Synacor, Inc.
Form 10-Q
May 14, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2013
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 Number 001-33843

Synacor, Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	16-1542712 (I.R.S. Employer Identification No.)
40 La Riviere Drive, Suite 300 Buffalo, New York	14202
(Address of principal executive offices)	(Zip Code)

(716) 853-1362
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large accelerated filer	o	Accelerated filer	o
Non-accelerated filer	x (Do not check if a smaller reporting company)	Smaller Reporting Company	o

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

As of April 30, 2013, there were 27,302,562 shares of the registrant’s common stock outstanding. All share and per share amounts in this Quarterly Report on Form 10-Q reflect the 1-for-2 reverse stock split of the registrant’s common stock which took effect immediately prior to the effectiveness of the registration statement for the registrant’s initial public offering.

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PART I — FINANCIAL INFORMATION
Item 1. Financial Statements
SYNACOR, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS—UNAUDITED
AS OF DECEMBER 31, 2012 AND MARCH 31, 2013
(In thousands except for share and per share data)

	December 31, 2012	March 31, 2013
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$41,944	$40,156
Accounts receivable—net of allowance of $25 and $46	15,624	14,548
Deferred income taxes	1,999	1,987
Prepaid expenses and other current assets	1,831	2,140
Total current assets	61,398	58,831
PROPERTY AND EQUIPMENT—Net	11,043	11,083
DEFERRED INCOME TAXES, NON-CURRENT	2,527	2,527
OTHER LONG-TERM ASSETS	543	503
GOODWILL	819	819
TOTAL ASSETS	$76,330	$73,763
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$14,204	$12,673
Accrued expenses and other current liabilities	7,328	6,180
Current portion of capital lease obligations	2,127	1,989
Total current liabilities	23,659	20,842
LONG-TERM PORTION OF CAPITAL LEASE OBLIGATIONS	1,712	1,246
OTHER LONG-TERM LIABILITIES	148	164
Total liabilities	25,519	22,252
COMMITMENTS AND CONTINGENCIES (Note 5)		
STOCKHOLDERS' EQUITY:		
Preferred stock, $0.01 par value—10,000,000 shares authorized, no shares issued and outstanding at December 31, 2012 and March 31, 2013	—	—
Common stock, $0.01 par value—100,000,000 shares authorized, 27,517,665 issued and 27,198,165 outstanding at December 31, 2012, and 100,000,000 authorized, 27,622,062 issued and 27,302,562 shares outstanding at March 31, 2013	275	276
Treasury stock—at cost, 319,500 shares at December 31, 2012 and March 31, 2013	(569)	(569)
Additional paid-in capital	99,449	100,115
Accumulated deficit	(48,338)	(48,311)
Accumulated other comprehensive income	(6)	—
Total stockholders' equity	50,811	51,511
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$76,330	$73,763

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

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SYNACOR, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS—UNAUDITED
FOR THE THREE MONTHS ENDED MARCH 31, 2012 AND 2013
(In thousands except for share and per share data)

	Three Months Ended March 31,	
	2012	2013
REVENUE	$30,670	$29,143
COSTS AND OPERATING EXPENSES:		
Cost of revenue (exclusive of depreciation shown separately below)	16,764	15,764
Research and development (exclusive of depreciation shown separately below)	6,288	6,865
Sales and marketing	2,377	2,130
General and administrative (exclusive of depreciation shown separately below)	2,840	3,144
Depreciation	781	1,130
Total costs and operating expenses	29,050	29,033
INCOME FROM OPERATIONS	1,620	110
OTHER EXPENSE	—	(7)
INTEREST EXPENSE	(47)	(58)
INCOME BEFORE INCOME TAXES	1,573	45
PROVISION FOR INCOME TAXES	399	18
NET INCOME	$1,174	$27
NET INCOME PER SHARE:		
Basic	$0.07	$0.00
Diluted	$0.04	$0.00
WEIGHTED AVERAGE SHARES USED TO COMPUTE NET INCOME PER SHARE:		
Basic	16,603,579	27,236,186
Diluted	26,778,455	28,233,297

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

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SYNACOR, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME—UNAUDITED
FOR THE THREE MONTHS ENDED MARCH 31, 2012 AND 2013
(In thousands)

	Three Months Ended March 31,	
	2012	2013
Net income	$1,174	$27
Other comprehensive income:		
Change in foreign currency translation adjustment	—	6
Comprehensive income	$1,174	$33

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

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SYNACOR, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS—UNAUDITED
FOR THE THREE MONTHS ENDED MARCH 31, 2012 AND 2013
(In thousands)

	Three Months Ended March 31,	
	2012	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$1,174	$27
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	781	1,130
Stock-based compensation expense	558	562
Deferred income taxes	395	12
Change in assets and liabilities, net of effect of acquisition:		
Accounts receivable, net	(781)	1,076
Prepaid expenses and other current assets	(534)	(309)
Other long-term assets	123	40
Accounts payable	236	(1,427)
Accrued expenses and other current liabilities	(1,232)	(1,873)
Other long-term liabilities	33	16
Net cash provided by (used in) operating activities	753	(746)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(879)	(544)
Cash paid for business acquisition	(600)	—
Net cash used in investing activities	(1,479)	(544)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment on bank financing	(125)	—
Repayments on capital lease obligations	(402)	(604)
Proceeds from exercise of common stock options	559	100
Proceeds from initial public offering	25,364	—
Initial public offering costs	(2,475)	—
Net cash provided by (used in) financing activities	22,921	(504)
Effect of exchange rate changes on cash and cash equivalents	—	6
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	22,195	(1,788)
CASH AND CASH EQUIVALENTS—Beginning of period	10,925	41,944
CASH AND CASH EQUIVALENTS—End of period	$33,120	$40,156
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for interest	$47	$49
Cash paid for income taxes	27	46
SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING TRANSACTIONS:		
Property and equipment acquired under capital lease obligations	$2,343	$—
Accrued business acquisition consideration	500	500
Accrued initial public offering costs	278	—
Accrued property and equipment expenditures	122	890

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

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SYNACOR, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—UNAUDITED
AS OF DECEMBER 31, 2012 AND MARCH 31, 2013, AND
FOR THE THREE MONTHS ENDED MARCH 31, 2012 AND 2013
(In thousands except for share and per share data)

1. The Company and Summary of Significant Accounting Policies

Synacor, Inc., together with its wholly-owned subsidiary, Synacor, Canada, Inc. (collectively, the “Company”), is a leading provider of startpages, TV Everywhere solutions, Identity Management (IDM) and various cloud-based services across multiple devices for cable, satellite, telecom and consumer electronics companies. The Company is also a leading provider of authentication and aggregation solutions for delivery of online content. The Company's technology allows its customers to package a wide array of online content and cloud-based services with their high-speed Internet, communications, television and other offerings. The Company's customers offer the Company's services under their own brands on Internet-enabled devices such as PCs, tablets, smartphones and connected TVs.

Initial Public Offering — In February 2012, the Company completed its initial public offering whereby 6,818,170 shares of common stock were sold to the public at a price of $5.00 per share. The Company sold 5,454,545 common shares and selling stockholders sold 1,363,625 common shares. The Company received aggregate proceeds of $25,364 from the initial public offering, net of underwriters’ discounts and commissions but before deducting offering expenses of $3,016.

In connection with the initial public offering in February 2012, the Board of Directors of the Company approved a 1-for-2 reverse stock split of the Company’s common stock. All common shares, stock options, and per share information presented in these condensed consolidated financial statements reflect the reverse stock split on a retroactive basis for all periods presented. There was no change in the par value of the Company’s common stock. The ratio by which shares of preferred stock were convertible into shares of common stock was adjusted to reflect the effects of the reverse stock split. In addition, in accordance with their rights and consistent with the conversion rates discussed in Note 6, Equity, all shares of the Company’s outstanding preferred stock were converted into common stock upon the closing of the initial public offering.

Basis of Presentation — The interim unaudited condensed consolidated financial statements and accompanying notes have been prepared in accordance with United States generally accepted accounting principles (“GAAP”) and include the accounts of the Company and its wholly-owned subsidiary, Synacor Canada, Inc. All intercompany balances and transactions have been eliminated in consolidation. In the opinion of the Company’s management, the interim unaudited condensed consolidated financial statements include all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of the Company’s financial position for the periods presented. These interim unaudited condensed consolidated financial statements are not necessarily indicative of the results expected for the full fiscal year or for any subsequent period and should be read in conjunction with the audited consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Accounting Estimates — The preparation of financial statements in conformity with GAAP in the U.S. requires management to make estimates, judgments and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, actual results may differ from estimated amounts.

Concentrations of Risk — As of December 31, 2012 and March 31, 2013, and for the three months ended March 31, 2012 and 2013, the Company had concentrations equal to or exceeding 10% of the Company’s accounts receivable and revenue as follows:

	Accounts Receivable	
	December 31, 2012	March 31, 2013

Google	40	%	37	%

	Revenue Three months ended March 31,			
	2012		2013	
Google	61	%	54	%

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For the three months ended March 31, 2012 and 2013, the following customers received revenue-share payments equal to or exceeding 10% of the Company’s cost of revenue. The costs represent revenue share paid to them for their supply of Internet traffic on the Company's startpages.

	Cost of Revenue Three months ended March 31,			
	2012		2013	
Customer A	20	%	20	%
Customer B	18		14	
Customer C	13		14	
Customer D	11		11	

Fair Value Measurements — The provisions of the Financial Accounting Standards Board (“FASB”) Accounting Standard Codification (“ASC”) 820, Fair Value Measurements and Disclosures, establish a framework for measuring the fair value in accounting principles generally accepted in the U.S. and establish a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value as follows:
Level 1 — Level 1 inputs are defined as observable inputs such as quoted prices in active markets.
Level 2 — Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (interest rates, yield curves, etc.), and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).
Level 3 — Level 3 inputs are unobservable inputs that reflect the Company’s determination of assumptions that market participants would use in pricing the asset or liability. These inputs are developed based on the best information available, including the Company’s own data.
Acquisition — In January 2012, the Company acquired the assets of Carbyn, Inc., or Carbyn, an Ontario, Canada-based company. The assets acquired are principally comprised of mobile device software and technology and other intellectual property, which the Company expects to enhance its efforts in the development of next generation web applications for
mobile devices. The aggregate purchase price is up to $1,100 for the acquired assets, of which $600 was paid upon consummation of the acquisition and the remaining $500 was paid in April 2013. In addition, the Company hired seven employees from Carbyn who have accepted employment with Synacor Canada, Inc., a newly-formed and wholly-owned subsidiary of the Company. The acquisition and its impact on the balance sheet and results of operations are not material. The purchase price was allocated to the assets acquired based on their respective fair values as of the acquisition date, with the amount exceeding the fair value recorded as goodwill of $819.
Joint Venture—In March 2013, the Company entered into a Joint Venture Agreement, pursuant to which it will initially own 50% of the newly formed Synacor China, Ltd, or the JV Company. The Company has agreed to provide $400 in initial funding and up to $1,600 in additional funding to the JV Company over the next two years. Subject to the completion of customary regulatory requirements, the JV Company will, through a wholly foreign-owned subsidiary in the People's Republic of China (the “PRC”), supply authentication and aggregation solutions for the delivery of online content and services to customers in the PRC.
2. Property and Equipment—Net

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Property and equipment, net consisted of the following (in thousands):

	December 31, 2012	March 31, 2013
Computer equipment (1)	$17,630	$17,869
Computer software	3,715	3,888
Furniture and fixtures	1,050	1,063
Leasehold improvements	732	737
Work in process (2)	226	953
Other	173	173
	23,526	24,683
Less accumulated depreciation (3)	(12,483)	(13,600)
Total property and equipment—net	$11,043	$11,083

Notes:

(1) Includes equipment under capital lease obligations of approximately $5,882 and $5,488 as of December 31, 2012 and March 31, 2013, respectively.

(2) Includes internal-use software development costs of $40 and $943 as of December 31, 2012 and March 31, 2013, respectively.

(3) Includes $1,834 and $1,879 of accumulated depreciation of equipment under capital leases as of December 31, 2012 and March 31, 2013, respectively.

3. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consisted of the following (in thousands):

	December 31, 2012	March 31, 2013
Accrued compensation	$4,265	$2,057
Accrued content fees	555	1,009
Accrued property and equipment expenditures	132	857
Accrued business acquisition consideration	500	500
Unearned revenue on contracts	297	310
Other	1,579	1,447
Total	$7,328	$6,180

4. Information About Segment and Geographic Areas

The Company considers operating segments to be components of the Company in which separate financial information is available that is evaluated regularly by the Company’s chief operating decision maker in deciding how to allocate resources and in assessing performance. The chief operating decision maker for the Company is the Chief Executive Officer. The Chief Executive Officer reviews financial information presented on a total Company basis, accompanied by information about revenue by major service line for purposes of allocating resources and evaluating financial performance. The Company has one business activity and there are no segment managers who are held accountable for operations, operating results or plans for levels or components below the Company level. Accordingly, the Company has determined that it has a single reporting segment and operating unit structure.

The following table sets forth revenue and long-lived tangible assets by geographic area (in thousands):

	Three Months Ended March 31,	
	2012	2013
Revenue		
United States	$30,515	$28,966
United Kingdom	155	177
Total revenue	$30,670	$29,143

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	December 31, 2012	March 31, 2013
Long-lived tangible assets		
United States	$10,638	$10,730
Netherlands	405	353
Total long-lived tangible assets	$11,043	$11,083

5. Commitments and Contingencies

Litigation —From time to time, the Company is a party to legal actions. In the opinion of management, the outcome of these matters is not expected to have a material impact on the financial statements of the Company.

Contract Commitments —The Company is obligated to make payments under various contracts with vendors and other business partners, principally for revenue-share and content arrangements. Contract commitments as of March 31, 2013 can be summarized as follows (in thousands):

Year ending December 31:	
2013 (remaining nine months)	$3,380
2014	1,419
2015	1,080
2016	1,080
2017	360
Due after 5 years	—
Total contract commitments	$7,319

6. Equity

Common Stock — Effective on February 15, 2012, the Company’s board of directors and stockholders approved the Fifth Amended and Restated Certificate of Incorporation. The total number of common shares that the Company is authorized to issue is 100 million with a par value of $0.01 per share.

Preferred Stock — Effective on February 15, 2012, the Company’s board of directors and stockholders approved the Fifth Amended and Restated Certificate of Incorporation. The total number of preferred shares that the Company is authorized to issue is 10 million with a par value of $0.01 per share. None have been issued to date.

Conversion — Prior to the Company's initial public offering, each share of Series A, A-1, B, and C preferred stock was convertible at the option of the holder at any time into common stock. The conversion rate was the quotient obtained by dividing the original issue price of the Series A, A-1, B, or C by the conversion price. Subsequent to the Second Certificate of Amendment to the Fourth Amended and Restated Certificate of Incorporation, the conversion price was adjusted to effect a conversion of one preferred share into one and one-half common shares, as explained in Note 1, The Company and Summary of Significant Accounting Policies. The conversion price was subject to adjustment as set forth in the Restated Certificate of Incorporation for certain dilutive issuances, splits, and combinations, as therein defined. Conversion was automatic upon either the consent of the holders of 66% of the outstanding shares of preferred stock or the effective date of a firm commitment underwritten public offering of the Company’s common stock in which the post-offering valuation on a fully diluted basis was at least $150 million and the proceeds were not less than $25 million. All shares of the Company’s outstanding preferred stock were converted into common stock in February 2012 in connection with the Company’s initial public offering.

7. Stock-based Compensation

The Company recorded $558 and $562 of stock-based compensation expense for the three months ended March 31, 2012 and 2013, respectively. No income tax deduction is allowed for incentive stock options, or ISOs. Accordingly, no deferred income tax asset is recorded for the expense related to these options. Stock option grants of non-qualified stock options, or NQSOs, result in the creation of a deferred tax asset, which is a temporary difference, until the time that the option is exercised.

Total stock-based compensation expense included in the accompanying condensed consolidated statements of operations for the periods presented, is as follows (in thousands):

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	Three Months Ended March 31,	
	2012	2013
Research and development	$107	$261
Sales and marketing	74	76
General and administrative	377	225
Total stock-based compensation expense	$558	$562

Stock Option Activity —A summary of the stock option activity for the three months ended March 31, 2013 is presented below:

	Number of Stock Options	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)	Weighted Average Remaining contractual Term (in years)
Outstanding—January 1, 2013	4,510,807	$4.06		
Granted	95,000	4.26		
Exercised	(104,397)	0.97		
Forfeited	(23,819)	9.26		
Outstanding—March 31, 2013	4,477,591	4.11	$ 1,732	7.35
Vested and expected to vest—March 31, 2013	4,119,041	3.99	$ 1,857	7.23
Vested and exercisable—March 31, 2013	2,087,014	2.48	$ 2,567	5.73

Aggregate intrinsic value represents the difference between the Company's closing stock price of its common stock and the exercise price of outstanding, in-the-money options. The Company's closing stock price as reported on the NASDAQ as of March 31, 2013 was $2.99. The total intrinsic value of options exercised was approximately $211 and for the three months ended March 31, 2013.

The per-share fair value of each stock option was determined on the date of grant using the Black-Scholes option pricing model using the following assumptions:

Grant Date	Options Granted	Weighted-Average Exercise Price	Expected Life of Options (In years)	Risk-Free Interest Rate	Expected Volatility	Expected Dividend Yield
February 3, 2013	44,500	$5.55	6.25	1.43 %	61 %	— %
March 11, 2013	50,500	$3.12	6.25	1.43 %	60 %	— %

As of March 31, 2013, the unrecognized compensation cost related to non-vested options granted, for which vesting is probable, under the plan was approximately $5,388. This cost is expected to be recognized over a weighted-average period of 3.0 years. The total fair value of shares vested was $277 during the three months ended March 31, 2013.

RSU Activity—A summary of RSU activity for the three months ended March 31, 2013, is as follows:

	Number of Shares	Weighted-Average Grant Date Fair Value
Unvested - January 1, 2013	50,000	$5.82
Granted	—	—
Released	—	—
Forfeited	—	—
Unvested - March 31, 2013	50,000	$5.82
Expected to vest—March 31, 2013	42,500	$5.82

As of March 31, 2013, total unrecognized compensation cost, adjusted for estimated forfeitures, related to RSUs was approximately $226, which is expected to be recognized over the next 3.67 years.

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8. Net Income Per Common Share Data

Basic net income per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income per share is computed using the weighted-average number of common shares and, if dilutive, potential common shares outstanding during the period. The Company's potential common shares consist of the incremental common shares issuable upon the exercise of stock options, and to a lesser extent, shares issuable upon the release of RSUs. In addition, at March 31, 2012 the potential common shares included the conversion of preferred stock on an as if converted basis prior to the Company's initial public offering in February 2012. The dilutive effect of these potential common shares is reflected in diluted earnings per share by application of the treasury stock method.

The following table presents the calculation of basic and diluted net income per share for the three month periods ended March 31, 2012 and 2013 (in thousands, except share and per share amounts):

	Three Months Ended, March 31,	
	2012	2013
Basic net income per share:		
Numerator:		
Net income	$1,174	$27
Denominator:		
Weighted-average common shares outstanding	16,603,579	27,236,186
Basic net income per share	$0.07	$0.00
Diluted net income per share:		
Numerator:		
Net income	$1,174	$27
Denominator:		
Number of shares used in basic calculation	16,603,579	27,236,186
Add weighted-average effect of dilutive securities:		
Conversion of preferred stock (as if converted basis)	7,837,369	—
Employee stock options and RSUs	2,337,507	997,111
Number of shares used in diluted calculation	26,778,455	28,233,297
Diluted net income per share	$0.04	$0.00

The following equivalent shares were excluded from the calculation of diluted net income per share because their effect would have been anti-dilutive for the periods presented:

	Three Months Ended March 31,	
	2012	2013
Antidilutive equity awards		
Stock options	506,250	1,502,575

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This quarterly report on Form 10-Q contains "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. In addition, we may make other written and oral communications from time to time that contain such statements. Forward-looking statements include statements as to industry trends and future expectations of ours and other matters that do not relate strictly to historical facts. These statements are often identified by the use of words such as "may," "expect," "believe," "anticipate," "intend," "could," "estimate," or "continue," ar expressions or variations. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. These forward-looking statements include statements in this Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations." Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled "Risk Factors" included elsewhere in this Form 10-Q and in our other Securities and Exchange Commission filings, including our Annual Report on Form 10-K for the fiscal year ended December 31, 2012. Furthermore, such forward-looking statements speak only as of the date of this report. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and related notes thereto appearing elsewhere in this Form 10-Q and with the consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operation appearing in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Overview

We are a leading provider of startpages, TV Everywhere solutions, Identity Management, or IDM, and various cloud-based services across multiple devices for cable, satellite, telecom and consumer electronics companies. We are also a leading provider of authentication and aggregation solutions for delivery of online content. Our technology allows our customers to package a wide array of online content and cloud-based services with their high-speed Internet, communications, television and other offerings. Our customers offer our services under their own brands on Internet-enabled devices such as PCs, tablets, smartphones and connected TVs.

We generate revenue from search and display advertising and by charging subscriber-based fees for services and products delivered through our startpages. Our results are driven primarily by our customer mix, the product and service mix preferences of those customers and the pricing of those products and services. We generate the majority of our revenue from search and display advertising on our startpages, which comprise consumer-facing components of our technology. Adding new customers with large consumer bases and expansion of our relationships with existing customers have resulted in an increasing shift in our revenue mix towards search and display advertising revenue. In addition, as new customers adopt our solutions, and as their respective consumers' use of our startpages ramps up as described below, our growth is increasingly driven by search and display advertising revenue. These increases are largely driven by our model of sharing a portion of this search and advertising revenue with our customers. As we expand our cloud-based and value added services offerings, we expect to generate increased subscriber-based revenue from our customers.

For the three months ended March 31, 2013, search and display advertising revenue was $24.1 million, a decrease of 7% compared to $25.8 million for the three months ended March 31, 2012. Over the same period, our unique visitors decreased by 5%, our search queries decreased by 22% and our advertising impressions increased by 35%. Search revenue decreased by $3.0 million. We believe a material portion of the decrease was due to the placement of our startpages on the second tab of the default Windows 8 Internet browser by our consumer electronics customers. In addition, and to a lesser extent, we believe the decrease was due to lower search activity associated with the increased usage of other devices such as tablets and smartphones generally across the consumer base. Display revenue increased by $1.3 million as advertising impressions increased across our startpages. For the reasons described above, during the remainder of 2013, we may continue to experience decreases in our search revenue from our existing customer base,

but anticipate that the signing and launching of new customers will help to offset this decrease.

Our subscriber-based revenue consists of fees charged for the use of our proprietary technology and for the use of, or access to, services, such as e-mail, security, TV Everywhere, online games, music and other value added services and paid content. During the three months ended March 31, 2013, subscriber-based revenue was $5.1 million, an increase of 3% from $4.9 million during the three months ended March 31, 2012. We believe there are opportunities to generate new sources of subscriber-based revenue, such as the introduction of new value added services, including those delivered cross-device and on

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touchscreen-enabled devices. We believe that the variety of value added services and the introduction of new value added services will also drive increased search and display advertising revenue.

As new customers introduce our startpages to their consumers, usage of our solutions and our revenue from our startpages tends to increase over time. There are a variety of reasons for this ramp-up period. For example, a new customer may migrate its consumers from its existing technology to our technology over a period of time. Moreover, a new customer may initially launch a selection of our services and products, rather than our entire suite of offerings, and subsequently broaden their service and product offerings over time. When a customer launches a new service or product, marketing and promotional activities may be required to generate awareness and interest among consumers. Search and display advertising revenue typically grows significantly during the first one to three years after a customer launch, although there can be notable variances from customer to customer. Thereafter, changes in revenue tend to mirror changes in the consumer base of the applicable customer.

For the three months ended March 31, 2013, we derived revenue from over 45 customers, with revenue attributable to four customers, CenturyLink, Inc. or CenturyLink (including revenue attributable to Qwest Communications International, Inc., or Qwest, which merged with CenturyLink in April 2011), Charter Communications Inc., or Charter, Verizon Corporate Services Group, Inc., or Verizon, and Toshiba America Information Systems, Inc., or Toshiba, together accounting for approximately 70% of our revenue for the three months ended March 31, 2013, or $20.3 million. One of these customers accounted for 20% or more of revenue in such period, and revenue attributable to each of the other three customers accounted for more than 10% in such period.

Revenue attributable to our customers includes the subscriber-based revenue earned directly from them, as well as the search and display advertising revenue generated through our relationships with our search and display advertising partners (such as Google Inc., or Google, for search advertising and advertising networks, advertising agencies and advertisers for display advertising). This revenue is attributable to our customers because it is produced from the traffic on our startpages. These partners provide us with advertisements that we then deliver with search results and other content on our startpages. Since our search advertising partner, Google, and our advertising network partners generate their revenue by selling those advertisements, we create a revenue stream for these partners. In the three months ended March 31, 2013, search advertising through our relationship with Google generated approximately 54% of our revenue, or $15.8 million (all of which was attributable to our customers).

The initiatives described below under “Key Initiatives” are expected to contribute to our ability to maintain and grow profitability via increases in advertising revenue, increases in customers and our consumer reach, and increases in availability of products across more devices. We expect the period in which we experience a return on future investments in each of these initiatives to differ. For example, more direct advertising at higher cost per thousand impressions (referred to as cost per mille, or CPM) would be expected to have an immediate and direct impact on profitability while expansion into international markets may require an investment that involves a longer term return.

We intend to utilize some of the proceeds of our initial public offering to improve our ability to achieve consistent profitability in the future by enhancing our technology and our systems capabilities to more efficiently support our customers, develop new products and features and report upon, analyze and manage the financial performance of the business.

Key Initiatives

We are focused on several key initiatives to drive our business:

- add new, and expand our existing offerings with current, cable, telecom, satellite and consumer electronics customers to increase our consumer reach;
- continue to expand our offerings of, and invest in, cloud-based services such as e-mail and TV Everywhere and increase the number of customers using our TV Everywhere technology;
- enhance our direct advertising sales effort to increase the CPMs derived from advertising;
- extend the availability of our existing and new products and services to additional devices including tablets and smartphones;
- expand our presence into international markets; and
-

invest in and acquire new technologies and products.

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Key Business Metrics

In addition to the line items in our financial statements, we regularly review a number of business metrics related to Internet traffic and search and display advertising to evaluate our business, determine the allocation of resources and make decisions regarding business strategies. We believe disclosing these metrics is useful for investors and analysts to understand the underlying trends in our business. The following table summarizes our key business metrics, which are unaudited, for the three months ended March 31, 2012 and 2013:

	Three Months Ended March 31,	
	2012	2013
Key Business Metrics:		
Unique Visitors (1)	21,293,075	20,260,966
Search Queries (2)	270,777,789	211,644,797
Advertising Impressions (3)	8,485,227,382	11,483,034,070

Notes:

(1) Reflects the number of unique visitors to our startpages computed on an average monthly basis during the applicable period.

(2) Reflects the total number of search queries during the applicable period.

(3) Reflects the total number of advertising impressions during the applicable period.

Unique Visitors

We define unique visitors as consumers who have visited one of our startpages at least once during a particular time period. We rely on comScore to provide this data. comScore estimates this data based on the U.S. portion of the Internet activity of its worldwide panel of consumers and its proprietary data collection method.

Search Queries

We define search queries as the number of instances in which a consumer entered a query into a search bar on our startpages during a particular time period. We rely on reports from our search partner, Google, to measure the number of such instances.

Advertising Impressions

We define advertising impressions as graphical, textual or video paid advertisements displayed to consumers on our startpages during a particular time period. We rely on reports from technology and advertising partners, including DoubleClick (a division of Google), to measure the number of advertising impressions delivered on our platform.

Components of our Results of Operations

Revenue

We derive our revenue from two categories: revenue generated from search and display advertising activities and subscriber-based revenue, each of which is described below. We record our search and display advertising revenue on a gross basis, which includes the net amount received from Google under our agreement with them. The following table shows the revenue in each category, both in amount and as a percentage of revenue, for the three months ended March 31, 2012 and 2013.

	Three Months Ended March 31,			
	2012		2013	
	(in thousands)			
Revenue:				
Search and display advertising	$25,780		$24,086	
Subscriber-based	4,890		5,057	
Total revenue	$30,670		$29,143	
Percentage of revenue:				
Search and display advertising	84	%	83	%
Subscriber-based	16		17	
Total revenue	100	%	100	%

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Search and Display Advertising Revenue

We use Internet search and display advertising to generate revenue from the traffic on our startpages.

- In the case of search advertising, we have a revenue-sharing relationship with Google, pursuant to which we include a Google-branded search tool on our startpages. When a consumer makes a search query using this tool, we deliver the query to Google and they return search results to consumers that include advertiser-sponsored links. If the consumer clicks on a sponsored link, Google receives payment from the sponsor of that link and shares a portion of that payment with us, which we in turn share with the applicable customer. The net payment we receive from Google is recognized as revenue.
- We generate display advertising revenue when consumers view or click on a text, graphic or video advertisement that was delivered on a Synacor-operated startpage. We fill our advertising inventory with advertisements sourced by our direct salesforce, independent advertising sales representatives and advertising network partners. Revenue may be calculated differently depending on our agreements with our advertisers or the agreements between our advertising network partners and their advertisers. It may be calculated on a cost per impression basis, which means the advertiser pays based on the number of times its advertisements appear, or a cost per action basis, which means that an advertiser pays when a consumer performs an action after engaging one of its advertisements. Historically only a small percentage of our display advertising revenue has been calculated on a cost per action basis.

Subscriber-Based Revenue

We define subscriber-based revenue as subscription fees and other fees that we receive from our customers for the use of our proprietary technology platform and the use of, or access to, e-mail, TV Everywhere, security, games and other services, including value added services and paid content. Monthly subscriber levels typically form the basis for calculating and generating subscriber-based revenue. They are generally determined by multiplying a per-subscriber per-month fee by the number of subscribers using the particular services being offered or consumed. In other cases, the fee is fixed. We recognize revenue from our customers as the service is delivered.

Costs and Expenses

Cost of Revenue

Cost of revenue consists of revenue sharing, content acquisition costs and co-location facility costs. Revenue sharing consists of amounts accrued and paid to our customers for the traffic on the startpages we operate for them that results in the generation of search and display advertising revenue. The revenue-sharing agreements with our customers are primarily variable payments based on a percentage of the search and display advertising revenue. Content acquisition agreements may be based on a fixed payment schedule, on the number of subscribers per month, or a combination of both. Fixed-payment agreements are expensed over the term defined in the agreement. Agreements based on the number of subscribers are expensed on a monthly basis. Co-location facility costs consist of rent and operating costs for our data center facilities.

Research and Development

Research and development expenses consist primarily of compensation-related expenses incurred for the development of, enhancements to, and maintenance and operation of our technology and related infrastructure.

Sales and Marketing

Sales and marketing expenses consist primarily of compensation-related expenses to our direct sales and marketing personnel, as well as costs related to advertising, industry conferences, promotional materials, and other sales and marketing programs. Advertising cost is expensed as incurred.

General and Administrative

General and administrative expenses consist primarily of compensation-related expenses for executive management, finance, accounting, human resources and other administrative functions.

Depreciation

Depreciation includes depreciation of our computer hardware and software, furniture and fixtures, leasehold improvements, and other property, and depreciation on capital leased assets.

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Other Expense

Other expense consists primarily of foreign exchange gains and losses.

Interest Expense

Interest expense primarily consists of expenses associated with our capital leases.

Provision for Income Taxes

Income tax expense consists of federal and state income taxes in the United States and taxes in certain foreign jurisdictions.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and the related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. Our estimates form the basis for our judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

An accounting policy is considered to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimate that are reasonably likely to occur, could materially impact the condensed consolidated financial statements. We believe that our critical accounting policies reflect the more significant estimates and assumptions used in the preparation of the condensed consolidated financial statements.

For a discussion of our critical accounting policies and estimates, see “Critical Accounting Policies and Estimates” included in our Annual Report on Form 10-K for the year ended December 31, 2012 under the caption Management’s Discussion and Analysis of Financial Condition and Results of Operations. We have made no significant changes to our critical accounting policies and estimates from those described in our Annual Report on Form 10-K for the year ended December 31, 2012.

Adjusted EBITDA

To provide investors with additional information regarding our financial results, we have disclosed within this Quarterly Report on Form 10-Q adjusted EBITDA, a non-GAAP financial measure. We have provided a reconciliation below of adjusted EBITDA to net income, the most directly comparable GAAP financial measure.

We have included adjusted EBITDA in this Quarterly Report on Form 10-Q because it is a key measure used by our management and board of directors to understand and evaluate our core operating performance and trends, to prepare and approve our annual budget and to develop short- and long-term operational plans. In particular, the exclusion of certain expenses in calculating adjusted EBITDA can provide a useful measure for period-to-period comparisons of our core business. Additionally, adjusted EBITDA is a key financial measure used by the compensation committee of our board of directors in connection with the payment of bonuses to our executive officers. Accordingly, we believe that adjusted EBITDA provides useful information to investors and others in understanding and evaluating our operating results in the same manner as our management and board of directors.

Our use of adjusted EBITDA has limitations as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our results as reported under GAAP. Some of these limitations are:

- although depreciation is a non-cash charge, the assets being depreciated may have to be replaced in the future, and adjusted EBITDA does not reflect capital expenditure requirements for such replacements or for new capital expenditure requirements;
- adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- adjusted EBITDA does not consider the potentially dilutive impact of equity-based compensation;
- adjusted EBITDA does not reflect tax payments that may represent a reduction in cash available to us; and

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- other companies, including companies in our industry, may calculate adjusted EBITDA differently, which reduces its usefulness as a comparative measure.

Because of these limitations, you should consider adjusted EBITDA alongside other financial performance measures, including various cash flow metrics, net income and our other GAAP results. The following table presents a reconciliation of adjusted EBITDA to net income for each of the periods indicated:

	Three Months Ended March 31,	
	2012	2013
	(in thousands)	
Reconciliation of Adjusted EBITDA:		
Net income	$1,174	$27
Provision for income taxes	399	18
Interest expense	47	58
Other expense	—	7
Depreciation	781	1,130
Stock-based compensation	558	562
Adjusted EBITDA	$2,959	$1,802

Results of Operations

The following tables set forth our results of operations for the periods presented in amount and as a percentage of revenue for those periods. The period to period comparison of financial results is not necessarily indicative of future results.

	Three Months Ended March 31,	
	2012	2013
	(in thousands)	
Revenue	$30,670	$29,143
Costs and operating expenses:		
Cost of revenue (1)	16,764	15,764
Research and development (1)(2)	6,288	6,865
Sales and marketing (2)	2,377	2,130
General and administrative (1)(2)	2,840	3,144
Depreciation	781	1,130
Total costs and operating expenses	29,050	29,033
Income from operations	1,620	110
Other expense	—	(7)
Interest expense	(47)	(58)
Income before income taxes	1,573	45
Provision for income taxes	399	18
Net income	$1,174	$27

Notes:

(1) Exclusive of depreciation shown separately.

(2) Includes stock-based compensation as follows:

	Three Months Ended March 31,	
	2012	2013
	(in thousands)	
Research and development	$107	$261
Sales and marketing	74	76
General and administrative	377	225
	$558	$562

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	Three Months Ended March 31,			
	2012		2013	
Revenue	100	%	100	%
Costs and operating expenses:				
Cost of revenue (1)	55		54	
Research and development (1)	21		24	
Sales and marketing	8		7	
General and administrative (1)	9		11	
Depreciation	3		4	
Total costs and operating expenses	95	%	100	%
Income from operations	5	%	—	%
Other expense	—		—	
Interest expense	—		—	
Income before income taxes	5		—	
Provision for income taxes	1		—	
Net income	4	%	—	%

Note:

(1) Exclusive of depreciation shown separately.

Comparison of the Three Months ended March 31, 2012 and 2013

Revenue

	Three Months Ended March 31,					
	2012		2013		% Change	
	(in thousands)					
Revenue:						
Search and display advertising	$25,780		$24,086		(7	)%
Subscriber-based	4,890		5,057		3	
Total revenue	$30,670		$29,143		(5	)
Percentage of revenue:						
Search and display advertising	84	%	83	%		
Subscriber-based	16		17			
Total revenue	100	%	100	%		

Three months ended 2012 compared to 2013. Revenue decreased by $1.5 million, or 5%, compared to the same period in 2012. Search revenue decreased by $3.0 million. We believe a material portion of the decrease was due to the placement of our startpages on the second tab of the default Windows 8 Internet browser by our consumer electronics customers. In addition, and to a lesser extent, we believe the decrease was due to lower search activity associated with the increased usage of other devices such as tablets and smartphones generally across the consumer base. Display revenue increased by $1.3 million as advertising impressions increased across our startpages. Subscriber-based revenue remained relatively constant, increasing $0.2 million, or 3% compared to the same period in 2012.

Cost of Revenue

	Three Months Ended March 31,					
	2012		2013		% Change	
	(in thousands)					
Cost of revenue	$16,764		$15,764		(6	)%
Percentage of revenue	55	%	54	%		

Three months ended 2012 compared to 2013. Our cost of revenue decreased by $1.0 million, or 6%, compared to 2012. The decrease in our cost of revenue was driven by a decrease in revenue-sharing costs due to decreased search

and display advertising. Cost of revenue as a percentage of revenue decreased slightly to 54% of revenue from 55% of revenue.

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Research and Development Expenses

	Three Months Ended March 31,		
	2012	2013	% Change
	(in thousands)		
Research and development	$6,288	$6,865	9 %
Percentage of revenue	21 %	24 %	

Three months ended 2012 compared to 2013. Research and development expenses increased by $0.6 million, or 9%, compared to 2012. The increase was primarily due to increases in employee-related costs as a result of the increase in headcount to support new product initiatives.

Sales and Marketing Expenses

	Three Months Ended March 31,		
	2012	2013	% Change
	(in thousands)		
Sales and marketing	$2,377	$2,130	(10)%
Percentage of revenue	8 %	7 %	

Three months ended 2012 compared to 2013. Sales and marketing expenses decreased by $0.2 million, or 10%, compared to 2012. The decrease was primarily due to a decrease in compensation related expenses.

General and Administrative Expenses

	Three Months Ended March 31,		
	2012	2013	% Change
	(in thousands)		
General and administrative	$2,840	$3,144	11 %
Percentage of revenue	9 %	11 %	

Three months ended 2012 compared to 2013. General and administrative expenses increased by $0.3 million, or 11%, compared to 2012. The increase was primarily due to an increase in legal fees in connection with the formation of the JV Company and other administrative fees associated with being a publicly traded company.

Depreciation

	Three Months Ended March 31,		
	2012	2013	% Change
	(in thousands)		
Depreciation	$781	$1,130	45 %
Percentage of revenue	3 %	4 %	

Three months ended 2012 compared to 2013. Depreciation increased by $0.3 million, or 45%, compared to 2012. This increase was driven by the purchase of assets during 2012 to support the high availability requirements of our customers..

Interest Expense

	Three Months Ended March 31,	
	2012	2013
	(in thousands)	
Interest expense	$47	$58

Our interest expense consists mainly of interest due on our capital lease obligations.

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Provision for Income Taxes

	Three Months Ended March 31,	
	2012	2013
	(in thousands)	
Provision for income taxes	$399	$18

Our income tax expense for the three months ended March 31, 2012 included $0.7 million of deferred income tax expense, partially offset by a tax benefit of $0.3 million relating to a research and development credit. Our income tax expense for the three months ended March 31, 2013 was nominal as our net income was nominal.

Liquidity and Capital Resources

Our primary liquidity and capital resource requirements are for financing working capital, investing in capital expenditures such as computer hardware and software, supporting research and development efforts, introducing new technology, enhancing existing technology, and marketing our services and products to new and existing customers. To the extent that existing cash and cash equivalents, cash from operations, cash from short-term borrowings and the net proceeds from our initial public offering are insufficient to fund our future activities, we may need to raise additional funds through public or private equity offerings or debt financings.

In connection with our initial public offering in February 2012, we received aggregate gross proceeds of $27.3 million. The net proceeds to Synacor from the offering were approximately $22.4 million after deducting underwriting discounts of $1.9 million and offering costs of $3.0 million.

In July 2011 we entered into an amended and restated loan and security agreement with a commercial bank. As of March 31, 2013, there was no outstanding principal amount.

The amended and restated loan and security agreement also provides us with a revolving credit line of $6.0 million, which we can draw on at any time before July 2013, subject to a borrowing base calculation. Borrowings under the revolving credit line accrue interest at a per annum rate equal to the bank's prime rate plus 0.25%, subject to a minimum rate of 4.0% per annum, and must be repaid by July 2013. As of March 31, 2013, $6.0 million was fully available under the revolving credit line, with no outstanding borrowings.

The amended and restated loan and security agreement contains provisions that allow the bank to accelerate repayment of the balance of the new term loan, if any, and the revolving credit line upon a material adverse change, as defined in the agreement, as well as other events of default. Our obligations under the agreement are secured by a blanket lien on all of our assets in favor of the bank. The agreement contains certain financial performance, reporting and other covenants, including restrictions on paying dividends and making distributions to our stockholders. As of March 31, 2013, we were in compliance with the covenants.

As of March 31, 2013, we had approximately $40.2 million of cash and cash equivalents. We did not have any short-term or long-term investments. We believe that our existing cash and cash equivalents, along with cash flows from operations and availability under our term loan and revolving credit line, will be sufficient to meet our anticipated working capital and capital expenditure requirements for at least the next 12 months.

Cash Flows

	Three Months Ended March 31,	
	2012	2013
	(in thousands)	
Statements of Cash Flows Data:		
Cash flows provided by (used in) operating activities	$753	$(746)
Cash flows used in investing activities	(1,479)	(544)
Cash flows provided by (used in) financing activities	22,921	(504)

Cash Provided by (Used in) Operating Activities

In the three months ended March 31, 2012, operating activities provided $0.8 million of cash. The cash flow from operating activities primarily resulted from our net income, adjusted for non-cash items, and changes in our operating assets

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and liabilities. We had net income of $1.2 million, which included a non-cash benefit from deferred income taxes of $0.4 million, non-cash depreciation of $0.8 million and non-cash stock-based compensation of $0.6 million. Changes in our operating assets and liabilities used $2.2 million of cash, primarily due to a decrease of our accrued expenses and other current liabilities of $1.2 million, an increase of our accounts receivable of $0.8 million, and an increase of our prepaid expenses and other current assets of $0.5 million, partially offset by an increase of our accounts payable of $0.2 million. The decrease in accrued expenses and other current liabilities was primarily driven by the payment of bonuses earned and expensed in 2011. The increase in our accounts receivable was primarily due to our revenue growth. The increase in prepaid expenses and other current assets was primarily due to prepayments made to vendors for components of our cost of revenue. The increase in accounts payable was the result of increased spending due to the growth of our revenue-share payments associated with our revenue growth.

In the three months ended March 31, 2013 operating activities used $0.8 million of cash. The cash flow from operating activities primarily resulted from our net income, adjusted for non-cash items, and changes in our operating assets and liabilities. Net income was $0.0, which included non-cash depreciation of $1.1 million and non-cash stock-based compensation of $0.6 million. Changes in our operating assets and liabilities used $2.5 million of cash, primarily due to a decrease of our accrued expenses and other current liabilities of $1.9 million and a decrease of our accounts payable of $1.4 million, partially offset by a decrease of our accounts receivable of $1.1 million. The decrease in accrued expenses and other current liabilities was primarily driven by the payment of bonuses earned and expensed in 2012. The decrease in our accounts payable was primarily driven by lower revenue-share payments associated with our decrease in revenue. The decrease in accounts receivable is primarily driven by lower search and display advertising revenue.

Cash Used in Investing Activities

Our primary investing activities have consisted of purchases of property and equipment specifically related to the build out of our data centers, as well as a payment for the acquisition of Carbyn. Purchases of property and equipment may vary from period to period due to the timing of the expansion of our operations and internal-use software development. We expect to continue to invest in property and equipment and development of software for the remainder of 2013 and thereafter.

Cash used in investing activities in the three months ended March 31, 2012 was $1.5 million consisting of $0.9 million of purchases of property, equipment and software to build out our data centers and $0.6 million paid for the acquisition of Carbyn.

Cash used in investing activities in the three months ended March 31, 2013 was $0.5 million and was primarily for purchases of property and equipment specifically related to the build out of our data centers and internal-use software development

Cash Provided by (Used in) Financing Activities

For the three months ended March 31, 2012, net cash provided by financing activities was $22.9 million, consisting of $25.4 million of proceeds from issuance of common stock in our IPO, partially offset by cash paid for issuance costs of $2.5 million, $0.6 million of proceeds from the exercise of common stock options, partially offset by $0.5 million for repayments on our capital lease obligations and bank financing.

For the three months ended March 31, 2013, net cash used in financing activities was $0.5 million primarily for repayment of $0.6 million on our capital lease obligations partially offset by proceeds of $0.1 million from the exercise of common stock options.

Off-Balance Sheet Arrangements

As of March 31, 2013, we did not have any off-balance sheet arrangements.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

We have operations both within the United States and internationally, and we are exposed to market risks in the ordinary course of our business. These primarily include interest rate and inflation risk.

Interest Rate Risk

Our cash and cash equivalents primarily consist of cash and money market funds. We currently have no investments of any type. Our exposure to market risk for changes in interest rates is limited because nearly all of our cash and cash

equivalents have a short-term maturity and are used primarily for working capital purposes.

Inflation Risk

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We do not believe that inflation has had a material effect on our business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2013. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Based upon the evaluation as of March 31, 2013, our Chief Executive Officer and Chief Financial Officer have concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting identified in management’s evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act during the quarter ended March 31, 2013 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II — OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we may become involved in legal proceedings arising in the ordinary course of our business. We are not presently involved in any legal proceedings, the outcome of which, if determined adversely to us, would have a material adverse effect on our business, results of operations or financial condition.

Item 1A. Risk Factors

Our business and financial results are subject to numerous risks and uncertainties, including those described below, which could adversely and materially affect our business, financial condition or results of operations. You should carefully consider these risks and uncertainties, including the following risk factors and all other information contained in this Quarterly Report on Form 10-Q, together with any other documents we file with the SEC. Risks and uncertainties not currently known to us or that we currently deem to be immaterial may in the future materially and adversely affect our business, financial condition and results of operations.

Risks Related to Our Business

Our search advertising partner, Google, accounts for a significant portion of our revenue, and any loss of, or diminution in, our business relationship with Google would materially and adversely affect our financial performance.

We rely on traffic on our startpages to generate search and display advertising revenue, a substantial portion of which is derived from text-based links to advertisers' websites as a result of Internet searches. We have a revenue-sharing relationship with Google under which we include a Google-branded search tool on our startpages. When a consumer makes a search request using this tool, we deliver it to Google, and Google returns search results to us that include advertiser-sponsored links. If the consumer clicks on a sponsored link, Google receives payment from the sponsor of that link and shares a portion of that payment with us. We then typically share a portion of that payment with the applicable customer. Our Google-related search advertising revenue attributable to our customers, which consists of the portion of the payment from the sponsor that Google shares with us, accounted for approximately 49%, 57%, and 56% of our revenue in 2010, 2011, and 2012, or $32.6 million, $51.5 million, and $68.5 million, respectively, and approximately 54% of our revenue in the three months ended March 31, 2013, or $15.8 million. Our agreement with Google expires in February 2014 unless we and Google mutually elect to renew it. Additionally, Google may terminate our agreement if we experience a change in control or enter into an agreement providing for a change in control or if we do not maintain certain search and display advertising revenue levels. If advertisers were to discontinue their advertising via Internet searches, if Google's revenue from search-based advertising were to decrease, if Google's share of the search revenue were to be increased or if our agreement with Google were to be terminated for any reason or renewed on less favorable terms, our business, financial condition and results of operations would be materially and adversely affected. Moreover, consumers' increased use of search tools other than the Google-branded search tool we provide would have similar effects.

A loss of any significant customer could negatively affect our financial performance.

We derive a substantial portion of our revenue from a small number of customers. For example, revenue attributable to two customers, Charter and CenturyLink (including our revenue attributable to Qwest, which merged with CenturyLink in April 2011), together accounted for approximately 60% of our revenue for the year ended December 31, 2010, or $39.8 million. Revenue attributable to each of these customers accounted for 20% or more of our revenue in 2010. Revenue attributable to Charter, CenturyLink (including our revenue attributable to Qwest) and Toshiba together accounted for approximately 62% of our revenue for the year ended December 31, 2011, or $56.9 million, with revenue attributable to one of these customers accounting for 20% or more in such period and revenue attributable to each of the other two customers accounting for more than 10% in such period. Revenue attributable to Charter, CenturyLink (including revenue attributable to Qwest), Toshiba and Verizon together accounted for approximately 73% of our revenue for the year ended December 31, 2012, or $88.4 million, with revenue attributable to one of these customers accounting for 20% or more in such period and revenue attributable to each of the other three customers accounting for more than 10% in such period. Revenue attributable to Charter, CenturyLink (including revenue attributable to Qwest), Toshiba and Verizon together accounted for approximately 70% of our revenue for the three months ended March 31, 2013, or $20.3 million, with revenue attributable to one of these

customers accounting for 20% or more in such period and revenue attributable to each of the other three customers accounting for more than 10% in such period. Revenue attributable to these customers includes the subscriber-based revenue earned directly from them, as well as the search and display advertising revenue earned through our relationships with our advertising partners, such as Google, based on traffic generated from our startpages.

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Our contracts with our customers generally have an initial term of approximately two to three years from the launch of their startpages and frequently provide for one or more automatic renewal terms of one to two years each. If any one of these key contracts is not renewed or is otherwise terminated, or if revenue from these significant customers declines because of competitive or other reasons, our revenue would decline and our ability to achieve or sustain profitability would be impaired. In addition to the loss of subscriber-based revenue, including startpage and paid content sales, we would also lose significant revenue from the related search and display advertising services that we provide. In addition to the decline of revenue, we may have to impair our long-lived assets, to the extent that such assets are used exclusively to support these customers, which would adversely impact our results of operations and financial position.

We have a history of significant net losses and may not be profitable in future periods.

We have incurred significant losses in each year of operation other than 2009, 2011, and 2012, including a net loss of $5.8 million in 2008 and a net loss of $3.6 million in 2010. Our net income in 2009, 2011, and 2012 was $0.3 million, $9.9 million, and $3.8 million, respectively, and our net income was $0.0 million in the three months ended March 31, 2013 as compared to $1.2 million for the three months ended March 31, 2012. We expect that our expenses will increase in future periods as we implement initiatives designed to grow our business including, among other things, the development and marketing of new services and products, licensing of content, expansion of our infrastructure, international expansion and general and administrative expenses associated with being a public company. If our revenue does not sufficiently increase to offset these expected increases in operating expenses, we may incur significant losses and may not be profitable. Our revenue growth in recent periods may not be indicative of our future performance. In fact, our revenue for the three months ended March 31, 2013 declined as compared to the same period in 2012. Accordingly, we may not be able to maintain profitability in the future. Any failure to maintain profitability may materially and adversely affect our business, financial condition and results of operations.

Many individuals are using devices other than personal computers and software applications other than Internet browsers to access the Internet. If users of these devices and software applications do not widely adopt the applications and other solutions we develop for them, our business could be adversely affected.

The number of people who access the Internet through devices other than PCs, including tablets, smartphones and connected TVs, has increased dramatically in the past few years and is projected to continue to increase. Similarly, individuals are increasingly accessing the Internet through apps other than Internet browsers, such as those available for download through Apple Inc.'s App Store and the Android Market. If consumers increasingly access the Internet on devices other than PCs, and if we are unable to successfully implement monetization strategies for such devices, our financial results could be negatively affected. While we are developing solutions to these alternative means of accessing the Internet, including through our acquisition of mobile device software and technology from Carbyn in January 2012, we do not currently offer our customers and their subscribers a wide variety of apps and other non-browser solutions. Additionally, as new devices and new apps are continually being released, it is difficult to predict the problems we may encounter in developing new versions of our apps and other solutions for use on these alternative devices and apps, and we may need to devote significant resources to the creation, support and maintenance of such apps and solutions. If users of these devices and apps do not widely adopt the apps and other solutions we develop, our business, financial condition and results of operations could be adversely affected.

Consumer tastes continually change and are unpredictable, and our sales may decline if we fail to enhance our service and content offerings to achieve continued subscriber acceptance.

Our business depends on aggregating and providing services and content that our customers will place on our startpages, including television programming, news, entertainment, sports and other content that their subscribers find engaging, and value added services and paid content that their subscribers will buy. Accordingly, we must continue to invest significant resources in licensing efforts, research and development and marketing to enhance our service and content offerings, and we must make decisions about these matters well in advance of product releases to implement them in a timely manner. Our success depends, in part, on unpredictable and volatile factors beyond our control, including consumer preferences, competing content providers and websites and the availability of other news, entertainment, sports and other services and content. While we work with our customers to have their consumers'

homepages set to our startpages upon the installation of our customer's services or the sale of our customer's product, a consumer may easily change that setting, which would likely decrease the use of our startpages. Similarly, consumers that change their device's operating system or Internet browser may no longer have our startpage set as their default homepage, and unless they change it back to our startpage, their usage of our startpages would likely decline and our results of operations could be negatively impacted. Consumers that acquire new consumer electronics devices will no longer have our startpage initially set as their default homepage, and unless they change the default to our startpage, their usage of our startpages would likely decline and our results of operations could be negatively impacted.

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If our services are not responsive to the requirements of our customers or the preferences of their consumers, or the services are not brought to market in a timely and effective manner, our business, financial condition and results of operations would be harmed. Even if our services and content are successfully introduced and initially adopted, a subsequent shift in the preferences of our customers or their consumers could cause a decline in the popularity of our services and content that could materially reduce our revenue and harm our business, financial condition and results of operations.

Our sales growth will be adversely affected if we are unable to expand the breadth of our services and products or to introduce new services and products on a timely basis.

To retain our existing customers, attract new customers and increase revenue, we must continue to develop and introduce new services and products on a timely basis and continue to develop additional features to our existing product base. If our existing and prospective customers do not perceive that we will deliver our services and products on schedule, and if they do not perceive our services and products to be of sufficient value and quality, we may lose the confidence of our existing customers and fail to increase sales to these existing customers, and we may not be able to attract new customers, each of which would adversely affect our operating results.

Our sales cycles and the contracting process with new customers are long and unpredictable and may require us to incur expenses before executing a customer agreement, which makes it difficult to project when, if at all, we will obtain new customers and when we will generate additional revenue and cash flows from those customers.

We market our services and products directly to high-speed Internet service providers and consumer electronics manufacturers. New customer relationships typically take time to obtain and finalize. Due to operating procedures in many organizations, a significant time period may pass between selection of our services and products by key decision-makers and the signing of a contract. The length of time between the initial customer sales call and the realization of significant sales is difficult to predict and can range from several months to several years. As a result, it is difficult to predict when we will obtain new customers and when we will begin to generate revenue and cash flows from these potential new customers.

As part of our sales cycle, we may incur significant expenses in the form of compensation and related expenses and equipment acquisition before executing a definitive agreement with a prospective customer so that we may be ready to launch shortly following execution of a definitive agreement. If conditions in the marketplace generally or with a specific prospective customer change negatively, it is possible that no definitive agreement will be executed, and we will be unable to recover any expenses incurred before a definitive agreement is executed, which would in turn have an adverse effect on our business, financial condition and results of operations.

Most of our customers are high-speed Internet service providers, and consolidation within the cable and telecommunications industries could adversely affect our business, financial condition and results of operations.

Our revenue from high-speed Internet service providers, including our search and display advertising revenue generated by online consumer traffic on our startpages, accounted for more than 95% of our revenue in 2010, 86% in 2011, 80% in 2012, and 82% in the three months ended March 31, 2013. The cable and telecommunications industries have experienced consolidation over the past several years, and we expect that this trend will continue. As a result of consolidation, some of our customers may be acquired by companies with which we do not have existing relationships and which may have relationships with one of our competitors or may have the in-house capacity to perform the services we provide. As a result, such acquisitions could cause us to lose customers and the associated subscriber-based and search and display advertising revenue. Under our agreements with some of our customers, including Charter, Verizon and CenturyLink, they have the right to terminate the agreement if we are acquired by one of their competitors.

Consolidation may also require us to renegotiate our agreements with our customers as a result of enhanced customer leverage. We may not be able to offset the effects of any such renegotiations, and we may not be able to attract new customers to counter any revenue declines resulting from the loss of customers or their subscribers.

As technology continues to evolve, the use of our products by our current and prospective consumer electronics manufacturer customers may decrease and our business could be adversely affected.

The consumer electronics industry is subject to rapid change, and our contract with Toshiba is not exclusive. As consumer electronics manufacturers continue to develop new technologies and introduce new models and devices, there can be no assurance that we will be able to develop solutions that will persuade consumer electronics manufacturers that are our customers at such time to utilize our technology for those new devices. If our current and prospective consumer electronics manufacturer customers elect not to integrate our solutions into their new products, our business, financial condition and results of operations could be adversely affected.

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Moreover, updates to Internet browser technology may adversely affect our business. For example, for our consumer electronics manufacturer customers that have the Windows 8 operating system pre-installed on some of their devices, the Windows 8 operating system places our startpages on a second tab when the Internet browser is launched, leading to decreased search revenue.

We invest in features and functionality designed to increase consumer engagement with our startpages; however, these investments may not lead to increased revenue.

Our future growth and profitability will depend in large part on the effectiveness and efficiency of our efforts to provide a compelling consumer experience that increases consumer engagement with our startpages. We have made and will continue to make substantial investments in features and functionality for our technology that are designed to drive consumer engagement. Not all of these activities directly generate revenue, and we cannot assure you that we will reap sufficient rewards from these investments to make them worthwhile. If the expenses that we incur in connection with these activities do not result in increased consumer engagement that in turn results in revenue increases that exceed these expenses, our business, financial condition and results of operations will be adversely affected.

Our services and products may become less competitive or even obsolete if we fail to respond to technological developments.

Our future success will depend, in part, on our ability to modify or enhance our services and products to meet customer and consumer needs, to add functionality and to address technological advancements that would improve their performance. For example, if our services and products do not adapt to the increasing video usage on the Internet or to take into account evolving developments in social networking, then they could begin to appear obsolete. Similarly, if we fail to develop new ways to deliver content and services through apps other than traditional Internet browsers, consumers could seek alternative means of accessing content and services.

To remain competitive, we will need to develop new services and products and adapt our existing ones to address these and other evolving technologies and standards. However, we may be unsuccessful in identifying new opportunities or in developing or marketing new services and products in a timely or cost-effective manner. In addition, our product innovations may not achieve the market penetration or price levels necessary for profitability. If we are unable to develop enhancements to, and new features for, our existing services and products or if we are unable to develop new services and products that keep pace with rapid technological developments or changing industry standards, our services and products may become obsolete, less marketable and less competitive, and our business will be harmed.

We depend on third parties for content that is critical to our business, and our business could suffer if we do not continue to obtain high-quality content at a reasonable cost.

We license the content that we aggregate on our startpages from numerous third-party content providers, and our future success is highly dependent upon our ability to maintain and enter into new relationships with these and other content providers. In the future, some of our content providers may not give us access to high-quality content, may fail to adapt to changes in consumer tastes or may increase the royalties, fees or percentages that they charge us for their content, any of which could have a material negative effect on our operating results. Our rights to the content that we offer to our customers and their consumers are not exclusive, and the content providers could license their content to our competitors. Our content providers could even grant our competitors exclusive licenses. In addition, our customers are not prohibited from entering into content deals directly with our content providers. Any failure to enter into or maintain satisfactory arrangements with content providers would adversely affect our ability to provide a variety of attractive services and products to our customers. Our reputation and operating results could suffer as a result, and it may be more difficult for us to develop new relationships with potential customers. Our costs as a percentage of revenue may also increase due to price competition.

Our revenue and operating results may fluctuate, which makes our results difficult to predict and could cause our results to fall short of expectations.

As a result of the rapidly changing nature of the markets in which we compete, our quarterly and annual revenue and operating results are likely to fluctuate from period to period. These fluctuations may be caused by a number of

factors, many of which are beyond our control, including but not limited to the various factors set forth in this "Risk Factors" section, as well as:

- any failure to maintain strong relationships and favorable revenue-sharing arrangements with our search and display advertising partners, in particular Google, including a reduction in the quantity or pricing of sponsored links that consumers click on or a reduction in the pricing of display advertisements by advertisers;

- any failure of significant customers to renew their agreements with us;

- our ability to attract new customers;
- our ability to increase sales of value added services and paid content to existing subscribers;
- the timing and success of new service and product introductions by us, our customers or our competitors;
- variations in the demand for our services and products and the implementation cycles of our services and products by our customers;
- changes to Internet browser technology that renders our startpages less competitive;
- changes in our pricing policies or those of our competitors;
- changes in the prices our customers charge for value added services and paid content;
- service outages, other technical difficulties or security breaches;
- limitations relating to the capacity of our networks, systems and processes;
- our failure to accurately estimate or control costs, including costs related to the initial launch of new customers;
- maintaining appropriate staffing levels and capabilities relative to projected growth;
- the timing of costs related to the development or acquisition of technologies, services or businesses to support our existing customers and potential growth opportunities; and
- general economic, industry and market conditions and those conditions specific to Internet usage and online businesses.

For these reasons and because the market for our services and products is relatively new and rapidly changing, it is difficult to predict our future financial results.

Expansion into international markets, which is an important part of our strategy, but where we have limited experience, will subject us to risks associated with international operations.

We plan to expand our product offerings internationally, particularly in Asia, Latin America and Europe. For example, we recently announced that we entered into a joint venture with Maxit Technology Incorporated, or Maxit, to supply authentication and aggregation solutions for the delivery of online content and services to customers in the People's Republic of China, or the PRC. We have limited experience in marketing and operating our services and products in international markets, and we may not be able to successfully develop our business in these markets. Our success in these markets will be directly linked to the success of relationships with potential customers, content partners and other third parties.

As the international markets in which we plan to operate continue to grow, we expect that competition in these markets will intensify. Local companies may have a substantial competitive advantage because of their greater understanding of, and focus on, the local markets. Some of our domestic competitors who have substantially greater resources than we do may be able to more quickly and comprehensively develop and grow in international markets. International expansion may also require significant financial investment including, among other things, the expense of developing localized products, the costs of acquiring foreign companies and the integration of such companies with our operations, expenditure of resources in developing customer and content relationships and the increased costs of supporting remote operations.

Other risks of doing business in international markets include the increased risks and burdens of complying with different legal and regulatory standards, difficulties in managing and staffing foreign operations, recruiting and retaining talented direct sales personnel, limitations on the repatriation of funds and fluctuations of foreign exchange rates, varying levels of Internet technology adoption and infrastructure, and our ability to enforce contracts and our intellectual property rights in foreign jurisdictions. In addition, our success in international expansion could be limited by barriers to international expansion such as tariffs, adverse tax consequences and technology export controls. If we cannot manage these risks effectively, the costs of doing business in some international markets may be prohibitive or our costs may increase disproportionately to our revenue. Some of our business partners also have international operations and are subject to the risks described above. Even if we are

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able to successfully manage the risks of international operations, our business may be adversely affected if our business partners are not able to successfully manage these risks.

Our agreements with some of our customers and content providers require fixed payments, which could adversely affect our financial performance.

Certain of our agreements with customers and content providers require us to make fixed payments to them. The aggregate amount of such fixed payments for the years ending December 31, 2013, 2014, 2015, and the two years thereafter are approximately $4.6 million, $1.4 million, $1.1 million, and $1.4 million, respectively. We are required to make these fixed payments regardless of the achievement of any revenue objectives or subscriber or usage levels. If we do not achieve our financial objectives, these contractual commitments would constitute a greater percentage of our revenue than originally anticipated and would adversely affect our profitability.

Our agreements with some of our customers and content providers contain penalties for non-performance, which could adversely affect our financial performance.

We have entered into service level agreements with most of our customers. These agreements generally call for specific system “up times” and 24 hours per day, seven days per week support and include penalties for non-performance. We may be unable to fulfill these commitments due to circumstances beyond our control, which could subject us to substantial penalties under those agreements, harm our reputation and result in a reduction of revenue or the loss of customers, which would in turn have an adverse effect on our business, financial condition and results of operations. To date, we have never incurred any material penalties.

System failures or capacity constraint