

NEUSTAR INC
Form 10-Q
October 30, 2009

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

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

For the quarterly period ended September 30, 2009

OR

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

For the transition period from

to

Commission file number 001-32548

NeuStar, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

52-2141938

(I.R.S. Employer
Identification No.)

**46000 Center Oak Plaza
Sterling, Virginia 20166**

(Address of principal executive offices) (zip code)

(571) 434-5400

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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
(Do not check if a 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

There were 74,363,152 shares of Class A common stock, \$0.001 par value, and 4,538 shares of Class B common stock, \$0.001 par value, outstanding at October 27, 2009.

NeuStar, Inc.
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PART I FINANCIAL INFORMATION**Item 1. Financial Statements**

NEUSTAR, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	December 31, 2008	September 30, 2009 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 150,829	\$ 262,614
Restricted cash	496	498
Short-term investments	10,824	40,614
Accounts receivable, net of allowance for doubtful accounts of \$1,209 and \$1,402 respectively	71,805	63,016
Unbilled receivables	830	1,310
Notes receivable	759	
Prepaid expenses and other current assets	8,928	10,657
Deferred costs	8,518	7,467
Income taxes receivable	4,621	3,445
Deferred tax assets	11,079	8,542
Total current assets	268,689	398,163
Investments, long-term	40,506	
Property and equipment, net	64,160	67,203
Goodwill	118,067	118,417
Intangible assets, net	16,594	10,523
Deferred costs, long-term	3,333	1,672
Deferred tax assets, long-term	4,244	3,556
Other assets	3,573	4,390
Total assets	\$ 519,166	\$ 603,924

See accompanying notes.

NEUSTAR, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	December 31, 2008	September 30, 2009 (unaudited)
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 6,901	\$ 5,960
Accrued expenses	52,202	51,039
Deferred revenue	32,530	35,659
Notes payable	2,587	1,777
Capital lease obligations	7,536	9,470
Accrued restructuring reserve	1,867	2,300
Other liabilities	430	3,891
Total current liabilities	104,053	110,096
Deferred revenue, long-term	11,657	9,036
Notes payable, long-term	1,777	
Capital lease obligations, long-term	10,156	6,959
Accrued restructuring reserve, long-term	1,589	1,099
Other liabilities, long-term	3,281	4,215
Total liabilities	132,513	131,405
Commitments and contingencies		
Stockholders equity:		
Preferred stock, \$0.001 par value; 100,000,000 shares authorized; no shares issued and outstanding as of December 31, 2008 and September 30, 2009		
Class A common stock, par value \$0.001; 200,000,000 shares authorized; 78,925,222 and 79,319,294 shares issued and outstanding at December 31, 2008 and September 30, 2009, respectively	79	79
Class B common stock, par value \$0.001; 100,000,000 shares authorized; 4,538 shares issued and outstanding at December 31, 2008 and September 30, 2009, respectively		
Additional paid-in capital	321,528	333,601
Treasury stock, 4,949,771 and 4,961,249 shares at December 31, 2008 and September 30, 2009, respectively, at cost	(128,403)	(128,598)
Accumulated other comprehensive loss	(879)	(229)
Retained earnings	194,328	267,666
Total stockholders equity	386,653	472,519
Total liabilities and stockholders equity	\$ 519,166	\$ 603,924

See accompanying notes.

NEUSTAR, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2008	2009	2008	2009
Revenue:				
Addressing	\$ 32,470	\$ 32,139	\$ 94,899	\$ 96,157
Interoperability	16,237	13,926	49,228	42,122
Infrastructure and other	75,103	71,138	217,305	207,876
Total revenue	123,810	117,203	361,432	346,155
Operating expense:				
Cost of revenue (excluding depreciation and amortization shown separately below)	27,683	26,629	78,983	82,808
Sales and marketing	17,865	20,447	56,808	59,193
Research and development	7,140	3,948	22,442	12,775
General and administrative	15,407	13,472	47,040	41,274
Depreciation and amortization	10,552	9,538	30,958	28,115
Restructuring charges		2,733		2,733
Impairment of goodwill			29,021	
	78,647	76,767	265,252	226,898
Income from operations	45,163	40,436	96,180	119,257
Other (expense) income:				
Interest and other expense	(1,110)	(2,596)	(4,434)	(4,669)
Interest and other income	359	2,747	3,200	6,352
Income before income taxes	44,412	40,587	94,946	120,940
Provision for income taxes	16,038	16,068	48,176	47,602
Net income	\$ 28,374	\$ 24,519	\$ 46,770	\$ 73,338
Net income per common share:				
Basic	\$ 0.38	\$ 0.33	\$ 0.63	\$ 0.99
Diluted	\$ 0.38	\$ 0.32	\$ 0.61	\$ 0.97
Weighted average common shares outstanding:				
Basic	73,859	74,356	74,509	74,269
Diluted	75,259	75,594	76,548	75,409

See accompanying notes.

NEUSTAR, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Nine Months Ended	
	September 30,	
	2008	2009
Operating activities:		
Net income	\$ 46,770	\$ 73,338
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	30,958	28,115
Stock-based compensation	13,339	10,123
Amortization of deferred financing costs	129	127
Excess tax benefits from stock-based compensation	(2,291)	(492)
Deferred income taxes	(560)	3,191
Impairment of goodwill	29,021	
Provision for doubtful accounts	1,906	1,965
Other-than-temporary loss on available-for-sale investments	2,637	
Gain on available-for-sale investments and trading securities		(3,055)
Loss on auction rate securities rights		1,771
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	9,242	5,884
Unbilled receivables	(1,531)	(480)
Notes receivable	1,603	759
Prepaid expenses and other current assets	(1,653)	(1,729)
Deferred costs	(377)	2,712
Income taxes receivable		1,668
Other assets	919	(633)
Other liabilities	(864)	4,395
Accounts payable and accrued expenses	(4,156)	(1,164)
Income taxes payable	(774)	
Accrued restructuring reserve	(308)	(57)
Deferred revenue	(5,674)	508
Net cash provided by operating activities	118,336	126,946
Investing activities:		
Purchases of property and equipment	(18,528)	(18,921)
Sales of investments, net	40,380	12,154
Business acquired, net of cash	(13,762)	(350)
Net cash provided by (used in) investing activities	8,090	(7,117)
Financing activities:		
Disbursement of restricted cash	(55)	(2)
Principal repayments on notes payable	(2,501)	(2,587)
Principal repayments on capital lease obligations	(3,670)	(7,429)
Proceeds from exercise of common stock options	6,018	1,458
Excess tax benefits from stock-based compensation	2,291	492

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Repurchase of restricted stock awards	(192)	(195)
Repurchase of common stock	(124,855)	
Net cash used in financing activities	(122,964)	(8,263)
Effect of foreign exchange rates on cash and cash equivalents	533	219
Net increase in cash and cash equivalents	3,995	111,785
Cash and cash equivalents at beginning of period	98,630	150,829
Cash and cash equivalents at end of period	\$ 102,625	\$ 262,614

See accompanying notes.

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NEUSTAR, INC.

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2009**

1. DESCRIPTION OF BUSINESS AND ORGANIZATION

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

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

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Unaudited Interim Financial Information

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The results of operations for the nine months ended September 30, 2009 are not necessarily indicative of the results that may be expected for the full fiscal year. The consolidated balance sheet as of December 31, 2008 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008 filed with the

Securities and Exchange Commission (SEC).

In connection with preparation of the consolidated financial statements and in accordance with the Subsequent Events Topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC), the Company evaluated subsequent events after the balance sheet date of September 30, 2009 through October 30, 2009, the issuance date of these unaudited interim financial statements.

NEUSTAR, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Reclassification

Certain prior period amounts have been reclassified to conform to current period presentation.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting periods. Significant estimates and assumptions are inherent in the analysis and the measurement of deferred tax assets; the identification and quantification of income tax liabilities due to uncertain tax positions; restructuring liabilities; valuation of investments; recoverability of intangible assets, other long-lived assets and goodwill; and the determination of the allowance for doubtful accounts. The Company bases its estimates on historical experience and assumptions that it believes are reasonable. Actual results could differ from those estimates.

Fair Value of Financial Instruments

The FASB ASC Topic Financial Instruments requires disclosures of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value. Due to their short-term nature, the carrying amounts reported in the consolidated financial statements approximate the fair value for cash and cash equivalents, accounts receivable, accounts payable and accrued expenses. As of December 31, 2008, the Company believes the carrying amount of its long-term debt approximates its fair value because the fixed and variable interest rates of the debt approximate a market rate. The Company's long-term debt balance as of September 30, 2009 is zero. The fair value of the Company's cash reserve fund included in short-term investments was primarily determined using pricing models that utilized recent trades for securities in active markets, dealer quotes for those securities considered to be inactive, and assumptions surrounding contractual terms, maturity and liquidity (see Note 4). The Company determined the fair value of its auction rate securities using an average of discounted cash flow models (see Note 4). The Company has rights to sell its auction rate securities at par beginning June 30, 2010, to the investment firm that brokered the original purchases (the auction rate securities rights). The fair value of the Company's auction rate securities rights is based on the estimated discounted cash flow of the associated auction rate securities (see Note 4). As permitted under the FASB ASC Topic Financial Instruments, the Company elected fair value measurement for the auction rate securities rights.

The estimated fair values of the Company's financial instruments are as follows (in thousands):

	December 31, 2008		September 30, 2009 (unaudited)	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 150,829	\$ 150,829	\$ 262,614	\$ 262,614
Restricted cash (current assets)	\$ 496	\$ 496	\$ 498	\$ 498
Short-term investments	\$ 10,824	\$ 10,824	\$ 40,614	\$ 40,614
Investments, long-term	\$ 40,506	\$ 40,506	\$	\$
Marketable securities (long-term other assets)	\$ 268	\$ 268	\$ 1,435	\$ 1,435
Deferred compensation (long-term other liabilities)	\$ 284	\$ 284	\$ 1,448	\$ 1,448
Notes payable, long-term	\$ 1,777	\$ 1,777	\$	\$

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

The Company's investments classified as available-for-sale are carried at estimated fair value, as determined by quoted market prices or other valuation methods, with unrealized gains and losses reported as a separate component of accumulated other comprehensive income. Realized gains and losses and declines in value judged to be other-than-temporary, if any, on available-for-sale securities are included in other (expense) income. The cost of available-for-sale short-term investments sold is based on the specific identification method for the three months ended March 31, 2008. Because of other-than-temporary charges related to short-term investments recognized in earnings subsequent to the first quarter of 2008, the cost of securities sold during the six months ended September 30, 2008, and the three and nine months ended September 30, 2009, is reduced by a pro-rata allocation of other-than-temporary losses previously recognized as a charge to earnings. Interest and dividends on these securities is included in interest and other income.

The Company periodically evaluates whether any declines in the fair value of its investments are other-than-temporary. This evaluation consists of a review of several factors, including but not limited to: the length of time and extent that a security has been in an unrealized loss position; the existence of an event that would impair the issuer's future earnings potential; the near-term prospects for recovery of the market value of a security; the Company's intent to sell an impaired security; and the probability that the Company will be required to sell the security before the market value recovers. Prior to April 1, 2009, declines in value below cost for investments which the Company had the ability and intent to hold the investment for a period of time sufficient to allow for a market recovery, were not recognized as an other-than temporary charge in earnings. Beginning April 1, 2009, if an investment which the Company does not intend to sell prior to recovery declines in value below the amortized cost basis and it is not more likely than not the Company will be required to sell the related security before the recovery of its amortized cost basis, the Company recognizes the difference between the present value of the cash flows expected to be collected and the amortized cost basis, or credit loss, as an other-than temporary charge in interest and other expense. The difference between the estimated fair value and the security's amortized cost basis at the measurement date related to all other factors is reported as a separate component of accumulated other comprehensive loss. As of September 30, 2009, there were no unrealized losses recorded for the Company's available-for-sale investments.

The Company's investments classified as trading are carried at estimated fair value with unrealized gains and losses reported in other (expense) income. At September 30, 2009, the Company classified its auction rate securities as trading pursuant to the Investments—Debt and Equity Securities Topic of the FASB ASC, with changes in the fair value of these securities recorded in interest and other income (see Note 3). Interest and dividends on these securities are included in interest and other income.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of assets acquired, as well as other definite-lived intangible assets. In accordance with the Intangibles—Goodwill and Other Topic of the FASB ASC, goodwill and indefinite-lived intangible assets are not amortized, but are reviewed for impairment upon the occurrence of events or changes in circumstances that would reduce the fair value of such assets below their carrying amount. The Company is required to test goodwill for impairment at least annually, or on an interim basis if circumstances change that would indicate the possibility of impairment. For purposes of the Company's annual impairment test, the Company has identified and assigned goodwill to two reporting units, Clearinghouse and NGM.

In the nine months ended September 30, 2008, the Company recorded a goodwill impairment charge of \$29.0 million related to its NGM reporting unit (see Note 5). There was no impairment charge related to the Company's Clearinghouse reporting unit in the nine months ended September 30, 2008. There were no impairment charges related to the Company's Clearinghouse or NGM reporting units during the nine months ended September 30, 2009.

Impairment of Long-Lived Assets

In accordance with the Property, Plant and Equipment Topic of the FASB ASC, the Company reviews long-lived assets and certain identifiable intangible assets for impairment whenever events or changes in circumstances indicate

the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the

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

assets. Recoverability measurement and estimates of undiscounted cash flows are done at the lowest possible level for which there are identifiable cash flows. If such assets are considered impaired, the amount of impairment recognized is equal to the amount by which the carrying amount of assets exceeds the fair value of the assets. Assets to be disposed of are recorded at the lower of the carrying amount or the fair value less costs to sell.

Revenue Recognition

The Company provides the North American communications industry with essential clearinghouse services that address the industry's addressing, interoperability, and infrastructure needs. The Company's revenue recognition policies are in accordance with the Revenue Recognition Topic of the FASB ASC. Pursuant to various private commercial and government contracts, the Company provides addressing, interoperability and infrastructure services.

Significant Contracts

The Company provides wireline and wireless number portability, implements the allocation of pooled blocks of telephone numbers and provides network management services pursuant to seven contracts with North American Portability Management LLC (NAPM), an industry group that represents all telecommunications service providers in the United States. In 2008, the Company recognized revenue under its contracts with NAPM primarily on a per-transaction basis. The aggregate fees for transactions processed under these contracts were determined by the total number of transactions, and these fees were billed to telecommunications service providers based on their allocable share of the total transaction charges. This allocable share was based on each respective telecommunications service provider's share of the aggregate end-user services revenues of all U.S. telecommunications service providers, as determined by the Federal Communications Commission. In January 2009, the Company amended its seven regional contracts with NAPM under which it provides telephone portability and other clearinghouse services to CSPs in the United States. These amendments provide for an annual fixed-fee pricing model under which the annual fixed-fee (Base Fee) is set at \$340.0 million in 2009 and is subject to an annual price escalator of 6.5% in subsequent years. The amendments also provide for a fixed credit of \$40.0 million in 2009, \$25.0 million in 2010 and \$5.0 million in 2011, which will be applied to reduce the Base Fee for the applicable year. Additional credits of up to \$15.0 million annually in 2009, 2010 and 2011 may be triggered if the customer reaches certain levels of aggregate telephone number inventories and adopts and implements certain Internet Protocol (IP) fields and functionality. Moreover, the amendments provide for credits in the event that the volume of transactions in a given year is above or below the contractually established volume range for that year. The determination of whether any volume credits have been earned is done annually at the end of the year and such credits, if any, are applied to the following year's invoices. The Company determines the fixed and determinable fee under the amendments on an annual basis and recognizes such fee on a straight-line basis over twelve months. For 2009, the Company has concluded that the fixed and determinable fee equals \$285.0 million, which is the Base Fee of \$340.0 million reduced by the \$40.0 million fixed credit and \$15.0 million of available additional credits. To the extent any available additional credits expire unused, they will be recognized in revenue at that time. The Company records the fixed and determinable fee amongst addressing, interoperability and infrastructure based on the relative volume of transactions in each of these service offerings processed during the applicable period.

Under the Company's contracts with NAPM, the Company also bills a Revenue Recovery Collections fee equal to a percentage of monthly billings to its customers, which is available to the Company if any telecommunications service provider fails to pay its allocable share of total transactions charges.

During 2008, per transaction pricing under the contracts with NAPM was derived on a straight-line basis using an effective rate calculation formula based on annualized transaction volume between 200 million and 587.5 million. For annualized transaction volumes less than or equal to 200 million, the price per transaction was equal to a flat rate of \$0.95 per transaction. For annualized volumes greater than or equal to 587.5 million, the price per transaction was equal to a flat rate of \$0.75 per transaction. For the three and nine months ended September 30, 2008, the average price per transaction was \$0.86 and \$0.87, respectively.

NEUSTAR, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the three and nine months ended September 30, 2009, the effective price per transaction under the contracts with NAPM was \$0.72 and \$0.73, respectively. The effective price per transaction is calculated by dividing the straight-line portion of the fixed and determinable fee by the number of transactions during the corresponding period.

Addressing

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

In addition to the administrative functions associated with its role as the National Pooling Administrator, the Company also generates revenue from implementing the allocation of pooled blocks of telephone numbers under its long-term contracts with NAPM. In 2008, the Company recognized revenue on a per-transaction fee basis as the services were performed. As discussed above under the heading *Revenue Recognition Significant Contracts*, beginning January 1, 2009, the Company determines the fixed and determinable fee on an annual basis and recognizes such fee on a straight-line basis over twelve months. For its Internet domain name services, the Company generates revenue for Internet domain registrations, which generally have contract terms between one and ten years. The Company recognizes revenue on a straight-line basis over the term of the related customer contracts.

The Company generates revenue through internal and external managed domain name services. The Company's revenue consists of customer set-up fees, monthly recurring fees and per-transaction fees for transactions in excess of pre-established monthly minimums under contracts with terms ranging from one to three years. Customer set-up fees are not considered a separate deliverable and are deferred and recognized on a straight-line basis over the term of the contract. Under the Company's contracts to provide its managed domain name services, customers have contractually established monthly transaction volumes for which they are charged a recurring monthly fee. Transactions processed in excess of the pre-established monthly volume are billed at a contractual per-transaction rate. Each month, the Company recognizes the recurring monthly fee and usage in excess of the established monthly volume on a per-transaction basis as services are provided. The Company generates revenue from its U.S. Common Short Code services under short-term contracts ranging from three to twelve months, and the Company recognizes revenue on a straight-line basis over the term of the customer contracts.

Interoperability

The Company's interoperability services consist primarily of wireline and wireless number portability and order management services. The Company generates revenue from providing telephone number portability services under its long-term contracts with NAPM. In 2008, the Company recognized revenue on a per-transaction fee basis as the services were performed. As discussed above under the heading *Revenue Recognition Significant Contracts*, beginning January 1, 2009, the Company determines the fixed and determinable fee on an annual basis and recognizes such fee on a straight-line basis over twelve months.

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

three years. These contracts consist of user subscription fees based on the number of subscribers that use mobile instant messaging services, as well as fees for set-

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

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

Infrastructure and Other

The Company's infrastructure services consist primarily of network management and connection services. The Company generates revenue from network management services under its long-term contracts with NAPM. In 2008, the Company recognized revenue on a per-transaction fee basis as the services were performed. As discussed above under the heading Revenue Recognition Significant Contracts, beginning January 1, 2009, the Company determines the fixed and determinable fee on an annual basis and recognizes such fee on a straight-line basis over twelve months. In addition, the Company generates revenue from connection fees and system enhancements under its contracts with NAPM. The Company recognizes connection fee revenue as the service is performed. System enhancements are provided under contracts in which the Company is reimbursed for costs incurred plus a fixed fee, and revenue is recognized based on costs incurred plus a pro rata amount of the fee. The Company generates revenue from its intra-carrier mobile instant messaging services under contracts with mobile operators that range from one to three years. These contracts consist of license fees based on the number of subscribers that use mobile instant messaging services, as well as fees for set-up and implementation. The Company recognizes license fee revenue on a straight-line basis over the term of the contract after completion of customer set-up and implementation. Customer set-up and implementation is not considered a separate deliverable; accordingly, the fees for these services are deferred and recognized as revenue on a straight-line basis over the remaining term of the contract following delivery of the set-up and implementation services.

Service Level Standards

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

Cost of Revenue and Deferred Costs

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

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

Stock-Based Compensation

The Company accounts for its stock-based compensation plans under the recognition and measurement provisions of the Compensation Stock Compensation Topic of the FASB ASC. The Company estimates the value of stock-based awards on the date of grant using the Black-Scholes option-pricing models. For stock-based awards subject to graded vesting, the Company has utilized the straight-line method for allocating compensation cost by period.

NEUSTAR, INC.**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Basic and Diluted Net Income per Common Share**

In 2009, the Company adopted and retrospectively applied the FASB standard which updated the Earnings Per Share Topic of the FASB ASC for determining whether instruments granted in share-based payment transactions are participating. The authoritative literature effective in 2009 clarifies that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are to be included in the computation of earnings per share under the two-class method. The Company's restricted stock awards are considered to be participating securities because they contain non-forfeitable rights to cash dividends, if declared and paid. In lieu of presenting earnings per share pursuant to the two-class method, the Company has included shares of unvested restricted stock awards in the computation of basic net income per common share as the resulting earnings per share would be the same under both methods. Diluted net income per common share for the three and nine months ended September 30, 2008 was not materially affected by the adoption and retrospective application of the provisions effective in 2009.

Basic net income per common share is computed by dividing net income by the weighted-average number of common shares and participating securities outstanding during the period. Unvested restricted stock units and performance vested restricted stock units (PVRSU) are excluded from the computation of basic net income per common share because the underlying shares have not yet been earned by the shareholder. Shares underlying stock options are also excluded because they are not considered outstanding shares. Diluted net income per common share assumes dilution and is computed based on the weighted-average number of common shares outstanding after consideration of the dilutive effect of stock options, unvested restricted stock units and PVRSU. The effect of dilutive securities is computed using the treasury stock method and average market prices during the period. Dilutive securities with performance conditions are excluded from the computation until the performance conditions are met.

Income Taxes

The Company accounts for income taxes in accordance with the Income Taxes Topic of FASB ASC. Deferred tax assets and liabilities are determined based on temporary differences between the financial reporting bases and the tax bases of assets and liabilities. Deferred tax assets are also recognized for tax net operating loss carryforwards. These deferred tax assets and liabilities are measured using the enacted tax rates and laws that will be in effect when such amounts are expected to be reversed or utilized. Valuation allowances are provided to reduce such deferred tax assets to amounts more likely than not to be ultimately realized.

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

The Company assesses uncertain tax positions in accordance with income tax accounting standards. Under these standards, income tax benefits should be recognized when, based on the technical merits of a tax position, the Company believes that if a dispute arose with the taxing authority and were taken to a court of last resort, it is more likely than not (*i.e.*, a probability of greater than 50 percent) that the tax position would be sustained as filed. If a position is determined to be more likely than not of being sustained, the reporting enterprise should recognize the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority. The Company's practice is to recognize interest and penalties related to income tax matters in income tax expense.

Comprehensive Income

Comprehensive income is comprised of net earnings and other comprehensive income, which includes certain changes in equity that are excluded from income.

The following table summarizes the components of total comprehensive income, net of taxes, during the three and nine months ended September 30, 2008 and 2009 (in thousands):

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2008	2009	2008	2009
Net income	\$ 28,374	\$ 24,519	\$ 46,770	\$ 73,338
Unrealized loss / gain on investments	(519)	(158)	(1,354)	295
Accumulated translation adjustments	124	396	372	355
 Total comprehensive income	 \$ 27,979	 \$ 24,757	 \$ 45,788	 \$ 73,988

The following table summarizes the tax (provision) or benefit for each component of total comprehensive income during the three and nine months ended September 30, 2008 and 2009 (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2008	2009	2008	2009
Tax (provision) benefit:				
Unrealized loss / gain on investments	\$ 321	\$ (114)	\$ 863	\$ (169)
Accumulated translation adjustments	\$ 26	\$ (239)	\$ (162)	\$ 57

Recent Accounting Pronouncements

In April 2009, the FASB issued guidance for the initial recognition and measurement, subsequent measurement and accounting, and disclosures for assets and liabilities arising from contingencies in business combinations. This new guidance, included in FASB ASC Topic Business Combinations, eliminates the distinction between contractual and non-contractual contingencies, including the initial recognition and measurement criteria for acquired contingencies, and is effective for contingent assets and contingent liabilities acquired in business combinations for which the acquisition date is on or after the first annual reporting period beginning on or after December 15, 2008. The Company expects the new guidance will have an impact on its consolidated financial statements, but the nature and magnitude of the specific effects will depend upon the nature, term and size of any contingencies acquired subsequent to January 1, 2009.

In June 2009, the FASB issued new guidance to (i) require an entity to perform an analysis to determine whether an entity's variable interest or interests give it a controlling financial interest in a variable interest entity; (ii) require ongoing reassessments of whether an entity is the primary beneficiary of a variable interest entity and eliminate the quantitative approach previously required for determining the primary beneficiary of a variable interest entity; (iii) amend certain guidance for determining whether an entity is a variable interest entity; and (iv) require enhanced disclosure that will provide users of financial statements with more transparent information about an entity's involvement in a variable interest entity. The Company is required to adopt the new guidance for its annual and interim periods beginning after November 15, 2009. The Company does not expect the adoption to have a material impact on its consolidated financial statements.

In September 2009, the FASB ratified Accounting Standard Update 2009-13, Revenue Recognition Topic 605 Multiple-Deliverable Revenue Arrangements (ASU 2009-13). When vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, the Company will be required to develop a best estimate of the selling price to separate deliverables and allocate arrangement consideration using the relative selling price method. ASU 2009-13 is effective for revenue arrangements entered into or materially modified beginning January 1, 2011, with earlier application permitted. The Company is currently evaluating the impact of adoption on its consolidated financial statements.

NEUSTAR, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. INVESTMENTS

A summary of the Company's securities available-for-sale as of December 31, 2008 and September 30, 2009 is as follows (in thousands):

	December 31, 2008			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Losses	
Cash reserve fund	\$ 10,824	\$	\$	\$ 10,824

	September 30, 2009			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Losses	
Cash reserve fund	\$ 2,258	\$ 154	\$	\$ 2,412

In December 2007, the Company was advised that a cash reserve fund, classified as an available-for-sale investment, would be closed to new investments and subject to scheduled redemptions as determined by the fund. In the event the estimated fair value of the Company's investment in this fund declines below its amortized cost basis, the Company believes it will more likely than not be required to redeem the security prior to market recovery and will record declines in fair value as a loss in the current period earnings.

The Company has evaluated its investment in the cash reserve fund to determine whether any unrealized losses represent an other-than-temporary impairment. Based on the Company's assessment, the Company recorded a \$0.2 million and \$1.0 million charge to earnings for the three and nine months ended September 30, 2008, respectively, to recognize unrealized losses on the cash reserve fund as other-than-temporary impairments. At September 30, 2009, the amortized cost of the Company's investment in the cash reserve fund reflects \$474,000 of other-than-temporary impairment charges recorded during 2008. The Company reduced the amortized cost for this investment by the amount of the other-than-temporary impairment charges. The new amortized cost basis will not be increased for subsequent recoveries in fair value, rather, recoveries will be recorded in accumulated other comprehensive income or loss. A further decline in fair value will be considered to be other-than-temporary, and the Company will record an additional loss in the period when the subsequent impairment becomes apparent. At September 30, 2009, the Company recorded an unrealized gain of \$154,000 related to this fund.

During the three and nine months ended September 30, 2008, the Company redeemed \$7.4 million and \$30.8 million, respectively, from this cash reserve fund and recognized losses from redemptions of \$53,000 and \$495,000, respectively. During the three and nine months ended September 30, 2009, the Company redeemed \$4.8 million and \$8.9 million, respectively, from this cash reserve fund and the Company recorded gains from redemptions of \$293,000 and \$338,000, respectively.

As of September 30, 2009, the Company had investments with an original par value of \$38.5 million and an estimated fair value of \$30.6 million that consist of auction rate securities (ARS) whose underlying assets are student loans, the majority of which are guaranteed by the federal government. ARS are intended to provide liquidity via an auction process that resets the applicable interest rate approximately every 30 days; investors can either roll over their holdings or sell the ARS at par. As a result of current negative conditions in the global credit markets, auctions for the \$30.6 million investment in these securities have failed to settle and may continue to fail to settle on their respective settlement dates. Consequently, the investments are not currently liquid and the Company will not be able to access

these funds until a future auction of these investments is successful, issuers redeem the securities or a buyer is found outside of the auction process. During the three and nine months ended September 30, 2009, the Company recorded gains of \$1.3 million and \$1.7 million, respectively, in income to earnings for changes in the estimated fair value of the ARS investments.

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

In November 2008, the Company accepted a settlement offer in the form of a rights offering from the investment firm that brokered the original purchases of the \$38.5 million par value of ARS, which provides the Company with rights to sell these securities at par value to the investment firm during a two-year period beginning June 30, 2010. At December 31, 2008, the estimated fair value of these rights of \$9.4 million was classified in long-term investments in the Company's consolidated balance sheets. The Company intends to exercise its right to sell these securities to the investment firm on June 30, 2010. At September 30, 2009, the estimated fair value of the ARS rights of \$7.6 million is classified in short-term investments in the Company's consolidated balance sheets. Changes in the fair value of the ARS rights are recorded in current period earnings, which the Company believes will substantially offset changes in fair value of the rights, subject to the continued expected performance by the investment firm of its obligations under the ARS rights. During the three and nine months ended September 30, 2009, the Company recorded a loss of \$2.2 million and \$1.8 million, respectively, related to the change in estimated fair value of the ARS rights.

Under the terms of the ARS rights offering, if the investment firm is successful in selling the ARS prior to June 30, 2010, the investment firm is obligated to pay the Company par value for the related ARS sold. During the three and nine months ended September 30, 2009, the Company received original par value of \$3.1 million and \$3.3 million, respectively, in cash from the investment firm related to the successful sale of certain ARS and recognized realized gains of \$942,000 and \$993,000, respectively.

4. FAIR VALUE MEASUREMENTS

The Company adopted the Fair Value Measurements and Disclosures Topic of FASB ASC on January 1, 2008, with respect to its financial assets and liabilities, and on January 1, 2009, with respect to its nonfinancial assets and nonfinancial liabilities that are recognized and disclosed at fair value on a nonrecurring basis. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Fair Value Measurements and Disclosure Topic of FASB ASC establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value and requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1. Observable inputs, such as quoted prices in active markets;

Level 2. Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

Level 3. Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

The Company evaluates assets and liabilities subject to fair value measurements on a recurring and non-recurring basis to determine the appropriate level to classify them for each reporting period. This determination requires significant judgments to be made.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table sets forth the Company's financial and non-financial assets and liabilities that are measured at fair value on a recurring basis as of September 30, 2009, by level within the fair value hierarchy (in thousands):

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

	Level 1	Level 2	Level 3	Total
Cash reserve fund available-for-sale securities (short-term investments)	\$	\$	\$ 2,412	\$ 2,412
Auction rate securities trading securities (short-term investments)	\$	\$	\$ 30,557	\$ 30,557
Auction rate securities rights (short-term investments)	\$	\$	\$ 7,645	\$ 7,645
Marketable securities (1)	\$ 1,435	\$	\$	\$ 1,435
Deferred compensation (2)	\$ 1,448	\$	\$	\$ 1,448

(1) In June 2008, the Company established the NeuStar, Inc. Deferred Compensation Plan (the Plan) to provide directors and certain employees with the ability to defer a portion of their compensation. The assets of the Plan are invested in marketable securities that are held in a Rabbi Trust and reported at market value in other assets.

(2) Obligations to pay benefits under the Plan are included in other long-term liabilities.

The following table provides a reconciliation of the beginning and ending balances for the major class of assets measured at fair value using significant unobservable inputs (Level 3) (in thousands):

	Cash Reserve Fund	Auction Rate Securities	ARS Rights
Balance on December 31, 2008	\$ 10,824	\$ 31,090	\$ 9,416
Transfers in and/or (out) of Level 3			
Total gains (losses) realized / unrealized included in earnings	338	2,717	(1,771)
Total unrealized gains included in accumulated other comprehensive loss	154		
Purchases, sales, issuances and settlements, net	(8,904)	(3,250)	
Balance on September 30, 2009	\$ 2,412	\$ 30,557	\$ 7,645

The fair value of the Level 3 cash reserve fund asset is primarily determined using pricing models that utilize recent trades for securities in active markets, dealer quotes for those securities considered to be inactive, and assumptions surrounding contractual terms, maturity and liquidity.

The valuation technique used to measure fair value for the Level 3 auction rate securities asset is the average of the values obtained using discounted cash flow methods. The discounted cash flow valuation methods involve management's judgment and assumptions regarding discount rates, coupon rates, estimated maturity for each of the ARS, and judgment regarding the selection of comparable transactions in a secondary market.

As described in Note 3, in November 2008, the Company accepted a settlement offer in the form of a rights offering from an investment firm which provides the Company with the right to sell the ARS at par to the investment firm during a two-year period beginning June 30, 2010. The valuation technique used to measure fair value of the rights is the discounted cash flow method, which involves judgment and assumptions surrounding the timing of cash flows, fair value of the underlying ARS and the ability of the investment firm to settle its obligation in accordance with ARS rights offering.

NEUSTAR, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. GOODWILL AND INTANGIBLE ASSETS

The change in the carrying amount of goodwill by reportable segment for the nine months ended September 30, 2008 is as follows (in thousands):

	Clearinghouse Services	NGM Services	Total
Balance at December 31, 2007	\$ 88,148	\$ 115,945	\$ 204,093
Acquisitions	6,379		6,379
Purchase price adjustments	847		847
Impairment charge		(29,021)	(29,021)
Balance at September 30, 2008	\$ 95,374	\$ 86,924	\$ 182,298

The change in the carrying amount of goodwill by reportable segment for the nine months ended September 30, 2009 is as follows (in thousands):

	Clearinghouse Services	NGM Services	Total
Balance at December 31, 2008	\$ 95,724	\$ 22,343	\$ 118,067
Acquisitions			
Purchase price adjustments	350		350
Impairment charge			
Balance at September 30, 2009	\$ 96,074	\$ 22,343	\$ 118,417

On January 10, 2008, the Company acquired Webmetrics, Inc. (Webmetrics) for cash consideration of \$12.5 million, subject to certain purchase price adjustments and contingent cash consideration of up to \$6.0 million, and acquisition costs of approximately \$685,000. In the nine months ended September 30, 2008 and 2009, the Company recorded \$0.7 million and \$350,000, respectively, in purchase price adjustments to goodwill related to earn-out consideration in accordance with the original purchase agreement.

Late in the first quarter of 2008, NGM experienced certain changes in market conditions and customer-related events that caused NGM to revise its business forecast, triggering the requirement to perform an interim goodwill impairment test. First, the Company compared the estimated fair value of the NGM reporting unit's net assets, including assigned goodwill, to the book value of these net assets. The estimated fair value for the reporting unit was calculated using a combination of discounted cash flow projections, market values for comparable businesses and terms, prices and conditions found in sales of comparable businesses. The Company determined that the fair value of the reporting unit was less than its net book value. The Company then performed a theoretical purchase price allocation to compare the carrying value of NGM's assigned goodwill to its implied fair value and recorded an impairment charge of \$29.0 million in the first quarter of 2008. The goodwill impairment has been recorded under the caption "Impairment of Goodwill" in the unaudited consolidated statements of operations. The Company did not identify an event or occurrence that would trigger the requirement to perform an interim impairment test during the three months ended September 30, 2008, or during the three and nine months ended September 30, 2009; as a result, no interim impairment test was performed.

Intangible assets consist of the following (in thousands):

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

	December 31, 2008	September 30, 2009 (unaudited)	Weighted- Average Amortization Period (in years) (unaudited)
Intangible assets:			
Customer lists and relationships	\$ 36,659	\$ 36,659	5.6
Accumulated amortization	(24,196)	(28,157)	
Customer lists and relationships, net	12,463	8,502	
Acquired technology	17,744	17,744	3.3
Accumulated amortization	(13,633)	(15,723)	
Acquired technology, net	4,111	2,021	
Trade name	200	200	3
Accumulated amortization	(180)	(200)	
Trade name, net	20		
Intangible assets, net	\$ 16,594	\$ 10,523	

Amortization expense related to intangible assets, which is included in depreciation and amortization expense, was approximately \$3.8 million and \$1.9 million for the three months ended September 30, 2008 and 2009, respectively, and \$11.4 million and \$6.1 million for the nine months ended September 30, 2008 and 2009, respectively.

Amortization expense related to intangible assets for the years ended December 31, 2009, 2010, 2011, 2012, and 2013, is expected to be approximately \$7.8 million, \$4.7 million, \$2.4 million, \$1.5 million, and \$0.2 million, respectively.

6. NOTES PAYABLE

On February 6, 2007, the Company entered into a credit agreement, which provides for a revolving credit facility in an aggregate principal amount of up to \$100 million (Credit Facility). Borrowings under the Credit Facility bear interest, at the Company's option, at either a Eurodollar rate plus a spread ranging from 0.625% to 1.25%, or at a base rate plus a spread ranging from 0.0% to 0.25%, with the amount of the spread in each case depending on the ratio of the Company's consolidated senior funded indebtedness to consolidated earnings before interest, taxes, depreciation and amortization (EBITDA). The Credit Facility expires on February 6, 2012. Borrowings under the Credit Facility may be used for working capital, capital expenditures, general corporate purposes and to finance acquisitions. There were no borrowings outstanding under the Credit Facility as of December 31, 2008 and September 30, 2009, but available borrowings were reduced by letters of credit of \$8.8 million and \$9.1 million, respectively. The Credit Facility contains customary representations and warranties, affirmative and negative covenants, requirements to maintain certain financial ratios and events of default. As of and for the year ended December 31, 2008 and the nine months ended September 30, 2009 the Company was in compliance with these covenants.

In May 2007, the Company entered into a note payable with a vendor for \$9.7 million for the purchase of software and services. The note payable is non-interest bearing and principal payments of approximately \$810,000 are due quarterly over the three year term ending April 2010.

7. STOCKHOLDERS EQUITY

Stock-Based Compensation

The Company has three stock incentive plans: the NeuStar, Inc. 1999 Equity Incentive Plan (1999 Plan), the NeuStar, Inc. 2005 Stock Incentive Plan (2005 Plan), and the NeuStar, Inc. 2009 Stock Incentive Plan (2009 Plan).

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

The Company may grant to its directors, employees and consultants awards under these plans in the form of incentive stock options, nonqualified stock options, stock appreciation rights, shares of restricted stock, restricted stock units, PVRsUs, and other stock-based awards. The Company will not grant any additional awards under the 1999 Plan or the 2005 Plan. The aggregate number of shares of Class A common stock with respect to which all awards may be granted under the 2009 Plan is 10,950,000, plus the number of shares underlying awards granted under the 1999 Plan and the 2005 Plan that remain undelivered following any expiration, cancellation or forfeiture of such awards. As of September 30, 2009, 10,920,323 shares were available for grant or award under the 2009 Plan.

Stock-based compensation expense recognized was \$4.4 million and \$1.9 million for the three months ended September 30, 2008 and 2009, respectively, and \$13.3 million and \$10.1 million for the nine months ended September 30, 2008 and 2009, respectively. As of September 30, 2009, total unrecognized compensation expense related to non-vested stock options, non-vested restricted stock and non-vested PVRsUs granted prior to that date was estimated to be \$29.3 million, which the Company expects to recognize over a weighted average period of approximately 1.5 years. Total unrecognized compensation expense as of September 30, 2009 is estimated based on outstanding non-vested stock options, non-vested restricted stock and non-vested PVRsUs and may be increased or decreased in future periods for subsequent grants or forfeitures.

Stock Options

The Company utilizes the Black-Scholes option-pricing model for estimating the fair value of stock options granted. The weighted-average grant date fair value of options granted during the three months ended September 30, 2008 and 2009 was \$8.45 and \$8.49, respectively, and for options granted during the nine months ended September 30, 2008 and 2009 was \$8.47 and \$6.25, respectively.

The following are the weighted-average assumptions used in valuing the stock options granted during the three and nine months ended September 30, 2008 and 2009, and a discussion of the Company's assumptions:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2008	2009	2008	2009
Dividend yield	%	%	%	%
Expected volatility	37.74%	41.84%	35.86%	43.85%
Risk-free interest rate	2.96%	2.17%	2.57%	1.54%
Expected life of options (in years)	4.37	4.42	4.37	4.42

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

Expected volatility Volatility is a measure of the amount by which a financial variable such as a share price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. Given the Company's limited historical stock data since its initial public offering in June 2005, the Company considered the implied volatility and historical volatility of its stock price over a term similar to the expected life of the grant in determining its expected volatility.

Risk-free interest rate The risk-free interest rate is based on U.S. Treasury bonds issued with similar life terms to the expected life of the grant.

Expected life of the options The expected term is the period of time that options granted are expected to remain outstanding. The Company determined the expected life of stock options based on the weighted average of (a) the time-to-settlement from grant of historically settled options and (b) a hypothetical holding period for the outstanding vested options as of the date of fair value estimation. The hypothetical holding period is the amount of time the Company assumes a vested option will be held before the option is exercised. To determine the hypothetical holding period, the Company

NEUSTAR, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

assumes that a vested option will be exercised at the midpoint of the time between the date of fair value estimation and the remaining contractual life of the unexercised vested option.

The following table summarizes the Company's stock option activity for the nine months ended September 30, 2009:

	Shares	Weighted- Average Exercise Price	Aggregate Intrinsic Value (in millions)	Weighted- Average Remaining Contractual Life (in years)
Outstanding at December 31, 2008	4,660,565	\$20.15		
Options granted	1,965,619	16.57		
Options exercised	(319,112)	4.57		
Options canceled	(491,176)	26.48		
Outstanding at September 30, 2009	5,815,896	19.26	\$ 35.7	4.97
Exercisable at September 30, 2009	2,983,661	\$ 18.41	\$ 24.0	3.92

The aggregate intrinsic value of options exercised during the nine months ended September 30, 2008 and 2009 was \$30.9 million and \$3.8 million, respectively.

Restricted Stock

The following table summarizes the Company's non-vested restricted stock activity for the nine months ended September 30, 2009:

	Shares	Weighted- Average Grant Date Fair Value	Aggregate Intrinsic Value (in millions)
Outstanding at December 31, 2008	260,298	\$25.50	
Granted	105,500	19.17	
Vested	(38,453)	27.03	
Forfeited	(30,540)	27.60	
Outstanding at September 30, 2009	296,805	\$22.83	\$ 6.7

During the three and nine months ended September 30, 2009, the Company repurchased 2,677 and 11,478 shares of common stock, respectively, for an aggregate purchase price of approximately \$61,000 and \$229,000 pursuant to the participants' rights under the Company's stock incentive plans to elect to use common stock to satisfy their tax withholdings obligations.

Performance Vested Stock Units

The following table summarizes the Company's non-vested PVRSU activity for the nine months ended September 30, 2009:

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NEUSTAR, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Shares	Weighted-Average Grant Date Fair Value
Non-vested at December 31, 2008	413,143	\$28.98
Granted	524,473	15.46
Forfeited	(89,055)	23.87
Non-vested at September 30, 2009	848,561	\$21.15

During 2007 and 2008, the Company granted 322,290 and 291,083 PVRSUs, respectively, to certain employees with an aggregate fair value of \$10.5 million and \$7.6 million, respectively. During the nine months ended September 30, 2009, the Company granted 524,473 PVRSUs, respectively, to certain employees with an aggregate fair value of \$8.1 million. The vesting of these stock awards is contingent upon the Company achieving specified financial targets at the end of the specified performance period and an employee's continued employment. The level of achievement of the performance conditions affects the number of shares that will ultimately be issued. The range of possible stock-based award vesting is between 0% and 150% of the initial target. Compensation expense related to these awards is being recognized over the requisite service period based on the Company's estimate of the achievement of the performance target. The Company currently estimates that 0%, 50%, and 100% of the performance target for its PVRSUs granted during 2007, 2008 and 2009, respectively, will be achieved. In the third quarter of 2009, the Company revised its estimate of target achievement for its PVRSUs granted during 2007 from 50% to 0%. The change in the Company's estimate resulted in the reduction of approximately \$2.2 million of compensation expense in the third quarter of 2009. The Company's consolidated net income for the three and nine months ended September 30, 2009 was \$24.5 million and \$73.3 million, respectively, and diluted earnings per share was \$0.32 and \$0.97 per share, respectively. The as adjusted net income would have been approximately \$23.1 million and \$71.8 million, respectively, and the as adjusted diluted earnings per share would have had been approximately \$0.31 and \$0.95 per share, respectively, had the Company continued to estimate that 50% of the performance target for PVRSUs granted during 2007 would be achieved. The fair value of a PVRSU is measured by reference to the closing market price of the Company's common stock on the date of the grant. Compensation expense is recognized on a straight-line basis over the requisite service period based on the number of PVRSUs expected to vest.

The aggregate intrinsic value for all non-vested PVRSUs outstanding under the Company's stock plans at September 30, 2009 was \$19.2 million.

Restricted Stock Units

The following table summarizes the Company's restricted stock units activity for the nine months ended September 30, 2009:

	Shares	Weighted-Average Grant Date Fair Value	Aggregate Intrinsic Value (in millions)
Outstanding at December 31, 2008	110,599	\$ 26.21	
Granted	52,512	22.85	
Vested			
Forfeited			

Outstanding at September 30, 2009	163,111	\$ 25.13	\$ 3.7
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NEUSTAR, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

These restricted stock units issued to non-employee members of the Company's board of directors will fully vest on the first anniversary of the date of grant. Upon vesting, each director's restricted stock units will be automatically converted into deferred stock units, which will be delivered to the director in shares of the Company's stock six months following the director's termination of Board service.

8. BASIC AND DILUTED NET INCOME PER COMMON SHARE

The following table reconciles the number of shares used in the basic and diluted net income per common share calculation (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2009	2008	2009
Computation on basic net income per common share:				
Net income	\$ 28,374	\$ 24,519	\$ 46,770	\$ 73,338
Weighted average common shares and participating securities outstanding basic	73,859	74,356	74,509	74,269
Basic net income per common share	\$ 0.38	\$ 0.33	\$ 0.63	\$ 0.99
Computation on diluted net income per common share:				
Net income	\$ 28,374	\$ 24,519	\$ 46,770	\$ 73,338
Weighted average common shares and participating securities outstanding basic	73,859	74,356	74,509	74,269
Effect of dilutive securities:				
Stock-based awards	1,400	1,238	2,039	1,140
Weighted average common shares outstanding diluted	75,259	75,594	76,548	75,409
Diluted net income per common share	\$ 0.38	\$ 0.32	\$ 0.61	\$ 0.97

Diluted earnings per common share reflects the potential dilution of common stock equivalents such as options and warrants, to the extent the impact is dilutive.

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