INFOSPACE INC
Form 10-Q
November 07, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2006

or

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

Commission File Number: 0-25131

INFOSPACE, INC.

(Exact name of registrant as specified in its charter)

Delaware	**91-1718107**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
601 108th Avenue NE, Suite 1200	
Bellevue, Washington	**98004**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (425) 201-6100

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. x Yes ¨ No

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at November 3, 2006
Common Stock, Par Value $.0001	31,358,006

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PART II OTHER INFORMATION

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Item 1. Financial Statements

INFOSPACE, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(amounts in thousands, except share data)

	September 30, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 172,557	$ 153,013
Short-term investments, available-for-sale	238,490	222,360
Accounts receivable, net of allowance of $1,235 and $1,507	64,600	71,661
Other receivables	4,432	3,972
Prepaid expenses and other current assets	10,686	12,639
Total current assets	490,765	463,645
Property and equipment, net	32,383	26,889
Goodwill	140,046	176,979
Other intangible assets, net	21,092	44,080
Deferred tax assets, net	34,623	25,000
Other long-term assets	9,351	6,786
Total assets	$ 728,260	$ 743,379
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 10,895	$ 11,585
Accrued expenses and other current liabilities	66,385	51,917
Short-term deferred revenue	3,502	2,474
Total current liabilities	80,782	65,976
Long-term liabilities:		
Other liabilities and deferred revenue	1,437	2,011
Deferred tax liabilities	5,390	10,421
Total long-term liabilities	6,827	12,432
Total liabilities	87,609	78,408
Commitments and contingencies (Note 4)		
Stockholders equity:		
Common stock, par value $.0001 authorized, 900,000,000 shares; issued and outstanding, 31,355,475 and 31,018,795 shares	3	3
Additional paid-in capital	1,702,565	1,684,974
Accumulated deficit	(1,063,230)	(1,020,525)
Accumulated other comprehensive income	1,313	519
Total stockholders equity	640,651	664,971
Total liabilities and stockholders equity	$ 728,260	$ 743,379

See accompanying notes to unaudited Condensed Consolidated Financial Statements.

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INFOSPACE, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(amounts in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Revenues	$ 96,298	$ 83,225	$ 282,418	$ 253,428
Operating expenses:				
Content and distribution	47,704	37,704	135,437	107,398
Systems and network operations	8,391	5,492	23,379	14,804
Product development	12,099	7,840	33,874	22,807
Sales and marketing	12,946	8,519	35,076	23,421
General and administrative	13,498	9,671	40,131	30,005
Depreciation	4,635	2,454	11,409	6,169
Amortization of intangible assets	3,046	3,709	10,365	11,555
Restructuring	57,789		57,789	
Total operating expenses	160,108	75,389	347,460	216,159
Operating income (loss)	(63,810)	7,836	(65,042)	37,269
Gain on equity investments, net				154
Other income, net	5,405	2,974	14,000	85,966
Income (loss) before income taxes	(58,405)	10,810	(51,042)	123,389
Income tax benefit (provision)	11,676	451	8,337	(1,943)
Net income (loss)	$ (46,729)	$ 11,261	$ (42,705)	$ 121,446
Net income (loss) per share Basic	$ (1.49)	$ 0.35	$ (1.37)	$ 3.71
Net income (loss) per share Diluted	$ (1.49)	$ 0.32	$ (1.37)	$ 3.35
Weighted average shares outstanding used in computing basic net income (loss) per share	31,316	31,958	31,213	32,703
Weighted average shares outstanding used in computing diluted net income (loss) per share	31,316	34,830	31,213	36,288
Other comprehensive income:				
Net income (loss)	$ (46,729)	$ 11,261	$ (42,705)	$ 121,446
Foreign currency translation adjustment	105	(49)	332	(630)
Net unrealized gain (loss) on investments	289	(29)	462	(44)
Other comprehensive income (loss)	$ (46,335)	$ 11,183	$ (41,911)	$ 120,772

See accompanying notes to unaudited Condensed Consolidated Financial Statements.

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INFOSPACE, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(amounts in thousands)

	Nine Months Ended September 30, 2006	2005
Operating activities:		
Net income (loss)	$ (42,705)	$ 121,446
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Restructuring	57,783	
Depreciation and amortization	21,774	17,724
Stock-based compensation	13,551	
Deferred income taxes	(9,623)	(1,448)
Other	101	335
Cash provided (used) by changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	6,965	(13,682)
Other receivables	(460)	14,515
Prepaid expenses and other current assets	1,953	(2,767)
Other long-term assets	(2,565)	(1,514)
Accounts payable	1,081	2,466
Accrued expenses and other current and long-term liabilities	416	(543)
Deferred revenue	426	(1,461)
Net cash provided by operating activities	48,697	135,071
Investing activities:		
Business acquisition, net of cash acquired		(26,364)
Increase in other long-term assets		(4,495)
Purchases of property and equipment	(18,525)	(11,729)
Proceeds from the sale of assets and equity investments	148	194
Proceeds from sales and maturities of investments	261,614	147,608
Purchases of investments	(277,283)	(155,302)
Net cash used by investing activities	(34,046)	(50,088)
Financing activities:		
Common stock repurchases		(62,275)
Proceeds from exercise of stock options	3,061	8,068
Proceeds from issuance of stock through employee stock purchase plan	1,832	1,512
Net cash provided (used) by financing activities	4,893	(52,695)
Net increase in cash and cash equivalents	19,544	32,288
Cash and cash equivalents:		
Beginning of period	153,013	85,245
End of period	$ 172,557	$ 117,533

See accompanying notes to unaudited Condensed Consolidated Financial Statements.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. The Company and Basis of Presentation

InfoSpace, Inc. (the Company or InfoSpace) is a provider and publisher of mobile content, products and services assisting consumers with finding information, personalization and entertainment on the mobile phone. The Company also uses its technology, including metasearch, to power its branded Web sites and provide private-label online search and directory services to its distribution partners.

The accompanying unaudited Condensed Consolidated Financial Statements include all adjustments, consisting of normal recurring adjustments that, in the opinion of management, are necessary to present fairly the financial information set forth herein. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the SEC). Results of operations for the three and nine months ended September 30, 2006 are not necessarily indicative of future financial results. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual amounts may differ, perhaps materially, from these financial estimates.

Investors should read these interim financial statements and related notes in conjunction with the audited financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005.

2. Stock-Based Compensation

On January 1, 2006, the Company adopted Statement of Financial Accounting Standard (SFAS) No. 123(R), *Share-Based Payment*, which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including stock option grants and purchases of stock made pursuant to the Company s 1998 Employee Stock Purchase Plan (the ESPP) based on estimated fair values. SFAS No. 123(R) supersedes the Company s previous accounting under Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees*. In March 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107, and the Company has applied SAB No. 107 s provisions in its adoption of SFAS No. 123(R).

The Company adopted SFAS No. 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006. In accordance with the modified prospective transition method, the Company s unaudited Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2005 have not been restated to reflect, and do not include, the impact of SFAS No. 123(R).

SFAS No. 123(R) requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the award s portion that is ultimately expected to vest is recognized as expense over the requisite service periods in the accompanying unaudited Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2006. Prior to the adoption of SFAS No. 123(R), the Company accounted for share-based awards to employees and directors using the intrinsic value method in accordance with APB No. 25 as allowed under SFAS No. 123, *Accounting for Stock-Based Compensation*. Under the intrinsic value method, share-based compensation expense was only recognized by the Company if the exercise price of the grant was less than the fair market value of the underlying stock at the date of grant. No stock-based compensation expense was recorded by the Company in 2005.

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As of September 30, 2006, total unrecognized share-based compensation cost related to unvested stock options was $33.5 million, which is expected to be recognized over a weighted average period of approximately 14 months. The Company has included the following amounts for share-based compensation cost, including the cost related to the ESPP, in the accompanying unaudited Condensed Consolidated Statement of Operations for the three and nine months ended September 30, 2006, respectively (amounts in thousands):

	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2006
Systems and network operations	$ 496	$ 1,150
Product development	762	1,891
Sales and marketing	1,412	3,963
General and administrative	2,137	6,547
Total	$ 4,807	$ 13,551

Excluded from the amounts above is a $1.1 million reduction in expense in the three months ended September 30, 2006 included in restructuring charges, resulting from options not expected to vest for terminated employees.

Share-based compensation expense recognized during the three and nine months ended September 30, 2006 includes (1) compensation expense for awards granted prior to, but not yet fully vested as of, January 1, 2006, and (2) compensation expense for the share-based payment awards granted subsequent to December 31, 2005, based on the grant date fair values estimated in accordance with the provisions of SFAS No. 123 and SFAS No. 123(R), respectively. The Company has historically disclosed and currently recognizes share-based compensation expense over the vesting period for each separately vesting portion of a share-based award as if they were, in substance, a multiple share-based award. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company s pro forma disclosures required under SFAS No. 123 for the periods prior to 2006, the Company accounted for forfeitures as they occurred. The Company has historically and continues to estimate the fair value of share-based awards using the Black-Scholes-Merton (Black-Scholes) option-pricing model.

Stock Incentive Plans

1996 Plan: During 2006 and 2005, the Company granted options to purchase common stock under the Restated 1996 Flexible Stock Incentive Program (the 1996 Plan). Options granted from the 1996 Plan typically vest over two, three or four years, a ratable portion vesting one year from the date of grant and ratably thereafter on a semi-annual basis, and expire seven years from the date of grant. Shares underlying options available under the 1996 Plan increase annually on the first day of January by an amount equal to the lesser of (A) five percent of the Company s outstanding shares at the end of the Company s preceding fiscal year, or (B) an amount determined by the Board of Directors. The 1996 Plan limits the number of shares of common stock that may be granted to any one individual pursuant to stock options in any fiscal year of the Company to 800,000 shares, plus an additional 800,000 shares in connection with his or her initial employment with the Company, which grant shall not count against the limit. If an option is surrendered or for any other reason ceases to be exercisable in whole or in part, the shares which were subject to the option but on which the option has not been exercised shall continue to be available under the 1996 Plan.

2001 Plan: In February 2001, the Company implemented the 2001 Nonstatutory Stock Option Plan (the 2001 Plan), under which nonqualified stock options to purchase common stock or shares of restricted stock may be granted to employees. Under the 2001 Plan, 2.5 million shares of common stock are authorized for grant of options or issuance of restricted stock. Options granted under the 2001 Plan before 2006 expire ten years from the date of the grant and vest over two years, with 50% vesting ratably on a monthly basis for the first 24 months and the remaining 50% balance vesting at the end of the two-year period. Options from the 2001 Plan granted during 2006 typically vest over two or three years, a ratable portion vesting one year from the date of grant and ratably thereafter on a semi-annual basis, and expire seven years from the date of grant.

Switchboard Plan: In conjunction with the acquisition of Switchboard Incorporated, the Company initiated the InfoSpace, Inc. Switchboard Incorporated Stock Incentive Plan (the Switchboard Plan), a plan under which incentive options and nonqualified stock options to purchase common stock may be granted to employees of InfoSpace, Inc. Under this plan, options to purchase 480,826 shares of the Company s common stock were reserved for grants. Options under the Switchboard Plan expire six years from the date of the grant. Options under this plan generally vest over four years, 25% one year from date of grant and ratably thereafter on a monthly basis.

Other plans: In addition to the plans described above, the Company has several option plans assumed through acquisitions by InfoSpace and Go2Net, Inc. Options granted under these plans typically vest over a four-year period, 25% one year from the date of grant and ratably thereafter on a quarterly basis and expire six or ten years from the date of grant.

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ESPP: The Company adopted the ESPP in August 1998. The ESPP is intended to qualify under Section 423 of the Code and permits eligible employees of the Company and its subsidiaries to purchase common stock through payroll deductions of up to 15% of their compensation. The ESPP was implemented with six-month offering periods that begin on each February 1 and August 1. The price of common stock purchased under the ESPP is the lesser of 85% of the fair market value on the first day of an offering period and 85% of the fair market value on the last day of an offering period. The ESPP does not have a fixed expiration date, but may be terminated by the Company s Board of Directors at any time.

A summary of the general terms of options to purchase common stock previously granted under these plans, including options outstanding and available for grant at September 30, 2006, is as follows:

	1996 Plan	2001 Plan	Switchboard Plan	Other Plans
Requisite service period in years	4 or less	3 or less	4	4
Vesting	1st year cliff then ratably thereafter	1st year cliff then ratably thereafter, or 50% ratably over service period then 50% cliff at end of service period	1st year cliff then ratably thereafter	1st year cliff then ratably thereafter
Life in years	7 or 10	7 or 10	6	6 or 10
Options outstanding at September 30, 2006	8,518,134	1,147,524	294,550	1,864
Options available for grant at September 30, 2006	1,880,502	1,655,182	127,401	

Share-Based Compensation Cost under SFAS No. 123

Prior to January 1, 2006, the Company disclosed compensation cost in accordance with SFAS No. 123. The provisions of SFAS No. 123 require the Company to disclose the assumptions used in calculating the fair value pro forma expense. Had compensation expense for the plans been determined based on the fair value of the options at the grant dates for awards under the plans consistent with SFAS No. 123, the Company s net income for the three and nine months ended September 30, 2005 would have been as follows (amounts in thousands, except per share data):

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net income as reported	$ 11,261	$ 121,446
Stock-based compensation, as reported		
Total stock-based compensation determined under fair value based method for all awards	(9,601)	(25,576)
Pro forma net income	$ 1,660	$ 95,870
Basic net income per share, as reported	$ 0.35	$ 3.71
Diluted net income per share, as reported	$ 0.32	$ 3.35
Basic net income per share, SFAS No. 123 adjusted	$ 0.05	$ 2.93
Diluted net income per share, SFAS No. 123 adjusted	$ 0.05	$ 2.72

Pro forma disclosures for the three and nine months ended September 30, 2006 are not presented because stock-based compensation is recognized in the unaudited Condensed Consolidated Statement of Operations.

To estimate compensation expense which would have been recognized under SFAS No. 123 for the three and nine months ended September 30, 2005 and the compensation cost that was recognized under SFAS No. 123(R) for the three and nine months ended September 30, 2006, the Company used the Black-Scholes option-pricing model with the following weighted-average assumptions for equity awards granted:

	Employee Stock Option Plans			
	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
Risk-free interest rate	5.01%	4.04%	4.70%	3.91%
Expected dividend yield	0%	0%	0%	0%
Volatility	63%	69%	63%	67%
Expected life	3.4 years	2.9 years	2.8 years	3.3 years

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	Employee Stock Purchase Plan			
	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
Risk-free interest rate	4.84%	3.73%	4.48%	3.19%
Expected dividend yield	0%	0%	0%	0%
Volatility	30%	79%	32%	67%
Expected life	6 months	6 months	6 months	6 months

The risk-free interest rate is based on the implied yield available on U.S. Treasury issues with an equivalent remaining term. The Company has not paid dividends in the past and does not plan to pay any dividends in the future. The expected volatility is based on historical volatility of the Company s stock for the related vesting period. The expected life of the equity award is based on historical experience.

Activity and pricing information regarding all options to purchase shares of common stock are summarized as follows:

	Options	Weighted Average Exercise Price
Outstanding at December 31, 2005	8,035,342	$ 29.40
Granted	895,000	25.35
Forfeited	(191,872)	37.24
Exercised	(97,609)	12.86
Outstanding at March 31, 2006	8,640,861	$ 28.99
Granted	2,268,650	24.00
Forfeited	(472,650)	27.96
Exercised	(108,894)	12.03
Outstanding at June 30, 2006	10,327,967	$ 28.12
Granted	290,000	21.73
Forfeited	(620,121)	33.12
Exercised	(35,774)	13.87
Outstanding at September 30, 2006	9,962,072	$ 27.68
Options exercisable at September 30, 2006	5,486,759	$ 30.77

During the three and nine months ended September 30, 2006, the total intrinsic value of options exercised to purchase common stock was $288,000 and $2.9 million, respectively, and the weighted average fair value of options to purchase common stock that were granted was $10.33 per share and $10.43 per share, respectively.

During the three and nine months ended September 30, 2006, financing cash generated from the exercise of stock options amounted to $496,000 and $3.1 million, respectively. During the three and nine months ended September 30, 2006, financing cash generated for the purchase of shares through the ESPP amounted to $889,000 and $1.8 million, respectively. The Company issues new shares upon exercise of options to purchase common stock or purchase through the ESPP.

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Additional information regarding options outstanding for all plans as of September 30, 2006, is as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (yrs.)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$1.22 $15.00	1,838,169	4.78	$ 11.75	1,634,684	$ 11.56
$15.56 $18.00	89,750	3.84	15.58	57,229	15.58
$18.09 $20.00	90,864	3.67	19.35	66,104	19.35
$20.64 $25.00	4,049,475	6.12	23.72	756,114	23.94
$25.12 $30.00	901,188	5.76	26.55	110,001	25.61
$30.26 $34.00	299,750	5.19	31.83	169,751	31.70
$34.11 $675.00	2,692,876	4.45	45.09	2,692,876	45.09
Total	9,962,072		$ 27.68	5,486,759	$ 30.77
Aggregate intrinsic value (in thousands)	$ 12,558			$ 11,412	
Weighted average remaining contractual life		5.31		4.60	

The aggregate intrinsic value in the table above is based on the Company s closing stock price of $18.44 per share as of September 30, 2006, which amount would have been received by the optionees had all options been exercised on that date.

Employee Stock Purchase Plan

There were 47,414 and 94,404 shares issued for the ESPP periods that ended in the three and nine months ended September 30, 2006, respectively. There were 36,352 and 60,058 shares issued for the ESPP periods that ended in the three and nine months ended September 30, 2005, respectively.

3. Net Income (Loss) Per Share

Basic net income per share is computed using the weighted average number of common shares outstanding during the period. Diluted net income per share is computed using the weighted average number of common and potentially dilutive shares outstanding during the period. Potentially dilutive shares consist of the incremental common shares issuable upon the exercise of outstanding stock options and warrants using the treasury stock method. Potentially dilutive shares are excluded from the computation of earnings per share if their effect is antidilutive.

The treasury stock method calculates the dilutive effect for only those stock options and warrants whose exercise price is less than the average stock price during the period presented. The number of dilutive stock options and warrants and the number of antidilutive stock options and warrants excluded from the calculation of weighted average dilutive common shares outstanding for the three and nine months ended September 30, 2006 and 2005 are shown below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Weighted average common shares outstanding, basic	31,315,616	31,958,024	31,213,442	32,702,535

Dilutive stock options and warrants		2,871,884		3,585,890
Weighted average common shares outstanding, diluted	31,315,616	34,829,908	31,213,442	36,288,425
Stock options and warrants excluded as antidilutive	8,099,540	4,004,360	5,847,103	2,674,627

4. Commitments and Contingencies

The following are the Company s contractual commitments associated with its operating lease obligations (in thousands):

	Remainder of 2006	2007	2008	2009	2010	Thereafter	Total
Operating lease commitments, net of sublease income	$ 1,927	$ 7,493	$ 5,201	$ 6,831	$ 6,695	$ 11,037	$ 39,184

As of September 30, 2006, the Company has pledged $4.3 million as collateral for standby letters of credit and bank guaranties for certain of its property leases, which is included in Other long-term assets.

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Litigation

On June 6, 2003, a complaint entitled Enger v. Richards, filed in the Superior Court of the State of Washington (King County), was amended to add the Company and Naveen Jain, its former chairman and chief executive officer, as defendants. The action alleged various claims in connection with the sale of Yellow Pages on the Internet, LLC to the Company in May 1997. In December 2003, the plaintiff voluntarily dismissed the Company from this action. In January 2004, defendant John Richards, a former Company employee, asserted a third-party claim for indemnification against the Company, which purports to seek reimbursement for his legal fees as well as any judgment. In January 2005, the plaintiff, Jain and the Company settled all of their respective claims including Jain s claim for indemnification against the Company and any potential claims that Enger could bring against the Company. The settlement was paid entirely by the Company s insurance. Richards claim for indemnification was not a part of the settlement agreement. On March 16, 2005, the trial court entered a judgment in Richards favor. Enger is appealing that judgment. The Company believes it has meritorious defenses to Richards claim for indemnification, but litigation is inherently uncertain and the Company may not prevail in this matter.

On March 26, 2004, a complaint entitled Alexander Hutton Capital, L.L.C. v. John Richards, Naveen Jain, et al., was filed in the Superior Court of the State of Washington (King County). Plaintiff did not name the Company as a defendant. As in the Enger v. Richards case (above) to which it is related, this action alleges various claims in connection with the sale of Yellow Pages on the Internet, LLC to the Company in May 1997. In July 2004, Richards asserted a third party claim for indemnification against the Company, which purports to seek reimbursement for his legal fees as well as any judgment. In February 2005, the plaintiff, the Jains and the Company settled their respective claims, including the Jains claim for indemnification against the Company and any potential claims that Hutton could bring against the Company. The settlement was paid entirely by the Company s insurance. On July 22, 2005, the Court granted Richards motion to dismiss his claim for indemnification without prejudice. By order dated July 20, 2006, the Court found Richards liable to plaintiff for fraud and breach of fiduciary duty in the amount of $3,029,443 and stated that the Court has reserved for other non-party Yellow Pages on the Internet, LLC members, including Enger (see related Enger v. Richards case above), an additional $4,525,279 that the Court found Richards received through his fraud. Richards has indicated his intention to appeal the Court s decision. The Company believes that it has meritorious defenses to any potential claim of indemnification by Richards and that the Court s findings of intentional misconduct for fraud and breach of fiduciary duty by Richards, in addition to other findings, bar any potential claim for indemnification against the Company. However, litigation is inherently uncertain and the Company may not prevail in this matter.

Certain shareholders of Authorize.Net Corporation, a former subsidiary acquired through the Company s merger with Go2Net, Inc., filed a lawsuit in May 2000 in Utah State Court to reallocate the consideration received in the acquisition of Authorize.Net by Go2Net. The plaintiffs made claims under the Utah Uniform Securities Act as well as various common law claims. The plaintiffs subsequently amended the complaint, recaptioned as Patrick O Keefe II, et al. v. David Heaps, et al., asserting claims against Authorize.Net, Go2Net and InfoSpace, and Authorize.Net asserted counterclaims against the plaintiffs. Two former officers of Authorize.Net also asserted cross-claims for indemnification and contribution against Authorize.Net. The Utah Court entered orders dismissing with prejudice all of plaintiffs claims against Authorize.Net, Go2Net and InfoSpace, and certain other of plaintiffs claims; the plaintiffs appealed the court s decision. On April 28, 2006, the parties entered into a settlement agreement that resolved all remaining claims between the parties and the plaintiffs appeal. The Utah Court approved and dismissed the case with prejudice by order dated May 18, 2006.

Other

From time to time the Company is subject to various other legal proceedings or claims that arise in the ordinary course of business. Additionally, the Company is subject to income taxes in the U.S. and several foreign jurisdictions and, in the ordinary course of business, there are transactions and calculations where the ultimate tax determination is uncertain. Although the Company cannot predict the outcome of these matters with certainty, the Company s management does not believe that the disposition of these ordinary course matters will have a material adverse effect on the Company s financial position, results of operations or cash flows.

In the ordinary course of business, the Company may provide indemnifications of varying scope and terms to customers, vendors, partners and other parties. The Company has agreed to hold certain parties harmless against losses arising from a breach of representations or covenants, or other claims made against certain parties. It is not possible to determine the maximum potential amount under these indemnification agreements due to the conditional nature of the Company s obligations and the unique facts and circumstances involved in each particular agreement. Accordingly, the Company has not recorded a liability related to indemnification provisions.

In addition, the Company periodically enters into agreements that require minimum performance commitments. The Company s management believes that the likelihood is remote that any such arrangements will have a significant adverse effect on our financial position or liquidity. Accordingly, the Company has not recorded a liability related to these contingencies.

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5. Goodwill and Other Intangible Assets, net

The Company is required to test goodwill and indefinite-lived intangible assets for impairment on an annual basis or between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of goodwill or indefinite-lived assets. The Company is required to test definite-lived intangible assets, consisting of core technology, customer relationships, and mobile media content for impairment only if an event occurs or circumstances change that would more likely than not reduce the fair value of these assets.

As discussed in Note 9, in September 2006, the Company announced that it had been informed by one of its carrier partners that the customer plans to develop direct licensing relationships with the major record labels beginning in 2007. This constituted an event for testing the fair value of the Company s Mobile business segment goodwill and definite-lived intangible assets.

The Company estimated the fair value of its Mobile business segment goodwill based on the present value of estimated future cash flows. Based on this analysis, the Company wrote off the carrying value of goodwill associated with the Mobile business segment.

The following table provides information about activity in goodwill by business segment for the period from January 1, 2006 to September 30, 2006 (in thousands):

	Mobile	Online	Total
Goodwill at December 31, 2005	$ 36,933	$ 140,046	$ 176,979
Adjustments for deferred taxes associated with IOMO Limited acquisition	(1,683)		(1,683)
Adjustments for deferred taxes associated with elkware GmbH acquisition	(3,348)		(3,348)
Impairment of Mobile goodwill	(31,902)		(31,902)
Goodwill at September 30, 2006	$	$ 140,046	$ 140,046

During the nine months ended September 30, 2006, the Company elected to include the taxable income of two of its foreign subsidiaries, IOMO Limited and InfoSpace GmbH (formerly elkware GmbH), in the calculation of its income subject to U.S. taxation. As a result, the Company recorded a reduction of the goodwill associated with the acquisitions of those subsidiaries, consistent with the provisions of SFAS No. 109, *Accounting for Income Taxes*.

The Company evaluated the fair value of its Mobile business segment definite-lived intangible assets based on the present value of estimated future cash flows for the Mobile business segment. Based on this analysis, the Company determined that $12.6 million of Other intangible assets, net associated with the Mobile business segment were excess. Accordingly, the Company reduced other intangible assets by $12.6 million.

The following table provides information about activity in other intangible assets by business segment for the period from January 1, 2006 to September 30, 2006 (in thousands):

	Mobile	Online	Total
Total indefinite-lived intangible assets at December 31, 2005	$	$ 15,583	$ 15,583
Gross definite-lived intangible assets at December 31, 2005	52,586	18,040	70,626
Accumulated amortization	(27,577)	(14,552)	(42,129)
Net other intangible assets at December 31, 2005	$ 25,009	$ 19,071	$ 44,080
Amortization	(8,015)	(2,350)	(10,365)
Impairment of Mobile intangible assets	(12,623)		(12,623)
Net other intangible assets at September 30, 2006	$ 4,371	$ 16,721	$ 21,092

The goodwill and intangible asset impairments were recorded in Restructuring in the unaudited Condensed Consolidated Statement of Operations in the three and nine months ended September 30, 2006.

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6. Other Income, net

Other income, net for the three and nine months ended September 30, 2006 and 2005, consists of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Interest income	$ 5,399	$ 3,112	$ 14,176	$ 7,760
Gain on litigation settlement				79,297
Foreign currency exchange loss	(50)	(42)	(60)	(1,062)
Other items, net	56	(96)	(116)	(29)
Other income, net	$ 5,405	$ 2,974	$ 14,000	$ 85,966

On March 25, 2005, the Company received proceeds of $83.2 million from the settlement of several outstanding litigation matters. The Company recognized a gain of $79.3 million during the nine months ended September 30, 2005, comprised of the settlement proceeds and interest of $83.2 million, less $3.9 million in legal fees. In addition, the Company recognized $2.0 million in income taxes related to the settlement, which is included in Income tax provision in the nine months ended September 30, 2005.

7. Segment Disclosures

SFAS No. 131*, Disclosures about Segments of an Enterprise and Related Information*, establishes standards for the way that companies report information about operating segments. It also establishes standards for related disclosures about products and services, geographic areas, and major customers.

In January 2006, the Company realigned its operations to a functional organization structure and combined the functional operations of its two separate business units, Mobile and Search & Directory, to leverage its search and directory technology to its mobile products, services and distribution channels. This resulted in a change in the way it presents financial information to its chief operating decision maker, reflecting how management measures operating performance. The Company presents revenues consistent with the historical presentation, Mobile and Online (formerly referred to as Search & Directory) and, additionally, presents segment content and distribution costs and segment gross profit, which is revenues less content and distribution costs for each of the two segments. Content and distribution costs consist principally of costs related to royalty and license fees related to the Company s Mobile products for items such as ringtones, graphics and games, and other content or data licenses, and revenue sharing arrangements with the Company s Online distribution partners as well as certain content and data licenses. Additionally, the Company does not allocate systems and network operations expenses, product development expenses, sales and marketing expenses, general and administrative expenses, depreciation, amortization of intangible assets, income taxes or other income to the reportable segments. For each segment, the historical financial results for 2005 are presented in a manner consistent with the Company s new measures for reportable segments information. The revised financial information for the new segment reporting is not indicative of how the Company operated or managed its business in the past and is different than the segment results previously presented.

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Information on reportable segments currently presented to the Company s chief operating decision maker and a reconciliation to consolidated net income (loss) for the three and nine months ended September 30, 2006 and 2005 are presented below (in thousands). The Company does not account for, and does not report to management, its assets or capital expenditures by segment.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Mobile				
Revenue	$ 47,731	$ 39,014	$ 137,348	$ 115,158
Content and distribution costs	29,487	20,153	82,823	55,396
Gross profit	18,244	18,861	54,525	59,762
Gross profit margin	38.2%	48.3%	39.7%	51.9%
Online				
Revenue	48,567	44,211	145,070	138,270
Content and distribution costs	18,217	17,551	52,614	52,002
Gross profit	30,350	26,660	92,456	86,268
Gross profit margin	62.5%	60.3%	63.7%	62.4%
Total				
Total segment revenues	96,298	83,225	282,418	253,428
Total segment content and distribution costs	47,704	37,704	135,437	107,398
Total segment gross profit	48,594	45,521	146,981	146,030
Total segment gross profit margin	50.5%	54.7%	52.0%	57.6%
Corporate				
Operating expenses	42,127	31,522	118,909	91,037
Restructuring	57,789		57,789	
Stock-based compensation	4,807		13,551	
Depreciation	4,635	2,454	11,409	6,169
Amortization of intangible assets	3,046	3,709	10,365	11,555
Gain on investments, net				(154)
Other income, net	(5,405)	(2,974)	(14,000)	(85,966)
Income tax provision (benefit)	(11,676)	(451)	(8,337)	1,943
	95,323	34,260	189,686	24,584
Net income (loss)	$ (46,729)	$ 11,261	$ (42,705)	$ 121,446

8. Stock Repurchase Plan

On May 30, 2006, the Company s Board of Directors approved a stock repurchase plan whereby the Company is authorized to purchase up to $100 million of its common stock during the succeeding twelve month period. Repurchased shares will be retired and resume the status of authorized but unissued shares of common stock. Under the previous repurchase plan authorized on May 13, 2005, which expired May 12, 2006, the Company purchased 2,633,002 shares in open-market transactions during 2005 at a total cost, exclusive of purchase and administrative costs, of $70.2 million, at an average price of $26.66 per share. The Company s stock repurchases for the three and nine months ended September 30, 2006 and 2005, are presented below (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005

Purchase of shares, exclusive of purchase and administrative costs	$	$ 51,124	$	$ 62,202
Shares purchased		1,997		2,333
Average price per share		25.60		26.66

9. Restructuring Charges

During September 2006, the Company announced that it had been informed by one of its carrier partners that the customer plans to develop direct licensing relationships with the major record labels beginning in 2007. The Company expects that these direct relationships will have a material negative impact on its revenues and operating results. As a result, during the three months ended September 30, 2006, the Company committed to a plan to make operational changes to its business to

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align costs with expected future revenues. The plan included a reduction of its workforce and consolidation of its facilities. Additionally, the Company recognized probable losses for contractual minimums for licensed properties and recorded a charge for certain fixed assets, including leasehold improvements and internally developed software, which have been abandoned as of September 30, 2006. The restructuring charge includes the closing of its office in Hamburg, Germany announced by the Company during September 2006. As a result, during the three months ended September 30, 2006 the Company recorded a $57.8 million restructuring charge, comprised of the following amounts for the three and nine months ended September 30, 2006.

	Three and Nine Months Ended September 30, 2006
Employee separation costs	$ 6,321
Recovery of previously expensed share-based awards due to forfeitures from employee separation	(1,054)
Impairment of goodwill	31,903
Impairment of definite-lived intangible assets	12,623
Losses on contractual commitments	5,621
Impairment of long-lived assets	1,019
Costs of abandoned facilities	1,356
Total restructuring charges	$ 57,789

At September 30, 2006, the accrued liability associated with the restructuring related charges was $11.3 million and consisted of the following (in thousands):

	2006 charges	Payments	Reserve balance at September 30, 2006
Employee Separation	$ 6,321	$ (6)	$ 6,315
Contractual Commitments	3,673		3,673
Facility Abandonment	1,331		1,331
Total	$ 11,325	$ (6)	$ 11,319

The Company also expects to record approximately $3 million to $4 million in additional pre-tax restructuring charges in the three months ended December 31, 2006 through mid-2007.

10. Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*. FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN No. 48 is effective for the Company s first fiscal year beginning after December 15, 2006. The Company is currently evaluating the provisions of FIN No. 48 to determine what effect its adoption on January 1, 2007 will have on the Company s financial position, cash flows, and results of operations.

In September 2006, the SEC issued SAB No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB No. 108 provides interpretive guidance on how the effects of prior-year uncorrected misstatements should be considered when quantifying misstatements in the current year financial statements. SAB No. 108 requires registrants to quantify misstatements using both an income statement (rollover) and balance sheet (iron curtain) approach and evaluate whether either approach results in a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. If prior year errors that had been previously considered immaterial now are considered material based on either approach, no restatement is required so long as management properly applied its previous approach and all relevant facts and circumstances were considered. If prior years are not restated, the cumulative effect adjustment is recorded in opening accumulated deficit as of the beginning of the fiscal year of implementation. SAB No. 108 is effective for fiscal years ending on or after November 15, 2006, with earlier implementation encouraged. The Company does not believe that its implementation of SAB No. 108 will have an effect on the Company s financial position, cash flows, or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosure of fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements and accordingly, does not require any new fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the provisions of SFAS No. 157 to determine what effect its adoption on January 1, 2008 will have on the Company s financial position, cash flows, and results of operations.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion and analysis in conjunction with our unaudited Condensed Consolidated Financial Statements and Notes thereto included elsewhere in this report and our annual report on Form 10-K for the year ended December 31, 2005. In addition to historical information, the following discussion contains certain forward-looking statements that involve known and unknown risks and uncertainties, such as statements of our plans, objectives, expectations and intentions. You should read the cautionary statements made in this report as being applicable to all related forward-looking statements wherever they appear in this report. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed below and in Item 1A. of Part II, Risk Factors, and in our reports filed with the Securities and Exchange Commission. You should not place undue reliance on these forward-looking statements, which reflect only our opinion as of the date of this report.

Overview

InfoSpace, Inc. (InfoSpace , Our or We) is a provider and publisher of mobile content, products and services that assist consumers with finding information, personalization and entertainment on the mobile phone. We also use our metasearch technology to power our own branded Web sites and provide private-label online search and directory services to distribution partners. We were founded in 1996 and are incorporated in the state of Delaware. Our principal corporate office is located in Bellevue, Washington. We also have facilities in Los Angeles and San Mateo, California; Westborough, Massachusetts; Woking and Eastleigh, United Kingdom; and Papendrecht, The Netherlands. Our common stock is listed on the newly designated NASDAQ Global Select Market under the symbol INSP.

In early 2006, we realigned our operations to a functional organization structure to leverage online search and directory technology and applications for mobile devices, and expand our distribution channels. The historical financial results for the first three quarters of 2005, as well as the first three quarters of 2006, are now presented in a manner consistent with our new reporting segments. The revised financial information for the new segment reporting was prepared for comparative purposes and may not be indicative of how we operated or managed our business in the past and is different than the segment results previously presented.

Our Mobile business provides media products and content to mobile operators and portal and infrastructure services that enable mobile operators to deliver content and programming across multiple devices to their subscribers. Through our products, content and service offerings, our mobile operator partners are able to aggregate, configure and customize the services they offer under their own brand and deliver them to their subscribers.

Our Online business provides search and directory services which enable Internet users to locate information, merchants, individuals and products online. We offer search and directory services through our branded Web sites, Dogpile.com, Switchboard.com, InfoSpace.com, Webcrawler.com and MetaCrawler.com, as well as through the Web properties of distribution partners. Partner versions of our search and directory services are generally private-labeled and delivered with each distribution partner s unique requirements.

Company Internet Site and Availability of SEC Filings

Our corporate Internet site is located at www.infospaceinc.com. We make available on that site our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K from 2003 through the current period, as well as any amendments to those filings, and other filings we make electronically with the U.S. Securities and Exchange Commission (the SEC). The filings can be found in the Investor Relations section of our site and are available free of charge. Information on our Internet site is not part of this Form 10-Q. In addition, the SEC maintains an Internet site at www.sec.gov that contains reports, proxy and information statements, and other information regarding us and other issuers that file electronically with the SEC.

Overview of Third Quarter 2006 Operating Results

The following is an overview of our operating results for the three months ended September 30, 2006. A more detailed discussion, comparing our operating results for the three and nine months ended September 30, 2006 and 2005, is included under the heading Historical Results of Operations in this Management s Discussion and Analysis of Financial Condition and Results of Operations.

In September 2006, we announced that we had been informed by one of our carrier partners that the customer plans to develop direct licensing relationships with the major record labels beginning in 2007, which we expect will have a material negative impact on our revenues and operating results starting in 2007. As a result, during the third quarter of 2006 we committed to a plan to make operational changes to our business, which included a reduction in our workforce and, as part of the workforce reduction,

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consolidation of our facilities. Additionally, in September 2006, we announced the closing of our office in Hamburg, Germany. As a result, in the three months ended September 30, 2006, we recorded a $57.8 million restructuring charge, which includes impairment for goodwill and other intangible assets, employee separation costs, losses on contractual commitments and costs to consolidate facilities.

Revenues for the three months ended September 30, 2006 increased to $96.3 million from $83.2 million in the three months ended September 30, 2005. Revenues from our Mobile business increased to $47.7 million in the third quarter of 2006 from $39.0 million in the third quarter of 2005, primarily attributable to an increase in sales of our media download products, such as ringtones and graphics. Revenues from our Online business increased to $48.6 million in the third quarter of 2006 from $44.2 million in the third quarter of 2005. This increase was primarily due to better monetization of our paid searches. During the third quarter of 2006, over 60% of our search revenues came from our search distribution partners.

Content and distribution costs for the three months ended September 30, 2006 increased to $47.7 million from $37.7 million in the three months ended September 30, 2005. Total segment gross profit, comprised of revenues net of content and distribution costs, increased to $48.6 million for the third quarter of 2006 from $45.5 million for the third quarter of 2005. Segment gross profit for our Mobile segment decreased to $18.2 million in the third quarter of 2006 from $18.9 million in the third quarter of 2005, primarily attributable to the loss of a service agreement at the end of 2005 and an increase in content costs associated with our media downloads. Mobile content costs, as a percentage of revenue, increased at a greater rate as a result of an increase in content costs and the shift of the mix of products and services we provide. In particular, sales of our labeltone or true tone (MP3-like quality) ringtones, that have a greater cost as a percentage of revenue than our other media download products, represented a larger share of our Mobile revenues in the third quarter of 2006. Segment gross profit from our Online business increased to $30.4 million in the third quarter of 2006 from $26.7 million in the third quarter of 2005, due to better monetization of our paid searches, primarily from our own branded Web sites.

Other operating expenses, excluding the restructuring charge of $57.8 million, for the three months ended September 30, 2006 were $54.6 million, an increase of $16.9 million from $37.7 million in the three months ended September 30, 2005. Other operating expenses include expenses related to systems and network operations, product development, sales and marketing, general and administrative, depreciation and amortization of intangible assets. The increase from the third quarter of 2005 was primarily attributable to spending on certain business initiatives, general growth in our operations, and the effect of expensing stock options and other equity based awards as required under Statement of Financial Accounting Standard (SFAS) No. 123(R), *Share-Based Payment*, which we adopted on January 1, 2006. Increased operating costs related to our initiatives and growth in our business primarily relate to increases in personnel costs, including salaries, benefits and other employee costs, and costs of temporary help from contractors to augment our staffing needs, as well as increases in marketing and promotional costs and depreciation expense. In light of the announcement described above, we have suspended investments in developing or obtaining new Mobile content and certain Mobile distribution channels, including our direct to consumer online web site, Moviso.com.

Net loss for the three months ended September 30, 2006 was $46.7 million compared to net income of $11.3 million in the three months ended September 30, 2005. The net loss was primarily attributable to the restructuring charge and, to a lesser extent, increases in operating expenses in 2006 as noted above. Additionally, we provided for income taxes at a rate of approximately 20% in the third quarter of 2006, as compared to approximately 5% in the third quarter of 2005.

Critical Accounting Policies and Estimates

Management s Discussion and Analysis of Financial Condition and Results of Operations, as well as disclosures included elsewhere in this Form 10-Q, are based upon our unaudited Condensed Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingencies.

The SEC has defined a company s most critical accounting policies as the ones that are the most important to the portrayal of the company s financial condition and results of operations, and which require the company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. On an ongoing basis, we evaluate the estimates used, including those related to impairment of goodwill and other intangible assets, useful lives of other intangible assets and property and equipment, contingencies, stock-based compensation and certain other operating expenses, the fair value of assets and liabilities acquired in our business combinations, and whether to provide a valuation allowance for some or all of our deferred tax assets. We base our estimates on historical experience, current conditions and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources as well as identifying and assessing our accounting treatment with respect to commitments and contingencies. Actual results may differ significantly from these estimates under different assumptions, judgments or conditions. We believe the following critical accounting policies involve the more significant judgments and estimates used in the preparation of our consolidated financial statements. We also have other key accounting policies, which involve the use of estimates, judgments and assumptions that are significant to understanding our results. For additional information see Item 8 of Part II Financial Statements and Supplementary Data Note 1: Summary of Significant Accounting Policies of our Annual Report on Form 10-K.

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Accounting for Goodwill and Certain Other Intangible Assets

SFAS No. 142, *Goodwill and Other Intangible Assets*, requires that goodwill be tested for impairment at the reporting unit level on an annual basis and between annual tests in certain circumstances. Application of the impairment test requires judgment, including the identification of reporting units, assigning assets, including goodwill and other intangible assets, and liabilities to reporting units, and determining the fair value of each reporting unit. Significant judgments are required to estimate the fair value of reporting units include estimating future cash flows, determining appropriate discount rates and other assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value for each reporting unit.

During the three months ended September 30, 2006, we announced that we had been informed by one of our carrier partners that the customer plans to develop direct licensing relationships with the major record labels beginning in 2007. This constituted an event for testing the fair value of our Mobile reporting segment goodwill and certain definite-lived intangible assets, which, pursuant to the analysis, resulted in a write-off of the entire carrying value of goodwill associated with the Mobile reporting segment of $31.9 million and the impairment of other intangible assets of $12.6 million associated with the Mobile business segment.

As of September 30, 2006, we had $140.0 million of goodwill on our balance sheet relating to our Online reporting unit and $21.1 million of other intangible assets, net related to our Mobile and Online reporting units.

Restructuring

During the three months ended September 30, 2006, we committed to a plan to make operational changes to our business, which included a reduction in our workforce and, as part of the workforce reduction, consolidation of our facilities. Charges associated with this restructuring plan are accounted for in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Changing business conditions may affect the assumptions related to the timing and extent of restructuring activities. We will review the status of these activities on a quarterly basis and, if appropriate, record changes based on updated estimates.

Revenue Recognition

Our revenues are derived from products and services delivered to our customers across our two segments, Mobile and Online. In general, we recognize revenues in the period in which the services are performed, products are delivered or the transaction occurs. In certain arrangements, we record deferred revenue for amounts received from customers in advance of the performance of services or upon execution of an agreement and recognize revenues ratably over the term of the agreement or expected customer life. We generally record revenue on a gross basis in accordance with Emerging Issues Task Force Issue No. 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*. For distribution partner arrangements in our Online business, we record revenue on a gross basis and the corresponding revenue sharing payments as a content and distribution expense. For mobile operator customers in which we license the content, we record revenue on a gross basis and the corresponding licensing expense as a content and distribution expense. In the event the mobile operator customer directly licenses the content, we record as revenue the service fees we earn.

Income Taxes

We account for income taxes under the asset and liability method, under which deferred tax assets, including net operating loss carryforwards, and liabilities are determined based on temporary differences between the book and tax basis of assets and liabilities. We periodically evaluate the likelihood of the realization of deferred tax assets, and reduce the carrying amount of the deferred tax assets by a valuation allowance to the extent we believe a portion will not be realized. We consider many factors when assessing the likelihood of future realization of our deferred tax assets, including our recent cumulative earnings experience by taxing jurisdiction, expectations of future taxable income, the carryforward periods available to us for tax reporting purposes, and other relevant factors. The range of possible judgments relating to the valuation of our deferred tax assets is wide.

At December 31, 2005, based on the weight of available evidence, we determined that it was more likely than not that a portion of our deferred tax asset would be realized and, at December 31, 2005, our deferred tax asset, net of the valuation allowance, was $25.0 million. This amount was based on total deferred assets of $425.8 million, primarily comprised of $379.7 million of accumulated net operating loss carryforwards, net of a $400.8 million valuation allowance. Significant judgment is required in making this assessment, and it is very difficult to predict when, if ever, our assessment may conclude that the remaining portion of our deferred tax assets is realizable.

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Business Combinations

Business combinations accounted for under the purchase method of accounting require management to estimate the fair value of the assets acquired and liabilities assumed. The allocation of the purchase price is based on the estimated fair value of assets and liabilities acquired and may be subject to adjustments during the year following the date of acquisition related to a change in the fair value of the assets and liabilities assumed.

Allowances for Sales and Doubtful Accounts

Our management must make estimates of potential future sales allowances related to current period revenues for our products and services. We analyze historical adjustments, current economic trends and changes in customer demand and acceptance of our products when evaluating the adequacy of the sales allowances. Estimates must be made and used in connection with establishing the sales allowance in any accounting period.

The allowance for doubtful accounts is a management estimate that considers actual facts and circumstances of individual customers and other debtors, such as financial condition and historical payment trends. We evaluate the adequacy of the allowance utilizing a combination of specific identification of potentially problematic accounts and identification of accounts that have exceeded payment terms.

Contingencies

We are subject to various legal proceedings and claims, the outcomes of which are subject to significant uncertainty. SFAS No. 5, *Accounting for Contingencies*, requires that an estimated loss from a loss contingency should be accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. Disclosure of a contingency is required if there is at least a reasonable possibility that a loss has been incurred. We evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. Changes in these factors could materially impact our financial position or our results of operations. See Note 4 to our unaudited Condensed Consolidated Financial Statements for further information regarding contingencies.

Historical Results of Operations

For the three months ended September 30, 2006, our net loss was $46.7 million and while we achieved profitability for each of the twelve fiscal quarters through June 30, 2006, and for the years ended December 31, 2004 and 2005, we incurred a net loss of $42.7 million in the nine months ended September 30, 2006. Additionally, prior to 2004, we had incurred annual losses since our inception and, as of September 30, 2006, had an accumulated deficit of $1.1 billion.

In light of the rapidly evolving nature of our business and overall market conditions, we believe that period-to-period comparisons of our revenues and operating expenses are not necessarily meaningful, and you should not rely upon them as indications of our future performance.

Results of Operations for the Three and Nine Months Ended September 30, 2006 and 2005

Revenues. Revenues are derived from deploying our services and products to customers. Under many of our agreements, we earn revenue from a combination of our products and services delivered to a range of customers. Revenues for the three and nine months ended September 30, 2006 and 2005 are presented below (amounts in thousands):

Revenues	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Change from 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005	Change from 2005
Mobile	$ 47,731	$ 39,014	$ 8,717	$ 137,348	$ 115,158	$ 22,190
Online	48,567	44,211	4,356	145,070	138,270	6,800
Total	$ 96,298	$ 83,225	$ 13,073	$ 282,418	$ 253,428	$ 28,990

The increase in revenue for our Mobile products and services for the three and nine months ended September 30, 2006 as compared to the three and nine months ended September 30, 2005, is primarily due to increased revenues from the sales of our media download products, primarily sales of our labeltone or true tone (MP3-like quality) ringtones, which is approximately 69% of our Mobile revenues for the three months ended September 30, 2006 as compared to approximately 67% for the three months ended June 30, 2006. Partially offsetting the increase in revenue for Mobile products and services is the loss of a service agreement at the end of 2005. We expect that there will be a decline in our Mobile revenue in 2007 due to one of our carrier partners developing direct licensing relationships with the major record labels.

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The increase in revenue for Online products and services for the three and nine months ended September 30, 2006 as compared to the three and nine months ended September 30, 2005, is primarily due to the growth in our online search services, in particular, better monetization for paid searches, and, to a lesser extent, directory revenues related to a contract we entered into in June 2005. These increases are partially offset by a decline in revenue due to one of our top customers, Verizon, not renewing certain key provisions of our subscription agreement for yellow pages listings in June 2005. During the three and nine months ended September 30, 2006 and 2005, over 60% of our search revenues came from our search distribution partners.

Seasonality

Our Online services are historically affected by seasonal fluctuations in Internet usage, which generally declines in the summer months. Our Mobile business may also be subject to seasonality based on the timing of consumer product cycles and other factors, such as the timing of new mobile phone sales.

Content and Distribution Expenses. Content and distribution expenses consist principally of costs related to royalty and license fees related to our Mobile products for items such as ringtones, graphics and games, and other content or data licenses, and revenue sharing arrangements with our Online distribution partners, as well as online content and data licenses. Content and distribution expenses in total dollars (in thousands) and as a percent of total revenues for the three and nine months ended September 30, 2006 and 2005 are presented below:

Content and Distribution Expense	**Three Months Ended September 30, 2006**	**Three Months Ended September 30, 2005**	**Change from 2005**	**Nine Months Ended September 30, 2006**	**Nine Months Ended September 30, 2005**	**Change from 2005**
Mobile	$ 29,487	$ 20,153	$ 9,334	$ 82,823	$ 55,396	$ 27,427
Percent of Mobile Revenue	61.8%	51.7%	10.1%	60.3%	48.1%	12.2%
Online	18,217	17,551	666	52,614	52,002	612
Percent of Online Revenue	37.5%	39.7%	(2.2%)	36.3%	37.6%	(1.3%)
Total	$ 47,704	$ 37,704	$ 10,000	$ 135,437	$ 107,398	$ 28,039
Percent of Total Revenues	49.5%	45.3%	4.2%	48.0%	42.4%	5.6%

Content and distribution expenses increased by $10.0 million to $47.7 million for the three months ended September 30, 2006, as compared to $37.7 million for the three months ended September 30, 2005. The absolute dollar and cost as a percent of revenues increase for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005, was primarily attributable to revenue growth from sales of our content and media products to our Mobile customers, in particular, sales of our labeltone or true tone (MP3-like quality) ringtones, for which our costs as a percentage of revenues are greater than our other media download products. Content and distribution costs related to our Online products and services increased in absolute dollars, primarily due to an increase in revenue shared with our distribution partners. We anticipate that our Mobile content and distribution costs will continue to increase in absolute dollars if revenues from sales of our content and media products to our Mobile customers continue to increase. In addition, our content license and royalty fees have increased as a percent of Mobile revenue as a result of content price increases, variation in carrier demand for our products and the change in mix of our product sales. The cost as a percent of revenues decrease for the three months ended September 30, 2006 for Online content and distribution expense as compared to the three months ended September 30, 2005, was primarily due to better monetization of our paid searches, primarily from our own branded Web sites. We anticipate that our Online content and distribution costs will continue to increase in absolute dollars if revenues increase through growth from existing arrangements with our Online distribution partners or we add new Online distribution partners. If Online revenue generated from our distribution partners increases at a greater rate than revenues generated from our own branded Web sites, content and distribution costs as a percent of revenue will increase. We expect that there will be a decline in our content and distribution costs related to our Mobile products and services in 2007 due to the loss of revenue from one of our carrier partners developing direct licensing relationships with the major record labels.

Content and distribution expenses increased by $28.0 million to $135.4 million for the nine months ended September 30, 2006, as compared to $107.4 million for the nine months ended September 30, 2005. The absolute dollar and cost as a percent of revenues increase for the nine months ended September 30, 2006 for Mobile content and distribution expense as compared to the nine months ended September 30, 2005, was primarily attributable to revenue growth from sales of our content and media products to our Mobile customers, in particular, sales of our labeltone or true tone (MP3-like quality) ringtones, for which our costs as a percentage of revenues are greater than our other media download products. The cost as a percent of revenues decrease for the nine months ended September 30, 2006 for Online content and distribution expense as compared to the nine months ended September 30, 2005, was primarily due to better monetization of our paid searches, primarily from our own branded Web sites.

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Systems and Network Operations Expenses. Systems and network operations consists of expenses associated with the delivery, maintenance and support of our products, services and infrastructure, including personnel expenses, which include salaries, benefits and other employee related costs, stock-based compensation, and temporary help and contractors to augment our staffing, professional service fees, and communication costs and equipment repair and maintenance. Systems and network operations expenses in total dollars (in thousands) and as a percent of total revenues for the three and nine months ended September 30, 2006 and 2005 are presented below:

	Three Months Ended September 30,		Change from	Nine Months Ended September 30,		Change from
	2006	2005	2005	2006	2005	2005
Systems and Network Operations	$ 8,391	$ 5,492	$ 2,899	$ 23,379	$ 14,804	$ 8,575
Percent of Revenues	8.7%	6.6%	2.1%	8.3%	5.8%	2.5%

Systems and network operations expenses increased by $2.9 million to $8.4 million for the three months ended September 30, 2006 as compared to $5.5 million for the three months ended September 30, 2005. The absolute dollar increase for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005 was primarily attributable to an increase in software license fees and communication costs of $1.2 million related to growth in our business, an increase of $758,000 in personnel expenses and contractors to augment our staffing, which was the result of additional headcount due to growth in our business, and stock-based compensation expense of $496,000.

Systems and network operations expenses increased by $8.6 million to $23.4 million for the nine months ended September 30, 2006, as compared to $14.8 million for the nine months ended September 30, 2005. The absolute dollar increase for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005 was primarily attributable to an increase of $3.9 million in personnel expenses and contractors to augment our staffing, which was the result of additional headcount due to growth in our business, stock-based compensation expense of $1.2 million, an increase in software license fees and communication costs of $3.0 million related to growth in our business, and an increase in professional service fees of $730,000. These increases were partially offset by reductions in facilities expenses.

Product Development Expenses. Product development expenses consist principally of personnel expenses, which include salaries, benefits and other employee related costs, stock-based compensation, and temporary help and contractors to augment our staffing, for research, development, support and ongoing enhancements of our products and services. Product development expenses in total dollars (in thousands) and as a percent of total revenues for the three and nine months ended September 30, 2006 and 2005 are presented below:

	Three Months Ended September 30,		Change from	Nine Months Ended September 30,		Change from
	2006	2005	2005	2006	2005	2005
Product Development Expenses	$ 12,099	$ 7,840	$ 4,259	$ 33,874	$ 22,807	$ 11,067
Percent of Revenues	12.6%	9.4%	3.2%	12.0%	9.0%	3.0%

Product development expenses increased by $4.3 million to $12.1 million for the three months ended September 30, 2006 as compared to $7.8 million for the three months ended September 30, 2005. The absolute dollar increase for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005 was primarily attributable to an increase of $3.7 million in personnel related expenses and contractors to augment our staffing, as we continued to invest in the development and enhancement of our products and services, and stock-based compensation of $762,000.

Product development expenses increased by $11.1 million to $33.9 million for the nine months ended September 30, 2006 as compared to $22.8 million for the nine months ended September 30, 2005. The absolute dollar increase for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005 was primarily attributable to an increase of $9.9 million in personnel related expenses and contractors to augment our staffing, as we continued to invest in the development and enhancement of our products and services, and $1.9 million of stock-based compensation. The increase for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005 was partially offset by reductions in professional service fees of $520,000.

Product development costs may not be consistent with revenue trends as they represent key costs to develop and enhance our product offerings. We believe that investments in technology and new products are necessary to remain competitive, and we anticipate that product development expenses will increase in absolute dollars as we continue to invest in our products and services.

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Sales and Marketing Expenses. Sales and marketing expenses consist principally of personnel costs, which include salaries, benefits and other employee related costs, stock-based compensation, and temporary help and contractors to augment our staffing, and advertising, market research and promotion expenses. Sales and marketing expenses in total dollars (in thousands) and as a percent of total revenues for the three and nine months ended September 30, 2006 and 2005 are presented below:

	Three Months Ended September 30,		Change from	Nine Months Ended September 30,		Change from
	2006	2005	2005	2006	2005	2005
Sales and Marketing Expenses	$ 12,946	$ 8,519	$ 4,427	$ 35,076	$ 23,421	$ 11,655
Percent of Revenues	13.5%	10.2%	3.3%	12.4%	9.2%	3.2%

Sales and marketing expenses increased by $4.4 million to $12.9 million for the three months ended September 30, 2006 as compared to $8.5 million for the three months ended September 30, 2005. The absolute dollar increase for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005 was primarily attributable to an increase in personnel expenses totaling $2.9 million and $1.4 million of stock-based compensation expense.

Sales and marketing expenses increased by $11.7 million to $35.1 million for the nine months ended September 30, 2006 as compared to $23.4 million for the nine months ended September 30, 2005. The absolute dollar increase for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005 was primarily attributable to an increase in personnel expenses totaling $6.0 million, $4.0 million of stock-based compensation, and an increase of $1.7 million in marketing and promotional expense.

Sales and marketing expenses may increase in absolute dollars as we continue to invest in marketing initiatives and sales promotions and expand our products, services and distribution channels, including our branded Web site, Moviso.com, where we provide media products and content directly to consumers.

General and Administrative Expenses. General and administrative expenses consist primarily of personnel expenses, which include salaries, benefits and other employee related costs, stock-based compensation, professional service fees, which include legal fees, audit fees, SEC compliance costs, which include costs related to compliance with the Sarbanes-Oxley Act of 2002, occupancy and general office expenses, and general business development and management expenses. General and administrative expenses in total dollars (in thousands) and as a percent of total revenues for the three and nine months ended September 30, 2006 and 2005 are presented below:

	Three Months Ended September 30,		Change from	Nine Months Ended September 30,		Change from
	2006	2005	2005	2006	2005	2005
General and Administrative Expenses	$ 13,498	$ 9,671	$ 3,827	$ 40,131	$ 30,005	$ 10,126
Percent of Revenues	14.0%	11.6%	2.4%	14.2%	11.8%	2.4%

General and administrative expenses increased by $3.8 million to $13.5 million for the three months ended September 30, 2006 as compared to $9.7 million for the three months ended September 30, 2005. The absolute dollar increase for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005 was primarily attributable to stock-based compensation expense of $2.1 million, a $1.4 million charge related to a liability incurred as a result of an arbitration decision, and an increase in facilities expenses totaling $607,000. These increases were partially offset by reductions in business taxes.

General and administrative expenses increased by $10.1 million to $40.1 million for the nine months ended September 30, 2006 as compared to $30.0 million for the nine months ended September 30, 2005. The absolute dollar increase for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005 was primarily attributable to stock-based compensation expense of $6.5 million, $2.2 million related to certain liabilities incurred as a result of arbitration decisions and certain litigation settlements, an increase in personnel related expenses totaling $1.7 million, an increase in recruiting costs of $1.2 million, and an increase in facilities expenses totaling $1.1 million. These increases were partially offset by reductions in business taxes of $1.4 million, reductions in litigation expenses of $872,000, and reductions in bad debt and public relations.

Restructuring. On September 20, 2006, we announced that we had been informed by one of our carrier partners that the customer plans to develop direct licensing relationships with the major record labels beginning in 2007. We expect that these direct relationships will have a material negative impact on our revenues and operating results. As a result, during the three months ended September 30, 2006, we committed to a plan to make operational changes to our business to align costs with expected future revenues. The plan included a reduction in our workforce and, as part of the workforce reduction, consolidation of our facilities. Also during September 2006, we initiated a plan to close our office in Hamburg, Germany. During the three and nine months ended September 30, 2006 we recorded a total restructuring charge of $57.8 million, consisting of $44.5 million impairment of intangible assets and goodwill, $5.6 million of expected losses on contractual commitments, $5.3 million employee separation costs (net of stock compensation expense recapture of $1.1 million), primarily severance payments, and $2.4 million in excess facilities and related fixed assets. In future periods, adjustments and additions

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may be made to the amounts recorded as of September 30, 2006. There were no restructuring charges in 2005. Salaries and other costs are expected to decline in the future as a result of the reduction in our workforce. We may also record approximately $3 million to $4 million in additional pre-tax restructuring charges in the future.

Depreciation. Depreciation of property and equipment includes depreciation of network servers and data center equipment, computers, software, office equipment and fixtures, and leasehold improvements. Depreciation of property and equipment totaled $4.6 million and $11.4 million for the three and nine months ended September 30, 2006, respectively, compared to $2.5 million and $6.2 million for the three and nine months ended September 30, 2005, respectively. Depreciation expense increased primarily as a result of property and equipment recently placed in service related to our redundant data center.

Amortization of Intangible Assets. Amortization of definite-lived intangible assets includes amortization of core technology, customer and content relationships, customer lists and other intangible assets. Amortization of other intangible assets totaled $3.0 million and $10.4 million during the three and nine months ended September 30, 2006, respectively, compared to $3.7 million and $11.6 million during the three and nine months ended September 30, 2005, respectively. The decrease from the three and nine months ended September 30, 2005 to the three and nine months ended September 30, 2006 is primarily attributable to intangible assets that reached the end of their estimated useful lives and were accordingly fully amortized. As part of the restructuring, related intangible assets have been assessed for impairment and changes in their useful lives. Any impairment was charged to restructuring costs. The expected future amortization of intangible assets at September 30, 2006 is $1.8 million for the remainder of 2006 and $3.7 million in 2007.

Other Income, Net. Other income, net, primarily consists of interest income, gain from litigation settlements and foreign currency gain (loss).

	Three Months Ended September 30,		Change from	Nine Months Ended September 30,		Change from
	2006	2005	2005	2006	2005	2005
Interest income	$ 5,399	$ 3,112	$ 2,287	$ 14,176	$ 7,760	$ 6,416
Gain on litigation settlement					79,297	(79,297)
Foreign currency transaction gain (loss)	(50)	(42)	(8)	(60)	(1,062)	1,002
Other items, net	56	(96)	152	(116)	(29)	(87)
	$ 5,405	$ 2,974	$ 2,431	$ 14,000	$ 85,966	$ (71,966)

The increase in interest income for the three and nine months ended September 30, 2006, as compared to the three and nine months ended September 30, 2005, was primarily attributable to an increase in interest rates. In the nine months ended September 30, 2005, we recorded a gain of $79.3 million in other income from the settlement of several outstanding litigation matters. The gain was based on the receipt of $83.2 million in cash in March 2005, less $3.9 million in legal fees. Partially offsetting this gain was a $934,000 foreign currency transaction loss related to a forward exchange contract we entered into in December 2004 in connection with a business acquisition.

Provision for Income Taxes. We recorded a benefit for income taxes of $11.7 million and $8.3 million for the three and nine months ended September 30, 2006, respectively. We recorded an income tax benefit of $451,000 and an income tax expense of $1.9 million for the three and nine months ended September 30, 2005, respectively. For the three and nine months ended September 30, 2006, the benefit for income taxes includes U.S. federal tax, U.S. federal alternative minimum tax (AMT), state, and international taxes. For 2005, the provision for income taxes included AMT, state, and international taxes. Due to our restructuring charge, we expect to record a tax benefit for U.S. federal, AMT, state, and international taxes for the remainder of 2006. In 2005, we recorded an income tax benefit of $23.5 million, primarily due to a $25.0 million tax benefit recorded in the fourth quarter of 2005 from the realization of a deferred tax asset related to a portion of our net operation loss carryforwards.

Liquidity and Capital Resources

As of September 30, 2006, we had cash and marketable investments of $411.0 million, consisting of cash and cash equivalents of $172.6 million and short-term investments available-for-sale of $238.5 million. We invest our excess cash in high quality marketable investments. These investments include securities issued by U.S. government agencies, certificates of deposit, money market funds, and taxable municipal bonds.

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Commitments and Pledged Funds

The following are our contractual commitments associated with our operating lease obligations (in thousands):

	Remainder of 2006	2007	2008	2009	2010	Thereafter	Total
Operating lease commitments, net of sublease income	$ 1,927	$ 7,493	$ 5,201	$ 6,831	$ 6,695	$ 11,037	$ 39,184

We have pledged a portion of our cash and cash equivalents as collateral for standby letters of credit and bank guaranties for certain of our property leases. At September 30, 2006, the total amount of collateral pledged under these agreements was $4.3 million.

Cash Flows

Net cash provided by operating activities consists of net income (loss) offset by certain adjustments not affecting current period cash flows, and the effect of changes in our operating assets and liabilities. Our net cash flows are comprised of the following for the nine months ended September 30, 2006 and 2005 (in thousands):

	Nine Months Ended September 30,	
	2006	2005
Net cash provided by operating activities	$ 48,697	$ 135,071
Net cash used by investing activities	(34,046)	(50,088)
Net cash provided (used) by financing activities	4,893	(52,695)
Net increase in cash and cash equivalents	$ 19,544	$ 32,288

Net cash provided by operating activities was $48.7 million for the nine months ended September 30, 2006, consisting of our net loss of $42.7 million, an increase in our operating assets and liabilities of $10.8 million, consisting of decreases in accounts receivable, prepaid expenses, and other current assets and increases in accounts payable, accrued expenses and other current and long-term liabilities and deferred revenue. Also increasing our operating cash were primarily adjustments not affecting cash flows provided by operating activities of $93.2 million, consisting of restructuring, depreciation, amortization, and stock-based compensation expense. These increases were partially offset by a $9.6 million change not affecting cash flows provided by operating activities in deferred income taxes and changes in our operating assets and liabilities of $3.0 million, consisting of increases in other long-term assets and other receivables.

Net cash provided by operating activities was $135.1 million for the nine months ended September 30, 2005, consisting of our net income of $121.4 million, which includes a $79.3 million net gain from a legal settlement, an increase in our operating assets and liabilities of $17.0 million, consisting of a decrease in notes and other receivables and an increase in accounts payable, and adjustments not affecting cash flows provided by operating activities of $18.2 million, consisting of depreciation and amortization and bad debt expense. Partially offsetting the increase are changes in our operating assets and liabilities of $20.0 million primarily consisting of increases in accounts receivable, and prepaid expenses and other current assets and decreases in accrued expenses, deferred revenue, and other liabilities, and adjustments not affecting operating cash flows of $1.6 million primarily consisting of deferred tax liabilities.

Net cash used by investing activities totaled $34.0 million for the nine months ended September 30, 2006, primarily consisting of $18.5 million used to purchase property and equipment and the net increase in short-term investments of $15.7 million.

Net cash used by investing activities totaled $50.1 million for the nine months ended September 30, 2005, primarily consisting of $26.4 million used for our acquisition of elkware, $11.8 million used to purchase property and equipment, and the net purchase of short-term and long-term investments of $7.7 million.

Net cash provided by financing activities totaled $4.9 million in the nine months ended September 30, 2006 and consisted of cash proceeds from the exercise of stock options and from sales of shares through our employee stock purchase plan.

Net cash used by financing activities totaled $52.7 million in the nine months ended September 30, 2005, and primarily consisted of $62.3 million used to repurchase our common stock. Partially offsetting the decrease was $9.6 million in cash proceeds from the exercise of stock options and from sales of shares through our employee stock purchase plan.

We plan to use our cash to fund operations, develop technology, advertise, market and distribute our products and application services, and continue the enhancement of our network infrastructure. We may use a portion of our cash for acquisitions or for common stock repurchases.

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We believe that existing cash balances, cash equivalents, short term investments and cash generated from operations will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next 12 months. However, the underlying assumed levels of revenues and expenses may not prove to be accurate. Our anticipated cash needs exclude any payments for pending or future litigation matters or claims. In addition, we evaluate acquisitions of businesses, products or technologies that complement our business from time to time. Any such transactions may use a portion of our cash and marketable investments. We may seek additional funding through public or private financings or other arrangements prior to such time. Adequate funds may not be available when needed or may not be available on favorable terms. If we raise additional funds by issuing equity securities, dilution to existing stockholders will result. If funding is insufficient at any time in the future, we may be unable to develop or enhance our products or services, take advantage of business opportunities or respond to competitive pressures, any of which could harm our business.

Stock Repurchase Program

On May 30, 2006, our Board of Directors approved a stock repurchase plan whereby we are authorized to purchase up to $100 million of our common stock during the succeeding twelve month period. Repurchased shares will be retired and resume the status of authorized but unissued shares of common stock. We did not purchase any shares during the nine months ended September 30, 2006. Under a previous repurchase plan authorized on May 13, 2005, which expired May 12, 2006, we purchased 2,633,002 shares in open-market transactions during 2005 at a total cost, exclusive of purchase and administrative costs, of $70.2 million, at an average price of $26.66 per share.

Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standard Board (FASB) issued Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*. FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN No. 48 is effective for our first fiscal year beginning after December 15, 2006. We are currently evaluating the provisions of FIN No. 48 to determine what effect its adoption on January 1, 2007 will have on our financial position, cash flows, and results of operations.

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB No. 108 provides interpretive guidance on how the effects of prior-year uncorrected misstatements should be considered when quantifying misstatements in the current year financial statements. SAB No. 108 requires registrants to quantify misstatements using both an income statement (rollover) and balance sheet (iron curtain) approach and evaluate whether either approach results in a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. If prior year errors that had been previously considered immaterial now are considered material based on either approach, no restatement is required so long as management properly applied its previous approach and all relevant facts and circumstances were considered. If prior years are not restated, the cumulative effect adjustment is recorded in opening accumulated deficit as of the beginning of the fiscal year of implementation. SAB No. 108 is effective for fiscal years ending on or after November 15, 2006, with earlier implementation encouraged. We do not believe that our implementation of SAB No. 108 will have an effect on our financial position, cash flows, or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosure of fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements and accordingly, does not require any new fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are currently evaluating the provisions of SFAS No. 157 to determine what effect its adoption on January 1, 2008 will have on our financial position, cash flows, and results of operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our market risks at September 30, 2006 have not changed significantly from those discussed in Item 7A of our Form 10-K for the year ended December 31, 2005 on file with the Securities and Exchange Commission. See also Management s Discussion and Analysis of Financial Condition and Results of Operations section of Item 2 of Part I of this Form 10-Q for additional discussions of our market risks.

Item 4. Controls and Procedures

(a) *Evaluation of disclosure controls and procedures*. Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our

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Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure, and that such information is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

(b) *Changes in internal control over financial reporting*. There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934).

PART II OTHER INFORMATION

Item 1. Legal Proceedings

See the litigation disclosure under the subheading Litigation in Note 4 to our unaudited Condensed Consolidated Financial Statements.

Item 1A. Risk Factors

RISKS RELATED TO OUR BUSINESS

A substantial portion of our revenues is dependent on our relationships with a small number of distribution partners who distribute our products and services, the loss of which would have a material adverse effect on our financial results.

We rely on our relationships with distribution partners, including mobile operators, Web portals and software application providers, for distribution of our products and services. We generated approximately 50%, 52%, and 51% of our total revenues through relationships with our top five distribution partners for the third, second, and first quarters of 2006, respectively. We cannot assure you that these relationships will continue or result in benefits to us that outweigh the cost of the relationships. One of our biggest challenges is providing our distribution partners with relevant products and services at competitive prices in rapidly evolving markets. In particular, our mobile operator distribution partners may at any time seek financial or competitive advantages by licensing content directly from our content providers, particularly the four major record labels, thereby reducing or eliminating the need for our products and services related to such content. We recently announced that one of our major mobile customers has informed us that it plans to develop direct licensing relationships with the major record labels beginning in 2007. We anticipate that the direct relationships to be developed by this mobile customer will have a material negative impact on our revenues and operating results. In addition, other distribution partners, including our other mobile distribution partners, may create their own products and services or also seek to license products and services from others that compete with or replace the products and services that we provide. Also, many of our search distribution partners are developing companies with limited operating histories and evolving business models that may prove unsuccessful even if our products and services are relevant and our prices competitive. If we are not able to maintain our relationships with our continuing distribution partners, our financial results would be materially adversely affected.

Our mobile operator distribution partner agreements generally come up for renewal on an annual basis, and our agreements with most of our online search and directory distribution partners come up for renewal in 2006 and 2007. Such agreements may be terminated or may not be renewed or replaced on favorable terms, which could adversely impact our financial results. In particular, we are experiencing pricing pressure in our mobile business, and competition is increasing for consumer traffic in the search and directory markets. We anticipate that the cost of our content for our mobile products and services and the cost of our revenue sharing arrangements with our search distribution partners will increase as revenues grow and may increase on a relative basis compared to revenues to the extent that there are changes to existing arrangements or we enter into new arrangements on less favorable terms.

Failure by us or our distribution partners to comply with the requirements imposed by our content providers relating to the distribution of content may require us to modify, terminate or not enter into certain distribution relationships, may cause the content provider to terminate its agreement with us, and may expose us to liability.

If our search distribution partners or we fail to meet the requirements and guidelines promulgated by our major search content providers, we may not be able to continue to provide content to such distribution partners, we may be liable to such content providers for certain damages they may suffer, and the content provider may terminate its agreement with us. Certain of our search content providers had notified us that we were not in compliance with respect to our use of their content or the redistribution of their content by our distribution partners. We have been able to cure such breaches, however, there can be no

assurance that if we breach our agreements in the future we will be able to cure the breach. Our agreements with some of our major content providers give such content providers the ability to terminate their agreements with us immediately in the case of certain breaches, regardless of whether such breaches could be cured.

Additionally, agreements with our search content providers may be amended from time to time by both parties or may be subject to different interpretation by either party, which may require the rights we grant to our search distribution partners to be modified to comply with such amendments or interpretations. The agreements with our search distribution partners generally provide that we may modify the rights we grant to them to avoid being in conflict with the agreements with our search content providers. For example, recent changes by some of our search content providers such as Yahoo! and Google to their approval processes and guidelines with respect to downloadable applications through which content is provided to end users have resulted in some of our search distribution partners changing the manner in which they distribute their downloadable applications to end users to meet the new approval processes and guidelines. Other distribution partners have not been able to meet the new guidelines, and as a result we no longer provide the applicable content or any content, as the case may be, to such distribution partners or certain of their downloadable applications. Also, our search content providers have approval processes with respect to the redistribution of their content by our distribution partners. Some of our distribution partners that redistribute such content have not complied with such approval processes, and we no longer provide the applicable content to such partners or such partners no longer redistribute the content. If our search content providers impose additional restrictions, some of our distribution partners may be required to make changes to the manner in which they distribute their downloadable applications or may be required to cease redistributing the content. If such distribution partners are unable to meet the new restrictions, we may need to terminate our agreement with such distribution partners or no longer provide the applicable content to such partners.

The loss or reduction of content that we can make available to our distribution partners, as well as the termination of distribution or content provider agreements, as described above, could have a material adverse effect on our financial results.

A substantial portion of our revenues is attributable to a small number of customers, the loss of any one of which would harm our financial results.

We derive a substantial portion of our revenues from a small number of customers. We expect that concentration will continue in the foreseeable future. Our top five customers represented approximately 86%, 85%, and 84% of our revenues in the third, second, and first quarters of 2006, respectively. Cingular Wireless, Google and Yahoo! each accounted for more than 10% of our revenues in the three month period ended September 30, 2006. Our principal agreements with these customers expire in 2006, 2009 and 2008, respectively. Also, some of these customers are competitors of each other, and the way we do business with one of them may not be acceptable to one or some of their competitors with whom we also do business, which may result in such competitors not renewing their agreements with us on favorable terms.

If any of our top customers significantly reduces or eliminates the content or services it receives from us under our existing contracts, or we are unable to renew the contracts on favorable terms, or any of these customers are unwilling to pay us amounts that they owe us, or dispute amounts they owe us or have paid to us, our financial results would materially suffer. For example, we recently announced that one of our mobile customers has informed us that it plans to develop direct licensing relationships with the major record labels beginning in 2007. Although this mobile content customer can continue to receive, or reduce further, the mobile content and services it receives from us under our existing agreements, we expect that the loss of the labeltones content portion will have a material negative impact on our revenues and operating results.

Our strategic direction is evolving, including through our restructuring, which could negatively affect our future results.

Since inception, our business model has evolved and is likely to continue to evolve as we refine our product offerings and market focus. Since 2003, we have focused on our search, directory, and mobile products and services. We continue to evaluate opportunities in a rapidly evolving market. We plan to leverage our intellectual capital and core competencies to focus more on mobile applications, products and services. As part of this plan, in early 2006, we realigned our operations to a functional organization structure, eliminating the separate business units of Mobile and Search & Directory. We recently announced that one of our mobile customers has informed us that it plans to develop direct licensing relationships with the major record labels beginning in 2007. In light of this announcement, we plan to continue building on our strong foundations in mobile technology and online discovery, including leveraging our search and directory technology and applications for mobile devices, but have suspended investments in developing or obtaining more mobile content and certain new mobile distribution channels, including our direct to consumer online web site, Moviso.com. These changes to our business may not prove successful in the short or long term due to a variety of factors, including competition, consumer adoption and demand for products and services, and other factors described in this section, and may have a material negative impact on our financial results.

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In addition, we have in the past and may in the future find it advisable to streamline operations and reduce expenses, including, without limitation, such measures as reductions in the workforce, discretionary spending, and/or capital expenditures as well as other steps to reduce expenses. We recently announced a restructuring plan that includes the elimination of approximately 250 positions taking place over time through mid-2007 and the recording of pre-tax restructuring charges of $57.8 million as part of our effort to align costs with expected future revenues that will be negatively impacted by one of our mobile distribution partners developing direct licensing relationships with the major record labels. Effecting this or any such restructuring will likely place significant strains on management and our operational, financial, employee and other resources. In addition, any such restructuring could impair our development, marketing, sales and customer support efforts or alter our product development plans. Our suspension of investment in developing or obtaining new content may also negatively impact our relationships with our mobile operator distribution partners who may decide to obtain content or services from other sources offering a more complete mobile content and services package.

We have a history of incurring net losses, we may incur net losses in the future, and we may not be able to regain or sustain profitability on a quarterly or annual basis.

We incurred net losses on an annual basis from our inception through December 31, 2003. For the nine months ended September 30, 2006, we recorded a loss of $42.7 million. As of September 30, 2006, we had an accumulated deficit of $1.1 billion. We may incur net losses in the future including from the impairment of goodwill or other intangible assets, losses from acquisitions, restructuring charges or stock option expensing. While we achieved profitability in each of the twelve fiscal quarters ending on June 30, 2006 and on an annual basis for the years ended December 31, 2005 and 2004, we incurred a net loss of $46.7 million during the third quarter of 2006 due primarily to costs associated with our recently announced restructuring plan. There can be no assurance that we will be able to regain profitability on a quarterly or annual basis or, if regained, to sustain it.

Our financial results are likely to continue to fluctuate, which could cause our stock price to be volatile or decline.

Our financial results have varied on a quarterly basis and are likely to fluctuate in the future. These fluctuations could cause our stock price to be volatile or decline. Several factors could cause our quarterly results to fluctuate materially, including:

- the loss, termination or reduction in scope of key distribution or content relationships, such as by distribution partners licensing content directly from content providers;
- variable demand for our products and services, including seasonal fluctuations, rapidly evolving technologies and markets and consumer preferences;
- the impact on revenues or profitability of changes in pricing for our products and services;
- increased costs related to investments for new initiatives, including new products and services and new distribution channels;
- additional restructuring charges we may need to incur in the future;
- the results from shifts in the mix of products and services we provide;
- the effects of acquisitions by us, our customers or our distribution partners;
- increases in the costs or availability of content for or distribution of our products;

- the adoption of the new accounting standard in 2006 that requires us to expense the fair value of our employee stock options and other equity awards;

- the adoption of new laws, rules or regulations, or new court rulings, regarding intellectual property that may adversely affect our ability to continue to acquire content and distribute our products and services, or the ability of our content providers or distribution partners to continue to provide us with their content or distribute our products and services or increase our potential liability;

- impairment in the value of long-lived assets or the value of acquired assets, including goodwill, core technology and acquired contracts and relationships;

- the effect of changes in accounting principles or in our accounting treatment of revenue or expense matters;

- litigation expense, including settlement claims;

- the adoption of new regulations or accounting standards; and

- the foreign currency effects from transactions denominated in currencies other than the U.S. dollar.

For these reasons, among others, you should not rely on period-to-period comparisons of our financial results to forecast our future performance. Furthermore, our fluctuating operating results may fall below the expectations of securities analysts or investors, which could cause the trading price of our stock to decline.

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We operate in new and rapidly evolving markets, and our business model continues to evolve, which makes it difficult to evaluate our future prospects.

Our potential for future profitability must be considered in the light of the risks, uncertainties, and difficulties encountered by companies that are in new and rapidly evolving markets and continuing to innovate with new and unproven technologies or services, as well as undergoing significant change. Our search, directory and mobile products and services are in young industries that have undergone rapid and dramatic changes in their short history. In addition to the other risks we describe in this section, some of these risks relate to our potential inability to:

- retain and expand our existing mobile operator arrangements, or maintain or expand amount of products and services provided to them under such arrangements, or expand into new distribution channels;
- attract and retain distribution partners for our search and directory services;
- attract and retain content partners;
- manage our growth, control expenditures and align costs with revenues; and
- respond quickly and appropriately to competitive developments, including:
  - rapid technological change;
  - alternatives to access the Internet or mobile devices;
  - changes in customer requirements;
  - new products introduced into our markets by our competitors; and
  - regulatory changes affecting the industries we operate in or the markets we serve both in the United States and foreign countries.

If we do not effectively address the risks we face, we may not be able to achieve profitability.

We depend on third parties for content, and the loss of access to or increased cost of this content could cause us to reduce our product offerings to customers and could negatively impact our financial results.

We currently create only a relatively small portion of our content. In most cases, we acquire rights to content from numerous third-party content providers, and our future success is highly dependent upon our ability to maintain relationships with these content providers and enter into new relationships with other content providers.

We typically license content under arrangements that require us to pay usage or fixed monthly fees for the use of the content or require us to pay under a revenue-sharing arrangement. Further, our musical composition and other media licenses for the creation of mobile content consisting of ringtones generally require royalty payments on a most favored nation basis, which requires us to pay the highest royalty paid to any licensor to all such licensors. In the future, some of our content providers may not give us access to important content or may increase the royalties, fees or percentages that they charge us for their content, which could have a material negative effect on our operating results. Also, our agreements with the four major record labels for ringtones, which comprise a significant portion of our mobile business revenues, typically have terms of one year or less. If we fail to enter into or maintain satisfactory arrangements with content providers, particularly with our major content providers, our ability to provide a variety of products and services to our customers could be severely limited, which would have a material negative effect on our operating results. Also, even if we maintain agreements with our major content partners, such partners may directly contract with our distribution partners as well, reducing the demand by our distribution partners for content coming through us. Additionally, our content license and royalty fees will increase to the extent that our revenues related to such products and services increase and may increase as a percent of revenues as a result of price competition and carrier demand for our products and services and the mix of our product sales.

We rely on a complex royalty calculation process to estimate our royalty liability and have been and are continuously subject to audits by our content providers and partners. If substantial errors are found in estimating our royalty obligation, it could subject us to significant liability to the affected content provider or distribution partner and have an adverse effect on our financial results.

Our agreements with some of our major customers contain minimum revenue or minimum service level requirements that we must meet in order to avoid reduction in payments from such customers.

Under our agreements with some of our major customers, we are required to generate a minimum amount of revenue. If we do not reach these minimums, we may be required to compensate our customer for the difference between the guarantee and the shortfall. If such shortfall is substantial, it could have a material adverse effect on our financial results.

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Furthermore, we have entered into service level agreements with most of our mobile operator customers and certain other customers. These agreements generally call for specific system up times and 24/7 support and include penalties for non-performance. We may be unable to fulfill these commitments, which could subject us to substantial penalties under those agreements, harm our reputation and result in the loss of customers and distribution partners, which would have an adverse effect on our financial results.

Our financial and operating results will suffer if we are unsuccessful at integrating acquired technologies and businesses.

We have acquired a number of technologies and businesses in the past and may engage in further acquisitions in the future. Acquisitions may involve use of cash, potentially dilutive issuances of stock, the potential incurrence of debt and contingent liabilities or amortization expenses related to certain intangible assets. In the past, our financial results have suffered significantly due to impairment charges of goodwill and other intangible assets related to prior acquisitions. Acquisitions also involve numerous risks which could materially and adversely affect our results of operations or stock price, including:

- difficulties in assimilating the operations, products, technology, information systems and personnel of acquired companies which result in unanticipated costs, delays or allocation of resources;
- difficulties in acquiring foreign companies, including risks related to integrating operations across different cultures and languages, currency risks and the particular economic, political and regulatory risks associated with specific countries;
- the dilutive effect on earnings per share as a result of incurring operating losses and the amortization of acquired intangible assets for the acquired business;
- diverting management s attention from other business concerns;
- impairing relationships with our customers or those of the acquired companies, or breaching a significant or material contract due to the consummation of the acquisition;
- impairing relationships with our employees or those of the acquired companies;
- failing to achieve the anticipated benefits of the acquisitions in a timely manner; and
- adverse outcome of litigation matters assumed in or arising out of the acquisitions.

The success of the operations of companies that we have acquired will often depend on the continued efforts of the management and key employees of those acquired companies. Accordingly, we have typically attempted to retain key employees and members of existing management of acquired companies under the overall supervision of our senior management. We have, however, not always been successful in these attempts at retention. Failure to retain key employees of an acquired company may make it more difficult to integrate or manage the business of the acquired company, may reduce the anticipated benefits of the acquisition by increasing costs, causing delays, or otherwise and may expose us to additional competition from companies these employees may join or form.

Our stock price has been and is likely to continue to be highly volatile.

The trading price of our common stock has been highly volatile. Since we began trading on December 15, 1998, our stock price has ranged from $3.70 to $1,385.00 (as adjusted for stock splits). On November 3, 2006, the closing price of our common stock was $19.85. Our stock price could decline or be subject to wide fluctuations in response to factors such as the other risks discussed in this section and the following, among others:

actual or anticipated variations in quarterly and annual results of operations;

announcements of significant acquisitions, dispositions, charges, changes in material contracts or other business developments by us, our customers, distribution partners or competitors;

conditions or trends in the search, directory or mobile products and services markets;

announcements of technological innovations, new products or services, or new customer or partner relationships by us or our competitors;

changes in financial estimates or recommendations by securities analysts;

disclosures of any material weaknesses in internal control over financial reporting;

the adoption of new regulations or accounting standards; and

announcements or publicity relating to litigation and similar matters.

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In addition, the stock market in general, and the Nasdaq Stock Market formerly known as the NASDAQ National Market and the market for Internet and technology company securities in particular, have experienced extreme price and volume fluctuations. These broad market and industry factors and general economic conditions may materially and adversely affect our stock price. Our stock has been subject to such price and volume fluctuations in the recent past. Often, class action litigation has been instituted against companies after periods of volatility in the overall market and the price of such companies stock. If such litigation were to be instituted against us, even if we were to prevail, it could result in substantial cost and diversion of management s attention and resources.

If we are unable to retain our key employees, we may not be able to successfully manage our business.

Our business and operations are substantially dependent on the performance of our executive officers and key employees, all of whom, except our chief executive officer, are employed on an at-will basis. If we lose the services of one or more of our executive officers or key employees and are unable to recruit and retain a suitable successor(s), we may not be able to successfully manage our business or achieve our business objectives. Additionally, our recently announced reduction of approximately 250 positions through mid-2007 as the result of our restructuring could place significant strain on many of the remaining employees, including key employees, as well as create uncertainty about their and our future prospects. Also, some employees scheduled to be terminated may decide to terminate their employment before their scheduled termination by us, creating additional strain and uncertainty on the remaining employees. If we are unable to retain the services of the remaining key employees, or if employees who are key during some aspects of the restructuring but who are scheduled to be terminated leave before their scheduled termination by us, it could increase the potential effects of the restructuring on our development, sales and customer support efforts or alter our product development plans.

Unless we are able to hire, retain and motivate highly qualified employees, we will be unable to execute our business strategy.

Our future success depends on our ability to identify, attract, hire, retain and motivate highly skilled technical, managerial, sales and marketing, and corporate development personnel. Our services and the industries to which we provide our services are relatively new. Qualified personnel with experience relevant to our business are scarce and competition to recruit them is intense. If we fail to successfully hire and retain a sufficient number of highly qualified employees, we may have difficulties in supporting our customers or expanding our business. Additional realignments of resources, reductions in workforce, including the recently announced reduction in workforce of approximately 250 positions through mid-2007, or other future operational decisions could create an unstable work environment and may have a negative effect on our ability to retain and motivate employees.

In light of current market and regulatory conditions, the value of stock options granted to employees may cease to provide sufficient incentive to our employees.

Like many technology companies, we use stock options to recruit technology professionals and senior level employees. Our stock options, which typically vest over a three- or four-year period, are one of the means by which we motivate long-term employee performance. Recent changes in accounting treatment of options requiring us to expense the fair value of our employee stock options beginning in 2006 may make it difficult or overly expensive for us to issue stock options to our employees in the future. We also face a significant challenge in retaining our employees if the value of these stock options is either not substantial enough or so substantial that the employees leave after their stock options have vested. If our stock price does not increase significantly above the prices of our options, or option programs become impracticable, we may need to issue new options or other equity incentives or increase other forms of compensation to motivate and retain our employees. We may undertake or seek stockholder approval to undertake programs to retain our employees, which may be viewed as dilutive to our stockholders or may increase our compensation costs. Additionally, there can be no assurance that any such programs we undertake will be successful in motivating and retaining our employees.

Our search and directory products and services may expose us to claims relating to how the content was obtained or distributed.

Our search and directory services link users, either directly through our Web sites or indirectly through the Web properties of our distribution partners, to third party Web pages and content in response to search queries. These services could expose us to legal liability from claims relating to such third-party content and sites, the manner in which these services are distributed by us or our distribution partners, or how the content provided by our third-party content providers was obtained or provided by our content providers. Such claims could include the following: infringement of copyright, trademark, trade secret or other proprietary rights; violation of privacy and publicity rights; unfair competition; defamation; providing false or misleading information; obscenity; and illegal gambling. Regardless of the legal merits of any such claims, they could result in costly litigation, be time consuming to defend and divert management s attention and resources. If there were a determination that we had violated third-party rights or applicable law, we could incur substantial monetary liability, be required to enter into costly royalty or licensing arrangements (if available), or be required to change our business practices. We may also have obligations to indemnify and hold harmless certain of our content or distribution partners for damages they suffer for such

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violations under our contracts with them. Implementing measures to reduce our exposure to such claims could require us to expend substantial resources and limit the attractiveness of our products and services to our customers. As a result, these claims could result in material harm to our business.

Recently, there have been legal actions brought or threatened against distributors of downloadable applications deemed to be adware or spyware. Additionally, certain bills are pending and some laws have been passed in certain jurisdictions setting forth requirements that must be met before a downloadable application is downloaded to an end user s computer. We partner with some distribution partners that provide adware to their users if the partners adhere to our strict guidelines requiring them, among other things, to disclose to the user what the adware does and to obtain the consent of the user before the application is downloaded. The adware must also be easy to uninstall. We also review the application the partner proposes to use before we distribute our results to them. We also have the right to audit our partners, and if we find that they are not following our guidelines, we can terminate our agreement with them or cease providing content to that downloadable application. Some partners have not been able to meet the new guidelines imposed by us or some of our content providers, and we no longer provide the applicable content or any content, as the case may be, to such partners or certain of their downloadable applications. We work closely with some of our major content providers to try to identify potential distribution partners that do not meet our guidelines or are in breach of our distribution agreements and we work with our distribution partners to ensure they deliver quality traffic. However, there can be no assurance that the measures we implement to reduce our exposure to claims that certain ways in which the content is distributed violate legal requirements will be successful. As stated above, these claims could result in material harm to our business.

Our efforts to increase our presence in markets outside the United States may be unsuccessful and could result in losses.

We plan to expand our mobile and search offerings internationally, particularly in Europe. We have limited experience in marketing and operating our products and services in international markets, and we may not be able to successfully execute our business model in these markets. Our success in these markets will be directly linked to the success of relationships with our distribution and content partners and other third parties.

As the international markets in which we operate continue to grow, competition in these markets will intensify. Local companies may have a substantial competitive advantage because of their greater understanding of and focus on the local markets. Some of our domestic competitors who have substantially greater resources than we do may be able to more quickly and comprehensively develop and grow in the international markets. International expansion may also require significant financial investment including, among other things, the expense of developing localized products, the costs of acquiring foreign companies and the integration of such companies with our operations, expenditure of resources in developing distribution and content relationships and the increased costs of supporting remote operations. Although our revenues from our European offerings have increased in absolute dollars, they have declined as a percentage of our overall revenues.

Other risks of doing business in international markets include the increased risks and burdens of complying with different legal and regulatory standards, difficulties in managing and staffing foreign operations, limitations on the repatriation of funds and fluctuations of foreign exchange rates, varying levels of Internet technology adoption and infrastructure, and ability to enforce our contracts in foreign jurisdictions. In addition, our success in international expansion could be limited by barriers to international expansion such as tariffs, adverse tax consequences, and technology export controls. If we cannot manage these risks effectively, the costs of doing business in some international markets may be prohibitive or our costs may increase disproportionately to our revenues.

We have implemented anti-takeover provisions that could make it more difficult to acquire us.

Our certificate of incorporation, bylaws and Delaware law contain provisions that could make it more difficult for a third party to acquire us without the consent of our board of directors, even if the transaction would be beneficial to our stockholders. Provisions of our charter documents which could have an anti-takeover effect include:

- the classification of our board of directors into three groups so that directors serve staggered three-year terms, which may make it difficult for a potential acquirer to gain control of our board of directors;

- the ability to authorize the issuance of shares of undesignated preferred stock without a vote of stockholders;

a prohibition on stockholder action by written consent; and

limitations on stockholders ability to call special stockholder meetings.

On July 19, 2002, our board of directors adopted a stockholder rights plan, pursuant to which we declared and paid a dividend of one right for each share of common stock held by stockholders of record as of August 9, 2002. Unless redeemed by us prior to the time the rights are exercised, upon the occurrence of certain events, the rights will entitle the holders to receive shares of our preferred stock, or shares of an acquiring entity. The issuance of the rights would make the acquisition of InfoSpace more expensive to the acquirer and could delay or discourage third parties from acquiring InfoSpace without the approval of our board of directors.

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Our systems could fail or become unavailable, which could harm our reputation, result in a loss of current and potential customers and cause us to breach agreements with our partners.

Our success depends, in part, on the performance, reliability and availability of our services. We have data centers in Seattle and Bellevue, Washington; Los Angeles, California; Waltham, Massachusetts; and Papendrecht, The Netherlands. Although we have completed our disaster and redundancy planning for certain of our business-critical systems so that some are now redundant across two physical locations, we have not yet completed our disaster recovery and redundancy planning for others. Our systems and operations could be damaged or interrupted by fire, flood, power loss, telecommunications failure, Internet breakdown, break-in, earthquake or similar events. We would face significant damage as a result of these events, and our business interruption insurance may not be adequate to compensate us for all the losses that may occur. In addition, our systems use sophisticated software that may contain bugs that could interrupt service. For these reasons, we may be unable to develop or successfully manage the infrastructure necessary to meet current or future demands for reliability and scalability of our systems.

If the volume of traffic to our products and services increases substantially, we must respond in a timely fashion by expanding our systems, which may entail upgrading our technology and network infrastructure. Due to the number of our customers and the products and services that we offer, we could experience periodic capacity constraints which may cause temporary unanticipated system disruptions, slower response times and lower levels of customer service. Our business could be harmed if we are unable to accurately project the rate or timing of increases, if any, in the use of our products and application services or expand and upgrade our systems and infrastructure to accommodate these increases in a timely manner.

The security measures we have implemented to secure information we collect and store may be breached, which could cause us to breach agreements with our partners and expose us to potential investigation and penalties by authorities and potential claims by persons whose information was disclosed.

We take reasonable steps to protect the security, integrity and confidentiality of the information we collect and store but there is no guarantee that inadvertent or unauthorized disclosure will not occur or that third parties will not gain unauthorized access despite our efforts. If such unauthorized disclosure or access does occur, we may be required to notify persons whose information was disclosed or accessed under existing and proposed laws. We also may be subject to claims of breach of contract for such disclosure, investigation and penalties by regulatory authorities and potential claims by persons whose information was disclosed.

We may be subject to liability for our use or distribution of information that we gather or receive from third parties.

We obtain content and commerce information from third parties. When we distribute this information, we may be liable for the data that is contained in that content. This could subject us to legal liability for such things as defamation, negligence, intellectual property infringement, violation of privacy or publicity rights and product or service liability, among others. Laws or regulations of certain jurisdictions may also deem some content illegal, which may expose us to legal liability as well. We also gather personal information from users in order to provide personalized services. Gathering and processing this personal information may subject us to legal liability for, among other things, negligence, defamation, invasion of privacy or product or service liability. We are also subject to laws and regulations, both in the United States and abroad, regarding the collection and use of end user information. If we do not comply with these laws and regulations, we may be exposed to legal liability.

Many of the agreements by which we obtain content do not contain indemnity provisions in favor of us. Even if a given contract does contain indemnity provisions, these provisions may not cover a particular claim or type of claim or the party giving the indemnity may not have the financial resources to cover the claim. Our insurance coverage may be inadequate to cover fully the amounts or types of claims that might be made against us. Any liability that we incur as a result of content we receive from third parties could harm our financial results.

If others claim that our products infringe their intellectual property rights, we may be forced to seek expensive licenses, reengineer our products, engage in expensive and time-consuming litigation or stop marketing and licensing our products.

We attempt to avoid infringing known proprietary rights of third parties in our product development efforts. However, we do not regularly conduct patent searches to determine whether the technology used in our products infringes patents held by third parties. Patent searches generally return only a fraction of the issued patents that may be deemed relevant to a particular product or service. It is therefore nearly impossible to determine, with any level of certainty, whether a particular product or service may be construed as infringing a U.S. or foreign patent. Because patent applications in the United States are not publicly disclosed until the patent is issued, applications may have been filed by third parties that relate to our products. In addition, other companies, as well as research and academic institutions, have conducted research for many years in the search and directory and mobile and wireless technology fields, and this research could lead to the filing of further patent applications.

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In addition to patent claims, third parties may make claims against us alleging infringement of copyrights, trademark rights, trade secret rights or other proprietary rights, or alleging unfair competition or violations of privacy or publicity rights. In some cases, the ownership or scope of an entity s or person s rights is unclear and may also change over time, including through changes in U.S. or international intellectual property laws or regulations or through court decisions or decisions by agencies or regulatory boards that manage such rights.

If we were to discover that our products violated or potentially violated third-party proprietary rights, including those third-party proprietary rights that came about due to decisions and other changes regarding a person s or entity s proprietary rights discussed above, we might be required to obtain licenses that are costly or contain terms unfavorable to us, or expend substantial resources to reengineer those products so that they would not violate such third party rights. Any reengineering effort may not be successful, and we cannot be certain that any such licenses would be available on commercially reasonable terms. Any third-party infringement claims against us could result in costly litigation or liability and be time consuming to defend, divert management s attention and resources, cause product and service delays or require us to enter into royalty and licensing agreements.

If advertisers perceive that they are not receiving quality traffic to their sites through their paid-per-click advertisements, they may reduce or eliminate their advertising through the Internet, which could have a negative material impact on our financial results.

Most of our revenues from our search and directory business are based on the number of paid clicks on commercial search results served on our own Web sites or our distribution partners Web properties. Generally, each time a user clicks on a commercial search result, the content provider that provided the commercial search result receives a fee from the advertiser who paid for such commercial click and the content provider pays us a portion of that fee. If the click originated from one of our distribution partners Web properties, we share a portion of the fee we receive with such partner. If an advertiser receives what it perceives to be a large percentage of clicks for which it needs to pay for but that do not result in the intended objectives for such advertiser, the advertiser may reduce or eliminate its advertisements through the content provider that provided the commercial search result to us. This leads to a loss of revenue to our content providers and consequently to fewer fees paid to us.

If we fail to detect invalid click activity, we could lose the confidence of advertisers and of our content providers, which could cause our business to suffer.

Poor quality traffic may be a result of invalid click activity. Such invalid click activity occurs, for example, when a person or automated click generation program clicks on a commercial search result to generate fees for the Web property displaying the commercial search result rather than to view the Web page underlying the commercial search result or when a competitor of the advertiser clicks on the advertiser s search result to increase the advertising expense of the advertiser. Some of this invalid click activity is sometimes referred to as click fraud. When such invalid click activity is detected, content providers may refund the fee paid by the advertiser for such invalid clicks. When such invalid click activity is detected as coming from one of our distribution partners Web properties or our own Web sites, our content providers may refund the fees paid by the advertisers for such invalid clicks, which in turn reduces the amount of fees the content provider pays us. If we or our content providers are unable to effectively detect and stop invalid click activity, advertisers may see a reduced return on their advertising investment with the content provider because such invalid clicks do not generate quality traffic to such advertisers, which could lead such advertisers to reduce or terminate their investment in such ads. This could also lead to a loss of advertisers and revenue to our content providers and consequently to fewer fees paid to us. Additionally, if we are unable to detect and stop invalid click activity that may originate from our own Web sites or the Web properties of our distribution partners, our content providers may impose restrictions on our ability to provide their commercial search results on our own Web sites or to our current and future distribution partners, which could have a material negative impact on our financial results. Although we and our content providers have in place certain systems to assist with the detection of invalid clicks, these systems may not detect all such invalid click activity, including new types of invalid click activity that may appear.

We rely heavily on our technology, but we may be unable to adequately or cost-effectively protect or enforce our intellectual property rights, thus weakening our competitive position and negatively impacting our financial results.

To protect our rights in our products and technology, we rely on a combination of copyright and trademark laws, patents, trade secrets, and confidentiality agreements with employees and third parties and protective contractual provisions. We also rely on the law pertaining to trademarks and domain names to protect the value of our corporate brands and reputation. Despite our efforts to protect our proprietary rights, unauthorized parties may copy aspects of our products or services or obtain and use information that we regard as proprietary, or infringe our trademarks. In addition, it is possible that others could independently develop substantially equivalent intellectual property. If we do not effectively protect our intellectual property, we could lose our competitive position.

Effectively policing the unauthorized use of our products and trademarks is time-consuming and costly, and there can be no assurance that the steps taken by us will prevent misappropriation of our technology or trademarks. Our intellectual property may be subject to even greater risk in foreign jurisdictions, as protection is not sought or obtained in every country in which our services are available. Also, the laws of many countries do not protect proprietary rights to the same extent as the laws of the United States. If we cannot adequately protect our intellectual property, our competitive position in markets abroad may suffer.

RISKS RELATED TO THE INDUSTRIES IN WHICH WE OPERATE

Intense competition in the mobile, search and directory markets could prevent us from increasing distribution of our services in those markets or cause us to lose market share.

Our current business model depends on distribution of our products and services into the mobile, search and directory markets, which are extremely competitive and rapidly changing. Many of our competitors have substantially greater financial, technical and marketing resources, larger customer bases, longer operating histories, more developed infrastructures, greater name recognition or more established relationships in the industry than we have. Our competitors may be able to adopt more aggressive pricing policies, develop and expand their service offerings more rapidly, adapt to new or emerging technologies and changes in customer requirements more quickly, take advantage of acquisitions and other opportunities more readily, achieve greater economies of scale, and devote greater resources to the marketing and sale of their services than we can. Because of these competitive factors and due to our relatively small size and financial resources, we may be unable to compete successfully.

Some of the companies we compete with are currently customers of ours, the loss of which could harm our business. Many of our customers have established relationships with some of our competitors. If these competitors develop products and services that compete with ours, we could lose market share and our revenues could decrease. Additionally, our financial results could be adversely affected as well if our distribution partners create their own products and services that compete or replace the products and services we provide.

Consolidation in the industries in which we operate could lead to increased competition and loss of customers.

The Internet industry (including the search and directory segments) and the wireless industry have experienced substantial consolidation. We expect this consolidation to continue. These acquisitions could adversely affect our business and results of operations in a number of ways, including the following:

- our distribution partners could acquire or be acquired by one of our competitors and terminate their relationship with us;
- our distribution partners could merge with each other, which could reduce our ability to negotiate favorable terms;
- competitors could improve their competitive positions through strategic acquisitions; and
- companies from whom we acquire content could acquire or be acquired by one of our competitors and stop licensing content to us, or gain additional negotiating leverage in their relationships with us.

Security breaches may pose risks to the uninterrupted operation of our systems.

Our networks may be vulnerable to unauthorized access by hackers or others, computer viruses and other disruptive problems. Someone who is able to circumvent security measures could misappropriate our proprietary information or cause interruptions in our operations. Subscribers to some of our services are required to provide information in order to utilize the service that may be considered to be personally identifiable or private information. Unauthorized access to, and abuse of, this information could subject us to a risk of loss or litigation and liability.

We may need to expend significant capital or other resources protecting against the threat of security breaches or alleviating problems caused by breaches. Although we intend to continue to implement and improve our security measures, persons may be able to circumvent the measures that we implement in the future. Eliminating computer viruses and alleviating other security problems may require interruptions, delays or cessation of service to users accessing our services, any of which could harm our business.

Governmental regulation and the application of existing laws may slow business growth, increase our costs of doing business and create potential liability.

The growth and development of the Internet and wireless communication have led to new laws and regulations, as well as the application of existing laws to wireless communications and the Internet. Application of these laws can be unclear. The costs of complying or failure to comply with these laws and regulations could limit our ability to operate in our markets, expose us to compliance costs and substantial liability and result in costly and time-consuming litigation.

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Several federal or state laws could impact our business. Federal laws include those designed to restrict the online distribution of certain materials deemed harmful to children and impose additional restrictions or obligations for online services when dealing with minors. Such legislation may impose significant additional costs on our business or subject us to additional liabilities. The application to advertising in our industries of existing laws regulating or requiring licenses for certain businesses can be unclear. Such regulated businesses may include, for example, gambling; distribution of pharmaceuticals, alcohol, tobacco or firearms; or insurance, securities brokerage and legal services. Additionally, certain bills are pending and some laws have been passed in certain jurisdictions setting forth requirements that must be met before a downloadable application is downloaded to an end user s computer. Moreover, regulations by the Federal Communications Commission regarding unsolicited commercial email to wireless devices have created new requirements that could adversely affect our business by limiting our ability to communicate with users and increasing our burden of disclosure.

We post our privacy policies and practices concerning the use and disclosure of user data. Any failure by us to comply with our posted privacy policies, Federal Trade Commission (the FTC) requirements or other privacy-related laws and regulations could result in proceedings by the FTC or others which could potentially have an adverse effect on our business, results of operations and financial condition. In this regard, there are a large number of legislative proposals before the United States Congress and various state legislative bodies regarding privacy issues related to our business. It is not possible to predict whether or when such legislation may be adopted, and certain proposals, if adopted, could materially and adversely affect our business through a decrease in user registrations and revenues. This could be caused by, among other possible provisions, the required use of disclaimers or other requirements before users can utilize our services.

The FTC has recommended to search engine providers that paid-ranking search results be delineated from non-paid results. To the extent that the FTC may in the future issue specific requirements regarding the nature of such delineation, which would require modifications to the presentation of search results, revenue from the affected search engines could be negatively impacted.

Due to the nature of the Internet, it is possible that the governments of states and foreign countries might attempt to regulate Internet transmissions, through data protection laws amongst others, or institute proceedings for violations of their laws. We might unintentionally violate such laws, such laws may be modified and new laws may be enacted in the future. Any such developments (or developments stemming from enactment or modification of other laws) could increase the costs of regulatory compliance for us or force us to change our business practices.

We rely on the infrastructure of the Internet and of wireless networks, over which we have no control and the failure of which could substantially undermine our operations.

Our success depends, in large part, on other companies maintaining the Internet system infrastructure and mobile operators who distribute our mobile content and services to maintain their proprietary wireless networks. In particular, with respect to the Internet, we rely on other companies to maintain a reliable network backbone that provides adequate speed, data capacity and security and to develop products that enable reliable Internet access and services. With respect to wireless networks, we depend on mobile operators to maintain their wireless networks so as to provide adequate speed, data capacity and security and that enable reliable mobile access to our products and services.

As the Internet and usage of mobile services continues to experience growth in the number of users, frequency of use and amount of data transmitted, the Internet system infrastructure and the wireless networks of mobile operators may be unable to support the demands placed on them, and the Internet s and mobile operators networks performance or reliability may suffer as a result of this continued growth. Some of the companies that we rely upon to maintain network infrastructure may lack sufficient capital to support their long-term operations. The failure of the internet infrastructure or wireless networks would substantially undermine our operations and may have a material adverse effect on our financial results.

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

Not applicable with respect to the current reporting period.

Item 3. Defaults Upon Senior Securities

Not applicable with respect to the current reporting period.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable with respect to the current reporting period.

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Item 5. Other Information

Not applicable with respect to the current reporting period.

Item 6. Exhibits

Exhibits	
31.1	Certification of Principal Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURE

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

INFOSPACE, INC.

By /s/ Allen M. Hsieh
Allen M. Hsieh
Chief Financial Officer
(Principal Financial Officer)

Dated: November 7, 2006

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