QUINSTREET, INC
Form 10-Q
May 07, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2015

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 No. 001-34628

QuinStreet, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware **(State or Other Jurisdiction of** **Incorporation or Organization)**	**77-0512121** **(I.R.S. Employer** **Identification No.)**
950 Tower Lane, 6th Floor **Foster City, California** **(Address of principal executive offices)**	**94404** **(Zip Code)**

650-578-7700

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 x 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 x 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.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	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 x

Number of shares of common stock outstanding as of April 30, 2015: 44,556,203

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

QUINSTREET, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

(Unaudited)

	March 31, 2015	June 30, 2014
Assets		
Current assets		
Cash and cash equivalents	$ 114,100	$ 84,177
Marketable securities		38,630
Accounts receivable, net	44,961	41,979
Deferred tax assets	223	223
Prepaid expenses and other assets	11,989	11,647
Total current assets	171,273	176,656
Property and equipment, net	8,811	11,126
Goodwill	55,451	55,451
Other intangible assets, net	21,444	31,441
Deferred tax assets, noncurrent	1,710	1,712
Other assets, noncurrent	523	457
Total assets	$ 259,212	$ 276,843
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable	$ 20,823	$ 19,517
Accrued liabilities	28,948	27,854
Deferred revenue	1,356	1,175
Debt	19,713	17,698
Total current liabilities	70,840	66,244
Debt, noncurrent	44,848	59,565
Other liabilities, noncurrent	5,567	5,883
Total liabilities	121,255	131,692

Commitments and contingencies (See Note 8)		
Stockholders equity		
Common stock: $0.001 par value; 100,000,000 shares authorized; 44,550,241 and 44,025,908 shares issued and outstanding at March 31, 2015 and June 30, 2014, respectively	44	44
Additional paid-in capital	247,105	239,558
Accumulated other comprehensive loss	(815)	(1,054)
Accumulated deficit	(108,377)	(93,397)
Total stockholders equity	137,957	145,151
Total liabilities and stockholders equity	$ 259,212	$ 276,843

See notes to condensed consolidated financial statements

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QUINSTREET, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2015	**2014**	**2015**	**2014**
Net revenue	$ 75,345	$ 71,888	$ 211,228	$ 214,994
Cost of revenue [1]	65,192	61,646	188,996	181,354
Gross profit	10,153	10,242	22,232	33,640
Operating expenses: [1]				
Product development	4,653	4,859	13,853	14,794
Sales and marketing	3,881	3,881	10,905	11,696
General and administrative	4,300	4,284	12,994	12,829
Operating loss	(2,681)	(2,782)	(15,520)	(5,679)
Interest income	7	30	61	84
Interest expense	(760)	(911)	(2,726)	(2,913)
Other income (expense), net	40	(3)	3,001	(51)
Loss before income taxes	(3,394)	(3,666)	(15,184)	(8,559)
Benefit from (provision for) taxes	178	993	204	(39,082)
Net loss	$ (3,216)	$ (2,673)	$ (14,980)	$ (47,641)
Net loss per share:				
Basic	$ (0.07)	$ (0.06)	$ (0.34)	$ (1.10)
Diluted	$ (0.07)	$ (0.06)	$ (0.34)	$ (1.10)
Weighted average shares used in computing net loss per share				
Basic	44,522	43,567	44,409	43,422
Diluted	44,522	43,567	44,409	43,422

[1] Cost of revenue and operating expenses include stock-based compensation expense as follows:

Cost of revenue	$ 863	$ 595	$ 2,292	$ 2,190
Product development	542	551	1,731	1,893
Sales and marketing	600	827	1,626	2,195

General and administrative	576	477	1,733	1,833

See notes to condensed consolidated financial statements

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QUINSTREET, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

(Unaudited)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2015	**2014**	**2015**	**2014**
Net loss	$ (3,216)	$ (2,673)	$ (14,980)	$ (47,641)
Other comprehensive loss				
Unrealized (loss) gain on investments				
Change in unrealized (loss) gain on investments		(5)	13	(5)
Less: reclassification adjustment related to realized loss on investments, net of tax of $0	16		16	
Net change	16	(5)	29	(5)
Foreign currency translation adjustment	10	32	(15)	(39)
Change in unrealized (loss) gain on interest rate swap	(29)	82	225	38
Other comprehensive (loss) income	(3)	109	239	(6)
Comprehensive loss	$ (3,219)	$ (2,564)	$ (14,741)	$ (47,647)

See notes to condensed consolidated financial statements

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QUINSTREET, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended March 31, 2015	Nine Months Ended March 31, 2014
Cash Flows from Operating Activities		
Net loss	$ (14,980)	$ (47,641)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	14,778	19,955
Net realized loss from sale of marketable securities	32	
Provision for sales returns and doubtful accounts receivable	58	(424)
Write-off of bank loan upfront fees	328	
Stock-based compensation	7,382	8,111
Excess tax benefits from stock-based compensation		(394)
Gain on sale of domain names	(3,331)	
Other adjustments, net	128	150
Changes in assets and liabilities, net of effects of acquisition:		
Accounts receivable	(3,040)	(3,198)
Prepaid expenses and other assets	(734)	(3,403)
Deferred taxes	2	41,938
Accounts payable	2,128	868
Accrued liabilities	2,146	(1,831)
Deferred revenue	181	(646)
Other liabilities, noncurrent	(316)	(524)
Net cash provided by operating activities	4,762	12,961
Cash Flows from Investing Activities		
Capital expenditures	(2,629)	(4,679)
Business acquisition		(875)
Other intangibles		(2,815)
Internal software development costs	(1,428)	(1,901)
Purchases of marketable securities	(16,600)	(36,390)
Proceeds from sales and maturities of marketable securities	55,277	35,820
Proceeds from sale of domain names	3,346	
Proceeds from sale of property and equipment	10	
Net cash provided by (used in) investing activities	37,976	(10,840)
Cash Flows from Financing Activities		

Proceeds from exercise of common stock options	1,300	2,259
Principal payments on bank debt	(12,500)	(8,750)
Payment of bank loan upfront fees	(272)	
Principal payments on acquisition-related notes payable	(444)	(2,599)
Excess tax benefits from stock-based compensation		394
Withholding taxes related to restricted stock net share settlement	(910)	(1,760)
Net cash used in financing activities	(12,826)	(10,456)
Effect of exchange rate changes on cash and cash equivalents	11	(39)
Net increase (decrease) in cash and cash equivalents	29,923	(8,374)
Cash and cash equivalents at beginning of period	84,177	90,117
Cash and cash equivalents at end of period	$ 114,100	$ 81,743
Supplemental Disclosure of Cash Flow Information		
Cash paid for interest	2,415	2,923
Cash paid for taxes	772	1,304

See notes to condensed consolidated financial statements

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QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. The Company

QuinStreet, Inc. (the Company) is a leader in performance marketing online. The Company was incorporated in California in April 1999 and reincorporated in Delaware in December 2009. The Company provides customer acquisition programs for clients in various industry verticals such as financial services and education. The corporate headquarters are located in Foster City, California, with additional offices throughout the United States, Brazil and India.

2. Summary of Significant Accounting Policies

Basis of Presentation

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany balances and transactions have been eliminated in consolidation.

Unaudited Interim Financial Information

The accompanying condensed consolidated financial statements and the notes to the condensed consolidated financial statements as of March 31, 2015 and for the three and nine months ended March 31, 2015 and 2014 are unaudited. These unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) and applicable rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Accordingly, these interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2014, as filed with the SEC on September 12, 2014. The condensed consolidated balance sheet at June 30, 2014 included herein was derived from the audited financial statements as of that date, but does not include all disclosures, including notes, required by GAAP.

The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, include all adjustments (consisting only of normal recurring adjustments) necessary for the fair statement of the Company s condensed consolidated balance sheet at March 31, 2015, its condensed consolidated statements of operations for the three and nine months ended March 31, 2015 and 2014, its condensed consolidated statements of comprehensive loss for the three and nine months ended March 31, 2015 and 2014, and its condensed consolidated statements of cash flows for the nine months ended March 31, 2015 and 2014. The results of operations for the three and nine months ended March 31, 2015 are not necessarily indicative of the results to be expected for the fiscal year ending June 30, 2015, or any other future period.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the period. On an ongoing basis, management evaluates these estimates, judgments and assumptions, including those related to revenue recognition, stock-based compensation, goodwill, intangible assets, long-lived assets, contingencies, and income taxes. The Company bases these estimates on historical and anticipated results and trends and on various other assumptions that the Company believes are reasonable under the circumstances, including assumptions as to future events. These estimates form the basis for making judgments about the carrying values of assets and liabilities and recorded revenue and expenses that are not readily apparent from other sources. Actual results could differ from those estimates, and such differences could affect the results of operations reported in future periods.

QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Accounting Policies

The significant accounting policies are described in Note 2, Summary of Significant Accounting Policies, to the consolidated financial statements included in the Annual Report on Form 10-K for the fiscal year ended June 30, 2014. There have been no significant changes in the accounting policies subsequent to June 30, 2014.

Concentrations of Credit Risk

No client accounted for 10% or more of net revenue for the three or nine months ended March 31, 2015 or for the same period in fiscal year 2014. No client accounted for 10% or more of net accounts receivable as of March 31, 2015 or June 30, 2014.

Fair Value of Financial Instruments

The Company s financial instruments consist principally of cash equivalents, accounts receivable, accounts payable, an acquisition-related promissory note, an interest rate swap, and a term loan. The fair value of the Company s cash equivalents is determined based on quoted prices in active markets for identical assets for its money market funds. The recorded values of the Company s accounts receivable and accounts payable approximate their current fair values due to the relatively short-term nature of these accounts. The fair value of the acquisition-related promissory note approximates its recorded amount as the interest rates on similar financing arrangements available to the Company at March 31, 2015 approximate the interest rates implied when this acquisition-related promissory note was originally issued and recorded. The fair value of the interest rate swap is based upon fair value quotes from the issuing bank and the Company assesses the quotes for reasonableness by comparing them to the present values of expected cash flows. The present value approach is based on observable market interest rate curves that are commensurate with the terms of the interest rate swap. The carrying value represents the fair value of the swap, as adjusted for any non-performance risk associated with the Company at March 31, 2015. The Company believes that the fair value of the term loan approximates its recorded amount at March 31, 2015 as the interest rate on the term loan is variable and is based on market interest rates and after consideration of default and credit risk.

Recent Accounting Pronouncements

In July 2013, the FASB issued a new accounting standard update on the financial presentation of unrecognized tax benefits. The new guidance provides that a liability related to an unrecognized tax benefit would be presented as reduction of a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax position is disallowed. The new guidance becomes effective for fiscal years beginning after December 15, 2014 and it should be applied prospectively to unrecognized tax benefits that exist at the effective date, although retrospective application is permitted. The adoption of this standard is not expected to have a material impact on the Company s consolidated financial statements.

In May 2014, the FASB issued a new accounting standard update on revenue from contracts with clients. The new guidance provides that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new guidance becomes effective for fiscal years beginning after December 15, 2016, and interim periods within those years. In April 2015, the FASB proposed a one year deferral of the effective date. The Company is currently assessing the impact of this new guidance.

In June 2014, the FASB issued a new accounting standard update on accounting for share-based payments when the terms of an award provide that a performance target could be achieved after the requisite service period, which amends ASC 718, Compensation - Stock Compensation. The amendment provides guidance on the treatment of shared-based payment awards with a specific performance target, requiring that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. The new guidance becomes effective for fiscal years beginning after December 15, 2015, and interim periods within those years, with early adoption permitted. The adoption of this standard is not expected to have a material impact on the Company s consolidated financial statements.

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QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

In August 2014, the FASB issued new guidance related to the disclosures around going concern. The new standard provides guidance around management s responsibility to evaluate whether there is substantial doubt about an entity s ability to continue as a going concern and to provide related footnote disclosures. The new guidance becomes effective for fiscal years beginning after December 15, 2016, and interim periods within those years, with early adoption permitted. The adoption of this standard is not expected to have a material impact on the Company s consolidated financial statements.

In April 2015, the FASB issued a new accounting standard update on the presentation of debt issuance costs. The new guidance provides that debt issuance costs related to a recognized debt liability be presented as a direct reduction from its carrying value. The new guidance becomes effective for fiscal years beginning after December 15, 2015, and interim periods within those years, with early adoption permitted. The adoption of this standard is not expected to have a material impact on the Company s consolidated financial statements.

3. Net Loss Attributable to Common Stockholders and Net Loss per Share

Basic net loss per share is computed by dividing net loss by the weighted average number of shares of common stock outstanding during the period. Diluted net loss per share is computed by using the weighted-average number of shares of common stock outstanding, including potential dilutive shares of common stock assuming the dilutive effect of outstanding stock options and restricted stock units using the treasury stock method.

The following table presents the calculation of basic and diluted net loss per share:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2015	**2014**	**2015**	**2014**
	(In thousands, except per share data)		(In thousands, except per share data)	
Numerator:				
Basic and Diluted:				
Net loss	$ (3,216)	$ (2,673)	$ (14,980)	$ (47,641)
Denominator:				
Basic and Diluted:				
Weighted average shares of common stock used in computing basic and diluted net loss per share	44,522	43,567	44,409	43,422
Net loss per share:				
Basic and Diluted [1]	$ (0.07)	$ (0.06)	$ (0.34)	$ (1.10)

Securities excluded from weighted average shares used in computing diluted net loss per share because the effect would have been anti-dilutive: [2]	6,524	9,677	8,879	8,463

[1] Diluted EPS does not reflect any potential common stock relating to stock options or restricted stock units due to net loss incurred for the three and nine months ended March 31, 2015 and 2014. The assumed issuance of any additional shares would be anti-dilutive.

[2] These weighted shares relate to anti-dilutive stock options and restricted stock units as calculated using the treasury stock method and could be dilutive in the future.

QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. Fair Value Measurements and Marketable Securities

Fair value is defined as the price that would be received on sale of an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants at the measurement date. The FASB has established a fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity s own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3).

The three levels of the fair value hierarchy under the guidance for fair value measurement are described below:

Level 1	Inputs are unadjusted quoted prices in active markets for identical assets or liabilities. Pricing inputs are based upon quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. The valuations are based on quoted prices of the underlying security that are readily and regularly available in an active market, and accordingly, a significant degree of judgment is not required. As of March 31, 2015, the Company used Level 1 assumptions for its money market funds.
Level 2	Pricing inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. As of March 31, 2015, the Company used Level 2 assumptions for its acquisition-related promissory note, term loan, and interest rate swap.
Level 3	Pricing inputs are generally unobservable for the assets or liabilities and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management s judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models, and similar techniques. As of March 31, 2015, the Company did not have any Level 3 financial assets or liabilities.

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QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The Company s financial instruments as of March 31, 2015 and June 30, 2014 were categorized as follows in the fair value hierarchy (in thousands):

	Fair Value Measurements as of March 31, 2015 Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Total
Assets:			
Money market funds	$ 78,021	$	$ 78,021
Liabilities:			
Acquisition-related promissory note [(1)]	$	$ 98	$ 98
Term loan [(1)]		64,463	64,463
Interest rate swap		405	405
	$	$ 64,966	$ 64,966

	Fair Value Measurements as of June 30, 2014 Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Total
Assets:			
U.S. municipal securities	$	$ 12,816	$ 12,816
Certificates of deposit		26,293	26,293
Money market funds	38,641		38,641
	$ 38,641	$ 39,109	$ 77,750
Liabilities:			
Acquisition-related promissory notes [(1)]	$	$ 603	$ 603
Term loan [(1)]		76,660	76,660

Interest rate swap		630	630
	$	$ 77,893	$ 77,893

(1) These liabilities are carried at historical cost on the Company s condensed consolidated balance sheets.

Marketable Securities

All liquid investments with maturities of three months or less at the date of purchase are classified as cash equivalents. Investments with maturities greater than three months at the date of purchase are classified as marketable securities. The Company s marketable securities have been classified and accounted for as available-for-sale. Management determines the appropriate classification of its investments at the time of purchase and reevaluates the available-for-sale designation as of each balance sheet date. Available-for-sale securities are carried at fair value, with unrealized gains and losses, net of tax, reported as a component of accumulated other comprehensive loss within stockholders equity.

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QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The following table summarizes unrealized gains and losses related to cash equivalents and available-for-sale securities held by the Company as of March 31, 2015 and June 30, 2014 (in thousands):

	As of March 31, 2015			
	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Money market funds	$ 78,021	$	$	$ 78,021

	As of June 30, 2014			
	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. municipal securities	$ 12,812	$ 4	$	$ 12,816
Certificates of deposit	26,330		37	26,293
Money market funds	38,641			38,641
	$ 77,783	$ 4	$ 37	$ 77,750

The Company realized losses of an immaterial amount from sales of its securities in the three and nine months ended March 31, 2015. The Company did not realize any gains or losses from sales of its securities in the three and nine months ended March 31, 2014. As of March 31, 2015 and June 30, 2014, the Company did not hold securities that had maturity dates greater than one year.

5. Intangible Assets and Goodwill

Intangible assets, net balances, excluding goodwill, consisted of the following (in thousands):

	March 31, 2015			June 30, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer/publisher/advertiser relationships	$ 37,034	$ (33,250)	$ 3,784	$ 37,040	$ (31,185)	$ 5,855
Content	62,162	(53,652)	8,510	62,196	(50,348)	11,848

Website/trade/domain names	31,591	(24,111)	7,480	31,652	(21,482)	10,170
Acquired technology and others	36,742	(35,072)	1,670	36,744	(33,176)	3,568
	$ 167,529	$ (146,085)	$ 21,444	$ 167,632	$ (136,191)	$ 31,441

Amortization of intangible assets was $2.9 million and $10.0 million in the three and nine months ended March 31, 2015 and $4.9 million and $15.1 million in the three and nine months ended March 31, 2014.

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QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Future amortization expense for the Company s intangible assets as of March 31, 2015 was as follows (in thousands):

Year Ending June 30,	**Amortization**
2015 (remaining 3 months)	$ 2,704
2016	9,190
2017	6,073
2018	1,919
2019	776
Thereafter	782
	$ 21,444

The change in the carrying amount of goodwill for the nine months ended March 31, 2015 was as follows (in thousands):

	Total
Balance at June 30, 2014	$ 55,451
Additions	
Balance at March 31, 2015	$ 55,451

In the nine months ended March 31, 2015, there were no additions to goodwill as the Company did not complete any acquisitions during such period.

6. Income Taxes

The Company recorded a benefit from income taxes of $0.2 million for the three and nine months ended March 31, 2015, primarily due to the carryback of prior year tax losses. The Company recorded a valuation allowance against the majority of the Company s deferred tax assets at the end of fiscal year 2014 and continues to maintain a full valuation allowance against its deferred tax assets as of March 31, 2015.

The Company recorded a benefit from income taxes of $1.0 million for the three months ended March 31, 2014 and a provision for income taxes of $39.1 million for the nine months ended March 31, 2014 primarily due to a one-time, non-cash charge to establish a valuation allowance for a significant portion of the Company s deferred tax assets and other discrete items.

7. Debt

Credit Facility

In November 2011, the Company entered into the Second Amended and Restated Revolving Credit and Term Loan Agreement (Second Loan Agreement) with Comerica Bank (the Bank), the administrative agent and lead arranger. The Second Loan Agreement consists of a $100.0 million five-year term loan, with annual principal amortization of 5%, 10%, 15%, 20% and 50%, and a $200.0 million five-year revolving credit line.

On February 15, 2013, the Company entered into the First Amendment to Credit Agreement and Amendment to Guaranty (First Amendment) with the Bank to, among other things: (1) amend the definition of EBITDA, effective as of December 31, 2012, to exclude extraordinary or non-recurring non-cash expenses or losses including, without limitation, goodwill impairments, and any extraordinary or non-recurring cash expenses in an aggregate amount not to exceed $5.0 million for the life of the Second Loan Agreement; and (2) reduce the $200.0 million five-year revolving credit line portion of the facility to $100.0 million, effective as of February 15, 2013. On July 17, 2014, the Company entered into the Second Amendment to Credit Agreement (Second Amendment) with the Bank to, among other things, amend the financial covenants and reduce the revolving loan facility from $100.0 million to $50.0 million, each effective as of June 30, 2014.

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QUINSTREET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Borrowings under the Second Loan Agreement are secured by substantially all of the Company s assets. Interest is payable at a rate computed using either Base rate or Eurodollar rate plus an applicable margin, at the Company s option. Base rate is defined as the applicable margin plus the greatest of (a) the Prime Rate for such day, (b) the Federal Funds Effective Rate in effect on such day, plus 1% and (c) the Daily Adjusting LIBOR Rate plus 1%. Base rate borrowings bear interest at a Base rate plus an applicable margin which varies from (1) 0.625% to 1.375% for revolving loans and (2) 1.00% to 1.75% for term loans, depending on the Company s funded debt to EBITDA ratio. Eurodollar rate borrowings bear interest at the Eurodollar rate plus an applicable margin which varies from (1) 1.625% to 2.375% for revolving loans and (2) 2.00% to 2.75% for term loans, depending on the Company s funded debt to EBITDA ratio. Pursuant to the Second Amendment, for the period beginning on the effective date of the Second Amendment until the delivery of financial statements for the fiscal quarter ending December 31, 2015, (1) the applicable margin for Base rate borrowings is set at (a) 1.375% for revolving loans or (b) 1.75% for term loans, and (2) the applicable margin for Eurodollar rate borrowings is set at (a) 2.375% for revolving loans or (b) 2.75% for term loans. Thereafter, the applicable margin varies depending on the Company funded debt to EBITDA ratio, as described above.

EBITDA is defined as net (loss) income less (provision for) benefit from taxes, depreciation expense, amortization expense, stock-based compensation expense, interest and other income (expense), acquisition costs for business combinations, extraordinary or non-recurring non-cash expenses or losses including, without limitation, goodwill impairments, and any extraordinary or non-recurring cash expenses in an aggregate amount not to exceed $5.0 million for the life of this Second Loan Agreement. The revolving loan facility requires an annual facility fee of 0.375% of the revolving credit line capacity.

The Second Loan Agreement expires in November 2016. The Second Loan Agreement, as amended, restricts the Company s ability to raise additional debt financing and pay dividends, and also requires the Company to comply with other nonfinancial covenants. In addition, the Company is required to maintain financial covenants as follows:

1. A minimum fixed charge coverage ratio as of the end of each fiscal quarter of not less than:

(a) 1.00:1:00 for the period between September 30, 2015 and June 30, 2016; and

(b) 1.15:1:00 for the period beginning July 1, 2016 and thereafter.

The fixed charge coverage ratio is not tested until the fiscal quarter ending September 30, 2015.

2. Minimum EBITDA as of the end of each fiscal quarter of not less than:

(a) $1 for the period between April 1, 2014 and June 30, 2015;

(b) $3,400,000 for the period between July 1, 2015 and September 30, 2015;

(c) $3,200,000 for the period between October 1, 2015 and December 31, 2015.

EBITDA is not tested after the fiscal quarter ending December 31, 2015.

3. Minimum liquidity as of the end of each month of not less than $20,000,000.

The Company was in compliance with the covenants of the Second Loan Agreement, as amended, as of March 31, 2015 and June 30, 2014.

Upfront arrangement fees incurred in connection with the Second Amendment totaled $0.3 million and were deferred and are being amortized over the remaining term of the arrangement. In connection with the reduction of the revolving credit line capacity, the Company accelerated amortization of approximately $0.3 million of unamortized deferred upfront costs.

As of March 31, 2015 and June 30, 2014, $65.0 million and $77.5 million were outstanding under the term loan. There were no outstanding balances under the revolving credit line as of March 31, 2015 or June 30, 2014.

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(Unaudited)

Interest Rate Swap

In February 2012, the Company entered into an interest rate swap to reduce its exposure to the financial impact of changing interest rates under its term loan. The Company does not speculate using derivative instruments. The Company entered into this derivative instrument arrangement solely for the purpose of risk management. The swap encompasses the principal balances outstanding as of January 1, 2014 and scheduled to be outstanding thereafter, such principal and notional amount totaling $85.0 million in January 2014 and amortizing to $35.0 million in November 2016. The effective date of the swap was April 9, 2012 with a maturity date of November 4, 2016. At March 31, 2015, the Company had approximately $65.0 million of notional amount outstanding in the swap agreement that exchanges a variable interest rate base (Eurodollar rate) for a fixed interest rate of 0.97% over the term of the agreement. This interest rate swap is designated as a cash flow hedge of the interest rate risk attributable to forecasted variable interest payments. The effective portion of the fair value gains or losses on this swap are included as a component of accumulated other comprehensive loss. Any hedge ineffectiveness will be immediately recognized in earnings in the current period.

At March 31, 2015, the fair value of the interest rate swap net liability was $0.4 million and the hedge effective portion of the interest rate swap was $0.4 million.

Promissory Notes

During the three and nine months ended March 31, 2015 and 2014, the Company did not issue any promissory notes for the acquisition of businesses. The outstanding amount under the promissory notes at March 31, 2015 and June 30, 2014 was $0.1 million and $0.6 million.

Debt Maturities

The maturities of the Company s debt as of March 31, 2015 were as follows (in thousands):

Year Ending June 30,	**Promissory Notes**	**Second Loan Agreement**
2015 (remaining three months)	$ 50	$ 5,000
2016	50	20,000
2017		40,000
	100	65,000
Less: imputed interest and unamortized discounts	(2)	(537)
Less: current portion	(50)	(19,663)

Noncurrent portion of debt	$	48	$	44,800

Letters of Credit

The Company has a $0.4 million letter of credit agreement with a financial institution that is used as collateral for fidelity bonds placed with an insurance company and a $0.5 million letter of credit agreement with a financial institution that is used as collateral for the Company s corporate headquarters operating lease. The letters of credit automatically renew annually without amendment unless cancelled by the financial institutions within 30 days of the annual expiration date.

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8. Commitments and Contingencies

Leases

The Company leases office space and equipment under non-cancelable operating leases with various expiration dates through 2020. Rent expense for the three and nine months ended March 31, 2015 was $0.9 million and $2.7 million and for the three and nine months ended March 31, 2014 was $0.8 million and $2.7 million. The Company recognizes rent expense on a straight-line basis over the lease period and accrues for rent expense incurred but not paid.

Future annual minimum lease payments under noncancelable operating leases as of March 31, 2015 were as follows (in thousands):

Year Ending June 30,	Operating Leases
2015 (remaining three months)	$ 926
2016	3,683
2017	3,323
2018	3,245
2019	1,303
2020 and thereafter	57
	$ 12,537

Guarantor Arrangements

The Company has agreements whereby it indemnifies its officers and directors for certain events or occurrences while the officer or director is, or was, serving at the Company s request in such capacity. The term of the indemnification period is for the officer or director s lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, the Company has a director and officer insurance policy that limits its exposure and enables the Company to recover a portion of any future amounts under certain circumstances and subject to deductibles and exclusions. As a result of its insurance policy coverage, the Company believes the estimated fair value of these indemnification agreements is not material. Accordingly, the Company had no liabilities recorded for these agreements as of March 31, 2015 and June 30, 2014.

In the ordinary course of its business, the Company from time to time enters into standard indemnification provisions in its agreements with its clients. Pursuant to these provisions, the Company may be obligated to indemnify its clients for certain losses suffered or incurred, including losses arising from violations of applicable law by the Company or by its third-party website publishers, losses arising from actions or omissions of the Company or its third-party publishers, and for third-party claims that a Company product infringed upon any United States patent, copyright or other intellectual property rights. Where practicable, the Company limits its liabilities under such indemnities.

The potential amount of future payments to defend lawsuits or settle indemnified claims under these indemnification provisions is generally limited and the Company believes the estimated fair value of these indemnity provisions is not material, and accordingly, the Company had no liabilities recorded for these agreements as of March 31, 2015 and June 30, 2014.

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Litigation

In December 2012, Internet Patents Corporation (IPC) filed a patent infringement lawsuit against the Company in the United States District Court for the Northern District of California, alleging that the Company has infringed a patent held by IPC. In September 2013, the court dismissed a related case because it found that the patent is invalid, and on the same date, the court issued IPC an Order to Show Cause that the lawsuit against the Company should not be dismissed. In October 2013, IPC filed a response to the order and the court subsequently dismissed the case against the Company. In October 2013, IPC filed its appeal in the United States Court of Appeals for the Federal Circuit. The United States Court of Appeals for Federal Circuit heard oral arguments on the appeal on August 6, 2014, and the Company is awaiting a decision. While the Company denies IPC s claims and believes that the probability of any loss is remote, there can be no assurance that the Company will prevail in this matter and any adverse ruling or settlement may have a significant impact on its business and operating results. In addition, regardless of the outcome of the matter, the Company may incur significant legal fees defending the action until it is resolved.

9. Stock Benefit Plans

Stock Incentive Plans

The Company may grant incentive stock options (ISOs), nonstatutory stock options (NQSOs), restricted stock, restricted stock units, stock appreciation rights, performance-based stock awards, and other forms of equity compensation, as well as performance cash awards, under its 2010 Equity Incentive Plan (the 2010 Incentive Plan) as well as NQSOs and restricted stock units to non-employee directors under the 2010 Non-Employee Directors Stock Award Plan (the Directors Plan). To date, the Company has issued only ISOs, NQSOs, restricted stock units and performance-based stock awards under the plans.

As of March 31, 2015, 11,411,822 shares were reserved and 8,391,628 shares were available for issuance under the 2010 Incentive Plan; 2,047,770 shares were reserved and 1,641,643 shares were available for issuance under the Directors Plan.

Stock-Based Compensation

The Company estimates the fair value of stock options at the date of grant using the Black-Scholes option-pricing model. Options are granted with an exercise price equal to the fair value of the common stock at the date of grant. The weighted average Black-Scholes model assumptions and the weighted average grant date fair value of employee stock options for the three and nine months ended March 31, 2015 and 2014 were as follows:

	Three Months Ended March 31,	Nine Months Ended March 31,

	2015	2014	2015	2014
Expected term (in years)	4.6	4.6	4.6	4.6
Expected volatility	47%	46%	46%	48%
Expected dividend yield	0.0%	0.0%	0.0%	0.0%
Risk-free interest rate	1.4%	1.6%	1.6%	1.4%
Grant date fair value	$ 2.32	$ 3.23	$ 1.79	$ 3.85

The fair value of restricted stock units is determined based on the closing price of the Company s common stock on the grant date. Compensation expense is amortized net of estimated forfeitures on a straight-line basis over the requisite service period of the stock-based compensation awards.

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10. Segment Information

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The Company s chief operating decision maker is its chief executive officer. The Company s chief executive officer reviews financial information presented on a consolidated basis, accompanied by information about operating segments, including net sales and operating income before depreciation, amortization and stock-based compensation expense.

The Company determined its reportable operating segment is DMS, which derives revenue from fees earned through the delivery of qualified leads, inquiries, clicks, calls, applications, customers and, to a lesser extent, display advertisements, or impressions. The remaining segment does not meet the quantitative threshold for an individually reportable segment and is therefore included in the All other line in the following table.

The Company evaluates the performance of its operating segments based on operating income before depreciation, amortization and stock-based compensation expense.

The Company does not allocate most of its assets, nor its depreciation and amortization expense, stock-based compensation expense, interest income, interest expense, other income or income tax expense by segment. Accordingly, the Company does not report such information.

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(Unaudited)

Summarized information by segment was as follows (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2015	**2014**	**2015**	**2014**
Net revenue by segment:				
DMS	$ 75,109	$ 71,641	$ 210,453	$ 214,178
All Other	236	247	775	816
Total net revenue	75,345	71,888	211,228	214,994
Segment operating income before depreciation, amortization, and stock-based compensation expense:				
DMS	4,131	6,169	6,159	21,898
All Other	139	110	481	489
Total segment operating income before depreciation, amortization, and stock-based compensation expense:	4,270	6,279	6,640	22,387
Depreciation and amortization	(4,370)	(6,611)	(14,778)	(19,955)
Stock-based compensation expense	(2,581)	(2,450)	(7,382)	(8,111)
Total operating loss	$ (2,681)	$ (2,782)	$ (15,520)	$ (5,679)

The following tables set forth net revenue and long-lived assets by geographic area (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2015	**2014**	**2015**	**2014**
Net revenue:				
United States	$ 73,575	$ 70,989	$ 207,042	$ 212,929
International	1,770	899	4,186	2,065
Total net revenue	$ 75,345	$ 71,888	$ 211,228	$ 214,994

	March 31, 2015	June 30, 2014
Property and equipment, net:		
United States	$ 8,588	$ 10,878
International	223	248
Total property and equipment, net:	$ 8,811	$ 11,126

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the fiscal year ended June 30, 2014, filed with the Securities and Exchange Commission (SEC).

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they do not materialize or if they prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are often identified by the use of words such as, but not limited to, anticipate, believe, can, continue, could, estimate, expect, intend, may, will, plan, project, seek, should, target, will, would, and similar expressions or variations intended to identify forward-looking statements. These statements reflect the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified in Part II Item 1A. Risk Factors below, and those discussed in the sections titled Special Note Regarding Forward-Looking Statements and Risk Factors included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2014, filed with the SEC. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Management Overview

QuinStreet is a leader in performance marketing online. We have built a strong set of capabilities to engage Internet visitors in targeted media and to connect our marketing clients with their potential customers online. We focus on serving clients in large, information-intensive industry verticals where relevant, targeted media and offerings help visitors make informed choices, find the products that match their needs, and thus become qualified customer prospects for our clients.

We deliver cost-effective marketing results to our clients most typically in the form of a qualified lead, inquiry, click, call, application, or customer. Leads, inquiries, clicks, calls, and applications can convert into a customer or sale for clients at a rate that results in an acceptable marketing cost to them. We are typically paid by clients when we deliver qualified leads, inquiries, clicks, calls, applications, or customers as defined by our agreements with them. References to the delivery of customers means a sale or completed customer transaction (e.g., bound insurance policies or customer appointments with clients). Because we bear the costs of media, our programs must deliver value to our clients and provide for a media yield, or generation of an acceptable margin on our media costs, that provides a sound financial outcome for us. To deliver leads, inquiries, clicks, calls, applications, and customers to our clients, generally we:

own or access targeted media through business arrangements or by purchasing media (e.g., clicks from major search engines);

run advertisements or other forms of marketing messages and programs in that media to create visitor responses in the form most typically of leads or inquiries (contact information and intent or requests), clicks (to further qualification or matching steps, or to online client applications or offerings) or calls (to our owned and operated call centers or that of our clients or their agents), applications (e.g., for enrollment or a financial product), or customers (e.g., bound insurance policies);

match these leads, inquiries, clicks, calls, applications, or customers to client offerings or brands that we believe can meet visitor interests or needs and client targets and requirements; and

optimize client matches and media yield such that we achieve desired results for clients and a sound financial outcome for us.

Our primary financial objective has been and remains creating revenue growth from sustainable sources, at target levels of profitability. Our primary financial objective is not to maximize profits, but rather to achieve target levels of profitability while investing in various growth initiatives, as we continue to believe we are in the early stages of a large, long-term market opportunity.

Our Direct Marketing Services (DMS) business accounted for the majority of our net revenue in the three and nine months ended March 31, 2015 and 2014. Our DMS business derives net revenue from fees earned through the delivery of qualified leads, inquiries, clicks, calls, applications, or customers and, to a lesser extent, display advertisements, or impressions. Through a vertical focus, targeted media presence and our technology platform, we are able to deliver targeted, measurable marketing results to our clients.

Our two largest client verticals within our DMS business are financial services and education. Our financial services client vertical represented 41% and 43% of net revenue in the three and nine months ended March 31, 2015 and 40% and 39% of net revenue in the three and nine months ended March 31, 2014. Our education client vertical represented 41% and 37% of net revenue in the three and nine months ended March 31, 2015 and 43% and 44% of net revenue in the three and nine months ended March 31, 2014. Other DMS client verticals, consisting primarily of business-to-business technology, home services and medical, represented 18% and 20% of net revenue in the three and nine months ended March 31, 2015 and 17% of net revenue in both the three and nine months ended March 31, 2014.

We generated the majority of our revenue from sales to clients in the United States.

No client accounted for 10% or more of our net revenue in the three and nine months ended March 31, 2015 or 2014.

Trends Affecting our Business

Client Verticals

To date, we have generated the majority of our revenue from clients in our financial services and education client verticals. We expect that a majority of our revenue for the remainder of fiscal year 2015 will continue to be generated from clients in these two client verticals.

Our financial services client vertical has been affected by a number of factors, including the limited availability of high quality media at acceptable margins caused by changes in search engine algorithms, acquisition of media sources by competitors and increased competition for quality media. These effects may continue to impact our business in the near future. To offset this impact, we have broadened our product set with enhanced click, lead, call and policy products where we expect better monetization to provide greater access to high quality media sources.

Our education client vertical has been significantly affected by regulations and enforcement activity affecting for-profit educational institutions over the past several years. For example, the Department of Education initiated an investigation of a publicly traded for-profit education client with respect to its enrollment activities and job placement, among other things, and in July 2014, the Department of Education signed an agreement with the client requiring it to wind down or sell its campuses. In addition, in October 2014, the Department of Education announced final regulations on gainful employment which go into effect on July 1, 2015. The regulation requires career college programs to prepare students for gainful employment in a recognized occupation which requires the programs graduates annual loan payments to be less than a defined percentage of earnings. Programs that do not pass the test could lose access to federal financial aid, which typically constitutes an important source of funding for these programs. As a result, such programs may be modified, curtailed or eliminated. Similar regulatory and enforcement activities have affected and are expected to continue to affect our clients businesses and marketing practices, which may result in a decrease in these clients spending with us, and fluctuations in the volume and mix of our business with these clients. To offset the impact these activities have had on the for-profit education clients, we have broadened our product set from our traditional lead business with the addition of better qualified and matched leads or inquiries, clicks and calls to our product mix; we believe these new products better match for-profit education client needs in the new regulatory environment. We are also broadening our markets in education to include not-for-profit schools and international expansions into Brazil and India.

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Development and Acquisition of Targeted Media

One of the primary challenges of our business is finding or creating media that is high quality and targeted enough to attract prospects for our clients at costs that provide a sound financial outcome for us. In order to grow our business, we must be able to find, develop or retain quality targeted media on a cost-effective basis. Consolidation of media sources, changes in search engine algorithms and increased competition for available media has, during some periods, limited and may continue to limit our ability to generate revenue at acceptable margins.

Seasonality

Our results are subject to significant fluctuation as a result of seasonality. In particular, our quarters ending December 31 (our second fiscal quarter) are typically characterized by seasonal weakness. In our second fiscal quarters, there is lower availability of lead supply from some forms of media during the holiday period on a cost effective basis and some of our clients have lower budgets. In our quarters ending March 31 (our third fiscal quarter), this trend generally reverses with better lead availability and often new budgets at the beginning of the year for our clients with fiscal years ending December 31.

Regulations

Our revenue has fluctuated as a result of recently adopted or amended regulations and the increased enforcement of existing regulations. Our business is affected directly because we operate websites and conduct telemarketing and email marketing, and indirectly as our clients adjust their operations as a result of regulatory changes that affect their industries.

One example of a regulatory change that may affect our business is the Telephone Consumer Protection Act (the TCPA), which the Federal Communications Commission recently amended to, among other things, impose heightened consent and opt-out requirements that companies conducting telemarketing must follow. Certain provisions of the regulations became effective in July 2012, and additional regulations requiring prior express written consent for telemarketing calls to wireless numbers became effective in October 2013. Our efforts to comply with the TCPA have thus far had a relatively small negative effect on traffic conversion rates. However, our clients may make business decisions based on their own experiences with the TCPA regardless of our products, and the changes we implemented to comply with the new regulations. Those decisions may negatively affect our revenue or profitability.

In addition, our education client vertical has been significantly affected by the adoption of regulations affecting for-profit educational institutions over the past several years, and a higher level of governmental scrutiny is expected to continue. Clients in our financial services vertical have increasingly been affected by laws and regulations as a result of the adoption of new regulations under The Dodd Frank Wall Street Reform and Consumer Protection Act and the increased enforcement of new and pre-existing laws and regulations. The effect of these regulations, or any future regulations, may continue to result in fluctuations in the volume and mix of our business with these clients.

Basis of Presentation

General

We operate in one reportable segment, DMS. The remainder of our business, which has historically been immaterial, is classified as All other . See Note 10, Segment Information, to our condensed consolidated financial statements for further discussion and financial information regarding our reporting segment.

Net Revenue

Our DMS business generates revenue from fees earned through the delivery of qualified leads, inquiries, clicks, calls, applications, customers and, to a lesser extent, display advertisements, or impressions. We deliver targeted and measurable results through a vertical focus that we classify into the following client verticals: financial services, education and other (which includes business-to-business technology, home services and medical).

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Cost of Revenue

Cost of revenue consists primarily of media costs, personnel costs, amortization of intangible assets, depreciation expense, and amortization of internal software development costs relating to revenue-producing technologies. Media costs consist primarily of fees paid to website publishers that are directly related to a revenue-generating event and pay-per-click, or PPC, ad purchases from Internet search companies. We pay these website publishers and Internet search companies on a revenue-share, a cost-per-lead, or CPL, cost-per-click, or CPC, and cost-per-thousand-impressions, or CPM, basis. Personnel costs include salaries, stock-based compensation expense, bonuses, and employee benefit costs. Personnel costs are primarily related to individuals associated with maintaining our servers and websites, our call center operations, our editorial staff, client management, creative team, content, compliance group, and media purchasing analysts. Costs associated with software incurred in the development phase or obtained for internal use are capitalized and amortized in cost of revenue over the software s estimated useful life.

Operating Expenses

We classify our operating expenses into three categories: product development, sales and marketing and general and administrative. Our operating expenses consist primarily of personnel costs and, to a lesser extent, professional services fees, rent and other costs. Personnel costs for each category of operating expenses generally include salaries, stock-based compensation expense, bonuses, commissions, and employee benefit costs.

Product Development. Product development expenses consist primarily of personnel costs and professional services fees associated with the development and maintenance of our technology platforms, development and launching of our websites, product-based quality assurance and testing. In the current period of business challenges, we are constraining expenses generally to the extent practicable. However, we expect product and development expenses to increase in absolute dollars in the future as we believe that continuous investment in technology is critical to attaining our strategic objectives.

Sales and Marketing. Sales and marketing expenses consist primarily of personnel costs, advertising, professional services fees, and travel costs. We expect sales and marketing expenses to continue to increase in absolute dollars as we increase advertising spend and hire additional personnel in sales and marketing to support our offerings.

General and Administrative. General and administrative expenses consist primarily of personnel costs of our executive, finance, legal, employee benefits and compliance, technical support and other administrative personnel, as well as accounting and legal professional services fees, and insurance. In the current period of business challenges, we are constraining expenses generally to the extent practicable. However, we expect general and administrative expenses to increase in absolute dollars in future periods as we continue to invest in corporate infrastructure.

Interest and Other Income (Expense), Net

Interest and other income (expense), net, consists primarily of interest income, interest expense, and other income and expense. Interest income represents interest earned on our cash, cash equivalents and marketable securities, which may increase or decrease depending on market interest rates and the amounts invested. Interest expense is related to our credit facility, interest rate swap, promissory note issued in connection with our acquisition, and imputed interest on non-interest bearing notes. Borrowings under our credit facility, the aggregate principal amount of outstanding promissory note and related interest expense could increase if, among other things, we make additional acquisitions through debt financing. Other income and expense includes gains and losses on foreign currency exchange, gains and losses on sales of non-strategic websites and domain names, and other non-operating items.

Benefit from (Provision for) Income Taxes

We are subject to tax in the United States as well as other tax jurisdictions or countries in which we conduct business. Earnings from our limited non-U.S. activities are subject to local country income tax and may be subject to U.S. income tax.

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Critical Accounting Policies, Estimates and Judgments

In presenting our consolidated financial statements in conformity with U.S. generally accepted accounting principles, or GAAP, we are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses, and related disclosures.

Some of the estimates and assumptions we are required to make relate to matters that are inherently uncertain as they pertain to future events. We base these estimates and assumptions on historical experience or on various other factors that we believe to be reasonable and appropriate under the circumstances. On an ongoing basis, we reconsider and evaluate our estimates and assumptions. Actual results may differ significantly from these estimates.

We believe that the critical accounting policies listed below involve our more significant judgments, assumptions and estimates and, therefore, could have the greatest potential impact on our consolidated financial statements.

- Revenue recognition;
- Valuation of goodwill and intangible assets;
- Stock-based compensation;
- Income taxes; and
- Valuation of long-lived assets.

There have been no material changes to our critical accounting policies, estimates and judgments disclosed in our Annual Report on Form 10-K subsequent to June 30, 2014. For further information on our critical and other significant accounting policies and estimates, see Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K for the year ended June 30, 2014, filed with the SEC.

Recently Issued Accounting Standards

See Note 2, Summary of Significant Accounting Policies, to our condensed consolidated financial statements.

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Results of Operations

The following table sets forth our condensed consolidated statement of operations for the periods indicated:

	Three Months Ended March 31, 2015		2014		Nine Months Ended March 31, 2015		2014	
	(In thousands)				(In thousands)			
Net revenue	$ 75,345	100.0%	$ 71,888	100.0%	$ 211,228	100.0%	$ 214,994	100.0%
Cost of revenue (1)	65,192	86.5	61,646	85.8	188,996	89.5	181,354	84.4
Gross profit	10,153	13.5	10,242	14.2	22,232	10.5	33,640	15.6
Operating expenses: (1)								
Product development	4,653	6.2	4,859	6.8	13,853	6.5	14,794	6.9
Sales and marketing	3,881	5.2	3,881	5.4	10,905	5.1	11,696	5.4
General and administrative	4,300	5.7	4,284	6.0	12,994	6.2	12,829	6.0
Operating loss	(2,681)	(3.6)	(2,782)	(4.0)	(15,520)	(7.3)	(5,679)	(2.7)
Interest income	7		30		61		84	
Interest expense	(760)	(1.0)	(911)	(1.3)	(2,726)	(1.3)	(2,913)	(1.4)
Other income (expense), net	40	0.1	(3)		3,001	1.4	(51)	
Loss before income taxes	(3,394)	(4.5)	(3,666)	(5.3)	(15,184)	(7.2)	(8,559)	(4.1)
Benefit from (provision for) taxes	178	0.2	993	1.4	204	0.1	(39,082)	(18.2)
Net loss	$ (3,216)	(4.3)%	$ (2,673)	(3.9)%	$ (14,980)	(7.1)%	$ (47,641)	(22.3)%

(1) Cost of revenue and operating expenses include stock-based compensation expense as follows:

Cost of revenue	$ 863	1.1%	$ 595	0.8%	$ 2,292	1.1%	$ 2,190	1.0%
Product development	542	0.7	551	0.8	1,731	0.8	1,893	0.9
	600	0.8	827	1.2	1,626	0.8	2,195	1.0

Sales and marketing								
General and administrative	576	0.8	477	0.7	1,733	0.8	1,833	0.9

Net Revenue

	Three Months Ended March 31,		Nine Months Ended March 31,		Three Months	Nine Months
	2015	2014	2015	2014	% Change	% Change
	(in thousands)					
Net revenue	$ 75,345	$ 71,888	$ 211,228	$ 214,994	5%	(2%)
Cost of revenue	65,192	61,646	188,996	181,354	6%	4%
Gross profit	$ 10,153	$ 10,242	$ 22,232	$ 33,640	(1%)	(34%)

Net revenue increased $3.5 million, or 5%, for the three months ended March 31, 2015, compared to the three months ended March 31, 2014. Our financial services client vertical revenue increased $1.9 million, or 7%, for the three months ended March 31, 2015, compared to the three months ended March 31, 2014, primarily due to our enhanced click, lead, call and policy products which enabled us to access higher quality media for our clients and has led to increased client budgets. Our education client vertical revenue was flat for the three months ended March 31, 2015, compared to the three months ended March 31, 2014. This included a one-time benefit from the collection of $1.6 million of previously deferred revenue related to a large for-profit education client. Our other client verticals revenue increased $1.6 million or 13%, for the three months ended March 31, 2015, compared to the three months ended March 31, 2014, primarily due to increased client demand in our business to business technology and home services client verticals.

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Net revenue decreased $3.8 million, or 2%, for the nine months ended March 31, 2015, compared to the nine months ended March 31, 2014. Our financial services client vertical revenue increased $5.9 million, or 7%, for the nine months ended March 31, 2015, compared to the nine months ended March 31, 2014, primarily due to our enhanced click, lead, call and policy products which enabled us to access higher quality media for our clients and has led to increased client budgets. Our education client vertical revenue decreased $14.4 million, or 15%, for the nine months ended March 31, 2015, compared to the nine months ended March 31, 2014, as a result of our education clients lower budgets, largely due to uncertainty surrounding regulations affecting for-profit educational institutions and their operational adjustment to those regulatory changes. Our other client verticals revenue increased $4.7 million, or 13%, for the nine months ended March 31, 2015, compared to the nine months ended March 31, 2014, primarily due to increased client demand in our business-to-business technology and home services client verticals and partially offset by decreased client demand in our medical client vertical.

Cost of Revenue and Gross Margin

Cost of revenue increased $3.5 million, or 6%, for the three months ended March 31, 2015, compared to the three months ended March 31, 2014, driven by increased media costs of $4.2 million, increased personnel costs of $0.8 million, offset by decreased amortization of intangible assets of $2.1 million. The increased media costs were attributable to increased costs for high quality media. The decreased amortization of intangible assets were attributable to assets from historical acquisitions becoming fully amortized and a reduced number of acquisitions in recent periods. Gross margin, which is the difference between net revenue and cost of revenue as a percentage of net revenue, was 13% for the three months ended March 31, 2015 and 14% for the three months ended March 31, 2014. The decrease in gross margin was attributable to increased media costs associated with our investments in optimizing high quality media in our financial services client vertical, offset by decreased amortization of intangible assets and a one-time net benefit from the collection of previously deferred revenue.

Cost of revenue increased $7.6 million, or 4%, for the nine months ended March 31, 2015, compared to the nine months ended March 31, 2014, driven by increased media costs of $7.2 million, increased personnel costs of $3.4 million and increased other expenses of $2.0 million, offset by decreased amortization of intangible assets of $5.2 million. The increased media costs were attributable to increased costs for high quality media. The increased personnel costs were attributable to an increase in average headcount. The decreased amortization of intangible assets were attributable to assets from historical acquisitions becoming fully amortized and a reduced number of acquisitions in recent periods. Gross margin was 11% for the nine months ended March 31, 2015 and 16% for the nine months ended March 31, 2014. The decrease in gross margin was attributable to increased media costs associated with our investments in optimizing high quality media in our financial services client vertical and a lower mix of traffic from owned and operated websites which have higher margins than traffic generated for third party publishers.

Operating Expenses

	Three Months Ended March 31,		Nine Months Ended March 31,		Three Months	Nine Months
	2015	2014	2015	2014	% Change	% Change
	(in thousands)					
Product development	$ 4,653	$ 4,859	$ 13,853	$ 14,794	(4%)	(6%)
Sales and marketing	3,881	3,881	10,905	11,696	0%	(7%)
General and administrative	4,300	4,284	12,994	12,829	0%	1%

Operating expenses	$ 12,834	$ 13,024	$ 37,752	$ 39,319	(1%)	(4%)

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Product Development Expenses

Product development expenses decreased $0.2 million, or 4%, for the three months ended March 31, 2015, compared to the three months ended March 31, 2014. This was primarily due to decreased personnel costs of $0.1 million.

Product development expenses decreased $0.9 million, or 6%, for the nine months ended March 31, 2015, compared to the nine months ended March 31, 2014. This was primarily due to decreased personnel costs of $0.4 million and decreased stock-based compensation of $0.2 million.

Sales and Marketing Expenses

Sales and marketing expenses were flat for the three months ended March 31, 2015, compared to the three months ended March 31, 2014. This was primarily due to increased marketing media services of $0.2 million, offset by decreased stock-based compensation of $0.2 million.

Sales and marketing expenses decreased $0.8 million, or 7%, for the nine months ended March 31, 2015, compared to the nine months ended March 31, 2014. This was primarily due to decreased stock-based compensation of $0.6 million and decreased personnel costs of $0.4 million.

General and Administrative Expenses

General and administrative expenses were flat for the three months ended March 31, 2015, compared to the three months ended March 31, 2014. This was primarily due to increased personnel costs of $0.2 million, offset by decreased professional services of $0.1 million.

General and administrative expenses increased $0.2 million, or 1%, for the nine months ended March 31, 2015, compared to the nine months ended March 31, 2014. This was primarily due to increased personnel costs of $0.3 million and increased professional services of $0.3 million, offset by decreased business tax assessment of $0.3 million.

Interest and Other Income (Expense), Net

	Three Months Ended March 31,		Nine Months Ended March 31,		Three Months	Nine Months
	2015	2014	2015	2014	% Change	% Change
	(in thousands)					
Interest income	$ 7	$ 30	$ 61	$ 84	(77%)	(27%)
Interest expense	(760)	(911)	(2,726)	(2,913)	(17%)	(6%)
Other income (expense), net	40	(3)	3,001	(51)	1433%	(5984%)
Interest and other income (expense), net	$ (713)	$ (884)	$ 336	$ (2,880)	19%	(112%)

Interest and other expense, net decreased $0.2 million, or 19% for the three months ended March 31, 2015 compared to the three months ended March 31, 2014. This was primarily due lower interest expense due to decreased debt obligations.

Interest and other income, net was $0.3 million for the nine months ended March 31, 2015, compared to interest and other expense, net of $2.9 million for the nine months ended March 31, 2014. This additional income of $3.2 million, or 112%, was due to the sale of non-strategic domain names for a gain of $3.3 million and lower interest expense due to decreased debt obligations, partially offset by the accelerated amortization of $0.3 million of unamortized deferred upfront costs incurred in connection with the Second Amendment to Credit Agreement.

Benefit from (Provision for) Taxes

	Three Months Ended March 31,		Nine Months Ended March 31,		Three Months % Change	Nine Months % Change
	2015	2014	2015	2014		
	(in thousands)					
Benefit from (provision for) taxes	$ 178	$ 993	$ 204	$ (39,082)	(82%)	(101%)

We recorded a benefit from income taxes of $0.2 million for the three and nine months ended March 31, 2015, primarily due to the carryback of prior year tax losses. We recorded a valuation allowance against the majority of our deferred tax assets at the end of fiscal year 2014 and continues to maintain a full valuation allowance against our deferred tax assets as of March 31, 2015. Our annual statutory tax rate was 35%. Due to the effects of our deferred tax asset valuation allowance and our net operating loss, our annual effective tax rate is not meaningful as our income tax amounts are not directly correlated to the amount of loss before income tax for the period.

We recorded a benefit from income taxes of $1.0 million for the three months ended March 31, 2014 and a provision for income taxes of $39.1 million for the nine months ended March 31, 2014 primarily due to a one-time, non-cash charge to establish a valuation allowance for a significant portion of the Company s deferred tax assets and other discrete items.

Liquidity and Capital Resources

As of March 31, 2015, our principal sources of liquidity consisted of cash and cash equivalents of $114.1 million, cash we expect to generate from operations, and our $50.0 million revolving credit line, which is committed until November 2016, a portion of which is available to be drawn subject to compliance with applicable covenants. Our cash and cash equivalents are maintained in highly liquid investments with remaining maturities of 90 days or less at the time of purchase. We believe our cash equivalents are liquid and accessible.

Our short-term and long-term liquidity requirements primarily arise from our working capital requirements, debt service on our $65.0 million term loan balance at March 31, 2015, and acquisitions from time to time. Our primary operating cash requirements include the payment of media costs, personnel costs, costs of information technology systems, and office facilities. Our ability to fund these requirements will depend on our future cash flows, which are determined, in part, by future operating performance and are, therefore, subject to prevailing global macroeconomic conditions and financial, business and other factors, some of which are beyond our control, and also our ability to access our credit facility. Even though we may not need additional funds to fund anticipated liquidity requirements, we may still elect to obtain additional debt