Support.com, Inc.
Form 10-Q
August 10, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended June 30, 2009

OR

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

Commission File No. 000-30901

SUPPORT.COM, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**94-3282005**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**

1900 Seaport Boulevard, 3rd Floor

Redwood City, CA 94063

(Address of Principal Executive Offices)

(Zip Code)

Registrant s Telephone Number, Including Area Code: (650) 556-9440

FORMER NAME: SUPPORTSOFT, INC.

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 ¨ 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 small reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

On July 31, 2009, 46,554,621 shares of the Registrant s Common Stock, $0.0001 par value, were outstanding.

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QUARTERLY PERIOD ENDED JUNE 30, 2009

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SUPPORT.COM, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	June 30, 2009 (Unaudited)	December 31, 2008 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 65,999	$ 64,306
Short-term investments	30,767	7,784
Auction-rate securities put option	3,424	
Accounts receivable, net	2,332	2,113
Prepaid expenses and other current assets	1,408	1,128
Current assets of discontinued operations		8,785
Total current assets	103,930	84,116
Long-term investments	2,930	15,766
Auction-rate securities put option long-term		7,148
Property and equipment, net	699	1,065
Goodwill	2,854	2,854
Intangible assets, net	334	417
Other assets	648	886
Long-term assets of discontinued operations		11,334
Total assets	$ 111,395	$ 123,586
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 170	$ 890
Accrued compensation	1,247	1,469
Other accrued liabilities	4,951	3,534
Deferred revenue	154	22
Current liabilities of discontinued operations		9,772
Total current liabilities	6,522	15,687
Other long-term liabilities	1,394	1,434
Long-term liabilities of discontinued operations		1,019
Total Liabilities	7,916	18,140
Stockholders equity:		
Common stock	5	5
Additional paid-in capital	220,070	217,647
Accumulated other comprehensive loss	(1,774)	(2,541)
Accumulated deficit	(114,822)	(109,665)

Total stockholders equity	103,479	105,446
Total liabilities and stockholders equity	$ 111,395	$ 123,586

(1) Derived from the December 31, 2008 audited Consolidated Financial Statements included in the Annual Report on Form 10-K, as filed with the Securities and Exchange Commission (SEC) on March 11, 2009.

See accompanying notes.

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SUPPORT.COM, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Revenue	$ 3,433	$ 891	$ 7,047	$ 1,593
Costs and expenses:				
Cost of revenue	4,280	1,858	8,650	3,100
Amortization of intangible assets	42	28	84	28
Research and development	1,342	1,392	2,748	2,872
Sales and marketing	2,273	2,492	4,620	5,448
General and administrative	2,980	3,654	6,578	6,953
Total costs and expenses	10,917	9,424	22,680	18,401
Loss from operations	(7,484)	(8,533)	(15,633)	(16,808)
Interest income and other, net	422	721	121	2,170
Loss from continuing operations, before income taxes	(7,062)	(7,812)	(15,512)	(14,638)
Income taxes provision/(benefit)	(2,841)	1	(2,837)	1
Loss from continuing operations	(4,221)	(7,813)	(12,675)	(14,639)
Income from discontinued operations, after income taxes	6,460	3,466	7,518	6,661
Net income/(loss)	$ 2,239	$ (4,347)	$ (5,157)	$ (7,978)
Earnings (loss) per share:				
Basic and diluted earnings per share				
Loss from continuing operations	$ (0.09)	$ (0.17)	$ (0.27)	$ (0.32)
Income from discontinued operations	0.14	0.08	0.16	0.15
Net earnings (loss) per share	$ 0.05	$ (0.09)	$ (0.11)	$ (0.17)
Shares used in computing per share amounts:				
Basic	46,360	46,076	46,345	46,065
Diluted	46,360	46,076	46,345	46,065

See accompanying notes.

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SUPPORT.COM, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Operating Activities:		
Net loss	$ (5,157)	$ (7,978)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Gain on the sale of discontinued operations, net of tax	(4,740)	
Depreciation	387	612
Write-off of fixed assets	104	
Amortization of premiums and discounts on marketable securities	(31)	(430)
Amortization of purchased technology	132	
Amortization of intangible assets	84	88
Realized loss on put option re-valuation	3,724	
Realized gain on auction-rate securities	(3,724)	
Stock-based compensation	2,158	2,507
Changes in assets and liabilities:		
Accounts receivable, net	3,035	609
Prepaid expenses and other current assets	(52)	698
Other long-term assets	(112)	12
Accounts payable	(737)	(79)
Accrued compensation	(488)	(139)
Other accrued liabilities	(6,811)	(996)
Other long-term liabilities	179	95
Deferred revenue	(1,466)	(1,641)
Net cash used in operating activities	(13,515)	(6,642)
Investing Activities:		
Proceeds from sale of discontinued operations	20,475	
Purchase of developed technology		(1,375)
Purchases of property and equipment	(66)	(322)
Purchases of marketable securities	(13,392)	(38,276)
Sales of marketable securities		22,300
Maturities of marketable securities	7,900	55,544
Acquisition of business, net of cash acquired		(2,778)
Net cash provided by investing activities	14,917	35,093
Financing Activities:		
Proceeds from issuances of common stock	265	195
Net cash provided by financing activities of continuing operations	265	195
Net increase in cash and cash equivalents	1,667	28,646
Effect of exchange rate changes on cash and cash equivalents	26	9

Cash and cash equivalents at beginning of period	64,306	12,926
Cash and cash equivalents at end of period	$ 65,999	$ 41,581
Supplemental schedule of cash flow information:		
Income taxes paid	$ 130	$ 137

See accompanying notes.

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SUPPORT.COM, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Significant Accounting Policies

Basis of Presentation

support.com, Inc. (the Company or support.com, we, us or our) is a Delaware corporation. The Company changed its name from SupportSof Inc. on June 22 2009. The Company s common stock continues to trade on the NASDAQ Global Select Market under the symbol SPRT.

On June 23, 2009 the Company sold its Enterprise Business to Consona Corporation. This business had accounted for a substantial majority of our revenue in 2009 and 2008. As a result of the sale of the Enterprise Business, our unaudited condensed consolidated financial statements, accompanying notes and other information provided in this Form 10-Q reflect the Enterprise Business as a discontinued operation for all periods presented. Detailed information regarding the financial results of the Enterprise Business is presented in Note 2.

The accompanying unaudited condensed consolidated financial statements include the accounts of support.com, Inc. and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated. The condensed consolidated balance sheet as of June 30, 2009 and the condensed consolidated statements of operations for the three and six months ended June 30, 2009 and 2008 and the condensed consolidated cash flows for the six months ended June 30, 2009 and 2008 are unaudited. In the opinion of our management, these unaudited interim condensed consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, that are necessary for a fair presentation of the results for, and as of, the periods shown. The results of operations for such periods are not necessarily indicative of the results expected for the full fiscal year or for any future period. The condensed consolidated financial statement information as of December 31, 2008 is derived from audited financial statements as of that date. These unaudited interim condensed consolidated financial statements and footnotes should be read with the consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 11, 2009.

Use of Estimates

The preparation of interim condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and the accompanying notes. Actual results could differ materially from these estimates.

Reclassifications

Certain amounts in the condensed consolidated financial statements and accompanying notes for the prior periods have been reclassified to conform to the current periods presentation. On June 23, 2009 the Company completed the sale of the Enterprise Business. The assets, liabilities and results of operations of the Enterprise Business have been reclassified from continuing operations to discontinued operations, and certain costs historically allocated to our previously reported operating segments, i.e., the Enterprise and Consumer operating segments, have been reclassified to general and administrative operating costs of the continuing operations (See Note 2, in each case for all periods presented).

Subsequent Events Evaluation

In accordance with FAS 165, our management has reviewed and evaluated material subsequent events from the balance sheet date of June 30, 2009 through the financial statements issue date of August 10, 2009. All appropriate subsequent event disclosures, if any, have been made in the notes to our unaudited condensed consolidated financial statements.

Revenue Recognition

support.com recognizes revenue in accordance with the SEC s Staff Accounting Bulletin No. 104 (SAB 104) *Revenue Recognition* and the Financial Standards Accounting Board (FASB) Emerging Issues Task Force (EITF) Issue No. 00-21 *Revenue Arrangements with Multiple Deliverables.*

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support.com revenues come primarily from premium (fee-based) technology services. We provide these services remotely, using skilled work-from-home agents who utilize our proprietary technology to deliver services.

We render services to consumers, either through our channel partners (which include brick and mortar and online retailers, anti-virus providers, and others) or directly via our website (www.support.com). We transact with consumers via direct transactions, referral programs or reseller programs. In reseller programs, the channel partner generally executes the financial transactions with the consumer and pays a fee to us. In such instances, since our channel partner is the transacting party that bears substantially all risks associated with the transaction, we record only the net fee received as revenue in accordance with the provisions of EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent.* In referral programs, support.com transacts with the consumer and pays a fixed fee to the referring party. In such instances, since support.com is the transacting party and bears substantially all risks associated with the transaction, we record the gross amount of revenue. In direct transactions, support.com sells directly to the consumer at the retail price. For all transactions, in accordance with SAB 104, we recognize revenue for these services only when all of the following criteria are met:

- Persuasive evidence of an arrangement exists;
- Delivery has occurred;
- Collection is considered probable; and
- The fees are fixed or determinable.

We consider all arrangements with payment terms longer than 90 days not to be fixed or determinable. If the fee is determined not to be fixed or determinable, revenue is recognized as payment becomes due from the customer.

Our services are of three types:

- Incident-Based Services Consumers purchase discrete, one-time services which are delivered at time of sale (or immediately thereafter). Revenue recognition occurs at time of sale, which is also the time of service delivery.
- Service Cards / Gift Cards A consumer may purchase a service card and/or gift card, which entitles the purchaser to redeem a certain service at a time of his/her choosing. For these sales, revenue is deferred until the card has been redeemed and the service has been rendered.
- Subscriptions Consumers may purchase subscriptions or service plans under which certain services are provided over a fixed subscription period. Revenues for subscriptions are recognized ratably over the respective subscription periods.

We also license certain of our consumer software products to channel partners who use our software to provide services to their customers. Such channel partners are charged a per-use fee for the software and revenue is recognized in the period usage occurs.

Channel partners are generally invoiced monthly for services delivered and subscriptions sold during that period. Fees from transactions directly with consumers are generally paid with a credit card at the time of delivery (for incident-based services) or time of sale (for gift cards/service cards and subscriptions). Revenue is recognized net of any applicable sales tax.

support.com generally provides a refund period on services, during which refunds may be granted to consumers under certain circumstances, including inability to resolve certain support issues. For our channel sales, the refund period varies by partner, but is generally between 5-10 days. For our direct-to-consumer sales, the refund period is generally 5 days. For all channels, we recognize revenue net of refunds and cancellations during the period.

Cash, Cash Equivalents and Investments

All liquid instruments with an original maturity at the date of purchase of ninety days or less are classified as cash equivalents. Cash equivalents and short-term investments consist primarily of money market funds, commercial paper, corporate and municipal bonds and auction-rate securities (ARS) held by UBS, which have a put option exercisable within one year. Long-term investments consist of other ARS positions not held with UBS. Other than the ARS held by UBS, our cash equivalents and short-term investments are classified as available-for-sale, and are reported at fair value with unrealized

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gains/losses (when deemed to be temporary) included in accumulated other comprehensive income within stockholders equity on the condensed consolidated balance sheets. The ARS held by UBS are classified as trading securities and are reported at fair value with realized gains/losses included in interest income (expense) and other, net in the condensed consolidated statements of operations. We have designated all long-term investments as available-for-sale and they are therefore reported at fair value, with unrealized gains and losses recorded in accumulated other comprehensive income. For the three months ended June 30, 2009, we recorded a realized loss of $1.6 million on the ARS put option re-valuation, offset by a realized gain of $1.8 million on the UBS ARS, for a net realized gain of $218,000. For the six months ended June 30, 2009, we had a net realized gain/loss of zero. This was due to the put option re-valuation fully offsetting the UBS ARS re-valuation. There were no other realized gains or losses for the three and six months ended June 30, 2008. We recorded net unrealized losses on available-for-sale securities of $0.7 million and $1.6 million at June 30, 2009 and December 31, 2008, respectively.

We monitor our investments for impairment on a quarterly basis and determine whether a decline in fair value is other-than-temporary by considering factors such as current economic and market conditions, the credit rating of the security s issuer, the length of time an investment s fair value has been below our carrying value, the Company s intent to sell the security and, the Company s belief that it will not be required to sell the security before the recovery of its amortized cost. If an investment s decline in fair value is deemed to be other-than-temporary, we reduce its carrying value to its estimated fair value, as determined based on quoted market prices or liquidation values. Declines in value judged to be other-than-temporary, if any, are recorded in operations as incurred. At June 30, 2009, the Company evaluated its unrealized gains/losses on available-for-sale securities, the majority of which are from the long-term ARS, and determined them to be temporary. The long-term investments have been in a continuous unrealized loss position for more than 12 months. In accordance with FSP No. 115-2, the Company concluded that it does not intend to sell a security with an unrealized loss and it will not be required to sell the security before the recovery of its amortized cost basis.

The following is a summary of cash, cash equivalents and investments at June 30, 2009 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Gross Realized Losses	Fair Value
Cash	$ 4,134	$	$	$	$ 4,134
Money market funds	54,865				54,865
Commercial paper	15,881				15,881
Agency bonds	2,000	1			2,001
Corporate bonds	2,519		(10)		2,509
Auction-rate securities (1)	24,400		(670)	(3,424)	20,306
	$ 103,799	$ 1	$ (680)	$ (3,424)	$ 99,696
Classified as:					
Cash and cash equivalents	$ 65,999	$	$	$	$ 65,999
Short-term investments	34,200	1	(10)	(3,424)	30,767
Long-term investments	3,600		(670)		2,930
	$ 103,799	$ 1	$ (680)	$ (3,424)	$ 99,696

(1) In addition to the fair value of our ARS holdings, we hold an ARS put option, which is classified as a short-term asset valued of $3.4 million as of June 30, 2009. At June 30, 2009, the fair value of cash, cash equivalents, investments and the ARS put option was $103.1 million.

The following table summarizes the estimated fair value of our available-for-sale and trading debt securities classified by the stated maturity date of the security:

Due within one year	13,391
Due within two years	
Due after three years	20,306

At June 30, 2009 and December 31, 2008 we had investments in AAA-rated ARS with various state student loan authorities with estimated fair values of $20.3 million and $15.8 million, respectively. The student loans made by these authorities are substantially guaranteed by the federal government through the Federal Family Education Loan Program (FFELP). ARS are long-term floating rate bonds tied to short-term interest rates. After the initial issuance of the securities, the interest rate on

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the securities is reset periodically, at intervals established at the time of issuance (e.g., every seven days, twenty-eight days, thirty-five days, or every six months), based on market demand, if the auctions are successful. ARS are bought and sold in the marketplace through a competitive bidding process often referred to as a Dutch auction. If there is insufficient interest in the securities at the time of an auction, the auction may not be completed and the ARS then pays a default interest rate. Following such a failed auction, we cannot access our funds that are invested in the corresponding ARS until a future auction of these investments is successful, new buyers express interest in purchasing these securities in between reset dates, issuers establish a different form of financing to replace these securities or final payments become due according to contractual maturities. Commencing in February 2008, conditions in the global credit markets resulted in failed auctions for all of our ARS held. In the near term, our ability to liquidate our investments or fully recover the carrying values may be limited or not exist.

In August 2008, UBS, the broker-dealer for most of our ARS, announced a settlement under which it has offered to provide liquidity solutions for, or purchase, the ARS held by its institutional clients. In October 2008, UBS extended an offer of rights to us to sell our eligible ARS at par value back to UBS beginning June 30, 2010 through July 2, 2012. All of the UBS ARS qualify as eligible for purposes of the rights offer. Under the offer, UBS will have sole discretion without prior notice to the Company, to sell our eligible ARS and return par value to the Company up through July 2, 2012. In November 2008, we elected to accept the offer of rights from UBS, which gives us the option to sell to UBS a total of \$20.8 million at par value at any time beginning June 30, 2010 through July 2, 2012. Upon acceptance of the UBS rights offer, we elected to value the ARS put option at fair value as allowed under SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities.* Refer to the Auction-Rate Securities Put Option section below for further discussion. Given the UBS rights offer, we have elected a one-time transfer of our UBS ARS from available-for-sale to trading securities in accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115). The transfer to trading securities reflects management s intent to exercise its ARS put option during the period June 30, 2010 to July 2, 2012. During the quarter ended June 30, 2009, we recorded a gain of \$1.8 million to adjust the value of the UBS ARS to fair value and a loss of \$1.6 million on ARS put option for a net realized gain of \$218,000 in interest income (expense) and other, net, in our condensed consolidated statement of operations. We also reclassified the UBS ARS and ARS put option to current assets in our condensed consolidated balance sheet as of June 30, 2009 because the ARS put option is now exercisable within one year. For the six months ended June 30, 2009 we had a net realized gain of zero. Further changes in the value of the UBS ARS will also be recorded on our condensed consolidated statement of operations in this manner.

We determined that the gross unrealized losses on our available-for-sale investments as of June 30, 2009 are temporary in nature. The fair value of our ARS at June 30, 2009 reflects an unrealized loss of \$0.7 million, entirely related to securities classified as available-for-sale.

Fair value for all ARS, including both the UBS securities classified as trading securities and the other ARS classified as available-for-sale, was based on a discounted cash flow valuation that takes into account a number of factors including the weighted average remaining term (WART) of the underlying securities, the expected return, and the discount rate. The actual WART from servicing reports was used where available. For securities where the actual WART was not available an estimate based on other securities held was used. The expected return was calculated based on the last twelve months average for the 91 day T-bill plus a spread. This rate is the typical default rate for ARS held by us. The discount rate was calculated using the 3-month LIBOR rate plus adjustments for the security type. Changes in any of the above estimates, especially the weighted average remaining term or the discount rate, could result in a material change to the fair value. At June 30, 2009, all ARS were classified as Level 3 assets in accordance with the Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* hierarchy. Presently we have determined the decline in value for the available-for-sale ARS to be temporary because i) we have no intent to sell the security, and we believe that we will not be required to sell the security before the recovery of its amortized cost due to our large cash reserves; ii) through June 30, 2009 all of the securities have maintained AAA credit ratings; and iii) loans made by the issuers are backed by the federal government. In accordance with FSP No. 115-2, we also conclude that we do not intend to sell an impaired available-for-sale security and will not be required to sell such a security before the recovery of our amortized cost.

However, if circumstances change, we may be required to record an other-than-temporary impairment charge on the available-for-sale ARS. We may similarly be required to record other-than-temporary impairment charges if the ratings on any of these securities are reduced or if any of the issuers default on their obligations. In addition to impairment charges, any of these events could cause us to lose part or all of our investment in these securities. Any of these events could materially affect our results of operations and our financial condition. We currently believe these securities are not significantly impaired for the reasons described above; however, it could take until the final maturity of the underlying notes (up to 30 years) to realize our investments recorded value.

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Auction-Rate Securities Put Option

In November 2008, we signed a Rights Agreement with UBS concerning the disposition of our ARS. The UBS agreement gives us the right to sell our ARS back to UBS, at par value, beginning June 30, 2010 through July 2, 2012. Prior to June 30, 2010, UBS has the right to sell our ARS holdings at any time, and return par value to us. The rights represent a freestanding financial instrument for accounting purposes. As noted above, we elected to value this put option at fair value as allowed under SFAS No. 159. As such, we recognized the value of the repurchase right as an asset with the corresponding gain recorded in earnings. Fair value was determined using a with and without approach based on a discounted cash flow valuation comparing the value of the auction-rate securities with the put option and without it. We took into account the same factors as those used to value the auction-rate securities noted above, adjusted to account for differences in cash flow timing and UBS credit risk. The value of the rights offer was recorded in interest income and expense, net. The value of the ARS put option at June 30, 2009 and December 31, 2008 was $3.4 million and $7.1 million. During the quarter ended June 30, 2009, we recorded a gain of $1.8 million to adjust the value of the UBS ARS to fair value and a loss of $1.6 million on ARS put option for a net gain of $218,000 in interest income (expense) and other, net, in our condensed consolidated statement of operations. At December 31, 2008 the ARS put option fully offset the realized loss recorded on the related ARS in our condensed statement of operations. Because the ARS put option represents a freestanding financial instrument and is valued separately taking into account adjustments to the factors used to value the related ARS, its value may not fully offset the realized losses on the related ARS in every reporting period. In any period in which a change in value of our ARS put option does not fully offset a change in value of our UBS ARS, or vice versa, our condensed consolidated statement of operations will be impacted.

As of June 30, 2009, our UBS ARS are presented as short-term investments on our condensed consolidated balance sheet, while the value of the Rights Agreement is presented separately in current assets as ARS put option. The ARS put option is not a traditional put option in that it is non-transferable, non-assignable and not available for trade in any financial market. If UBS has insufficient funding to fulfill their obligation to buy back the ARS per the Rights Agreement, then we may incur further losses in our statement of operations.

The offer of rights includes the right to a loan from UBS at no net cost for up to the amount of the par value of our eligible ARS. The loan option is available until June 30, 2010. As of June 30, 2009, we had not exercised our right to obtain a loan.

Fair Value Measurements

Effective January 1, 2008, we adopted SFAS No. 157, *Fair Value Measurements* . SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined under SFAS No. 157 as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under SFAS No. 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

In accordance with SFAS No. 157, the following table represents our fair value hierarchy for our financial assets (cash equivalents and investments) measured at fair value on a recurring basis as of June 30, 2009 and December 31, 2008 (in thousands):

As of June 30, 2009	**Level 1**	**Level 2**	**Level 3**	**Total**
Money market funds	$ 58,999	$	$	$ 58,999

Commercial paper	15,881		15,881
Corporate bonds	4,510		4,510
Auction-rate securities		20,306	20,306
Auction-rate securities put option		3,424	3,424

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As of December 31, 2008	Level 1	Level 2	Level 3	Total
Money market funds	$ 55,058	$	$	$ 55,058
Commercial paper		7,781		7,781
Corporate bonds		2,999		2,999
Auction-rate securities			15,766	15,766
Auction-rate securities put option			7,148	7,148

Level 3 assets consist of ARS with various state student loan authorities and the ARS put option. Since the auctions for these securities have continued to fail since February 2008, these investments are not currently trading and therefore do not have a readily determinable market value. The fair value of the ARS as of June 30, 2009 and 2008 was estimated by management.

The following table provides a summary of changes in fair value of our Level 3 financial assets as of June 30, 2009 and 2008 (in thousands):

	Three Months Ended June 30, 2009		Three Months Ended June 30, 2008	
	Auction-Rate Securities	Auction-Rate Securities Put Option	Auction-Rate Securities	Auction-Rate Securities Put Option
Beginning balance at March 31	$ 18,216	$ 5,037	$ 23,934	$
Transfer into Level 3				
Sales			(500)	
Total gains/(losses):				
Included in interest income (expense) and other, net	1,831	(1,613)		
Included in other comprehensive income	259		(169)	
Ending balance at June 30	$ 20,306	$ 3,424	$ 23,265	$

	Six Months Ended June 30, 2009		Six Months Ended June 30, 2008	
	Auction-Rate Securities	Auction-Rate Securities Put Option	Auction-Rate Securities	Auction-Rate Securities Put Option
Beginning balance at December 31	$ 15,766	$ 7,148	$	$
Transfer into Level 3			25,300	
Sales			(500)	
Total gains/(losses):				
Included in interest income (expense) and other, net	3,724	(3,724)		
Included in other comprehensive income	816		(1,535)	
Ending balance at June 30	$ 20,306	$ 3,424	$ 23,265	$

Concentrations of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash equivalents, investments and trade accounts receivable. Our investment portfolio consists of investment grade securities. Except for obligations of the United States government and securities issued by agencies of the United States government, we diversify our investments by limiting our holdings with any individual issuer. We also limit the amount of credit risk exposure to any one country except the United States. We are exposed to credit risks in the event of default by the issuers of the securities we hold to the extent of the amount recorded on the balance sheet. At June 30, 2009 we held approximately $20.3 million of AAA-rated student loan ARS.

The student loans made by the issuers of these securities are substantially guaranteed by the federal government through FFELP. Prior to February 2008, these securities had not experienced failed auctions, however, since February 2008 all auctions for these securities have failed. See the Cash, Cash Equivalents and Investments section of this Note 1 to the condensed consolidated financial statements for more information.

The credit risk in our trade accounts receivable is mitigated by our credit evaluation process, reasonably short payment terms and because we sell our products primarily to large organizations. At June 30, 2009 and December 31, 2008 Office Depot accounted for a substantial majority of our total accounts receivable.

For the three- and six-month periods ended June 30, 2009, and for the three- and six-month periods ended June 30, 2008 Office Depot accounted for the substantial majority of our revenue.

Trade Accounts Receivable and Allowance for Doubtful Accounts

Trade accounts receivable are recorded at the invoiced amount. We perform evaluations of our customers financial condition and generally do not require collateral. We make judgments as to our ability to collect outstanding receivables and provide allowances for the portion of receivables when collection becomes doubtful. Provisions are made based upon a specific review of all significant outstanding invoices. For those invoices not specifically provided for, provisions are recorded at differing rates based upon the age of the receivable. If the judgments and estimates we use to calculate the allowance for doubtful accounts do not reflect the future ability to collect outstanding receivables, additional provisions for doubtful accounts may be needed and the future results of operations could be materially affected. Our Enterprise Business accounts receivable were sold to Consona as part of the sale of our Enterprise Business in June 2009 (see Note 2 for details). We currently believe that we have no specific account collectability risk in our continuing business, and have recorded no specific reserves against our Consumer Business as of June 30, 2009 and December 31, 2008.

Property and Equipment

Property and equipment is stated at cost, less accumulated depreciation which is determined using the straight-line method over the estimated useful lives of 2 years for computer equipment and software, 3 years for furniture and fixtures, and the shorter of the estimated useful lives or the lease term for leasehold improvements. Repairs and maintenance costs are expensed as incurred.

Business Combinations Purchase Accounting

Under the purchase method of accounting we allocate the purchase price of acquired companies to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. We record the excess of purchase price over the aggregate fair values as goodwill. We engage third-party appraisal firms to assist us in determining the fair values of assets acquired and liabilities assumed. These valuations require us to make significant estimates and assumptions, especially with respect to intangible assets. We have estimated the economic lives of certain acquired assets and these lives are used to calculate depreciation and amortization expenses. We have estimated the future cash flows to be derived from such assets, and these estimates are used to determine the fair value of the assets. If our estimates of the economic lives or the future cash flows change, depreciation or amortization expenses could be accelerated and the value of our intangible assets could be impaired.

Accounting for Goodwill and Other Intangible Assets

Goodwill is measured as the excess of the cost of acquisition over the sum of the amounts assigned to identifiable assets acquired less liabilities assumed. We record purchased intangible assets at fair value. The original cost is amortized on a straight-line basis over the estimated useful life of each asset.

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, we review goodwill and other intangible assets that have indefinite useful lives for impairment at least annually in our third fiscal quarter, or more frequently if an event occurs indicating the potential for impairment. In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, we review intangible assets that have finite useful lives and other long-lived assets when an event occurs indicating the potential for impairment. In our reviews, we look for facts or circumstances, either internal or external, indicating that we may not recover the carrying value of the asset. We measure impairment losses related to long-lived assets based on the amount by which the carrying amounts of these assets exceed their fair values.

Stock-Based Compensation

We comply with Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment,* (SFAS No. 123R) which requires the measurement and recognition of compensation expense for all stock-based payment awards, including grants of stock and options to purchase stock, made to employees and directors based on estimated fair values.

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The fair value of our stock options granted to employees and employee stock purchases for the three and six months ended June 30, 2009 and 2008 was estimated using the following assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Stock Option Plan:				
Risk-free interest rate	2.1%	3.1%	2.1%	2.5%
Expected term	4.4 years	4.1 years	4.4 years	4.1 years
Volatility	60.2%	51.4%	60.2%	51.4%
Expected dividend	0%	0%	0%	0%
Weighted average fair value	$ 1.09	$ 1.62	$ 1.09	$ 1.59
Employee Stock Purchase Plan (ESPP):				
Risk-free interest rate	n/a	1.5%	n/a	1.5%
Expected term	n/a	0.5 years	n/a	0.5 years
Volatility	n/a	58.6%	n/a	58.6%
Expected dividend	n/a	0%	n/a	0%
Weighted average fair value	n/a	$ 1.15	n/a	$ 1.15

On June 23, 2009 the Company sold its Enterprise Business to Consona Corporation pursuant to an Asset Purchase Agreement (see Note 2). A sale of this nature qualifies as the sale of substantially all the assets of the business, and according to the terms of the ESPP plan document such a sale automatically terminates the ESPP. As a result of the automatic termination of the ESPP, the company reversed all ESPP expenses related to the current purchase period and refunded all amounts to the employees. We recorded the following stock-compensation expense for the three and six months ended June 30, 2009 and 2008 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Stock option compensation expense recognized in:				
Cost of revenue	$ 31	$ 20	$ 65	$ 30
Research and development	62	67		