerce, we operate the .us Internet domain registry. This contract was originally granted in October 2001 and was renewed in October 2007 for a period of three years, with two one-year extension periods exercisable at the option of the U.S. Department of Commerce. Under each of these registry service contracts, we are required to:

provide equal access to all registrars of domain names;

comply with Internet standards established by the industry;

implement additional policies as they are adopted by the U.S. government or ICANN; and

with respect to the .us registry, establish, operate and ensure appropriate content on a kids.us domain to serve as a haven for material that promotes positive experiences for children and families using the Internet.

### **Intellectual Property**

Our success depends in part upon our proprietary technology. We rely principally upon trade secret and copyright law to protect our technology, including our software, network design, and subject matter expertise. We enter into confidentiality or license agreements with our employees, distributors, customers, and potential customers and limit access to and distribution of our software, documentation, and other proprietary information. We believe, however, that because of the rapid pace of technological change in the communications industry, the legal protections for our services are less significant factors in our success than the knowledge, ability, and experience of our employees and the timeliness and quality of services provided by us. With our entry into the IM market, we have supplemented our traditional approach to technology protection with patent prosecution designed to protect our technology and our ability to deliver our IM solutions to our customers.

### **Available Information and Exchange Certifications**

We maintain an Internet website at [www.neustar.biz](http://www.neustar.biz). Information contained on, or that may be accessed through, our website is not part of this report. Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to reports filed or furnished pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available on the Investor Relations section of our website under the heading SEC Filings by NeuStar, as soon as reasonably practicable after we electronically file such reports with, or furnish those reports to, the Securities and Exchange Commission. Our Principles of Corporate Governance, Board of

Directors committee charters (including the charters of the Audit Committee, Compensation Committee, and Nominating and Corporate Governance Committee) and code of ethics entitled Corporate Code of Business Conduct also are available on the Investor Relations section of our website. Stockholders may request free copies of these documents, including a copy of our annual report on Form 10-K, by sending a written request to our Corporate Secretary at NeuStar, Inc., 46000 Center Oak Plaza, Sterling, VA 20166. In the event that we make any changes to, or provide any waivers from, the provisions of our Corporate Code of Business Conduct, we intend to disclose these events on our website or in a report on Form 8-K within four business days of such event.

Because our common stock is listed on the NYSE, our Chief Executive Officer is required to make an annual certification to the NYSE stating that he is not aware of any violation by us of the corporate governance listing standards of the NYSE. Our Chief Executive Officer made his annual certification to that effect to the NYSE on August 1, 2007. In addition, we have filed, as an exhibit to this Annual Report on Form 10-K, the certification of our principal executive officer and principal financial officer required under Section 302 of the Sarbanes-Oxley Act of 2002 to be filed with the Securities and Exchange Commission regarding the quality of our public disclosure.

### **Cautionary Note Regarding Forward-Looking Statements**

This report contains forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expects, intends, plans, anticipates, believes, estimates, continue or the negative of these terms 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 risks and other factors include those listed under Risk Factors in Item 1A of this report and elsewhere in this report and include:

failures or interruptions of our systems and services;

security or privacy breaches;

loss of, or damage to, a data center;

termination, modification or non-renewal of our contracts to provide telephone number portability and other clearinghouse services;

adverse changes in statutes or regulations affecting the communications industry;

our failure to adapt to rapid technological change in the communications industry;

competition from our customers in-house systems or from other providers of addressing, interoperability or infrastructure services;

our failure to achieve or sustain market acceptance at desired pricing levels;

a decline in the volume of transactions we handle;

inability to manage our growth;

economic, political, regulatory and other risks associated with our potential expansion into international markets;

inability to obtain sufficient capital to fund our operations, capital expenditures and expansion; and

loss of members of senior management, or inability to recruit and retain skilled employees.

### **ITEM 1A. RISK FACTORS**

**Risks Related to Our Business**

*The loss of, or damage to, a data center or any other failure or interruption to our systems or services could materially harm our revenue and impair our ability to conduct our operations.*

Because virtually all of the services we provide require communications service providers to query a copy of our continuously updated databases and directories to obtain necessary routing and other essential operational data, the integrity of our data centers and the systems through which we deliver our services is essential to our business. Notably, our data centers and related systems are essential to the orderly operation of the U.S. telecommunications system because they enable CSPs to ensure that telephone calls are routed to the appropriate destinations. Our system architecture is integral to our ability to process a high volume of transactions in a timely and effective

manner. Moreover, both we and our customers rely on hardware, software and other equipment developed, supported and maintained by third-party providers. We could experience failures or interruptions of our systems and services, or other problems in connection with our operations, as a result of:

damage to, or failure of, our computer software or hardware or our connections and outsourced service arrangements with third parties;

failure of, or defects in, the third party systems, software or equipment on which we or our customers rely to access our data centers and other systems;

errors in the processing of data by our system;

computer viruses or software defects;

physical or electronic break-ins, sabotage, distributed denial of service, or DDoS, attacks, intentional acts of vandalism and similar events;

increased capacity demands or changes in systems requirements of our customers;

power loss, natural disasters, or telecommunications failures; or

errors by our employees or third-party service providers.

We may not have sufficient redundant systems or back-up facilities to allow us to receive and process data in the event of one of the foregoing events. Further, as the scope of services we provide expands or changes, we may be required to make significant expenditures to establish new data centers from which we may provide services. If we cannot adequately protect the ability of our data centers and related systems to perform consistently at a high level and without interruptions, or otherwise fail to meet our customers' expectations:

we may experience damage to our reputation, which may adversely affect our ability to attract or retain customers for our existing services, and may also make it more difficult for us to market our services;

we may be subject to significant penalties or damages claims, under our contracts or otherwise, including the requirement to pay substantial penalties related to service level requirements in our contracts;

we may be required to make significant expenditures to repair or replace equipment, third party systems or, in some cases, an entire data center, or to establish new data centers and systems from which we may provide services;

our operating expenses or capital expenditures may increase as a result of corrective efforts that we must perform;

our customers may postpone or cancel subsequently scheduled work or reduce their use of our services; or

one or more of our significant contracts may be terminated early, or may not be renewed.

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

***Security breaches could result in significant liabilities, interruptions of service or reduced quality of service, which could increase our costs or result in a reduction in the use of our services by our customers.***

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



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

Our seven contracts with North American Portability Management LLC, an industry group that represents all telecommunications service providers in the United States, to provide telephone number portability and other clearinghouse services are not exclusive and could be terminated or modified in ways unfavorable to us. These seven separate contracts, each of which represented between 10.4% and 18.3% of our total revenue in 2007, represented in the aggregate approximately 70.3% of our total revenue in 2007. North American Portability Management LLC could, at any time, solicit or receive proposals from other providers to provide services that are the same as or similar to ours. In addition, these contracts have finite terms and are currently scheduled to expire in June 2015. Furthermore, any of these contracts could be terminated in advance of its scheduled expiration date in limited circumstances, most notably if we are in default of these agreements. Although these contracts do not contain cross-default provisions, conditions leading to a default by us under one of our contracts could lead to a default under others, or all seven.

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

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

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

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

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

North American Numbering Plan Administrator, under which we maintain the authoritative database of telephone numbering resources in North America;

National Pooling Administrator, under which we perform the administrative functions associated with the administration and management of telephone number inventory and allocation of pooled blocks of unassigned telephone numbers;

provider of number portability services in Canada;

operator of the .us registry;

operator of the .biz registry; and

operator of the registry of U.S. Common Short Codes.

Each of these contracts provides for early termination in limited circumstances, most notably if we are in default. In addition, our contracts to serve as the North American Numbering Plan Administrator and as the

National Pooling Administrator and to operate the .us registry, each of which is with the U.S. government, may be terminated by the government at will. If we fail to meet the expectations of the FCC, the U.S. Department of Commerce or our customers, as the case may be, for any reason, including for performance-related or other reasons, or if another provider offers to perform the same or similar services for a lower price, we may be unable to extend or renew these contracts. Further, with respect to the renewal or extension of any of our government contracts, we may be subject to bid protests from a competitor, which may require the dedication of substantial company resources, and may result in the loss of the contract. If we were unable to renew or extend any of these contracts, the number of services we are able to offer may be reduced, which would adversely affect our revenue from the provision of these services. Further, each of the contracts listed above establishes us as the sole provider of the particular services covered by that contract during its term. If one of these contracts were terminated, or if we were unable to renew or extend the term of any particular contract, we would no longer be able to provide the services covered by that contract and could suffer a loss of prestige that would make it more difficult for us to compete for contracts to provide similar services in the future.

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

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

***Regulatory and statutory changes that affect us or the communications industry in general may increase our costs or otherwise adversely affect our business.***

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

increase regulatory oversight over the services we provide;

adopt or modify statutes, regulations, policies, procedures or programs that are disadvantageous to the services we provide, or that are inconsistent with our current or future plans, or that require modification of the terms of our existing contracts, including the manner in which we charge for certain of our services. For example,

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In November 2005, BellSouth Corporation filed a petition with the FCC seeking changes in the way our customers are billed for services provided by us under our contracts with North American Portability Management LLC; and

In June 2007, Telcordia Technologies, Inc. filed a petition with the FCC requesting an order that would require North American Portability Management LLC to conduct a new bidding process to appoint

a provider of telephone number portability services in the United States. If successful, this petition could result in the loss of one or more of our contracts with North American Portability Management LLC;

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

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

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

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

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

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

Our industry is characterized by rapid technological change and frequent new service offerings. Significant technological changes could make our technology and services obsolete. We must adapt to our rapidly changing market by continually improving the features, functionality, reliability and responsiveness of our addressing, interoperability and infrastructure services, and by developing new features, services and applications to meet changing customer needs. We cannot guarantee that we will be able to adapt to these challenges or respond successfully or in a cost-effective way. Our failure to do so would adversely affect our ability to compete and retain customers or market share.

Although we currently provide our services primarily to traditional telecommunications companies, many existing and emerging companies are providing, or propose to provide, IP-based voice services. Our future revenue and profits will depend, in part, on our ability to provide services to IP-based service providers. For example, we are currently developing and conducting trial tests of SIP-IX, a comprehensive suite of services designed to enable direct network-to-network peering between trading partners for voice, video and content services using Session Initiation Protocol (SIP)-based technologies such as IP multimedia subsystem (IMS) and Voice over Internet Protocol (VoIP). There can be no assurance that IP communications will grow in any meaningful fashion, or that SIP-IX will be adopted by potential customers, nor can we guarantee that we will be able to reach acceptable contract terms with customers to provide this service. In addition, we may experience delays in the development of one or more features of SIP-IX, which could materially reduce the potential benefits to us for providing this service.

***Our customers face implementation and support challenges in introducing IP-based services, which may slow their rate of adoption or implementation of our solutions.***

Historically, communications service providers have been relatively slow to implement new, complex services such as instant messaging and other IP-based communications. For example, during 2007, we witnessed slower than anticipated deployment of our mobile instant messaging solutions by our carrier customers. We have limited or no control over, and may not accurately predict, the pace at which communications service providers implement these new IP-based services. Moreover, the launch of new IP-based services by communications service providers requires significant capital expenditures by our customers to market and drive adoption by end users. We cannot control the decision over whether such capital expenditures will occur or the timing of such expenditures. In turn, even if CSPs attempt to drive adoption of new IP-based services, our future revenue and profits will also depend, in

part, on the wide adoption of such services by end users. Specifically, we may be required to expend substantial resources to support the efforts of our customers to market and drive the adoption of our mobile instant messaging services by end users. The failure of, or delay by, communications service providers to introduce and support IP-based services utilizing our solutions in a timely and effective manner, or the failure by end users to adopt such services, could have a material adverse effect on our business and operating results.

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

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

***Our instant messaging technology relies on the use of open standards, which makes us vulnerable to competition.***

Our instant messaging solutions are integrated with the systems of our CSP customers and with mobile devices through the use of open standards. If we are unable to integrate our instant messaging solutions with systems used by our customers or device manufacturers because they do not adopt open standards or otherwise, revenue from our instant messaging solutions will not grow as expected and may decline. In addition, the failure of, or delay by, the communications industry to create open standards and protocols for instant messaging could have an adverse effect on the mobile data market in general and, consequently, our business and operating results. Conversely, the proliferation of open standards and protocols could make it easier for new market entrants and existing competitors to introduce products that compete with our solutions, which could adversely affect our business and operating results.

***If we were unable to protect our intellectual property rights adequately, the value of our services and solutions could be diminished.***

Our success is dependent in part on obtaining, maintaining and enforcing our proprietary rights and our ability to avoid infringing on the proprietary rights of others. While we take precautionary steps to protect our technological advantages and intellectual property and rely in part on patent, trademark, trade secret and copyright laws, we cannot assure that the precautionary steps we have taken will completely protect our intellectual property rights. Because patent applications in the United States are maintained in secrecy until either the patent application is published or a patent is issued, we may not be aware of third-party patents, patent applications and other intellectual property relevant to our services and solutions that may block our use of our intellectual property or may be used by third-parties who compete with our services and solutions

As we expand our business and introduce new services and solutions, there may be an increased risk of infringement and other intellectual property claims by third parties. From time to time, we and our customers may receive claims alleging infringement of intellectual property rights, or may become aware of certain third party patents that may

relate to our services and solutions. For example, our instant messaging solutions are designed to conform to Open Mobile Alliance, or OMA, specifications and those of other standards bodies. To the extent that any individual or organization that has contributed intellectual property to OMA or other standards bodies claims that it has retained its rights relating to such intellectual property, we may be subject to claims of infringement by



such individuals or organizations, some of which have greater financial resources and larger intellectual property portfolios than our own.

Additionally, some of our customer agreements require that we indemnify our customers for infringement claims resulting from their use of our intellectual property embedded in their products. Any litigation regarding patents or other intellectual property could be costly and time consuming and could divert our management and key personnel from our business operations. The complexity of the technology involved, and the number of parties holding intellectual property within the communications industry, increase the risks associated with intellectual property litigation. Moreover, the commercial success of our services and solutions may increase the risk that an infringement claim may be made against us. Royalty or licensing arrangements, if required, may not be available on terms acceptable to us, if at all. Any infringement claim successfully asserted against us or against a customer for which we have an obligation to defend could result in costly litigation, the payment of substantial damages, and an injunction that prohibits us from continuing to offer the service or solution in question, any of which could have a material adverse effect on our business, operating results and financial condition.

***Our intellectual property could be misappropriated, which could force us to become involved in expensive and time-consuming litigation.***

Our ability to compete and continue to provide technological innovation is substantially dependent upon internally developed technology. We rely on a combination of patent, copyright, and trade secret laws to protect our intellectual property or proprietary rights in such technology. Despite our efforts to protect our intellectual property and proprietary rights, unauthorized parties may copy or otherwise obtain and use our products, technology or trademarks. Effectively policing our intellectual property is time consuming and costly, and the steps taken by us may not prevent infringement of our intellectual property or proprietary rights in our products, technology and trademarks, particularly in foreign countries where in many instances the local laws or legal systems do not offer the same level of protection as in the United States.

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

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

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

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

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

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

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

We earn revenue under our contracts to provide telephone number portability services on a per transaction basis. There are no minimum revenue requirements in these contracts, which means that there is no limit to the potential adverse effect on our revenue from a decrease in our transaction volumes. As a result, if industry participants reduce their usage of our services from their current levels, our revenue and results of operations will suffer. For example, consolidation in the industry could result in a decline in transactions if the remaining CSPs decide to handle changes to their networks internally rather than use the services that we provide. Moreover, if

customer churn among CSPs in the industry stabilizes or declines, or if CSPs do not compete vigorously to lure customers away from their competitors, use of our telephone number portability and other services may decline. If CSPs develop internal systems to address their infrastructure needs, or if the cost of such transactions makes it impractical for a given carrier to use our services for these purposes, we may experience a reduction in transaction volumes. Similarly, if instant messaging is not broadly adopted by the end users serviced by our customers, revenue from our instant messaging solutions will be adversely impacted. Finally, the trends that we believe will drive the future demand for our clearinghouse services, such as the emergence of IP services, growth of wireless services, consolidation in the industry, and pressure on carriers to reduce costs, may not actually result in increased demand for our services, which would harm our future revenue and growth prospects.

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

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

***We may not be successful in obtaining complete license usage reports from our customers on a timely basis, which could impact our reported results.***

Although the customers of our instant messaging solutions are generally contractually obligated to provide license usage reports to us, we may be unable to obtain such reports in a timely manner, or at all, and we may not be able to confirm that the results provided accurately reflect actual usage. If license usage reports are not received in a timely manner, we intend to estimate our revenue from instant messaging based on historical reporting trends, if reasonably possible. Because our estimates may be based upon late or incomplete information, the timing or amount of revenue we recognize may vary significantly from actual or expected customer usage and could adversely impact our reported results.

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

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

adverse operating issues that we fail to discover through due diligence prior to the acquisition. The failure to discover such issues prior to such acquisition could have a material adverse effect on our business and results of operations.

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

In 2006, we acquired Followap Inc., a UK-based enterprise, and we intend to pursue international business opportunities in the future. International operations and business expansion plans are subject to numerous additional risks, including economic and political risks in foreign jurisdictions in which we operate or seek to operate, the difficulty of enforcing contracts and collecting receivables through some foreign legal systems, unexpected changes in regulatory requirements and the difficulties associated with managing a large organization spread throughout various countries. If we continue to expand our business globally, our success will depend, in large part, on our ability to anticipate and effectively manage these and other risks associated with our international operations. However, any of these factors could adversely affect our international operations and, consequently, our operating results.

For example, our instant messaging solutions primarily target international markets. Risks inherent in conducting business internationally include:

- differing technology standards and pace of adoption;
- export restrictions on encryption and other technologies;
- fluctuations in currency exchange rates and any imposition of currency exchange controls;
- increased competition by local, regional, or global companies; and
- difficulties in collecting accounts receivable and longer collection periods.

While we attempt to hedge our currency risk, we may be unable to do so effectively. In addition, international sales could decline due to unexpected changes in regulatory requirements applicable to our business, or differences in foreign laws and regulations, including foreign tax, intellectual property, labor and contract law. Any of these factors could harm our international operations and, consequently, our operating results.

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

We believe that our success depends in part on the continued contributions of our Chief Executive Officer, Jeffrey Ganek, and other members of our senior management. We rely on our executive officers and senior management to generate business and execute programs successfully. In addition, the relationships and reputation that members of our management team have established and maintain with our customers and our regulators contribute to our ability to maintain good customer relations. If we do not retain the services of Jeffrey Ganek or any other member of senior management, or if we fail to adequately plan for the succession of such individuals, our customer relationships, results of operations and financial condition may be adversely affected.

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

We believe that an integral part of our success is our ability to recruit and retain employees who have advanced skills in the services and solutions that we provide and who work well with our customers in the regulated environment in which we operate. In particular, we must hire and retain employees with the technical expertise and industry knowledge necessary to maintain and continue to develop our operations and must effectively manage our growing

sales and marketing organization to ensure the growth of our operations. Our future success depends on the ability of our sales and marketing organization to establish direct sales channels and to develop multiple distribution channels with Internet service providers and other third parties. The employees with the skills we require are in great demand and are likely to remain a limited resource in the foreseeable future. If we are unable to recruit and retain a sufficient number of these employees at all levels, our ability to maintain and grow our business could be negatively impacted.

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

We have historically relied on outside financing and cash flow from operations to fund our operations, capital expenditures and expansion. We may require additional capital in the future to fund our operations, finance investments in equipment or infrastructure, or respond to competitive pressures or strategic opportunities. However, our neutrality requirements may limit or prohibit our ability to obtain debt or equity financing by restricting the ability of certain parties from acquiring our stock or our debt, or the amount that such parties may acquire. In addition, additional financing may not be available on terms favorable to us, or at all. Further, the terms of available financing may place limits on our financial and operating flexibility. If we are unable to obtain sufficient capital in the future, we may:

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

**Risks Related to Our Common Stock**

***Our common stock price may be volatile.***

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

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

Each of these factors, among others, could have a material adverse effect on the market price of our Class A common stock. In addition, in recent years, the stock market in general and the shares of technology companies in particular

have experienced extreme price fluctuations. This volatility has had a substantial effect on the market prices of securities issued by many companies for reasons unrelated to the operating performance of the specific companies. Some companies that have had volatile market prices for their securities have had securities class action suits filed against them. If a suit were to be filed against us, regardless of the outcome, it could result in substantial costs and a diversion of our management's attention and resources. This could have a material adverse effect on our business, prospects, financial condition and results of operations.

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

We are a Delaware corporation, and the anti-takeover provisions of the Delaware General Corporation Law may discourage, delay or prevent a change in control by prohibiting us from engaging in a business combination



with an interested stockholder for a period of three years after the person becomes an interested stockholder, even if a change of control would be beneficial to our existing stockholders. In addition, our certificate of incorporation and bylaws may discourage, delay or prevent a change in our management or control over us that stockholders may consider favorable. Our certificate of incorporation and bylaws:

authorize the issuance of blank check preferred stock that could be issued by our board of directors to thwart a takeover attempt;

prohibit cumulative voting in the election of directors, which would otherwise enable holders of less than a majority of our voting securities to elect some of our directors;

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

require that directors only be removed from office for cause;

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

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

limit who may call special meetings of stockholders;

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

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

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

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

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

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

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

Our board of directors has the authority to make determinations as to whether any particular holder of our capital stock is a telecommunications service provider or an affiliate of a telecommunications service provider. Any

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

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

These restrictions and requirements may:

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

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

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

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

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

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

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

#### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

Our corporate headquarters are located in Sterling, Virginia under leases that are scheduled to expire in July and August 2010. We have two five-year renewal options on these leases.

In addition, we lease operating space in Staines, United Kingdom, Haifa, Israel, Dusseldorf, Germany, Hong Kong and Singapore. Within the United States, we also lease operating space in North Carolina, the District of Columbia, Arizona and California. These domestic and international leases expire on various dates through March

2017. We believe that our existing facilities are sufficient to meet our requirements, and that new space will be available on commercially reasonable terms as we expand.

### ITEM 3. 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 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASE OF EQUITY SECURITIES

#### Market for Our Common Stock

Prior to June 29, 2005, there was no established public trading market for our Class A common stock. Since June 29, 2005, our Class A common stock has traded on the New York Stock Exchange under the symbol NSR. As of February 15, 2008, our Class A common stock was held by 129 stockholders of record. The following table sets forth the per-share range of the high and low sales prices of our Class A common stock as reported on the New York Stock Exchange for the periods indicated:

|  | <b>High</b> | <b>Low</b> |
|--|-------------|------------|
| <b>Fiscal year ended December 31, 2006</b> |             |            |
| First quarter                              | \$ 32.32    | \$ 27.00   |
| Second quarter                             | \$ 37.73    | \$ 28.41   |
| Third quarter                              | \$ 33.01    | \$ 25.03   |
| Fourth quarter                             | \$ 33.80    | \$ 26.80   |
| <b>Fiscal year ended December 31, 2007</b> |             |            |
| First quarter                              | \$ 32.96    | \$ 28.03   |
| Second quarter                             | \$ 30.76    | \$ 26.60   |
| Third quarter                              | \$ 36.30    | \$ 28.58   |
| Fourth quarter                             | \$ 36.33    | \$ 27.44   |

There is no established public trading market for our Class B common stock. As of February 15, 2008, our Class B common stock was held by 7 stockholders of record.

#### Dividends

We did not pay any cash dividends on our Class A or Class B common stock in 2006 or 2007 and we do not expect to pay any cash dividends on our common stock for the foreseeable future. We currently intend to retain any future earnings to finance our operations and growth. Our revolving credit facility limits our ability to declare or pay dividends. We are also limited by Delaware law in the amount of dividends we can pay. Any future determination to

pay cash dividends will be at the discretion of our board of directors and will depend on earnings, financial condition, operating results, capital requirements, any contractual restrictions and other factors that our board of directors deems relevant.

### Unregistered Sales of Equity Securities

The following table is a summary of our repurchases of common stock during each of the three months in the quarter ended December 31, 2007:

| Month                       | Total<br>Number<br>of Shares<br>Purchased(1) | Average<br>Price Paid<br>per Share | Total Number of<br>Shares Purchased<br>as<br>Part of Publicly<br>Announced Plans<br>or<br>Programs | Maximum<br>Number of<br>Shares<br>that May Yet<br>Be<br>Purchased<br>Under<br>the Plans or<br>Programs |
|-----------------------------|--|------------------------------------|--|--|
| October 1 through 31, 2007  | 615  | \$ 35.18                           |  |  |
| November 1 through 30, 2007 | 162  | 33.33                              |  |  |
| December 1 through 31, 2007 |  |                                    |  |  |
| Total                       | 777  | 34.79                              |  |  |

- (1) The number of shares purchased consists of shares of common stock tendered by employees to the Company to satisfy the employees' tax withholding obligations arising as a result of vesting of restricted stock grants under the Company's stock incentive plan, which shares were purchased by the Company based on their fair market value on the vesting date. None of these share purchases were part of a publicly announced program to purchase common stock of the Company.

### Performance Graph

The following chart shows how \$100 invested in our Class A common stock on June 29, 2005, the day our Class A common stock began trading on the New York Stock Exchange, would have grown through the period ended December 31, 2007, compared with: (a) \$100 invested in the Russell 2000 Index, and (b) \$100 invested in the NYSE TMT Index, each over that same period. The comparison assumes reinvestment of dividends. The stock performance in the graph is included to satisfy our SEC disclosure requirements, and is not intended to forecast or to be indicative of future performance.

This Performance Graph shall not be deemed to be incorporated by reference into our SEC filings and shall not constitute soliciting material or otherwise be considered filed under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.

| Company Name/Index | 6/29/05 | 12/31/05 | 12/31/06 | 12/31/07 |
|--------------------|---------|----------|----------|----------|
| NeuStar, Inc.      | \$ 100  | \$ 117   | \$ 125   | \$ 110   |
| Russell 2000 Index | \$ 100  | \$ 105   | \$ 123   | \$ 119   |

NYSE TMT Index

\$ 100

\$ 103

\$ 126

\$ 140



**ITEM 6. SELECTED FINANCIAL DATA.**

The tables below present selected consolidated statements of operations data for each of the five years ended December 31, 2007 and selected consolidated balance sheet data as of December 31, 2003, 2004, 2005, 2006 and 2007. The selected consolidated statements of operations data for each of the three years ended December 31, 2005, 2006 and 2007, and the selected consolidated balance sheet data as of December 31, 2006 and 2007, have been derived from, and should be read together with, our audited consolidated financial statements and related notes appearing in this report. The selected consolidated statements of operations data for each of the two years ended December 31, 2003 and 2004, and the selected consolidated balance sheet data as of December 31, 2003, 2004 and 2005, have been derived from our audited consolidated financial statements and related notes not included in this report. The share and per share data included in the selected consolidated statements of operations data for the years ended December 31, 2003 and 2004 reflect the 1.4-for-1 split of our common stock effected as part of the Recapitalization, but do not reflect other aspects of the Recapitalization.

The following information should be read together with, and is qualified in its entirety by reference to, the more detailed information contained in Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of this report and our consolidated financial statements and related notes in Item 8 of this report.

|  | <b>2003</b> | <b>Year Ended December 31,</b>               |             |             | <b>2007</b> |
|--|-------------|--|-------------|-------------|-------------|
|  |             | <b>2004</b>                                  | <b>2005</b> | <b>2006</b> |             |
|  |             | <b>(In thousands, except per share data)</b> |             |             |             |
| <b>Consolidated Statements of Operations Data:</b>                               |             |  |             |             |             |
| Total revenue  | \$ 111,693  | \$ 165,001                                   | \$ 242,469  | \$ 332,957  | \$ 429,172  |
| Operating expense:   |             |  |             |             |             |
| Cost of revenue (excluding depreciation and amortization shown separately below) | 37,846      | 49,261                                       | 64,891      | 86,106      | 94,948      |
| Sales and marketing  | 14,381      | 22,743                                       | 29,543      | 47,671      | 70,833      |
| Research and development   | 6,678       | 7,377  | 11,883      | 17,639      | 27,381      |
| General and administrative   | 11,359      | 21,144                                       | 28,048      | 34,902      | 48,633      |
| Depreciation and amortization  | 16,051      | 17,285                                       | 16,025      | 24,016      | 37,731      |
| Restructuring recoveries   | (1,296)     | (220)  | (389)       |             |             |
|  | 85,019      | 117,590                                      | 150,001     | 210,334     | 279,526     |
| Income from operations   | 26,674      | 47,411                                       | 92,468      | 122,623     | 149,646     |
| Other (expense) income:  |             |  |             |             |             |
| Interest expense   | (3,119)     | (2,498)                                      | (2,121)     | (1,300)     | (1,694)     |
| Interest and other income  | 1,299       | 1,629  | 2,406       | 4,024       | 5,159       |
| Income before minority interest and income taxes                                 | 24,854      | 46,542                                       | 92,753      | 125,347     | 153,111     |
| Minority interest  | 10          |  | (104)       | (95)        |             |
| Income before income taxes   | 24,864      | 46,542                                       | 92,649      | 125,252     | 153,111     |
| Provision for income taxes   | 836         | 1,166  | 37,251      | 51,353      | 60,776      |

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|  |           |           |           |           |           |
|--|-----------|-----------|-----------|-----------|-----------|
| Net income   | 24,028    | 45,376    | 55,398    | 73,899    | 92,335    |
| Dividends on and accretion of preferred stock                    | (9,583)   | (9,737)   | (4,313)   |           |           |
| Net income attributable to common stockholders                   | \$ 14,445 | \$ 35,639 | \$ 51,085 | \$ 73,899 | \$ 92,335 |
| Net income attributable to common stockholders per common share: |           |           |           |           |           |
| Basic  | \$ 3.09   | \$ 6.33   | \$ 1.48   | \$ 1.02   | \$ 1.22   |
| Diluted  | \$ 0.31   | \$ 0.57   | \$ 0.72   | \$ 0.94   | \$ 1.17   |
| Weighted average common shares outstanding:                      |           |           |           |           |           |
| Basic  | 4,680     | 5,632     | 34,437    | 72,364    | 75,954    |
| Diluted  | 76,520    | 80,237    | 77,046    | 78,267    | 79,235    |

|   | 2003      | 2004      | As of December 31,<br>2005<br>(In thousands) | 2006      | 2007       |
|---|-----------|-----------|--|-----------|------------|
| <b>Consolidated Balance Sheet Data:</b>                                 |           |           |  |           |            |
| Cash, cash equivalents and short-term investments                       | \$ 63,987 | \$ 63,929 | \$ 103,475                                   | \$ 58,252 | \$ 198,678 |
| Working capital   | 23,630    | 38,441    | 113,296                                      | 53,970    | 210,870    |
| Goodwill and intangible assets  | 54,751    | 50,703    | 54,150                                       | 257,051   | 240,944    |
| Total assets  | 190,245   | 211,454   | 283,215                                      | 448,259   | 616,661    |
| Deferred revenue and customer credits, excluding current portion        | 14,840    | 13,892    | 18,463                                       | 17,921    | 18,063     |
| Long-term debt and capital lease obligations, excluding current portion | 5,996     | 7,964     | 4,459  | 3,925     | 10,923     |
| Convertible preferred stock, Series B, Series C and Series D            | 161,041   | 140,454   |  |           |            |
| Total stockholders (deficit) equity                                     | (68,581)  | (31,858)  | 186,163                                      | 341,146   | 480,535    |

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## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*You should read the following discussion and analysis in conjunction with the information set forth under "Selected Financial Data" in Item 6 of this report and our consolidated financial statements and related notes in Item 8 of this report. The statements in this discussion related to our expectations regarding our future performance, liquidity and capital resources, and other non-historical statements in this discussion, are forward-looking statements. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, the risks and uncertainties described in "Risk Factors" in Item 1A of this report and "Business Cautionary Note Regarding Forward-Looking Statements" in Item 1 of this report. Our actual results may differ materially from those contained in or implied by any forward-looking statements.*

### **Overview**

We continued to experience increased demand for our services in 2007, resulting in a 29% increase in revenue over 2006. Under our contracts to provide telephone number portability services in the United States, we processed 318.5 million transactions, a growth of 36% over 2006. We believe that this growth in transaction volume demonstrates strong demand for our services from numerous sources, including, most significantly, customers who have been optimizing their network and who have been upgrading to next generation technologies, such as Internet Protocol, or IP, systems. Revenue growth from increased transaction volume was partially offset by the reduction in per transaction pricing that went into effect as part of the amendment and extension of these contracts in September 2006. In addition, with increased reliance by many enterprises on the Internet as a key enabling technology for their businesses, we have experienced significant growth in demand for NeuStar Ultra Services.

To support our corporate goals of continued growth and to meet the demands of our customers, we initiated several programs in 2007 to maintain our position in the industry as a provider of essential services. In particular, we have fully integrated our Ultra Services operations team and technology, leading to streamlined capabilities and enhanced scalability of our Ultra Services operations. Further, we made substantial investments in the business we acquired from Followup Inc. in November 2006, which we believe will position this business to take advantage of the maturing market for mobile instant messaging services. In particular, we have assembled a team with the skills to enable this business to realize the potential of this developing technology and drive its adoption in the market.

### **Our Company**

We provide the communications industry with critical technology services that solve the industry's addressing, interoperability and infrastructure needs. These services are used by CSPs to manage a range of their technical and operating requirements, including:

*Addressing.* We enable CSPs to use critical, shared addressing resources, such as telephone numbers, Internet top-level domain names, and U.S. Common Short Codes.

*Interoperability.* We enable CSPs to exchange and share critical operating data so that communications originating on one provider's network can be delivered and received on the network of another CSP. We also facilitate order management and work flow processing among CSPs.

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

We derive a substantial portion of our annual revenue on a transaction basis, most of which is derived from long-term contracts.

Our costs and expenses consist of cost of revenue, sales and marketing, research and development, general and administrative, and depreciation and amortization.

Cost of revenue includes all direct materials, direct labor, and those indirect costs related to the generation of revenue such as indirect labor, materials and supplies and facilities cost. Our primary cost of revenue is related to personnel costs associated with service implementation, product maintenance, customer deployment and customer care, including salaries, stock-based compensation and other personnel-related expense. In addition, cost of revenue

includes costs relating to developing modifications and enhancements of our existing technology and services, as well as royalties paid related to our U.S. Common Short Code services. Cost of revenue also includes our information technology and systems department, including network costs, data center maintenance, database management, data processing costs, and facilities costs.

Sales and marketing expense consists of personnel costs, such as salaries, sales commissions, travel, stock-based compensation, and other personnel-related expense; costs associated with attending and sponsoring trade shows; costs of computer and communications equipment and support services; facilities costs; consulting fees; costs of marketing programs, such as Internet and print, including product branding, market analysis and forecasting; and customer relationship management.

Research and development expense consists primarily of personnel costs, including salaries, stock-based compensation and other personnel-related expense; consulting fees; and the costs of facilities, computer and support services used in service and technology development.

General and administrative expense consists primarily of personnel costs, including salaries, stock-based compensation, and other personnel-related expense, for our executive, administrative, legal, finance, and human resources functions. General and administrative expense also includes facilities, support services, and professional services fees.

Depreciation and amortization relates to amortization of identifiable intangibles, and the depreciation of our property and equipment, including our network infrastructure and facilities related to our services.

### **Critical Accounting Policies and Estimates**

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

We believe the following to be our critical accounting policies because they are important to the portrayal of our financial condition and results of operations and they require critical management judgments and estimates about matters that are uncertain. If actual results or events differ materially from those contemplated by us in making these estimates, our reported financial condition and results of operation for future periods could be materially affected. See Item 1A of this report, *Risk Factors*, for certain matters that may bear on our future results of operations.

### ***Revenue Recognition***

Our revenue recognition policies are in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104, *Revenue Recognition*. We provide the following services pursuant to various private commercial and government contracts.

*Addressing.* Our addressing services include telephone number administration, implementing the allocation of pooled blocks of telephone numbers, directory services for Internet domain names and U.S. Common Short Codes, and internal and external managed domain name services. We generate revenue from our telephone number administration services under two government contracts. Under our contract to serve as the North American Numbering Plan Administrator, we earn a fixed annual fee and recognize this fee as revenue on a straight-line basis as services are provided. Under our contract to serve as the National Pooling Administrator, we earn a fixed fee associated with administration of the pooling system plus reimbursement for costs incurred. We recognize revenue

for this contract based on costs incurred plus a pro rata amount of the fixed-fee. In the event we estimate losses on our fixed fee contracts, we recognize these losses in the period in which a loss becomes apparent.

In addition to the administrative functions associated with our role as the National Pooling Administrator, we also generate revenue from implementing the allocation of pooled blocks of telephone numbers under our long-term contracts with North American Portability Management LLC, and we recognize revenue on a per transaction fee basis as the services are performed. For our Internet domain name services, we generate revenue for Internet domain registrations, which generally have contract terms between one and ten years. We recognize revenue on a straight-line basis over the lives of the related customer contracts.

We generate revenue through internal and external managed domain name services. Our revenue 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 our contracts to provide our managed domain name 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 we recognize the recurring monthly fee and usage in excess of the established monthly volume on a per transaction basis as services are provided. We generate revenue from our U.S. Common Short Code services under short-term contracts ranging from three to twelve months, and we recognize revenue on a straight-line basis over the term of the customer contracts.

*Interoperability.* Our interoperability services consist primarily of wireline and wireless number portability and order management services. We generate revenue from number portability under our long-term contracts with North American Portability Management LLC and Canadian LNP Consortium Inc. We recognize revenue on a per transaction fee basis as the services are performed. We provide 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 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. We generate revenue from our inter-carrier mobile instant messaging services under contracts with mobile operators that range from one to three years. These contracts consist of license fees based on the number of subscribers that use mobile instant messaging services, as well as fees for set-up and implementation. We recognize license fee revenue ratably over the term of the contract after completion of customer set-up and implementation. Customer set-up and implementation is not considered a separate deliverable; accordingly, the fees are deferred and recognized as revenue on a straight line basis over the remaining term of the contract following delivery of the set-up and implementation services.

*Infrastructure and Other.* Our infrastructure services consist primarily of network management and connection services. We generate revenue from network management services under our long-term contracts with North American Portability Management LLC. We recognize revenue on a per transaction fee basis as the services are performed. In addition, we generate revenue from connection fees and system enhancements under our contracts with North American Portability Management LLC. We recognize our connection fee revenue as the service is performed. System enhancements are provided under contracts in which we are reimbursed for costs incurred plus a fixed fee. Revenue is recognized based on costs incurred plus a pro rata amount of the fee. We generate revenue from our intra-carrier mobile instant messaging services under contracts with mobile operators that range from one to three years. These contracts consist of license fees based on the number of subscribers that use mobile instant messaging services, as well as fees for set-up and implementation. We recognize license fee revenue ratably over the term of the contract after completion of customer set-up and implementation. Customer set-up and implementation is not considered a separate deliverable; accordingly, the fees are deferred and recognized as revenue on a straight line basis over the remaining term of the contract following delivery of the set-up and implementation services.





### ***Significant Contracts***

We provide wireline and wireless number portability, implement the allocation of pooled blocks of telephone numbers and provide network management services pursuant to seven contracts with North American Portability Management LLC, an industry group that represents all telecommunications service providers in the United States. We recognize revenue under our contracts with North American Portability Management LLC primarily on a per transaction basis. The aggregate fees for transactions processed under these contracts are determined by the total number of transactions, and these fees are billed to telecommunications service providers based on their allocable share of the total transaction charges. This allocable share is based on each respective telecommunications service provider's share of the aggregate end-user services revenue of all U.S. telecommunications service providers, as determined by the FCC. On November 3, 2005, BellSouth Corporation filed a petition seeking changes in the way our customers are billed for services provided by us under our contracts with North American Portability Management LLC. In response to the BellSouth petition, the FCC solicited comments from other interested parties. As of February 15, 2008, the FCC had not indicated whether it will take any action based on this petition, and the BellSouth petition remains pending. We do not believe that the proposed change to the manner in which we bill for services under these contracts would have a material impact on our customers' demand for these services. In addition, on June 13, 2007, Telcordia Technologies, Inc. filed a petition with the FCC requesting an order that would require North American Portability Management LLC to conduct a new bidding process to appoint a provider of telephone number portability services in the United States. As of February 15, 2008, the FCC had not initiated a formal rulemaking process, and the Telcordia petition remains pending. Under our contracts, we also bill a Revenue Recovery Collections, or RRC, fee of a percentage of monthly billings to our customers, which is available to us if any telecommunications service provider fails to pay its allocable share of total transactions charges. If the RRC fee is insufficient for that purpose, these contracts also provide for the recovery of such differences from the remaining telecommunications service providers.

The per transaction pricing under these contracts provided for annual volume-based credits that were earned on all transactions in excess of the pre-determined annual volume threshold. For 2005 and 2006, the maximum aggregate volume-based credit was \$7.5 million, which was applied via a reduction in per transaction pricing once the pre-determined annual volume threshold was surpassed. When the aggregate credit was fully satisfied, the per transaction pricing was restored to the prevailing contractual rate. In both 2005 and 2006, the pre-determined annual transaction volume threshold under these contracts was exceeded, which resulted in the issuance of \$7.5 million of volume-based credits for both years. In September 2006, we amended our contracts with North American Portability Management LLC. Under these amended terms, there are no volume-based credits that were applied in 2007 or will be applied in later fiscal periods.

### ***Service Level Standards***

Pursuant to certain of our private commercial contracts, we are subject to service level standards and to corresponding penalties for failure to meet those standards. We record a provision for these performance-related penalties when we become aware that required service levels that would trigger such a penalty have not been met, which results in a corresponding reduction of our revenue.

For more information regarding how we recognize revenue for each of our service categories, please see the discussion above under Revenue Recognition.

### ***Goodwill***

We have made numerous acquisitions, including the 2006 acquisitions of UltraDNS Corporation and Followap Inc., resulting in our recording of goodwill, which represents the excess of the purchase price over the fair value of assets acquired, as well as other definite-lived intangible assets. In accordance with Statement of Financial Accounting

Standards No. 142, *Goodwill and Other Intangible Assets*, or SFAS No. 142, goodwill and indefinite-lived intangible assets are not amortized, but are reviewed for impairment upon the occurrence of events or changes in circumstances that would reduce the fair value of such assets below their carrying amount. Goodwill is required to be tested for impairment at least annually, or on an interim basis if circumstances change that would indicate the

possibility of impairment. For purposes of our annual impairment test, we have identified and assigned goodwill to two reporting units, our Clearinghouse segment and our NGM segment.

Goodwill is tested for impairment at the reporting unit level using a two-step approach. The first step is to compare the fair value of a reporting unit's net assets, including assigned goodwill, to the book value of its net assets, including assigned goodwill. Fair value of the reporting unit is determined using both an income and market approach. To assist in the process of determining if a goodwill impairment exists, we perform internal valuation analyses and consider other market information that is publicly available, and we may obtain appraisals from external advisors. If the fair value of the reporting unit is greater than its net book value, the assigned goodwill is not considered impaired. If the fair value is less than the reporting unit's net book value, we perform a second step to measure the amount of the impairment, if any. The second step would be to compare the book value of the reporting unit's assigned goodwill to the implied fair value of the reporting unit's goodwill, using a theoretical purchase price allocation based on this implied fair value to determine the magnitude of the impairment. If we determine that an impairment has occurred, we are required to record a write-down of the carrying value and charge the impairment as an operating expense in the period the determination is made.

The goodwill impairment test and the determination of the fair value of intangible assets involve the use of significant estimates and assumptions by management, and are inherently subjective. In particular, for each of our reporting units, the significant assumptions used include market penetration, anticipated growth rates, and risk-adjusted discount rates for the income approach, as well as the selection of comparable companies and comparable transactions for the market approach. Changes in estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. Specifically, for our NGM reporting unit, due to the early stage of its operations and the emerging nature of mobile instant messaging technology, key assumptions incorporated within the valuation have a higher degree of subjectivity and are more likely to change over time. We believe that the assumptions and estimates used to determine the estimated fair values of each of our reporting units are reasonable. However, any changes in key assumptions about our businesses and their prospects, or changes in market conditions, could result in an impairment charge. Such a charge could have a material effect on our consolidated financial statements because of the significance of goodwill and intangible assets to our consolidated balance sheet.

#### ***Impairment of Long-Lived Assets***

Our long-lived assets primarily consist of property and equipment and intangible assets. In accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, we review long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the assets. Recoverability measurement and estimating of undiscounted cash flows is done at the lowest possible level for which there is identifiable assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of assets exceeds the fair value of the assets. Assets to be disposed of are recorded at the lower of the carrying amount or fair value less costs to sell.

#### ***Accounts Receivable, Revenue Recovery Collections, and Allowance for Doubtful Accounts***

Accounts receivable are recorded at the invoiced amount and do not bear interest. In accordance with our contracts with North American Portability Management LLC, we bill a RRC fee of a percentage of monthly billings to our customers. The aggregate RRC fees collected may be used to offset uncollectible receivables from an individual customer. The RRC fees are recorded as an accrued liability when collected. For the period from January 1, 2005 through June 30, 2005, this fee was 2% of monthly billings. On July 1, 2005, the RRC fee was reduced to 1%. Any

accrued RRC fees in excess of uncollectible receivables are paid back to the customers annually on a pro rata basis. All other receivables related to services not covered by the RRC fees are evaluated and, if deemed not collectible, are appropriately reserved.

### ***Deferred Income Taxes***

We recognize deferred tax assets and liabilities based on temporary differences between the financial reporting bases and the tax bases of assets and liabilities. 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 reverse or be utilized. The realization of deferred tax assets is contingent upon the generation of future taxable income. When appropriate, we recognize a valuation allowance to reduce such deferred tax assets to amounts that are more likely than not to be ultimately realized. The calculation of deferred tax assets (including valuation allowances) and liabilities requires us to apply significant judgment related to such factors as the application of complex tax laws, changes in tax laws and our future operations. We review our deferred tax assets on a quarterly basis to determine if a valuation allowance is required based upon these factors. Changes in our assessment of the need for a valuation allowance could give rise to a change in such allowance, potentially resulting in additional expense or benefit in the period of change.

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

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109, or FIN 48, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109. FIN 48 is effective for fiscal years beginning after December 15, 2006, and was adopted by us on January 1, 2007. FIN 48 provides a two-step approach to recognize and measure tax benefits when the benefits' realization is uncertain. The first step is to determine whether the benefit is to be recognized; the second step is to determine the amount to be recognized. Income tax benefits should be recognized when, based on the technical merits of a tax position, the entity believes that if a dispute arose with the taxing authority and were taken to a court of last resort, it is more likely than not (*i.e.*, a probability of greater than 50 percent) that the tax position would be sustained as filed. If a position is determined to be more likely than not of being sustained, the reporting enterprise should recognize the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority. The cumulative effect of applying the provisions of FIN 48 upon adoption is to be reported as an adjustment to beginning retained earnings. Our practice is to recognize interest and penalties related to income tax matters in income tax expense.

### ***Stock-Based Compensation***

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

Prior to January 1, 2006, we accounted for our stock-based compensation plans under the recognition and measurement provisions of APB No. 25, and related interpretations, as permitted by SFAS No. 123. Effective January 1, 2006, we adopted SFAS No. 123(R), including the fair value recognition provisions, using the modified-prospective transition method. Under the modified-prospective transition method, compensation cost recognized in fiscal 2006 and forward includes: (a) compensation cost for all stock-based awards granted prior to but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all stock-based awards granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). Under the

modified prospective transition method, prior periods are not restated. For stock-based awards subject to graded vesting, we have utilized the straight-line method for allocating compensation cost by period. Prior to adoption of SFAS No. 123(R), we presented all benefits of tax deductions resulting from the exercise of stock-based compensation as an operating cash flow in the consolidated statements of cash flows. Beginning on January 1,

2006, we changed our cash flow presentation in accordance with SFAS No. 123(R), which requires benefits of tax deductions in excess of the compensation cost recognized (excess tax benefits) to be classified as a financing cash inflow with a corresponding operating cash outflow.

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

If factors change and we employ different assumptions in the application of SFAS No. 123(R) in future periods, the compensation expense that we record under SFAS No. 123(R) may differ significantly from what we have recorded in the current period. Therefore, we believe it is important for investors to be aware of the high degree of subjectivity involved when using option pricing models to estimate stock-based compensation under SFAS No. 123(R).

Option-pricing models were developed for use in estimating the value of traded options that have no vesting or hedging restrictions, are fully transferable and do not cause dilution. Because our stock-based awards have characteristics significantly different from those of freely traded options, and because changes in the subjective input assumptions can materially affect our estimates of fair values, in our opinion, existing valuation models, including the Black-Scholes option-pricing model, may not provide reliable measures of the fair values of our stock-based compensation. Consequently, there is a risk that our estimates of the fair values of our stock-based compensation awards on the grant dates may bear little resemblance to the actual values realized upon the exercise, expiration, early termination or forfeiture of those stock-based awards in the future. Certain stock-based awards, such as employee stock options, may expire worthless or otherwise result in zero intrinsic value as compared to the fair values originally estimated on the grant date and reported in our consolidated financial statements. Alternatively, value may be realized from these instruments that is significantly in excess of the fair values originally estimated on the grant date and reported in our consolidated financial statements. Although the fair value of our stock-based awards is determined in accordance with SFAS No. 123(R) and the SEC's Staff Accounting Bulletin No. 107, *Share-Based Payment*, using an option-pricing model, that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction.

## **Acquisitions**

We have expanded the scope of our services and increased our customer base through selective acquisitions. Our objective for each acquisition was to expand the scope of the services that we provide and to leverage our clearinghouse capabilities in order to maximize efficiency and provide added value to our customers.

### ***UltraDNS Corporation***

On April 21, 2006, we acquired UltraDNS Corporation for \$61.8 million in cash and acquisition costs of \$0.8 million. The acquisition further expanded our domain name services and our Internet protocol technologies. The acquisition was accounted for as a purchase business combination in accordance with SFAS No. 141. Of the total cash consideration, approximately \$6.1 million was distributed to an escrow account for indemnification claims as set forth in the acquisition agreement. Funds remaining in the account were distributed to the former stockholders of UltraDNS in accordance with the acquisition agreement following the first anniversary of the acquisition.



Of the total purchase price, \$8.5 million has been allocated to net tangible assets acquired and \$20.0 million has been allocated to definite-lived intangible assets acquired. We utilized a third party valuation specialist to assist management in determining the fair value of the definite-lived intangible asset base. The income approach, which includes an analysis of cash flows and the risks associated with achieving such cash flows, was the primary technique utilized in valuing the identifiable intangible assets. The \$20.0 million of definite-lived intangible assets acquired consists of the value assigned to UltraDNS's direct customer relationships of \$14.7 million, web customer

relationships of \$0.3 million, acquired technology of \$4.8 million, and trade names of \$0.2 million. We are amortizing the value of the UltraDNS direct and web customer relationships in proportion to the respective discounted cash flows over an estimated useful life of 7 and 5 years, respectively. Both acquired technology and trade names are being amortized on a straight-line basis over 3 years.

### ***Followap Inc.***

On November 27, 2006, we acquired Followap Inc. for \$139.0 million in cash and acquisition costs of \$1.8 million along with the assumption and payment of certain Followap debt and other liabilities of \$5.6 million. The acquisition further expanded our Internet protocol technologies, which is a key strategic initiative for us. The acquisition was accounted for as a purchase business combination in accordance with SFAS No. 141. Of the total cash consideration, approximately \$14.1 million was distributed to an escrow account for indemnification claims as set forth in the acquisition agreement. The acquisition agreement provides that, following the first anniversary of the acquisition and the resolution of any pending claims, all funds remaining in the account will be distributed to the former stockholders and optionholders of Followap in accordance with the acquisition agreement.

Of the total estimated purchase price, a preliminary estimate of \$0.2 million has been allocated to net tangible liabilities assumed and \$30.6 million has been allocated to definite-lived intangible assets acquired. We utilized a third party valuation in determining the fair value of the definite-lived intangible asset base. The income approach, which includes an analysis of cash flows and the risks associated with achieving such cash flows, was the primary technique utilized in valuing the identifiable intangible assets. The \$30.6 million of definite lived intangible assets acquired consists of the value assigned to Followap's customer relationships of \$20.8 million and acquired technology of \$9.8 million. We are amortizing the value of the Followap customer relationships using an accelerated basis over five years and the value of the acquired technology on a straight-line basis over 3 years.

### **Current Trends Affecting Our Results of Operations**

In 2007, we made substantial investments in areas of our business that we believe will serve as the foundation for our future growth—namely, our telephone number portability platform, Ultra services and mobile instant messaging. In particular, we focused our efforts and resources on enhancing and developing our systems and platforms, and to hiring and retaining necessary personnel, to position us to take advantage of the developing opportunities that we see in the market.

Increased demand for our telephone number portability services, which has been driven by market trends such as the implementation of new technologies, expansion of new applications and end user services, has driven increased transaction volume in our clearinghouse. As the communications industry continues to evolve and change, we believe that we will experience continued demand for our addressing, interoperability and infrastructure services. To meet increased demand for our services, we will continue to work with our customers to identify the problems that they are facing, and develop solutions for those problems through our existing services as well as the development of new features and functionalities.

We continued to see increased demand for secure, reliable and scalable DNS systems, which was driven predominantly by enterprises with increasing reliance on the Internet as a key enabling technology for the operation of their businesses. We believe that enterprises will continue to increase their reliance on the Internet and their DNS-based systems to run their businesses. As a result, we expect the demand for NeuStar Ultra Services to increase over time.

We expect continued growth in wireless communications and competition among mobile network operators, as well as continued development of new wireless applications, such as mobile instant messaging, or mobile IM. Based on our

experience in 2007, and the early development of the mobile instant messaging market, we believe that mobile network operators will continue to launch and support mobile IM, which will result in increased demand for our solutions.

We anticipate making further investments in our business to support our ability to take advantage of our long-term growth opportunities, particularly for those businesses that we have acquired and in areas where we may acquire business in the future. For example, we made, and anticipate making, substantial investments in additions to

our sales force, increased facilities and personnel in international markets, and have incurred and expect to continue to incur costs related to the marketing of our expanded services and solutions. This use of resources may affect our operating margins.

## Consolidated Results of Operations

### *Year Ended December 31, 2006 Compared to the Year Ended December 31, 2007*

The following table presents an overview of our results of operations for the years ended December 31, 2006 and 2007.

|   | 2006                                  | 2007       | 2006 vs. 2007 |             |
|---|---------------------------------------|------------|---------------|-------------|
|   | \$                                    | \$         | \$<br>Change  | %<br>Change |
|   | (In thousands, except per share data) |            |               |             |
| Revenue:  |                                       |            |               |             |
| Addressing  | \$ 103,858                            | \$ 109,799 | \$ 5,941      | 5.7%        |
| Interoperability  | 56,454                                | 61,679     | 5,225         | 9.3%        |
| Infrastructure and other  | 172,645                               | 257,694    | 85,049        | 49.3%       |
| Total revenue   | 332,957                               | 429,172    | 96,215        | 28.9%       |
| Operating expense:  |                                       |            |               |             |
| Cost of revenue (excludes depreciation and amortization shown separately below) | 86,106                                | 94,948     | 8,842         | 10.3%       |
| Sales and marketing   | 47,671                                | 70,833     | 23,162        | 48.6%       |
| Research and development  | 17,639                                | 27,381     | 9,742         | 55.2%       |
| General and administrative  | 34,902                                | 48,633     | 13,731        | 39.3%       |
| Depreciation and amortization   | 24,016                                | 37,731     | 13,715        | 57.1%       |
|   | 210,334                               | 279,526    | 69,192        | 32.9%       |
| Income from operations  | 122,623                               | 149,646    | 27,023        | 22.0%       |
| Other (expense) income:   |                                       |            |               |             |
| Interest expense  | (1,300)                               | (1,694)    | (394)         | 30.3%       |
| Interest and other income   | 4,024                                 | 5,159      | 1,135         | 28.2%       |
| Income before minority interest and income taxes                                | 125,347                               | 153,111    | 27,764        | 22.1%       |
| Minority interest   | (95)                                  |            | 95            | (100.0)%    |
| Income before income taxes  | 125,252                               | 153,111    | 27,859        | 22.2%       |
| Provision for income taxes  | 51,353                                | 60,776     | 9,423         | 18.3%       |
| Net income  | \$ 73,899                             | \$ 92,335  | \$ 18,436     | 24.9%       |
| Net income attributable to common stockholders per common share:                |                                       |            |               |             |
| Basic   | \$ 1.02                               | \$ 1.22    |               |             |

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|   |         |         |
|---|---------|---------|
| Diluted                                     | \$ 0.94 | \$ 1.17 |
| Weighted average common shares outstanding: |         |         |
| Basic                                       | 72,364  | 75,954  |
| Diluted                                     | 78,267  | 79,235  |

## **Revenue**

*Total revenue.* Total revenue increased \$96.2 million due primarily to increases in infrastructure transactions under our contracts to provide telephone number portability services in the United States, our expanded range of DNS services, and growth in the use of U.S. Common Short Codes.

*Addressing.* Addressing revenue increased \$5.9 million due to the expanded range of DNS services we offer as a result of our acquisition of UltraDNS Corporation in April 2006, and the continued increase in the use of U.S. Common Short Codes. Specifically, revenue from DNS services increased \$18.4 million, consisting of a \$15.0 million increase in revenue from increased use of our NeuStar Ultra Services, and a \$3.4 million increase in revenue from an increased number of domain names under management. In addition, revenue from U.S. Common Short Codes increased \$7.8 million due to an increased number of subscribers for U.S. Common Short Codes. These increases were offset by a decrease of \$19.5 million in revenue under our contracts to provide telephone number portability services in the United States. We believe that this reduction in addressing revenue was due to a return to normal network expansion activities by carriers from unusually high levels in 2006, and the reduced pricing under these contracts that went into effect on January 1, 2007.

*Interoperability.* Interoperability revenue increased \$5.2 million, of which \$1.8 million was attributable to our Clearinghouse business segment and \$3.4 million was attributable to our NGM business segment. Clearinghouse revenue increased predominantly due to increased demand for telephone number portability services in advance of the introduction of wireless number portability in Canada. Specifically, revenue from telephone number portability services in Canada increased \$6.4 million, which was partially offset by a decrease in revenue of \$4.8 million under our contracts to provide telephone number portability services in the United States due to decreased competitive churn. NGM revenue was \$3.4 million, which was driven by an expansion of the number of carrier customers utilizing inter-carrier services and the initial stages of end user adoption of mobile instant messaging. We acquired the NGM business at the end of November 2006; thus there was no corresponding NGM revenue in 2006.

*Infrastructure and other.* Infrastructure and other revenue increased \$85.0 million, of which \$80.4 million was attributable to our Clearinghouse business segment and \$4.6 million was attributable to our NGM business segment. Clearinghouse revenue increased predominantly due to increased demand for our network management services, primarily due to customers making changes to their networks that required actions such as disconnects and modifications to network elements. We believe these changes were driven largely by trends in the industry, including the implementation of new technologies by our customers, such as wireless technology upgrades and network optimization. In addition, infrastructure revenue from our NGM business segment increased \$4.6 million, which was driven by an expansion of the number of carrier customers utilizing intra-carrier services and the initial stages of end user adoption of mobile instant messaging.

## **Expense**

*Cost of revenue.* Cost of revenue increased \$8.8 million, of which \$2.0 million was attributable to our Clearinghouse business segment and \$6.8 million was attributable to our NGM business segment. Clearinghouse cost of revenue increased due to an increase of \$5.7 million in royalty expenses related to U.S. Common Short Code services. This increase was offset by a reduction of \$3.0 million in personnel and personnel-related expense, which was driven by increased operating efficiencies relating to support of our platforms, and a reduction of \$1.5 million in contractor costs and professional fees. NGM cost of revenue totaled \$7.3 million for 2007, representing a \$6.8 million increase over the one month of cost of revenue we incurred following our acquisition of Followup in November 2006.

*Sales and marketing.* Sales and marketing expense increased \$23.2 million, of which \$13.6 million was attributable to our Clearinghouse business segment and \$9.6 million was attributable to our NGM business segment. Clearinghouse

sales and marketing expense increased \$9.5 million in personnel and personnel-related expense due primarily to additions to our sales and marketing team to focus on branding, product launches, expanded DNS service offerings, and new business development opportunities, including international expansion. In addition, external costs and other general marketing expense increased \$2.0 million. NGM sales and marketing expense

totaled \$10.6 million for 2007, representing a \$9.6 million increase over the one month of sales and marketing expense we incurred following our acquisition of Followap in November 2006.

*Research and development.* Research and development expense increased \$9.7 million, of which \$2.4 million was attributable to our Clearinghouse business segment and \$7.3 million was attributable to our NGM business segment. Clearinghouse research and development expense increased \$2.5 million in personnel and personnel-related expense due primarily to additions to our research and development team to support our service offerings. NGM research and development expense totaled \$7.9 million for 2007, representing a \$7.3 million increase over the one month of research and development expense we incurred following our acquisition of Followap in November 2006.

*General and administrative.* General and administrative expense increased \$13.7 million, of which \$5.7 million was attributable to our Clearinghouse business segment and \$8.0 million was attributable to our NGM business segment. Clearinghouse general and administrative expense increased \$3.9 million in personnel and personnel-related expense due to increased headcount to support business growth. In addition, this increase was further augmented by the reversal of a legal contingency accrual of \$1.5 million in the second quarter of 2006 for which there was no comparable reversal during the year ended December 31, 2007. NGM general and administrative expense totaled \$8.2 million for 2007, representing an \$8.0 million increase over the one month of general and administrative expense we incurred following our acquisition of Followap in November 2006.

*Depreciation and amortization.* Depreciation and amortization expense increased \$13.7 million, of which \$5.1 million was attributable to our Clearinghouse business segment and \$8.6 million was attributable to our NGM business segment. Clearinghouse depreciation and amortization expense increased primarily due to a \$3.4 million increase in depreciation of capital assets and a \$1.7 million increase in amortization of identified intangibles as a result of our acquisition of UltraDNS. NGM depreciation and amortization expense totaled \$9.5 million for 2007, representing an \$8.6 million increase over the one month of depreciation and amortization expense we incurred following our acquisition of Followap in November 2006. This increase was primarily due to \$7.1 million of expense related to the amortization of identified intangibles as a result of our acquisition of Followap.

*Interest expense.* Interest expense for the year ended December 31, 2007 increased \$0.4 million as compared to the year ended December 31, 2006 due primarily to higher average balances under notes payable.

*Interest and other income.* Interest and other income for the year ended December 31, 2007 increased \$1.1 million as compared to the year ended December 31, 2006 due to higher yields on average combined cash and short-term investment balances.

*Provision for income taxes.* Income tax provision for the year ended December 31, 2007 increased \$9.4 million as compared to the year ended December 31, 2006 due primarily to an increase in income from operations. Our annual effective tax rate decreased to 39.7% for the year ended December 31, 2007 from 41.0% for the year ended December 31, 2006.



**Year Ended December 31, 2005 Compared to the Year Ended December 31, 2006**

The following table presents an overview of our results of operations for the years ended December 31, 2005 and 2006. The share and per share data in the following table reflect the 1.4-for-1 stock split effected as part of the Recapitalization, but do not reflect the other aspects of the Recapitalization.

|   | 2005                                  | 2006       | 2005 vs. 2006 |          |
|---|---------------------------------------|------------|---------------|----------|
|   | \$                                    | \$         | \$<br>Change  | % Change |
|   | (In thousands, except per share data) |            |               |          |
| Revenue:  |                                       |            |               |          |
| Addressing  | \$ 75,036                             | \$ 103,858 | \$ 28,822     | 38.4%    |
| Interoperability  | 52,488                                | 56,454     | 3,966         | 7.6%     |
| Infrastructure and other  | 114,945                               | 172,645    | 57,700        | 50.2%    |
| Total revenue   | 242,469                               | 332,957    | 90,488        | 37.3%    |
| Operating expense:  |                                       |            |               |          |
| Cost of revenue (excludes depreciation and amortization shown separately below) | 64,891                                | 86,106     | 21,215        | 32.7%    |
| Sales and marketing   | 29,543                                | 47,671     | 18,128        | 61.4%    |
| Research and development  | 11,883                                | 17,639     | 5,756         | 48.4%    |
| General and administrative  | 28,048                                | 34,902     | 6,854         | 24.4%    |
| Depreciation and amortization   | 16,025                                | 24,016     | 7,991         | 49.9%    |
| Restructuring recoveries  | (389)                                 |            | 389           | (100.0)% |
|   | 150,001                               | 210,334    | 60,333        | 40.2%    |
| Income from operations  | 92,468                                | 122,623    | 30,155        | 32.6%    |
| Other (expense) income:   |                                       |            |               |          |
| Interest expense  | (2,121)                               | (1,300)    | 821           | (38.7)%  |
| Interest and other income   | 2,406                                 | 4,024      | 1,618         | 67.2%    |
| Income before minority interest and income taxes                                | 92,753                                | 125,347    | 32,594        | 35.1%    |
| Minority interest   | (104)                                 | (95)       | 9             | (8.7)%   |
| Income before minority interest   | 92,649                                | 125,252    | 32,603        | 35.2%    |
| Provision for income taxes  | 37,251                                | 51,353     | 14,102        | 37.9%    |
| Net income  | 55,398                                | 73,899     | 18,501        | 33.4%    |
| Dividends on and accretion of preferred stock                                   | (4,313)                               |            | 4,313         | (100.0)% |
| Net income attributable to common stockholders                                  | \$ 51,085                             | \$ 73,899  | \$ 22,814     | 44.7%    |
| Net income attributable to common stockholders per common share:                |                                       |            |               |          |
| Basic   | \$ 1.48                               | \$ 1.02    |               |          |

|   |         |         |
|---|---------|---------|
| Diluted                                     | \$ 0.72 | \$ 0.94 |
| Weighted average common shares outstanding: |         |         |
| Basic                                       | 34,437  | 72,364  |
| Diluted                                     | 77,046  | 78,267  |

***Revenue***

*Total revenue.* Total revenue increased \$90.5 million due to increases in addressing, interoperability and infrastructure transactions.

*Addressing.* Addressing revenue increased \$28.8 million due primarily to the expanded range of DNS services offered by NeuStar as a result of the acquisition of UltraDNS in April 2006, and the continued increase in the number of subscribers for U.S. Common Short Codes. This increase in addressing revenue was also driven by the continued implementation and expansion of carrier networks to facilitate new communications services, such as Internet telephony. Specifically, revenue from DNS services increased \$18.4 million, consisting of \$15.4 million in revenue from NeuStar Ultra Services and a \$3.0 million increase in revenue from our other DNS services as a result of an increased number of domain names under management. In addition, revenue from U.S. Common Short Codes increased \$8.3 million and national pooling revenue increased \$1.7 million.

*Interoperability.* Interoperability revenue increased \$4.0 million due to an increase in wireline and wireless competition and the associated movement of end users from one CSP to another, and carrier consolidation. Specifically, revenue from number portability transactions increased \$4.5 million, partially offset by a decrease of \$0.5 million in revenue principally due from our order management services.

*Infrastructure and other.* Infrastructure and other revenue increased \$57.7 million due to an increase in the demand for our network management services. Of this amount, \$55.4 million was attributable to customers making changes to their networks that required actions such as disconnects and modifications to network elements. We believe these changes were driven largely by trends in the industry, including the implementation of new technologies by our customers, wireless technology upgrades, carrier vendor changes and network optimization. The remaining increase of \$2.3 million was principally due to other infrastructure services.

### ***Expense***

*Cost of revenue.* Cost of revenue increased \$21.2 million due to growth in personnel, contractor costs to support higher transaction volumes and royalties related to our U.S. Common Short Code services. Of this amount, personnel-related expense increased \$6.8 million due to increased personnel to support our customer deployment group, software engineering group and operations group. Included in personnel-related expense for the year ended December 31, 2006 is \$1.8 million in stock-based compensation expense; there was no stock-based compensation expense recorded for the year ended December 31, 2005. Contractor costs for software maintenance activities and managing industry changes to our clearinghouse increased \$5.4 million. Cost of revenue also increased by \$7.1 million principally due to royalty expenses related to U.S. Common Short Code services and revenue share cost associated with our Internet domain names and registry gateway services. Additionally, general data center facility costs increased \$1.0 million to support higher transaction volumes and expanded service offerings.

*Sales and marketing.* Sales and marketing expense increased \$18.1 million due to additions to our sales and marketing team to focus on branding, product launches, expanded DNS service offerings and new business development opportunities, including international expansion. Of this amount, personnel and personnel-related expense increased \$16.0 million, and professional fees for product branding increased \$0.9 million. Included in personnel-related expense for the year ended December 31, 2006 is \$3.9 million in stock-based compensation, as compared to \$1.0 million for the year ended December 31, 2005.

*Research and development.* Research and development expense increased \$5.8 million due to the development of Internet telephony solutions to enhance our service offerings. Of this increase, personnel and personnel-related costs increased \$4.5 million due to increased headcount. Included in personnel-related expense for the year ended December 31, 2006 is \$1.2 million in stock-based compensation expense; there was no stock-based compensation expense included in research and development expense for the year ended December 31, 2005. In addition, consulting expenses increased \$1.2 million due to expanded use of outside consultants to augment our internal research and development resources.

*General and administrative.* General and administrative expense increased \$6.9 million primarily due to costs incurred to support business growth and costs incurred to comply with our requirements as a public company, including the Sarbanes-Oxley Act of 2002. Specifically, personnel and personnel-related costs increased \$9.7 million to support business growth and compliance with our requirements as a public company. Included in this personnel-related expense for the year ended December 31, 2006 is \$4.9 million in stock-based compensation expense, as compared to \$1.7 million for the year ended December 31, 2005. In addition, professional fees increased \$0.7 million and general operational costs also increased \$3.6 million, which included a \$1.5 million increase in bad

debt expense related to our Ultra Services and order management services. These increases were partially offset by a \$5.8 million reduction of general and administrative expense related to costs and related expenses we incurred in connection with our two public offerings in 2005 for which there was no comparable expense in 2006. These increases were further offset by the reversal of a legal contingency accrual of \$1.5 million in the second quarter of 2006 for which there was no comparable reversal in 2005.

*Depreciation and amortization.* Depreciation and amortization expense increased \$8.0 million due primarily to an increase of \$5.0 million in the amortization of identified intangibles, which is primarily a result of our acquisition of UltraDNS and Followup. Additionally, depreciation and amortization expense increased \$2.8 million relating to additional capital assets to support operations.

*Restructuring recoveries.* In 2005, we recorded a net restructuring recovery of \$0.4 million, which included a restructuring recovery of \$0.7 million after entering into a sub-lease for our leased property in Chicago with sub-lease rates more favorable than originally assumed when the restructuring liability for the closure of excess facilities was recorded in 2002. This was partially offset by a restructuring charge of \$317,000 for the closure of our facility in Oakland, CA, which was completed on October 31, 2005. There were no similar charges during the year ended December 31, 2006.

*Interest expense.* Interest expense decreased \$0.8 million in 2006 as compared to 2005 due predominantly to a decrease in the principal amount outstanding under notes payable and a decrease in the amount of assets subject to existing capital leases.

*Interest and other income.* Interest income increased \$1.6 million due to higher average cash balances.

*Provision for income taxes.* Income tax provision in 2006 increased \$14.1 million as compared to 2005 due to an increase in net income. Our annual effective rate increased to 41.0% for the year ended December 31, 2006 from 40.2% for the year ended December 31, 2005.

## **Consolidated Results of Operations**

We operate in two business segments – Clearinghouse and NGM. We have provided consolidated results of operations for our Clearinghouse business segment and our NGM business segment. For further discussion of the operating results of our Clearinghouse business segment and our NGM business segment, including revenue, income (loss) from operations, total assets, goodwill, and intangible assets, see Note 15 to the Consolidated Financial Statements in Item 8.

## **Liquidity and Capital Resources**

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

Total cash and cash equivalents and short-term investments were \$198.7 million at December 31, 2007, an increase from \$58.3 million at December 31, 2006. This increase was due primarily to cash provided by operating activities.

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

***Debt and Credit Facilities***

On February 6, 2007, we entered into a credit agreement, which provides for a revolving credit facility in an aggregate principal amount of up to \$100.0 million. Borrowings under this revolving credit facility bear interest, at our 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 such spread in each case depending on the ratio of our consolidated senior funded indebtedness to consolidated EBITDA. This credit agreement expires on February 6, 2012. As of February 15, 2008, there were no outstanding borrowings under this facility, but available borrowings were reduced by

outstanding letters of credit of \$10.1 million. Borrowings under the revolving credit facility may be used for working capital, capital expenditures, general corporate purposes and to finance acquisitions as permitted by the terms of this credit agreement.

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 consolidated EBITDA to consolidated interest charge ratio and a maximum consolidated senior funded indebtedness to consolidated EBITDA ratio. If an event of default occurs and is continuing, we may be required to repay all amounts outstanding under the credit agreement. Lenders holding more than 50% of the loans and commitments under the new credit agreement may elect to accelerate the maturity of amounts due thereunder upon the occurrence and during the continuation of an event of default. As of and for the year ended December 31, 2007, we were in compliance with these covenants.

In addition, our credit agreement contains terms that enable us to ensure compliance with neutrality obligations to which we are subject, including neutrality-based restrictions on assignment and provisions that allow us to replace or remove a lender or agent to preserve our ability to comply with our neutrality obligations.

### ***Short-term investments***

In December 2007, we were advised that a cash reserve fund that we had invested in would be closed to new investments and immediate redemptions and that there had been a one percent decline in the net asset value of the fund. As of December 31, 2007, we had approximately \$49.2 million invested in this fund. The fund currently has a projected redemption schedule that will result in approximately 90 percent of the fund being redeemed in 2008. As of December 31, 2007, we recorded an unrealized loss of \$628,000 related to this fund. As of February 15, 2008, we had redeemed \$17.0 million and have \$32.2 million remaining in this fund.

## **Discussion of Cash Flows**

### ***Cash flows from operations***

Net cash provided by operating activities for the year ended December 31, 2007 was \$145.9 million, as compared to cash provided by operating activities of \$117.4 million for the year ended December 31, 2006. This \$28.5 million increase was principally the result of a \$28.7 million reduction to the cash outflow relating to excess tax benefits from stock-based compensation, and a \$18.4 million increase in net income offset by a \$19.8 million increase in other non-cash adjustments primarily related to depreciation and amortization resulting predominantly from our acquisitions.

### ***Cash flows from investing***

Net cash used in investing activities for the year ended December 31, 2007 was \$110.5 million, as compared to \$167.8 million for the year ended December 31, 2006. This \$57.3 million decrease in net cash used in investing activities was principally due to a decrease of \$209.5 million in cash paid for acquisitions, which was partially offset by a \$138.6 million increase in the purchase of short-term investments and a \$13.6 million increase in purchases of property and equipment.

### ***Cash flows from financing***

Net cash provided by financing activities was \$23.6 million for the year ended December 31, 2007, as compared to \$62.1 million for the year ended December 31, 2006. This \$38.5 million decrease in net cash provided by financing activities was principally the result of a decrease of \$28.7 million of excess tax benefits from stock-based

compensation. In addition, the overall decrease in net cash provided by financing activities resulted from a decrease in proceeds of \$5.4 million from the exercise of common stock options and \$3.2 million of shares repurchased by us during the year ended December 31, 2007 pursuant to the exercise by stock incentive plan participants of their right to elect to use common stock to satisfy their tax withholding obligations.



## Contractual Obligations

Our principal commitments consist of obligations under leases for office space, computer equipment and furniture and fixtures. The following table summarizes our long-term contractual obligations as of December 31, 2007.

### Payments Due by Period

|                             | Total          | Less Than<br>1 Year | 1-3<br>Years | 4-5<br>Years | More<br>Than<br>5 Years |
|-----------------------------|----------------|---------------------|--------------|--------------|-------------------------|
|                             | (In thousands) |                     |              |              |                         |
| Capital lease obligations   | \$ 9,227       | \$ 3,511            | \$ 5,717     | \$           | \$                      |
| Operating lease obligations | 31,189         | 8,510               | \$ 13,966    | \$ 5,024     | \$ 3,689                |
| Long-term debt              | 7,707          | 2,501               | \$ 5,206     | \$           | \$                      |
| Total                       | \$ 48,123      | \$ 14,522           | \$ 24,889    | \$ 5,024     | \$ 3,689                |

The amounts presented in the table above may not necessarily reflect our actual future cash funding requirements, because the actual timing of the future payments made may vary from the stated contractual obligation. In addition, due to the uncertainty with respect to the timing of future cash flows associated with our unrecognized tax benefits at December 31, 2007, we are unable to make reasonably reliable estimates of the period of cash settlement with the respective taxing authority. Therefore, \$2.0 million of unrecognized tax benefits have been excluded from the contractual obligations table above. See Note 11 to notes to consolidated financial statements for a discussion on income taxes.

## Effect of Inflation

Inflation generally affects us by increasing our cost of labor and equipment. We do not believe that inflation had any material effect on our results of operations during the years ended December 31, 2005, 2006 and 2007.

## Recent Accounting Pronouncements

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

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

We are currently evaluating the impact of the provisions of SFAS No. 159 on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS No. 141(R)), which replaces SFAS No. 141. SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non-controlling interest in the acquiree and the goodwill acquired. SFAS No. 141(R) also establishes disclosure requirements which will enable users to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. Early adoption of this standard is prohibited. In the absence of

any planned future business combinations, we do not currently expect SFAS No. 141(R) to have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained non-controlling equity investments when a subsidiary is deconsolidated. The Statement also establishes reporting requirements that require sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. SFAS 160 is effective for fiscal years beginning after December 15, 2008. Early adoption of this standard is prohibited. In the absence of any noncontrolling (minority) interests, we do not currently expect SFAS No. 160 to have a material impact on our consolidated financial statements.

In February 2008, the FASB issued FASB Staff Position (FSP) FAS 157-b, *Effective Date of FASB Statement No. 157*, which would delay the effective date of SFAS No. 157, or all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The effective date would be delayed by one year to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. We are currently evaluating the impact of FSP FAS 157-b, together with SFAS 157, on our consolidated financial statements.

In December 2007, the SEC issued Staff Accounting Bulletin No. 110 (SAB 110) which, effective January 1, 2008, expresses the views of the staff regarding the use of a simplified method, as discussed in SAB No. 107 (SAB 107), in developing an estimate of expected term of plain vanilla share options in accordance with SFAS No. 123(R). Under the simplified method, the expected term is calculated as the midpoint between the vesting date and the end of the contractual term of the option. In particular, SAB 107 provides for a company's election to use the simplified method, regardless of whether the company has sufficient information to make more refined estimates of expected term. The use of the simplified method was scheduled to expire on December 31, 2007, as it was anticipated that more detailed external information about employee exercise behavior would become available. SAB 110 extends the use of the simplified method for plain vanilla awards in certain situations. We expect to continue our use of the simplified method for awards issued after December 31, 2007 until such time that historical exercise information provides a more reliable estimate of the expected term.

#### **Off-Balance Sheet Arrangements**

We had no off-balance sheet arrangements as of December 31, 2006 and 2007.

#### **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are subject to market risk associated with changes in foreign currency exchange rates and interest rates.

Interest rate exposure is primarily limited to the approximately \$100 million of short-term investments owned by us at December 31, 2007. Such investments consist principally of high-grade auction rate securities and U.S. government or corporate debt securities. We do not actively manage the risk of interest rate fluctuations on our short-term investments; however, such risk is mitigated by the relatively short-term nature of these investments. For the year ended December 31, 2007, a one-percentage point adverse change in interest rates would have reduced our interest income for the year ended December 31, 2007 by approximately \$700,000. In addition, we do not consider the present rate of inflation to have a material impact on our business.

We have accounts on our foreign subsidiaries' ledgers which are maintained in the respective subsidiary's local foreign currency and remeasured into the United States dollar. As a result, we are exposed to movements in the exchange rates of various currencies against the United States dollar and against the currencies of other countries in which we sell services.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders  
NeuStar, Inc.

We have audited the accompanying consolidated balance sheets of NeuStar, Inc. as of December 31, 2006 and 2007, and the related consolidated statements of operations, stockholders' (deficit) equity, and cash flows for each of the three years in the period ended December 31, 2007. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of NeuStar, Inc. at December 31, 2006 and 2007, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), NeuStar, Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 25, 2008 expressed an unqualified opinion thereon.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2007, NeuStar, Inc. adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* and an interpretation of FASB Statement No. 109. As discussed in Note 2 to the consolidated financial statements, effective January 1, 2006, NeuStar, Inc. adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment*.

/s/ Ernst & Young LLP

McLean, Virginia  
February 25, 2008

## NEUSTAR, INC.

**CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share and per share data)

|  | <b>December 31,</b> |                   |
|--|---------------------|-------------------|
|  | <b>2006</b>         | <b>2007</b>       |
| <b>ASSETS</b>  |                     |                   |
| Current assets:  |                     |                   |
| Cash and cash equivalents  | \$ 39,242           | \$ 98,630         |
| Restricted cash  |                     | 488               |
| Short-term investments   | 19,010              | 100,048           |
| Accounts receivable, net of allowance for doubtful accounts of \$1,103 and \$1,654, respectively | 53,108              | 76,632            |
| Unbilled receivables   | 810                 | 383               |
| Notes receivable   | 1,994               | 2,159             |
| Prepaid expenses and other current assets  | 6,945               | 9,608             |
| Deferred costs   | 6,032               | 8,281             |
| Income taxes receivable  | 893                 |                   |
| Deferred tax assets  | 7,641               | 13,907            |
| <b>Total current assets</b>  | <b>135,675</b>      | <b>310,136</b>    |
| Property and equipment, net  | 42,678              | 56,191            |
| Goodwill   | 205,855             | 204,093           |
| Intangible assets, net   | 51,196              | 36,851            |
| Notes receivable, long-term  | 2,918               | 759               |
| Deferred costs, long-term  | 4,411               | 3,575             |
| Deferred tax assets, long-term   | 4,500               |                   |
| Other assets   | 1,026               | 5,056             |
| <b>Total assets</b>  | <b>\$ 448,259</b>   | <b>\$ 616,661</b> |

See accompanying notes.

## NEUSTAR, INC.

**CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share and per share data)

|   | <b>December 31,</b> |             |
|---|---------------------|-------------|
|   | <b>2006</b>         | <b>2007</b> |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                     |             |
| Current liabilities:  |                     |             |
| Accounts payable  | \$ 3,619            | \$ 9,742    |
| Accrued expenses  | 49,460              | 47,501      |
| Deferred revenue  | 22,923              | 32,236      |
| Notes payable   | 768                 | 2,501       |
| Capital lease obligations   | 4,367               | 3,511       |
| Accrued restructuring reserve   | 368                 | 413         |
| Income taxes payable  |                     | 3,254       |
| Other liabilities   | 200                 | 108         |
| <br>Total current liabilities   | <br>81,705          | <br>99,266  |
| <br>Deferred revenue, long-term   | <br>17,921          | <br>18,063  |
| Notes payable, long-term  | 174                 | 5,206       |
| Capital lease obligations, long-term  | 3,751               | 5,717       |
| Accrued restructuring reserve, long-term  | 2,206               | 1,793       |
| Other liabilities, long-term  | 1,356               | 3,866       |
| Deferred tax liability  |                     | 2,215       |
| <br>Total liabilities   | <br>107,113         | <br>136,126 |
| <br>Commitments and contingencies   |                     |             |
| <br>Stockholders equity:  |                     |             |
| Preferred stock, \$0.001 par value; 100,000,000 shares authorized; No shares issued or outstanding as of December 31, 2006 and 2007   |                     |             |
| Class A common stock, \$0.001 par value; 200,000,000 shares authorized; 74,351,200 shares issued or outstanding as of December 31, 2006; 77,082,161 shares issued and outstanding as of December 31, 2007 | 74                  | 77          |
| Class B common stock, \$0.001 par value; 100,000,000 shares authorized; 18,330 and 4,538 shares issued and outstanding as of December 31, 2006 and 2007, respectively                                     |                     |             |
| Additional paid-in capital  | 243,395             | 293,785     |
| Treasury stock, 756 and 99,286 shares, at cost, at December 31, 2006 and 2007, respectively   | (22)                | (3,221)     |
| Accumulated other comprehensive loss  |                     | (140)       |
| Retained earnings   | 97,699              | 190,034     |
| <br>Total stockholders equity   | <br>341,146         | <br>480,535 |



|  |            |            |
|--|------------|------------|
| Total liabilities and stockholders' equity | \$ 448,259 | \$ 616,661 |
|--|------------|------------|

See accompanying notes.

## NEUSTAR, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

|  | Year Ended December 31, |            |            |
|--|-------------------------|------------|------------|
|  | 2005                    | 2006       | 2007       |
| Revenue:   |                         |            |            |
| Addressing   | \$ 75,036               | \$ 103,858 | \$ 109,799 |
| Interoperability   | 52,488                  | 56,454     | 61,679     |
| Infrastructure and other   | 114,945                 | 172,645    | 257,694    |
| Total revenue  | 242,469                 | 332,957    | 429,172    |
| Operating expense:   |                         |            |            |
| Cost of revenue (excluding depreciation and amortization shown separately below) | 64,891                  | 86,106     | 94,948     |
| Sales and marketing  | 29,543                  | 47,671     | 70,833     |
| Research and development   | 11,883                  | 17,639     | 27,381     |
| General and administrative   | 28,048                  | 34,902     | 48,633     |
| Depreciation and amortization  | 16,025                  | 24,016     | 37,731     |
| Restructuring recoveries   | (389)                   |            |            |
|  | 150,001                 | 210,334    | 279,526    |
| Income from operations   | 92,468                  | 122,623    | 149,646    |
| Other (expense) income:  |                         |            |            |
| Interest expense   | (2,121)                 | (1,300)    | (1,694)    |
| Interest and other income  | 2,406                   | 4,024      | 5,159      |
| Income before minority interest and income taxes                                 | 92,753                  | 125,347    | 153,111    |
| Minority interest  | (104)                   | (95)       |            |
| Income before income taxes   | 92,649                  | 125,252    | 153,111    |
| Provision for income taxes   | 37,251                  | 51,353     | 60,776     |
| Net income   | 55,398                  | 73,899     | 92,335     |
| Dividends on and accretion of preferred stock                                    | (4,313)                 |            |            |
| Net income attributable to common stockholders                                   | \$ 51,085               | \$ 73,899  | \$ 92,335  |
| Net income per share attributable to common stockholders:                        |                         |            |            |
| Basic  | \$ 1.48                 | \$ 1.02    | \$ 1.22    |
| Diluted  | \$ 0.72                 | \$ 0.94    | \$ 1.17    |
| Weighted average common shares outstanding:                                      |                         |            |            |
| Basic  | 34,437                  | 72,364     | 75,954     |

|         |        |        |        |
|---------|--------|--------|--------|
| Diluted | 77,046 | 78,267 | 79,235 |
|---------|--------|--------|--------|

See accompanying notes.

## NEUSTAR, INC.

**CONSOLIDATED STATEMENT OF STOCKHOLDERS (DEFICIT) EQUITY**  
(In thousands)

|  | Class A<br>Common Stock |        | Class B<br>Common Stock |        | Additional<br>Paid-in<br>Capital | Deferred<br>Stock<br>Compensation | Treasury<br>Stock | Accumulated                                | Accumulated                      | Total<br>Stockholders'<br>(Deficit) Equity |
|--|-------------------------|--------|-------------------------|--------|----------------------------------|-----------------------------------|-------------------|--|----------------------------------|--|
|  | Shares                  | Amount | Shares                  | Amount |                                  |                                   |                   | Other<br>Comprehensive<br>(Loss)<br>Income | Deficit)<br>Retained<br>Earnings |  |
| Balance at<br>December 31, 2004  |                         | \$     | 6,160                   | \$ 6   | \$                               | \$ (1,733)                        | \$ (1,125)        | \$   | \$ (29,006)                      | \$ (31,874)                                |
| Non stock options<br>exercised   |                         |        | 466                     | 1      | 246                              |                                   |                   |  |                                  |  |
| Compensation expense<br>accrued with options<br>vested to nonemployees                   |                         |        |                         |        | 2,214                            |                                   |                   |  |                                  | 2,214                                      |
| Issuance of<br>Common Stock, Inc.  |                         |        | 36                      |        | 388                              |                                   |                   |  |                                  |  |
| Repurchase of treasury<br>stock  |                         |        | (236)                   |        | (1,125)                          |                                   | 1,125             |  |                                  |  |
| Conversion of preferred<br>stock and related<br>expenses                                 |                         |        |                         |        | (1,721)                          |                                   |                   |  | (2,592)                          | (4,313)                                    |
| Conversion of Class B<br>non stock pursuant<br>to conversion of<br>convertible preferred |                         |        | 53,435                  | 53     | 138,452                          |                                   |                   |  |                                  | 138,938                                    |
| Conversion of Class B<br>non stock to<br>Class A common stock                            | 59,662                  | 60     | (59,662)                | (60)   |                                  |                                   |                   |  |                                  |  |
| Compensation expense<br>accrued with issuance<br>of restricted stock                     |                         | 5      |                         |        | 160                              | (160)                             |                   |  |                                  |  |
| Amortization of<br>restricted stock<br>compensation                                      |                         |        |                         |        |                                  | 447                               |                   |  |                                  |  |
| Non stock options<br>exercised   | 2,122                   | 2      |                         |        | 7,709                            |                                   |                   |  |                                  | 7,711                                      |
| Dividends exercised  | 6,362                   | 6      |                         |        | 418                              |                                   |                   |  |                                  |  |
| Benefit from stock<br>option exercises   |                         |        |                         |        | 17,000                           |                                   |                   |  |                                  | 17,000                                     |
| Net income   |                         |        |                         |        |                                  |                                   |                   |  | 55,398                           | 55,398                                     |

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|   |        |       |       |            |            |          |            |            |
|---|--------|-------|-------|------------|------------|----------|------------|------------|
| Balance at<br>December 31, 2005   | 68,151 | 68    | 199   | 163,741    | (1,446)    |          | 23,800     | 186,000    |
| Restricted stock<br>cancellation  |        |       |       | (1,446)    | 1,446      |          |            |            |
| Common stock options<br>exercised   | 5,919  | 6     |       | 19,693     |            |          |            | 19,693     |
| Share-based<br>cancellation expense   |        |       |       | 11,890     |            |          |            | 11,890     |
| Conversion of Class B<br>common stock to<br>Class A common stock                        | 181    |       | (181) |            |            |          |            |            |
| Restricted stock granted<br>(net of forfeitures)  | 100    |       |       |            |            |          |            |            |
| Repurchase of common<br>stock   |        |       |       |            |            | (22)     |            |            |
| Benefit from stock<br>option exercises  |        |       |       | 49,517     |            |          |            | 49,517     |
| Other non-recurring<br>income   |        |       |       |            |            |          | 73,899     | 73,899     |
| Balance at<br>December 31, 2006   | 74,351 | 74    | 18    | 243,395    | (22)       |          | 97,699     | 341,000    |
| Common stock options<br>exercised   | 2,493  | 2     |       | 14,319     |            |          |            | 14,319     |
| Share-based<br>cancellation expense   |        |       |       | 15,265     |            |          |            | 15,265     |
| Conversion of Class B<br>common stock to<br>Class A common stock                        | 14     |       | (14)  |            |            |          |            |            |
| Common stock issued<br>in connection with<br>the acquisition of<br>Common stock units   | 224    | 1     |       |            |            |          |            |            |
| Common stock received<br>in connection with<br>the acquisition of<br>Common stock units |        |       |       |            |            | (3,199)  |            | (3,199)    |
| Benefit from stock<br>option exercises  |        |       |       | 20,806     |            |          |            | 20,806     |
| Other non-recurring<br>income   |        |       |       |            |            |          | 92,335     | 92,335     |
| Other comprehensive<br>income (loss)  |        |       |       |            |            |          |            |            |
| Realized loss on<br>available-for-sale<br>investments,<br>net of tax of \$247           |        |       |       |            |            |          | (381)      | (381)      |
| Translation of<br>foreign currency<br>statements,<br>net of tax of \$125                |        |       |       |            |            |          | 241        | 241        |
| Other comprehensive<br>income   |        |       |       |            |            |          |            | 92,335     |
| Balance at<br>December 31, 2007   | 77,082 | \$ 77 | 4     | \$ 293,785 | \$ (3,221) | \$ (140) | \$ 190,034 | \$ 480,000 |

See accompanying notes.

## NEUSTAR, INC.

**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

|   | <b>Year Ended December 31,</b> |             |             |
|---|--------------------------------|-------------|-------------|
|   | <b>2005</b>                    | <b>2006</b> | <b>2007</b> |
| Operating activities:   |                                |             |             |
| Net income  | \$ 55,398                      | \$ 73,899   | \$ 92,335   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                |             |             |
| Depreciation and amortization   | 16,025                         | 24,016      | 37,731      |
| Stock-based compensation  | 2,661                          | 11,890      | 15,265      |
| Amortization of deferred financing costs  | 57                             | 5           | 158         |
| Tax benefit from stock option exercises   | 17,000                         | (49,517)    | (20,806)    |
| Deferred income taxes   | (2,289)                        | 1,448       | 3,585       |
| Noncash restructuring recoveries  | (389)                          |             |             |
| Provision for doubtful accounts   | 551                            | 2,041       | 2,601       |
| Minority interest   | 104                            | 95          |             |
| Changes in operating assets and liabilities, net of acquisitions:                 |                                |             |             |
| Accounts receivable   | (5,254)                        | (21,221)    | (27,743)    |
| Unbilled receivables  | (5,414)                        | 5,944       | 427         |
| Notes receivable  | 4,290                          | (3,838)     | 1,994       |
| Prepaid expenses and other current assets   | (1,570)                        | 2,560       | (59)        |
| Deferred costs  | (5,902)                        | (170)       | (1,413)     |
| Income tax receivable   | (14,595)                       | 63,219      | 21,699      |
| Other assets  | 658                            | (411)       | 211         |
| Other liabilities   |                                |             | 1,119       |
| Accounts payable and accrued expenses   | 7,840                          | 6,263       | 7,098       |
| Income taxes payable  | (419)                          |             | 3,254       |
| Accrued restructuring reserve   | (1,551)                        | (534)       | (368)       |
| Customer credits  | (15,541)                       |             |             |
| Deferred revenue  | 9,542                          | 1,691       | 8,782       |
| Net cash provided by operating activities   | 61,202                         | 117,380     | 145,870     |
| Investing activities:   |                                |             |             |
| Purchases of property and equipment   | (12,890)                       | (13,658)    | (27,244)    |
| (Purchases) sales of investments, net   | (31,036)                       | 56,936      | (81,666)    |
| Businesses acquired, net of cash acquired   | (2,540)                        | (211,072)   | (1,569)     |
| Net cash used in investing activities   | (46,466)                       | (167,794)   | (110,479)   |
| Financing activities:   |                                |             |             |
| Release (disbursement) of restricted cash   | 5,296                          | 374         | (488)       |
| Principal repayments on notes payable   | (5,406)                        | (1,443)     | (3,323)     |
| Principal repayments on capital lease obligations                                 | (5,939)                        | (5,998)     | (4,486)     |
| Proceeds from exercise of common stock options                                    | 5,661                          | 19,699      | 14,321      |

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|   |           |             |           |
|---|-----------|-------------|-----------|
| Proceeds from exercise of warrants                            | 424       |             |           |
| Payment of preferred stock dividends                          | (6,262)   |             |           |
| Excess tax benefits from stock-based compensation             |           | 49,517      | 20,806    |
| Repurchase of common stock                                    |           | (22)        | (3,199)   |
| Net cash (used in) provided by financing activities           | (6,226)   | 62,127      | 23,631    |
| Effect of foreign exchange rates on cash and cash equivalents |           |             | 366       |
| Net increase in cash and cash equivalents                     | 8,510     | 11,713      | 59,388    |
| Cash and cash equivalents at beginning of year                | 19,019    | 27,529      | 39,242    |
| Cash and cash equivalents at end of year                      | \$ 27,529 | \$ 39,242   | \$ 98,630 |
| Supplemental cash flow information:                           |           |             |           |
| Cash paid for interest  | \$ 1,377  | \$ 870      | \$ 1,056  |
| Cash paid (refunds received) for income taxes                 | \$ 37,583 | \$ (14,172) | \$ 30,953 |

See accompanying notes.



**NEUSTAR, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. DESCRIPTION OF BUSINESS AND ORGANIZATION**

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

The Company was founded to meet the technical and operational challenges of the communications industry when the U.S. government mandated local number portability in 1996. While the Company remains the provider of the authoritative solution that the communications industry relies upon to meet this mandate, the Company has developed a broad range of innovative services to meet an expanded range of customer needs. The Company provides the communications industry with critical technology services that solve the addressing, interoperability and infrastructure needs of CSPs. These services are now used by CSPs to manage a range of their technical and operating requirements, including:

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

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

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

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

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

**NEUSTAR, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation and Consolidation**

The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All material intercompany transactions and accounts have been eliminated in consolidation. The Company consolidates investments where it has a controlling financial interest as defined by Accounting Research Bulletin (ARB) No. 51, *Consolidated Financial Statements*, as amended by Statement of Financial Accounting Standards (SFAS) No. 94, *Consolidation of all Majority-Owned Subsidiaries*. The usual condition for controlling financial interest is ownership of a majority of the voting interest and, therefore, as a general rule, ownership, directly or indirectly, of more than 50% of the outstanding voting shares is a condition indicating consolidation. Minority interest is recorded in the statement of operations for the share of income or loss allocated to minority stockholders to the extent that the minority stockholder's investment in the subsidiary does not fall below zero. For investments in variable interest entities, as defined by Financial Accounting Standards Board (FASB) Interpretation No. 46, *Consolidation of Variable Interest Entities*, the Company would consolidate when it is determined to be the primary beneficiary of a variable interest entity. For those investments in entities where the Company has significant influence over operations, but where the Company neither has a controlling financial interest nor is the primary beneficiary of a variable interest entity, the Company follows the equity method of accounting pursuant to Accounting Principles Board (APB) Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*. The Company does not have any variable interest entities or investments accounted for under the equity method of accounting.

**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 quantification of income tax liabilities due to uncertain tax positions, and the determination of the allowance for estimated uncollectible accounts. Actual results could differ from those estimates.

The goodwill impairment test and the determination of the fair value of intangible assets involve the use of significant estimates and assumptions by management, and are inherently subjective. In particular, for each of the Company's reporting units, the significant assumptions used include market penetration, anticipated growth rates, and risk-adjusted discount rates for the income approach, as well as the selection of comparable companies and comparable transactions for the market approach. Changes in estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. Specifically, for the Company's NGM reporting unit, due to the early stage of its operations and the emerging nature of mobile instant messaging technology, key assumptions incorporated within the valuation have a higher degree of subjectivity

and are more likely to change over time. The Company believes that the assumptions and estimates used to determine the estimated fair values of each of its reporting units are reasonable. However, any changes in key assumptions about the Company's businesses and prospects, or changes in market conditions, could result in an impairment charge. Such a charge could have a material effect on the Company's consolidated financial statements because of the significance of goodwill and intangible assets to the Company's consolidated balance sheet.

## NEUSTAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**Fair Value of Financial Instruments**

SFAS No. 107, *Disclosures about Fair Value of 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 consolidated financial statements approximate the fair value for cash and cash equivalents, accounts receivable, accounts payable and accrued expenses. As of December 31, 2006 and 2007, the Company believes the carrying value of its long-term notes receivable approximates fair value as the interest rates approximate a market rate. The fair value of the Company's long-term debt is based upon quoted market prices for the same and similar issuances giving consideration to quality, interest rates, maturity and other characteristics. As of December 31, 2006 and 2007, the Company believes the carrying amount of its long-term debt approximates its fair value since the fixed and variable interest rates of the debt approximate a market rate.

**Cash and Cash Equivalents**

The Company considers all highly liquid investments, which are readily convertible into cash and have original maturities of three months or less at the time of purchase, to be cash equivalents. Supplemental non-cash information to the consolidated statements of cash flows is as follows:

|  | <b>Year Ended December 31,</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2005</b>                    | <b>2006</b> | <b>2007</b> |
|  | <b>(In thousands)</b>          |             |             |
| Fixed assets acquired through capital leases       | \$ 3,470                       | \$ 5,154    | \$ 5,597    |
| Fixed assets acquired through notes payable        | 1,002                          |             | 10,049      |
| Accounts payable incurred to purchase fixed assets | 79                             | 85          | 345         |
| Business acquired with common shares (see Note 3)  | 388                            |             |             |

**Restricted Cash**

At December 31, 2007, approximately \$488,000 of cash was held with a local bank in the form of a bank guarantee as security for the Company's performance under a noncancelable operating lease agreement and was classified as restricted cash on the consolidated balance sheets. There was no restricted cash at December 31, 2006.

**Derivatives and Hedging Activities**

The Company recognizes all derivative financial instruments in the consolidated financial statements at fair value regardless of the purpose or intent for holding the instrument, in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. Changes in the fair value of derivative financial instruments are either recognized periodically in the results of operations or in stockholders' equity as a component of other comprehensive income, depending on whether the derivative financial instrument qualifies for hedge accounting and, if so, whether it qualifies as a fair value hedge or cash flow hedge. Generally, changes in the fair value of the derivatives accounted for as fair value hedges are recorded in the results of operations along with the portions of the

changes in the fair values of the hedged items that relate to the hedged risks. Changes in fair value of derivatives accounted for as cash flow hedges, to the extent they are effective as hedges, are recorded in other comprehensive income. Changes in fair values of derivatives not qualifying as hedges are reported in the results of operations.

**Concentrations of Credit Risk**

Financial instruments that are potentially subject to a concentration of credit risk consist principally of cash, cash equivalents, short-term investments and accounts receivable. The Company's cash and short-term investment

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

policies are in place to restrict placement of these instruments with only financial institutions evaluated as highly creditworthy.

With respect to accounts receivable, the Company performs ongoing evaluations of its customers, generally granting uncollateralized credit terms to its customers, and maintains an allowance for doubtful accounts based on historical experience and management's expectations of future losses. Customers under the Company's contracts with the North American Portability Management LLC are charged a Revenue Recovery Collection fee (See Accounts Receivable, Revenue Recovery Collection and Allowance for Doubtful Accounts).

**Short-term Investments**

The Company's short-term investments are classified as available-for-sale and carried at estimated fair value, as determined by quoted market prices or other valuation methods, with unrealized gains and losses reported in a separate component of accumulated other comprehensive income (loss). Realized gains and losses and declines in value judged to be other-than-temporary, if any, on available-for-sale securities are included in interest income. The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale is included in interest and other income.

The Company periodically evaluates whether any declines in the fair value of investments are other-than-temporary. This evaluation consists of a review of several factors, including but not limited to: the length of time and extent that a security has been in an unrealized loss position; the existence of an event that would impair the issuer's future earnings potential; the near-term prospects for recovery of the market value of a security; and the intent and ability of the Company to hold the security until the market value recovers. Declines in value below cost for investments where it is considered probable that all contractual terms of the investment will be satisfied, is due primarily to changes in market demand (and not because of increased credit risk), and where the Company intends and has the ability to hold the investment for a period of time sufficient to allow a market recovery, are not assumed to be other-than-temporary.

A summary of the Company's securities available for sale as of December 31, 2007 and December 31, 2006 is as follows:

|                                    | <b>December 31, 2007</b> |                   |               |                   |
|------------------------------------|--------------------------|-------------------|---------------|-------------------|
|                                    | <b>Amortized</b>         | <b>Gross</b>      |               | <b>Estimated</b>  |
|                                    | <b>Cost</b>              | <b>Unrealized</b> | <b>Losses</b> | <b>Fair Value</b> |
| Cash reserve fund                  | \$ 49,851                | \$                | \$ (628)      | \$ 49,223         |
| High grade auction rate securities | 50,825                   |                   |               | 50,825            |
|                                    | \$ 100,676               | \$                | \$ (628)      | \$ 100,048        |

**December 31, 2006**

|                                     | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Losses</b> | <b>Estimated<br/>Fair Value</b> |
|-------------------------------------|---------------------------|---------------------------------------|---------------|---------------------------------|
| Commercial paper/money market funds | \$ 60                     | \$                                    | \$            | \$ 60                           |
| High grade auction rate securities  | 18,950                    |                                       |               | 18,950                          |
|                                     | \$ 19,010                 | \$                                    | \$            | \$ 19,010                       |

In December 2007, the Company was advised that a cash reserve fund that the Company had invested in would be closed to new investments and immediate redemptions and that there had been a one percent decline in the net asset value of the fund. As of December 31, 2007, the Company had approximately \$49.2 million invested in this fund. The fund currently has a projected redemption schedule that will result in approximately 90 percent of the



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

fund being redeemed in 2008. As of December 31, 2007, the Company recorded an unrealized loss of \$628,000 related to this fund. As of February 15, 2008, the Company had redeemed \$17.0 million and has \$32.2 million remaining in this fund.

**Accounts Receivable, Revenue Recovery Collections and Allowance for Doubtful Accounts**

Accounts receivable are recorded at the invoiced amount and do not bear interest. In accordance with the Company's contracts with North American Portability Management LLC, the Company bills a Revenue Recovery Collections (RRC) fee to offset uncollectible receivables from any individual customer. The RRC fee is based on a percentage of monthly billings. From January 1, 2004 through June 30, 2005, the RRC fee was 2%. On July 1, 2005, the RRC fee was reduced to 1%. The RRC fees are recorded as an accrued liability when collected. If the RRC fee is insufficient the amounts can be recovered from the customers. Any accrued RRC fees in excess of uncollectible receivables are paid back to the customers annually on a pro rata basis. RRC fees of \$2.9 million and \$3.6 million are included in accrued expenses as of December 31, 2006 and 2007, respectively. All other receivables related to services not covered by the RRC fees are evaluated and, if deemed not collectible, are reserved. The Company recorded an allowance for doubtful accounts of \$1.1 million and \$1.7 million as of December 31, 2006 and 2007, respectively. Bad debt expense amounted to \$551,000, \$2.0 million and \$2.6 million for the years ended December 31, 2005, 2006 and 2007, respectively.

**Deferred Financing Costs**

The Company amortizes deferred financing costs using the effective-interest method and records such amortization as interest expense. Amortization of debt discount and annual commitment fees for unused portions of available borrowings are also recorded as interest expense.

**Property and Equipment**

Property and equipment, including leasehold improvements and assets acquired through capital leases, are recorded at cost, net of accumulated depreciation and amortization. Depreciation and amortization of property and equipment are determined using the straight-line method over the estimated useful lives of the assets, as follows:

|                        |   |
|------------------------|---|
| Computer hardware      | 3-5 years                                   |
| Equipment              | 5 years                                     |
| Furniture and fixtures | 5-7 years                                   |
| Leasehold improvements | Lesser of related lease term or useful life |

Amortization expense of capital leased assets is included in depreciation and amortization expense in the consolidated statements of operations. Replacements and major improvements are capitalized; maintenance and repairs are charged to expense as incurred.

The Company capitalizes software development and acquisition costs in accordance with Statement of Position (SOP) No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. SOP No. 98-1 requires the capitalization of costs incurred in connection with developing or obtaining software for internal use. Costs

incurred to develop the application are capitalized, while costs incurred for planning the project and for post-implementation training and maintenance are expensed as incurred. The capitalized costs of purchased technology and software development are amortized using the straight-line method over the estimated useful life of three to five years. During the years ended December 31, 2005, 2006 and 2007, the Company capitalized costs related to internal use software of \$8.2 million, \$7.9 million and \$11.0 million, respectively. Amortization expense related to internal use software for the years ended December 31, 2005, 2006 and 2007 was \$3.7 million, \$5.8 million and \$9.2 million, respectively and is included in depreciation and amortization expense in the consolidated statements of operations.

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

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

Goodwill is tested for impairment at the reporting unit level using a two-step approach. The first step is to compare the fair value of a reporting unit's net assets, including assigned goodwill, to the book value of its net assets, including assigned goodwill. Fair value of the reporting unit is determined using both an income and market approach. To assist in the process of determining if a goodwill impairment exists, the Company performs internal valuation analyses and considers other market information that is publicly available, and the Company may obtain appraisals from external advisors. If the fair value of the reporting unit is greater than its net book value, the assigned goodwill is not considered impaired. If the fair value is less than the reporting unit's net book value, the Company performs a second step to measure the amount of the impairment, if any. The second step would be to compare the book value of the reporting unit's assigned goodwill to the implied fair value of the reporting unit's goodwill, using a theoretical purchase price allocation based on this implied fair value to determine the magnitude of the impairment. If the Company determines that an impairment has occurred, the Company is required to record a write-down of the carrying value and charge the impairment as an operating expense in the period the determination is made. There were no impairment charges recognized during the years ended December 31, 2005, 2006 and 2007.

**Identifiable Intangible Assets**

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

The Company's identifiable intangible assets are amortized as follows:

|                                  | <b>Years</b> | <b>Method</b> |
|----------------------------------|--------------|---------------|
| Acquired technologies            | 3 to 4       | Straight-line |
| Customer lists and relationships | 3 to 7       | Various       |
| Trade name                       | 3            | Straight-line |

Amortization expense related to intangible assets is included in depreciation and amortization expense in the consolidated statements of operations.

### **Impairment of Long-Lived Assets**

In accordance with SFAS No. 144, the Company reviews long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the assets. Recoverability measurement and estimating of undiscounted cash flows is done at the lowest possible level for which there is identifiable assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of assets exceeds the fair value of the assets. Assets to be disposed of are recorded at the lower of the carrying amount or fair value less costs to sell.

**NEUSTAR, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Revenue Recognition**

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

***Addressing***

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

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

The Company generates revenue through internal and external managed domain name services. The Company's revenue 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 its managed domain name services, customers have contractually established monthly transaction volumes for which they are charged a recurring monthly fee. Transactions processed in excess of the pre-established monthly volume are billed at a contractual per transaction rate. Each month the Company recognizes the recurring monthly fee and usage in excess of the established monthly volume on a per transaction basis as services are provided. The Company generates revenue from its U.S. Common Short Code services under short-term contracts ranging from three to twelve months, and the Company recognizes revenue on a straight-line basis over the term of the customer contracts.

***Interoperability***

The Company's interoperability services consist primarily of wireline and wireless number portability and order management services. The Company generates revenue from number portability under its long-term contracts with

North American Portability Management LLC and Canadian LNP Consortium, Inc. The Company recognizes revenue on a per transaction fee basis as the services are performed. The Company provides order management services (OMS), consisting of customer set-up and implementation followed by transaction processing, under contracts with terms ranging from one to three years. Customer set-up and implementation is not considered a separate deliverable; accordingly, the fees are deferred and recognized as revenue on a straight-line basis over the term of the contract. Per transaction fees are recognized as the transactions are processed. The Company generates revenue from its inter-carrier mobile instant messaging services under contracts with mobile operators that range from one to three years. These contracts consist of license fees based on the number of subscribers that use mobile

**NEUSTAR, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

instant messaging services, as well as fees for set-up and implementation. The Company recognizes license fee revenue ratably over the term of the contract after completion of customer set-up and implementation. Customer set-up and implementation is not considered a separate deliverable; accordingly, the fees are deferred and recognized as revenue on a straight line basis over the remaining term of the contract following delivery of the set-up and implementation services.

***Infrastructure and Other***

The Company's infrastructure services consist primarily of network management and connection services. The Company generates revenue from network management services under its long-term contracts with North American Portability Management LLC. The Company recognizes revenue on a per transaction fee basis as the services are performed. In addition, the Company generates revenue from connection fees and system enhancements under its contracts with North American Portability Management LLC. The Company recognizes its connection fee revenue as the service is performed. System enhancements are provided under contracts in which the Company is 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 generates revenue from its intra-carrier mobile instant messaging services under contracts with mobile operators that range from one to three years. These contracts consist of license fees based on the number of subscribers that use mobile instant messaging services, as well as fees for set-up and implementation. The Company recognizes license fee revenue ratably over the term of the contract after completion of customer set-up and implementation. Customer set-up and implementation is not considered a separate deliverable; accordingly, the fees are deferred and recognized as revenue on a straight line basis over the remaining term of the contract following delivery of the set-up and implementation services.

***Significant Contracts***

The Company provides wireline and wireless number portability, implements the allocation of pooled blocks of telephone numbers and provides network management services pursuant to seven contracts with North American Portability Management LLC, an industry group that represents all telecommunications service providers in the United States. The Company recognizes revenue under its contracts with North American Portability Management LLC primarily on a per transaction basis. The aggregate fees for transactions processed under these contracts are determined by the total number of transactions, and these fees are billed to telecommunications service providers based on their allocable share of the total transaction charges. This allocable share is based on each respective telecommunications service provider's share of the aggregate end-user services revenues of all U.S. telecommunications service providers, as determined by the Federal Communications Commission (FCC). Under the Company's contracts, the Company also bills an RRC fee of a percentage of monthly billings to its customers, which is available to the Company if any telecommunications service provider fails to pay its allocable share of total transactions charges. The amount of revenue derived under the Company's contracts with North American Portability Management LLC was approximately \$188.8 million, \$249.3 million and \$301.8 million for the years ended December 31, 2005, 2006 and 2007, respectively.

Prior to 2007, the per transaction pricing under these contracts provided for annual volume-based credits that were earned on all transactions in excess of the pre-determined annual volume threshold. For 2005 and 2006, the maximum aggregate volume-based credit was \$7.5 million, which was applied via a reduction in per transaction pricing once the pre-determined annual volume threshold was surpassed. When the aggregate credit was fully satisfied, the per

transaction pricing was restored to the prevailing contractual rate. In both 2005 and 2006, the pre-determined annual transaction volume threshold under these contracts was exceeded, which resulted in the issuance of \$7.5 million of volume-based credits for both years. In September 2006, the Company amended its contracts with North American Portability Management LLC. Under these amended terms, no volume-based credits were applied in 2007 and none will be applied in later fiscal periods.



**NEUSTAR, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Service Level Standards***

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

**Cost of Revenue and Deferred Costs**

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

Deferred costs represent direct labor related to professional services incurred for the setup and implementation of contracts. These costs are recognized in cost of revenue on a straight-line basis over the contract term. Deferred costs also include royalties paid related to the Company's U.S. Common Short Code services, which are recognized in cost of revenue on a straight-line basis over the contract term. Deferred costs are classified as such on the consolidated balance sheets.

**Research and Development**

The Company expenses its research and development costs as incurred. Research and development expense consists primarily of personnel costs, including salaries, stock-based compensation and other personnel-related expense; consulting fees; and the costs of facilities, computer and support services used in service and technology development.

**Advertising**

The Company expenses advertising as incurred. Advertising expense was approximately \$809,000, \$1.1 million and \$2.7 million for the years ended December 31, 2005, 2006 and 2007, respectively.

**Stock-Based Compensation**

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

Prior to January 1, 2006, the Company accounted for its stock-based compensation plans under the recognition and measurement provisions of APB No. 25, and related interpretations, as permitted by SFAS No. 123. Effective

January 1, 2006, the Company adopted SFAS No. 123(R), including the fair value recognition provisions, using the modified-prospective transition method. Under the modified-prospective transition method, compensation cost recognized in fiscal 2006 and forward includes: (a) compensation cost for all stock-based awards granted prior to but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all stock-based awards granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). Under the modified prospective transition method, prior periods are not restated. Both prior and subsequent to the adoption of SFAS No. 123(R), the Company estimated the value of stock-based awards on the date of grant using the Black-

**NEUSTAR, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Scholes option-pricing models. For stock-based awards subject to graded vesting, the Company has utilized the straight-line method for allocating compensation cost by period.

In accordance with FASB Staff Position No. FAS 123(R)-3, *Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards*, the Company elected to adopt the alternative method for calculating the tax effects of stock-based compensation pursuant to SFAS No. 123(R), as provided in this FASB Staff Position. The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of employee stock-based compensation, which is available to absorb tax deficiencies recognized subsequent to the adoption of SFAS No. 123(R).

Prior to adoption of SFAS No. 123(R), the Company presented all benefits of tax deductions resulting from the exercise of stock-based compensation as an operating cash flow in the consolidated statements of cash flows. Beginning on January 1, 2006, the Company changed its cash flow presentation in accordance with SFAS No. 123(R), which requires benefits of tax deductions in excess of the compensation cost recognized (excess tax benefits) to be classified as a financing cash inflow with a corresponding operating cash outflow. For the years ended December 31, 2006 and 2007, the Company included \$49.5 million and \$20.8 million, respectively, of excess tax benefits as a financing cash inflow with a corresponding operating cash outflow.

Prior to the adoption of SFAS No. 123(R), the Company recognized the full fair value of phantom stock units and restricted stock awards upon issuance within stockholders' (deficit) equity. As of December 31, 2005, approximately \$1.4 million of deferred compensation costs had been recognized in additional paid-in capital, offset by an equal amount recorded in deferred stock compensation. Pursuant to the adoption of SFAS No. 123(R) on January 1, 2006, the Company reversed previously recorded deferred stock compensation costs and recognized stock-based awards pertaining to phantom stock units and restricted stock awards in accordance with the related awards' vesting provisions.

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

Net income per share is computed in accordance with SFAS No. 128, *Earnings Per Share*. Basic net income attributable to common stockholders per common share is computed by dividing net income by the weighted-average number of common shares outstanding. Unvested restricted stock and performance vested restricted stock units ( PVRSU ) are excluded from the computation of basic net income attributable to common stockholders per common share because the shares have not yet been earned by the shareholder. Stock options are also excluded since they are not considered outstanding shares. Diluted net income attributable to common stockholders per common share assumes dilution and is computed based on the weighted-average number of common shares outstanding after consideration of the dilutive effect of stock options, unvested restricted stock and PVRSU. The effect of dilutive securities is computed using the treasury stock method and average market prices during the period. Dilutive securities with performance conditions are excluded from the computation until the performance conditions are met.

**Income Taxes**

The Company accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS No. 109). Under SFAS No. 109, the liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on temporary differences between the financial

reporting bases and the tax bases of assets and liabilities. Deferred tax assets are also recognized for tax net operating loss carryforwards. These deferred tax assets and liabilities are measured using the enacted tax rates and laws that will be in effect when such amounts are expected to be reversed or utilized. The realization of total deferred tax assets is contingent upon the generation of future taxable income. Valuation allowances are provided to reduce such deferred tax assets to amounts more likely than not to be ultimately realized.

Income tax provision includes U.S. federal, state, local and foreign income taxes and is based on pre-tax income or loss. The interim period provision or benefit for income taxes is based upon the Company's estimate of its

**NEUSTAR, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

annual effective income tax rate. In determining the estimated annual effective income tax rate, the Company analyzes various factors, including projections of the Company's annual earnings and taxing jurisdictions in which the earnings will be generated, the impact of state and local income taxes and the ability of the Company to use tax credits and net operating loss carryforwards.

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109. FIN 48 is effective for fiscal years beginning after December 15, 2006, and was adopted by the Company on January 1, 2007. FIN 48 provides a two-step approach to recognize and measure tax benefits when the realization of the benefits is uncertain. The first step is to determine whether the benefit is to be recognized; the second step is to determine the amount to be recognized. Income tax benefits should be recognized when, based on the technical merits of a tax position, the entity believes that if a dispute arose with the taxing authority and were taken to a court of last resort, it is more likely than not (i.e., a probability of greater than 50 percent) that the tax position would be sustained as filed. If a position is determined to be more likely than not of being sustained, the reporting enterprise should recognize the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority. The cumulative effect of applying the provisions of FIN 48 upon adoption is to be reported as an adjustment to beginning retained earnings. The Company's practice is to recognize interest and penalties related to income tax matters in income tax expense.

**Foreign Currency**

Assets and liabilities of consolidated foreign subsidiaries, whose functional currency is the local currency, are translated to U.S. dollars at fiscal year end exchange rates. Revenue and expense items are translated to U.S. dollars at the average rates of exchange prevailing during the fiscal year. The adjustment resulting from translating the financial statements of such foreign subsidiaries to U.S. dollars is reflected as a cumulative translation adjustment and reported as a component of accumulated other comprehensive income (loss) in the Consolidated Statement of Stockholders (Deficit) Equity.

Transactions denominated in currencies other than the functional currency are recorded based on exchange rates at the time such transactions arise. Subsequent changes in exchange rates result in transaction gains or losses, which are reflected within other income (expense) in the consolidated statement of operations.

**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 Company includes unrealized holding gains and losses on available-for-sale securities, if any, and foreign currency translation adjustments in other comprehensive income in the Consolidated Statement of Stockholders (Deficit) Equity.

**Recent Accounting Pronouncements**

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 provides enhanced guidance for using fair value to measure assets and liabilities. It clarifies the principle that fair

value should be based on the assumptions market participants would use when pricing the asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of SFAS No. 157 on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159), to permit all entities to choose to elect, at specified election dates, to measure eligible financial instruments at fair value. An entity shall report unrealized gains and losses on items for which the fair

**NEUSTAR, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

value option has been elected in earnings at each subsequent reporting date, and recognize upfront costs and fees related to those items in earnings as incurred and not deferred. SFAS No. 159 applies to fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has also elected to apply the provisions of SFAS No. 157. An entity is prohibited from retrospectively applying SFAS No. 159, unless it chooses early adoption. The Company is currently evaluating the impact of the provisions of SFAS No. 159 on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS No. 141 (R)), which replaces SFAS No. 141. SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non-controlling interest in the acquiree and the goodwill acquired. SFAS No. 141(R) also establishes disclosure requirements which will enable users to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. Early adoption of this standard is prohibited. In the absence of any planned future business combinations, the Company does not currently expect SFAS No. 141(R) to have a material impact on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained non-controlling equity investments when a subsidiary is deconsolidated. The Statement also establishes reporting requirements that require sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. SFAS 160 is effective for fiscal years beginning after December 15, 2008. Early adoption of this standard is prohibited. In the absence of any noncontrolling (minority) interests, the Company does not currently expect SFAS No. 160 to have a material impact on its consolidated financial statements.

In February 2008, the FASB issued FASB Staff Position (FSP) FAS 157-b, *Effective Date of FASB Statement No. 157*, which would delay the effective date of SFAS No. 157, for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The effective date would be delayed by one year to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. The Company is currently evaluating the impact of FSP FAS 157-b, together with SFAS 157, on its consolidated financial statements.

In December 2007, the SEC issued Staff Accounting Bulletin No. 110 (SAB 110) which, effective January 1, 2008, expresses the views of the staff regarding the use of a "simplified" method, as discussed in SAB No. 107 ( "SAB 107" ), in developing an estimate of expected term of "plain vanilla" share options in accordance with SFAS No. 123(R). Under the simplified method, the expected term is calculated as the midpoint between the vesting date and the end of the contractual term of the option. In particular, SAB 107 provides for a company's election to use the simplified method, regardless of whether the company has sufficient information to make more refined estimates of expected term. The use of the simplified method was scheduled to expire on December 31, 2007, as it was anticipated that more detailed external information about employee exercise behavior would become available. SAB 110 extends the use of the simplified method for plain vanilla awards in certain situations. The Company expects to continue its use of the simplified method for awards after December 31, 2007 until such time that historical exercise information provides a more reliable estimate of the expected term.

### 3. ACQUISITIONS

#### **fiducianet, Inc.**

In February 2005, the Company acquired fiducianet, Inc. (Fiducianet) for \$2.2 million in cash and the issuance of 35,745 shares of the Company's common stock for total purchase consideration of \$2.6 million. The acquisition of Fiducianet enables the Company to serve as a single point of contact in managing all day-to-day customer



**NEUSTAR, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

obligations involving subpoenas, court orders and law enforcement agency requests under electronic surveillance laws including the Communications Assistance for Law Enforcement Act, the USA. Patriot Act of 2001 and the Homeland Security Act of 2002. The acquisition was accounted for as a purchase, and the results of Fiducianet have been included in the accompanying consolidated statements of operations since the date of the acquisition.

The Company allocated the purchase price principally to customer lists (\$2.6 million) and goodwill (\$1.1 million) based on their estimated fair values on the acquisition date. Customer lists are included in intangible assets and are being amortized on a straight-line basis over five years. In accordance with SFAS No. 109, the Company recorded a deferred tax liability of approximately \$1.0 million with a corresponding increase to goodwill. Goodwill is not deductible for tax purposes.

**Foretec Seminars Inc.**

In December 2005, the Company acquired Foretec Seminars, Inc. (Foretec) a provider of secretariat services to the Internet Engineering Task Force (IETF), from the Corporation for National Research Initiatives (CNRI) for \$875,000 in cash, of which \$500,000 is payable upon the achievement of certain milestones, as well as the payment of approximately \$213,000 in legal fees incurred by CNRI to establish a public trust to administer IETF-related intellectual property. In accordance with FASB Statement No. 141, *Business Combinations* (SFAS No. 141), the \$500,000 payable upon the achievement of certain milestones has been included in the purchase consideration since this amount was determinable as of the date of acquisition.

The acquisition was accounted for as a purchase and accordingly, the results of Foretec have been included in the accompanying consolidated statements of operations since the date of the acquisition. The purchase price was allocated to net liabilities assumed of approximately \$53,000 and goodwill (\$929,000) based on their estimated fair values on the acquisition date. Goodwill is not deductible for tax purposes. During 2006, the first milestone was achieved and the Company paid \$100,000 during the year ended December 31, 2006. During 2007, the second milestone was achieved and the Company paid \$100,000 during the year ended December 31, 2007. As of December 31, 2007, the Company determined that the remaining milestones would not be achieved and no further payments would be required in accordance with the acquisition agreement. As such, the Company eliminated the remaining liability with a corresponding reduction to goodwill.

**NeuLevel, Inc.**

In March 2006, the Company acquired 10% of NeuLevel, Inc. (NeuLevel), from Melbourne IT Limited for cash consideration of \$4.3 million, raising the Company's ownership interest from 90% to 100%. The acquisition of the remaining 10% of NeuLevel was accounted for as a purchase business combination in accordance with SFAS No. 141. The Company allocated the purchase price principally to customer relationships (\$4.1 million) based on their estimated fair values on the acquisition date. Customer relationships are included in intangible assets and are being amortized on an accelerated basis over five years. In accordance with SFAS No. 109, the Company recorded a deferred tax liability of approximately \$1.6 million with a corresponding increase to goodwill. Goodwill is not deductible for tax purposes.

**UltraDNS Corporation**

On April 21, 2006, the Company acquired UltraDNS Corporation (UltraDNS) for \$61.8 million in cash and acquisition costs of \$0.8 million. The acquisition further expanded the Company's domain name services and its Internet protocol technologies. The acquisition was accounted for as a purchase business combination in accordance with SFAS No. 141 and the results of operations of UltraDNS have been included in the accompanying consolidated statements of operations since the date of acquisition.

Of the total cash consideration, approximately \$6.1 million was distributed to an escrow account, of which \$6.0 million was allocated for indemnification claims as set forth in the acquisition agreement. The other

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

\$0.1 million was allocated for reimbursement of certain costs of the representative of the former stockholders of UltraDNS. On the first anniversary of the acquisition, \$5.8 million of the escrow account was distributed to the former UltraDNS stockholders in accordance with the acquisition agreement and \$0.2 million was returned to the Company to resolve claims under the acquisition agreement.

Under the purchase method of accounting, the total purchase price as shown in the table below was allocated to UltraDNS's net tangible and identifiable intangible assets based on their estimated fair values. The excess purchase price over the net tangible and identifiable intangible assets was recorded as goodwill. The purchase price was allocated as follows (in thousands):

|   |           |
|---|-----------|
| Accounts receivable                       | \$ 1,221  |
| Unbilled receivables                      | 360       |
| Prepaid expenses and other current assets | 298       |
| Property and equipment                    | 1,020     |
| Other assets                              | 63        |
| Deferred tax assets, net                  | 7,774     |
| Accounts payable                          | (173)     |
| Accrued expenses                          | (1,463)   |
| Deferred revenue                          | (472)     |
| Notes payable                             | (134)     |
| Other liabilities                         | (14)      |
| Net tangible assets acquired              | 8,480     |
| Definite-lived intangible assets acquired | 20,000    |
| Goodwill                                  | 33,920    |
| Total purchase price                      | \$ 62,400 |

Of the total purchase price, \$8.5 million has been allocated to net tangible assets acquired and \$20.0 million has been allocated to definite-lived intangible assets acquired. The Company utilized a third party valuation specialist to assist management in determining the fair value of the definite-lived intangible asset base. The income approach, which includes an analysis of cash flows and the risks associated with achieving such cash flows, was the primary technique utilized in valuing the identifiable intangible assets. The \$20.0 million of definite-lived intangible assets acquired consists of the value assigned to UltraDNS's direct customer relationships of \$14.7 million, web customer relationships of \$0.3 million, acquired technology of \$4.8 million, and trade names of \$0.2 million. The Company is amortizing the value of the UltraDNS direct and web customer relationships in proportion to the respective discounted cash flows over an estimated useful life of 7 and 5 years, respectively. Both acquired technology and trade names are being amortized on a straight-line basis over 3 years.

As a result of the UltraDNS acquisition, the Company recorded net deferred tax assets of \$7.8 million in purchase accounting. This balance is comprised primarily of \$15.8 million of deferred tax assets related to federal and state net operating losses, capitalized research and development, and certain amortization and depreciation expenses. These

deferred tax assets were offset by \$8.0 million in deferred tax liabilities resulting from the related intangibles identified from the acquisition. Of the total purchase price, approximately \$33.9 million has been allocated to goodwill. Goodwill is not deductible for tax purposes.

**Followap Inc.**

On November 27, 2006, the Company acquired Followap Inc. (Followap) for \$139.0 million in cash and acquisition costs of \$1.8 million along with the assumption and payment of certain Followap debt and other liabilities of \$5.6 million. Followap is a leading provider of next-generation communications solutions for network

## NEUSTAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

operators, delivering interoperability between operators and Internet portals in five different functional areas, which are instant messaging, presence, multimedia gateways, inter-carrier messaging hubs, and services for handset clients. The acquisition was accounted for as a purchase business combination in accordance with SFAS No. 141 and the results of operations of Followap have been included in the accompanying consolidated statements of operations since the date of acquisition.

Of the total cash consideration, approximately \$14.1 million was distributed to an escrow account, of which \$13.8 million will be used for indemnification claims as set forth in the acquisition agreement. The other \$0.3 million will be used for the reimbursement of certain costs and expenses of the representative for the former stockholders of Followap. All funds remaining in the account will be distributed to former Followap stockholders in accordance with the agreement and plan of merger following the resolution of any claims made pursuant to the agreement prior to the first anniversary of the acquisition.

Under the purchase method of accounting, the total purchase price is allocated to Followap's net tangible liabilities assumed and intangible assets acquired based on their estimated fair values as of November 27, 2006, the effective date of the acquisition. The excess purchase price over the net tangible and identifiable intangible liabilities was recorded as goodwill. The preliminary purchase price is allocated as follows (in thousands):

|   |            |
|---|------------|
| Cash and cash equivalents                 | \$ 2,218   |
| Accounts receivable                       | 1,161      |
| Prepaid expenses and other current assets | 283        |
| Property and equipment                    | 1,094      |
| Other assets                              | 870        |
| Accounts payable                          | (707)      |
| Accrued expenses                          | (3,223)    |
| Deferred revenue                          | (212)      |
| Other liabilities                         | (1,019)    |
| Deferred tax liabilities, net             | (646)      |
| Net tangible liabilities assumed          | (181)      |
| Definite-lived intangible assets acquired | 30,600     |
| Goodwill                                  | 115,945    |
| Total purchase price                      | \$ 146,364 |

Of the total estimated purchase price, a preliminary estimate of \$0.2 million has been allocated to net tangible liabilities assumed and \$30.6 million has been allocated to definite-lived intangible assets acquired. The Company utilized a third party valuation specialist in determining the fair value of the definite-lived intangible asset base. The income approach, which includes an analysis of cash flows and the risks associated with achieving such cash flows, was the primary technique utilized in valuing the identifiable intangible assets. The \$30.6 million of definite lived intangible assets acquired consists of the value assigned to Followap's customer relationships of \$20.8 million and acquired technology of \$9.8 million. The Company is amortizing the value of the Followap customer relationships

using an accelerated basis over five years and the value of the acquired technology on a straight-line basis over 3 years.

As a result of the Followap acquisition, the Company recorded net deferred tax liabilities of \$0.6 million in purchase accounting. This balance is comprised of \$11.2 million of deferred tax assets primarily related to federal and state net operating losses. These deferred tax assets were offset by \$11.8 million in deferred tax liabilities resulting from the related intangibles identified from the acquisition. Of the total purchase price, approximately \$115.9 million has been allocated to goodwill. Goodwill is not deductible for tax purposes.

**NEUSTAR, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****I-View.com**

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

***Pro Forma Financial Information for acquisitions of UltraDNS and Followap***

The unaudited financial information in the table below summarizes the combined results of operations of the Company, UltraDNS and Followap on a pro forma basis, as though the companies had been combined as of the beginning of each of the periods presented. The pro forma financial information is presented for information purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at the beginning of each of the periods presented. The pro forma financial information for all periods presented also includes amortization expense from acquired intangible assets, adjustments to interest income and related tax effects.

|  | <b>Year Ended December 31,</b>               |             |
|--|--|-------------|
|  | <b>2005</b>                                  | <b>2006</b> |
|  | <b>(In thousands, except per share data)</b> |             |
|  | <b>(unaudited)</b>                           |             |
| Total revenue  | \$ 267,387                                   | \$ 344,236  |
| Net income   | \$ 43,703                                    | \$ 57,201   |
| Net income attributable to common stockholders per common share: |  |             |
| Basic  | \$ 1.14                                      | \$ 0.79     |
| Diluted  | \$ 0.57                                      | \$ 0.73     |

**4. DEFERRED FINANCING COSTS**

During 2005 and 2006, the Company did not pay any loan origination fees. In 2007, the Company paid \$862,000 of loan origination fees related to its new credit facility. Total amortization expense was approximately \$57,000, \$7,000 and \$158,000 for the years ended December 31, 2005, 2006 and 2007, respectively, and is reported as interest expense in the consolidated statements of operations. As of December 31, 2006 and 2007, the balance of unamortized deferred financing fees was \$0 and \$704,000, respectively.

**NEUSTAR, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****5. PROPERTY AND EQUIPMENT**

Property and equipment consists of the following (in thousands):

|   | <b>December 31,</b> |             |
|---|---------------------|-------------|
|   | <b>2006</b>         | <b>2007</b> |
| Computer hardware                         | \$ 36,178           | \$ 51,188   |
| Equipment                                 | 1,572               | 1,891       |
| Furniture and fixtures                    | 1,379               | 2,377       |
| Leasehold improvements                    | 15,240              | 15,850      |
| Construction in-progress                  | 1,252               | 7,748       |
| Capitalized software                      | 39,319              | 39,463      |
|   | 94,940              | 118,517     |
| Accumulated depreciation and amortization | (52,262)            | (62,326)    |
| Property and equipment, net               | \$ 42,678           | \$ 56,191   |

The Company entered into capital lease obligations of \$5.2 million and \$5.6 million for the years ended December 31, 2006 and 2007, respectively, primarily for computer hardware.

Depreciation and amortization expense related to property and equipment for the years ended December 31, 2005, 2006 and 2007 was \$14.8 million, \$17.8 million and \$22.8 million, respectively.

**6. GOODWILL AND INTANGIBLE ASSETS**

Goodwill consists of the following (in thousands):

|          | <b>December 31,</b> |             |
|----------|---------------------|-------------|
|          | <b>2006</b>         | <b>2007</b> |
| Goodwill | \$ 205,855          | \$ 204,093  |

In January 2007, the Company recorded \$1.3 million of goodwill related to its acquisition of MetaInfo. During 2007, the Company recorded purchase price adjustments related to its 2006 acquisitions of UltraDNS and Followap. The adjustments for UltraDNS increased amounts recorded to goodwill by \$800,000. The adjustments for Followap reduced the amounts recorded to goodwill by \$3.7 million.





## NEUSTAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Intangible assets consist of the following (in thousands):

|                                       | <b>December 31,</b> |             | <b>Weighted-<br/>Average<br/>Amortization<br/>Period<br/>(in years)</b> |
|---------------------------------------|---------------------|-------------|---|
|                                       | <b>2006</b>         | <b>2007</b> |   |
| Intangible assets:                    |                     |             |   |
| Customer lists and relationships      | \$ 43,467           | \$ 43,740   | 5.7   |
| Accumulated amortization              | (5,817)             | (15,463)    |   |
| Customer lists and relationships, net | 37,650              | 28,277      |   |
| Acquired technology                   | 16,808              | 17,068      | 3.0   |
| Accumulated amortization              | (3,416)             | (8,581)     |   |
| Acquired technology, net              | 13,392              | 8,487       |   |
| Trade name                            | 200                 | 200         | 3.0   |
| Accumulated amortization              | (46)                | (113)       |   |
| Trade name, net                       | 154                 | 87          |   |
| Intangible assets, net                | \$ 51,196           | \$ 36,851   |   |

Amortization expense related to intangible assets for the years ended December 31, 2005, 2006 and 2007 of approximately \$1.2 million, \$6.2 million and \$14.9 million, respectively, is included in depreciation and amortization expense. Amortization expense related to intangible assets for the years ended December 31, 2008, 2009, 2010, 2011 and 2012 is expected to be approximately \$13.2 million, \$11.0 million, \$6.5 million, \$5.0 million and \$0.9 million, respectively.

**7. ACCRUED EXPENSES**

Accrued expenses consist of the following (in thousands):

|                      | <b>December 31,</b> |             |
|----------------------|---------------------|-------------|
|                      | <b>2006</b>         | <b>2007</b> |
| Accrued compensation | \$ 29,720           | \$ 27,967   |
| RRC reserve          | 2,908               | 3,624       |

|       |           |           |
|-------|-----------|-----------|
| Other | 16,832    | 15,910    |
|       | \$ 49,460 | \$ 47,501 |

## NEUSTAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 8. NOTES PAYABLE

Notes payable consist of the following (in thousands):

|   | December 31, |          |
|---|--------------|----------|
|   | 2006         | 2007     |
| Promissory note payable to vendor; principal and interest payable quarterly at 2.08% per annum with a maturity date of April 1, 2007; secured by the equipment financed | 164          |          |
| Promissory note payable to vendor; principal and interest payable quarterly at 0.0% per annum with a maturity date of May 18 2007; secured by the equipment financed    | 693          |          |
| Promissory note payable to vendor; principal and interest payable quarterly at 6.31% per annum with a maturity date of April 1, 2008; secured by the equipment financed | 85           | 35       |
| Promissory note payable to vendor; principal and interest payable quarterly at 5.58% per annum with a maturity date of April 1, 2010; secured by the equipment financed |              | 804      |
| Promissory note payable to vendor; non-interest bearing, principal payable quarterly with a maturity date of April 1, 2010; secured by the equipment financed           |              | 6,868    |
|   | 942          | 7,707    |
| Less: current portion   | (768)        | (2,501)  |
| Notes payable, long-term  | \$ 174       | \$ 5,206 |

As of December 31, 2007, remaining principal payments under promissory notes payable are as follows (in thousands):

|       |          |
|-------|----------|
| 2008  | \$ 2,501 |
| 2009  | 3,429    |
| 2010  | 1,777    |
| Total | \$ 7,707 |

**Revolving Credit Facility**

In August 2002, the Company entered into a Revolving Credit Facility (Revolving Credit Facility), which provided the Company with up to \$15 million in available credit. Borrowings under the Revolving Credit Facility were either Base Rate loans or Eurodollar rate loans. Base Rate loans bore interest at a fluctuating rate per annum equal to the higher of the federal funds rate plus 0.5% or the lender's prime rate. Eurodollar rate loans bore interest at the Eurodollar rate plus the applicable margin. There were no outstanding borrowings under the Revolving Credit Facility at December 31, 2005 and December 31, 2006; however, total available borrowings were reduced by outstanding

letters of credit of \$10.7 million and \$9.6 million at December 31, 2005 and December 31, 2006, respectively (see Note 9), which reduced the amount the Company may borrow under the Revolving Credit Facility.

The Company's obligations under the Revolving Credit Facility were secured by substantially all of the Company's assets. Under the terms of the Revolving Credit Facility, the Company was required to comply with certain financial covenants such as maintaining minimum levels of consolidated net worth, quarterly consolidated EBITDA, and liquid assets and not exceeding certain levels of capital expenditures and leverage ratios. Additionally, there were negative covenants that limited the Company's ability to declare or pay dividends, acquire additional indebtedness, incur liens, dispose of significant assets, make acquisitions or significantly change

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

the nature of the business without permission of the lender. During 2004, 2005 and 2006, the Company was not in compliance with certain covenants and obtained waivers for such defaults. On February 6, 2007, the Company terminated the Revolving Credit Facility.

On February 6, 2007, the Company entered into a new credit agreement, which provides for a revolving credit facility in an aggregate principal amount of up to \$100 million (2007 Credit Facility). Borrowings under the 2007 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 such spread in each case depending on the ratio of the Company's consolidated senior funded indebtedness to consolidated EBITDA. The 2007 Credit Facility expires on February 6, 2012. Borrowings under the 2007 Credit Facility may be used for working capital, capital expenditures, general corporate purposes and to finance acquisitions. There were no borrowings outstanding under the 2007 Credit Facility as of December 31, 2007, but available borrowings were reduced by letters of credit of \$10.1 million outstanding on that date.

The 2007 Credit Facility contains customary representations and warranties, affirmative and negative covenants, and events of default. The 2007 Credit Facility requires the Company to maintain a minimum consolidated EBITDA to consolidated interest charge ratio and a maximum consolidated senior funded indebtedness to consolidated EBITDA ratio. If an event of default occurs and is continuing, the Company may be required to repay all amounts outstanding under the 2007 Credit Facility. Lenders holding more than 50% of the loans and commitments under the 2007 Credit Facility may elect to accelerate the maturity of amounts due thereunder upon the occurrence and during the continuation of an event of default. As of and for the year ended December 31, 2007, the Company was in compliance with these covenants.

**9. COMMITMENTS and CONTINGENCIES****Capital Leases**

The following is a schedule of future minimum lease payments due under capital lease obligations (in thousands):

|   |          |
|---|----------|
| 2008                                    | \$ 4,101 |
| 2009                                    | 3,860    |
| 2010                                    | 2,326    |
| Total minimum lease payments            | 10,287   |
| Less: amounts representing interest     | (1,059)  |
| Present value of minimum lease payments | 9,228    |
| Less: current portion                   | (3,511)  |
| Capital lease obligation, long-term     | \$ 5,717 |

The following assets were capitalized under capital leases at the end of each period presented (in thousands):

|                                | <b>December 31,</b> |             |
|--------------------------------|---------------------|-------------|
|                                | <b>2006</b>         | <b>2007</b> |
| Equipment and hardware         | \$ 18,166           | \$ 24,107   |
| Furniture and fixtures         | 334                 | 334         |
|                                | 18,500              | 24,441      |
| Less: accumulated amortization | (10,376)            | (15,337)    |
|                                | \$ 8,124            | \$ 9,104    |

**NEUSTAR, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Operating Leases**

The Company leases office space under noncancelable operating lease agreements. The leases terminate at various dates through 2017 and generally provide for scheduled rent increases. Future minimum lease payments under noncancelable operating leases as of December 31, 2007, are as follows (in thousands):

|            |           |
|------------|-----------|
| 2008       | \$ 8,510  |
| 2009       | 8,143     |
| 2010       | 5,823     |
| 2011       | 2,835     |
| 2012       | 2,189     |
| Thereafter | 3,689     |
|            | \$ 31,189 |

Rent expense was \$3.6 million, \$4.6 million and \$6.7 million for the years ended December 31, 2005, 2006 and 2007, respectively.

**Contingencies**

Currently, and from time to time, the Company is involved in litigation incidental to the conduct of its business. The Company is not a party to any lawsuit or proceeding that, in the opinion of management, is reasonably possible to have a material adverse effect on its financial position, results of operations or cash flows.

**10. RESTRUCTURING CHARGES****Workforce Reduction**

The restructuring program during 2005 resulted in workforce reductions of approximately 20 employees which were located in the Company's Oakland, California office. The Company recorded workforce reduction charges of \$317,000 during the year ended December 31, 2005, primarily for severance and fringe benefits.

**Closure of Excess Facilities**

During 2005, the Company recorded a change in estimate of approximately \$706,000 to reduce the restructuring liability due to a change in the Company's assumptions regarding the sub-lease rate for this property.

At December 31, 2006 and 2007, the accrued liability associated with the restructuring and other related charges was \$2.6 million and \$2.2 million, respectively. Amounts related to the lease termination due to the closure of excess facilities will be paid over the respective lease terms, the longest of which extends through 2011. The Company paid approximately \$1.9 million, \$534,000 and \$368,000, in the years ended December 31, 2005, 2006 and 2007, respectively, related to restructuring charges.





## NEUSTAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 11. INCOME TAXES

The provision for income taxes consists of the following components (in thousands):

|                                  | Year Ended December 31, |           |           |
|----------------------------------|-------------------------|-----------|-----------|
|                                  | 2005                    | 2006      | 2007      |
| Current:                         |                         |           |           |
| Federal                          | \$ 32,381               | \$ 50,054 | \$ 47,478 |
| State                            | 5,905                   | 9,129     | 10,837    |
| Total current                    | 38,286                  | 59,183    | 58,315    |
| Deferred:                        |                         |           |           |
| Federal                          | (876)                   | (6,585)   | 2,572     |
| State                            | (159)                   | (1,245)   | (111)     |
| Total deferred                   | (1,035)                 | (7,830)   | 2,461     |
| Total provision for income taxes | \$ 37,251               | \$ 51,353 | \$ 60,776 |

A reconciliation of the statutory United States income tax rate to the effective income tax rate follows:

|                               | Year Ended December 31, |       |       |
|-------------------------------|-------------------------|-------|-------|
|                               | 2005                    | 2006  | 2007  |
| Tax at statutory rate         | 35.0%                   | 35.0% | 35.0% |
| State taxes                   | 4.1                     | 4.0   | 4.6   |
| AMT credit/tax                | 1.6                     | 0.0   | 0.0   |
| Other                         | (0.5)                   | 2.0   | (0.1) |
| Change in valuation allowance | 0.0                     | 0.0   | 0.2   |
| Effective tax rate            | 40.2%                   | 41.0% | 39.7% |

The Company realized certain tax benefits related to nonqualified and incentive stock option exercises in the amounts of \$17.0 million, \$49.5 million and \$20.8 million for the years ended December 31, 2005, 2006 and 2007.

## NEUSTAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's net deferred income taxes are as follows (in thousands):

|                                       | <b>December 31,</b> |                  |
|---------------------------------------|---------------------|------------------|
|                                       | <b>2006</b>         | <b>2007</b>      |
| Deferred tax assets:                  |                     |                  |
| Domestic NOL carryforwards            | \$ 21,105           | \$ 17,379        |
| Foreign NOL carryforwards             | 1,011               | 760              |
| Restructuring accrual                 | 1,002               | 908              |
| Deferred revenue                      | 7,887               | 7,436            |
| Accrued compensation                  | 1,330               | 1,350            |
| Stock-based compensation expense      | 3,589               | 6,320            |
| Other reserves                        | 90                  | 16               |
| Other                                 | 1,840               | 2,591            |
| <b>Total deferred tax assets</b>      | <b>37,854</b>       | <b>36,760</b>    |
| Valuation allowance                   | (1,011)             | (1,787)          |
| <b>Total deferred tax assets, net</b> | <b>36,843</b>       | <b>34,973</b>    |
| Deferred tax liabilities:             |                     |                  |
| Unbilled receivables                  | (315)               | (151)            |
| Depreciation and amortization         | (1,634)             | (4,968)          |
| Identifiable intangibles              | (20,000)            | (14,148)         |
| Deferred expenses                     | (2,693)             | (3,815)          |
| Other                                 | (60)                | (199)            |
| <b>Total deferred tax liabilities</b> | <b>(24,702)</b>     | <b>(23,281)</b>  |
| <b>Net deferred tax assets</b>        | <b>\$ 12,141</b>    | <b>\$ 11,692</b> |

As of December 31, 2007, the Company had U.S. net operating loss carryforwards for federal tax purposes of approximately \$43.1 million which expire, if unused, in various years from 2022 to 2027. As of December 31, 2007, the Company had foreign net operating loss carryforwards of approximately \$4.2 million, \$4.1 million of which can be carried forward indefinitely under current local tax laws and \$0.1 million can be carried forward through 2014.

As of December 31, 2007, the approximate amount of earnings from foreign subsidiaries that the Company considers permanently reinvested and for which deferred taxes have not been provided was approximately \$1.1 million. United States income taxes have not been provided on earnings that are planned to be reinvested indefinitely outside the United States and determination of the amount of such taxes is not practicable.

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the adoption of FIN 48, the Company recognized no material adjustment in the liability for unrecognized income tax benefits. At the adoption date of January 1, 2007, the Company had \$2.2 million of unrecognized tax benefits on a gross basis or \$0.8 million on a tax effected basis. At December 31, 2007, the Company had unrecognized tax benefits of \$2.0 million on a tax effected basis, of which \$1.5 million would affect the Company's effective tax rate if recognized. The net increase in

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

the liability for unrecognized income tax benefits since the date of adoption resulted from the following (in thousands):

|  |          |
|--|----------|
| Balance at January 1, 2007                       | \$ 825   |
| Increase related to tax positions of prior years | 1,215    |
| Other  | (70)     |
| Balance at December 31, 2007                     | \$ 1,970 |

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of December 31, 2007, there was approximately \$220,000 of accrued interest related to uncertain tax positions. To the extent interest is 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 2004 through 2006 remain open to examination by the major taxing jurisdictions to which the Company is subject.

The Company anticipates that total unrecognized tax benefits will decrease by approximately \$0.8 million over the next 12 months due to the expiration of certain statutes of limitations.

**12. CONVERTIBLE PREFERRED STOCK**

Prior to the Company's initial public offering on June 28, 2005 (See Note 1), holders of 100,000 shares of Series B Voting Convertible Preferred Stock (Series B), 28,569,692 shares of Series C Voting Convertible Preferred Stock (Series C), and 9,098,525 shares of Series D Voting Convertible Preferred Stock (Series D) converted their shares into 500,000, 28,569,692, and 9,098,525 shares of the Company's common stock, respectively, after which each share of common stock was split by means of a reclassification into 1.4 shares of Class B common stock and subsequently converted, at the election of the holder, into Class A common stock.

**Series B Preferred Stock**

The holders of the Series B were entitled to receive preferential cumulative dividends in cash at the rate per share of 6% of stated value (\$0.651) or \$0.04 per annum, compounded quarterly. Dividends were declared and paid on the Series B. Each share of Series B was convertible into seven shares of common stock, subject to anti-dilution adjustments, and was entitled to that number of votes. Conversion into common stock was automatic in the event of an underwritten public offering (or a combination of offerings) of common stock with gross proceeds to the Company of not less than \$50 million (Qualified IPO). In the event of liquidation, dissolution, or winding up of the Company, the holders of the Series B would have received, on par with the holders of the Series C, a liquidation preference of \$0.651 per share plus any accrued and unpaid dividends per share. Dividends on the Series B were approximately \$2,000 for the year ended December 31, 2005. All accrued and unpaid dividends were fully paid in cash on June 28, 2005 in connection with the Company's initial public offering.

The Series B had a deemed liquidation provision included among the rights given to its holders whereby, upon the sale of the Company or substantially all the Company's assets, the holders of the Series B were entitled to elect to receive a cash payment equal to the liquidation preference or the amount of consideration that would have been payable had the Series B converted to common stock.

**Series C Preferred Stock**

The holders of the Series C were entitled to receive cumulative dividends in cash at the rate per share of 6% of stated value (\$2.956) or \$0.18 per annum, compounded quarterly. Dividends were declared and paid on the Series C in preference in respect to other series of stock determined as subordinate. The Series C were convertible to

**NEUSTAR, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

common shares on a 1.4-for-1 basis, subject to anti-dilution adjustments. Upon a Qualified IPO, the Series C would have automatically converted to common stock at the applicable conversion price. Each share of Series C was entitled to the same number of votes as the shares of common stock into which it was convertible. The Company also had the right to redeem, in whole or in part, the Series C outstanding at the Series C redemption price of \$2.956 per share, plus an amount equal to any and all dividends accrued and unpaid, with consent of the holders of a majority of the Series C. In the event of liquidation, dissolution, or winding up of the Company, the holders of the Series C would have received, on par with the holders of the Series B, a liquidation preference of \$2.956 per share plus any accrued and unpaid dividends per share. Dividends on the Series C were approximately \$2.5 million for the year ended December 31, 2005. All accrued and unpaid dividends were fully paid in cash on June 28, 2005 in connection with the Company's initial public offering.

The Series C had a deemed liquidation provision included among the rights given to its holders whereby, upon the sale of the Company or substantially all the Company's assets, the holders of the Series C were entitled to elect to receive a cash payment equal to the liquidation preference or the amount of consideration that would have been payable had the Series C converted to common stock.

**Series D Preferred Stock**

Holders of the Series D were entitled to receive cumulative dividends in cash at the rate per share of 6% of stated value (\$5.935) or \$0.36 per annum, compounded quarterly. Dividends were declared and paid on the Series D. Upon a Qualified IPO, the Series D would have automatically converted to common stock at the conversion price applicable at that time. Each share of Series D was entitled to that number of votes as the shares of common stock into which it was convertible.

During the period commencing on August 5, 2006 and ending September 5, 2006, the holders of a majority of the then-outstanding shares of Series D could have required the Company to engage an independent investment banker to seek a third-party purchaser for then-outstanding Series D at not less than the applicable liquidation amount or some or all of the Company's assets or to sell additional securities to fund the redemption of the Series D, such that the holders of such shares would have received the applicable liquidation amount. If the shares of Series D had not been purchased or redeemed by the Company prior to June 5, 2007, the Company would have been required to redeem such shares on that date. If a majority of the holders of Series D did not elect to have their shares redeemed, a certain holder of Series D had a one-month period ending in October 2006 to have required the Company to redeem its shares on June 5, 2009. If the board of directors had determined that funds would not be reasonably available to satisfy the redemption obligation, the Company would not have been required to do so, provided that it increased the dividend rate on shares held by a certain holder of Series D by 0.5% per annum, up to a maximum dividend rate of 15% per annum. Series D was redeemable in amounts equal to the original investment plus accrued and unpaid dividends. The redemption amount of the Series D, \$54.0 million plus accrued and unpaid dividends, was accreted to its redemption rate.

In the event of a liquidation, dissolution, or winding up of the Company, the holders of the Series D were entitled to a liquidation preference over holders of all other series of preferred and common stock. The holders of the Series B and C were pari passu and had preference over the common stockholders. Dividends on and accretion of the Series D were approximately \$1.6 million for the year ended December 31, 2005. All accrued and unpaid dividends were fully paid in cash on June 28, 2005 in connection with the Company's initial public offering.

### **13. STOCKHOLDERS (DEFICIT) EQUITY**

#### **Preferred Stock**

The Company is authorized to issue up to 100,000,000 shares of preferred stock, \$0.001 par value per share, in one or more series, to establish from time to time the number of shares to be included in each series, and to fix the rights, preferences, privileges, qualifications, limitations and restrictions of the shares of each wholly unissued series.



**NEUSTAR, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Common Stock**

The Company is authorized to issue up to 200,000,000 shares of Class A common stock, \$0.001 par value per share and 100,000,000 shares of Class B common stock, \$0.001 par value per share. Each holder of Class A and Class B common stock is entitled to one vote for each share of common stock held on all matters submitted to a vote of stockholders. Subject to preferences that may apply to shares of preferred stock outstanding at the time, the holders of Class A and Class B common stock are entitled to receive dividends out of assets legally available at the times and in the amounts as the Company's board of directors may from time to time determine.

On June 28, 2005, the Company made an initial public offering of 31,625,000 shares of Class A common stock, which included the underwriters' over-allotment option exercise of 4,125,000 shares of Class A common stock. All the shares of Class A common stock sold in the IPO were sold by selling stockholders and, as such, the Company did not receive any proceeds from the offering. In connection with this transaction, the Company incurred offering costs and other IPO-related expenses of approximately \$4.9 million.

On December 6, 2005, the Company completed an additional offering (December 2005 offering) of 20,000,000 shares of Class A common stock. All the shares of Class A common stock sold in the December 2005 offering were sold by selling stockholders and, as such, the Company did not receive any proceeds from that offering. In connection with this transaction, the Company incurred offering costs of approximately \$900,000.

**Warrants**

In prior years, the Company issued warrants to purchase 6,361,383 shares of common stock at \$0.0667 per share in connection with certain debt financings. On December 12, 2005, the Company issued 6,361,383 shares of Class A common stock upon the exercise these warrants in exchange for cash proceeds of approximately \$424,000.

**Stock-Based Compensation**

The Company has two stock incentive plans, the NeuStar, Inc. 1999 Equity Incentive Plan (the 1999 Plan) and the NeuStar, Inc. 2005 Stock Incentive Plan (the 2005 Plan). Under the 1999 Plan, the Company had the ability to grant to its directors, employees and consultants stock or stock-based awards in the form of incentive stock options, nonqualified stock options, stock appreciation rights, performance share units, shares of restricted common stock, phantom stock units and other stock-based awards. In May 2005, the Company's board of directors adopted the 2005 Plan, which was approved by the Company's stockholders in June 2005. In connection with the adoption of the 2005 Plan, the Company's board of directors amended the 1999 Plan to provide that no further awards would be granted under the 1999 Plan as of the date stockholder approval for the 2005 Plan was obtained. All shares available for grant as of that date, plus any other shares under the 1999 Plan that again become available due to forfeiture, expiration, settlement in cash or other termination of awards without issuance, will be available for grant under the 2005 Plan. Under the 2005 Plan, the Company may grant to its directors, employees and consultants awards in the form of incentive stock options, nonqualified stock options, stock appreciation rights, shares of restricted stock, restricted stock units, performance awards and other stock-based awards. The aggregate number of shares of Class A common stock with respect to which all awards may be granted under the 2005 Plan is 6,044,715, plus any shares available for issuance under the 1999 Plan. As of December 31, 2007, 4,102,926 shares were available for grant or award under the 2005 Plan.

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

## NEUSTAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The board of directors or Compensation Committee of the board of directors 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 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 under SFAS No. 123(R) for the year ended December 31, 2007 was \$15.3 million. As of December 31, 2007, total unrecognized compensation expense related to non-vested stock options, non-vested restricted stock and non-vested performance vested restricted stock units granted prior to that date is estimated at \$27.5 million, which the Company expects to recognize over a weighted average period of approximately 2.2 years. Total unrecognized compensation expense as of December 31, 2007 is estimated based on outstanding non-vested stock options, non-vested restricted stock and non-vested performance vested restricted stock units, and may be increased or decreased in future periods for subsequent grants or forfeitures.

The following table illustrates the effect on net income attributable to common stockholders and net income attributable to common stockholders per common share if the Company had applied the fair value recognition provisions of SFAS No. 123(R) to stock-based employee compensation for the year ended December 31, 2005. The pro forma disclosure for the year ended December 31, 2005 utilized the Black-Scholes option-pricing model to estimate the value of the respective options with such value amortized to compensation expense over the options vesting periods.

|   | <b>Year Ended<br/>December 31,<br/>2005</b>      |
|---|--|
|   | <b>(In thousands, except<br/>per share data)</b> |
| Pro forma basic net income attributable to common stockholders:   |  |
| Basic net income attributable to common stockholders, as reported   | \$ 51,085  |
| Add: stock-based compensation expense included in reported net income attributable to common stockholders | 1,607  |
| Deduct: total stock-based compensation expense determined under fair value-based method for all awards    | (6,282)  |
| Pro forma basic net income attributable to common stockholders  | \$ 46,410  |
| Pro forma diluted net income attributable to common stockholders:   |  |
| Basic net income attributable to common stockholders, as reported   | \$ 51,085  |
| Dividends on and accretion of convertible preferred stock   | 4,313  |
| Diluted net income attributable to common stockholders  | 55,398   |
| Add: stock-based compensation expense included in reported net income attributable to common stockholders | 1,607  |
|   | (6,282)  |

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Deduct: total stock-based compensation expense determined under fair value-based method for all awards

|  |    |        |
|--|----|--------|
| Pro forma diluted net income attributable to common stockholders | \$ | 50,723 |
| Net income attributable to common stockholders per common share: |    |        |
| Basic as reported  | \$ | 1.48   |
| Basic pro forma  | \$ | 1.35   |
| Diluted as reported  | \$ | 0.72   |
| Diluted pro forma  | \$ | 0.66   |

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

The above pro forma disclosures are provided for 2005 because, in contrast to the presentation for the years ended December 31, 2006 and 2007, stock-based compensation expense was not recognized using the fair-value method under SFAS No. 123(R) during the period presented. Pro forma disclosure has not been presented for the years ended December 31, 2006 and 2007 because stock-based compensation expense has been recognized by the Company in accordance with the fair-value method set forth in SFAS No. 123(R) for such periods.

The Company has utilized the Black-Scholes option-pricing model for estimating the fair value of stock options granted during the year ended December 31, 2005, as well as for option grants during all prior periods. The weighted-average fair value of options at the date of grant for options granted during the year ended December 31, 2005 was \$11.19.

As a result of adopting SFAS 123(R) on January 1, 2006, the Company's income before income taxes and net income for the year ended December 31, 2006 were approximately \$10.4 million and \$7.6 million less, respectively, than if the Company had not adopted SFAS 123(R). The Company's income before income taxes and net income for the year ended December 31, 2007 were approximately \$11.0 million and \$7.6 million less, respectively, than if the Company had not adopted SFAS 123(R). Basic and diluted net income attributable to common stockholders per common share for the year ended December 31, 2006 were each approximately \$0.10 less than if the Company had not adopted SFAS 123(R). Basic and diluted net income attributable to common stockholders per common share for the year ended December 31, 2007 were each approximately \$0.10 less than if the Company had not adopted SFAS 123(R). Upon the adoption of SFAS No. 123(R), the Company continued to utilize the Black-Scholes option pricing model for estimating the fair value of stock options granted during the year ended December 31, 2006. The weighted-average fair value of options at the date of grant for options granted during the years ended December 31, 2006 and 2007 was \$12.24 and \$11.60, respectively. The following are the weighted-average assumptions used in valuing the stock options granted during the years ended December 31, 2006 and 2007, and a discussion of the Company's assumptions.

|                                     | <b>Year Ended<br/>December 31,</b> |             |
|-------------------------------------|------------------------------------|-------------|
|                                     | <b>2006</b>                        | <b>2007</b> |
| Dividend yield                      | 0.00%                              | 0.00%       |
| Expected volatility                 | 38.56%                             | 33.27%      |
| Risk-free interest rate             | 4.68%                              | 4.39%       |
| Expected life of options (in years) | 4.56                               | 4.59        |

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

**Expected volatility** Volatility is a measure of the amount by which a financial variable such as a share price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. Given the Company's limited historical stock data from its initial public offering in June 2005, the Company has used a blended volatility to estimate expected volatility. The blended volatility includes the average of the Company's preceding weekly historical volatility from its initial public offering to the respective grant date, the Company's preceding six-months market implied volatility and an average of the Company's peer group preceding weekly historical volatility consistent with the expected life of the option. Market implied volatility is the volatility implied by the trading prices of publicly

available stock options for the Company's common stock. The Company's peer group historical volatility includes the historical volatility of companies that are similar in revenue size, in the same industry or are competitors.

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

**Expected life of the options** This is the period of time that the options granted are expected to remain outstanding. This estimate is derived from the average midpoint between the weighted average vesting period and the contractual term as described in the SEC's Staff Accounting Bulletin No. 107, *Share-Based Payment*.

## NEUSTAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Stock Options

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

|                                  | Shares      | Weighted-Average Exercise Price |
|----------------------------------|-------------|---------------------------------|
| Outstanding at December 31, 2004 | 14,375,642  | \$ 3.29                         |
| Options granted                  | 1,149,844   | 20.33                           |
| Options exercised                | (2,588,631) | 3.07                            |
| Options forfeited                | (315,302)   | 6.10                            |
| Outstanding at December 31, 2005 | 12,621,553  | 4.81                            |
| Options granted                  | 1,547,200   | 31.10                           |
| Options exercised                | (5,919,098) | 3.33                            |
| Options forfeited                | (332,927)   | 10.26                           |
| Outstanding at December 31, 2006 | 7,916,728   | 10.83                           |
| Options granted                  | 932,030     | 32.78                           |
| Options exercised                | (2,492,811) | 5.75                            |
| Options forfeited                | (687,446)   | 21.14                           |
| Outstanding at December 31, 2007 | 5,668,501   | 15.42                           |
| Exercisable at December 31, 2007 | 3,501,651   | 8.54                            |
| Exercisable at December 31, 2006 | 4,382,608   | 3.86                            |
| Exercisable at December 31, 2005 | 8,692,844   | 2.41                            |

The following table summarizes information regarding options outstanding at December 31, 2007:

| Range of Exercise Price | Options Outstanding           |                                 | Weighted-Average Remaining Contractual Life (in years) | Options Exercisable           |                                 |
|-------------------------|-------------------------------|---------------------------------|--|-------------------------------|---------------------------------|
|                         | Number of Options Outstanding | Weighted-Average Exercise Price |  | Number of Options Exercisable | Weighted-Average Exercise Price |

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|                   |           |         |      |           |         |
|-------------------|-----------|---------|------|-----------|---------|
| \$ 0.00 - \$ 3.20 | 1,463,957 | \$ 0.28 | 2.58 | 1,463,957 | \$ 0.28 |
| \$ 3.21 - \$ 6.24 | 224,327   | 4.49    | 5.27 | 224,327   | 4.49    |
| \$ 6.25 - \$ 6.41 | 531,300   | 6.25    | 6.48 | 416,993   | 6.25    |
| \$ 6.42 - \$ 8.38 | 667,286   | 6.43    | 5.97 | 502,150   | 6.43    |
| \$ 8.39 - \$10.86 | 324,501   | 9.27    | 6.97 | 194,173   | 9.51    |
| \$10.87 - \$22.00 | 273,051   | 22.00   | 7.49 | 103,469   | 22.00   |
| \$22.01 - \$30.20 | 849,862   | 30.00   | 5.39 | 384,481   | 29.94   |
| \$30.21 - \$34.84 | 1,334,217 | 32.90   | 6.24 | 212,101   | 33.09   |
|                   | 5,668,501 | 15.42   | 5.22 | 3,501,651 | 8.54    |

The aggregate intrinsic value of options exercised for the years ended December 31, 2005, 2006 and 2007 was \$59.0 million, \$161.4 million and \$62.5 million, respectively. The aggregate intrinsic value for all options outstanding under the Company's stock plans as of December 31, 2007 was \$82.0 million. The aggregate intrinsic value for options exercisable under the Company's stock plans as of December 31, 2007 was \$72.0 million. The weighted-average remaining contractual life for all options outstanding under the Company's stock plans as of December 31, 2007 was 5.22 years. The weighted-average remaining contractual life for options exercisable under the Company's stock plans as of December 31, 2007 was 4.62 years.



## NEUSTAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In February 2005, the Company granted fully vested options to nonemployees for the purchase of 22,400 shares of common stock at a weighted average exercise price of \$10.86 per share. The Company recognized compensation expense of approximately \$180,000. The fair value of these awards was calculated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions: expected life of the award equal to the remaining contractual life; volatility 63.11%; risk-free interest rate, 3.38%; and dividend yield of 0.00% during the option term.

In March 2005, an employee of the Company changed status to a consultant and, in accordance with the terms of that employee's original option agreement, continued to vest in 26,250 options as of March 29, 2005. As a result, the Company re-measured the fair value of the vested options and recognized compensation expense of approximately \$331,000. The fair value of this award was calculated on the modification date using the Black-Scholes option-pricing model with the following weighted average assumptions: expected life of the award equal to the remaining contractual life; volatility 63.11%; risk-free interest rate, 3.43%; and dividend yield of 0.00% during the option term.

In March 2005, the Company accelerated the vesting of certain options issued to nonemployees. This acceleration enabled the optionholders to vest immediately in approximately 102,000 options, which otherwise would have vested over the options' original vesting period, generally 48 months. In connection with this acceleration, the Company recorded approximately \$1.6 million as compensation expense based on the fair value of the options on the date of acceleration. The fair value of these awards was remeasured on the acceleration date using the Black-Scholes option-pricing model with the following weighted average assumptions: expected life of the award equal to the remaining contractual life; volatility 63.11%; risk-free interest rate, 3.72%; and dividend yield of 0.00% during the option term. As of March 31, 2005, all options granted to nonemployees had vested.

**Restricted Stock**

The following table summarizes the Company's non-vested restricted stock activity:

|                                  | Shares  | Weighted-Average<br>Grant Date<br>Fair Value |
|----------------------------------|---------|--|
| Outstanding at December 31, 2004 |         |  |
| Restricted stock granted         | 5,000   | \$ 31.95                                     |
| Restricted stock vested          |         |  |
| Restricted stock forfeited       |         |  |
| Outstanding at December 31, 2005 | 5,000   | 31.95  |
| Restricted stock granted         | 102,490 | 31.37  |
| Restricted stock vested          | (2,367) | 31.43  |
| Restricted stock forfeited       | (1,900) | 30.57  |
| Outstanding at December 31, 2006 | 103,223 | 31.41  |

|                                  |          |       |
|----------------------------------|----------|-------|
| Restricted stock granted         | 18,800   | 31.78 |
| Restricted stock vested          | (27,538) | 31.48 |
| Restricted stock forfeited       | (18,825) | 31.13 |
| Outstanding at December 31, 2007 | 75,660   | 31.55 |

The total aggregate intrinsic value of restricted stock vested during the year ended December 31, 2007 was approximately \$790,000. The aggregate intrinsic value for all restricted stock outstanding under the Company's stock plans as of December 31, 2007 was \$2.2 million. During the year ended December 31, 2007, the Company repurchased 6,817 shares of common stock for an aggregate purchase price of approximately \$210,000 pursuant to

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

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, 2007, the Company granted approximately 322,290 performance vested restricted stock units (PVRsUs) to certain employees with an aggregate fair value of \$10.5 million. 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. The performance conditions affect 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. Under SFAS No. 123(R), compensation expense related to these awards is being recognized over the requisite service period based on the Company's estimate of the achievement of the performance target. The Company has currently estimated that 125% of the target will be achieved. The fair value is measured by the closing market price of the Company's common stock on the date of the grant. Compensation expense is recognized ratably over the requisite service period based on those PVRsUs expected to vest.

The following table summarizes the Company's non-vested PVRsU activity for the year ended December 31, 2007:

|                              | Shares   | Weighted-Average<br>Grant Date<br>Fair Value |
|------------------------------|----------|--|
| Non-vested December 31, 2006 |          |  |
| Granted                      | 322,290  | 32.59  |
| Vested                       |          |  |
| Forfeited                    | (19,210) | 32.59  |
| Non-vested December 31, 2007 | 303,080  | 32.59  |

The aggregate intrinsic value for all non-vested PVRsUs outstanding under the Company's stock plans at December 31, 2007 was \$8.7 million.

**Restricted Stock Units**

In July 2006, the Compensation Committee of the board of directors issued 27,170 restricted stock units to the Company's non-management directors. The aggregate intrinsic value of the restricted stock units granted totaled \$880,000. For those directors who were elected at the 2006 Annual Meeting of Stockholders, as well as incumbent directors whose terms did not expire in 2006, these restricted stock units were granted on July 1, 2006. For those directors appointed by the Company's board of directors on July 26, 2006, the date of grant was July 27, 2006. In August and November 2007, the Company's non-management directors were issued 30,828 and 3,342 restricted stock units, respectively, with an aggregate intrinsic value on the grant date of approximately \$900,000 and \$114,000, respectively.

These restricted stock units will fully vest on the first anniversary of the date of grant. Upon vesting, each director's restricted stock units will be automatically 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. Following the resignation of two of the Company's directors on July 26, 2006 and April 10, 2007, respectively, a total of 6,518 restricted stock units were forfeited.

The aggregate intrinsic value for these restricted stock units as of December 31, 2007 was approximately \$1.6 million.

### **Phantom Stock Units**

In July 2004, the board of directors granted 350,000 phantom stock units to one of the Company's executive officers. Effective March 1, 2007, the officer was no longer employed with the Company. On that date, 224,383

## NEUSTAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

phantom stock units vested in accordance with the terms of the officer's phantom stock agreement, which had an aggregate intrinsic value of approximately \$7.3 million. Of the 224,383 shares of the Company's common stock issuable to the officer in respect of his vested phantom stock units, the Company repurchased 91,713 shares on March 1, 2007 for an aggregate purchase price of approximately \$3.0 million pursuant to the officer's right under the applicable stock incentive plan to elect to use common stock to satisfy his tax withholding obligations.

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

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

|   | Year Ended December 31, |           |           |
|---|-------------------------|-----------|-----------|
|   | 2005                    | 2006      | 2007      |
| Basic net income attributable to common stockholders per common share:        |                         |           |           |
| Net income  | \$ 55,398               | \$ 73,899 | \$ 92,335 |
| Dividends on and accretion of convertible preferred stock                     | (4,313)                 |           |           |
| Basic net income attributable to common stockholders                          | \$ 51,085               | \$ 73,899 | \$ 92,335 |
| Basic net income attributable to common stockholders per common share         | \$ 1.48                 | \$ 1.02   | \$ 1.22   |
| Diluted net income attributable to common stockholders per common share:      |                         |           |           |
| Basic net income attributable to common stockholders                          | \$ 51,085               | \$ 73,899 | \$ 92,335 |
| Dividends on and accretion of convertible preferred stock                     | 4,313                   |           |           |
| Diluted net income attributable to common stockholders                        | \$ 55,398               | \$ 73,899 | \$ 92,335 |
| Diluted net income attributable to common stockholders per common share       | \$ 0.72                 | \$ 0.94   | \$ 1.17   |
| Weighted average common shares outstanding - basic                            | 34,437                  | 72,364    | 75,954    |
| Dilutive effect of:   |                         |           |           |
| Stock options for the purchase of common stock                                | 10,163                  | 5,903     | 3,281     |
| Conversion of preferred stock and accrued dividends payable into common stock | 26,453                  |           |           |
| Warrants for the purchase of common stock                                     | 5,993                   |           |           |
| Weighted average common shares outstanding - diluted                          | 77,046                  | 78,267    | 79,235    |

#### 15. SEGMENT INFORMATION

Prior to January 1, 2007, the Company operated in one business segment; providing critical technology services to the communications industry, including telephone number administration, telephone number pooling, internet domain name services, common short code registry services, wireline and wireless number portability, order management services, and network management services. The Company was not organized by market and was managed and operated as one business. A single management team reported to the chief operating decision maker who comprehensively managed the business. The Company did not operate any material separate lines of business or separate business entities with respect to its services. Accordingly, the Company did not accumulate discrete financial information with respect to separate service lines and did not have separately reportable segments as defined by SFAS No. 131, *Disclosure About Segments of an Enterprise and Related Information* (SFAS No. 131).

## NEUSTAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On November 27, 2006, the Company acquired Followap Inc. (Followap) and became a provider of next-generation communications solutions for mobile network operators by delivering instant messaging, presence, multimedia gateways, and inter-carrier messaging hubs. As a result of the Followap acquisition, the Company began accumulating discrete financial information with respect to separate service lines with separate reportable segments as defined by SFAS No. 131. The Company operated in two reportable business segments for the year ended December 31, 2007, Clearinghouse Services and Next Generation Messaging (NGM) Services, and only one business segment, Clearinghouse Services, for the corresponding year ended December 31, 2006.

Information for the year ended December 31, 2007 regarding the Company's reportable operating segments is as follows (in thousands):

|                               | Clearinghouse<br>Services | NGM<br>Services | Consolidated<br>Total |
|-------------------------------|---------------------------|-----------------|-----------------------|
| Revenue                       | \$ 421,062                | \$ 8,110        | \$ 429,172            |
| Depreciation and amortization | \$ 28,241                 | \$ 9,490        | \$ 37,731             |
| Income (loss) from operations | \$ 184,955                | \$ (35,309)     | \$ 149,646            |
| Capital expenditures          | \$ 24,371                 | \$ 2,873        | \$ 27,244             |

Information as of December 31, 2007 regarding the Company's reportable operating segments is as follows (in thousands):

|                   | Clearinghouse<br>Services | NGM<br>Services | Consolidated<br>Total |
|-------------------|---------------------------|-----------------|-----------------------|
| Total assets      | \$ 449,523                | \$ 167,138      | \$ 616,661            |
| Goodwill          | \$ 88,148                 | \$ 115,945      | \$ 204,093            |
| Intangible assets | \$ 14,973                 | \$ 21,878       | \$ 36,851             |

Geographic area revenues from external customers for the year ended December 31, 2007, and long-lived assets as of December 31, 2007 were as follows (in thousands):

|                                | Revenue    | Long-Lived<br>Assets |
|--------------------------------|------------|----------------------|
| North America                  | \$ 403,536 | \$ 61,027            |
| Europe, Middle East and Africa | 17,004     | 32,012               |
| Other regions                  | 8,632      | 3                    |
| Total                          | \$ 429,172 | \$ 93,042            |

## **16. EMPLOYEE BENEFIT PLANS**

The Company has a 401(k) Profit-Sharing Plan for the benefit of all employees who meet certain eligibility requirements. This plan covers substantially all of the Company's full-time employees. The plan documents provide for the Company to make matching and other discretionary contributions, as determined by the board of directors. The Company recognized contribution expense totaling \$2.0 million, \$2.4 million and \$4.3 million for the years ended December 31, 2005, 2006 and 2007, respectively.

## **17. RELATED PARTY TRANSACTIONS**

During the years ended December 31, 2005, 2006 and 2007, the Company received professional services from a company owned by a family member of the Chairman and CEO of the Company. The services were related to tenant improvements in the Company's leased office spaces. The amounts paid to the related party during the years ended December 31, 2005, 2006 and 2007 were approximately \$99,000, \$292,000 and \$227,000, respectively. As of December 31, 2006 and 2007, the Company owed \$58,000 and \$2,000 for outstanding payables to this party.



## NEUSTAR, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In March 2006, the Company acquired 10% of NeuLevel, Inc. from Melbourne IT Limited (MIT), raising the Company's ownership interest from 90% to 100%. Prior to the acquisition of the remaining 10% ownership interest, the Company had an agreement with MIT whereby MIT served as a registrar for domain names within the .biz top-level domain. During the years ended December 31, 2005 and 2006, the Company recorded approximately \$684,000 and \$837,000, respectively, in revenue from MIT related to domain name registration services and other nonrecurring revenue from IP claim notification services and pre-registration services.

## 18. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

|   | Quarter Ended                         |                  |                  |                  |
|---|---------------------------------------|------------------|------------------|------------------|
|   | Mar. 31,<br>2006                      | Jun. 30,<br>2006 | Sep. 30,<br>2006 | Dec. 31,<br>2006 |
|   | (In thousands, except per share data) |                  |                  |                  |
| Summary consolidated statement of operations:                             |                                       |                  |                  |                  |
| Total revenue   | \$ 76,163                             | \$ 82,263(1)     | \$ 82,509(1)     | \$ 92,022        |
| Income from operations  | 30,275                                | 32,728           | 27,930           | 31,690           |
| Net income  | 18,285                                | 19,952           | 17,104           | 18,558           |
| Net income attributable to common stockholders per common share - basic   | \$ 0.26                               | \$ 0.28          | \$ 0.23          | \$ 0.25          |
| Net income attributable to common stockholders per common share - diluted | \$ 0.24                               | \$ 0.26          | \$ 0.22          | \$ 0.24          |

|   | Quarter Ended                         |                  |                  |                  |
|---|---------------------------------------|------------------|------------------|------------------|
|   | Mar. 31,<br>2007                      | Jun. 30,<br>2007 | Sep. 30,<br>2007 | Dec. 31,<br>2007 |
|   | (In thousands, except per share data) |                  |                  |                  |
| Summary consolidated statement of operations:                             |                                       |                  |                  |                  |
| Total revenue   | \$ 97,448                             | \$ 99,693        | \$ 110,757       | \$ 121,274       |
| Income from operations  | 29,332                                | 31,401           | 41,894           | 47,019           |
| Net income  | 17,968                                | 19,149           | 25,702           | 29,516           |
| Net income attributable to common stockholders per common share - basic   | \$ 0.24                               | \$ 0.25          | \$ 0.34          | \$ 0.38          |
| Net income attributable to common stockholders per common share - diluted | \$ 0.23                               | \$ 0.24          | \$ 0.32          | \$ 0.37          |

(1) Revenue for the quarters ended September 30, 2005, December 31, 2005, June 30, 2006 and September 30, 2006 reflects contractual pricing discounts based on pre-established annual aggregate transaction volume targets under the Company's contracts with North American Portability Management LLC, which had an impact of \$5.0 million, \$2.5 million, \$2.1 million and \$5.4 million, respectively.

**19. SUBSEQUENT EVENT**

On January 10, 2008, the Company acquired certain assets of Webmetrics, Inc., a provider of web and network performance testing, monitoring and measurement services, for cash consideration of \$12.5 million subject to certain purchase price adjustments and contingent cash consideration of up to \$6.0 million. The acquisition of Webmetrics expands the Company's Internet and infrastructure services. The acquisition was accounted for as a purchase. The Company is currently in the process of completing its preliminary purchase price allocation.

## **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

Not applicable.

### **ITEM 9A. CONTROLS AND PROCEDURES**

Attached as exhibits to this Form 10-K are certifications of our Chief Executive Officer and Chief Financial Officer, which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended. This

Controls and Procedures section includes information concerning the controls and controls evaluation referred to in the certifications. The report of Ernst & Young LLP, our independent registered public accounting firm, regarding its audit of our internal control over financial reporting is set forth below in this section. This section should be read in conjunction with the certifications and the Ernst & Young report for a more complete understanding of the topics presented.

#### **Evaluation of Disclosure Controls and Procedures**

We conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Form 10-K. The controls evaluation was conducted under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. Disclosure controls are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, such as this Form 10-K, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls are also designed to reasonably assure that such information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our quarterly evaluation of disclosure controls includes an evaluation of some components of our internal control over financial reporting, and internal control over financial reporting is also separately evaluated on an annual basis for purposes of providing the management report which is set forth below.

The evaluation of our disclosure controls included a review of the controls' objectives and design, our implementation of the controls and their effect on the information generated for use in this Form 10-K. In the course of the controls evaluation, we reviewed identified data errors, control problems or indications of potential fraud and, where appropriate, sought to confirm that appropriate corrective actions, including process improvements, were being undertaken. This type of evaluation is performed on a quarterly basis so that the conclusions of management, including the Chief Executive Officer and Chief Financial Officer, concerning the effectiveness of the disclosure controls can be reported in our periodic reports on Form 10-Q and Form 10-K. Many of the components of our disclosure controls are also evaluated on an ongoing basis by our finance organization. The overall goals of these various evaluation activities are to monitor our disclosure controls, and to modify them as necessary. Our intent is to maintain the disclosure controls as dynamic systems that change as conditions warrant.

Based upon the controls evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this Form 10-K, our disclosure controls were effective to provide reasonable assurance that information required to be disclosed in our Securities Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the SEC, and that material information related to NeuStar and its consolidated subsidiaries is made known to management, including the Chief Executive Officer and Chief Financial Officer, particularly during the period when our periodic reports are being prepared. We reviewed the results of management's evaluation with the Audit Committee of our Board of Directors.

#### **Management Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining effective internal control over financial reporting to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the

company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles; and (iii) provide reasonable assurance regarding authorization to effect the acquisition, use or disposition of company assets, as well as the prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Management assessed our internal control over financial reporting as of December 31, 2007, the end of our fiscal year. Management based its assessment on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management's assessment included evaluation of such elements as the design and operating effectiveness of key financial reporting controls, process documentation, accounting policies and our overall control environment. This assessment is supported by testing and monitoring performed by our finance organization.

Based on this assessment, management has concluded that our internal control over financial reporting was effective as of the end of the fiscal year to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

Our independent registered public accounting firm, Ernst & Young LLP, independently assessed the effectiveness of the company's internal control over financial reporting. Ernst & Young has issued an attestation report, which is included at the end of this section.

#### **Inherent Limitations on Effectiveness of Controls**

A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Other inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

#### **Changes in Internal Control over Financial Reporting**

On a quarterly basis we evaluate any changes to our internal control over financial reporting to determine if material changes occurred. There were no changes in our internal controls over financial reporting during the quarterly period ended December 31, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM  
ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Board of Directors and Stockholders  
NeuStar, Inc.

We have audited NeuStar, Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). NeuStar, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, NeuStar, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007 based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of NeuStar, Inc. as of December 31, 2006 and 2007, and the related consolidated statements of operations, shareholders' (deficit) equity, and cash flows for each of the three years in the period ended December 31, 2007 and our report dated February 25, 2008 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

McLean, Virginia  
February 25, 2008



**ITEM 9B. OTHER INFORMATION**

None.

**PART III**

**ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT AND CORPORATE GOVERNANCE**

Information about our directors and executive officers and our corporate governance is incorporated by reference to our definitive proxy statement for our 2008 Annual Meeting of Stockholders, or our 2008 Proxy Statement, which is anticipated to be filed with the Securities and Exchange Commission within 120 days of December 31, 2007, under the headings Board of Directors, Executive Officers and Management and Governance of the Company. Information about compliance with Section 16(a) of the Exchange Act is incorporated by reference to our 2008 Proxy Statement under the heading Section 16(a) Beneficial Ownership Reporting Compliance. Information about our Audit Committee, including the members of the Audit Committee, and Audit Committee financial experts, is incorporated by reference to our 2008 Proxy Statement under the heading Governance of the Company. Information about the NeuStar policies on business conduct governing our employees, including our Chief Executive Officer, Chief Financial Officer and our controller, is incorporated by reference to our 2008 Proxy Statement under the heading Governance of the Company.

**ITEM 11. EXECUTIVE COMPENSATION**

Information about director and executive officer compensation is incorporated by reference to our 2008 Proxy Statement, under the headings Governance of the Company.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

Information required by Item 12 of this report is incorporated by reference to our 2008 Proxy Statement, under the headings Beneficial Ownership of Shares of Common Stock and Equity Compensation Plan Information.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by Item 13 of this report is incorporated by reference to our 2008 Proxy Statement, under the heading Governance of the Company.

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

Information about the fees for professional services rendered by our independent auditors in 2006 and 2007 is incorporated by reference to the discussion under the heading Audit and Non-Audit Fees in our 2008 Proxy Statement. Our audit committee's policy on pre-approval of audit and permissible non-audit services of our independent auditors is incorporated by reference from the discussion under the heading Governance of the Company.



**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

(a) Documents filed as part of this report:

(1)

|   | <b>Page</b> |
|---|-------------|
| Report of Independent Registered Public Accounting Firm   | 47          |
| Consolidated Financial Statements covered by the Report of Independent Registered Public Accounting Firm:     |             |
| Consolidated Balance Sheets as of December 31, 2006 and 2007  | 48          |
| Consolidated Statements of Operations for the years ended December 31, 2005, 2006 and 2007                    | 50          |
| Consolidated Statements of Stockholders (Deficit) Equity for the years ended December 31, 2005, 2006 and 2007 | 51          |
| Consolidated Statements of Cash Flows for the years ended December 31, 2005, 2006 and 2007                    | 52          |
| Notes to the Consolidated Financial Statements  | 53          |

(2)

|  |    |
|--|----|
| Schedule for the three years ended December 31, 2005, 2006 and 2007: |    |
| II Valuation and Qualifying Accounts                                 | 92 |

(a) (3) and (b) Exhibits required by Item 601 of Regulation S-K:

## NEUSTAR, INC.

## SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS

|   | As of December 31, |          |          |
|---|--------------------|----------|----------|
|   | 2005               | 2006     | 2007     |
|   | (In thousands)     |          |          |
| <b>Allowance for Doubtful Accounts</b>        |                    |          |          |
| Beginning Balance                             | \$ 468             | \$ 494   | \$ 1,103 |
| Additions                                     | 551                | 2,041    | 2,601    |
| Reductions(1)                                 | (525)              | (1,432)  | (2,050)  |
| Ending Balance                                | \$ 494             | \$ 1,103 | \$ 1,654 |
| <b>Deferred Tax Asset Valuation Allowance</b> |                    |          |          |
| Beginning Balance                             | \$                 | \$       | \$ 1,011 |
| Additions                                     |                    | 1,011    | 776      |
| Reductions                                    |                    |          |          |
| Ending Balance                                | \$                 | \$ 1,011 | \$ 1,787 |

(1) Includes the reinstatement and subsequent collections of account receivable that were previously written-off.

Exhibits identified in parentheses below are on file with the SEC and are incorporated herein by reference. All other exhibits are provided as part of this electronic submission.

| Exhibit Number | Description of Exhibit  |
|----------------|---|
| (2.1)          | Agreement and Plan of Merger, dated as of April 19, 2006, by and among NeuStar, Inc., UDNS Merger Sub, Inc., UltraDNS Corporation, and Ron Lachman as the Holder Representative, incorporated herein by reference to Exhibit 2.1 to our Current Report on Form 8-K, filed April 25, 2006.   |
| (2.2)          | Agreement and Plan of Merger, dated as of November 27, 2006, by and among Neustar, Inc., Followap Inc., B&T Merger Sub, Inc. and Carmel V.C. Ltd. And Sequoia Seed Capital II L.P. (Israel), as Holder Representatives, incorporated herein by reference to Exhibit 2.1 to our Current Report on Form 8-K, filed November 27, 2006.   |
| (3.1)          | Restated Certificate of Incorporation, incorporated herein by reference to Exhibit 3.1 to Amendment No. 7 to our 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 3.1 to our Current Report on Form 8-K, filed July 13, 2007.  |
| (10.1)         | Contractor services agreement entered into the 7th day of November 1997 by and between NeuStar, Inc. and North American Portability Management LLC, as amended, incorporated herein by reference to (a) Exhibit 10.1 to our Quarterly Report on Form 10-Q, filed August 15, 2005; (b) Exhibit 10.1.1. to our Annual Report on Form 10-K, filed March 29, 2006; (c) Exhibit 10.1.2 to our Quarterly Report on Form 10-Q, filed August 14, 2006; (d) Exhibit 10.1.3 to our Quarterly Report on Form 10-Q, filed August 14, 2006**;                                |
| 10.1.1         | Amendment to the contractor services agreement by and between NeuStar, Inc. and North American Portability Management LLC, as amended**.  |
| (10.2)         | Contractor services agreement, restated as of June 1, 2003, by and between Canadian LNP Consortium Inc. and NeuStar, Inc., as amended, incorporated herein by reference to (a) Exhibit 10.2 to Amendment No. 6 to our Registration Statement on Form S-1, filed June 28, 2005 (File No. 333-123635); (b) Exhibit 10.2.1 to our Quarterly Report on Form 10-Q, filed August 15, 2005; (c) Exhibit 10.2.1 to our Annual Report on Form 10-K, filed March 29, 2006; (d) Exhibit 10.2.2 to our Annual Report on Form 10-K filed March 29, 2006; (e) Exhibit 10.2.3. |

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to our Quarterly Report on Form 10-Q, filed August 14, 2006\*\*; (f) Exhibit 10.2.1. to our Annual Report on Form 10-K, filed March 1, 2007\*\*; (g) Exhibit 10.2.2 to our Annual Report on Form 10-K, filed March 1, 2007\*\*; (h) Exhibit 10.2.3 to our Annual Report on Form 10-K, filed March 1, 2007\*\*; (i) Exhibit 10.2.4 to our Quarterly Report on Form 10-Q, filed August 8, 2007\*\*; and (j) Exhibit 10.2.5 to our Quarterly Report on Form 10-Q, filed August 8, 2007\*\*.

- 10.2.1 Amendment to the contractor services agreement between Canadian LNP Consortium Inc. and NeuStar, Inc., as amended.\*\*
- 10.2.2 Amendment to the contractor services agreement between Canadian LNP Consortium Inc. and NeuStar, Inc., as amended.\*\*
- (10.3) National Thousands-Block Pooling Administration agreement awarded to NeuStar, Inc. by the Federal Communications Commission, effective August 14, 2007, incorporated herein by reference to our Quarterly Report on Form 10-Q, filed November 5, 2007\*\*.
- 10.3.1 Amendments to the National Thousands-Block Pooling Administration agreement awarded to NeuStar, Inc. by the Federal Communications Commission.

| Exhibit Number | Description of Exhibit  |
|----------------|---|
| (10.4)         | North American Numbering Plan Administrator agreement awarded to NeuStar, Inc. by the Federal Communications Commission, effective July 9, 2003, incorporated herein by reference to (a) Exhibit 10.4 to Amendment No. 7 to our Registration Statement on Form S-1, filed June 28, 2005 (File No. 333-123635); (b) Exhibit 10.4.1 to our Current Report on Form 8-K, filed September 15, 2005; (c) Exhibit 10.4.1 to our Annual Report on Form 10-K, filed March 29, 2006; (d) Exhibit 10.4.2 to our Quarterly Report on Form 10-Q, filed August 14, 2006; (e) Exhibit 10.4.3 to our Quarterly Report on Form 10-Q, filed November 14, 2006; (f) Exhibit 10.4.1 to our Annual Report on Form 10-K, filed March 1, 2007; (g) Exhibit 10.4.2 to our Quarterly Report on Form 10-Q, filed May 10, 2007; (h) Exhibit 10.4.3 to our Quarterly Report on Form 10-Q, filed August 10, 2007; and (i) Exhibit 10.4.4 to our Quarterly Report on Form 10-Q, filed November 5, 2007. |
| 10.4.1         | Amendment to the North American Numbering Plan Administrator agreement awarded to NeuStar, Inc. by the Federal Communications Commission.   |
| 10.5           | .us Top-Level Domain Registry Management and Coordination agreement awarded to NeuStar, Inc. by the National Institute of Standards and Technology on behalf of the Department of Commerce on October 18, 2007.   |
| (10.6)         | Registry Agreement by and between the Internet Corporation for Assigned Names and Numbers and NeuStar, Inc., dated as of December 18, 2006, as amended, incorporated herein by reference to Exhibit 10.6 to our Quarterly Report on Form 10-Q, filed August 8, 2007.  |
| (10.7)         | Common Short Code License Agreement made and entered into October 17, 2003, by and between the Cellular Telecommunications and Internet Association and NeuStar, Inc., incorporated herein by reference to (a) Exhibit 10.7 to Amendment No. 7 to our Registration Statement on Form S-1, filed June 28, 2005 (File No. 333-123635); (b) Exhibit 10.7.1 to our Annual Report on Form 10-K, filed March 29, 2006; (c) Exhibit 10.7.2 to our Quarterly Report on Form 10-Q, filed November 14, 2006**; and (d) Exhibit 10.7.1 to our Quarterly Report on Form 10-Q, filed May 10, 2007.   |
| (10.8)         | NeuStar, Inc. 1999 Equity Incentive Plan (the 1999 Plan ), incorporated herein by reference to Exhibit 10.8 to Amendment No. 3 to our Registration Statement on Form S-1, filed May 27, 2005 (File No. 333-123635).   |
| (10.9)         | NeuStar, Inc. 2005 Stock Incentive Plan (the 2005 Plan ), incorporated herein by reference to Exhibit 10.51 to our Quarterly Report on Form 10-Q, filed August 8, 2007.   |
| (10.10)        |   |

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Incentive Stock Option Agreement under the 1999 Plan, made as of April 10, 2000, by and between NeuStar, Inc. and Jeffrey Ganek, incorporated herein by reference to Exhibit 10.10 to Amendment No. 1 to our Registration Statement on Form S-1, filed April 8, 2005 (File No. 333-123635).

- (10.11) Incentive Stock Option Agreement under the 1999 Plan, made as of April 10, 2000, by and between NeuStar, Inc. and Mark Foster, incorporated herein by reference to Exhibit 10.11 to Amendment No. 1 to our Registration Statement on Form S-1, filed April 8, 2005 (File No. 333-123635).
- (10.12) Incentive Stock Option Agreement under the 1999 Plan, made as of June 6, 2002, by and between NeuStar, Inc. and Jeffrey Ganek, incorporated herein by reference to Exhibit 10.14 to Amendment No. 1 to our Registration Statement on Form S-1, filed April 8, 2005 (File No. 333-123635).
- (10.13) Incentive Stock Option Agreement under the 1999 Plan, made as of June 6, 2002, by and between NeuStar, Inc. and Mark Foster, incorporated herein by reference to Exhibit 10.15 to Amendment No. 1 to our Registration Statement on Form S-1, filed April 8, 2005 (File No. 333-123635).
- (10.14) Nonqualified Stock Option Agreement under the 1999 Plan, made as of June 6, 2002, by and between NeuStar, Inc. and Jeffrey Ganek, incorporated herein by reference to Exhibit 10.16 to Amendment No. 1 to our Registration Statement on Form S-1, filed April 8, 2005 (File No. 333-123635).

| Exhibit Number | Description of Exhibit  |
|----------------|---|
| (10.15)        | Incentive Stock Option Agreement under the 1999 Plan, made as of December 18, 2003, by and between NeuStar, Inc. and Jeffrey Ganek, as amended as of June 22, 2004, incorporated herein by reference to Exhibit 10.20 to Amendment No. 1 to our Registration Statement on Form S-1, filed April 8, 2005 (File No. 333-123635).  |
| (10.16)        | Incentive Stock Option Agreement under the 1999 Plan, made as of December 18, 2003, by and between NeuStar, Inc. and Mark Foster, as amended as of June 22, 2004, incorporated herein by reference to Exhibit 10.22 to Amendment No. 1 to our Registration Statement on Form S-1, filed April 8, 2005 (File No. 333-123635).    |
| (10.17)        | Nonqualified Option Agreement under the 1999 Plan, made as of December 18, 2003, by and between NeuStar, Inc. and Jeffrey Ganek, as amended as of June 22, 2004, incorporated herein by reference to Exhibit 10.24 to Amendment No. 1 to our Registration Statement on Form S-1, filed April 8, 2005 (File No. 333-123635).     |
| (10.18)        | Nonqualified Stock Option Agreement under the 1999 Plan, made as of December 18, 2003, by and between NeuStar, Inc. and Mark Foster, as amended as of June 22, 2004, incorporated herein by reference to Exhibit 10.26 to Amendment No. 1 to our Registration Statement on Form S-1, filed April 8, 2005 (File No. 333-123635). |
| (10.19)        | Incentive Stock Option Agreement under the 1999 Plan, made as of June 22, 2004, by and between NeuStar, Inc. and Jeffrey Babka, as amended as of May 20, 2005, incorporated herein by reference to Exhibit 10.28 to Amendment No. 3 to our Registration Statement on Form S-1, filed May 27, 2005 (File No. 333-123635).        |
| (10.20)        | Nonqualified Stock Option Agreement under the 1999 Plan, made as of June 22, 2004, by and between NeuStar, Inc. and Jeffrey Babka, as amended as of May 20, 2005, incorporated herein by reference to Exhibit 10.29 to Amendment No. 3 to our Registration Statement on Form S-1, filed May 27, 2005 (File No. 333-123635).     |
| (10.21)        | Nonqualified Stock Option Agreement under the 1999 Plan, made as of April 10, 2000, by and between NeuStar, Inc. and Ken Pickar, incorporated herein by reference to Exhibit 10.34 to Amendment No. 1 to our Registration Statement on Form S-1, filed April 8, 2005 (File No. 333-123635).                                     |
| (10.22)        | Nonqualified Stock Option Agreement under the 1999 Plan, made as of February 14, 2005, by and between NeuStar, Inc. and Jim Cullen, incorporated herein by reference to Exhibit 10.35 to Amendment No. 1 to our Registration Statement on Form S-1, filed April 8, 2005 (File No. 333-123635).                                  |

- (10.23) Loudoun Tech Center Office Lease by and between Merritt-LT1, LLC, Landlord, and NeuStar, Inc., Tenant, incorporated herein by reference to Exhibit 10.37 to Amendment No. 2 to our Registration Statement on Form S-1, filed May 11, 2005 (File No. 333-123635).
- (10.24) Credit Agreement, dated as of February 6, 2007, among NeuStar, Inc., JPMorgan Chase Bank, N.A., and other lenders, incorporated herein by reference to Exhibit 10.1 to our Current Report on Form 8-K, filed February 9, 2007, and Exhibit 10.31.1 to our Quarterly Report on Form 10-Q, filed November 5, 2007.
- (10.25) Guarantee Agreement dated February 6, 2007 among certain subsidiaries of NeuStar, Inc. in favor of JPMorgan Chase Bank, N.A., as administrative agent for the lenders, incorporated herein by reference to Exhibit 10.2 to our Current Report on Form 8-K, filed February 9, 2007.
- (10.26) NeuStar, Inc. Annual Performance Incentive Plan, incorporated herein by reference to Exhibit 99.2 to our Current Report on Form 8-K, filed July 13, 2007.
- (10.27) NeuStar, Inc. 2007 Key Employee Severance Pay Plan, incorporated herein by reference to Exhibit 99.1 to our Current Report on Form 8-K, filed July 13, 2007.
- (10.28) Executive Relocation Policy, incorporated herein by reference to Exhibit 10.35 to our Annual Report on Form 10-K, filed March 1, 2007.
- (10.29) Employment Continuation Agreement, made as of April 8, 2004, by and between NeuStar, Inc. and Jeffrey Ganek, incorporated herein by reference to Exhibit 10.43 to Amendment No. 3 to our Registration Statement on Form S-1, filed May 27, 2005 (File No. 333-123635).



| <b>Exhibit Number</b> | <b>Description of Exhibit</b>   |
|-----------------------|---|
| (10.30)               | Employment Continuation Agreement, made as of April 8, 2004, by and between NeuStar, Inc. and Mark Foster, incorporated herein by reference to Exhibit 10.44 to Amendment No. 3 to our Registration Statement on Form S-1, filed May 27, 2005 (File No. 333-123635).            |
| (10.31)               | Form of Restricted Stock Agreement under the 2005 Plan, incorporated herein by reference to Exhibit 10.45 to Amendment No. 3 to our Registration Statement on Form S-1, filed May 27, 2005 (File No. 333-123635).   |
| (10.32)               | Form of Nonqualified Stock Option Agreement under the 2005 Plan, incorporated herein by reference to Exhibit 99.4 to our Quarterly Report on Form 10-Q, filed March 5, 2007.  |
| (10.33)               | Form of Incentive Stock Option Agreement under the 2005 Plan, incorporated herein by reference to Exhibit 10.47 to Amendment No. 3 to our Registration Statement on Form S-1, filed May 27, 2005 (File No. 333-123635).   |
| (10.34)               | Summary of relocation arrangement with Jeffrey A. Babka, incorporated herein by reference to Exhibit 10.48 to Amendment No. 3 to our Registration Statement on Form S-1, filed May 27, 2005 (File No. 333-123635).  |
| (10.35)               | Form of Indemnification Agreement, incorporated herein by reference to Exhibit 10.49 to Amendment No. 5 to our Registration Statement on Form S-1, filed June 10, 2005 (File No. 333-123635).   |
| (10.36)               | Summary Description of Non-Management Director Compensation incorporated herein by reference to Exhibit 10.50 to our Quarterly Report on Form 10-Q, filed August 8, 2007.   |
| (10.37)               | Form of Directors Restricted Stock Unit Agreement, incorporated herein by reference to Exhibit 99.2 to our Current Report on Form 8-K, filed April 14, 2006.  |
| (10.38)               | Form of Performance Award Agreement under the NeuStar, Inc 2005 Stock Incentive Plan, as amended, incorporated herein by reference to Exhibit 99.3 to our Current Report on Form 8-K, filed July 13, 2007.  |
| (10.39)               | Incentive Stock Option Agreement under the 1999 Plan, made as of November 18, 2004, by and between NeuStar, Inc. and John Spirtos, as amended as of May 20, 2005, incorporated herein by reference to Exhibit 10.52 to our Quarterly Report on Form 10-Q, filed August 8, 2007. |

- (10.40) Nonqualified Stock Option Agreement under the 1999 Plan, made as of November 18, 2004, by and between NeuStar, Inc. and John Spirtos, as amended as of May 20, 2005, incorporated herein by reference to Exhibit 10.53 to our Quarterly Report on Form 10-Q, filed August 8, 2007.
- (10.98) .us Top-Level Domain Registry Management and Coordination agreement awarded to NeuStar, Inc. by the National Institute of Standards and Technology on behalf of the Department of Commerce on October 26, 2001, incorporated herein by reference to (a) Exhibit 10.5 to Amendment No. 7 to our Registration Statement on Form S-1, filed June 28, 2005 (File No. 333-123635); (b) Exhibit 10.5.1 to our Quarterly Report on Form 10-Q, filed November 14, 2005; (c) Exhibit 10.5.2 to our Quarterly Report on Form 10-Q, filed November 14, 2005; (d) Exhibit 10.5.3 to our Quarterly Report on Form 10-Q, filed November 14, 2006; (e) Exhibit 10.5.1 to our Annual Report on Form 10-K, filed March 1, 2007; and (f) Exhibit 10.5.2 to our Quarterly Report on Form 10-Q, filed May 10, 2007.
- 10.99 Amendments to .us Top-Level Domain Registry Management and Coordination agreement awarded to NeuStar, Inc. by the National Institute of Standards and Technology on behalf of the Department of Commerce on October 26, 2001.
- 21.1 Subsidiaries of NeuStar, Inc.
- 23.1 Consent of Ernst & Young LLP.
- 24.1 Power of Attorney (included on the signature page herewith).
- 31.1 Chief Executive Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Chief Financial Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

| Exhibit Number | Description of Exhibit  |
|----------------|---|
| 99.1           | Update to the Functional Requirements Specification, which is attached as Exhibit B to the contractor services agreement by and between NeuStar, Inc. and North American Portability Management, LLC. |
| 99.2           | Update to the Interoperable Interface Specification, which is attached as Exhibit C to the contractor services agreement by and between NeuStar, Inc. and North American Portability Management, LLC. |

Compensation arrangement.

\*\* Confidential treatment has been requested or granted for portions of this document. The omitted portions of this document have been filed with the Securities and Exchange Commission.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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 on February 28, 2008.

NEUSTAR, INC.

By: /s/ Jeffrey E. Ganek  
Jeffrey E. Ganek  
*Chairman of the Board of Directors  
and Chief Executive Officer*

We, the undersigned directors and officers of NeuStar, Inc., hereby severally constitute Jeffrey E. Ganek and Martin K. Lowen, and each of them singly, our true and lawful attorneys with full power to them and each of them to sign for us, in our names in the capacities indicated below, any and all amendments to this Annual Report on Form 10-K filed with the Securities and Exchange Commission.

Pursuant to the requirements of the Securities Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on February 28, 2008.

| <b>Signature</b>                         | <b>Title</b>  |
|--|---|
| /s/ Jeffrey E. Ganek<br>Jeffrey E. Ganek | Chairman of the Board of Directors and Chief Executive Officer<br>(Principal Executive Officer)                     |
| /s/ Jeffrey A. Babka<br>Jeffrey A. Babka | Senior Vice President and Chief Financial Officer (Principal<br>Financial Officer and Principal Accounting Officer) |
| /s/ James G. Cullen<br>James G. Cullen   | Director  |
| /s/ Joel P. Friedman<br>Joel P. Friedman | Director  |

/s/ Ross K. Ireland Director

Ross K. Ireland

/s/ Paul A. Lacouture Director

Paul A. Lacouture

/s/ Dr. Kenneth A. Pickar Director

Dr. Kenneth A. Pickar

/s/ Michael J. Rowny Director

Michael J. Rowny

/s/ Hellene S. Runtagh Director

Hellene S. Runtagh