

Answers CORP  
Form 10-Q  
November 09, 2009

UNITED STATES OF AMERICA  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549  
FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED: SEPTEMBER 30, 2009

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

For the transition period from \_\_\_ to \_\_\_\_

Commission File Number: 001-32255

ANSWERS CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware  
(State or Other Jurisdiction of Incorporation or  
Organization)

98-0202855  
(I.R.S. Employer Identification No.)

237 West 35th Street, Suite 1101, New York, New York  
(Address of principal executive offices)

10001  
(Zip Code)

(646) 502-4777  
(Registrant's telephone number)

(Former Name, Former Address and Former Fiscal Year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Edgar Filing: Answers CORP - Form 10-Q

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

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

Large accelerated Filer  Accelerated filer  Non-accelerated filer   
Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The number of the registrant's shares of common stock outstanding was 7,936,763 as of November 6, 2009.

---

ANSWERS CORPORATION

FORM 10-Q

CONTENTS

Table of Contents

PART I — FINANCIAL INFORMATION

<u>Item 1.</u>	<u>Consolidated Financial Statements (unaudited)</u>	2
	<u>Consolidated Balance Sheets as of September 30, 2009 and December 31, 2008</u>	2
	<u>Consolidated Statements of Operations for the three and nine months ended September 30, 2009 and 2008</u>	3
	<u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2009 and 2008</u>	4
	<u>Notes to Consolidated Financial Statements</u>	5
<u>Item 2.</u>	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	21
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	39
<u>Item 4T.</u>	<u>Controls and Procedures</u>	39
PART II — OTHER INFORMATION		
<u>Item 1.</u>	<u>Legal Proceedings</u>	40
<u>Item 1A.</u>	<u>Risk Factors</u>	40
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	51
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>	51
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>	51
<u>Item 5.</u>	<u>Other Information</u>	51
<u>Item 6.</u>	<u>Exhibits</u>	51
<u>Signatures</u>		

INTRODUCTORY NOTE

This Report on Form 10-Q for Answers Corporation (“Answers” or the “Company”) may contain forward-looking statements. You can identify these statements by forward-looking words such as “may,” “will,” “expect,” “intend,” “anticipate,” “believe,” “estimate” and “continue” or similar words. Forward-looking statements include information concerning possible or assumed future business success or financial results. You should read statements that contain these words carefully because they discuss future expectations and plans, which contain projections of future results of operations or financial condition or state other forward-looking information. We believe that it is important to communicate future expectations to investors. The forward-looking statements included herein are based on current expectations that involve a number of risks and uncertainties, which are discussed in Item 1A, “Risk Factors” and in other sections of this Form 10-Q and in our other filings with the Securities and Exchange Commission. These risks and uncertainties could cause actual results or events to differ materially from the forward-looking statements that we make.

Although, there may be events in the future that we are not able to accurately predict or control, we do not undertake any obligation to update any forward-looking statements for any reason, even if new information becomes available or other events occur in the future. Accordingly, to the extent that this Form 10-Q contains forward-looking statements regarding the financial condition, operating results, business prospects or any other aspect of the Company, please be advised that Answers' actual financial condition, operating results and business performance may differ materially from that projected or estimated by the Company in forward-looking statements.

---

Table of Contents

## PART I - FINANCIAL INFORMATION

## Answers Corporation and Subsidiary

## Consolidated Balance Sheets (unaudited, in thousands except share and per share data)

	September 30 2009 \$	December 31 2008 \$
Assets		
Current assets:		
Cash and cash equivalents	21,344	11,739
Accounts receivable	2,257	1,680
Prepaid expenses and other current assets	789	818
Deferred tax asset	17	-
Total current assets	24,407	14,237
Long-term deposits (restricted)	271	257
Deposits in respect of employee severance obligations	1,665	1,337
Property and equipment, net of \$2,606 and \$2,083 accumulated depreciation as of September 30, 2009 and December 31, 2008, respectively	1,838	1,234
Other assets:		
Intangible assets, net of \$898 and \$769 accumulated amortization as of September 30, 2009 and December 31, 2008, respectively	816	994
Goodwill	437	437
Prepaid expenses, long-term, and other assets	227	220
Deferred tax assets long term	24	-
Total other assets	1,504	1,651
Total assets	29,685	18,716
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	436	537
Accrued expenses	717	751
Accrued compensation	1,024	628
Warrant to purchase units of Series B preferred stock and warrants	-	8,698
Capital lease obligation – current portion	81	78
Deferred revenues	-	16
Total current liabilities	2,258	10,708
Long-term liabilities:		
Liability in respect of employee severance obligations	1,770	1,534
Capital lease obligation, net of current portion	44	106

Edgar Filing: Answers CORP - Form 10-Q

Deferred tax liability	34	26
Series A and Series B Warrants	8,748	-
Total long-term liabilities	10,596	1,666
Commitments and contingencies		
Series A and B convertible preferred stock: \$0.01 par value; stated value and liquidation preference of \$100 per share; 6% cumulative annual dividend; 130,000 and 60,000 shares authorized, issued and outstanding as of September 30, 2009 and December 31, 2008, respectively	1,796	624
Stockholders' equity:		
Preferred stock: \$0.01 par value; 870,000 and 940,000 shares authorized as of September 30, 2009 and December 31, 2008, respectively, none issued	-	-
Common stock; \$0.001 par value; 100,000,000 shares authorized; 7,936,763 and 7,870,538 shares issued and outstanding as of September 30, 2009 and December 31, 2008, respectively	8	8
Additional paid-in capital	88,867	77,091
Accumulated other comprehensive income (loss)	75	(28)
Accumulated deficit	(73,915)	(71,353)
Total stockholders' equity	15,035	5,718
Total liabilities and stockholders' equity	29,685	18,716

The accompanying notes are an integral part of these consolidated financial statements.

Edgar Filing: Answers CORP - Form 10-Q

Table of Contents

Answers Corporation and Subsidiary

Consolidated Statements of Operations (unaudited, in thousands except share and per share data)

	Three months ended September		Nine months ended September	
	2009	2008	2009	2008
	\$	\$	\$	\$
<b>Revenues:</b>				
Advertising revenue	4,970	3,539	14,684	9,536
Answers service licensing	17	24	53	61
	4,987	3,563	14,737	9,597
<b>Costs and expenses:</b>				
Cost of revenue	1,264	945	3,489	3,754
Research and development	921	866	2,611	2,670
Community development, sales and marketing	621	563	1,679	2,258
General and administrative	1,201	1,311	3,666	3,640
Write-off of the Brainboost Answer Engine	-	-	-	3,138
Termination fees and write-off of costs relating to the terminated Lexico acquisition and abandoned follow-on offering	-	-	-	2,543
Total operating expenses	4,007	3,685	11,445	18,003
Operating income (loss)	980	(122)	3,292	(8,406)
Interest income (expense), net	4	(43)	(445)	30
Other income (expense), net	(5)	11	-	(38)
Loss resulting from fair value adjustments of Series A Warrants, Series B Warrants and warrant to purchase units of Series B preferred stock and warrants	(999)	(2,056)	(3,374)	(2,056)
Loss before income taxes	(20)	(2,210)	(527)	(10,470)
Income tax benefit (expense), net	(50)	91	(121)	65
Net loss	(70)	(2,119)	(648)	(10,405)
<b>Basic and diluted net loss per common share</b>				
	(0.11)	(0.31)	(0.28)	(1.37)
	7,930,440	7,865,263	7,897,391	7,861,681

Number of shares used in computing basic  
and diluted net loss per common share

The accompanying notes are an integral part of these consolidated financial statements.

3

---



Table of Contents

Answers Corporation and Subsidiary

Consolidated Statements of Cash Flows (unaudited, in thousands)

	Nine months ended September 30	
	2009	2008
	\$	\$
Cash flows from operating activities:		
Net loss	(648)	(10,405)
Adjustments to reconcile net loss to net cash flows from operating activities:		
Depreciation and amortization	883	1,080
Increase in deposits in respect of employee severance obligations	(328)	(198)
Increase in liability in respect of employee severance obligations	234	380
Stock-based compensation to employees and directors	1,166	1,312
Write-off of the Brainboost Answers Engine	-	3,138
Write-off of amounts paid in prior periods, relating to the terminated Lexico acquisition and abandoned follow-on offering	-	663
Fair value adjustments of Series A Warrants, Series B Warrants and warrant to purchase Units of Series B preferred stock and warrants	3,374	2,056
Loss on disposal of property and equipment	72	4
Gains from exchange rate forward contracts, net	-	(46)
Unrealized gains from exchange rate forward contracts	103	-
Exchange rate (gains) losses	-	38
Changes in operating assets and liabilities:		
Increase in accounts receivable, and prepaid expenses and other current assets	(259)	(339)
(Increase) decrease in prepaid expenses and other assets	(12)	1
(Increase) decrease in deferred taxes, net	(33)	9
Decrease in accounts payable	(212)	(254)
Increase (decrease) in accrued expenses and accrued compensation	396	(150)
(Decrease) increase in deferred revenues	(16)	6
Net cash provided by (used in) operating activities	4,720	(2,705)
Cash flows from investing activities:		
Capital expenditures	(1,275)	(435)
Increase in long-term deposits	(14)	(28)
Proceeds from sales of investment securities	-	700
Net cash provided by (used in) investing activities	(1,289)	237
Cash flows from financing activities:		
Repayment of capital lease obligation	(58)	(36)
Dividends paid on preferred shares	(404)	-
Stock registration costs	-	(47)
Exercise of common stock options	177	10
Redpoint financings, net of issuance costs	6,480	5,380
Net cash provided by financing activities	6,195	5,307

Edgar Filing: Answers CORP - Form 10-Q

Effect of exchange rate changes on cash and cash equivalents	(21)	36
Net increase in cash and cash equivalents	9,605	2,875
Cash and cash equivalents at beginning of period	11,739	6,778
Cash and cash equivalents at end of period	21,344	9,653
Supplemental disclosures of cash flow information:		
Income taxes paid	121	7
Non-cash investing activities:		
Capital expenditures on account	108	-
Acquisition of assets through capital lease obligation	-	239
Non-cash financing activities:		
Increase in accrued dividends	-	106
Amortization of discounts on Series A and Series B convertible preferred shares	1,155	279

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

ANSWERS CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

Note 1 - Business

Answers Corporation (“the Parent”), a Delaware corporation, and its wholly-owned Israeli subsidiary that engages primarily in research and development services to the Parent (“the Subsidiary”), are collectively referred to as “the Company.” The Parent is a public company and trades on the NASDAQ Capital Market under the symbol “ANSW”.

As of September 30, 2009, approximately \$873 thousand of the Company’s net assets were located outside of the United States.

The Company provides answer-based search services to users primarily through its website Answers.com®, which includes WikiAnswers® and ReferenceAnswers™. In the Company’s reports prior to its quarterly report for the second quarter of 2009, it referred to ReferenceAnswers as Answers.com. Beginning with the quarterly report for the second quarter of 2009 it refers to that property as ReferenceAnswers or ReferenceAnswers.com.

On June 16, 2008, the Company raised \$6 million, before related fees and costs, in a private placement offering, and on June 10, 2009 the Company raised an additional \$7 million, before related fees and costs, from the exercise of the second tranche warrant of such private placement offering. See Note 4 for further details.

In the first quarter of 2008, the Company’s planned acquisition of Lexico Publishing Group LLC and the related planned offering of securities were terminated due to unfavorable market conditions. As a result, the Company recorded a charge to its statement of operations, amounting to approximately \$2.54 million.

Note 2 - Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements include the accounts of Answers Corporation and its Subsidiary and are presented in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). All significant intercompany balances and transactions have been eliminated in consolidation.

During the third quarter of 2009, the new Accounting Standards Codification (ASC) as issued by the Financial Accounting Standards Board (FASB) became effective. The ASC has become the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. The ASC does not change Generally Accepted Accounting Principles in the U.S. (U.S. GAAP); and, therefore, does not have any impact on the Company’s consolidated financial statements. Beginning with this quarterly report, all references to GAAP in the notes to the consolidated financial statements use the new Codification numbering system.

The Company has evaluated subsequent events for recognition or disclosure through November 6, 2009, the date upon which these financial statements were available to be issued.

The accompanying unaudited consolidated financial statements were prepared in accordance with the instructions for Form 10-Q and, therefore, do not include all disclosures necessary for a complete presentation of financial condition, results of operations, and cash flows in conformity with generally accepted accounting principles. All adjustments, which are, in the opinion of management, of a normal recurring nature and are necessary for a fair presentation of the interim financial statements, have been included. Nevertheless, these financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company’s Annual Report on

## Edgar Filing: Answers CORP - Form 10-Q

Form 10-K for the year ended December 31, 2008. The results of operations for the three and nine months ended September 30, 2009 are not necessarily indicative of the results that may be expected for the entire fiscal year or any other interim period.

### Use of Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported results of operations during the reporting periods. Actual results could differ from those estimates.

Table of Contents

ANSWERS CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
 (UNAUDITED)

## Note 2 - Summary of Significant Accounting Policies (cont'd)

## Revenue Recognition

The Company, through its website Answers.com, generates revenues via advertising in the form of pay-per-performance ads and paid-for-impression advertising. In the pay-per-performance model, the Company earns revenue based on the number of clicks associated with such ads. In the paid-for-impression model, the Company's revenue is derived from the display of ads.

Most of the Company's advertising revenue is obtained through the efforts of third parties rather than through direct contracts with advertisers. The third party is obligated to pay the Company a portion of the revenue it receives from advertisers, as compensation for the Company's sale of promotional space on its Internet properties. Amounts received from such third parties are reflected as revenue in the period in which such advertising services are provided.

The Company also earns an immaterial amount of revenue from partners that pay the Company for providing them with answer-based services that they then use in their own products, via co-branded web pages.

The Company earned advertising revenue from its two web properties, as follows:

	Three months ended September 30		Nine months ended September 30	
	2009	2008	2009	2008
	\$ (in thousands)			
Advertising revenue				
WikiAnswers	3,422	1,960	9,984	4,891
ReferenceAnswers	1,548	1,579	4,700	4,645
	4,970	3,539	14,684	9,536

## Accounting for Stock-Based Compensation

Stock-based compensation is the fair value of stock options granted to employees and directors and is recorded in operating expenses over the vesting periods of the stock options. Such fair value is estimated at the date of grant using the Black-Scholes option-pricing model, which takes into consideration the share price at the date of grant, the exercise price of the option, the expected life of the option, expected interest rates and the expected volatility.

Table of Contents

## ANSWERS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(UNAUDITED)

## Note 2 - Summary of Significant Accounting Policies (cont'd)

## Net Loss per Common Share

Basic net loss per share is computed by dividing the net loss for the period by the weighted average number of common shares outstanding during the period. Diluted net loss per share is computed by dividing the net loss for the period by the weighted average number of shares of common stock and potentially dilutive common stock outstanding during the period. The dilutive effect of outstanding options is reflected in diluted earnings per share by application of the treasury stock method. The calculation of diluted net loss per share excludes all anti-dilutive shares. The diluted net loss per share is the same as basic net loss per share as the inclusion of the Company's common stock equivalents would be anti-dilutive.

The following table sets forth the computation of basic and diluted net loss per share for the periods indicated:

	Three months ended September 30		Nine months ended September 30	
	2009	2008	2009	2008
	\$ (in thousands, except share and per share amounts)		\$ (in thousands, except share and per share amounts)	
Basic and diluted net loss per common share computation				
Numerator:				
Net loss	(70)	(2,119)	(648)	(10,405)
Series A and Series B Convertible Preferred Stock dividends	(198)	(91)	(404)	(106)
Amortization of Series A and Series B Convertible Preferred Stock discounts	(585)	(239)	(1,155)	(279)
Net loss attributable to common shares (basic)	(853)	(2,449)	(2,207)	(10,790)
Denominator:				
Weighted average number of common shares outstanding during the period	7,930,440	7,865,263	7,897,391	7,861,681
Basic and diluted net loss per common share	(0.11)	(0.31)	(0.28)	(1.37)
Common stock equivalents excluded because their effect would have been anti-dilutive	3,379,837	1,373,822	2,704,963	584,989

Table of Contents

## ANSWERS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(UNAUDITED)

## Note 2 - Summary of Significant Accounting Policies (cont'd)

## Derivatives and hedging

The Company recognizes all derivatives on the balance sheet at fair value. If the derivatives meet the definition of a hedge and are so designated, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities, firm commitments or forecasted transactions, or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value, if any, is recognized in earnings. Gains (losses) from a derivative's change in fair value that are not designated as hedges are recognized in earnings.

To mitigate the potential impact of adverse fluctuations in cash flows resulting from forecasted new Israeli shekels (NIS) exchange rates, the Subsidiary hedges portions of its forecasted expenses denominated in NIS with currency forwards and options. The Subsidiary does not speculate in these hedging instruments in order to profit from foreign currency exchanges, nor does it enter into trades for which there are no underlying exposures.

Through April 2009, the Subsidiary's currency forwards and options were not designated as hedging instruments and, therefore, the net gains (losses) that resulted from such derivatives were recognized in earnings as they occurred.

Starting May 2009, the Subsidiary designated all of its currency hedging activity, which currently consists only of forward contracts, as cash flow hedges as they were all eligible. The Company documents all relationships between the hedging instruments and hedged items, as well as its risk management objective for undertaking these hedging transactions. The Company also formally assesses, both at the inception of the hedge and on an ongoing basis, whether or not each derivative is highly effective in offsetting changes in fair value of the hedged items.

Gains (losses) from forward and option contracts are included in operating expenses, as follows:

	Three months ended September 30		Nine months ended September 30	
	2009	2008	2009	2008
	\$ (in thousands)		\$ (in thousands)	
Cost of revenue	8	(3)	(3)	6
Research and development	42	(26)	(1)	22
Sales and marketing	8	(2)	(2)	5
General and administrative	22	(13)	(4)	13
	80	(44)	(10)	46

The gains for the three months ended September 30, 2009, derived from forward contracts that were designated as hedging instruments.

The net loss for the nine months ended September 30, 2009 of \$10 thousand, is comprised by \$90 thousand of losses from option and forward contracts that were not designated as hedging instruments, less \$80 thousand of gains from forward contracts that were designated as hedging instruments.

Edgar Filing: Answers CORP - Form 10-Q

As of September 30, 2009, the notional amount of the Subsidiary's outstanding forward contracts was approximately \$2.9 million, constituting an asset with a fair value of \$103,000. Such asset is included in prepaid expenses and other current assets as the foreign exchange forward contracts mature through May 28, 2010, and the change in fair value has been recorded in equity as accumulated other comprehensive income (loss) (see Note 3). The amounts recorded as accumulated other comprehensive income will be reclassified to earnings as the forward contracts mature or if, and to the extent the hedging relationship is deemed ineffective.



Table of Contents

ANSWERS CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(UNAUDITED)

## Note 3 – Comprehensive Income (Loss)

Comprehensive income represents net income (loss) plus any revenue, expenses, gains and losses that are specifically excluded from net income (loss) and recognized directly as a component of shareholders' equity.

The reconciliation from net income to comprehensive income is as follows:

	Three months ended September		Nine months ended September	
	2009	2008	2009	2008
	30		30	
	\$ (in thousands)		\$ (in thousands)	
Net loss	(70)	(2,119)	(648)	(10,405)
Unrealized gains on derivative and hedging activity, net	103	-	103	-
Less:				
Reclassification adjustment for gains on derivative and hedging activity included in net loss	(44)	-	-	-
Total other comprehensive loss	(11)	(2,119)	(545)	(10,405)

## Note 4 – Redpoint Financing

## General

On June 16, 2008 (the "Initial Closing Date"), pursuant to a private placement of the Company's securities, Redpoint Omega, L.P. and Redpoint Omega Associates, LLC (collectively "Redpoint") purchased \$6,000,000 of the Company's Series A Convertible Preferred Stock (the "Series A Financing"), initially convertible into 1,333,333 shares of common stock at a conversion price of \$4.50 per share (the "Series A Convertible Preferred Stock"), and Common Stock Purchase Warrants exercisable for 666,667 shares of common stock at an exercise price of \$4.95 per share (the "Series A Warrants"). Redpoint also received a warrant (the "Series B Unit Warrant"), exercisable until June 16, 2009, to purchase units of up to \$7,000,000 of Series B Convertible Preferred Stock and Common Stock Purchase Warrants. After deducting placement agent fees and legal expenses, the Company's net proceeds from the private placement on June 16, 2008, were approximately \$5,380,000.

On June 10, 2009, Redpoint exercised its Series B Unit Warrant and purchased \$7,000,000 of the Company's Series B Convertible Preferred Stock (the "Series B Financing"), initially convertible into 1,272,727 shares of common stock at a conversion price of \$5.50 per share (the "Series B Convertible Preferred Stock"), and Common Stock Purchase Warrants exercisable for 636,364 shares of common stock at an exercise price of \$6.05 per share (the "Series B Warrants"). After deducting placement agent fees and legal expenses, the Company's net proceeds from the Series B Financing were approximately \$6,480,000.

Transaction costs for both investments were allocated on a pro rata basis, based on the amounts allocated to each of the components of the transaction. Transaction costs relating to the Series A Convertible Preferred Stock and the Series B Convertible Preferred Stock have been reflected as a reduction to the proceeds from the issuance of such instruments. Transaction costs relating to the Series B Unit Warrant were deferred and amortized to interest expense over one year, which was the life of the unit warrant. Transaction costs relating to the Series A Warrants were initially reflected as a reduction to the proceeds from the issuance of such instrument and then written off to retained earnings upon adoption of EITF Issue 07-5, “Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity’s Own Stock” (now incorporated in ASC 815–40, “Derivatives and hedging – Contracts in Entity’s Own Equity”) (see below). Transaction costs relating to the Series B Warrants have been included in the statement of operations as interest expense for the nine months ended September 30, 2009.

The Series A Convertible Preferred Stock, the Series B Convertible Preferred Stock, the Series A Warrants and the Series B Warrants are collectively referred to as the “Redpoint Securities”. The two transactions, in aggregate, are collectively referred to as the “Redpoint Financings”.

Table of Contents

ANSWERS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(UNAUDITED)

Note 4 – Redpoint Financing (cont'd)

The Series A Convertible Preferred Stock has the rights and preferences set forth in the Company's Certificate of Designations, which amended the Company's Amended and Restated Certificate of Incorporation on June 16, 2008. The Series B Convertible Preferred Stock has the rights and preferences set forth in the Company's Certificate of Designations, which amended the Company's Amended and Restated Certificate of Incorporation on June 9, 2009.

In connection with the Redpoint Financings the Company entered into a registration rights agreement with Redpoint, pursuant to which the Company agreed to register with the SEC for resale the common stock underlying the Redpoint Securities. In connection with the registration rights agreements, the Company agreed to pay a penalty of 1.0% per month, on a daily pro rata basis, up to a maximum of 8.0%, of the aggregate purchase price, as partial liquidated damages, for certain default events and subject to certain circumstances. The partial liquidated damages may trigger if the registration is not declared effective or ceases to remain continuously effective, as the case may be. On July 30, 2008, following the Series A Financing, the Company filed a registration statement for the registration of shares of common stock issuable upon conversion of Series A Convertible Preferred Stock, and shares of common stock issuable upon exercise of the Series A Warrants, which was declared effective by the SEC on September 16, 2008. On June 15, 2009, following the Series B Financing, the Company filed a registration statement for the registration of shares of common stock issuable upon conversion of Series B Convertible Preferred Stock, shares of common stock issuable upon exercise of the Series B Warrants, and shares of common stock that may be issued as dividends pursuant to the terms of the Series A Convertible Preferred Stock and the Series B Convertible Preferred Stock, which was declared effective by the SEC on July 28, 2009.

In connection with the Redpoint Financings, Redpoint received the right to appoint two individuals to serve as voting members of the Company's board of directors.

Accounting for Series A Financing

The \$6,000,000 of proceeds from the Series A Financing, were first allocated to the Series B Unit Warrant, which was classified as a liability, based on its fair value, and the residual amount was allocated among the Series A Convertible Preferred Stock and the Series A Warrants based on their relative fair values, all in accordance with the guidance in ASC 480, "Distinguishing Liabilities from Equity" (formerly SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity"), and ASC 815-40, "Derivatives and hedging – Contracts in Entity's Own Equity" (formerly EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"). The Series A Convertible Preferred Stock has been classified as temporary equity, in accordance with the guidance in ASC 480-10-S99A (formerly EITF D-98, "Classification and Measurement of Redeemable Securities"), and, prior to January 1, 2009, the Series A Warrants were classified in permanent equity.

In June 2008, the FASB ratified the consensus of EITF 07-5 (incorporated in ASC 815-40). ASC 815-40 responded to practice questions about whether an instrument or embedded feature is indexed to the reporting company's own stock by establishing a framework for the determinations and by nullifying some previous requirements. The adoption of EITF 07-5 (incorporated in ASC 815-40) requirements affects issuers' accounting for warrants and many convertible instruments with provisions that protect holders from declines in the stock price ("Down-Round" provisions). Warrants with such provisions are no longer recorded in equity, and many convertible instruments with such provisions require "bifurcation" with the conversion option separately accounted for as a derivative under ASC 815 (formerly SFAS 133).



Table of Contents

## ANSWERS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(UNAUDITED)

## Note 4 – Redpoint Financing (cont'd)

## Accounting for Series A Financing (cont'd)

As a result of the adoption of ASC 815–40, effective January 1, 2009, and due to the Down-Round Protection of the Series A Warrants, such warrants are separately accounted for as a derivative under ASC 815 (formerly SFAS 133) and are no longer recorded in equity but rather as a liability, initially valued at fair value to be revalued at each reporting date.

ASC 815–40 was initially applied by recording a cumulative-effect adjustment to opening retained earnings as of January 1, 2009, to effect the accounting for the Series A Warrants as a liability. The following table summarizes the allocation of the Series A Financing had the Company been subject to the provisions of ASC 815–40 at the Initial Closing Date:

	Series A Convertible Preferred Stock	Series A Warrants \$ (in thousands)	Series B Unit Warrant	Total
Allocated amount	661	1,828	3,511	6,000
Less: Transaction costs	(69)	(188)	(363)	(620)
	592	1,640	3,148	5,380

On January 1, 2009, the Company recorded a cumulative effect of change in accounting principle as reflected in the following table:

	December 31, 2008	Effect of Adoption of EITF 07-5 \$ (in thousands)	January 1, 2009
Additional paid-in capital	77,091	(1,657)(1)	75,434
Accumulated deficit	(71,353)	(1,726)(2)	(73,267)
		(188)(3)	
Long-term liability – Series A Warrants	-	3,554 (4)	3,554
Series A convertible preferred stock	624	17 (5)	641
		-	

- (1) Reflects the re-allocation of the Series A Warrants from equity to liabilities and the reduction of the discount relating to the Beneficial Conversion Feature.
- (2) Reflects the cumulative change in the fair value of the Series A Warrants between June 16, 2008 and December 31, 2008

- (3) Reflects the deferred charges attributable to the Series A Warrants that would have been expensed at the Redpoint Closing Date
- (4) Reflects the fair value of the Series A Warrants as of December 31, 2008
- (5) Reflects the increased amortization due to change in discounts.

On September 30, 2009, the Company assessed the fair value of the Series A Warrants as compared to their value as of December 31, 2008 and June 30, 2009. The change in fair value has been included in the statement of operations as loss resulting from fair value adjustment of Series A Warrants, and amounted \$505,000 and \$901,000 for the three and nine months ended September 30, 2009, respectively.

Table of Contents

## ANSWERS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(UNAUDITED)

## Note 4 – Redpoint Financing (cont'd)

## Accounting for Series B Financing

The change in value of the Series B Unit Warrant from January 1, 2009 through June 10, 2009, has been included in the statement of operations as loss resulting from fair value adjustment of warrant to purchase units of Series B preferred stock and warrants, and amounted to \$0 and \$2.08 million for the three and nine months ended September 30, 2009, respectively. On June 10, 2009, Redpoint exercised, in full, the Series B Unit Warrant, which was valued at approximately \$10.8 million on such date, thus extinguishing this liability from the Company's balance sheet through a corresponding increase to additional paid-in capital.

The \$7 million of proceeds from the Series B Financing, were first allocated to the Series B Warrants which were classified as a liability, recoded at fair value, and the residual amount was allocated to the Series B Convertible Preferred Stock, all in accordance with the guidance in ASC 815 (formerly SFAS 133), ASC 480 (formerly SFAS 150) and ASC 815-40 (formerly EITF Issue No. 07-5). The Series B Convertible Preferred Stock has been classified as temporary equity, in accordance with the guidance in ASC 480-10-S99A (formerly EITF D-98).

Resulting from the allocation of the proceeds as described above, and in comparison to the fair market value of the Company's common stock on the date of issuance, the effective conversion rate of the Series B Convertible Preferred Stock, represents an additional beneficial conversion value. Thus, the Company recorded an additional discount to the Series B Convertible Preferred Stock, with a corresponding increase in paid-in capital, of \$2,868,000, reducing the Series B Convertible Preferred Stock to zero. In accordance with ASC 470-20, "Debt with Conversion and Other Options" (formerly EITF 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments"), the aforesaid discount is amortized to paid-in capital over five years from the date of issuance, the earliest redemption date of the stock.

The following table summarizes the allocation of the Series B Financing:

	Series B Convertible Preferred Stock	Series B Warrants \$ (in thousands)	Total
Allocated amount	3,098	3,902	7,000
Less: Transaction costs	(230)	(290)	(520)
	2,868	3,612	6,480

On September 30, 2009, the Company assessed the fair value of the Series B Warrants as compared to their value on June 10, 2009 and June 30, 2009. The change in fair value has been included in the statement of operations as a loss resulting from fair value adjustment of Series B Warrants, and amounted \$494,000 and \$391,000 for the three and nine months ended September 30, 2009, respectively.

Table of Contents

ANSWERS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(UNAUDITED)

Note 5 – Fair Value Measurements

The Company measures fair value in accordance with ASC 820-10, “Fair Value Measurements and Disclosures” (formerly SFAS 157, “Fair Value Measurements”). ASC 820-10 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, ASC 820-10 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

- Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 - Include other inputs that are directly or indirectly observable in the marketplace.
- Level 3 - Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company measures its cash equivalents, foreign currency derivative contracts and Series A and B Warrants at fair value. In accordance with ASC 820-10, the Company’s cash equivalents are classified within Level 1. This is because the cash equivalents are valued using quoted active market prices. The Company’s foreign currency derivative contracts are classified within Level 2, because they are valued utilizing market observable inputs. The Series A and B Warrants are classified within Level 3 because they are valued using the Black-Scholes model which utilizes significant inputs that are unobservable in the market such as expected stock price volatility, risk-free interest rate and the dividend yield, and estimated period of time the warrants will be outstanding before they are ultimately exercised.



Table of Contents

## ANSWERS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(UNAUDITED)

## Note 5 – Fair Value Measurements (cont'd)

The following table presents the Company's assets and liabilities measured at fair value on a recurring basis as of December 31, 2008 and as of September 30, 2009, aggregated by the level in the fair-value hierarchy within which those measurements fall:

Description	December 31, 2008	Fair value measurement at reporting date using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
\$ (in thousands)				
<b>Assets</b>				
Cash Equivalents - Money Market Funds	10,948	10,948	-	-
Foreign currency derivative contracts	26	-	26	-
<b>Total Assets</b>	<b>10,974</b>	<b>10,948</b>	<b>26</b>	<b>-</b>

<b>Liabilities</b>				
Series B Unit Warrant	8,698	-	-	8,698

Description	September 30, 2009	Fair value measurement at reporting date using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
\$ (in thousands)				
<b>Assets</b>				
Cash Equivalents - Money Market Funds	20,670	20,670	-	-
Foreign currency derivative contracts (see Note 2)	103	-	103	-
<b>Total Assets</b>	<b>20,773</b>	<b>20,670</b>	<b>103</b>	<b>-</b>

<b>Liabilities</b>				
Series A Warrants	4,455	-	-	4,455
Series B Warrants	4,293	-	-	4,293
<b>Total Liabilities</b>	<b>8,748</b>	<b>-</b>	<b>-</b>	<b>8,748</b>

In addition to the above, the Company's financial instruments at September 30, 2009, consisted of cash, prepaid expenses, deposits in respect of employee severance obligations, long term deposits, accrued expenses, accrued compensation and related liabilities and deferred revenues. The carrying amounts of all the aforementioned financial

instruments, approximate fair value.

14

---

Table of Contents

## ANSWERS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(UNAUDITED)

## Note 5 – Fair Value Measurements (cont'd)

The following table summarizes the changes in the Company's liabilities measured at fair value using significant unobservable inputs (Level 3) as defined in ASC 820-10, during the nine months ended September 30, 2009:

	Series B Unit Warrant \$ (in thousands)	Level 3 Series A and B Warrants \$ (in thousands)	Total \$ (in thousands)
December 31, 2008	8,698	-	8,698
Cumulative effect of change in accounting principle – adoption of ASC 815 – 40 (formerly EITF 07-5)	-	3,554	3,554
Fair value adjustments included in net loss	(1,528)	(482)	(2,010)
March 31, 2009	7,170	3,072	10,242
Exercise of the Series B Unit Warrant	(10,780)	-	(10,780)
Issuance of series B warrants	-	3,902	3,902
Fair value adjustments included in net loss	3,610	775	4,385
June 30, 2009	-	7,749	7,749
Fair value adjustments included in net loss	-	999	999
September 30, 2009	-	8,748	8,748

Table of Contents

## ANSWERS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(UNAUDITED)

## Note 6 - Series A and B Convertible Preferred Stock (Redeemable)

As a result of Redpoint's Series A Financing (see Note 4), the Company's Amended and Restated Certificate of Incorporation has been amended to provide for the issuance of up to 60,000 shares of Series A Convertible Preferred Stock, par value \$0.01, of which all were issued with a stated value of \$100 per share, pursuant to the Certificate of Designations, Number, Voting Powers, Preferences and Rights of Series A Convertible Preferred Stock filed with the State of Delaware on June 16, 2008 (the "Series A Certificate of Designations").

As a result of Redpoint's Series B Financing (see Note 4), the Company's Amended and Restated Certificate of Incorporation was further amended to provide for the issuance of up to 70,000 shares of Series B Convertible Preferred Stock, par value \$0.01, of which all were issued with a stated value of \$100 per share, pursuant to the Certificate of Designations, Number, Voting Powers, Preferences and Rights of Series B Convertible Preferred Stock filed with the State of Delaware on June 9, 2009 (the "Series B Certificate of Designations").

The rights and preferences of the Series A Convertible Preferred Stock are set forth in the Series A Certificate of Designations filed with the State of Delaware on June 16, 2008, as disclosed in the consolidated financial statements and related notes in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

The rights and preferences of the Series B Convertible Preferred Stock are set forth in the Series B Certificate of Designations filed with the State of Delaware on June 9, 2009, and are identical to the rights and preferences of the Series A Convertible Preferred Stock.

The following table summarizes the changes in the Series A and B Convertible Preferred Stock during the nine-month period ending September 30, 2009:

	Series A Convertible Preferred Stock	Series B Convertible Preferred Stock	Total
		\$ (in thousands)	
December 31, 2008	624	-	624
Cumulative effect of change in accounting principle – adoption of ASC 815–40 (formerly EITF 07-5 - see Note 4)	17	-	17
Issuance of Series B Convertible Preferred Stock	-	7,000	7,000
Issuance costs	-	(230)	(230)
Discount resulting from the issuance of the Series B Warrants	-	(3,902)	(3,902)
Discount resulting from the Beneficial Conversion Feature	-	(2,868)	(2,868)
Amortizations of discounts during the period	742	413	1,155
September 30, 2009	1,383	413	1,796

Edgar Filing: Answers CORP - Form 10-Q

The Series A Convertible Preferred Stock and the Series B Convertible Preferred Stock accrue cumulative dividends at a rate of 6% per annum whether or not dividends have been declared by the Company's Board of Directors and whether or not there are profits, surplus or other funds available for the payment of such dividends. Due to the Company's decision to pay Series A Convertible Preferred Stock dividends accrued through September 30, 2008, in the form of additional shares of Series A Convertible Preferred Stock, the dividend accrual through such date is reflected as an increase in the stated value of the Series A Convertible Preferred Stock with a corresponding decrease in the additional paid-in capital. All Convertible Preferred Stock dividends subsequent to September 30, 2008, were paid in cash.

Table of Contents

## ANSWERS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(UNAUDITED)

## Note 7 – Stockholders' Equity

## General

The following table summarizes the changes in the Company's stockholders' equity during the nine-month period ending September 30, 2009:

	\$ (in thousands)
December 31, 2008	5,718
Stock-based compensation	1,166
Amortizations of discounts from the Redpoint Financings for the nine months ended September 30, 2009	(1,155)
Dividends on Series A and Series B Convertible Preferred Stock	(404)
Cumulative effect of change in accounting principle - adoption of ASC 815-40 (formerly EITF 07-5)	(3,570)
Exercise of Series B Unit Warrant	10,780
Discount to temporary equity resulting from the Beneficial Conversion Feature in the Series B Financing	2,868
Change in other comprehensive income (loss), net	103
Exercise of stock options	177
Net loss for the period	(648)
September 30, 2009	15,035

## Common Stock

During the nine months ended September 30, 2009, the Company issued a total of 66,225 shares of common stock due to the exercise of 66,225 stock options, for total consideration of \$177,000.

## Common Stock Warrants

In addition to the Series A Warrants and Series B Warrants discussed in Note 3, as of September 30, 2009 there were 1,155,591 outstanding common stock warrants with a weighted average exercise price of \$16.17. All warrants are exercisable immediately. In April 2009, 2,172 warrants expired. No common stock warrants were exercised during the nine months ended September 30, 2009.

## Stock Options

During the nine months ended September 30, 2009, the Company granted a total of 369,750 stock options to its directors and employees at an average exercise price of \$7.94 per share. Additionally, during the same period, 66,225 and 58,135 stock options were exercised and forfeited, respectively.

The total fair value of stock options vested during the three and nine months ended September 30, 2009, amounted to \$400,000 and \$1,166,000, respectively, and was recorded as stock-based compensation expense.

At the stockholders' annual meeting which was held on September 9, 2009, the stockholders of the Company agreed to amend the Company's 2005 Incentive Compensation Plan to increase the number of shares available for grant under such plan from 1,350,000 shares to 1,600,000 shares. As of September 30, 2009, 222,696 and 140,340 options were available for grant under the 2005 Plan and the 2004 Stock Plan, respectively. All prior option plans are closed for future grants.

Table of Contents

## ANSWERS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(UNAUDITED)

## Note 8 - Commitments and Contingencies

- (a) Future minimum lease payments under non-cancelable operating leases for office space and cars, as of September 30, 2009, are as follows:

Year ending December 31	\$ (in thousands)
2009 (three months ending December 31, 2009)	203
2010	301
2011	41
	545

Rental expense for operating leases for the three months ended September 30, 2009 and 2008 was \$145,000, and \$158,000, respectively. Rental expense for operating leases for the nine months ended September 30, 2009 and 2008 was \$420,000 and \$456,000, respectively.

- (b) Future minimum lease payments under non-cancelable capital leases for computer equipment, as of September 30, 2009, are as follows:

Year ending December 31	Principal \$ (in thousands)	Interest
2009 (three months ending December 31, 2009)	20	1
2010	82	3
2011	24	1
	126	5

- (c) A bank guarantee given to the Subsidiary's landlord, is secured by a lien on some of the Subsidiary's bank deposits. As of September 30, 2009, such deposits amounted to \$809,000, including a restricted long-term deposit of \$140,000.
- (d) In connection with the Redpoint Financings the Company entered into registration rights agreements with Redpoint, pursuant to which the Company agreed to register with the SEC for resale the common stock underlying the Redpoint Securities. In connection with the registration rights agreements, the Company agreed to pay a penalty of 1.0% per month, on a daily pro rata basis, up to a maximum of 8.0%, of the aggregate purchase price, as partial liquidated damages, for certain default events and subject to certain circumstances. The partial liquidated damages may trigger if the registration statements, which the Company filed on July 30, 2008 and June 15, 2009, and which were declared effective by the SEC on September 16, 2008 and July 28, 2009, respectively, cease to remain continuously effective.
- (e) In the ordinary course of business, the Company enters into various arrangements with vendors and other business partners, principally for content, web-hosting, marketing and various consulting arrangements. As of September 30, 2009, the total future commitments under these arrangements amounted to approximately \$713,000.





Table of Contents

ANSWERS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(UNAUDITED)

Note 8 - Commitments and Contingencies (cont'd)

- (f) In the ordinary course of business, the Company may provide indemnifications of varying scope and terms to customers, vendors, lessors, business partners, and other parties with respect to certain matters, including, but not limited to, losses arising out of its breach of agreements, services to be provided by it, or from intellectual property infringement claims made by third parties. Additionally, the Company has indemnified its board members, officers, employees, and agents serving at the request of the Company to the fullest extent permitted by applicable law. It is not possible to determine the maximum potential amount of liability under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Such indemnification agreements may not be subject to maximum loss clauses. To date, the Company has not incurred costs as a result of obligations under these agreements and has not accrued any liabilities related to such indemnification obligations in its accompanying financial statements.
- (g) From time to time, the Company receives various legal claims incidental to its normal business activities, such as intellectual property infringement claims and claims of defamation and invasion of privacy. Although the results of claims cannot be predicted with certainty, the Company believes the final outcome of such matters will not have a material adverse effect on its financial position, results of operations, or cash flows.
- (h) On or about July 24, 2009, the Company received a letter from Wikia, Inc. (Wikia) advising that Wikia believes that it has superior rights in the Company's registered trademark WikiAnswers®, and threatening to file a Petition with the U.S. Trademark Office to cancel the Company's recently registered WikiAnswers trademark and possibly take other action, if the Company does not abandon its registered mark for WikiAnswers and its application to register WikiAnswers.com and cease use of the WikiAnswers trademark. In September 2009, Wikia also filed a notice of opposition with the Trade Marks and Design Registration Office of the European Union with respect to our WikiAnswers CTM application. The Company has investigated Wikia's claims, believes the claims are without merit and intends to vigorously defend its rights in and to its US registered mark WikiAnswers. Notwithstanding the foregoing, there is no assurance that we will obtain a favorable ruling, should litigation ensue. An adverse judgment forcing us to abandon our use of the WikiAnswers and/or WikiAnswers.com marks would have the potential of materially harming our business. Litigation could also be costly for us and divert management attention.

Table of Contents

ANSWERS CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(UNAUDITED)

Note 9 – Risks and Uncertainties

- (a) Most of the Company's revenue was generated through the efforts of third party suppliers (the “Monetization Partners”). During the three and nine months ending September 30, 2009, the Company earned approximately 86% and 89% of its revenue, respectively, through one of its Monetization Partners, Google Inc. (“Google”), compared to 82% and 79% of advertising revenue from Google during the three and nine months ending September 30, 2008. The Company’s relationship with Google is governed by its Google Services Agreement, which was recently renewed for a two-year period ending January 31, 2012.
- (b) Search engines serve as origination Web properties for users in search of information, and the Company’s Websites’ topic pages often appear as one of the top links on the pages returned by search engines in response to users’ search queries. Thus, in addition to the ads the Company receives through Google, its traffic is mostly driven by search engine traffic, mostly from the Google search engine. For the third quarter of 2009, according to the Company’s internal estimates, search engine traffic represented approximately 85% of traffic. Search engines, at any time and for any reason, could change their algorithms that direct queries to the Company’s Web properties or could specifically restrict the flow of users visiting the Company’s Web properties. On occasion the Company’s Web properties have experienced decreases in traffic, and consequently in revenue, due to these search engine actions. The Company cannot guarantee that it will successfully react to these actions in the future and recover lost traffic. Accordingly, a change in algorithms that search engines use to identify Web pages towards which traffic will ultimately be directed, or a restriction on the flow of users visiting the Company’s Web properties from search engines, could cause a significant decrease in traffic and revenues.
- (c) Close to half of the Company’s operating expenses, excluding non-cash items such as stock-based compensation and Gain (Loss) from fair value adjustment of Series A Warrants, Series B Warrants and Warrant to purchase units of Series B preferred stock and warrants, are denominated in New Israel Shekels (NIS). The Company expects of the amount of such NIS expenses to grow in the foreseeable future. In recent years, the U.S. dollar-NIS exchange rate has been volatile. If the value of the U.S. dollar weakens against the value of NIS, there will be a negative impact on the Company’s operating costs. In addition, to the extent the Company holds monetary assets and liabilities that are denominated in currencies other than the U.S. dollar, the Company will be subject to the risk of exchange rate fluctuations. The Company uses various hedging tools, including forward contracts, to lessen the effect of currency fluctuations on its results of operations.
- (d) The Series A Warrants and Series B Warrants are revalued each reporting date, and any change in their fair value is recorded in the Statement of Operations. The Company uses the Black-Scholes valuation model to determine the values of the warrants. Inputs used in this model include our stock price and risk-free interest rate. The primary reason for the change in value of the aforesaid warrants over the last several quarters has been the change in the market value of our common stock on the measurement dates. To the extent that the market value of our common stock rises or declines in future periods, the Company may continue to experience significant gains or losses resulting from the fair value adjustments of Series A Warrants and Series B Warrants.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with, and is qualified in its entirety by, our financial statements (and notes related thereto) and other more detailed financial information appearing elsewhere in this report. Consequently, you should read the following discussion and analysis of our financial condition and results of operations together with such financial statements and other financial data included elsewhere in this report. Some of the information contained in this discussion and analysis or set forth elsewhere in this report, including information with respect to our plans and strategy for our business, includes forward-looking statements that involve risks and uncertainties. You should review the "Risk Factors" section of this report for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis. See also "Risk Factors" in Part II, Item 1A, of this report.

General

We own and operate Answers.com®, the leading Q&A site, dedicated to providing useful answers to questions about anything. Answers.com includes WikiAnswers® and ReferenceAnswers™. WikiAnswers is a community-generated social knowledge Q&A platform, leveraging wiki-based technologies. Through the contributions of the community, our questions and answers are continuously growing, improving and being updated, to form the world's greatest Q&A database. ReferenceAnswers provides trusted editorial content on millions of topics licensed from the world's top reference publishers. WikiAnswers.com According to comScore, under its new hybrid audience measurement methodology, Answers.com had approximately 56.4 million unique visitors in the U.S. in September 2009, ranking the site number 13 in the top U.S. Web properties for that month. Also according to comScore, Answers.com had approximately 83.1 million unique worldwide visitors in September 2009, ranking us number 25 worldwide. Our goal is to become the Internet's best place for people to find and share answers to questions.

New Answers.com: Integration of WikiAnswers and ReferenceAnswers

In September 2009 we announced the launch of the new Answers.com, in recognition of our completing the integration of our two Web properties, culminating a process that began several quarters earlier. The product strategy guiding the integration was our desire to give users the best answers to all types of questions – be they community-generated from WikiAnswers, or editorially licensed from ReferenceAnswers.

The first stages of the integration were minor and subtle - creating a similar "look and feel" for, and cross-linking between, the properties. Thus, for example, a user looking up "Michael Jackson" in ReferenceAnswers, arrived at a page displaying reference content covering the specific query, in addition to being asked to answer WikiAnswers unanswered questions relating to Michael Jackson. The result page also resembled a WikiAnswers page by way of including the standard "Ask" and "Answer" bar in the header of the page, as opposed to the original "Search" button displayed adjacent to the query bar. Subsequently, we added an "All" radio button adjacent to the query bar on both properties, allowing users, should they choose, to find a result by searching both properties. In the second quarter of 2009, we took an additional step in integrating both Web properties by making the "All" radio button the default setting above the query box of both properties. As a result of this user-interface change, users typing in queries into either of our properties are automatically directed to the Web page our algorithms deem most appropriate as a response. For example, a user typing the query, "When did WWII start?" in ReferenceAnswers, lands on a Web page belonging to WikiAnswers with an answer to that question. A user typing the query "Who is Oprah Winfrey?" in WikiAnswers, arrives at a ReferenceAnswers page displaying the Oprah Winfrey topic. In September 2009, we took our final step in integrating the two Web properties by creating a new unified Answers.com home page and login, integrating features from both properties, and making other changes in our user interface to strengthen our positioning as having one dominant product and brand, Answers.com, comprised of the two properties, WikiAnswers and ReferenceAnswers.

## Internationalization

In the third quarter of 2009 we launched French, Italian, German and Spanish language versions of WikiAnswers. The Q&A platform also supports Tagalog (Filipino). Our strategy will capitalize on the needs of users around the globe who are searching for answers online and will leverage our core strengths: community building and Q&A space. Further, we plan on leveraging our large and dynamic English language database and community, to grow our foreign language versions. The WikiAnswers English language database contains close to 6 million answered questions. We have begun to selectively translate some of our answered English language questions, to help accelerate the adoption of our non-English versions, and plan to continue that effort. Our largest competitor already has successful international sites and receives much of its traffic from those sites, thus we view this area as critical to our future growth.

## Table of Contents

### Revenue

### Traffic

Our revenue is driven by the traffic generated by Answers.com and our ability to effectively monetize that traffic. Search engines, primarily Google, are responsible for most of the traffic to Answers.com. Users submit queries and search engines respond by generating a list of Web pages that they deem likely to offer the most relevant content. When an Answers.com page ranks high in the algorithmic systems of search engines, our results are more likely to be accessed by users. For the three and nine months ended September 30, 2009, according to our internal estimates, this source of traffic represented approximately 85% and 83%, respectively, of Answers.com's traffic.

Presently, the balance of the traffic arriving at Answers.com originates from direct usage, i.e., users visiting our home page and/or navigating within Answers.com, and from users who have clicked on Google's Definition Link feature. Since 2005, we benefited from an informal, non-contractual relationship with Google under which Google linked certain search results related to definitional queries to ReferenceAnswers. This link (or links, in the case of multiple-phrasal queries) appeared at the right end of the blue header bar for Google Search Results. For the nine months ended September 30, 2009, according to our internal estimates, this source of traffic represented approximately 5% of our overall traffic and revenue. In October 2009, Google informed us that beginning sometime during the fourth quarter of 2009, they will no longer be sending us traffic from the Google Definition Link. As of the filing of this quarterly report, most of this traffic appears to have been discontinued.

Search engines, at any time and for any reason, could change their algorithms that direct search queries to our Web properties or could restrict the flow of users visiting our Web properties specifically. In fact, our Web properties – which rely so heavily on search engine traffic – have experienced decreases in traffic, and consequently in revenue. Thus, we expend considerable resources guarding and improving the volume of this traffic. The industry commonly refers to such efforts as search engine optimization, or SEO. We often refer to traffic from search engines as SEO traffic. One of the areas that we focus on is the "quality" of the Q&A data base, since poor quality could negatively impact our SEO traffic.

### Seasonality

Our results of operations have historically been affected by seasonal patterns in both traffic to our Web properties and advertising demand. Many of our users are students who utilize our Web properties as reference sources. Our traffic fluctuates with the academic school year, rising from January through May, falling to lower levels during the summer months, rising again in September through November, and falling again in December, coinciding with school breaks and the holiday season. We expect traffic to our Web properties to continue to fluctuate seasonally in the future. This seasonal fluctuation in traffic results in a fluctuation in our quarterly revenues, since lower traffic on our Web properties translates into fewer users clicking on or viewing the advertisements on our Web properties. Our current seasonal patterns may become more pronounced or may change as we grow domestically and internationally.

### Monetization

**Advertising Revenue.** We earn practically all of our revenue from advertising. There are two primary categories of Internet advertising: pay-per-performance, also known as cost-per-click, or CPC, and pay-per-impression, also known as display ads or cost per 1,000 impressions, or CPM. In the pay-per-performance model, we earn revenue based on the number of clicks associated with an ad; in the pay-per-impression model, we derive revenue from the display of ads. The overwhelming majority of our advertising revenue is earned from CPC advertising. We obtain CPC and CPM advertisements from third-party ad networks. These ad networks compensate us by paying us a portion of the revenue they earn from advertisers for our provision of promotional space on our Web properties.

We gauge the effectiveness of our monetization efforts and trends by measuring our revenue per thousand page views, or RPM. Throughout this quarterly report, we refer to estimates of traffic, or page views. In our Management's Discussion and Analysis of Financial Condition and Results of Operations prior to our quarterly report on Form 10-Q for the quarterly period ended June 30, 2008, we tracked the traffic on ReferenceAnswers and WikiAnswers Web properties using two separate systems:

- ReferenceAnswers traffic was measured using our internally developed server-side, log-based system ("Internal Data Warehouse"). This system was designed to identify traffic from search engine robots and other known Web robots, commonly referred to as Web spiders or Web crawlers, as well as from suspected automated spidering scripts, and excluded such traffic from the traffic activity measurements.
- WikiAnswers traffic was tracked using HBX Analytics, a tag-based Web analytics system offered by Omniture, Inc., which we will refer to as Omniture. Traffic measurements from this system are generated by our placement of tags on our Web pages. The Omniture system then independently generates traffic metrics.

## Table of Contents

Beginning with the Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our quarterly report on Form 10-Q for the quarterly period ended June 30, 2008, all traffic measurements (including measurements previously reported in past filings using our Internal Data Warehouse) for ReferenceAnswers are also presented based on the Omniture data. We estimate that the historical page views for ReferenceAnswers pursuant to Omniture data, as set forth in our reports beginning with our quarterly report on Form 10-Q for the quarterly period ended June 30, 2008, are approximately 11% lower than the traffic measurements reported in previous filings. Consequently, our ReferenceAnswers RPMs, as reported in our current reports, reflect higher values than those presented in previous filings.

We also use Google, Inc.'s Google Analytics measurement services and Google AdSense data to estimate the breakdown of our traffic sources, noted above. Google Analytics measurements are generated by our placement of tags on our Web properties' pages, which Google Analytics uses to count and report audience metrics independently.

In this Quarterly Report, statistics gathered from Omniture and Google Analytics are also referred to as "internal estimates".

Third party services measuring traffic audiences may provide different estimates than the estimates reported by other similar services and our internal estimates. These discrepancies may result from differences in methodologies applied or the sampling approaches used by each measuring service.

We also generate community-related statistics, including total number of questions, answers and users, from our own systems contained in the WikiAnswers property.

Our primary third party ad network, Google AdSense, accounted for approximately 86% and 89% of our total revenue in the three and nine months ending September 30, 2009, as compared to approximately 82% and 79% of our total revenue in the three and nine months ending September 30, 2008. We obtain CPC ads from Google. In addition to Google, we utilize the services of other third party ad networks that provide us with CPM ads. We expect that for the foreseeable future, CPC ads will continue to generate the overwhelming majority of our revenue, and we have no plans to reduce our reliance on CPC ads.

Direct Ad Sales. In the second quarter of 2008, we decided to suspend our direct ad sales efforts and to instead focus on selling ads through advertising networks, primarily Google AdSense. In the second and third quarter of 2008 we terminated all of our direct ad sales employees. This decision allowed us to focus on our core competency – growing the community, growing our traffic and monetizing via Google and other ad networks. Notwithstanding the lack of a direct ad sales team, we are occasionally approached directly by advertisers who wish to advertise on Answers.com, and we often facilitate such requests.

Licensing Revenue. We earn a negligible portion of our revenues from partners that pay us for providing them with our answer-based services that they then use in their own products, via co-branded Web pages. Revenue from these arrangements are based on various formulae, including fees based on the number of user queries and fixed periodic fees.

## Costs and Expenses

### Cost of Revenue

Cost of revenue consists of fees to third parties to license and translate content, data center costs, including depreciation of information technology assets, compensation, travel and overhead costs relating to personnel who are engaged in production operations, content editing and content integration, Web search service fees, ad serving fees,



amortization of the cost of acquired software used in our products, and contractual revenue sharing fees to various Web property operators for visitors directed to our Web properties, or traffic acquisition costs. Our cost of revenue, as a percentage of revenue, is generally expected to decrease as we grow revenue, since many of its components, such as content licensing, are not directly tied to revenue. Notwithstanding, we do not expect to experience margin improvement over the next few quarters because of the various initiatives we are planning, including translation of English-language content into foreign languages. Depending on the pace of such initiatives, our margins may even decline.

#### Research and Development Expenses

Research and development expenses consist of compensation, travel and overhead costs of personnel conducting research and development of our products and services, and consulting costs. Our research and development team works primarily on projects to improve and enhance product functionality, quality, performance, user interface, and monetization. We generally expect that our research and development expenses will decline as a percentage of revenue as we grow our revenue.

## Table of Contents

### Community Development, Sales and Marketing Expenses

Community development, sales and marketing expenses consist of compensation, travel and overhead costs of personnel in charge of developing and encouraging the WikiAnswers community of users asking and answering questions and volunteer supervisors, sales and marketing, product management, marketing and market information services, public relations and promotional costs. As a result of our termination of direct ad sales in 2008, we expect that the primary future growth in this expense line item will be in the area of WikiAnswers community development. We generally expect that our sales, marketing and community development expenses will decline as a percentage of revenue as we grow our revenue.

### General and Administrative Expenses

General and administrative expenses consist primarily of compensation, travel and overhead costs for financial, legal, human resources, and other administrative personnel, professional services, including investor relations, legal, accounting, payroll and other consulting services, insurance fees, amortization of domain names, and other general corporate expenses. We generally expect that our general and administrative expenses will decline as a percentage of revenue as we grow our revenue.

### Overhead Costs

Overhead costs consist primarily of rent, telecommunications, utilities and depreciation expenses.

### Stock-Based Compensation

New employees typically receive stock option awards within three months of their start date. We also grant additional stock option awards to existing employees and directors. We account for stock-based awards under Accounting Standards Codification (“ASC”) 718, “Compensation – Stock Compensation” (formerly SFAS No. 123 (revised 2004), “Share-Based Payment”), which requires measurement of compensation cost for all stock-based awards at fair value on date of grant and recognition of compensation over the service period awards are expected to vest. Costs resulting from stock-based compensation are part of our compensation expense and are included in the operating expense categories in our Statements of Operations.

### Impact of Foreign Currency Fluctuations

The dollar cost of our operations is heavily influenced by changes in the value of the dollar in relation to the New Israeli Shekel (“NIS”), mostly due to the NIS-based salaries of our Israel-based employees. Close to half of our operating expenses, excluding non-cash items such as stock-based compensation, are denominated in New Israel Shekels (NIS). We enter into forward contracts to hedge some of our NIS-based expenses. Prior to May 2009, these derivatives were not designated as hedging instruments under the rules of ASC 815, “Derivatives and Hedging” (formerly SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities”), and therefore, the net gains (losses) arising from these derivatives were recognized in operating expenses as they occurred. Starting May 2009, we designated all of our currency hedging activity as cash flow hedges as they were all eligible.

In the three months ended September 30, 2009, compensation, excluding stock-based compensation (thereafter, “Cash-Based Compensation”), to employees amounted to \$1,791 thousand compared to \$1,727 thousand during the same period in 2008, a net increase of \$64 thousand. As a result of the strengthening of the dollar as compared to the NIS and the effect of foreign currency derivatives, Cash-Based Compensation in the three months ended September 30, 2009 would have declined approximately \$104 thousand as compared to the same period in 2008, however, such decline was offset by other compensation changes, including increases in headcount and raises, amounting to \$168

thousand.

In the nine months ended September 30, 2009, Cash-Based Compensation to employees amounted to \$5,233 thousand compared to \$5,553 thousand during the same period in 2008, a decrease of \$320 thousand. As a result of the strengthening of the dollar as compared to the NIS and the effect of foreign currency derivatives, Cash-Based Compensation in the nine months ended September 30, 2009 would have declined approximately \$509 thousand as compared to the same period in 2008, however, such decline was offset, to some extent, by other compensation changes, including increases in headcount and raises, amounting to \$190 thousand.

Our period-over-period discussion regarding operating expenses includes the impact of foreign currency on such expenses. We expect our NIS-based expenses in 2009, to be in excess of 2008 levels, which approximated \$6.5 million, thus, if the dollar continues to fluctuate as compared to the NIS, we will experience further fluctuation in the dollar amount of our NIS-based expenses.

24

---

Table of Contents

Termination fees and write-off of cost relating to the terminated Lexico acquisition and abandoned follow-on offering

In the first quarter of 2008, we recorded a charge of \$2,543 thousand consisting of \$1,618 thousand of accounting, legal, banking, consulting and travel costs we incurred in 2007 and in the first quarter of 2008, in connection with the terminated acquisition of Lexico and abandoned follow-on offering of securities, and \$925 thousand relating to termination fees we paid as a result of the termination of the acquisition and a Securities Purchase Agreement with an institutional investor, for the optional purchase and sale of \$8.5 million of our senior secured convertible notes. A summary of the events that led to the termination of the acquisition and financing follows:

On July 13, 2007, we entered into a Purchase Agreement that we subsequently amended on July 31, 2007 and November 12, 2007; and on January 15, 2008 we entered into an Amended and Restated Purchase Agreement, which we subsequently amended on February 8, 2008, to acquire all of the outstanding limited liability interests of Lexico Publishing Group, LLC for an aggregate purchase price of \$100 million in cash, subject to adjustments for closing net working capital. Consummation of the acquisition of Lexico was subject to our ability to secure financing for the acquisition.

On July 17, 2007, we filed a universal shelf registration statement on Form S-3 with the Securities and Exchange Commission which was declared effective on August 6, 2007. The registration statement covered up to an aggregate of \$140 million of common stock, preferred stock, warrants, debt securities, units or any combination thereof. On January 16, 2008, we filed a prospectus supplement for a proposed public offering which we later amended on February 8, 2008. On February 13, 2008 we canceled our proposed public offering due to unfavorable market conditions. On March 1, 2008, the members of Lexico terminated the purchase agreement, due to our inability to finance the acquisition. Additionally, in connection with the Lexico transaction, on January 15, 2008, we entered into a Securities Purchase Agreement with an institutional investor, or the senior notes investor, for the optional purchase and sale of \$8.5 million of our senior secured convertible notes. Our intent was to close the senior secured convertible notes financing in conjunction with our follow-on offering, if we needed such funds to close the Lexico acquisition. Since our purchase agreement with Lexico was terminated, the Securities Purchase Agreement also terminated.

Interest Income (Expense), Net

Interest income (expense), net, is comprised of interest income earned on cash, cash equivalents and investment security balances, interest expense on capital leases, transaction costs we incurred in connection with the issuance of the Series B Warrants in June 2009 and amortization of deferred costs we incurred in connection with the issuance of the Series B Unit Warrant, in June 2008.

Other Income (Expense), Net

Other income (expense), net, is comprised of foreign currency gains and losses.

Loss Resulting from Fair Value Adjustment of Series A and Series B Warrants and Warrant to Purchase Units of Series B Preferred Stock and Warrants

The Series A and Series B Warrants and the Series B Unit Warrant (prior to exercise), which are components of transactions with Redpoint Omega, L.P. and Redpoint Omega Associates, LLC (collectively, "Redpoint") are revalued each reporting date. Any change to their fair value is recorded as a gain or loss in the statement of operations. Background regarding the transaction with Redpoint follows.

Redpoint Financings

On June 16, 2008, pursuant to a private placement of our securities, Redpoint purchased \$6 million of our Series A Convertible Preferred Stock (60,000 shares), convertible into 1,333,333 shares of common stock at an initial conversion price of \$4.50 per share, along with Common Stock Purchase Warrants exercisable for 666,667 shares of common stock at an exercise price of \$4.95 per share (“Series A Warrants”). In conjunction therewith, Redpoint also received a warrant, referred to as the “Series B Unit Warrant”, exercisable until June 16, 2009, to purchase units of up to \$7 million of Series B Convertible Preferred Stock (70,000 shares) and Common Stock Purchase Warrants exercisable for 636,364 shares of common stock (“Series B Warrants”). The Series B Convertible Preferred Stock is initially convertible into 1,272,727 shares of common stock at an initial conversion price of \$5.50 per share. The Series B Warrants have an exercise price of \$6.05 per share. On June 10, 2009, Redpoint exercised the Series B Unit Warrant, in full.

After deducting placement agent fees and legal expenses, our net proceeds from the private placement, in June 2008, were \$5,380,000, while our net proceeds from the exercise of the Series B Unit warrant, in June 2009, were \$6,480,000. The transaction that took place on June 16, 2008 is referred to as the “Series A Financing”. The transaction that took place on June 10, 2009 is referred to as the “Series B Financing”. The two transactions, in aggregate, are collectively referred to as the “Redpoint Financings”. The Series A Convertible Preferred Stock, the Series B Convertible Preferred Stock, the Series A Warrants and the Series B Warrants are collectively referred to as the “Redpoint Securities”.

Table of Contents

The Series A Convertible Preferred Stock has the rights and preferences set forth in our Certificate of Designations, Number, Voting Powers, Preferences and Rights of Series A Convertible Preferred Stock, which, as of its date of filing on June 16, 2008, amended our Amended and Restated Certificate of Incorporation. For a detailed description of the rights and preferences of the Series A Convertible Preferred Stock, we refer you to the notes to the financial statements included in our annual report on form 10-K filed on March 9, 2009. The rights and preferences of the Series B Convertible Preferred Stock are set forth in the Series B Certificate of Designations filed with the State of Delaware on June 9, 2009, and are identical to the rights and preferences of the Series A Convertible Preferred Stock.

In connection with the Redpoint Financings, Redpoint received the right to appoint two individuals to serve as voting members of our board of directors.

In connection with the Redpoint Financings we entered into a registration rights agreement with Redpoint, pursuant to which we agreed to register with the SEC for resale the common stock underlying the Redpoint Securities. In connection with the registration rights agreement, we agreed to pay a penalty of 1.0% per month, on a daily pro rata basis, up to a maximum of 8.0%, of the aggregate purchase price, as partial liquidated damages, for certain default events and subject to certain circumstances. The partial liquidated damages may trigger if the registration statements covering the Series A Convertible Preferred Stock and the Series B Convertible Preferred Stock, which we filed on July 30, 2008 and June 15, 2009 respectively, and which were declared effective by the SEC on September 16, 2008 and July 28, 2009 respectively, cease to remain continuously effective.

Income Tax Benefit (Expense), Net

Our effective tax rate differs from the statutory federal rate primarily due to differences between income and expense recognition prescribed by income tax regulations and Generally Accepted Accounting Principles. We utilize different methods and useful lives for depreciating and amortizing property, equipment and intangible assets and different methods and timing for certain expenses. Furthermore, permanent differences arise from certain income and expense items recorded for financial reporting purposes but not recognizable for income tax purposes. In addition, our income tax expense has been adjusted for the effect of state and local taxes and foreign income from our wholly owned subsidiary. At September 30, 2009, our deferred tax assets were almost entirely offset by a valuation allowance because realization depends on generating future taxable income, which, in our estimation, is not more likely than not to transpire.

Our Israeli subsidiary had net income in 2008 and 2007, resulting from services we received from the Israeli subsidiary. The Israeli subsidiary charges us for research & development and certain management services it provides us, plus a profit margin, currently 8.3%. However, the subsidiary is an “approved enterprise” (and a “beneficiary enterprise” as later amended in amendment No. 60 to the Investment Law) under Israeli law, which means that income arising from the subsidiary’s approved research & development activities, is subject to zero percent tax under the “alternative benefit” path for a period of ten years. Management services are taxable at the Israeli corporate tax rate in effect at the time (26 % and 27% in 2009 and 2008, respectively). Currently, the subsidiary operates under two separate “approved enterprise” plans, ending December 31, 2009 and December 31, 2014, respectively, and a “beneficiary enterprise” plan ending December 31, 2017. After the close of the first approved enterprise plan in 2009, the subsidiary will have to pay taxes at the regular corporate income tax rate on the relative proportion of taxable income attributable to the first approved enterprise plan.

In the event of distributions by the subsidiary to the parent, the subsidiary would have to pay a 10% corporate tax on the amount distributed, and the recipient would have to pay a 15% tax to be withheld at source on the amounts of such distributions received. Furthermore, the parent would be subject to a 35% federal tax on dividends received, before applying any credits possibly allowed for NOL carryforwards or by the income tax treaty between the United States and Israel. At present, we do not plan on having the subsidiary distribute a dividend to Answers Corporation.

Edgar Filing: Answers CORP - Form 10-Q

Three Months and Nine Months Ended September 30, 2009 and 2008

Revenue

	Three Months Ended September 30, 2009			Nine Months Ended September 30, 2009		
	2008	Change	2008	Change		
	(\$ - in thousands)			(\$ - in thousands)		
WikiAnswers advertising revenue	3,422	1,960	1,462	9,984	4,891	5,093
ReferenceAnswers advertising revenue	1,548	1,579	(31)	4,700	4,645	55
Licensing revenue	17	24	(7)	53	61	(8)
	4,987	3,563	1,424	14,737	9,597	5,140

26

---

## Table of Contents

Revenue increased \$1,424 thousand, or 40%, to \$4,987 thousand for the three months ended September 30, 2009 from \$3,563 thousand for the three months ended September 30, 2008. Revenue increased \$5,140 thousand, or 54%, to \$14,737 thousand for the nine months ended September 30, 2009 from \$9,597 thousand for the nine months ended September 30, 2008.

WikiAnswers advertising revenue in the three months ended September 30, 2009 increased \$1,462 thousand, or 75%, compared to the same period in 2008, due to increases in traffic, offset to some extent by decreased RPM.

WikiAnswers average daily page views in the three months ended September 30, 2009 were 6,336,000, an increase of 105% compared to the average daily page views of 3,094,000 in the same period in 2008. We believe that the traffic growth that WikiAnswers has experienced in the three months ended September 30, 2009 as compared to the same period in 2008 is primarily due to the dynamics of the property. As our database of questions and answers grows, we draw new traffic, primarily from SEO, which in turn results in the creation of new questions and answers, or new content, which in turn drives additional growth. The growth in revenue from the aforesaid traffic growth was partially offset by a decrease in our RPM. The WikiAnswers RPM in the three months ended September 30, 2009 was \$5.87, a decrease of 15% compared to the RPM of \$6.89 in the same period in 2008. We believe the general economic downturn is the primary cause for the decline in RPM.

WikiAnswers advertising revenue in the nine months ended September 30, 2009 increased \$5,093 thousand, or 104%, compared to the same period in 2008, due to increased traffic, offset, to some extent, by decreased RPM. WikiAnswers average daily page views in the nine months ended September 30, 2009 were 5,919,000, an increase of 143% compared to the average daily page views of 2,432,000 in the same period in 2008. We believe that the traffic growth that WikiAnswers has experienced in the nine months ended September 30, 2009 as compared to the same period in 2008 is primarily due to the dynamics of the property. As our database of questions and answers grows, we draw new traffic, primarily from SEO, which in turn results in the creation of new questions and answers, or new content, which in turn drives additional growth. The growth in revenue from the aforesaid traffic growth was partially offset by a decrease in our RPM. The WikiAnswers RPM in the nine months ended September 30, 2009 was \$6.16, a decrease of 12% compared to the RPM of \$6.97 in the same period in 2008. We believe the general economic downturn is the primary cause for the decline in RPM.

ReferenceAnswers advertising revenue in the three months ended September 30, 2009 decreased \$31 thousand, or 2%, compared to the same period in 2008, due to lower RPM, offset, to some extent, by an increase in traffic. The ReferenceAnswers RPM in the three months ended September 30, 2009 was \$5.89, a decrease of 8%, compared to the RPM of \$6.44 during the same period in 2008. We attribute the decline in RPM to the general economic downturn, as well as the elimination of direct sales in the third quarter of 2008. ReferenceAnswers average daily page views in the three months ended September 30, 2009 were 2,857,000, an increase of 7% compared to the average daily page views of 2,666,000 in the same period in 2008.

ReferenceAnswers advertising revenue in the nine months ended September 30, 2009 increased \$55 thousand, or 1%, compared to the same period in 2008. The increase was the result of an increase in traffic, offset, to some extent, by lower RPM. ReferenceAnswers average daily page views in the nine months ended September 30, 2009 were 2,935,000, an increase of 3% compared to the average daily page views of 2,844,000 in the same period in 2008. The ReferenceAnswers RPM in the nine months ended September 30, 2009 was \$5.85, a decrease of 7%, compared to the RPM of \$6.28, during the same period in 2008. We attribute the decline in RPM to the general economic downturn, as well as the elimination of direct sales in the third quarter of 2008.

## Integration of ReferenceAnswers and WikiAnswers

As described in further detail above, in September 2009, we announced the launch of the new Answers.com, in recognition of our completing the integration of WikiAnswers and ReferenceAnswers. The product strategy guiding



such integration was our desire to give users the best answers to all types of questions – be they community-generated from WikiAnswers, or editorially licensed from ReferenceAnswers. In September 2009, we took our final step in this integration by creating a new unified Answers.com home page and login, integrating features from both properties, and making other changes in our user interface to strengthen our positioning as having one dominant product and brand, Answers.com, comprised by two properties, WikiAnswers and ReferenceAnswers. Since the new unified Answers.com home page was designed to give prominence to WikiAnswers and to encourage users to enter their questions into the site’s query bar, beginning September 2009, visits to that page, which on average approximate 175,000 per day, are being recorded as a WikiAnswers page-view rather than a ReferenceAnswers page-view, contrary to the previous practice.

Table of Contents

## Traffic and Revenue Trends

The following table illustrates the historical trends of our two Web properties' revenues, average daily page views and RPMs, by quarter, beginning the first quarter of 2008:

	2008				2009		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Ad Revenue (\$ - in thousands)							
WikiAnswers	1,185	1,500	1,960	2,879	3,162	3,400	3,422
ReferenceAnswers	1,828	1,485	1,579	1,730	1,567	1,585	1,548
Total	3,013	2,985	3,539	4,609	4,729	4,985	4,970
WikiAnswers	39%	50%	55%	62%	67%	68%	69%
ReferenceAnswers	61%	50%	45%	38%	33%	32%	31%
Total	100%	100%	100%	100%	100%	100%	100%
Traffic – Average Daily Page Views							
WikiAnswers	1,885,000	2,318,000	3,094,000	4,350,000	5,337,000	6,082,000	6,336,000
ReferenceAnswers	3,225,000	2,641,000	2,666,000	3,027,000	2,982,000	2,965,000	2,857,000
Total	5,110,000	4,959,000	5,760,000	7,377,000	8,319,000	9,047,000	9,193,000
WikiAnswers	37%	47%	54%	59%	64%	67%	69%
ReferenceAnswers	63%	53%	46%	41%	36%	33%	31%
Total	100%	100%	100%	100%	100%	100%	100%
RPM							
WikiAnswers	\$6.91	\$7.11	\$6.89	\$7.19	\$6.58	\$6.14	\$5.87
ReferenceAnswers	\$6.23	\$6.18	\$6.44	\$6.21	\$5.84	\$5.87	\$5.89

## Traffic Trends

WikiAnswers' average daily page views in the third quarter of 2009 were 6.34 million, an increase of 4% compared to the previous quarter. WikiAnswers' average daily page views in the third quarter of 2008 grew 33% as compared to the second quarter of 2008. The primary reason for the mere 4% traffic growth in the third quarter of 2009 as compared to the growth in third quarter of 2008 was the traffic declines we experienced in July and August of 2009, which we attribute to summer seasonality which was more pronounced than in previous years, and the effect of product changes intended to improve longer-term traffic and quality. The decline in July and August was followed by strong traffic growth in September and October, similar to our experience in previous years.

Since we purchased WikiAnswers in November 2006, the Web property has grown significantly, each quarter, both in terms of traffic and revenue. We believe that the growth that WikiAnswers has experienced is primarily due to the dynamics of the property. As our database of questions and answers grows, we draw new traffic, primarily from SEO, which in turn results in the creation of new questions and answers, or new content, which in turn drives additional growth. This is a self-reinforcing growth model that we consider a "virtuous cycle of growth". Notwithstanding our

belief in this cycle of growth, WikiAnswers' growth has, over time decelerated, and we believe that, as WikiAnswers grows further, its rate of growth will decelerate further. In addition, since the integration of our two Web properties was completed only fairly recently, we cannot predict how that integration will impact future growth.

Beginning the third quarter of 2007, when we experienced a drop in our traffic to ReferenceAnswers due to a search engine algorithm adjustment by Google, through the first quarter of 2009, ReferenceAnswers average daily page views in every quarter has declined, compared to the same quarter in the immediately preceding year. This trend was reversed beginning the second quarter of 2009. In the second and third quarters of 2009, ReferenceAnswers average daily page views were 12% and 7% higher, respectively, than the average daily page views for the same periods in 2008. We attribute this increase to a number of factors. First, in the second quarter of 2008, in an effort to defend and improve our SEO traffic, we made changes to the property, that caused traffic in the third and fourth quarters of 2008 and in the first quarter of 2009 to decline compared to the same periods in the immediately preceding year. Hence, beginning the second quarter of 2009, ReferenceAnswers traffic was no longer in decline, compared to 2008. Second, the integration of our two Web properties resulted in a net increase of traffic to ReferenceAnswers in May 2009. However, ReferenceAnswers experienced traffic declines in the months of September and October 2009, as compared to the same months in 2008. We believe that the final steps of integration taken in September 2009, namely a new Answers.com homepage geared more towards WikiAnswers, was one of the factors that led to these declines. We are presently not able to identify a predictable traffic trend for this property. Finally, for the nine months ended September 30, 2009, according to our internal estimates, approximately 5% of our overall Company traffic and revenue was derived from the Google Definition Link. In October 2009, Google informed us that beginning sometime during the fourth quarter of 2009, they will no longer be sending us traffic from the Google Definition Link. As of the filing of this quarterly report, most of this traffic appears to have been discontinued.

## RPM Trends

We believe that the general economic downturn has hurt our RPMs during the nine months ended September 30, 2009. Based on recent trends in the industry, we are hopeful that RPMs have stabilized and that we will begin to see RPM improvement in the coming months. Notwithstanding, the current general economic downturn may continue or escalate and may result in fewer page views that result in commercial activities by our users. Further, the revenue rates we receive from Google depend upon a number of factors outside of our control, including the amount Google charges its network of advertising businesses. If Google charges its advertisers less, due to a weaker economy, our ultimate revenue share will also decrease. These potential developments could delay improvement in RPMs or could even have a further negative impact on the RPM of both our Web properties.

Our relationship with Google, our primary third-party ad network, is governed by our Google Services Agreement, or GSA, which was recently renewed for a two-year period ending January 31, 2012 at financial terms that are slightly less favorable than the terms we had for the two-year period ending January 31, 2010.

## Costs and Expenses

## Cost of Revenue

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
	(\$ - in thousands)			(\$ - in thousands)		
Cost of revenue	1,264	945	319	3,489	3,754	(265)

Cost of revenue increased \$319 thousand, or 34%, to \$1,264 thousand in the three months ended September 30, 2009, from \$945 thousand in the three months ended September 30, 2008. The change in cost of revenue was due primarily to an increase of \$71 thousand in compensation related expenses, excluding stock based compensation, a \$7 thousand decrease in stock based compensation, increased data center costs, including depreciation of equipment, of \$192 thousand, and increased content-related costs of \$58 thousand.

Cost of revenue decreased \$265 thousand, or 7%, to \$3,489 thousand in the nine months ended September 30, 2009, from \$3,754 thousand in the nine months ended September 30, 2008. The change in cost of revenue was due primarily to the following factors: Amortization expense from intangible technology assets we purchased in connection with the Brainboost acquisition that took place in December 2005 decreased \$358 thousand, because we wrote off the Brainboost Answer Engine on May 25, 2008, thus there was no amortization in the nine months ended September 30, 2009. Additionally, data center costs decreased \$113 thousand and stock-based compensation decreased \$26 thousand. The aforesaid decreases were partially offset by a \$101 thousand increase in compensation costs, excluding stock based compensation, increases in recruitment fees of \$28 thousand and increases in content licensing costs of \$101 thousand.

## Research and Development Expenses

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
	(\$ - in thousands)			(\$ - in thousands)		
Research and development	921	866	55	2,611	2,670	(59)

Edgar Filing: Answers CORP - Form 10-Q

Research and development expenses increased \$55 thousand, or 6%, to \$921 thousand in the three months ended September 30, 2009, from \$866 thousand in the three months ended September 30, 2008. The change in research and development expenses was due primarily to an increase of \$28 thousand in compensation related expenses, excluding stock based compensation, a \$4 thousand decrease in stock based compensation and a \$29 thousand increase in overhead.

Research and development expenses decreased \$59 thousand, or 2%, to \$2,611 thousand in the nine months ended September 30, 2009, from \$2,670 thousand in the nine months ended September 30, 2008. The change in research and development expenses was due primarily to a decrease of \$53 thousand in compensation related expenses, excluding stock based compensation, and a decrease in stock based compensation of \$43 thousand, offset, to some extent, by increases in travel and overhead of \$21 thousand and \$20 thousand, respectively.

Table of Contents

## Community Development, Sales and Marketing Expenses

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
	(\$ - in thousands)			(\$ - in thousands)		
Community development, sales and marketing	621	563	58	1,679	2,258	(579)

Community development, sales and marketing expenses increased \$58 thousand or 10%, to \$621 thousand, in the three months ended September 30, 2009, from \$563 thousand in the three months ended September 30, 2008. The primary factors that caused this expense to increase were increases in promotion and advertising of \$30 thousand, increases in community consulting services of \$23 thousand and that in the third quarter of 2008 expenses were reduced by \$40 thousand to reflect an adjustment to the cost of terminating our direct ad sales operation. The aforesaid increases were partially offset by decreases in compensation related expenses, excluding stock based compensation, of \$15 thousand. At the end of the second quarter of 2008 we decided to abandon direct ad sales, and terminated most of our direct ad sales staff. On the other hand, the savings we experienced from decreasing headcount in direct ad sales was mostly offset by hiring additional WikiAnswers community staff due to the growth we are experiencing in WikiAnswers. Additionally, overhead expenses increased \$15 thousand.

Community development, sales and marketing expenses decreased \$579 thousand, or 26%, to \$1,679 thousand, in the nine months ended September 30, 2009, from \$2,258 thousand in the nine months ended September 30, 2008. The primary factor that caused this line item to decrease was that compensation related expenses, excluding stock based compensation, decreased \$429 thousand, and stock based compensation decreased \$84 thousand, mostly due to the termination of our direct ad sales team in the second and third quarters of 2008. At the end of the second quarter of 2008 we decided to abandon direct ad sales, and terminated most of our direct ad sales staff. Further, as a result of our decision to abandon our direct ad sales efforts, there was a net charge of \$90 thousand, in the nine months ended September 30, 2008, to account for the termination of certain service contracts relating to our abandoned direct ad sales efforts. Finally, there was also a decrease of \$43 thousand in overhead expenses in the nine months ended September 30, 2009 as compared to the same period in 2008. The aforesaid decreases were partially offset by increases in costs relating to promotion and marketing of \$60 thousand, and increases in community consulting services of \$67 thousand.

## General and Administrative Expenses

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
	(\$ - in thousands)			(\$ - in thousands)		
General and administrative	1,201	1,311	(110)	3,666	3,640	26

General and administrative expenses decreased \$110 thousand, or 8%, to \$1,201 thousand in the three months ended September 30, 2009, from \$1,311 thousand in the three months ended September 30, 2008. The change in general and administrative expenses was due primarily to the following factors: Accounting and legal fees decreased by \$63 thousand, compensation related expenses, excluding stock based compensation, decreased \$20 thousand, stock administration decreased by \$20 thousand and overhead expenses decreased by \$48 thousand. The aforesaid decreases were partially offset by an increase in stock-based compensation of \$14 thousand and a \$20 thousand increase in non-income related taxes.

Edgar Filing: Answers CORP - Form 10-Q

General and administrative expenses increased \$26 thousand, or 1%, to \$3,666 thousand in the nine months ended September 30, 2009, from \$3,640 thousand in the nine months ended September 30, 2008. The change in general and administrative expenses was due primarily to the following factors: Compensation costs, excluding stock based compensation, increased by \$56 thousand, stock based compensation increased \$8 thousand, travel and conference expenses increased by \$62 thousand, investor relations increased \$47 thousand and non-income related taxes increased by \$43 thousand. The aforesaid increases were partially offset by a decrease of \$113 thousand in accounting and legal fees, \$60 thousand in stock administration, and \$27 thousand in overhead expenses.

Table of Contents

## Write-off of the Brainboost Answer Engine

	Three Months Ended September 30, 2009			Nine Months Ended September 30, 2009		
	2008	Change	2008	Change		
	(in thousands)		(in thousands)			
Write-off of the Brainboost Answer Engine	-	-	-	-	3,138	(3,138)

As a result of our decision to effectively abandon our use of the Brainboost Answer Engine, the net book value of the Brainboost Answer Engine, as of May 25, 2008, in the amount of \$3,138 thousand, was written off and the resulting charge included in our statement of operations for the nine months ended September 30, 2008.

## Termination Fees and Write-off of Costs Relating to the Terminated Lexico Acquisition and Abandoned Follow-on Offering

	Three Months Ended September 30, 2009			Nine Months Ended September 30, 2009		
	2008	Change	2008	Change		
	(\$ - in thousands)		(\$ - in thousands)			
Termination fees and write-off of costs relating to the terminated Lexico acquisition and abandoned follow-on offering	-	-	-	-	2,543	(2,543)

During the nine months ended September 30, 2008, we recorded a charge of \$2,543 thousand for various costs and fees we incurred in connection with the terminated acquisition of Lexico and the abandoned follow-on offering of securities.

## Interest Income (Expense), Net

	Three Months Ended September 30, 2009			Nine Months Ended September 30, 2009		
	2008	Change	2008	Change		
	(\$ - in thousands)		(\$ - in thousands)			
Interest income (expense), net	4	(43)	47	(445)	30	(475)

Interest income (expense), net changed \$47 thousand to \$4 thousand income, net, in the three months ended September 30, 2009, from \$(43) thousand expense, net, in the three months ended September 30, 2008. The change in interest income (expense), net, resulted mostly from two matters. Firstly, in the three months ended September 30, 2008, we recorded \$91 thousand of amortization relating to \$363 thousand of transaction costs that we incurred in connection with the Series B Unit Warrant in June 2008. In the three months ended September 30, 2009, we did not incur this expense since the charges were fully amortized by June 2009. Secondly, interest earned from our cash balance in the three months ended September 30, 2009 was \$5 thousand, compared to interest of \$40 thousand earned, during the same period in 2008. The reduction in interest income earned on our cash balances was the result of lower short-term interest rates.



Interest income (expense), net changed \$475 thousand to \$(445) thousand expense, net, in the nine months ended September 30, 2009, from \$30 thousand income, net, in the nine months ended September 30, 2008. The change in interest income (expense), net, resulted mostly from the following matters. Firstly, in the nine months ended September 30, 2009, we recorded \$166 thousand of amortization relating to \$363 thousand of transaction costs that we incurred in connection with the Series B Unit Warrant in June 2008. In the nine months ended September 30, 2008, such amortization amounted to \$110 thousand. Secondly, in the nine months ended September 30, 2009, we recorded a \$290 thousand charge relating to the Series B Warrants transaction costs we incurred in June 2009. Those costs were charged in full in the second quarter of 2009. Finally, interest earned from our cash balance in the nine months ended September 30, 2009 was \$15 thousand, compared to interest of \$102 thousand earned, during the same period in 2008. The reduction in interest income earned on our cash balances was the result of lower short-term interest rates.

Table of Contents

## Other Income (Expenses), Net

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
	(\$ - in thousands)			(\$ - in thousands)		
Other income (expense), net	(5)	11	(16)	-	(38)	38

Other income (expense), net, in the three months ended September 30, 2009 was \$(5) thousand expense, net, compared to \$11 thousand income, net, in the same period in 2008. Other income (expense), net, results from foreign currency net gains and losses.

Other income (expense), net, in the nine months ended September 30, 2009 was \$0 thousand income, net, compared to \$(38) thousand expense, net, in the same period in 2008. Other income (expense), net, results from foreign currency net gains and losses.

## Loss Resulting from Fair Value Adjustments of Series A Warrants, Series B Warrants and Warrant to Purchase Units of Series B Preferred Stock and Warrants

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
	(\$ - in thousands)			(\$ - in thousands)		
Loss resulting from fair value adjustment of Series A Warrants, Series B Warrants and warrant to purchase units of Series B preferred stock and warrants	(999)	(2,056)	1,057	(3,374)	(2,056)	(1,318)

The Series A Warrants and Series B Warrants are revalued each reporting date, and any change to their fair value is recorded in the statement of operations. The Warrant to Purchase Units of Series B Preferred Stock and Warrants was, up to its exercise in June 2009, revalued each reporting period and the change in fair value was recorded in the statement of operations.

The primary reason for the change in value of the aforesaid warrants is the market price of our common stock on the measurement dates. An increase in the price of our common stock increases the value of the warrants and thus results in a loss on our statement of operations. Conversely, a decline in the price of our common stock decreases the value of the warrants and thus results in a gain on our statement of operations.

## Income Tax Benefit (Expense), Net

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
	(\$ - in thousands)			(\$ - in thousands)		
Income tax benefit (expense), net	(50)	91	(141)	(121)	65	(186)

Income tax benefit (expense), net changed by \$141 thousand for the three months ended September 30, 2009, as compared to the same period in 2008. The tax expense for the three months ended September 30, 2009 was primarily the result of \$35 thousand related to estimated income taxes for U.S. federal, state and local, and Israeli income taxes. The tax benefit for the three months ended September 30, 2008 was primarily the result of the recognition of \$93 thousand of tax benefits relating to closed tax years.

Income tax benefit (expense), net, changed by \$186 thousand in the nine months ended September 30, 2009 as compared to the same period in 2008. The tax expense for the nine months ended September 30, 2009 was primarily the result of \$149 thousand related to estimated income taxes for U.S. federal, state and local, and Israeli income taxes, partially offset by \$36 thousand of net deferred tax assets recorded by the subsidiary. The tax benefit for the nine months ended September 30, 2008 was primarily the result of the recognition of \$93 thousand of tax benefits relating to closed tax years, which was partially offset by Israeli income taxes amounting to approximately \$20 thousand.

We had net operating loss carryforwards, or NOLs, for federal income tax purposes of approximately \$59 million at December 31, 2008, and approximately \$54 million at December 31, 2007. The federal net operating losses will expire if not utilized on various dates from 2019 through 2028. Because we have experienced one or more ownership changes, within the meaning of Section 382 of the Internal Revenue Code of 1986, as amended, an annual limitation is imposed on our ability to use at least \$32 million of these carryforwards. We estimate that the annual limitation on the use of such \$32 million of our NOLs is approximately \$1.8 million per year. Any unused portion of the \$1.8 million annual limitation applicable to our restricted NOLs is available for use in future years until such NOLs are scheduled to expire. The recent Redpoint Financing and other financing events that transpired since October 2004 may further impact our ability to use our NOLs, however, since we have not conducted a Section 382 Study since October 2004 we cannot make that determination. We plan to complete a new Section 382 Study in 2009. At December 31, 2008, our Israeli subsidiary has capital loss carryforwards of approximately \$790 thousand that can be applied to future capital gains for an unlimited period of time under current tax rules.

Table of Contents

We file U.S. federal, various state and local and foreign income tax returns. Answers Corporation is no longer subject to U.S. federal income tax examinations by tax authorities for years prior to 2005 and New York State and City income tax examinations for years prior to 2006. In September 2008, the Israeli income tax authorities completed its audit of our Israeli subsidiary for the tax years 2004 through 2006, resulting in no adjustments.

## Liquidity and Capital Resources

Historically, our principal sources of liquidity were our cash inflows from revenues and funds that were raised through various financing events that took place through June 2008. Beginning the last quarter of 2008, our principal source of liquidity has been our cash inflows from operations, and we expect that going forward, cash flow from operations will continue to be our principal source of liquidity. Notwithstanding, as a result of Redpoint's exercise of their Series B Unit Warrant in June 2009, we received an additional infusion of funds in the amount of \$7 million before transaction costs.

	Nine Months Ended September 30,	
	2009	2008
	(\$ - in thousands)	
Net cash provided by (used in) operating activities	4,720	(2,705)
Net cash provided by (used in) investing activities	(1,289)	237
Net cash provided by financing activities	6,195	5,307

## Operating Activities

Despite a net loss of \$648 thousand in the nine months ended September 30, 2009, the net cash provided by operations was \$4,720 thousand. The adjustments to reconcile the two amounts, including changes to the balances of our various operating assets and liabilities, are noted in detail on the accompanying statement of cash flows. The largest reconciling items are the non-cash loss resulting from the fair value adjustment of the Series A Warrants, Series B Warrants and warrant to purchase units of Series B preferred stock and warrants of \$3,374 thousand, stock-based compensation of \$1,166 thousand, and depreciation and amortization of \$883 thousand.

Despite a net loss of \$10,405 thousand in the nine months ended September 30, 2008, net cash used in operations was \$2,705 thousand. The adjustments to reconcile the two amounts, including changes to the balances of our various operating assets and liabilities, are noted in detail on the accompanying statement of cash flows. The largest reconciling items are the write-off of the Brainboost Answers Engine of \$3,138 thousand, the non-cash loss resulting from the fair value adjustment of the warrant to purchase units of Series B preferred stock and warrants of \$2,056 thousand, stock-based compensation of \$1,312 thousand, depreciation and amortization of \$1,080 thousand, and the write-off of amounts that were paid in prior periods relating to the terminated Lexico acquisition and abandoned follow-on offering, of \$663 thousand.

## Investing Activities

Net cash used in investing activities of \$1,289 thousand, in the nine months ended September 30, 2009, is attributable to cash used for capital expenditures of \$1,275 thousand, and cash used to increase long-term deposits of \$14 thousand. Most of our capital expenditures resulted from the establishment of our second colocation facility in the second quarter of 2009.

Net cash provided by investing activities in the nine months ended September 30, 2008 is attributable to the proceeds from the sale of investment securities, of \$700 thousand, less cash used for capital expenditures of \$435 thousand and cash used to increase long-term deposits of \$28 thousand.

#### Financing Activities

Net cash flow from financing activities in the nine months ended September 30, 2009 resulted almost entirely from the Redpoint Financing event in June 2009, less dividends paid to Redpoint. Net cash flow from financing activities in the nine months ended September 30, 2008 resulted almost entirely from the Redpoint Financing event in June 2008.

#### Future Operations

Based on our current cash and cash equivalent levels and expected cash flow from operations, we believe we have sufficient cash and cash equivalents to meet our working capital and operating requirements for at least the next twelve months. Further, in estimating our expected cash flow, we have considered the current general economic downturn and its impact on our future revenue, as discussed in the earlier revenue discussion.

## Table of Contents

We assess acquisition opportunities as they arise. Financing in excess of our current cash and cash equivalents may be required if we decide to make additional acquisitions. There can be no assurance, however, that any such opportunities may arise, or that any such acquisitions may be consummated. Additional financing may not be available on satisfactory terms when required. To the extent that we raise additional funds by issuing equity securities, our stockholders may experience significant dilution.

As a result of the Redpoint Financings in June 2008 and June 2009, we raised net proceeds of approximately \$11.9 million, significantly improving our cash position. The Series A and Series B Preferred Stock contain redemption provisions which allow the holders of a majority of the Series A and Series B Preferred Stock to request redemption, at any time on or after June 16, 2014, of all or any part of their stock.

## Off-Balance Sheet Arrangements

As of September 30, 2009, there were no off-balance sheet arrangements.

## Critical Accounting Estimates

While our significant accounting policies are more fully described in the notes to our audited consolidated financial statements for the years ended December 31, 2008 and 2007, and our unaudited consolidated financial statements for the three and nine months ended September 30, 2009 and 2008, we believe the following accounting policies to be the most critical in understanding the judgments and estimates we use in preparing our consolidated financial statements.

## Goodwill, Intangibles and Other Long-Lived Assets

We account for our purchases of acquired companies in accordance with ASC 805, “Business Combinations” (formerly SFAS 141), and for goodwill and other identifiable definite and indefinite-lived acquired intangible assets in accordance with ASC 350, “Intangibles – Goodwill and Other” (formerly SFAS 142, “Goodwill and Other Intangible Assets”). Additionally, we review our long-lived assets for recoverability in accordance with ASC 360, “Property, Plant and Equipment” (formerly SFAS 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”).

The identification and valuation of intangible assets and the determination of the estimated useful lives at the time of acquisition are based on various valuation methodologies including reviews of projected future cash flows. The use of alternative estimates and assumptions could increase or decrease the estimated fair value of our goodwill and other intangible assets, and potentially result in a different impact to our results of operations. Further, changes in business strategy and/or market conditions may significantly impact these judgments thereby impacting the fair value of these assets, which could result in an impairment of the goodwill and acquired intangible assets.

We evaluate our long-lived tangible and intangible assets for impairment in accordance with ASC 350, with the annual goodwill impairment testing date set at September 30. Further, in accordance with ASC 360 and ASC 350, we also evaluate our long-lived tangible and intangible assets, respectively, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. While we use available information to prepare our estimates and to perform impairment evaluations, the completion of annual impairment tests requires significant management judgments and estimates.

As of September 30, 2009, we determined that there was no impairment of goodwill and that there were no events or changes in circumstances indicating that the carrying amount of our intangible and other long-lived assets may not be recoverable; therefore, there was no need to evaluate the recoverability or compute impairment of any of the aforesaid

assets.

#### Accounting for Stock-based Compensation

We account for stock-based awards under ASC 718, “Compensation – Stock Compensation” (formerly SFAS 123R, “Share-Based Payment”), which requires measurement of compensation cost for stock-based awards at fair value on date of grant and recognition of compensation over the service period awards are expected to vest. The estimation of stock-based awards that will ultimately vest requires judgment, and to the extent actual results differ from our estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. We consider various factors when estimating expected forfeitures, including historical experience. Actual results may differ substantially from these estimates.

34

---

## Table of Contents

We determine the fair value of stock options granted to employees and directors using the Black-Scholes valuation model, which requires significant assumptions regarding the expected stock price volatility, the risk-free interest rate and the dividend yield, and the estimated period of time option grants will be outstanding before they are ultimately exercised. We estimate our expected stock volatility based on our own historical stock volatility rates. Had we made different assumptions about our stock price volatility or the estimated time option and warrant grants will be outstanding before they are ultimately exercised, the related stock based compensation expense, and our net income (loss) and net earnings (loss) per share amounts could have been significantly different, in the three and nine months ended September 30, 2009 and 2008.

### Accounting for Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves management estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not more likely than not, we must establish a valuation allowance. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. At September 30, 2009, we have fully offset our U.S. net deferred tax asset with a valuation allowance. Our lack of earnings history and the uncertainty surrounding our ability to generate US taxable income prior to the expiration of such deferred tax assets were the primary factors considered by management in establishing the valuation allowance.

ASC 740, "Income Taxes" (formerly FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement 109"), prescribes how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. Additionally, for tax positions to qualify for deferred tax benefit recognition under ASC 740, the position must have at least a "more likely than not" chance of being sustained upon challenge by the respective taxing authorities, and whether or not it means that criteria is a matter of significant judgment.

### Accounting for Redpoint Financings

In accounting for Redpoint's Series A Financing, the proceeds were first allocated to the Series B Unit Warrant, which was classified as a current liability, based on its fair value, and the residual amount was allocated among the Series A Convertible Preferred Stock and the Series A Warrants based on their relative fair values, all in accordance with the guidance in ASC 480, "Distinguishing Liabilities from Equity" (formerly SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity"), ASC 815, "Derivatives and Hedging" (formerly SFAS 133, "Accounting for Derivative Instruments and Hedging Activities") and ASC 815-40, "Derivatives and hedging – Contracts in Entity's Own Equity" (formerly EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"). The Series B Unit Warrant has been revalued at each reporting date, since its inception until it was exercised on June 10, 2009. The Series A Convertible Preferred Stock has been classified as temporary equity, in accordance with the guidance in ASC 480-10-S99A (formerly EITF D-98, "Classification and Measurement of Redeemable Securities"), and, prior to January 1, 2009, the Series A Warrants were classified in permanent equity.

In June 2008, the FASB ratified the consensus of EITF 07-5, "Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock" (incorporated in ASC 815-40). ASC 815-40 responded to practice questions about whether an instrument or embedded feature is indexed to the reporting company's own stock by establishing a framework for the determinations and by nullifying some previous requirements. The adoption of



ASC 815-40's requirements affects issuers' accounting for warrants and many convertible instruments with provisions that protect holders from declines in the stock price ("Down-Round" provisions). Warrants with such provisions are no longer recorded in equity, and many convertible instruments with such provisions require "bifurcation" with the conversion option separately accounted for as a derivative under ASC 815. As a result of ASC 815-40, effective January 1, 2009, and due to the Down-Round Protection of the Series A Warrants, such warrants are separately accounted for as a derivative under ASC 815 and are no longer recorded in equity but rather as a liability to be revalued at each reporting date.

On June 10, 2009, Redpoint exercised, in full, the Series B Unit Warrant, which was valued at approximately \$10.8 million on such date, thus extinguishing this liability from the Company's balance sheet through a corresponding increase to additional paid-in capital. In accounting for Redpoint's Series B Financing, the proceeds were first allocated to the Series B Warrants which were classified as a liability, based on its fair value, and the residual amount was allocated to the Series B Convertible Preferred Stock, all in accordance with the guidance in ASC 480, ASC 815 and ASC 815-40. The Series B Convertible Preferred Stock has been classified as temporary equity, in accordance with the guidance in ASC 480-10-S99A.

We used various valuation models and techniques to determine the individual values of the various components in the Redpoint Financings, including Monte Carlo and Black-Scholes. Inputs used in the models include our stock price and risk-free interest rate. Additionally, significant assumptions used in applying these techniques included redemption behavior estimates (including likelihood of forced conversion, and timing of liquidation event if such event transpires) and expected volatility of our stock price. While we believe we applied appropriate judgment in the aforesaid assumptions, variations in judgment could have materially affected the valuation results, and thus, our financial statements. We continue to use the Black-Scholes valuation model in our periodic fair value adjustments.

The Series A Convertible Preferred Stock and the Series B Convertible Preferred Stock issued as part of the Redpoint Financings contain an embedded conversion option which could potentially require separate accounting under ASC 815. According to ASC 815-15 (formerly paragraph 12(a) of SFAS 133), in order to determine whether separate accounting is required, one has to evaluate whether the economic characteristics and risks of the conversion option are closely related to the host contract, and the nature of the host contract. We exercised judgment and evaluated this matter in accordance with ASC 815-10 (formerly EITF Topic D-109, "Determining the Nature of a Host Contract Related to a Hybrid Financial Instrument Issued in the Form of a Share under FASB Statement No.133"). ASC 815-10 conveys the SEC staff's views on determining whether the characteristics of a host contract in a hybrid financial instrument issued in the form of a share is more akin to debt or equity. In evaluating an embedded derivative feature for separation under ASC 815, the consideration of the economic characteristics and risks of the host contract should not ignore the stated or implied substantive terms and features of the hybrid financial instrument. We considered various factors including redemption provisions, stated rate, voting rights, whether returns are discretionary or mandatory, collateral requirements, participation in residual earnings and liquidation preferences, in making our determination that the host contract was more akin to equity. The most important factor that led us to the conclusion that the host contract was more akin to equity was the fact that the redemption feature was not mandatory or likely to occur. Had we determined that the host contract was more akin to debt and not equity it would have impacted the accounting for the host contract and the embedded conversion option and could have had a material impact on our financial statements.

Table of Contents

## Quarterly Results

The following table sets forth our historical quarterly consolidated statement of operations data and certain non-GAAP financial measures beginning with the first quarter of 2008. You should read this information together with our consolidated financial statements and the related notes appearing elsewhere in our filings. The results of historical periods are not necessarily indicative of the results of operations for a full year or any future period.

	Quarter Ended						
	Mar. 31, 2008	Jun. 30, 2008	Sep. 30, 2008	Dec. 31, 2008	Mar. 31, 2009	Jun. 30, 2009	Sep. 30, 2009
	(in thousands, except page views and RPM data)						
Revenues:							
Advertising revenue	\$3,013	\$2,985	\$3,539	\$4,609	\$4,729	\$4,985	\$4,970
Answers services licensing	18	18	24	21	18	19	17
	3,031	3,003	3,563	4,630	4,747	5,004	4,987
Costs and expenses:							
Cost of revenue	1,393	1,416	945	887	1,059	1,166	1,264
Research and development	875	929	866	812	873	817	921
Community development, sales and marketing	762	933	563	476	499	558	621
General and administrative	1,131	1,198	1,311	1,159	1,219	1,248	1,201
Write-off of the Brainboost Answers Engine	—	3,138	—	—	—	—	—
Termination fees and write-off of costs relating to the terminated Lexico acquisition and abandoned follow-on offering	2,543	—	—	—	—	—	—
Total operating expenses	6,704	7,614	3,685	3,334	3,650	3,789	4,007
Operating income (loss)	(3,673)	(4,611)	(131)	1,296	1,097	1,215	980
Interest income (expense), net	55	18	(43)	(86)	(87)	(362)	4
Other income (expense), net	(38)	(11)	11	57	15	(9)	(5)
Gain (loss) resulting from fair value	—	—	(2,056)	(3,131)	2,010	(4,385)	(999)

Edgar Filing: Answers CORP - Form 10-Q

adjustment of Series A  
Warrants, Series B  
Warrants and warrant to  
purchase units of  
Series B preferred stock  
and warrants

Income (loss) before income taxes	(3,655)	(4,604)	(2,210)	(1,864)	3,035	(3,541)	(20)
--------------------------------------	---------	---------	---------	---------	-------	---------	------

Income tax benefit (expense), net	(11)	(15)	91	17	6	(78)	(50)
--------------------------------------	------	------	----	----	---	------	------

Net income (loss)	\$(3,667)	\$(4,619)	\$(2,119)	\$(1,847)	\$3,041	\$(3,619)	\$(70)
-------------------	-----------	-----------	-----------	-----------	---------	-----------	--------

Other Data:

Adjusted EBITDA(1)	\$(181)	\$(670)	\$520	\$1,950	\$1,744	\$1,895	\$1,708
--------------------	---------	---------	-------	---------	---------	---------	---------

ReferenceAnswers

average daily

page views	3,225,000	2,641,000	2,666,000	3,027,000	2,982,000	2,965,000	2,857,000
------------	-----------	-----------	-----------	-----------	-----------	-----------	-----------

WikiAnswers average

daily page views	1,885,000	2,318,000	3,094,000	4,350,000	5,337,000	6,082,000	6,336,000
------------------	-----------	-----------	-----------	-----------	-----------	-----------	-----------

ReferenceAnswers RPM	\$6.23	\$6.18	\$6.44	\$6.21	\$5.84	\$5.87	\$5.89
----------------------	--------	--------	--------	--------	--------	--------	--------

WikiAnswers RPM	\$6.91	\$7.11	\$6.89	\$7.19	\$6.58	\$6.14	\$5.87
-----------------	--------	--------	--------	--------	--------	--------	--------

Table of Contents

(1) We define Adjusted EBITDA as net earnings before interest, taxes, depreciation, amortization, gain (loss) resulting from fair value adjustment of Series A Warrants, Series B Warrants and warrant to purchase units of Series B preferred stock and warrants, stock-based compensation, foreign currency exchange rate differences and certain non-recurring revenues and expenses.

We use Adjusted EBITDA as an additional measure of our overall performance for purposes of business decision-making, developing budgets and managing expenditures. It is useful because it removes the impact of our capital structure (interest expense and gain (loss) resulting from fair value adjustment of Series A Warrants, Series B Warrants and warrant to purchase units of Series B preferred stock and warrants), asset base (amortization and depreciation), stock-based compensation expenses, taxes, foreign currency exchange rate differences and certain non-recurring revenues and expenses from our results of operations. We believe that the presentation of Adjusted EBITDA provides useful information to investors in their analysis of our results of operations for reasons similar to the reasons why we find it useful and because these measures enhance their overall understanding of the financial performance and prospects of our ongoing business operations. By reporting Adjusted EBITDA, we provide a basis for comparison of our business operations between current, past and future periods, and peer companies in our industry.

More specifically, we believe that removing these impacts is important for several reasons:

- **Amortization of Intangible Assets.** Adjusted EBITDA disregards amortization of intangible assets. Specifically, we exclude (a) amortization, and the write-off, of acquired technology from the acquisition of Brainboost Technology, LLC, developer of the Brainboost Answer Engine in December 2005; and (b) amortization of intangible assets resulting from the acquisition of WikiAnswers and other related assets in November 2006. These acquisitions resulted in operating expenses that would not otherwise have been incurred. We believe that excluding such expenses is significant to investors, due to the fact that they derive from prior acquisition decisions and are not necessarily indicative of future cash operating costs. In addition, we believe that the amount of such expenses in any specific period may not directly correlate to the underlying performance of our business operations. While we exclude the aforesaid expenses from Adjusted EBITDA we do not exclude revenues derived as a result of such acquisitions. The amount of revenue that resulted from the acquisition of WikiAnswers and other related assets is disclosed in the revenue discussion of this Item 2. The amount of revenue that resulted from the acquisition of technology from Brainboost is not quantifiable due to the nature of its integration.
- **Stock-based Compensation Expense.** Adjusted EBITDA disregards expenses associated with stock-based compensation, a non-cash expense arising from the grant of stock-based awards to employees and directors. We believe that, because of the variety of equity awards used by companies, the varying methodologies for determining stock-based compensation expense, and the subjective assumptions involved in those determinations, excluding stock-based compensation from Adjusted EBITDA enhances the ability of management and investors to compare financial results over multiple periods.
- **Depreciation, Interest, Gain (Loss) Resulting from Fair Value Adjustment of Series A Warrants, Series B Warrants and Warrant to Purchase Units of Series B Preferred Stock and Warrants, Taxes and Exchange Rate Differences.** We believe that, excluding these items from the Adjusted EBITDA measure provides investors with additional information to measure our performance, by excluding potential differences caused by variations in capital structures (affecting interest expense), asset composition, and tax positions.
-

Terminated Lexico Acquisition and Follow-On Offering. Adjusted EBITDA disregards \$2,543 thousand in costs associated with our terminated acquisition of Lexico and the cancellation of our follow-on offering. We believe that, excluding these costs provides investors with additional information to measure our performance, by excluding events that are of a non-recurring nature.

Adjusted EBITDA is not a measure of liquidity or financial performance under generally accepted accounting principles, or GAAP, and should not be considered in isolation from, or as a substitute for, a measure of financial performance prepared in accordance with GAAP. Investors are cautioned that there are inherent limitations associated with the use of Adjusted EBITDA as an analytical tool. Some of these limitations are:

- Non-GAAP financial measures are not based on a comprehensive set of accounting rules or principles;
- Many of the adjustments to Adjusted EBITDA reflect the exclusion of items that are recurring and will be reflected in our financial results for the foreseeable future;
- Other companies, including other companies in our industry, may calculate Adjusted EBITDA differently than us, thus limiting its usefulness as a comparative tool;
- Adjusted EBITDA does not reflect the periodic costs of certain tangible and intangible assets used in generating revenues in our business;
  - Adjusted EBITDA does not reflect interest income from our investments in cash and investment securities;

Table of Contents

- Adjusted EBITDA does not reflect foreign exchange net gains and losses;
- Adjusted EBITDA does not reflect interest expense and other cost relating to financing our business, including gains and losses resulting from fair value adjustment of Redpoint Venture's Series A Warrants, Series B Warrants and their Warrant to Purchase Units of Series B Preferred Stock and Warrants;
- Adjusted EBITDA excludes taxes, which are an integral cost of doing business; and
- Because Adjusted EBITDA does not include stock-based compensation, it does not reflect the cost of granting employees equity awards, a key factor in management's ability to hire and retain employees.

We compensate for these limitations by providing specific information in the reconciliation to the GAAP amounts excluded from Adjusted EBITDA, as follows:

	Quarter Ended						
	Mar. 31, 2008	Jun. 30, 2008	Sep. 30, 2008	Dec. 31, 2008	Mar. 31, 2009	Jun. 30, 2009	Sep. 30, 2009
	\$ (in thousands)						
Net income (loss)	(3,667)	(4,619)	(2,119)	(1,847)	3,041	(3,619)	(70)
Interest (income) expense, net	(55)	(18)	43	86	87	362	(4)
Foreign currency (gains) losses	38	11	(11)	(57)	(15)	9	5
Income tax (benefit) expense, net	11	15	(91)	(17)	(6)	78	50
Depreciation and amortization	448	383	250	248	261	299	328
Stock-based compensation	501	420	392	406	386	381	400
Write-off of the Brainboost Answers Engine	—	3,138	—	—	—	—	—
Termination fees and write-off of costs relating to the terminated Lexico acquisition and abandoned follow-on offering	2,543	—	—	—	—	—	—
(Gain) loss resulting from fair value adjustment of Series A Warrants, Series B Warrants and warrant to purchase units of Series B preferred stock and warrants	—	—	2,056	3,131	(2,010)	4,385	999
Adjusted EBITDA	(181)	(670)	520	1,950	1,744	1,895	1,708

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Currency Risk. Our revenue is denominated solely in U.S. dollars. However, close to half of our operating expenses (excluding non-cash items such as stock-based compensation and gain (loss) from fair value adjustment of Series A Warrants, Series B Warrants and Warrant to purchase units of Series B preferred stock and warrants) are denominated in New Israel Shekels (NIS). In recent years, the U.S. dollar-NIS exchange rate has been volatile. We expect the amount of such NIS denominated expenses to grow in the foreseeable future. If the value of the U.S. dollar weakens against the value of NIS, there will be a negative impact on our results of operations. In addition, to the extent we hold cash and cash equivalents that are denominated in currencies other than the U.S. dollar; we are subject to the risk of exchange rate fluctuations. We often hedge our foreign currency commitments. Such transactions are mainly designed to hedge short term cash flows related to anticipated expenses.

Other Market Risk. Currently, we invest all of our excess cash in highly liquid investments with an original maturity of three months or less. Due to the short-term nature of these investments, we believe that there is no material exposure to interest rate risk arising from our investments. Based on our investment policy, such instruments are highly rated by rating agencies and therefore we believe that there is no material exposure to the principal amount from our investments. We expect that in the future a certain portion of our cash will be invested in investments with maturities in excess of three months.

ITEM 4T. CONTROLS AND PROCEDURES

Based on the evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934, as amended) required by paragraph (b) of Rule 13a-15 or Rule 15d-15, as of September 30, 2009, our Chief Executive Officer and Principal Financial Officer have concluded that our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. Our Chief Executive Officer and Principal Financial Officer also concluded that, as of September 30, 2009, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

During the three months ended September 30, 2009, there were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not currently involved in any legal proceedings. However, from time to time, we may receive various legal claims incidental to our normal business activities, such as intellectual property infringement claims and claims of defamation and invasion of privacy. Results of claims cannot be predicted with certainty. Regardless of the legal outcome of any such claims, litigation can have an adverse impact on us because of defense costs, diversion of management resources and other factors.

ITEM 1A. RISK FACTORS

Risks Relating to our Business

If search engines alter their algorithms or methods or otherwise restrict the flow of users visiting Answers.com, our business and financial results could suffer.

Search engines serve as the primary Web entry point for most users in search of information, and our topic and answer pages often appear as one of the top links on the pages returned by search engines in response to users' search queries. As a result, we rely heavily on search engines for the overwhelming share of users visiting Answers.com. According to our internal estimates, traffic to Answers.com originating from search engines during the first three quarters of 2009, excluding Google-directed definition link traffic, was approximately 83% of overall traffic, the majority of which originated from Google. If our traffic from search engines declines for any reason, we would suffer a significant decline in overall traffic and revenue. For example, in July 2007, a search engine algorithm adjustment by Google led to a drop in Google directed traffic to ReferenceAnswers. This adjustment reduced our overall traffic by approximately 28% based on the average traffic directed to ReferenceAnswers from Google for the week prior to the adjustment as compared to the week after. As a result, our revenue declined proportionately. In September 2007, Yahoo! dropped our content from its search index, which led to a drop in our Yahoo! directed traffic. This action was reversed within a week. We have experienced other such cases of decreases, and at times, increases, in traffic due to adjustments made by the search engines.

Search engines, at any time and for any reason, could change their algorithms that direct search queries to, or could restrict the flow of users visiting, Answers.com. In fact, as illustrated above, Answers.com has on occasion experienced decreases in traffic, and consequently in revenue, due to these search engine actions. We cannot guarantee that we will successfully react to these actions in the future and recover the lost traffic. Accordingly, a change in algorithms that search engines use to identify Web pages towards which traffic will ultimately be directed, or a restriction on users visiting Answers.com from the search engines, could cause a significant decrease in traffic and revenues, which could adversely affect our business and financial results.

If Answers.com results do not continue to rank high in the result pages of search engines, traffic to our site may decline, which could adversely affect our business and financial results.

The search algorithms used by search engines are designed to offer users the best results to the queries searched. For this reason, the level of quality of content offered by Websites plays an important role in determining whether a search engine will include links to any given Website on its result page. Particularly in light of the enormous amount of user-generated content offered on Answers.com via the WikiAnswers component, in the event the quality of content on Answers.com pages does not improve and/or if it deteriorates, our pages may rank low in the algorithmic systems of search engines. Low ranking content could cause Answers.com's results to be less likely to be accessed by users, resulting in traffic declines which could adversely impact our business and financial results.



If our Google Service Agreement, or GSA, is terminated by Google, we would have to seek an alternative provider of listings and advertisements, which could adversely affect our business and financial results.

Our business is dependent on the GSA, under which we obtain most of the advertisements displayed on Answers.com and earn most of our ad revenues. Google may terminate the GSA with no advance notice if we:

- take certain prohibited actions including, among other things:
  - o editing or modifying the order of search results,
  - o redirecting end users, producing or distributing any software which prevents the display of ads by Google,
- o modifying, adapting or otherwise attempting to obtain source code from Google technology, content, software and documentation or
  - o engaging in any action or practice that reflects poorly on Google or otherwise disparaging or devaluing Google's reputation or goodwill;
- breach the grant of a license to us by Google of certain trade names, trademarks, service marks, logos, domain names and other distinctive brand features of Google;
  - breach the confidentiality provisions of the GSA;
  - breach the exclusivity provisions of the GSA; or
- materially breach the GSA more than two times, irrespective of any cure to such breaches.

The GSA, extended for an additional two years pursuant to an October 2009 amendment, is scheduled to expire on January 31, 2012.

Google's termination of the GSA would result in our need to replace this relationship and obtain listings and advertisements from alternative providers, and we may not succeed in receiving equally favorable terms as those provided in the GSA. Termination of the GSA and our failure to replace it on equally favorable terms could result in a material reduction in our ad revenues and could adversely affect our business and financial results.

## Table of Contents

A downturn in the United States and global economic conditions could adversely affect the profitability of our business.

The U.S. and global economies are currently experiencing a contraction, and we may see further economic downturn in the immediate and near future. The deterioration in economic conditions generally has caused, and may continue to cause, decreases and/or delays in advertising expenditures and decreases in queries likely to generate revenue, one or both of which would reduce revenues shared with us by our advertising partners, including Google, and adversely affect our business, financial condition and results of operations.

We face significant competition from question and answer sites, search engines and other free reference and industry-specific Web properties that could adversely impact our competitive position.

We face significant competition from a wide variety of Web properties. Question and answer sites, such as Yahoo! Answers, Askville (owned by Amazon), Yedda (owned by AOL), eHow and Answerbag (both owned by Demand Media, Inc.) and Wikia, Inc. compete with the WikiAnswers component of Answers.com. As part of this competition, we run the risk of other Q&A and content sites outranking us in the search engine algorithms, thus causing fewer users to find our answers and/or content and visit our site which could adversely affect our ad revenues and our financial results.

Destination portals and other free online information and/or reference services, such as About.com (owned by the New York Times), TheFreeDictionary.com, Dictionary.com (owned by IAC/InterActiveCorp) and Wikipedia.org, compete with the ReferenceAnswers component of Answers.com. Other competitors of ReferenceAnswers include vertical industry-specific Web properties, such as Bankrate.com and WebMD.com. Since several companies operating traditional search engines, such as Yahoo!, Microsoft, AOL and Ask.com offer their own question and answer services, they too can be viewed as competitors of our answers-driven products, particularly in light of the fact that some search engines have begun putting snippets of useful answers at the top of many of their pages, in response to queries made by users. Nevertheless, search engines remain the greatest source of traffic arriving at Answers.com.

Many of our competitors have longer operating histories, more extensive management experience, an employee base with more extensive experience, better geographic coverage, larger consumer bases, greater brand recognition and significantly greater financial, marketing and other resource than we do. We expect competition to intensify in the future. If our competitors are more successful than we are in developing compelling products or attracting and retaining more users, then our competitive position and financial results could be adversely affected.

The failure of WikiAnswers to grow in accordance with our expectations could have an adverse impact on our business and financial results.

WikiAnswers is currently our primary growth driver, and it exceeds ReferenceAnswers in both traffic and revenue. Our projections assume that the growth of WikiAnswers will continue to be greater than that of ReferenceAnswers. If, for whatever reason, WikiAnswers fails to perform as well as we anticipate, and the growth we are experiencing decelerates significantly, falters or ceases, our business and financial results could be adversely affected.

If Internet users do not interact with WikiAnswers frequently or if we fail to attract new users to the service, our business and financial results will suffer.

The success of WikiAnswers is largely dependent upon users constantly visiting the site by asking questions, posting answers and improving upon both. We have seen a very high correlation between growth in questions and answers and growth in the site's page views. We need to attract users to visit the Web property frequently and spend increasing amounts of time on the Web property when they visit. If we are unable to encourage users to interact more frequently

with WikiAnswers and to increase the amount of user generated content they provide, our ability to attract new users to the Web property and increase the number of loyal users will be diminished and adversely affected. In addition, our efforts aimed at integrating WikiAnswers and ReferenceAnswers may ultimately have a negative impact on the dynamics of the creation of user-generated content on WikiAnswers. Users arriving at pages displaying non-editable reference content may not become engaged with the site, in which case the growth of our community and database of questions and answers could be harmed. As a result, we may not be able to grow our business as planned and our business and financial results would suffer.

If we are unable to maintain and improve the quality of content being contributed to WikiAnswers and if we fail to fight vandalism the site has been experiencing, the Web property will become less valuable to the users, less popular as a destination for obtaining answers to questions and its growth will be negatively affected, which in turn could adversely impact our financial results.

It is critical that we ensure that the quality of content being posted on WikiAnswers, both questions and answers, is maintained and improved over time. The better the quality of the content generated on the Web property, the more valuable the Web property will be for users in search of answers, as well as for search engines indexing the content to continue featuring it in their search engine result pages. Improved quality content should lead to stronger growth in the community size and will lessen the risk of a search engine's algorithm and/or policy makers downgrading the rank of WikiAnswers. In addition, it is critical that we ward off vandals and eliminate vandalism on the Web property to the greatest extent possible. If we fail to maintain and improve the quality of the Web property's content, the appeal of WikiAnswers to users and search engines may diminish and the growth of the Web property may be negatively affected, which in turn could cause our financial results to suffer.

Table of Contents

We have launched additional versions of WikiAnswers, in foreign languages, targeting non-English speaking users, resulting in additional risks.

In September 2009, we launched several versions of WikiAnswers in foreign languages – French, Italian, German and Spanish. In the future, we may continue to expand our international presence. In order for our products and services in foreign languages to achieve widespread acceptance, commercial use and acceptance of the Internet must continue to grow, which growth may occur at slower rates than those experienced in the U.S. Moreover, we must continue to successfully tailor our services to the unique customs and cultures of non-English speaking audiences, which can be difficult and costly and the failure to do so could slow our international growth. Operating sites in languages other than English exposes us to additional risks, including difficulties in managing operations due to cultural differences, and including compliance with laws and regulations governing the Internet in foreign jurisdictions. Our success in international markets may also depend, in part, on our ability to identify potential acquisition candidates, joint venture or other partners, and to enter into arrangements with these parties on favorable terms, given that we could encounter significant barriers to entry in connection with expansion efforts outside of these arrangements.

If, in the interest of improving user experience and user satisfaction, we decide to decrease the number of ad elements displayed on Answers.com, our advertising revenues will decline and our financial results will be adversely impacted.

We closely monitor the ratio between ad elements and actual content appearing on our Web pages. In the future we may decide that in order to enhance the user-experience and increase user satisfaction, our pages should display fewer ad elements. Displaying less ad-intensive Web pages is likely to result in faster page-load and offering more content per-page is likely to appeal more to the user. A better user experience may result in more stickiness on Answers.com and a higher rate of user-retention and return visits. However, there is no assurance that reducing advertising on Answers.com will result in better user-retention and return visits and there can be no guarantee that the short term reduction in ad revenues will pay off in the long term in the form of increased traffic. A decrease in the number of ad elements displayed on Answers.com will result in a drop in RPM and advertising revenues which may not be recovered through higher traffic, thus having an adverse impact on our results of operations.

If we are unable to attract and retain dedicated volunteer supervisors for encouraging the community's expansion, our plans for growing WikiAnswers may fail and our results of operations may be adversely affected.

We benefit from the heavy involvement of a large group of external volunteer supervisors who are not employed by us and are not compensated for their site activity. The volunteer supervisors, for their own personal motives and enjoyment, are involved in monitoring questions and answers in specific categories in an effort to help questions get answered quickly. Volunteers also help prevent vandalism, improve content consistency, encourage high-quality contributions and identify potential new volunteers. Volunteers are also engaged in various community programs aimed at strengthening the community and contributors' sense of connection to the site and the community at large and help instill a sense of camaraderie among users interested in various categories of WikiAnswers. As of September 30, 2009, the community enjoyed the benefit of over 600 such supervisors. If we are not able to attract enough volunteers, WikiAnswers may suffer and the Web property may become less attractive to users, which in turn will adversely affect the site's growth, our business and financial results. Alternatively, we may be forced to hire paid employees to engage in many of the initiatives that volunteers currently take upon themselves for their own personal pleasure and gratification, which, in turn, would increase the cost of maintaining and improving WikiAnswers and adversely affect our financial results.

Components of our business and operations are experiencing rapid growth. If we fail to effectively manage our growth, our business and operating results could be harmed.

We have experienced rapid growth in our operations over the past several years, which has placed, and will continue to place, significant demands on our management, operational and financial infrastructure. If we do not effectively manage our growth, the quality of our products and services could suffer, which could negatively affect our brand and operating results. To effectively manage this growth, we will need to continue to improve our operational, financial and management controls and our reporting systems and procedures. These systems enhancements and improvements will require significant capital expenditures and management resources. Failure to implement these improvements could hurt our ability to manage our growth and our financial position.

We may not be able to obtain capital when desired on favorable terms, if at all, or without dilution to our stockholders.

We believe we have sufficient cash and cash equivalents to meet our working capital and operating requirements for at least the next twelve months, based on our current cash and cash equivalent levels and expected cash flow from operations. Further, in estimating our expected cash flow during the next twelve months, we have considered the current general economic downturn and its impact on our future revenue. However, we may need or desire additional financing to execute on our current or future business strategies, including to:

- improve traffic monetization and expand content on Answers.com;
  - enhance our operating infrastructure;
  - acquire businesses or technologies; or
- otherwise respond to competitive pressures.

If we decide to raise additional funds through the issuance of equity or convertible debt securities, and are successful at raising such capital, the percentage ownership of our stockholders could be significantly diluted, and these newly issued securities may have rights, preferences or privileges senior to those of existing stockholders. We cannot assure you that additional financing will be available on terms favorable to us, or at all, particularly in light of the weakness of the financial markets and the economic crisis. For example, we experienced such financing difficulties during the course of our failed attempt to acquire Lexico Publishing Group, LLC and our ultimate abandonment of a follow-on offering. If adequate funds are not available or are not available on acceptable terms, when we desire them, our ability to fund our operations, take advantage of unanticipated opportunities, develop or enhance our services, or otherwise respond to competitive pressures would be significantly limited.

Table of Contents

We generate our revenue almost entirely from advertising so uncertainties in the Internet advertising market and our failure to increase advertising inventory on Answers.com could adversely affect our ad revenues.

Although worldwide online advertising spending is growing, it represents only a moderate percentage of total advertising expenditures. Our advertisers can generally terminate their contracts with us at any time. Advertisers will not continue to do business with us if their investment in Internet advertising with us does not generate sales leads, and ultimately customers, or if we do not deliver their advertisements in an appropriate and effective manner. If the Internet does not continue to be as widely accepted as a medium for advertising and the rate of advertising on the Internet does not increase, our ability to generate increased revenues could be adversely affected. We believe that growth in our ad revenues will also depend on our ability to increase the number of pages on our Web properties to provide more advertising inventory. If we fail to increase our advertising inventory at a sufficient rate, our ad revenues could grow more slowly than we expect, which could have an adverse effect on our financial results.

New technologies could block Internet ads, which could harm our financial results.

Technologies have been developed, and are likely to continue to be developed, that can block the display of Internet ads. Most of our revenues are derived from fees paid to us by advertisers in connection with the display of their ads. Ad-blocking technology may cause a decrease in the number of ads that we can display on Answers.com, which could adversely affect our ad revenues and our financial results.

Our failure to generate direct traffic to Answers.com could adversely affect our business and financial results.

Some Internet users arrive at Answers.com directly by typing our website address directly into their Web browser, bookmarking Answers.com, visiting sites that direct users to our Answers.com, or, by using AnswerTips. Given the wide availability of free search engines and reference content sites, we may not be able to retain current Internet users or attract new Internet users in this direct fashion. If we are unable to retain our direct Internet users or attract new direct Internet users, our ability to generate revenues would be adversely impacted, which could adversely affect our business and financial results.

Traffic to Answers.com and advertising demand fluctuates significantly on a seasonal basis, which impacts our operations from quarter to quarter.

Many of our users are students that utilize Answers.com as reference sources. Our traffic fluctuates with the academic school year, rising from January through May, falling to lower levels during the summer months, rising again in September through November, and falling again in December, coinciding with school breaks and the holiday season. We expect traffic to Answers.com to continue to fluctuate seasonally in the future. This seasonal fluctuation in traffic results in a fluctuation in our quarterly revenues, since fewer visits to Answers.com translates into fewer users clicking on or viewing advertisements. In addition, the demand for our advertising inventory fluctuates during the year based on the seasonal needs of our advertisers, rising to its highest levels during the fourth quarter and falling to its lowest levels in the first quarter. Accordingly, our revenue fluctuates based on the seasonality of our traffic and advertising demand. Further, sometimes seasonal trends intensify or change, depending on the size and composition of our traffic, which makes it difficult to estimate future revenues based on the results of any specific quarter, thus it is difficult to make operating plans relating to hiring and expenses. Additionally, as a result of the difficulty to estimate revenues, we may be unable to meet our revenue or profit and loss forecasts which could have a negative impact on the market price of our common stock.

Our operating results may fluctuate, which makes comparing our operating results on a period-to-period basis difficult and could cause our results to fall short of expectations.

Our operating results may fluctuate as a result of a number of factors, many outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful, and you should not rely on our past results as an indication of our future performance. Our quarterly, year-to-date and annual expenses as a percentage of our revenues may differ significantly from our historical or projected rates. Our operating results in future quarters may fall below expectations. Any of these events could cause our stock price to fall.

We may not be successful in expanding our business through acquisitions, business combinations and other transactions, and, even if we are successful, our operations may be adversely affected as a result of these transactions.

We may pursue acquisitions, business combinations and joint ventures, which we refer to as extraordinary transactions. Our ability to implement this business strategy depends in large part on our ability to compete successfully with other entities for acquisition candidates and joint venture partners. Factors affecting our ability to compete successfully include:

- our financial condition and resources relative to the financial condition and resources of competitors;
  - our ability to issue common stock as potential consideration;
- the attractiveness of our common stock as potential consideration relative to the common stock of competitors;
  - our ability to obtain financing; and
- our available cash, which depends upon our results of operations and our cash demands.

In addition, we may not be able to find suitable acquisition candidates and we may not be able to complete acquisitions on favorable terms, if at all. If we do complete acquisitions, we may not ultimately strengthen our competitive position or achieve our goals, or such acquisitions may be viewed negatively by customers, financial markets or investors. In addition, any acquisitions that we make could lead to difficulties in integrating personnel and operations from the acquired businesses and in retaining and motivating key personnel from these businesses. Acquisitions may disrupt our ongoing operations, divert management from day-to-day responsibilities, increase our expenses or adversely affect our business, operating results and financial condition. For example, we experienced such disruption, diversion and increased expenses during the course of our recent failed attempt to acquire Lexico Publishing Group, LLC. Future acquisitions may reduce our cash available for operations and other uses and could result in an increase in amortization expense related to identifiable assets acquired, potentially dilutive issuances of equity securities or the incurrence of debt, which could harm our business, financial condition and operating results.

Table of Contents

If we fail to maintain and enhance awareness of Answers.com, our business and financial results could be adversely affected.

We believe that maintaining and enhancing awareness of Answers.com is critical to achieving widespread acceptance of our services and to the success of our business. We also believe that the importance of brand recognition will increase due to the relatively low barriers to entry in our market. Maintaining and enhancing awareness of Answers.com may require us to spend increasing amounts of money on, and devote greater resources to, advertising, marketing and other brand-building efforts, and these investments may not be successful. Further, even if these efforts are successful, they may not be cost-effective. If we are unable to continuously maintain and enhance the Answers.com brand, our traffic may decrease and we may fail to attract advertisers, which could in turn result in lost revenues and adversely affect our business and financial results.

Our failure to offer compelling content and provide our users with quality information on ReferenceAnswers could result in lost revenue, as a result of a loss of users and advertisers.

We believe our future success depends in part upon our ability to deliver valuable editorial content through ReferenceAnswers. We are heavily dependent on licensed content. We cannot guarantee that we will be able to enter into new or renew current or future content agreements on commercially acceptable terms or at all. If we are unable to maintain and enhance our existing relationships with content providers or develop new relationships with alternative providers of content, our ReferenceAnswers property may become less attractive to Internet users, resulting in decreased traffic to ReferenceAnswers, which could have an adverse effect on our ad revenues and a negative impact on our business.

If we are unable to maintain and expand our computer and communications systems, then interruptions and failures in our services could result, making our services less attractive to consumers and subjecting us to lost revenue from the loss of users and advertisers.

Our ability to provide high quality user experience depends on the efficient and uninterrupted operation of our computer and communications systems. Over time, Answers.com has experienced significant increases in traffic, and we continuously seek to further increase our user base. Accordingly, our Internet servers must accommodate spikes in demand for our Web pages in addition to potential significant growth in traffic. Delays and interruptions could frustrate users and reduce traffic on Answers.com, adversely affecting our operations and growth prospects. Furthermore, our systems may be vulnerable to damage or interruption from earthquakes, terrorist attacks, floods, fires, power loss, telecommunications failures, computer viruses, computer denial of service attacks or other attempts to harm our systems, which could adversely affect our operations.

We manage our Web operations through our own colocation facilities. Our facility located in New Jersey is provided by NetAccess Corporation (the "First Facility") and our facility located in Utah is provided by C7 Data Centers, Inc (the "Second Facility"). The Second Facility was recently deployed and currently partially supports our daily flow of data. Further, we expect that no later than the latter half of the fourth quarter of 2009 that data center will provide redundancy of Web operations at the data center level. Until such time, failures of our First Facility could cause interruptions and/or delays in our service, making our services less attractive to consumers and subjecting us to lost revenue. Additionally, if we are unable to recruit and retain skilled employees to manage the Web hosting operations, we may not be able to properly manage the necessary tasks to keep our systems running smoothly and grow the business.

If we were to lose the services of our key personnel, we may not be able to execute our business plan and our business could be adversely affected.



## Edgar Filing: Answers CORP - Form 10-Q

Our ability to execute our business plan depends upon the continued service of our executive officers and other key personnel. Our employment agreements with our executive officers and key employees are terminable by either party upon 30-90 days notice. If we lose the services of one or more of our key employees, or if one or more of our executive officers or key employees joined a competitor or otherwise competed with us, our business could be adversely affected. We cannot assure you that we will be able to retain or replace our key personnel, and the services of key members of our research and development team, in particular, would be difficult to replace. If we do not succeed in retaining or replacing our key personnel, we may be unable to execute our business plan and, as a result, our stock price may decline.

Table of Contents

Our business depends on increasing use of the Internet by users searching for information, advertisers marketing products and services and Web properties seeking to earn revenue to support their web content. If the Internet infrastructure does not grow and is not maintained to support these activities, our business will be harmed.

Our success will depend on the continued growth and maintenance of the Internet infrastructure. This includes maintenance of a reliable network backbone with the necessary speed, data capacity and security for providing reliable Internet services. Internet infrastructure may be unable to support the demands placed on it if the number of Internet users continues to increase, or if existing or future Internet users access the Internet more often or increase their bandwidth requirements. In addition, viruses, worms and similar programs may harm the performance of the Internet. The Internet has experienced a variety of outages and other delays as a result of damage to portions of its infrastructure, and could face outages and delays in the future. These outages and delays could reduce the level of Internet usage as well as our ability to provide our solutions.

Rules established by the Financial Accounting Standards Board, or FASB, require us to expense equity compensation given to our employees and may impact our ability to effectively utilize equity compensation to attract and retain employees.

The FASB has adopted changes that require companies to record a charge to earnings for employee stock option grants and other equity incentives effective January 1, 2006, which we have adopted. These accounting changes may cause us to reduce the availability and amount of equity incentives provided to employees, which may make it more difficult for us to attract, retain and motivate key personnel. Additionally, it may be difficult for us to estimate the impact of such compensation charges on future operating results because they will be based upon the fair market value of our common stock and other assumptions at future dates.

We may be subject to liability for online services, which may not be limited by the safe harbors in The Digital Millennium Copyright Act, or DMCA, The Communications Decency Act, or CDA, or the U.S. Children's Online Privacy Protection Act, or COPPA. If we do not meet the safe harbor requirements, or if it is otherwise determined that Answers.com contains actionable content, we could be subject to claims, which could be costly and time-consuming to defend.

We host certain services that enable individuals to generate content and engage in various online activities. The law relating to the liability of providers of these online services for activities of their users is currently unsettled both within the United States and internationally. Claims have been threatened and may in the future be brought against us for defamation, invasion of privacy, negligence, copyright or trademark infringement, unlawful activity, tort, including personal injury, fraud, or other theories based on the nature and content of information to which we provide links, or that may be posted online or generated by the users of Answers.com. Our defense of any of these actions could be costly and involve significant time and attention of our management and other resources.

The DMCA is intended, among other things, to reduce the liability of online service providers for listing or linking to third party Web properties that include materials that infringe copyrights or rights of others. Additionally, portions of the CDA are intended to provide statutory protections to online service providers who distribute third party content. A safe harbor for copyright infringement is also available under the DMCA to certain online service providers that provide specific services, if the providers take certain affirmative steps as set forth in the DMCA. Important questions regarding the safe harbor under the DMCA and the CDA have yet to be litigated, and we can not guarantee that we will meet the safe harbor requirements of the DMCA or of the CDA. If we are not covered by a safe harbor, for any reason, we could be exposed to claims, which could be costly and time-consuming to defend.

In addition, COPPA was enacted in October 1998. COPPA imposes civil and criminal penalties on persons distributing material harmful to minors over the Internet to persons under the age of 17 or collecting personal

information from children under the age of 13. We do not knowingly collect and disclose personal information from minors. The manner in which COPPA may be interpreted and enforced cannot yet be determined. Moreover, the applicability to the Internet of existing laws governing issues such as property ownership, copyright, defamation, obscenity and personal privacy is uncertain. We may be subject to claims that our content violates such laws, which could damage our business and cause our stock price to decline.

We also periodically enter into arrangements to offer third party products, services or content under the Answers brand or through Answers.com. We may be subject to claims concerning these products, services or content by virtue of our involvement in marketing, branding, broadcasting or providing access to them, even if we do not ourselves host, operate, provide, or provide access to them.

It is also possible that, if any information provided directly by us contains errors or is otherwise negligently provided to users, third parties could make claims against us. While it is our belief that the Terms of Use governing the use of Answers.com covers us against these types of claims, there are no assurances as to the final determination of these types of claims by any court of law. Furthermore, investigating and defending any of these types of claims is expensive, even to the extent that the claims are without merit or do not ultimately result in liability.

Table of Contents

Third parties may claim that we are infringing on their patents, trademarks or copyrights, which could result in substantial costs, diversion of significant managerial resources and significant harm to our reputation.

The industry in which we operate is characterized by the existence of a large number of patents and frequent litigation based on allegations of patent infringement. We expect that Internet technologies, software products and services may be increasingly subject to third party patent infringement claims as the number of competitors in our industry segment grows and the functionality of products in different industry segments overlaps. From time to time, third parties have asserted, and may in the future assert, patent infringement claims against us in various jurisdictions that are important to our business. Further, we have received, and may receive in the future, notices or offers from third parties claiming to have intellectual property rights in technologies that we use in our businesses and inviting us to license those rights. Additionally, third parties may assert trademark infringement claims with respect to brand names we use from time to time and content we display on Answers.com. We have received, and may receive in the future, cease and desist demands based on claims that a brand and trademark of ours infringes upon a name used by a competitor. For example, in July 2009 we received a letter from Wikia, Inc., advising that it believes it has superior rights in our registered trademark WikiAnswers, and threatening to file a Petition with the U.S. Trademark Office to cancel the mark and possibly take other action. A third party may also make claims against us over the display of search results triggered by search terms that include trademark terms. With respect to copyright laws, we may be faced with copyright infringement claims. We have received, and are likely to continue to receive, "cease and desist" letters demanding that we remove infringing content from Answers.com based on a theory of copyright and trademark infringement.

A successful patent, trademark or copyright infringement claim against us by any third party, could subject us to:

- substantial liability for damages and litigation costs, including attorneys' fees;
- lawsuits that prevent us from further use of intellectual property and require us to permanently cease and desist from selling or marketing products that use the intellectual property;
- licensing intellectual property from a third party, which could include significant licensing and royalty fees not presently paid by us, adding materially to the our costs of operations;
- developing new intellectual property, as a non-infringing alternative, that could delay projects, add materially to our costs of operations and be unacceptable to our users, which in turn could adversely affect our traffic and revenues; and
- indemnifying third parties who have entered into agreements with us with respect to losses they incurred as a result of the infringement, which could include consequential and incidental damages that are material in amount.

Regardless of the merit of third party infringement claims, these claims could result in substantial costs, diversion of significant resources and management attention, loss of users and significant harm to our reputation.

Finally, many of our agreements with advertisers, distribution partners, and other third party partners require us to indemnify these partners for certain third party intellectual property infringement claims, which could increase our costs as a result of defending the claims and may require that we pay damages if there were an adverse ruling in any of the claims. An adverse determination could also prevent us from offering our products and services to others and may require that we procure substitute products or services, which could adversely affect our business and financial results.

Misappropriation of our intellectual property could harm our reputation, adversely affecting our competitive position and financial results.

Our ability to compete depends in part upon the strength of our proprietary rights in our technologies, brands and content. We rely on a combination of U.S. and foreign patents, copyrights, trademark, trade secret laws and license agreements to establish and protect our intellectual property and proprietary rights. The efforts we have taken to protect our intellectual property and proprietary rights may not be sufficient or effective at stopping unauthorized use of our intellectual property and proprietary rights. In addition, effective trademark, patent, copyright and trade secret protection may not be available or cost-effective in every country in which our services are made available through the Internet. There may be instances where we are not able to fully protect or utilize our intellectual property in a manner that maximizes competitive advantage. If we are unable to protect our intellectual property and proprietary rights from unauthorized use, the value of Answers.com may be reduced, which could negatively impact our business. In addition, protecting our intellectual property and other proprietary rights is expensive and diverts critical managerial resources. If any of the foregoing were to occur, or if we are otherwise unable to protect our intellectual property and proprietary rights, our business and financial results could be adversely affected.

## Table of Contents

We have incurred significant net losses and may continue to incur losses.

We incurred net losses of approximately \$12.3 million and \$648 thousand for the year ended December 31, 2008 and for the nine months ended September 30, 2009, respectively. As of December 31, 2008 and September 30, 2009, we had an accumulated deficit of approximately \$71 million and approximately \$74 million, respectively. We cannot assure you that we will be able to achieve net income on a quarterly or annual basis. If our revenues do not increase, or if our operating expenses exceed expectations or cannot be reduced, we will continue to incur substantial losses, which would materially adversely affect our business and financial results.

New government regulation and legal uncertainties could require us to incur significant expenses.

The laws and regulations applicable to the Internet, and to our products and services, are evolving and unclear and could damage our business. In addition, we will be subject to any new laws and regulations directly applicable to our products and services. It is possible that laws and regulations may be adopted covering issues such as user privacy, pricing, taxation, content regulation, quality of products and services, and intellectual property ownership and infringement. This legislation could expose us to substantial liability as well as dampen the growth in use of the Internet generally, decrease the acceptance of the Internet as a communications and commercial medium, or require us to incur significant compliance expenses. Compliance with these laws and regulations may also cause us to change or limit our business practices in a manner adverse to our business. Upon launching sites in foreign languages, our exposure to legislation and regulation by foreign jurisdictions may increase, which may expose us to additional substantial liability.

Increased regulation or the imposition of access fees could substantially increase the costs of communicating on the Internet, potentially decreasing the demand for our products. A number of proposals have been made at the federal, state and local level that would impose additional taxes on the sale of goods and services through the Internet. Such proposals, if adopted, could substantially impair the growth of electronic commerce and could adversely affect us.

Due to the global nature of the Internet, it is possible that the governments of other states and foreign countries might attempt to regulate its transmissions or prosecute us for violations of their laws. We might unintentionally violate these laws. Such laws may be modified, or new laws may be enacted, in the future. Our business may be negatively affected by a variety of new or existing laws and regulations, which may expose us to substantial compliance costs and liabilities and may impede the growth in use of the Internet generally.

### Risks Related to our Common Stock

Our common stock may be affected by limited trading volume and may fluctuate significantly.

Our common stock is traded on The NASDAQ Capital Market. Although an active trading market has developed for our common stock, there can be no assurance that an active trading market for our common stock will be sustained. Failure to maintain an active trading market for our common stock may adversely affect our shareholders' ability to sell our common stock in short time periods, or at all. Our common stock has experienced, and may experience in the future, significant price and volume fluctuations, which could adversely affect the market price of our common stock.

You may experience dilution in your percentage ownership interest as a result of any additional issuances of our common stock.

We have authorized 100 million shares of our common stock, of which approximately 15.4 million shares were issued and outstanding after giving effect to the assumed exercise of all outstanding warrants and options and assumed conversion of preferred stock as of September 30, 2009. Our board of directors has the authority, without action or

vote of our stockholders in many cases, to issue all or a part of any authorized but unissued shares. Such stock issuances may be made at a price that reflects a discount from the then-current trading price of our common stock. In addition, we may need to issue securities that are convertible into or exercisable for a significant amount of our common stock. For example, on June 16, 2008, we sold Series A Convertible Preferred Stock and related warrants for \$6.0 million and issued the Unit Warrant to Redpoint Ventures. On June 10, 2009 Redpoint Ventures exercised in full its Unit Warrant and we issued Series B Convertible Preferred Stock and related warrants in exchange for \$7.0 million. These issuances may dilute your percentage ownership interest, which will have the effect of reducing your influence on matters on which our stockholders vote.

You may incur additional dilution if holders of stock options, whether currently outstanding or subsequently granted, exercise their options or if warrant holders exercise their warrants to purchase shares of our common stock. In addition, these issuances, or the perception that such issuances may occur in the future, may have a depressant effect on our stock price and make it more difficult to raise capital in the future on reasonable terms or at all.

Table of Contents

There may be substantial sales of our common stock, which could cause our stock price to fall.

All of our issued and outstanding shares are immediately available for sale in the public market without registration under Rule 144. Sales of a substantial number of shares of our common stock could cause the price of our securities to fall and could impair our ability to raise capital by selling additional securities.

We do not intend to pay dividends on our common stock.

We have never declared or paid any cash dividend on our common stock. We currently intend to retain any future earnings and do not expect to pay any dividends on our common stock in the foreseeable future.

We may incur penalties if the registration statement covering the common stock underlying the Series A Convertible Preferred Stock, the Series B Convertible Preferred Stock and the Common Stock Purchase Warrants and the Common Stock issued for the payment of accrued dividends on the Series A Convertible Preferred Stock and Series B Convertible Preferred Stock does not remain effective.

Under the terms of the registration rights agreement we entered into with the holders of our Series A Convertible Preferred Stock and Series B Convertible Stock, we are obligated to register the common stock underlying the Series A Convertible Preferred Stock, Series B Convertible Preferred Stock and the Common Stock Purchase Warrants and register the common stock issued for the payment of accrued dividends on the Series A Convertible Preferred Stock and Series B Convertible Preferred Stock. The registration rights carry penalties in the event we do not meet these registration obligations. The registration statement registering the common stock underlying the Series A Convertible Preferred Stock and the Common Stock Purchase Warrants was declared effective by the Securities and Exchange Commission on September 16, 2008. The registration statement registering the common stock underlying the Series B Convertible Preferred Stock and the Common Stock Purchase Warrants, as well as the common stock issued for the payment of past accrued and future dividends on the Series A Convertible Preferred Stock and Series B Convertible Preferred Stock, was declared effective by the Securities and Exchange Commission on July 28, 2009. We agreed to use our commercially reasonable best efforts to ensure the continued effectiveness of the registration statement thereafter. In the event sales of any or all of the securities covered by the registration statement cannot be made, whether because of our failure to keep the registration statement effective, or for various other reasons, then we must pay liquidated damages in cash to the holders of our Series A Convertible Preferred Stock and Series B Convertible Preferred Stock in the amount of 1.0% per month, on a daily pro rata basis, up to a maximum of 8.0%, of the aggregate purchase price of \$6,000,000 with respect to the shares issued or issuable in connection with the Series A Purchase Agreement and aggregate purchase price of \$7,000,000 with respect to the shares issued or issuable in connection with the Series B Warrant Agreement.

We have issued and could issue additional “blank check” preferred stock without stockholder approval with the effect of diluting then current stockholder interests.

Our certificate of incorporation authorizes the issuance of up to 1,000,000 shares of “blank check” preferred stock with designations, rights and preferences as may be determined from time to time by our board of directors. Accordingly, our board of directors is empowered, without stockholder approval, to issue a series of preferred stock with dividend, liquidation, conversion, voting or other rights, which could dilute the interest of, or impair the voting power of, our stockholders. The issuance of a series of preferred stock could be used as a method of discouraging, delaying or preventing a change in control. Although we do not presently intend to issue any additional shares of preferred stock, we may do so in the future. On June 16, 2008, we issued 60,000 shares of Series A Convertible Preferred Stock to Redpoint Ventures. In addition, on June 10, 2009 Redpoint Ventures exercised its Unit Warrant and we issued 70,000 shares of Series B Convertible Preferred Stock to them.



The holders of our Series A Convertible Preferred Stock and Series B Convertible Preferred Stock are entitled to receive liquidation payments in preference to the holders of our common stock.

Pursuant to the terms of the certificates of designation creating the Series A Convertible Preferred Stock and the Series B Convertible Preferred Stock, upon a liquidation of our company, the holders of shares of the Series A Convertible Preferred Stock and Series B Convertible Preferred Stock are entitled to receive a liquidation payment prior to the payment of any amount with respect to the shares of our common stock. The amount of this preferential liquidation payment is equal to the greater of (i) \$100 per share of Series A Convertible Preferred Stock or Series B Convertible Preferred Stock, as the case may be, plus the amount of any accrued but unpaid dividends on those shares and any other fees or liquidated damages owing thereon or (ii) such amount per share as would have been payable had all shares of Series A Convertible Preferred Stock or Series B Convertible Preferred Stock, as the case may be, been upon any such liquidation converted to common stock immediately prior to such liquidation. Dividends accrue on the shares of Series A Convertible Preferred Stock and Series B Convertible Stock at a rate of 6% per annum.

Table of Contents

Provisions in our charter documents and under Delaware law could discourage a takeover that stockholders may consider favorable.

Provisions of our Amended and Restated Certificate of Incorporation and Bylaws could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. For example, our board of directors is divided into three classes, with one class being elected each year by our stockholders, which generally makes it more difficult for stockholders to replace a majority of directors and obtain control of our board. In addition, stockholder meetings may be called only by our board of directors, the chairman of the board and the president, advance notice is required prior to stockholder proposals and stockholders may not act by written consent. Furthermore, we have authorized preferred stock that is undesignated, making it possible for our board of directors to issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to change control of our company.

Delaware law also could make it more difficult for a third party to acquire us. Specifically, Section 203 of the Delaware General Corporation Law, to which our company is subject, may have an anti-takeover effect with respect to transactions not approved in advance by our board of directors, including discouraging attempts that might result in a premium over the market price for the shares of common stock held by our stockholders.

We are at risk of securities class action litigation.

Securities class action litigation has often been brought against a company following a decline in the market price of its securities. This risk is especially relevant for us because Internet companies often experience significant stock price volatility. If we faced such litigation, it could result in substantial costs and diversion of management's attention and resources, which could adversely affect our business.

Weaknesses in our internal controls may impede our ability to produce timely and accurate financial statements, which could cause us to fail to file our periodic reports timely, result in inaccurate financial reporting or restatements of our financial statements, subject our stock to delisting and materially harm our business reputation and stock price.

As a public company, we are required to file annual and quarterly periodic reports containing our financial statements with the Securities and Exchange Commission within prescribed time periods. As part of The NASDAQ Capital Market listing requirements, we are also required to provide our periodic reports, or make them available, to our shareholders within prescribed time periods. If we are required to restate our financial statements in the future, any specific adjustment may be adverse and may cause our operating results and financial condition, as restated, on an overall basis to be materially and adversely impacted. As a result, we or members of our management could be the subject of adverse publicity, investigations and sanctions by such regulatory authorities as the Securities and Exchange Commission and subject to shareholder lawsuits. Any of the above consequences could cause our stock price to decline materially and could impose significant unanticipated costs on us.

If we are not able to issue our financial statements in a timely manner, we will not be able to comply with the periodic reporting requirements of the Securities and Exchange Commission and the listing requirements of The NASDAQ Capital Market. If these events occur, our common stock listing on The NASDAQ Capital Market could be suspended or terminated and our stock price could materially suffer. In addition, we or members of our management could be subject to investigation and sanction by the Securities and Exchange Commission and other regulatory authorities and to shareholder lawsuits, which could impose significant additional costs on us, divert management attention and materially harm our operating results, financial condition, business reputation and stock price.

Risks Related to our Location in Israel

Conditions in Israel may limit our ability to produce and sell our product, which would lead to a decrease in revenues.

Because most of our operations are conducted in Israel, our operations are directly affected by economic, political and military conditions affecting Israel. Specifically, we could be adversely affected by:

- any major hostilities involving Israel;
- a full or partial mobilization of the reserve forces of the Israeli army;
- the interruption or curtailment of trade between Israel and its present trading partners;
- risks associated with the fact that a certain number of our key employees and one officer reside in what are commonly referred to as occupied territories;

Table of Contents

- risks associated with outages and disruptions of communications networks due to any hostilities involving Israel; and
- a significant downturn in the economic or financial conditions in Israel.

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors and a state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Despite negotiations to effect peace between Israel and its Arab neighbors, the future of these peace efforts is uncertain. Since October 2000, there has been a significant increase in violence, civil unrest and hostility, including armed clashes between the State of Israel and the Palestinians, and acts of terror have been committed inside Israel and against Israeli targets in the West Bank and Gaza Strip. There is no indication as to how long the current hostilities will last or whether there will be any further escalation. Any further escalation in these hostilities or any future conflict, political instability or violence in the region may have a negative effect on our business, harm our results of operations and adversely affect our share price.

Furthermore, there are a number of countries that restrict business with Israel or with Israeli companies, which may limit our ability to promote our products and services those countries.

We may not be able to enforce covenants not-to-compete under current Israeli law that might result in added competition for our products.

We have non-competition agreements with all of our employees, almost all of which are governed by Israeli law. These agreements prohibit our employees from competing with or working for our competitors, generally during and for up to 12 months after termination of their employment. However, Israeli courts are reluctant to enforce non-compete undertakings of former employees and tend, if at all, to enforce those provisions for relatively brief periods of time in restricted geographical areas and only when the employee has obtained unique value to the employer specific to that employer's business and not just regarding the professional development of the employee. If we are not able to enforce non-compete covenants, we may be faced with added competition.

The Israeli government tax benefits program in which we currently participate and from which we receive benefits requires us to meet several conditions. These programs or benefits may be terminated or reduced in the future, which may result in an increase in our tax liability.

Our Israeli subsidiary receives tax benefits authorized under Israeli law for capital investments that are designated as "Approved Enterprises" and "Beneficial Enterprise." To be eligible for these tax benefits, we must meet certain conditions on a recurring basis. If we fail to meet such conditions, these tax benefits could be cancelled, and we could be required to pay increased taxes or refund the amount of tax benefits we received, together with interest and penalties. Israeli governmental authorities have indicated that the government may in the future reduce or eliminate the benefits of such programs. The termination or reduction of these programs and tax benefits could increase our Israeli tax rates, and thereby reduce our net profits or increase our net losses.

U.S. and Israeli tax authorities may interpret tax issues in manners other than those which we have adopted, which may expose us to tax liabilities.

We operate in the U.S. and in Israel and our earnings are subject to taxation in both jurisdictions, at different rates. Relevant tax authorities may disagree with our interpretation and application in practice of tax laws and may dispute various assumptions we make during our tax planning process. Further, the tax authorities in the U.S. and/or Israel may take exception with the transfer price of transactions between Answers Corporation and its wholly owned Israeli subsidiary. If there is a successful tax challenge of our tax position, our interpretation and/or application of tax laws in

practice, we may be forced to recognize additional tax liabilities, which may include interest and penalties. This may harm our results of operations and adversely affect our financial condition.

Our business may be impacted by NIS exchange rate fluctuations, which may negatively affect our earnings.

Exchange rate fluctuations between the U.S. dollar and the NIS may negatively affect our earnings. Our revenues are denominated in U.S. dollars. However, a significant portion of our expenses, associated with our Israeli operations, including personnel and facilities-related expenses, are incurred in NIS. Consequently, a devaluation of the U.S. dollar in comparison to the NIS will have the effect of increasing the dollar cost of our operations in Israel and an increase in the value of the U.S. dollar in comparison to the NIS may artificially reduce the U.S. dollar cost of our operations in Israel. Despite the fact that we often use various hedging tools, including forward contracts, to minimize the effect of currency fluctuations on our income, if the U.S. dollar cost of our operations in Israel increases, our dollar-measured consolidated results of operations will be adversely affected.

Table of Contents

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

N/A

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

N/A

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

At our Annual Meeting of Stockholders held on September 9, 2009, the following actions were taken:

A proposal to amend the Company's 2005 Incentive Compensation Plan to increase the number of shares available for grant under such plan from 1,350,000 shares to 1,600,000 shares was approved. The stockholders cast 4,109,007 votes in favor of this proposal and 812,422 votes against. There were 4,621 abstentions.

A proposal to ratify the appointment by the Company's Audit Committee of Somekh Chaikin, a firm member of KPMG International, to serve as independent registered public accounting firm for the Company for the fiscal year ending December 31, 2009 was approved. The stockholders cast 8,758,278 votes in favor of this proposal and 608,886 votes against. There were 2 abstentions.

ITEM 5. OTHER INFORMATION

N/A

ITEM 6. EXHIBITS

<u>10.1*</u>	<u>Amendment 7 to Google Order Form and Google Services Agreement.</u>
<u>31.1</u>	<u>Certification of Chief Executive Officer required under Rule 13a-14(a)/15d-14(a) under the Exchange Act.</u>
<u>31.2</u>	<u>Certification of Principal Financial Officer required under Rule 13a-14(a)/15d-14(a) under the Exchange Act.</u>
<u>32.1</u>	<u>Certification of Chief Executive Officer pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
<u>32.2</u>	<u>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.</u>

\* Portions of this exhibit were omitted and filed separately with the U.S Securities and Exchange Commission pursuant to a request for confidential treatment.



Table of Contents

SIGNATURES

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

ANSWERS CORPORATION  
(Registrant)

Date: November 9, 2009

By: /s/ Robert S.  
Rosenschein

Robert S.  
Rosenschein  
Chief Executive  
Officer

Date: November 9, 2009

By: /s/ Steven Steinberg

Steven Steinberg  
Chief Financial  
Officer  
(Principal Financial  
Officer)