

NEUSTAR INC
Form 10-K
March 01, 2007

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

Form 10-K

**b ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934
for the fiscal year ended December 31, 2006**

OR

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

Commission File No. 001-32548

NeuStar, Inc.

(Exact name of registrant as specified in its charter)

Delaware

*(State or other jurisdiction of
incorporation or organization)*

46000 Center Oak Plaza

Sterling, Virginia

(Address of principal executive offices)

52-2141938

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

20166

(Zip Code)

(571) 434-5400

(Registrant's telephone number, including area code)

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

Title of Each Class	Name of Each Exchange on Which Registered
Class A Common Stock	New York Stock Exchange

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

None

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer .

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

On February 15, 2007, 74,446,428 shares of NeuStar Class A common stock were outstanding and 17,164 shares of NeuStar Class B common stock were outstanding. The aggregate market value of the NeuStar common equity held by non-affiliates as of June 30, 2006 was approximately \$2.39 billion.

DOCUMENTS INCORPORATED BY REFERENCE:

Information required by Part III (Items 10, 11, 12, 13 and 14) is incorporated by reference to portions of NeuStar's definitive proxy statement for its 2007 Annual Meeting of Stockholders, which NeuStar intends to file with the Securities and Exchange Commission within 120 days of December 31, 2006.

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

PART I

ITEM 1. BUSINESS

Overview

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

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

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

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

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

Company Information and History

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

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

Class A common stock, and we anticipate that all holders of Class B common stock will ultimately convert their shares into shares of Class A common stock.

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

Industry Background

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

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

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

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

Connect. Route the communication across disparate networks;

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

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

Our Clearinghouse

We provide our services from a set of unique databases, systems and platforms in geographically dispersed data centers, which we refer to collectively as our clearinghouse. Our clearinghouse has been designed to provide substantial advantages in meeting the challenges facing the communications industry for both traditional voice and IP networks. First, our clearinghouse databases and capabilities provide competing CSPs with fair, equal and secure access to essential shared resources such as telephone numbers and domain names. This sharing of data is critical for locating end-users and establishing their identity. Second, our clearinghouse databases and capabilities serve as an authoritative directory to ensure proper routing of voice, advanced data applications and IP-based communications,

such as mobile instant messaging, regardless of originating or terminating technologies. Third, our clearinghouse allows CSPs access through standard interfaces. Our clearinghouse also enables connections to authoritative operating data for CSPs and providers of other service elements, including content, entertainment and financial transactions. As a result, it facilitates advanced services, such as multi-media content services and mobile instant messaging. Finally, our services facilitate the management of networks and services, including the deployment of new technologies and protocols, the balancing of communications traffic

across a CSP's internal networks, network consolidation, and the control of instant messaging services, which promote a CSP's ability to create differentiated and value-added services.

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

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

Scalable. The modular design of our clearinghouse enables capacity expansion without service interruption and with incremental investment, providing significant economies of scale.

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

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

NeuStar Services

Addressing

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

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

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

Communications Commission, or FCC.

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

Internet Domain Name Services.

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

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

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

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

Interoperability

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

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

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

Infrastructure and Other

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

networks and systems in response to changes in the market. Our services include:

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

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

Service Order Provisioning. We provide service order provisioning services that enable CSPs to manage their internal systems through an automated interface to our clearinghouse and other shared industry databases. This service eliminates the need for service providers to build and maintain their own internal service order provisioning system. We are paid on a per transaction basis for these services.

Mobile Instant Messaging. Through our recent acquisition of Followap Inc., we provide scalable solutions to mobile network operators worldwide, which allow them to manage instant messaging, or IM, and to create their own branded IM services.

Operations

Sales Force and Marketing

As of December 31, 2006, our sales and marketing organization consisted of approximately 240 people who work together to proactively deliver advanced technologies and solutions to serve our customers' needs. Our sales teams work closely with our customers to identify and address their needs, while our marketing team works closely with our sales teams to deliver comprehensive services, develop a clear and consistent corporate image and offer a full customer support system.

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

Customer Support

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

Operational Capabilities

We operate geographically diverse state-of-the-art data centers that support our clearinghouse services. Our data centers are custom designed for the processing and transmission of high volumes of transaction-related, time-sensitive data in a highly secure environment. We are committed to employing best-of-breed tools and equipment for application development, infrastructure management, operations management, and information security. These include equipment from International Business Machines Corporation, or IBM, Cisco Systems, Inc., Sun Microsystems, Inc., Dell Inc., and EMC Corporation, and database systems and software from Oracle Corporation and IBM. In general, we subscribe to the highest level of service and responsiveness available from each third party vendor that we use. Further, to protect the integrity of our systems, the major components of our networks are

generally designed to eliminate any single point of failure. In addition, we employ encryption and other security techniques that well exceed industry standards.

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

Research and Development

Our first focus in research and development is to innovate. We understand our customers' challenges in managing an expanding array of technologies and end-user services across a growing number of CSPs. We employ industry experts in areas of technology that we believe are key to solving these problems. We believe their work has had a profound impact on the communications industry. For instance, we led the industry effort to design the architecture that underlies local number portability, which today is necessary to route virtually all calls in North America.

Our second focus in research and development is to promote open industry standards around innovative solutions that serve our customers' needs. We are active in industry forums where our technical expertise and neutral position in the industry are valuable in promoting consensus among competing CSPs. We led the development of the Session Initiation Protocol (SIP) technology at the Internet Engineering Task Force. This technology has been adopted by most global industry communication groups, including wireline, wireless, and IP, as the standard for VoIP and other real-time multimedia transmission over IP, such as video, music, and multimedia conferencing, and other enhanced services.

Once the standard has been adopted, our third focus is to develop the standards-based solution that can be delivered industry-wide as a service through our clearinghouse, yielding significant benefits both to the communications industry and us. The communications industry benefits from a uniform solution that can be delivered in a timely fashion in a cost-effective manner. We benefit by introducing new services that leverage our clearinghouse and expand the sources of our revenue. For example, in a collaborative effort with several of the world's largest Internet Exchange providers, we are currently in the development process for SIP-IX, the first comprehensive suite of services designed to enable direct network-to-network peering between trading partners for voice, video and content services using SIP-based technologies such as IP multimedia subsystem (IMS) and VoIP.

As of December 31, 2006, we had approximately 130 employees dedicated to research and development, approximately 70 of whom were added through our acquisition of Followap. We expense our research and development costs as incurred. Our research and development expense was \$7.4 million, \$11.9 million and \$17.6 million for the years ended December 31, 2004, 2005 and 2006, respectively.

Customers

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

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

communicate with them via text messaging. Mobile network operators throughout Europe, including Vodafone Group Plc and Wind Telecomunicazioni SpA, rely on our instant messaging solutions to provide mobile instant messaging to their end users.

Our customers include over 7,300 different entities, each of which is separately billed for the services we provide, regardless of whether it may be affiliated with one or more of our other customers. No single entity accounted for more than 10% of our total revenue in 2006. The amount of our revenue derived from customers

inside the United States was \$159.8 million, \$235.5 million and \$317.3 million for the years ended December 31, 2004, 2005 and 2006, respectively. The amount of our revenue derived from customers outside the United States was \$5.2 million, \$7.0 million and \$15.7 million for the years ended December 31, 2004, 2005 and 2006, respectively. The amount of our revenue derived under our contracts with North American Portability Management LLC was \$130.0 million, \$188.8 million and \$249.3 million for the years ended December 31, 2004, 2005 and 2006, respectively.

Competition

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

In our roles as the North American Numbering Plan Administrator, National Pooling Administrator, administrator of local number portability for the communications industry, operator of the sole authoritative registry for the .us and .biz Internet domain names, and operator of the sole authoritative registry for U.S. Common Short Codes, there are no other providers currently providing the services we offer. However, we were awarded the contracts to administer these services in open and competitive procurement processes where we competed against companies including Accenture Ltd, Computer Sciences Corporation, Hewlett-Packard Company, IBM, Mitretek Systems, Inc., Nortel Networks Corporation, NCS Pearson, Inc., Perot Systems Corporation, Telcordia Technologies, Inc. and VeriSign, Inc. We have renewed or extended the term of several of these contracts since we first entered into them. As the terms of these contracts expire, we expect that other companies may seek to bid on renewals or new contracts, and we may not be successful in renewing them. In addition, prior to the expiration of our contracts to provide number portability services, North American Portability Management LLC could solicit, or our competitors may submit, proposals to replace us, in whole or in part, as the provider of the services covered by these contracts. Similarly, with respect to our contracts to act as the North American Number Plan Administrator, the National Pooling Administrator, operator of the authoritative registry for the .us and .biz Internet domain names, and the operator of the authoritative registry for U.S. Common Short Codes, the relevant counterparty could elect not to exercise the extension period under the contract, if applicable, or to terminate the contract in accordance with its terms, in which case we could be forced to compete with other providers to continue providing the services covered by the relevant contract. However, we believe that our position as the incumbent provider of these services will enable us to compete favorably for contract renewals or for new contracts to continue to provide these services.

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

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

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

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

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

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

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

We believe our clearinghouse has inherent advantages relative to discrete software solutions that require sales, customization and ongoing maintenance for CSPs on a one-customer-at-a-time basis. Many companies that have developed discrete software solutions have lacked the scale and financial resources necessary to develop carrier-grade solutions and achieve sufficiently broad customer acceptance to create viable business models. We also believe that our one-to-many clearinghouse can offer more economical services than in-house solutions or outsourcing to a systems integrator. However, many of our current and potential competitors have the financial, technical, marketing and other resources to develop a clearinghouse and compete with us directly with similar services and a similar delivery model.

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

- our responsiveness to customers' needs;
- our ability to support existing and new industry standards and protocols;
- our ability to continue development of technical innovations; and
- the quality, reliability, security and price-competitiveness of our services.

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

Employees

As of December 31, 2006, we employed 822 persons worldwide. None of our employees is currently represented by a labor union. We have not experienced any work stoppages and consider our relationship with our employees to be good.

Contracts

We provide many of our addressing, interoperability and infrastructure services pursuant to private commercial and government contracts. Specifically, we provide wireline and wireless number portability, implement the allocation of pooled blocks of telephone numbers and provide network management services pursuant to seven contracts with North American Portability Management LLC, an industry group that represents all telecommunications service providers in the United States. Although the FCC has plenary authority over the administration of telephone number portability, it is not a party to our contracts with North American Portability Management LLC. The North American Numbering Council, a federal advisory committee to which the FCC has delegated limited oversight responsibilities, reviews and oversees North American Portability Management LLC's management of these contracts. See Regulatory Environment Telephone Numbering. We recognize revenue under our contracts with North American Portability

Management LLC primarily on a per transaction basis. The aggregate fees for transactions processed under these contracts are determined by the total number of transactions, and these fees are billed to telecommunications service providers based on their allocable share of the total transaction charges. This allocable share is based on each respective telecommunications service provider's share of the aggregate end-user services revenues of all U.S. telecommunications service providers as determined by the FCC. On November 4, 2005, BellSouth Corporation filed a petition seeking changes in the way our customers are billed for services provided by us under our contracts with North American Portability Management LLC. In response to the BellSouth petition, the FCC requested comments from interested parties. As of February 15, 2007, the FCC had not initiated a formal rulemaking process, and the BellSouth petition remains pending. We do not

believe that this proposed change to the manner in which we bill for services under these contracts would have a material impact on our customers' demand for these services. Under our contracts, we also bill a revenue recovery collections, or RRC, fee of a percentage of monthly billings to our customers, which is available to us if any telecommunications service provider fails to pay its allocable share of total transaction charges. If the RRC fee is insufficient for that purpose, these contracts also provide for the recovery of such differences from the remaining telecommunications service providers. Under these contracts, users of our clearinghouse also pay fees to connect to our data center and additional fees for reports that we generate at the user's request. Our contracts with North American Portability Management LLC continue through June 2015.

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

We serve as the North American Numbering Plan Administrator and the National Pooling Administrator pursuant to two separate contracts with the FCC. Under these contracts, we administer the assignment and implementation of new area codes in North America, the allocation of central office codes (which are the prefixes following the area codes) to telecommunications service providers in the United States, and the assignment and allocation of pooled blocks of telephone numbers in the United States in a manner designed to conserve telephone number resources. The North American Numbering Plan Administration contract is a fixed-fee government contract that was awarded by the FCC in 2003. The contract is structured as a one-year agreement with four one-year options exercisable by the FCC. The FCC has exercised three of these one-year extension options and may extend the contract for two additional one-year periods continuing through July 8, 2008. The National Pooling Administration contract is a cost-plus government contract that was awarded by the FCC in 2001. This contract also is structured as a one-year agreement with four one-year options exercisable by the FCC. The FCC exercised each of the four options, and this contract was due to expire on June 14, 2006. Since that time, the National Pooling Administration contract has been extended for several short-term periods while the FCC conducts a formal rebid of the contract. We expect to compete for a renewal of this contract.

We are the operator of the .biz Internet top-level domain by contract with the Internet Corporation for Assigned Names and Numbers, or ICANN. The .biz contract was originally granted in May 2001. In December 2006, the ICANN awarded to us a renewal of the .biz contract through December 2012. Under the terms of the amended agreement, the .biz contract automatically renews after 2012 unless it has been determined that we have been in fundamental and material breach of certain provisions of the agreement and have failed to cure such breach. Similarly, pursuant to a contract with the U.S. Department of Commerce, we operate the .us Internet domain registry. This contract was awarded in October 2001 for a period of four years, which may be extended by the government for two additional one-year periods. The government exercised the first one-year option in October 2005, and the second one-year option in October 2006. These contracts allow us to provide domain name registration services to domain name registrars, who pay us on a per-name basis. We expect to compete for a renewal of this contract.

We have an exclusive contract with the CTIA - The Wireless Association® to serve as the registry operator for the administration of U.S. Common Short Codes. U.S. Common Short Codes are short strings of numbers to which text messages can be addressed - a common addressing scheme that works across all participating wireless networks. We were awarded this contract in October 2003 through an open procurement process by the major wireless carriers. The initial term of the contract continued through April 2006, and was renewed automatically for an additional two-year

period pursuant to the terms of the contract. Under the terms of the contract, the term automatically renews for additional two-year periods unless terminated in accordance with its terms. We provide U.S. Common Short Code registration services to wireless content providers, who pay us subscription fees per U.S. Common Short Code registered.

Regulatory Environment

Telephone Numbering

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

Telephone Number Portability. The Telecommunications Act requires telephone number portability, which is the ability of users of telecommunications services to retain existing telephone numbers without impairment of quality, reliability, or convenience when switching from one telecommunications service provider to another. Through a series of competitive procurements, we were selected by a consortium of service providers representing the telecommunications industry to develop, build and operate a solution to enable telephone number portability in the United States. We ultimately entered into seven regional contracts to administer the system that we developed, after which the North American Numbering Council recommended to the FCC, and the FCC approved, our selection to serve as a neutral administrator of telephone number portability. The FCC also directed the seven original regional entities, each comprising a consortium of service providers operating in the respective regions, to manage and oversee the administration of telephone number portability in their respective regions, subject to North American Numbering Council oversight. Under the rules and policies adopted by the FCC, North American Portability Management LLC, as successor in interest to the seven regional consortiums, has the power and authority to negotiate master agreements with an administrator of telephone number portability, so long as that administrator is neutral.

North American Numbering Plan Administrator and National Pooling Administrator. We have contracts with the FCC to act as the North American Numbering Plan Administrator and the National Pooling Administrator, and we must comply with the rules and regulations of the FCC that govern our operations in each capacity. We are charged with administering numbering resources in an efficient and non-discriminatory manner, in accordance with FCC rules and industry guidelines developed primarily by the Industry Numbering Committee. These guidelines provide governing principles and procedures to be followed in the performance of our duties under these contracts. The communications industry regularly reviews and revises these guidelines to adapt to changed circumstances or as a result of the experience of industry participants in applying the guidelines. A committee of the North American Numbering Council evaluates our performance against these rules and guidelines each year and provides an annual review to the North American Numbering Council and the FCC. If we violate these rules and guidelines, or if we fail to perform at required levels, the FCC may reevaluate our fitness to serve as the North American Numbering Plan Administrator and the National Pooling Administrator and may terminate our contracts or impose fines on us. The division of the North American Numbering Council responsible for reviewing our performance as the North American Numbering Plan Administrator and the National Pooling Administrator has determined that, with respect to our performance in 2005, we exceeded and more than met our performance guidelines under each such respective review. Similar reviews of our performance in 2006 have not yet been completed.

Neutrality. Under FCC rules and orders establishing the qualifications and obligations of the North American Numbering Plan Administrator and National Pooling Administrator, and under our contracts with North American Portability Management LLC to provide telephone number portability services, we are required to comply with neutrality regulations and policies. Under these neutrality requirements, we are required to operate our numbering plan, pooling administration and number portability functions in a neutral and impartial manner, which means that we cannot favor any particular telecommunications service provider, telecommunications industry segment or technology or group of telecommunications consumers over any other telecommunications service

provider, industry segment, technology or group of consumers in the conduct of those businesses. We are examined periodically on our compliance with these requirements by independent third parties. The combined effect of our contracts and the FCC's regulations and orders requires that we:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In connection with the neutrality requirements imposed by our code of conduct and under our contracts, we are subject to a number of neutrality audits that are performed on a quarterly and semi-annual basis. In connection with these audits, all of our employees, directors and officers must sign a neutrality certification that states that they are

familiar with our neutrality requirements and have not violated them. Failure to comply with applicable neutrality requirements could result in government fines, corrective measures, curtailment of contracts or even the revocation of contracts. See Risk Factors Risks Related to Our Business Failure to comply with neutrality requirements could result in loss of significant contracts in Item 1A of this report.

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

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

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

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

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

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

Internet Domain Name Registrations

We are also subject to government and industry regulation under our Internet registry contracts with the U.S. government and ICANN, the industry organization responsible for regulation of Internet top-level domains. We are the operator of the .biz Internet domain under a contract with ICANN originally granted to us in May 2001, which currently runs through December 2012 and renews automatically thereafter unless it has been determined that we have been in fundamental and material breach of certain provisions of the agreement and have failed to cure such breach. Similarly, pursuant to a contract with the U.S. Department of Commerce, we operate the .us Internet domain registry. This contract was granted in October 2001 for a period of four years, with two one-year extension periods exercisable at the option of the U.S. Department of Commerce. The Department of Commerce exercised the first one-year option in October 2005, and the second one-year option in October 2006. Under each of these registry service contracts, we are required to:

provide equal access to all registrars of domain names;

comply with Internet standards established by the industry;

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

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

Intellectual Property