

AVG Technologies N.V.  
Form 20-F  
April 26, 2012  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 20 F**

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

**OR**

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

**For the fiscal year ended December 31, 2011**

**OR**

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

**OR**

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

**Date of event requiring this shell company report** .

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

## AVG TECHNOLOGIES N.V.

(Exact name of Registrant as specified in its charter

and translation of Registrant's name into English)

### The Netherlands

(Jurisdiction of incorporation or organization)

### Gatwickstraat 9-39, 1043 GL Amsterdam, The Netherlands

(Address of principal executive offices)

#### Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class	Name of each exchange on which registered
Ordinary Shares, par value 0.01 per share	The New York Stock Exchange

#### Securities registered or to be registered pursuant to Section 12(g) of the Act.

None

(Title of Class)

#### Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None

(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

Title of each class	Number of shares outstanding
Class A Shares	16,200,000
Class B Shares	12,600,000
Class D Preferred Shares	12,000,000

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Class E Shares

7,000,000

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

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.  Yes  No

Note: Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) (or for such shorter period that the Registrant was required to file such reports).  Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP

International Financial Reporting Standards as issued

Other

by the International Accounting Standards Board

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the Registrant has elected to follow.  
 Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  Yes  No

The registrant is an emerging growth company that has not elected to take advantage of the extended transition period provided in section 13(a) of the Exchange Act for complying with new or revised accounting standards.



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**INTRODUCTION**

This annual report contains forward-looking statements that involve risks and uncertainties. Our actual results may differ significantly from future results as a result of factors such as those set forth in Item 3. Key Information D. Risk factors and Item 5. Operating and Financial Review and Prospects G. Safe harbor.

The financial information included in this annual report is based on U.S. GAAP, unless otherwise indicated.

In presenting and discussing our financial position, operating results and cash flows, management uses certain non-U.S. GAAP financial measures. These non-U.S. GAAP financial measures should not be viewed in isolation or as alternatives to the equivalent U.S. GAAP measures and should be used in conjunction with the most directly comparable U.S. GAAP measures. A discussion of non-U.S. GAAP measures included in this annual report and a reconciliation of such measures to the most directly comparable U.S. GAAP measures are contained in this annual report under Item 5. Operating and Financial Review and Prospects A. Operating results Non-U.S. GAAP Measures.

Unless otherwise indicated or the context otherwise requires, all references in this annual report to AVG or the Company, we, our, ours, us, similar terms refer to AVG Technologies N.V. and its subsidiaries, or if before November 25, 2011, to our predecessor company and former wholly owned subsidiary AVG Technologies N.V. and its subsidiaries. See Item 4. Information on the Company A. History and development of the company. AV®, LinkScanner®, TuneUp and our logo are our key brands, and are variously registered in several jurisdictions. This annual report contains references to these and others of our marks and those of other entities and these references may omit the ® or symbols solely for convenience. Such references are not intended, however, to imply that we will not enforce our rights in any of our marks to the fullest extent permitted by law.

**Table of Contents****PART I****ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS**

Not Applicable.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not Applicable.

**ITEM 3. KEY INFORMATION****A. SELECTED FINANCIAL DATA**

We have derived the following consolidated statement of comprehensive income data for 2007 and consolidated balance sheet data as of December 31, 2007 and 2008 from our unaudited consolidated financial statements not included in this annual report, the following consolidated statement of comprehensive income data for 2008 and consolidated balance sheet data as of December 31, 2009 from our audited consolidated financial statements not included in this annual report and consolidated statement of comprehensive income data for 2009, 2010 and 2011 and consolidated balance sheet data as of December 31, 2010 and 2011 from our audited consolidated financial statements included elsewhere in this annual report. You should read the consolidated financial data set forth below in conjunction with our consolidated financial statements and related notes and the information under Item 5. Operating and Financial Review and Prospects. Our reporting currency is the U.S. dollar. Our historical results are not necessarily indicative of our results to be expected in any future period. We have prepared the financial statements included in this annual report in accordance with U.S. GAAP.

	Year ended December 31,				
	2007	2008	2009	2010	2011
	(in thousands, except for share data and per share data)				
	(unaudited)				
<b>Statement of Comprehensive Income Data and Other Operating Metrics:</b>					
<b>Revenue:</b>					
Subscription	\$ 52,010	\$ 104,762	\$ 151,365	\$ 166,904	\$ 175,654
Platform-derived		9,079	30,603	50,314	96,738
<b>Total revenue</b>	<b>52,010</b>	<b>113,841</b>	<b>181,968</b>	<b>217,218</b>	<b>272,392</b>
<b>Cost of revenue:<sup>(1)</sup></b>					
Subscription	14,611	24,458	30,112	26,686	23,374
Platform-derived			1,308	2,293	7,849
<b>Total cost of revenue</b>	<b>14,611</b>	<b>24,458</b>	<b>31,420</b>	<b>28,979</b>	<b>31,223</b>

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Gross profit	37,399	89,383	150,548	188,239	241,169
Operating expenses: <sup>(1)</sup>					
Sales and marketing	17,826	26,963	45,988	58,562	76,933
Research and development	6,190	13,725	19,533	23,364	35,008
General and administrative	9,763	18,997	24,404	40,683	60,710
Total operating expenses	33,779	59,685	89,925	122,609	172,651
Operating income	3,620	29,698	60,623	65,630	68,518
Other income (expense), net	(1,363)	1,313	(1,600)	1,722	(17,104)
Income (loss) before income taxes and loss from investment in equity affiliate					
	2,257	31,011	59,023	67,352	51,414
Benefit (provision) for income taxes	(506)	(1,643)	(6,538)	(9,394)	49,260
Loss from investment in equity affiliate				(46)	(242)
Net income (loss)	1,751	29,368	52,485	57,912	100,432
Preferred share dividends			(1,802)	(7,210)	(7,208)
Distributed and undistributed earnings to participating securities				(12,676)	(27,513)



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	2007 (unaudited)	Year ended December 31, (in thousands, except for share data and per share data)			2011
		2008	2009	2010	
Net income available to ordinary shareholders basic <sup>(2)</sup>	\$ 1,751	\$ 29,368	\$ 50,683	\$ 38,026	\$ 65,711
Earnings per ordinary share basic <sup>(2)(3)</sup>	\$ 0.04	\$ 0.65	\$ 1.19	\$ 1.06	\$ 1.83
Earnings per ordinary share diluted <sup>(2)(3)</sup>	\$ 0.04	\$ 0.62	\$ 1.09	\$ 0.99	\$ 1.69
Weighted-average ordinary shares outstanding basic <sup>(3)</sup>	45,000,000	45,000,000	42,750,000	36,000,000	36,000,000
Weighted-average ordinary shares outstanding diluted <sup>(3)</sup>	46,489,256	47,423,334	48,155,490	38,585,664	38,974,953

- (1) We have recognized employee share-based compensation in the consolidated statements of comprehensive income for the periods indicated as follows:

	Year ended December 31, (in thousands)		
	2009	2010	2011
Cost of revenue	\$ 178	\$ 61	\$ 21
Sales and marketing	2,520	2,049	949
Research and development	1,108	1,008	1,116
General and administrative	4,483	3,655	4,310
<b>Total share based compensation expense</b>	<b>\$ 8,289</b>	<b>\$ 6,773</b>	<b>\$ 6,396</b>

- (2) During the 2011 fiscal year the Company had 12 million Class D preferred shares which were entitled to a preference dividend of approximately \$1.8 million per calendar quarter, as well as their pro rata amount of net income assuming distribution to each separate class of shareholder. These shares were excluded from calculations of net income available to ordinary shareholders basic. At the time of the initial public offering, or IPO, these shares converted to ordinary shares on a 1 for 1 basis, and preference dividends are no longer payable.
- (3) The shares issued in March 2009, which had the effect of a 10 for 1 share split, are considered as outstanding for purposes of calculating earnings per ordinary share and weighted-average ordinary shares outstanding in 2007 and 2008, as this issuance of shares was in substance a recapitalization of our share capital.

**Other operating metrics:**

	2007 (unaudited)	As of December 31,			2011
		2008	2009	2010	
Cash dividends declared per ordinary share <sup>(1)</sup>	\$ 0.23	\$ 0.44	\$ 3.28	\$ 0.83	\$ 4.53
Cash dividends declared per preferred share				\$ 1.43	\$ 5.13

- (1) The shares issued in March 2009, which had the effect of a 10 for 1 share split, are considered as outstanding for purposes of calculating cash dividends declared per ordinary share in 2007 and 2008, as this issuance of shares was in substance a recapitalization of our share capital.



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	For the year ended or as of December 31,		
	2009	2010	2011
Adjusted net income <sup>(1)</sup> (unaudited, in thousands)	\$ 62,796	\$ 66,246	\$ 56,508
Net cash provided by operating activities (in thousands)	\$ 79,483	\$ 87,911	\$ 82,911
Net cash used in investing activities (in thousands)	\$ (19,157)	\$ (15,340)	\$ (69,544)
Net cash used in financing activities (in thousands)	\$ (71,702)	\$ (54,367)	\$ (15,329)
Free cash flow <sup>(2)</sup> (unaudited, in thousands)	\$ 72,680	\$ 76,196	\$ 89,558
Active users <sup>(3)</sup> (unaudited, in millions)	99	98	108
Subscription users <sup>(4)</sup> (unaudited, in millions)	10	12	15
Revenue per average active user <sup>(5)</sup> (unaudited)	\$ 2.00	\$ 2.21	\$ 2.65

- (1) Adjusted net income is defined as net income for the period, adding back: share-based payments; acquisition-related intangible asset amortization expense; settlement of pre-existing relationships with a reseller on acquisition in 2011; and benefit (provision) for income taxes and deducting from adjusted profit before taxes the impact of a normalized tax rate of 14% in 2010 and 2011 and a blended rate of 11.1% in 2009 based on the effective tax rates of the relevant jurisdictions for the applicable adjustments. For a reconciliation of adjusted net income to net income, the most comparable U.S. GAAP measure, see Item 5. Operating and Financial Review and Prospects A. Operating results Non-U.S. GAAP Measures Adjusted net income.
- (2) Free cash flow is defined as net cash provided by operating activities less capital expenditures (which we define as being made up of payments for property and equipment and intangible assets) less interest income (expense), net (which includes amortization of financing costs and loan discount) and in 2011 adding an adjustment net of taxes for the settlement of pre-existing relationships as a result of the acquisition of a reseller. For a reconciliation of free cash flow to net cash provided by operating activities, the most directly comparable U.S. GAAP financial measure, see Item 5. Operating and Financial Review and Prospects A. Operating results Non-U.S. GAAP Measures Free cash flow.
- (3) Active users are those who (i) have downloaded and installed our free software on a PC or mobile device and have connected to our server twice in the preceding 30-day period or (ii) have a valid subscription license for our software. For further detail on our definition and counting of active users, see Item 5. Operating and Financial Review and Prospects A. Operating results Key Metrics Active and subscription users.
- (4) Subscription users are a subset of active users who subscribe to one or more of our premium products. Payments from subscription users make up the substantial majority of subscription revenue. For further detail on our definition and counting of subscription users, see Item 5. Operating and Financial Review and Prospects A. Operating results Key Metrics Active and subscription users.
- (5) The number of average active users is calculated as the simple average of active users at the beginning of a period and the end of a period.

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	2007	2008	As of December 31, 2009	2010	2011
	(unaudited)	(unaudited)	(in thousands)		
<b>Consolidated Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 23,623	\$ 58,585	\$ 47,711	\$ 63,146	\$ 60,740
Working capital (deficit)	(26,581)	(13,933)	(41,804)	(34,234)	(100,871)
Goodwill and other intangible assets, net	23,242	21,970	40,711	42,213	106,402
Total assets	68,202	120,020	143,787	175,957	311,635
Deferred revenue, current	51,003	84,324	101,147	107,214	120,269
Deferred revenue, less current portion	17,401	20,321	27,925	28,213	30,839
Debt		806	1,072	1,050	225,440
Total liabilities	83,443	124,450	159,518	176,717	441,960
Net assets (liabilities)	(15,421)	(4,430)	(15,731)	(760)	(130,325)
Class D preferred shares <sup>(1)</sup>			191,954	191,954	191,954
Total shareholders' equity	(15,241)	(4,430)	(207,685)	(192,714)	(322,279)

- (1) In connection with the initial investment in us in October 2009 by TA Coöperatief (which subsequently transferred such investment to TA Sàrl), we amended our articles of association and converted 5,850,000 outstanding Class A ordinary shares and 3,150,000 outstanding Class B ordinary shares into an aggregate of 9,000,000 Class D preferred shares, which our shareholders then sold to TA Coöperatief. At the same time we also issued 3,000,000 Class D preferred shares to TA Coöperatief for \$47.8 million, net of issuance costs. We recorded a distribution in excess of capital in shareholders' equity (deficit) of \$144.1 million in connection with the conversion into 9,000,000 Class D preferred shares of ordinary shares and the issuance of 3,000,000 Class D preferred shares to TA Coöperatief.

**B. CAPITALIZATION AND INDEBTEDNESS**

Not Applicable.

**C. REASONS FOR THE OFFER AND USE OF PROCEEDS**

Not Applicable.

**D. RISK FACTORS**

*An investment in our ordinary shares involves a high degree of risk. You should carefully consider the risks and uncertainties described below and the other information in this annual report before making an investment in our ordinary shares. Our business, financial condition or results of operations could be materially and adversely affected if any of these risks occurs, and as a result, the market price of our ordinary shares could decline.*

*This annual report also contains forward-looking statements that involve risks and uncertainties. See Item 5. Operating and Financial Review and Prospects G. Safe Harbor. Our actual results could differ materially and adversely from those anticipated in these forward-looking*

*statements as a result of certain factors.*

**Risks Relating to Our Business and Our Industry**

*Our business model is evolving and we may be unable to increase or monetize our active user base sufficiently to increase or maintain our profitability.*

Our business model has evolved in recent years toward seeking to increase and monetize all of our active user base through a variety of means rather than drawing revenue primarily from users purchasing subscriptions

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to our premium products and online services. To expand our user base, we have added and plan to continue to add new products and online services to our product portfolio, broadening our focus beyond security solutions and increasing our support for mobile computing devices. The evolution of our business model is ongoing and may depart further from the subscription-based model we used for much of our operating history.

We may be unsuccessful in executing our new business model of adding compelling new products and online services and monetizing all of our active user base. Our primary means of monetizing our active user base has been our dynamic secure search solution under, until November 2010, our search agreement with Yahoo! and, since its implementation in November 2010, our search agreement with Google. These search agreements have provided us with a significant revenue stream. We have also generated revenue from the sale of threat-analysis data derived from online search activity. Our new products and online services, in addition to helping to expand our user base, have generated revenue more directly via the sale of backup recovery CDs, online backup space and extended download files for data recovery. If we cannot find additional methods of monetizing our active user base and additional products and online services that users find compelling, we will not be able to continue our recent growth and increase our revenue, margins and profitability. If our new methods of monetizing our active user base or our new products and online services cannot be sustained, our revenue, margins and profitability could recede toward those we had with our previous, subscription-based model.

***We must maintain our relationships with our existing users and attract new users if we are to continue to expand and improve the quality of our user base, which we may be unable to do.***

A significant portion of our users stop using our products in any given period because the cost of switching to the products and online services of competitors on existing hardware is minimal and because competitors' products are often preinstalled on new hardware purchased by our users, among other reasons. For example, in the security software market, about 95% of new desktop computers have one of our competitors' security products preinstalled. To continue to expand our user base, we must retain our existing users to the extent possible and continuously attract new users, both to replace the many users who exit our user base and to expand that base. Any failure to continue to expand our user base could have a material adverse effect on our business, operating results and financial condition.

In addition, our ability to monetize our active user base varies depending on many characteristics of those users, including level of engagement with our products, amount and nature of Internet and computing activities, geographic location and income level. If we are unable to retain and recruit users whose characteristics contribute to a user base with optimum potential for monetization, our business, operating results and financial condition could suffer materially. The significant turnover in our user base also limits our ability to predict our revenue and cash flows for future periods, making it more difficult for us to manage our business.

***Our search-traffic program is crucial to our effort to monetize more of our active user base and this program is vulnerable to technological change, including the rise of mobile computing, and our reliance on one search provider.***

Our most successful program to monetize all of our active user base has been our dynamic secure search solution, including our browser toolbar, which gives our users a convenient way to access a search engine at any time and to be secure that the sites that are the results of the search will not infect or damage their computers. Search engine companies pay us for the search queries we steer to them via our dynamic secure search solution. If software companies that provide Internet browsers prevent the addition of our toolbar, either directly by limiting space for toolbars in the browser interface or indirectly by restricting access to software code, our ability to monetize all of our active user base will be adversely affected. The rise of mobile computing makes this risk more acute as most mobile devices have smaller screens than desktop and laptop computers and software developed for these devices may not as readily accommodate additional toolbars as software developed for desktop and laptop computers. We have not yet begun distributing our toolbar with software designed specifically for mobile devices but intend to do so in future, as mobile represents a small but expanding



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proportion of the total search market. In addition, we currently expect that revenue per active mobile user will be lower than revenue from traditional active users. As such, there can be no assurance that revenue from our dynamic secure search solution or other similar solutions we may develop will grow in line with our expectations, or that we will be able to maintain or expand our current and future platform-derived agreements or enter into additional agreements to generate platform-derived revenue. The failure of these markets to continue to grow would have an adverse effect on our results of operations.

For the majority of platform-derived revenue from our dynamic secure search, we have relied upon agreements with one search engine company at a time, previously Yahoo! and now Google, to generate revenue from our dynamic secure search solution. Our revenue generated by Google accounted for 28% of our total revenue in 2011. Under our previous Yahoo! contract there was a transition period, ending in May 2011, during which users of our Yahoo! sourced search could continue to use Yahoo! sourced search through our toolbar, thereby still generating revenue under our Yahoo! contract, until they chose to switch to our Google sourced search. Revenue generated by Yahoo! sourced search accounted for 6% of our revenue in 2011. We have revenue concentration risk as we rely on our contractual arrangement with Google for a significant portion of our revenue and we cannot guarantee that the revenue generated from the Google sourced search agreement will continue. Furthermore, in most jurisdictions we may only use Google as our search service provider. Google pays us a percentage of any search revenue generated by Google whenever a user clicks on an ad (also called a sponsored link) served by Google and hosted on one of AVG's search domains. Our users can click on such ads via the toolbar, default search, address bar search or the AVG search homepage. Any decline in the popularity of our products or Google's search engine among users could result in a decrease in revenue under this agreement. Google can also unilaterally make changes to its policies and guidelines, which primarily concern the operations and technology of its search services. These changes could require us to modify or suspend certain of our activities relating to our toolbar, which could be costly for us to implement or lead to a reduction in the number of our toolbar users. We need Google's permission to use the toolbar in a form other than that previously approved in connection with our initial contract with Google, which, if Google did not grant such permission, could adversely impact our ability to generate revenue by preventing us from using the toolbar as we otherwise could. In addition, Google may terminate this agreement if the advertisement revenue generated through our dynamic secure search solution falls below a certain amount for a period of three months and has other customary termination rights under the agreement, including upon a change of control. The agreement expires on September 30, 2012, and Google is under no obligation to renew this agreement. If, upon the termination or expiration of our agreement with Google, we fail to enter into a new agreement with Google or a similar search provider on substantially the same or more favorable terms, our revenue would significantly decrease.

***If we are unable to maintain and enhance our brand, our business and operating results may be harmed.***

We believe that maintaining and enhancing our brand identity is critical to our business. The successful promotion of our brand will depend largely upon our marketing and public relations efforts, the quality of our Internet security solutions and our ability to differentiate ourselves from our competitors. The promotion of our brand may require us to make substantial expenditures, which will likely increase as our market becomes more competitive and as we expand into new markets. If we are not successful at maintaining and enhancing our brand, our ability to attract new users would be adversely affected and we could lose users, third-party distributors and resellers.

Our business depends on our brand recognition and the failure to maintain or enhance our brand image could adversely affect our business and market position. In particular, we rely on our active users as primary drivers of our user-driven marketing strategy and any negative change to the perception of our brand among our active users could have a material adverse effect on our business.

In addition, independent industry analysts often provide reviews of our solutions, as well as those of our competitors. Perception of our products in the marketplace may be significantly influenced by these reviews. Our



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brand could be harmed if industry analysts provide negative reviews of our security software solutions or our company. Furthermore, we depend upon certain third-party distributors of our solutions and actions by those third parties could have a negative effect on our brand.

*We are subject to fluctuations in demand for our products and online services as a result of numerous factors, most of which are beyond our control.*

Demand for our products and online services fluctuates from period to period due to factors such as general economic conditions, competition, product obsolescence, technological change, shifts in buying patterns, financial and business conditions of our current and potential customers and levels of Internet usage. There are also particular factors driving demand for each of our specific products and online services. For instance, demand for our Internet security solutions among our targeted customer base of small businesses and consumers is driven by our small business customers' need for protection of business-critical data, consumers' need for protection of their own personal data, potential users' awareness of Internet security threats (including cybercrime) generally, the perceived potential damage caused by information loss and other factors. Most of these factors are beyond our control. A change in the factors driving demand for our products and online services generally or for particular products and online services could adversely affect our revenue, cash flows, financial condition and results of operations.

*Any failure or perceived failure to anticipate, prepare for and respond promptly to technological developments and the changing nature of online security threats could harm our competitive position and business prospects.*

The needs of our customers and the threats they face evolve constantly. For example, in the endpoint security market, hackers and cybercriminals continuously develop and employ increasingly sophisticated techniques to penetrate systems and networks and access information. Although the market expects timely introduction of software solutions to respond to new threats, the development of these solutions can be challenging and time-consuming. We may experience delays in the introduction of new solutions, updates, enhancements and features. If we fail or are perceived to fail to respond to the rapidly changing needs of our users by developing and introducing on a timely basis Internet security solutions that effectively protect against new security threats, our competitive position, reputation and business prospects could be harmed.

Similarly, the endpoint security market is dynamic, characterized by new technologies and access points to the Internet, which also require protection from hackers and cybercriminal attacks. Responding to the challenges posed by these new platforms and their corresponding new threats can be difficult and require significant reengineering of our software. We may therefore fail or be perceived to fail to provide solutions for these new technology platforms as threats to them arise, which could harm our competitive position, reputation and business prospects and would have an adverse effect on our business, financial condition and results of operations.

*If our upgrades and new products and online services, whether acquired or internally developed, fail to achieve widespread market acceptance, our competitive position and business prospects will be harmed.*

Our ability to attract new users and to maintain or increase revenue from existing users depends largely upon our ability to continue providing competitive new products and enhanced solutions that meet the changing needs of our target user base as these needs arise. We plan to continue to invest in acquisitions, research and development, marketing, promotion and sales of our products and online services, with new features, functionalities, enhancements and upgrades. Acquisition of new companies and products creates integration risk, while development of upgrades and new products and online services involves significant time, labor and expense and is subject to risks and challenges including management of the length of the development cycle, adaptation to evolving industry standards, entry into new markets, integration into our existing product line, regulatory compliance, evolution in sales methods and acquisition and maintenance of intellectual property.



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rights. If we fail to launch these upgrades or new solutions on time, or they do not achieve widespread market acceptance, do not meet user expectations, do not operate in an efficient manner, otherwise create the perception of slow operating performance, or generate revenue that is not sufficient to recoup or justify the cost of development, our revenue, financial condition and results of operations may be adversely affected.

*A significant percentage of our total revenue comes from purchases of subscriptions to our premium products, which must by their terms be renewed by our users to remain in force.*

Historically, a significant majority of our active users have been users of our free products and online services. Our growth strategy is based in part on offering premium products on top of our core, free products. To the extent we are not able to convert these free users into subscription users, our ability to generate subscription revenue would be adversely affected.

We generally provide our premium Internet security solutions pursuant to one-year and two-year subscriptions, after which the relevant product or services either cease to operate or are no longer updated with the latest online threat information (rendering the product increasingly less useful as new threats emerge). In 2011, subscription revenue accounted for 64.5% of our total revenue. While we offer subscription users the option to renew their subscriptions, a significant portion of our subscription users choose not to do so. We have taken steps to increase our renewal rates by, for example, adding an auto-renew option on our premium products and online services, but there can be no assurance that these efforts will be successful in increasing our renewal rates. Approximately 43% of users purchasing a license online in 2011 opted for auto-renewal. The European Union is developing a new EU Consumer Rights Directive, however, that is scheduled to come into effect in 2013 that will restrict the use of auto-renewals if the directive is enacted in its current form. We may consequently be forced to reduce or eliminate our use of auto-renewals with subscription users in the European Union once these rules go into effect. Proposals to restrict auto-renewals are also under consideration in the United States. To the extent that we must reduce or eliminate use of auto-renewals in these or other markets, our renewal rates may fall, potentially reducing the number of our subscription users. As a consequence, the growth of our subscription revenue depends significantly on attracting new subscription users, and this dependence could increase due to regulations concerning auto-renewal that are outside of our control. Any failure to maintain or improve the renewal rates of our subscription users or to attract new subscription users could have a material adverse effect on our results of operations.

Furthermore, our ability to measure the conversion of free users into subscription users is limited as there are multiple upgrade paths to our premium products and online services, not all of which we are currently able to track or track accurately. If we are unable to effectively track changes in conversion rates, regardless of the reason for such changes, we may be unable to react to changing market dynamics, and this may negatively affect our growth and revenue. Uncertainty about the renewal rates of our subscription users also limits visibility with respect to future subscription revenue.

*We operate in highly competitive markets and many of our competitors have significantly greater resources than we do.*

The markets for the software solutions we offer are highly competitive and subject to rapid technological changes as customers' needs and the threats they face evolve. We expect competition to increase in the future and we may not be able to compete successfully against current or potential competitors. In particular, some of our competitors may make acquisitions or enter into agreements or other strategic relationships to offer more comprehensive products and/or services, and new competitors may enter the market through acquisitions, agreements or strategic or other such relationships.

We and other vendors compete on price and functionality at different price points. Additional competition may cause increased pricing pressure, which could reduce our revenue per user. For example, in the endpoint security software market, while we have historically been able to reduce

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pricing pressure on our premium solutions and limit the decline in revenue per subscription user by releasing regular product enhancements, there

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can be no assurance that pricing pressure will not adversely affect our subscription revenue, which would have a material adverse effect on our business and results of operations. Similarly, across our markets, our competitors may offer free products perceived to be superior to our offerings, causing our free and/or subscription users to switch and shrinking our monetizeable user base.

Our main competitors fall into the following categories:

vendors with freemium pricing like our own, such as Avast!, Avira, PC Tools (which was acquired by Symantec), Carbonite and Dropbox;

traditional vendors such as McAfee (which was acquired by Intel Corporation), Symantec and Trend Micro (which primarily provide software solutions, including security software, for large enterprises) and Eset, Kaspersky Labs, Panda Software, Sophos, Rising, Kingsoft, Check Point and F-Secure (which offer more customized and segment-focused products);

vendors offering tune-up products, such as UniBlue; and

large corporations offering a wide variety of products, only a few of which compete with ours, such as Microsoft, Google, which recently introduced free security software solutions, Apple, which offers cloud-based data protection, Qihoo, Tencent and Facebook.

Many of these competitors have significantly greater brand name recognition and financial resources to devote to the development, promotion and sale of their products and/or services than we do. For example, Microsoft entered the endpoint security market through the introduction of Microsoft Security Essentials, a free Internet security product that has captured a significant share of the free endpoint security market. Similarly, Google, our primary provider for our search revenue stream, recently entered the security space by adding a malware alarm to its search engine results display and it may increase its security offerings in future. Further, smaller and/or more regionally focused vendors may be able to adapt more quickly to new or emerging technologies and changes in customer demand as recently evidenced by the rapid growth of Internet companies like Qihoo and Tencent.

Software vendors have begun to employ a cloud-based or software-as-a-service business model in which vendors host applications for use by customers over the Internet. This model may disrupt existing models like the model we employ for most of our products and online services, based on software downloaded from the Internet that resides on a user's hard drive. Our competitors, including new cloud-based entrants or larger competitors with greater resources to shift to a new model, may have success with cloud-based provision of software, decreasing the demand for those of our products based on another model.

In the future, we may face competition from both emerging and established companies operating in our sector and in other areas of the IT business that may develop or acquire security software that they may offer as part of their broader product or service offerings and/or for free. Original equipment manufacturers, or OEMs, or operating system vendors may seek to include pre-installed, fully functional Internet security solutions with their core product offering. For example, Intel acquired McAfee, one of our leading competitors, and has indicated its intention to integrate McAfee's security solutions into its hardware products, which may adversely affect sales of our aftermarket and/or standalone security solutions. Intel is one of the world's largest semiconductor chip manufacturers and its investment division has been a shareholder in AVG since 2005. Intel's shares are held through one of its indirect subsidiaries, Intel Capital (Cayman) Corporation, or Intel Capital, which held 11.9% of the issued share capital in AVG as of February 29, 2012. Intel receives information about us at the same time and in the same fashion as our other public shareholders. In addition, other competitors may leverage their greater resources to develop relationships with OEMs or operating system vendors, thereby diminishing demand for our products and adversely affecting our ability to acquire and retain customers.



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*Our failure to adequately protect our users' personal information could have a material adverse effect on our business.*

A wide variety of provincial, state, national and international laws and regulations apply to the collection, use, retention, protection, disclosure, transfer and other processing of personal data. These data protection and privacy-related laws and regulations are evolving and may result in ever-increasing regulatory and public scrutiny and escalating levels of enforcement and sanctions. Failure to comply with applicable laws and regulations, or to protect such data, could result in enforcement action, including fines, imprisonment of company officials and public censure, claims for damages by customers and other affected individuals, damage to reputation and loss of goodwill (both in relation to existing customers and prospective customers), any of which could have a material adverse effect on our operations, financial performance and prospects. Evolving and changing definitions of personal data and personal information, both within the European Union and elsewhere, especially relating to classification of IP addresses, machine identification, location data and other information, may limit or inhibit our ability to operate or expand our business, including limiting strategic partnerships that may involve the sharing of data. Even the perception of privacy concerns, whether or not valid, may harm our reputation and inhibit adoption of our solutions by current and future customers.

*We are subject to privacy laws, which have become increasingly stringent.*

We collect and process personal data (including email addresses, IP addresses, customer satisfaction data, physical names and addresses, customer service issues and website visits) as part of our business and part of our strategy for future growth involves greater interaction with our customer base. In addition, a majority of our online customers purchase our services online with a credit card. As a result, we must comply with strict data protection and privacy laws in the European Union, the United States and certain other jurisdictions where we operate, as well as data protection and documentation standards adopted by credit card issuers. Those laws and standards regulate and restrict our ability to collect and use personal information relating to customers and potential customers.

There have been significant developments in the laws and regulations concerning data protection and privacy, including in relation to the use of cookies and the solicitation, collection, processing or other use of personal data, including data relating to consumers. Furthermore, the proposed U.S. Do Not Track law would allow users to opt out of online monitoring and would thereby block even monitoring conducted with benign intent, such as monitoring to increase the efficacy of security software. Additionally, efforts in the United States to propose a privacy bill of rights could lead to legislation that would require us to adopt additional security measures or prevent us from retaining or using certain data. Such regulation could affect our ability to execute our strategy of building additional commercial partnerships, as the sharing of customer data needed to derive value from those partnerships may be prohibited by regulation. Any present or future laws which restrict the collection and use of personal data could have a material adverse effect on our business.

The requirements imposed by data protection laws and regulations can conflict with laws, and the demands of regulators and other governmental authorities, in foreign jurisdictions. For example, U.S. authorities can demand access to data that is accessible by our group companies that are located in the United States, pursuant to the USA PATRIOT Act. If any of that data includes personal data, it is possible that any such disclosure could cause us to breach data protection laws and regulations in one or more member states of the European Union.

*Our data security defenses could be breached.*

Notwithstanding our efforts to secure our IT, data security and other systems, we are exposed to the risk that this data could be wrongfully accessed or used, whether by employees, customers or other third parties, or otherwise lost or disclosed or processed in a manner that violates applicable data protection law and regulation. In certain jurisdictions where we operate, we are under an affirmative legal obligation to notify the appropriate government authorities or data subjects in circumstances where personal data may have been wrongfully accessed or used, or otherwise

lost or disclosed. Efforts to mitigate and comply with such laws, and even the perception of



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a data security breach, increase the risk that such incidents will lead to sanctions (including fines and other penalties), claims by data subjects and disclosure leading to public knowledge of the breach, potentially causing reputational damage to our business.

*Regulation of the Internet and the lack of certainty regarding application of existing laws to the Internet could substantially harm our operating results and business.*

We are subject to laws and regulations applicable to doing business on the Internet. It is often not clear how existing laws governing issues such as property ownership, sales and other taxes, libel and personal privacy apply to the Internet as these laws have in some cases failed to keep pace with technological change. Recently enacted laws governing the Internet could also impact our business. For instance, existing and future regulations on taxing Internet use or restricting the exchange of information over the Internet could result in reduced growth or a decline in the use of the Internet and could diminish the viability of our services. In particular, the European Union has approved rules that will come into effect in 2013, and the United States is considering similar proposals, to restrict the use of automatic renewals, which may reduce the renewal rate of and subscription revenue for our premium products. Furthermore, it is possible that governments of one or more countries may censor, limit or block certain users' access to our websites. Changing industry standards and industry self-regulation regarding the collection, use and disclosure of certain data may have similar effects. Any such adverse legal or regulatory developments could substantially harm our operating results and our business.

*We believe that we and our resellers have sold or provided our products to users in jurisdictions that are the subject of export controls and sanctions administered by the U.S. Commerce Department's Bureau of Industry and Security and the U.S. Treasury Department's Office of Foreign Assets Control. We believe that we may have inadvertently violated certain of these controls and sanctions in the past. We cannot currently assess the nature and extent of fines or other penalties, if any, that the Bureau of Industry and Security or other U.S. governmental agencies may impose against us or our employees for any such violations.*

Sale of certain of our products into Cuba, Iran, North Korea, Sudan and Syria may be restricted or prohibited under U.S. export control laws and/or economic sanctions administered by the U.S. Commerce Department's Bureau of Industry and Security, or BIS, and the U.S. Treasury Department's Office of Foreign Assets Control, or OFAC. We have discovered that, from time to time, we have sold or provided free of charge through the Internet licenses to use our products to a small number of users (relative to our active and subscription user bases) in Cuba, Iran, North Korea, Sudan and Syria. In August 2011, we filed initial voluntary self-disclosures with OFAC and BIS relating to these transactions. We conducted an investigation to determine the scope of possible violations over the past five years of the export control laws and economic sanctions administered by BIS and OFAC. While we had and continue to have certain controls in place to prevent sale into, and have not actively marketed our products in, any of the jurisdictions that are the target of economic sanctions, we have determined that some sales took place to users in those jurisdictions resulting in revenue to us constituting less than one half of one percent of total paid license fee revenues over the past three years. We filed our supplemental report concerning the results of our investigation with OFAC and BIS in November 2011. In December 2011, we received a cautionary letter from OFAC indicating that it has closed its investigation without imposing any penalty and without a final agency determination on whether a violation has occurred. We cannot predict when BIS will complete its review and determination. We have implemented a remediation plan that includes having terminated access to licenses and blocked the transmission of updates and upgrades of our products to all users with a geographic internet protocol (GEOIP) address in Cuba, Iran, North Korea, Sudan or Syria. While there can be no assurance that future violations will not occur, the remedial measures we have implemented are designed to prevent future violations of regulations administered by OFAC and BIS. We will be required to spend a significant amount of time and monetary and managerial resources to address these issues, and we could experience a loss of users as a result of these issues. If we are found to be in violation of BIS regulations, we may face criminal and/or civil penalties and/or reputational harm, which could have a material adverse effect on our business and financial results.

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***Our future revenue depends on our ability to continue to market to new users, which we may not be able to accomplish on a cost-effective basis or at all.***

We are dependent on the acquisition of new users, many of whom have not previously used products and online services such as those we provide. We rely and have relied on a variety of marketing methods to attract new users to our solutions, such as generating interest through our user base and social networking services to create a user-driven marketing effect, public relations campaigns around new product and service launches and Internet security threats and efforts to improve our positioning in response to online searches through search engine optimization, search engines and other online advertising. Our ability to attract new users depends on the perceived value of our products and online services versus that of the premium and free products and online services offered by our competitors. If our current marketing initiatives are not successful or become less effective, or if the cost of such initiatives were to significantly increase, we may not be able to attract new customers as efficiently and, as a result, our revenue and results of operations would be adversely affected.

We have historically relied heavily on user-driven marketing to attract new users to our solutions, although we expect to increase our spending on marketing in the future. If we are unable to maintain or increase the efficacy of our user-driven marketing strategy, or if our more costly marketing campaigns do not have the desired impact, we may be required to increase marketing expenses still further to compensate, which could have an adverse effect on our results of operations. We cannot assure our shareholders that we will be successful in maintaining or expanding our user base on a cost-effective basis or at all, and failure to do so would adversely affect our business, operating results and financial condition.

***Our software solutions may contain undetected errors, defects or security vulnerabilities, which could cause harm to our reputation and adversely affect our business.***

Our software is inherently complex and may contain material defects, errors or vulnerabilities that may cause it to fail to perform in accordance with user expectations. As may happen to any vendor of software, errors, failures and bugs may be found in some of our new offerings after initial distribution of those offerings, particularly given that end users may deploy our products in computing environments with operating systems, software and/or hardware different than those in which we test our products before release. The costs incurred in analyzing, correcting or eliminating any material defects or errors in our software may be substantial. Furthermore, we may not be able to correct any defects or errors or address vulnerabilities promptly, or at all, causing significant harm to our reputation and competitive position.

Any defects, errors or vulnerabilities may cause interruptions to the availability of our software and result in lost or delayed market acceptance and sales, or may require us to issue refunds to our customers. Security products are critical to the businesses of many of our customers, which may make them more sensitive to defects in our products than to defects in other types of software. We could face claims for product liability, tort, breach of warranty or damages caused by faulty installation of, or defects in, our products. In the event of claims, provisions in our contracts relating to warranty disclaimers and liability limitations may be unenforceable. Defending a lawsuit, regardless of its merit, could be costly and divert management attention. Defects, errors and vulnerabilities may also lead to loss of existing or potential customers, to diversion of development resources, or to increasing our services, warranty, product replacement and product liability insurance costs, and may damage our reputation. Our product liability insurance coverage may be inadequate or future coverage may be unavailable on acceptable terms or at all.

***We have experienced rapid growth in recent years and we may not be able to sustain the same rate of growth or maintain our operating or profit margins going forward.***

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Our revenue has grown significantly in recent years, increasing by 25.4% in 2011 compared to 2010 and by 19.4% in 2010 compared to 2009. However, our operating income margins decreased by 16.7% in 2011 compared to 2010 and by 9.3% in 2010 compared to 2009, partially counteracting the effects of revenue growth

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on our profitability. We operate in a dynamic and changing market and investors should not rely on our historical results as an indication of our future operating performance. Further, as a result of the increased scale of our business, we believe that it is unlikely that we will be able to maintain the historical rate of growth of our revenue in future periods, and we cannot assure our shareholders that decreases in our operating margins will not continue.

***We may not be able to manage our growth effectively, which could harm our business and operating results, and we may need to incur significant expenditure to address the additional operational requirements of our growth.***

We have recently experienced a period of significant growth and expansion and we plan to pursue a strategy of continued growth, which has required and will continue to require substantial managerial and financial resources. Our current systems, procedures and staffing may not be adequate to support our future operations. To accommodate our recent and future growth, we must continue to expand our operational, engineering and financial systems and IT infrastructure, improve our accounting and other internal management procedures and systems and hire additional staff. In addition, our efforts to expand our business geographically include developing local language versions of our security software solutions, opening new offices and call centers, including centers to support our solutions in additional languages, hiring staff in new areas and adding additional functionality to our solutions. If we fail to manage our growth adequately, to adapt our operational, financial and management information systems and IT infrastructure, or to motivate or manage our employees effectively, the quality of our products and the management of our operations and costs would suffer, which could adversely affect our operating results. Furthermore, like many peer companies, we engage contractors as well as employees. There is some risk that relevant authorities, both in jurisdictions where we have well-established operations and those we have recently entered, could seek to reclassify our arrangements with certain contractors as employment relationships, with potentially adverse tax and regulatory consequences.

In addition, we regularly evaluate and, where appropriate, implement changes to, our internal control structure. Implementing any such changes to our internal control structure may divert management attention, entail substantial costs and take significant time to complete. These changes may not, however, be effective in maintaining the adequacy of our internal control structure in line with the growth of the business, and any failure to maintain that adequacy, or consequent inability to produce financial statements or provide accurate data from which we derive our key metrics, or monitor business developments on a timely basis, could have a material adverse effect on our business.

***If our revenue growth for any period falls short of our expectations, we may not be able to adjust our costs in a timely manner, which could reduce our profit margin in that period.***

Although we base our planned operating expenses in part on our expectations of future revenue, a substantial portion of our expenses is fixed in the short term and cannot be reduced quickly if our future revenue falls short of expectations. Accordingly, if the rate of growth of our revenue in any period is significantly less than we anticipated, because either our user base is smaller, our subscription renewal rate is lower than expected or our efforts to monetize our active user base fall short, we may be unable to adjust our cost base proportionally on an accurate and timely basis, which would reduce our operating margin.

***Our current operations are international in scope and we plan further geographic expansion, creating a variety of operational challenges.***

Our offices, personnel and customers are dispersed around the world. We face difficulties including costs associated with developing software and providing support in many languages, varying seasonality patterns, potential adverse movement of currency exchange rates, longer payment cycles and difficulties in collecting accounts receivable in some countries, tariffs and trade barriers, a variety of regulatory or contractual limitations on our ability to operate, adverse tax events, reduced protection of intellectual property rights in some countries



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and a geographically and culturally diverse workforce and customer base. Failure to overcome any of these difficulties could negatively affect our results of operations. We intend to further expand our operations globally by initially seeking to expand our user base, developing a local version of our product, seeking to introduce localized services and finding a local distributor to manage the distribution of our premium solutions. If these efforts are unsuccessful in creating and expanding our global user base, or if our expansion increases the difficulties of running a global company, our results of operations could be harmed.

***We may not be able to integrate businesses we have acquired or may in the future acquire and those acquisitions may fail to provide us with the benefits we anticipated.***

We have acquired and made investments in other companies and services to expand our technology capabilities, our product breadth and functionalities, our user base and our geographical presence, and we intend to continue to make acquisitions and investments in the future. The integration of those businesses and their operations, technologies and products involves the incurrence of acquisition costs and may expose us to liabilities, including unanticipated liabilities and tax liabilities, operating difficulties and expenditures associated with the assimilation and retention of employees of the acquired business, acquisition legal contingencies, risks related to maintaining procedures, controls and quality standards and other risks and difficulties. We may not be able to achieve the anticipated benefits from any acquisition or investment and the consideration paid for an acquisition or investment may also affect our financial results. Such acquisitions and investments could divert management's time and focus from operating our business and divert other resources needed in other parts of our business. The financing of acquisitions or investments in other companies may require us to use a substantial portion of our available cash, raise debt, which would increase our interest expense, or to issue shares or other rights to purchase shares, which may result in dilution to existing shareholders and decrease our earnings per share. Moreover, acquisitions may result in write-offs and restructuring charges as well as in creation of goodwill and other intangible assets that are subject to regular impairment testing, which could result in future impairment charges. All of these factors could adversely affect our business, results of operations and financial condition.

***We are subject to fluctuations in our financial results, making it difficult to project future results.***

A variety of factors cause volatility in our financial results, making any projections of future results uncertain. Such factors include but are not limited to fluctuations in demand for or pricing of our products, impacts of acquisitions, timing of product orders and payments, issues relating to alliances with third parties, product and geographic mix, timing of new products and customers, currency exchange fluctuations and potential accelerations of prepaid expenses and deferred costs.

***Accurately measuring the number and retention of our active and subscription users is difficult and our failure to accurately measure the number and retention of our active and subscription users at any time will compromise our ability to monitor our key performance indicators, which in turn could adversely affect our ability to manage our business.***

We measure the number of our active users as the number who (i) have downloaded and installed our free software on a PC or mobile device and have connected to our server twice in the preceding 30-day period or (ii) have a valid subscription license for our software. We measure the number of our subscription users as the number who have a valid subscription license for our software. We made a series of improvements to our tracking capabilities in 2009 and early 2010 in order to mitigate the double-counting arising from the previous system's inability to distinguish active users who may have had multiple installations during the relevant period, but these improvements also render our active users metric from previous dates not directly comparable. We have continued to have difficulties measuring the number of our active users, in part due to system constraints during upgrade campaigns. For example, at times during the second half of 2009 and the first nine months of 2010, we experienced double-counting issues due to the launch of new products and related issues with service capacity caused by high download volumes. We have also continued to have difficulties measuring the number of our subscription users, as the variety of channels by which we sell licenses requires us to draw on disparate and



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variously-dated data sources and employ manual calculations in the measurement. For the periods prior to June 30, 2009, our active and subscription user measurements should be viewed as being indicative only and as management's best estimate for the reasons noted above, as we have not been able to quantify the extent to which the figures may not be comparable and there is an inherent degree of uncertainty in these metrics. We will continue to attempt to improve the accuracy of our measurement of the numbers of our active and subscription users, but we cannot assure our shareholders that we will be successful in doing so. For example, we have made various adjustments to our counting methodology over time, including by changing the way users are recognized and counted during upgrade campaigns. While we believe these adjustments have improved the overall accuracy of our user numbers, we have still discovered some errors. As a result, we also recently introduced two new systems for counting user numbers. This project is ongoing, however, and will not be fully implemented until all users have migrated to the new version of our products. Once these counting systems are fully implemented, based on initial results, we expect that we will have greater confidence in the accuracy of our user counts, but these systems remain new and have not been tested over time, and there can be no assurance that they will meet our expectations. Our understanding and management of our business depends on accurate measures of the numbers of our active and subscription users and other key performance indicators derived from these metrics and our management decisions may be suboptimal if our measurements of these key metrics are inaccurate. Furthermore, if a significant understatement or overstatement of our active users or subscription users metrics were to occur, the market might perceive us to be underperforming or to have inadequate systems, which would adversely affect our share price.

We also face difficulties in quantifying user retention, both in terms of user churn and subscription renewal rates. This difficulty is in part due to our limited ability to track non-subscription users based on personally identifiable information. For instance, when a non-subscription user replaces a device on which he or she uses our products and services, this event typically registers as the loss of an existing user and the gain of a new one, causing no change to the size of our user base but inflating the level of apparent churn. We compile renewal rates for users of particular subscription products, but such rates only describe the activities of subscription users representing a small portion of our total active user base. Furthermore, we offer a variety of products and online services and do not have integrated methods of quantifying retention of our users across these products and services. This inability to quantify certain aspects of aggregate user behavior may adversely affect our business if we are unable to accurately monitor the results of our strategic decisions on pricing and product introduction and marketing. In particular, if we are unable to accurately assess and predict user behavior, our initiative to up-sell and cross-sell our expanding set of products and services to users across our platform may be harmed.

***We depend on download sites and search engines to attract a significant percentage of our users and if those sites or search engines change their listings, increase their pricing or experience a material reduction in their online traffic, our ability to attract new users would be adversely affected.***

Many of our users locate our products and online services and our website through download sites and search engines. In 2011, a significant number of new users of our endpoint security solution acquired that software through just one of the many download sites that features our products, CNET's Download.com website. If any of our key download sites such as Download.com cease to feature or carry our solutions, fewer potential users may download our products, particularly our AVG Anti-Virus Free Edition. Search engines typically provide two types of search results—algorithmic and purchased listings—and we rely on both types. Algorithmic listings cannot be purchased and are determined and displayed based on criteria formulated by the relevant search engine. Search engines revise their algorithms from time to time in an attempt to optimize their search results. If the search engines on which we rely for algorithmic listings modify their algorithms in a manner that reduces the prominence of our listings, fewer potential users may click through to our websites, requiring us to resort to more costly methods of attracting this traffic. Furthermore, the majority of our traffic from search engines came from a single source, Google. This traffic is unrelated to our agreement with Google to steer search queries to Google in connection with our dynamic secure search solution. The concentration of search traffic from a single search engine increases our vulnerability to potential algorithm modifications by that search engine. Any failure to replace the traffic to our website coming from search engines could reduce our revenue or require us to increase our customer acquisition expenditures.



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Similarly, we have in the past and may in the future be the target of so-called cybersquatters, who seek to register Internet domain names that are confusingly similar to our own domains or marks. Although we have not suffered material losses due to cybersquatters to date, we nonetheless make diligent efforts to block their activities. Some cybersquatters have taken our free product and sold it to users, which could lead to confusion among our users and, ultimately, a loss of these users, which would reduce any platform revenue that we would have received from these users. In addition, although no cyber-squatting incidents have raised material security concerns relating to our business and products to date, there can be no guarantee that future cybersquatting incidents will not cause material losses or raise security concerns. If search engines rank cybersquatters' imitation websites above our own sites, existing or potential customers may be misled, and this could harm our reputation, cost us consumer goodwill and negatively affect our operating results.

*Adverse conditions in national and global economies or adverse information technology spending trends in the consumer and small business markets may adversely affect our business and financial results.*

National and global economies have recently experienced a prolonged downturn and the future severity of adverse economic conditions and the length of time such conditions may persist is unknown. In particular, ongoing concerns about sovereign debt in both the European Union and the United States have increased economic uncertainty and raised the possibility of further disruption in the global capital markets. During challenging economic times, periods of high unemployment and in tight credit markets, many of our users may delay or reduce technology purchases. This is true of both consumers and small businesses, which we define as businesses with 100 seats or less, where a seat is an identified computer workstation, whether independent or part of a network. Such delays or reductions in purchasing could result in reductions in sales primarily of our online services, as well as our products, difficulties in collecting our accounts receivable, slower adoption of new technologies, lower renewal rates and increased price competition.

Other trends (whether the result of economic factors or otherwise), such as declines in the demand for PCs, servers and other computing devices, or softness in small business and consumer information technology spending, could have similar effects. The persistence of any of these conditions would likely harm our business, operating results, cash flows and financial condition.

In 2011, 60.0% of our total revenue was comprised of sales into the Americas. We are therefore exposed to conditions in the Americas and particularly in the United States, which accounted for 54.2% of our total revenue in 2011. Any continuation of or further deterioration in these conditions or a reduction in consumer or small business information technology spending for any reason could result in a downturn in sales of our premium software solutions, which, in turn, could have a material adverse effect on our growth, business, revenue and results of operations.

*False detection of viruses or other security threats by our products and online services could adversely affect our business.*

Some of our solutions identify threats by behavioral monitoring, which is a methodology that seeks to identify threats by their behavior rather than scanning for malicious code. There are inherent inaccuracies in the detection of threats based on behavioral monitoring and as a result, our anti-virus and other Internet security services may falsely indicate the presence of viruses and other threats that do not actually exist even when these programs are working correctly. These false positives may impair the perceived reliability of our services and may therefore harm our market reputation. Also, our anti-spam and anti-spyware services may falsely identify emails or programs as unwanted spam or potentially unwanted programs, or alternatively fail to properly identify unwanted emails or programs, particularly as spam emails or spyware are often designed to circumvent Internet security software. Parties whose emails or programs are blocked by our services may seek redress against us for labeling them as spammers or spyware, or for interfering with their business. In addition, false identification of emails or programs as unwanted spam or potentially unwanted software may reduce the popularity and adoption



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of our services. If our system restricts important files or applications based on falsely identifying them as malware or some other item that should be restricted, this could adversely affect customers' systems and cause material system failures. Any such false identification of important files or applications could result in negative publicity, loss of customers and sales, increased costs to remediate and costly litigation.

***Our software products and IT infrastructure may be subject to intentional disruption that could harm our reputation and future sales.***

We have been the target of spam attacks on our email addresses and denial of service and other sophisticated attacks on our websites, mail system and firewalls. Although we believe we have sufficient controls in place to prevent intentional disruptions, we expect to be an ongoing target of attacks specifically designed to impede the performance of our products. Similarly, experienced computer programmers, including programmers on our staff, could attempt to penetrate our network security or the security of our solutions and misappropriate proprietary information or cause interruption of our services. Because the techniques used by such computer programmers to access or sabotage networks change frequently and may not be recognized until launched against a target, we may be unable to anticipate these attacks. In addition, hackers have created pirated versions of our software, malware that attacks our software after it has been downloaded onto customers' computers and malware that deceptively assumes our brand name and imitates the interface of our software, encouraging our users and potential users to download it in place of our software. We may face legal liability, our activities could be adversely affected and our reputation, brand and future sales could be harmed if these intentionally disruptive efforts are or are perceived to be successful.

***We may be required to expend significant resources both to protect us against system architecture and network failure and disruption and to enable us to grow our business.***

Our web server content is stored in five separate data centers, which are located in Amsterdam, London, Toronto, Hong Kong and Brno (Czech Republic). Virus definition files are sent to Akamai Technologies GmbH, a software distributor, for distribution to our customers and backed up at our primary and secondary data centers, which are located at separate sites in Brno for redundancy purposes. At present, we have no written or formal business continuity plan with regard to our virus research specifically, or systems and system architectures in general. Furthermore, our systems are composed of various components which were not designed to interoperate with one another, potentially leading to significant system breakdowns. Although we believe we have the technical knowledge necessary to mitigate problems relating to our systems and system architecture, we may at any time be required to expend significant capital or other resources (including staff and management time and resources) to protect ourselves against network failure and disruption, including the replacement or upgrading of our existing business continuity systems, procedures and security measures. In addition, our evolving business model and growth plan will require expansion and upgrading of our systems to support additional users, localities, products and online services. These expansions and upgrades will likely consume significant capital and managerial resources.

If replacements, expansions, upgrades and/or other maintenance are not implemented successfully or completed efficiently, or there are operational failures, the quality of our product portfolio and service experienced by our users will be adversely affected. If, as a result, users were to reduce or stop their use of our Internet security solutions, this could have a material adverse effect on our operations, financial performance and prospects.

***We may become subject to unanticipated tax liabilities that have a material adverse effect on us or our shareholders.***

AVG Technologies N.V. is a company incorporated under the laws of the Netherlands and on this basis is subject to Netherlands tax laws as a Netherlands resident taxpayer. We believe that it is resident solely in the Netherlands for tax purposes and that we, and in certain cases, the holders of our shares, can rely on this position.



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for purposes of the application of tax treaties concluded by the Netherlands with other jurisdictions. However, if our tax position were successfully challenged by applicable tax authorities, or if there were changes in the tax laws, tax treaties, or the interpretation or application thereof (which could in certain circumstances have retroactive effect) or in the manner in which we conduct our activities, AVG Technologies N.V. could be considered or may become a resident of a jurisdiction other than the Netherlands, which could subject us to unanticipated tax liabilities, possibly on a retroactive basis and holders of our shares could become subject to different tax treatment in respect of the acquisition, holding (including in respect of dividend payments on our shares), redemption or disposal of our shares.

*Challenges by various tax authorities to our international structure may, if successful, increase our effective tax rate and adversely affect our earnings.*

We are a Dutch public limited liability company holding subsidiaries that operate in multiple jurisdictions, including the United States, Czech Republic, Germany, Cyprus, United Kingdom, France and China. Our income taxes are based upon the applicable tax laws and tax rates in the Netherlands and such jurisdictions as well as upon our operating structures in these countries. We determine the amount of taxes we are required to pay based on our interpretation of the applicable laws and regulations in the jurisdictions in which we operate and our application of the general transfer pricing principles to our cross-border intercompany transactions. Many countries' tax laws and international treaties impose taxation upon entities that conduct a trade or business or operate through a permanent establishment in those countries. However, these applicable laws and treaties are subject to interpretation. The tax authorities in these countries may contend that a greater portion of the income of the group should be subject to income or other tax in their respective jurisdictions. This may result in an increase to our effective tax rate and adversely affect our results of operations.

*Changes in tax laws or in the channels in which we distribute our solutions may adversely affect our reported results.*

Changes in tax laws, regulations, related interpretations and tax accounting standards in the United States, Czech Republic, Germany, Cyprus, United Kingdom, France, China, the Netherlands and other jurisdictions may result in a higher tax rate on our earnings, which may result in a significant negative impact on our earnings and cash flow from operations. Governments are increasingly considering tax law changes as a means to cover budgetary shortfalls resulting from the recent economic environment. If such proposals were enacted, or if modifications were made to certain existing tax treaties, or if tax authorities were to change their interpretations of such existing laws or treaties, the consequences may have a material adverse impact on us, including increasing our tax burden, increasing costs of our tax compliance or otherwise adversely affecting our financial condition, results of operations and cash flows. Moreover, tax audits may expose us to potential adverse tax consequences, including interest payments and potential penalties.

In addition, even if tax laws and regulations remain unchanged, a change in the channels in which we distribute our solutions could adversely affect our effective tax rate. For example, growth in retail box-on-shelf sales would subject us to additional income tax in the jurisdiction of the relevant selling entity, resulting in a higher portion of our income being subject to a higher tax rate. These events could increase our effective tax rate and therefore reduce our net profits.

*Potential changes in the tax deductibility of interest in the Netherlands may adversely affect our financial position.*

The Dutch government has approved new legislation limiting the deductibility of interest. The new law limits the interest deductions in respect of all loans used to acquire a Dutch target company which is either (1) included in a corporation tax consolidation (i.e. fiscal unity) with the acquirer or (2) merged with the acquirer. Interest expenses incurred on borrowings obtained to finance such acquisition structures would be deductible against the stand-alone taxable income of the acquirer only (i.e., in effect, the fiscal unity or legal merger is



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disregarded). A grandfathering applies for leveraged acquisitions that resulted in the inclusion of the Dutch target company in a fiscal unity or legal merger with the acquirer before November 15, 2011. The new legislation should not limit the tax deductibility of the interest payable by us under our current indebtedness. However, in certain circumstances if we were to incur new indebtedness, the new legislation would limit the tax deductibility of the interest payable by us in the future and could therefore have a material adverse effect on our financial condition and results of operation.

### ***U.S. states may seek to impose state and local business taxes.***

Even if AVG's non-U.S. entities are not subject to U.S. federal income tax, those entities could still be liable for U.S. state and local business activity taxes based upon income or gross receipts. States generally impose business activity taxes on entities deriving revenue from customers located within the state, owning or leasing property in the state or employing personnel in the state. States are becoming increasingly aggressive in asserting nexus for business activity tax purposes. Therefore, in states where we have customers, employees, agents or any activity, state tax authorities may attempt to assert nexus. If, based on our sale of products or services in the state, a state tax authority asserts that our activities give rise to nexus, we could be subject to an increased state and local tax burden.

### ***End-user taxation in our key sales jurisdictions could impact our revenues and a successful assertion that we should have been collecting (or collecting additional) sales tax or other transaction taxes on prior sales of products or services could result in substantial tax liabilities.***

Point-of-sale taxation, including U.S. state and local sales/use taxes, of our products and of services provided over the Internet or other charges imposed by government agencies or by private organizations for accessing the Internet, may be imposed on our end users and/or on us. Increased taxation on our end users for the purchase or use of our products and online services could have a material impact on the purchasing decisions of our end users and adversely affect our revenues and could also increase our internal costs. If we do not collect reimbursement for such assessments from our customers, we would become liable for these taxes. In addition, a successful assertion by any state, local jurisdiction or country that we should have been collecting (or should have been collecting additional) sales or other transaction taxes on the sale of our products or services could result in substantial tax liabilities related to past sales.

Historically, we have taken the position that our sales of software delivered over the Internet are not subject to sales/use taxes in the states in the United States. This conclusion was based on one or both of the following propositions: (i) many states do not impose sales/use tax on electronic delivery of our products; and (ii) AVG Cyprus (and, subsequent to our internal reorganization, AVG Ecommerce) did not have a physical presence and did not have nexus in any state in the United States. However, it is possible that a state or local jurisdiction in which we do not charge and collect sales/use tax or other transaction taxes could assert that we should have previously been collecting such taxes in prior periods; if successful, such challenges could require us to pay substantial amounts of taxes, interest and penalties, which could have an adverse effect on our business.

In addition, national and local governments are facing deteriorating fiscal situations and tax authorities are currently reviewing the appropriate treatment of transactions and companies engaged in electronic commerce. New or revised tax laws and regulations are being passed that may subject us or our customers to additional sales, income and other taxes. In particular, there has recently been much activity and legislation as well as audits and court cases involving imposition of sales/use taxes on e-commerce transactions in several U.S. states.

For example, some states are adopting statutes (sometimes colloquially referred to as Amazon Laws) which attribute to out-of-state vendors the in-state physical presence of a referral source, and these laws may adversely affect our business. If the vendor compensates even unrelated parties for driving business to its website (i.e., by click-through) then, in some states, there is a rebuttable presumption the vendor has nexus,

which enables the state to charge sales tax on the vendor's transactions. We use referral sources which we compensate,



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and there is a risk that we will have to collect sales/use taxes or terminate our relationship with important referral sources, including those based in key states such as California and New York that have adopted these so-called Amazon Laws. In addition to click-through nexus statutes, some states have introduced extensive and onerous reporting requirements that are burdensome and costly and could affect our business. Although the constitutionality of these click-through statutes and reporting requirements is being challenged on various grounds, if these laws are upheld as constitutional, such a result likely would lead to more widespread adoption of similar legislation which could further negatively impact our business.

***We rely on software licensed from third parties, including server software, and intellectual property rights associated with such software, that are required for the provision of our services. These licenses may be difficult to retain or the third-party software could cause errors or failures of our solutions.***

We rely on software licensed from third parties to offer our services, including server software from Mailshell and Agnitum, and other patented third-party technology. In addition, we may need to obtain future licenses from third parties to use intellectual property rights associated with the development of our solutions, which might not be available to us on acceptable terms, or at all. Any loss of the right to use any third-party software required for the development and maintenance of our solutions could result in delays in the provision of our solutions until equivalent technology is either developed by us, or, if available, is identified, obtained and integrated, which could harm our business. Any errors or defects in third-party software could result in errors or a failure of our solutions which could harm our business.

***Some of our solutions contain open source software, which may pose increased risk to our proprietary software.***

We may have in the past and could in the future combine our proprietary software with certain open source software in a certain manner, which could, under certain of the open source licenses, require us to release the source code of our proprietary software. In addition to risks related to license requirements, usage of certain open source software can lead to greater risks than use of third-party commercial software, as open source licensors generally do not provide warranties or controls on the origin of software. We cannot be sure that all open source code is submitted by our developers to our internal review process for approval prior to its inclusion in our products. In addition, many of the risks associated with the usage of open source software may be difficult to eliminate and could, if not properly addressed, negatively affect our business.

***We could be subject to claims for infringing third-party intellectual property rights, which could adversely affect our business.***

Because of the nature of our business, including development and acquisition of intellectual property rights and the hiring of employees formerly employed by competitors, we may become subject to material claims of infringement by competitors and other third parties with respect to current and future software solutions, trademarks, licenses or other intellectual property rights. In addition, we license and utilize certain third-party proprietary and open source software as part of our solutions offering. If an author or another third party that distributes such third-party or open source software were to allege that we had not complied with the conditions of one or more of these licenses, we could be required to incur significant legal expenses defending against such allegations and could be subject to significant damages, required to disclose and/or provide part of the source code of our proprietary software for no fee, enjoined from the sale of our services and required to comply with conditions that could disrupt the distribution and sale of some of our services.

To the extent that we gain greater visibility and market exposure as a public company, we may face a higher risk of being the subject of intellectual property rights infringement claims. Moreover, some of these claims may involve patent holding companies or other adverse patent owners who have no relevant product revenue of their own and against whom our own patent portfolio may therefore provide little or no deterrence. Any claims of infringement by a third party, even those without merit, could damage our reputation and the value of our brand,



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cause us to incur substantial defense costs and distract our management and employees from our business. Furthermore, a party making such a claim, if successful, could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent or limit us from offering our software. In addition, we might be required to seek a license for the use of the infringed intellectual property rights, which may not be available on commercially reasonable terms or at all. Alternatively, we might be required to develop non-infringing technology, which could require significant effort and expense and which might not be successful.

Third parties may also assert infringement claims relating to our software against our customers. Any of these claims might require us to initiate or defend potentially protracted and costly litigation on their behalf, regardless of the merits of these claims. If any of these claims were to succeed, we might be forced to pay damages on behalf of our customers, which could adversely affect our business.

*Protection of our intellectual property rights is currently limited and any misuse of our intellectual property rights by others could adversely affect our revenue and results of operations.*

Proprietary technology used in our software is important to our success. To protect our intellectual property proprietary rights related to our software, product, services, solutions and development, we have to date focused primarily on copyrights, trademarks, trade secrets, confidentiality procedures and protections afforded by contractual provisions. For example, we have registered trademarks such as AVG and our logo in the United States, the European Union and in various countries throughout the world where we currently do business or are planning to do business.

*Intellectual property rights laws and regulations are uncertain.*

The protection from and enforcement of any intellectual property rights in the markets in which we operate are uncertain. The laws of countries in which we operate or intend to expand our operations, including China, may afford little or no protection to our copyrights, trade secrets and other intellectual property rights. While we monitor the use of and respect for our intellectual property rights, policing unauthorized use of our copyrighted and trade secret technologies and proving misappropriation of our technologies are difficult. In addition, certain of our licenses are click-through licenses or are unsigned, which may render them unenforceable under the laws of some jurisdictions. Furthermore, any changes in, or unexpected interpretations of, the copyright, trade secret and other intellectual property rights laws in any country in which we operate or intend to expand our operations may adversely affect our ability to enforce our copyright, trade secret and other intellectual property rights. Costly and time-consuming litigation could be necessary to enforce or defend our intellectual property rights and/or to determine the scope of our confidential information, intellectual property right and trade secret protection. If we are unable to protect our intellectual property rights or if third parties independently develop similar technologies to ours or otherwise gain legal access to our or similar technologies, our competitive position and brand recognition could suffer and our revenue, financial condition and results of operations could be adversely affected.

*Protection of trade secrets is limited.*

We seek to protect our software, trade secrets and proprietary information, in part, by generally requiring our employees and consultant contractors to enter into agreements providing for the maintenance of confidentiality and the assignment of rights to inventions made by them while employed by or providing consulting services to us. We also enter into non-disclosure agreements with our distributors, resellers and other business partners to protect our confidential and proprietary information. There can be no assurance that our confidentiality agreements with our employees and third parties will not be breached, that we will be able effectively to enforce these agreements or to have adequate remedies for any breach or that our trade secrets and other proprietary information will not be disclosed or otherwise cease to be protected. Accordingly, despite our efforts, we may be unable to prevent third parties infringing or misappropriating our intellectual property rights and using our

technology for their competitive advantage. Any such infringement or misappropriation could have an adverse effect on our business, results of operations and financial condition.

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*We may encounter difficulties and uncertainties in obtaining patents.*

Currently we have several patent applications pending in various jurisdictions, including the United States, the European Patent Organization, Canada and Russia, and filed under the Patent Cooperation Treaty. For example, to date we have applied for patent protection for our LinkScanner technology, as well as our software for detection of harmful software, code analyses and removal of harmful software. We do not know whether any pending patent applications we have filed or will file in the future will result in the issuance of patents. Moreover, any patents that are granted may be opposed, contested or designed around by a third party, or may be subject to other limitations. We therefore may not receive significant competitive advantages from any patent rights that may ultimately be granted to us.

*Our business will suffer if the small business market for our products and online services proves less lucrative than projected or if we fail to effectively acquire and service small business customers.*

We market and sell a significant proportion of our products and online services to small businesses. Some of our competitors, by contrast, have emphasized sales to larger enterprises, which are attractive customers due to the high revenue and low relative costs they offer per transaction and their low failure and high renewal rates. Small businesses frequently have limited budgets and may choose to allocate resources to items other than our products and online services, especially in times of economic uncertainty. We believe that the small business market is underserved, however, and we intend to continue to devote substantial resources to it. We aim to grow our revenue by adding new small business customers, selling additional services to existing small business customers and encouraging existing small business customers to renew their subscriptions to our premium products. If the small business market fails to be as lucrative as we project or we are unable to market and sell our services to small businesses effectively, our ability to grow our revenue quickly and remain profitable will be harmed.

*Our business relies on the significant experience and expertise of our senior management and technical staff and we must continue to attract and retain highly skilled personnel in order to grow our business successfully.*

Our future performance depends on the continued service and performance of our key management, research and development and sales personnel. In particular, we rely on J.R. Smith, our Chief Executive Officer, or CEO, and member of our Management Board, who has been critical in developing our core strategy and vision and in leading execution of our business model over the four years of his tenure as CEO. We may fail to retain our key management, research and development and sales employees, or to attract the qualified staff needed to manage and grow our business. We may also fail to attract or retain highly qualified technical, services and management personnel in the future, or may face time-consuming and costly integration of replacement personnel. Any of these factors could adversely affect our business, revenue and results of operations.

*Our ability to sell our products is partially dependent on the quality of our support services and our failure to offer adequate support services could have an adverse effect on our reputation and results of operations.*

Our users depend on us and, to some extent, on our user community, to resolve installation, technical or other issues relating to our security software solutions. We consider a high level of service to be critical for the successful marketing and sale of our software as well as for retaining our existing users. In providing that service, we rely in part on the feedback and knowledge shared through our active online user community. Also, we have outsourced certain of our consumer support functions to third-party service providers, which may fail to perform at the level specified in our contracts with them. If we, our user community or our third-party service providers do not provide accurate technical assistance or otherwise succeed in helping our users resolve issues related to the use of our security software solutions, our reputation could be harmed and our results of operations could be adversely affected.



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*In addition to our direct sales and distribution channels, we rely on third-party distributors and resellers to sell our software. If we fail to sell our products effectively through our third-party distributors and resellers, our results of operations could be adversely affected.*

Sales made indirectly through third-party distributors and resellers accounted for 25.1% of our total revenue in 2011, and we expect this sales channel to continue to represent a large portion of our total revenue. We have limited control over the amount of software that these indirect sales partners purchase from us or sell on our behalf. Weakness in the end-user market could negatively affect the cash flow of our distributors and resellers who could, in turn, delay paying their obligations to us. Furthermore, a change in the credit quality at one of our distributors or other counterparties can increase the risk that such counterparty is unable or unwilling to pay amounts owed to us, which could directly or indirectly (through a disruption in our distribution network) have a material adverse effect on our results of operations. Any material decrease in the volume of revenue generated by our indirect sales channels could adversely affect our revenue and results of operations.

While we believe we conduct appropriate due diligence on our sales partners, we may not be able to monitor their activities for regulatory compliance. Furthermore, certain national regulations could require licenses from governments or government agencies for the use of our products and these regulations may limit our penetration of certain markets by us or our indirect sales partners. For instance, we were required to obtain a business license to begin distribution of our products in China, which took approximately two months, entailed defining the scope of our business and would require a revised license if that scope changed. China is the only jurisdiction important to our business in which we have sought a license to date, but developments such as release of new products, entry into new markets or regulatory changes in existing markets could oblige us to seek additional licenses in other jurisdictions in the future. If we violate the terms of a required license, it could cause us to lose the license, damage our reputation or require the reorganization of our distribution model.

While we have standard contract terms for our third-party distributors and resellers that allow those parties the flexibility to decide where to sell our solutions and the price at which they are sold, some of our distribution and resale contracts contain provisions relating to exclusivity or allocation of territories and/or minimum price requirements. It is possible that resellers or distributors may seek to challenge these contractual provisions on the basis of local competition law, which, regardless of its merit, could divert management time and attention and have a material adverse effect on our financial condition and results of operations. This risk may be highest among third-party distribution contracts that we may seek to terminate.

*Any material disruption of our relationships with major providers of Internet distribution services, including Akamai, and payment services could adversely affect our business.*

Third parties supply us with certain products and services that are integral to our business. For example, we depend on Akamai for the distribution of our security software, for software updates to our active users and for acceleration and caching of our Web pages. We consider the possibility of Akamai failing to be remote and we have not developed a formal back-up or business continuity plan in the event of Akamai's failure. If Akamai's systems were to fail, we would be able to accommodate the distribution of our software and software updates on our own systems, but the delivery of our content would be slower. These services are material to our business. Accordingly, any disruption in the relationship between us and Akamai or between us and one of our Internet payment service providers, including any disruption of service, or the existence of any dispute, may harm our business and results of operations.

*We are exposed to risks associated with credit card fraud and credit card payment processing.*

Our customers use credit and debit cards to pay for our services and products. We may suffer losses as a result of orders placed with fraudulent credit and debit cards. We, our payment providers and our reseller network may not have the means to detect or control payment fraud, which

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could have an adverse effect on our results of operations. The secure transmission of confidential credit and debit card information is essential to maintain customer and supplier confidence in us. Advances in technology or other developments could make it



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possible to compromise or breach the technology that we use to protect subscriber and transaction data. It is possible that our security measures may not prevent security breaches, and we may be unsuccessful in, protecting against these potential exposures. Security breaches, whether of our system or third party systems, could significantly harm our business or our reputation. In addition, we currently do not adhere to the Payment Card Industry Data Security Standard, which is a worldwide information security standard defined by the Payment Card Industry Data Security Standards Council. The standard was created to help payment card industry organizations that process card payments prevent credit and debit card fraud through increased controls around data and its exposure to compromise. Efforts to mitigate and comply with the standard, or similar standards, and even the perception of a breach of such standards increase the risk that such incidents will lead to sanctions (including fines and other penalties), claims by banks, card holders and others and disclosure leading to public knowledge of such incidents, potentially causing reputational damage to our business.

For credit and debit card transactions we pay interchange and other fees which may increase over time and raise our operating costs and lower profitability. In addition, our credit card fees may be increased by credit card companies if our chargeback rate, or the rate of payment refunds, exceeds certain minimum thresholds. If we are unable to maintain our chargeback rate at acceptable levels, our credit card fees for chargeback transactions, or for all credit card transactions, may be further increased, and credit card companies may increase our fees or terminate their relationship with us. Any increase in the credit card fees we are required to pay could adversely affect our results of operations and cash flows. The termination of our ability to process payments on any major credit or debit card could significantly impair our ability to operate and grow our business.

We are also subject to rules regarding payments of disputed charges, and if we have disputed charges over the permitted amount, we could be subject to fines and penalties and our ability to use credit cards and debit cards as a payment mechanism may be terminated. We rely on third parties to provide payment processing services, including the processing of credit and debit cards, and it could disrupt our business if these companies become unwilling or unable to provide these services to us on commercially reasonable terms or at all. We are also subject to payment card association operating rules, certification requirements and rules governing electronic funds transfers, which could change or be reinterpreted or otherwise make it difficult or impossible for us to comply. If we fail to comply with these rules or requirements, we may be subject to fines and higher transaction fees and lose our ability to accept credit and debit card payments from our customers, process or facilitate other types of online payments, and our business and operating results could be adversely affected.

***We may be unable to obtain additional financing or generate sufficient cash flows to make additional investments or fund potential acquisitions.***

We may need to raise additional funds in the future in order to invest in or acquire complementary businesses, technologies, products or services. Additional financing may not be available on terms acceptable to us, or at all. If we raise additional funds by issuing equity securities, our shareholders may experience further dilution of their ownership interests. If we raise additional funds by issuing debt securities or obtaining loans from third parties, the terms of those debt securities or financing arrangements may include covenants or other restrictions on our business that could impair our operational flexibility and would also require us to fund additional interest expense. If additional financing is not available or is not available on acceptable terms when required, we may be unable successfully to develop or enhance our security software solutions, which could materially adversely affect our business, results of operations and financial condition.

***Our indebtedness could affect our financing options and liquidity.***

On March 15, 2011, we borrowed \$235 million under our credit agreement. In addition, our credit agreement permits us to request up to an additional \$100 million in borrowings subject to lender consent and covenant compliance. Our indebtedness is secured by substantially all of our assets and could have important consequences to our business or the holders of our ordinary shares, including:

limiting our ability to obtain additional financing in the future for working capital, capital expenditures or acquisitions;

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requiring a significant portion of our net cash provided by operations to be dedicated to the payment of the principal of and interest on our indebtedness, thereby reducing funds available for other purposes;

making us more vulnerable to economic downturns, interest rate changes and limiting our ability to withstand competitive pressures; and

preventing us from paying dividends on our ordinary shares.

***We are subject to debt covenants that impose operating and financial restrictions on us and could limit our ability to grow our business.***

Covenants in our credit agreement impose significant operating and financial restrictions on us. These restrictions prohibit or limit, among other things, our incurrence of additional indebtedness, creation of certain types of liens, mergers or consolidations, asset sales, payment of dividends, investments and transactions with affiliates. These restrictions could limit our ability to take advantage of business opportunities. Furthermore, our indebtedness requires us to maintain a maximum leverage ratio and a minimum interest coverage ratio. Our ability to comply with this ratio may be affected by events beyond our control, including prevailing economic, financial and industry conditions. If we are unable to comply with the covenants and ratios in our credit agreement in the future, we may be in default under the agreement. A change in control, including our current shareholders failing to continue to own at least 30% of our issued share capital, would also constitute an event of default. A default would result in an increase in the rate of interest and may cause the loan to be accelerated. These developments could have a material adverse effect on our business.

***Changes in the relative value of currencies against the U.S. dollar could adversely affect our results of operations.***

At the parent company level, our reporting currency is the U.S. dollar and our revenue and costs are reported in U.S. dollars. The majority of our revenue is earned in U.S. dollars while a significant portion is earned in British pounds sterling, Czech crowns and euros. A substantial portion of our costs are incurred in Czech crowns. We are exposed to transaction currency risk from fluctuations in exchange rates between the U.S. dollar and British pound sterling, Czech crown and euro. In addition, we are exposed to translational risk resulting from our international sales denominated in currencies other than U.S. dollars and the resulting foreign currency balances held on our balance sheet. We enter into foreign exchange contracts to hedge much of our transactional exposure between the U.S. dollar and British pound sterling, Czech crown and euro. However, these hedging arrangements may not fully protect us from currency risk. In addition, due to Czech regulations, the functional currency of our primary Czech operating subsidiary is the Czech crown. This gives rise to a profit and loss revaluation charge on the U.S. dollar denominated assets of that Czech subsidiary. The same applies to certain other subsidiaries in other jurisdictions, such as Germany and the United Kingdom, although to a lesser extent. We manage this balance sheet exposure but do not use financial instruments to hedge these positions as we believe these are technical accounting exposures only. As a result, currency exchange rate fluctuations could adversely affect our results of operations and financial condition.

***If we fail to maintain proper and effective internal controls, our ability to produce accurate financial statements would be impaired, which could adversely affect our operating results, our ability to operate our business and our share price.***

We must ensure that we have adequate internal financial and accounting controls and procedures in place to produce accurate financial statements on a timely basis. Section 404(a) of the Sarbanes-Oxley Act will require annual management assessments of the effectiveness of our internal controls over financial reporting. We qualify as an emerging growth company under the recently-enacted JOBS Act, potentially delaying the time at which we have to comply with section 404(b) of the Sarbanes-Oxley Act, which will require a report by our independent auditors addressing these management assessments. We are only at the early stages of implementing systems and controls to fully comply with

Section 404. In addition, we may need to implement additional

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systems and controls with respect to new acquisitions and as our business model evolves. Both we and our independent auditors will be testing our internal controls in connection with the Section 404 requirements and could identify areas for further attention or improvement, including identifying issues that individually or taken together could represent a significant deficiency or material weakness in our internal control over financial reporting.

Implementing changes to our internal controls will require compliance training for our directors, officers and employees, will entail substantial costs to modify our accounting systems and may take a significant period of time to complete. For instance, we have no existing risk compliance staff. Such changes may not, however, be effective in maintaining the adequacy of our internal control over financial reporting and any failure to maintain that adequacy, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and could materially impair our ability to operate our business. In addition, investors' perceptions that our internal control over financial reporting is inadequate or that we are unable to produce accurate financial statements may materially adversely affect our share price.

*We will have new compliance burdens as a public company and as a foreign company reporting in the United States.*

As a public company, we incur significant legal, accounting and other expenses that we did not incur as a private company. The Sarbanes-Oxley Act and rules of the Securities and Exchange Commission, or SEC, and the NYSE impose various requirements on public companies beyond establishment and maintenance of effective disclosure and financial controls. We will need to continue to strengthen our internal procedures in a range of areas to match the standards expected of public companies. In addition, our recent entry into the U.S. capital markets imposes new and complex tax burdens and disclosure obligations unfamiliar to us as a company foreign to the United States. Similarly, our financial statements historically were prepared and will continue to be prepared in accordance with international financial reporting standards as adopted by the European Union, but beginning at our IPO, we have prepared and will continue to prepare our financials under U.S. GAAP for purposes of our reporting as a public company in the United States as well. Compliance with these laws and standards have increased and will continue to increase our legal, insurance and financial compliance costs and consume staff and management time, particularly while we are setting up new compliance initiatives, potentially harming our business and financial position.

## **Risks Relating to Ownership of our Ordinary Shares**

*Our share price has been and may continue to be volatile and the value of an investment in our ordinary shares may decline.*

Actual or anticipated fluctuations in our quarterly financial or operating results, the risks described above and additional factors listed below, some of which are beyond our control, may cause significant volatility in our share price. These additional factors include:

the failure of financial analysts to cover our ordinary shares or changes in financial estimates by analysts;

changes in financial estimates by financial analysts, or any failure by us to meet or exceed any of these estimates, or changes in the recommendations of any financial analysts that elect to follow our ordinary shares or the shares of our competitors;

announcements by us or our competitors of significant contracts or acquisitions;

future sales of our shares; and

investor perceptions of us and the industries in which we operate.

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In addition, the stock market in general has experienced substantial price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of particular companies affected. These broad market and industry factors may materially harm the market price of our ordinary shares, regardless of our operating performance. In the past, following periods of volatility in the market price of certain companies' securities, securities class action litigation has been instituted against these companies. This litigation, if instituted against us, could adversely affect our financial condition or results of operations.

*A substantial sale of our ordinary shares, or a perception that such sales may occur, could cause the price of our ordinary shares to decline.*

In connection with our IPO, all of our then existing shareholders agreed to certain restrictions on the sale or other disposition of our ordinary shares or any shares or other securities convertible into, or exercisable or exchangeable for, our ordinary shares, except with the prior written consent of Morgan Stanley & Co. LLC, J.P. Morgan Securities LLC and Goldman, Sachs & Co. (subject to certain exceptions). We cannot predict whether substantial numbers of our ordinary shares will be sold in the open market following the expiration of the applicable lock-up period, or during the lock-up period with the prior consent of Morgan Stanley & Co. LLC, J.P. Morgan Securities LLC and Goldman, Sachs & Co. A future sale of a substantial number of our ordinary shares, or the perception that such sales could occur, could adversely affect the market price of our ordinary shares and could also impede our ability to raise capital through an issue of ordinary shares in the future.

*Concentration of ownership among our directors, officers and large shareholders and their affiliates may prevent new investors from influencing corporate decisions.*

Current members of our management board, our supervisory board and our senior management and holders of greater than 5% of our ordinary shares and their affiliates beneficially-owned an aggregate of approximately 83.7% of our outstanding ordinary shares as of February 29, 2012. As a result, these persons will be in a position to exert significant influence over the outcome of matters submitted to a vote of our shareholders, including matters such as approval of the financial statements, declarations of dividends, the appointment and removal of the members of our management board and our supervisory board, capital increases and amendments to our articles of association. In addition, four of the members of our supervisory board are affiliated with holders of greater than 5% of our ordinary shares.

In addition, certain shareholders' significant shareholdings in us may have the effect of making certain transactions more difficult without the support of these shareholders and may have the effect of delaying or preventing our acquisition or other change in control.

*Anti-takeover provisions in our articles of association may prevent or delay change-of-control transactions.*

Our articles of association contain provisions that may have the effect of making a takeover of our company more difficult or less attractive, including:

the staggered four-year terms of our supervisory board members, as a result of which only approximately one-fourth of our supervisory board members will be subject to election in any one year;

a provision that our management board and supervisory board members may only be removed at the general meeting of shareholders by a two-thirds majority of votes cast representing at least 50% of our outstanding share capital if such removal is not proposed by

our supervisory board;

the authorization of a class of preference shares that may be issued by our management board, subject to the approval of our supervisory board, in such a manner as to dilute the interest of any potential acquirer;

requirements that certain matters, including an amendment of our articles of association, may only be brought to our shareholders for a vote upon a proposal by our management board that has been approved by our supervisory board; and



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minimum shareholding thresholds, based on nominal value, for shareholders to call general meetings of our shareholders or to add items to the agenda for those meetings.

*We are a Dutch public company with limited liability. The rights of our shareholders may be different from the rights of shareholders in companies governed by the laws of U.S. jurisdictions.*

We are a Dutch public company with limited liability (*naamloze vennootschap*). Our corporate affairs are governed by our articles of association and by the laws governing companies incorporated in the Netherlands. The rights of shareholders and the responsibilities of members of our management board and supervisory board may be different from the rights and obligations of shareholders in companies governed by the laws of U.S. jurisdictions. In the performance of its duties, our management board and supervisory board are required by Dutch law to consider the interests of our company, its shareholders, its employees and other stakeholders, in all cases with due observation of the principles of reasonableness and fairness. It is possible that some of these parties will have interests that are different from, or in addition to, the interests of our shareholders.

*We are a foreign private issuer and, as a result, are not subject to U.S. proxy rules and are subject to Exchange Act reporting obligations that, to some extent, are more lenient and less frequent than those of a U.S. domestic public company.*

We report under the Securities Exchange Act of 1934, as amended, or the Exchange Act, as a non-U.S. company with foreign private issuer status. Because we qualify as a foreign private issuer under the Exchange Act and although we are subject to Dutch laws and regulations with regard to such matters and intend to furnish quarterly financial information to the SEC, we are exempt from certain provisions of the Exchange Act that are applicable to U.S. domestic public companies, including (i) the sections of the Exchange Act regulating the solicitation of proxies, consents or authorizations in respect of a security registered under the Exchange Act; (ii) the sections of the Exchange Act requiring insiders to file public reports of their stock ownership and trading activities and liability for insiders who profit from trades made in a short period of time; and (iii) the rules under the Exchange Act requiring the filing with the SEC of quarterly reports on Form 10-Q containing unaudited financial and other specified information, or current reports on Form 8-K, upon the occurrence of specified significant events. In addition, foreign private issuers are not required to file an annual report on Form 20-F until 120 days after the end of each fiscal year, while U.S. domestic issuers that are accelerated filers are required to file an annual report on Form 10-K within 75 days after the end of each fiscal year. Foreign private issuers are also exempt from the Regulation Fair Disclosure, aimed at preventing issuers from making selective disclosures of material information. As a result of the above, our shareholders may not have the same protections afforded to shareholders of companies that are not foreign private issuers.

*As a foreign private issuer and as permitted by the listing requirements of the New York Stock Exchange, we rely on certain home country governance practices rather than the corporate governance requirements of the New York Stock Exchange.*

We are a foreign private issuer. As a result, in accordance with the listing requirements of the NYSE, we rely on home country governance requirements and certain exemptions thereunder rather than relying on the corporate governance requirements of the NYSE. See Item 16G. Corporate Governance. Accordingly, our shareholders may not have the same protections afforded to shareholders of companies that are not foreign private issuers.

*We are not obligated to and do not comply with all the best practice provisions of the Dutch Corporate Governance Code.*

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As a Dutch company we are subject to the Dutch Corporate Governance Code, or DCGC. The DCGC contains both principles and best practice provisions for management boards, supervisory boards, shareholders and general meetings of shareholders, financial reporting, auditors, disclosure, compliance and enforcement standards. The DCGC applies to all Dutch companies listed on a government-recognized stock exchange.

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whether in the Netherlands or elsewhere, including the NYSE. The principles and best practice provisions apply to our management board and our supervisory board (in relation to role and composition, conflicts of interest and independency requirements, board committees and remuneration), shareholders and the general meeting of shareholders (for example, regarding anti-takeover protection and obligations of the company to provide information to its shareholders) and financial reporting (such as external auditor and internal audit requirements). We do not comply with all the best practice provisions of the DCGC. See Item 16G. Corporate Governance. This may affect the rights of our shareholders, who may not have the same level of protection as shareholders in a Dutch company that fully complies with the DCGC.

***Only a relatively small percentage of our ordinary shares are publicly traded, which may limit the liquidity of the investments of our shareholders and may have a material adverse effect on the price of our ordinary shares.***

8,000,000 of our ordinary shares, representing 14.7% of our outstanding ordinary shares, are held by parties other than members of our management board and our supervisory board, senior management, shareholders holding 5% or more of our ordinary shares, other selling shareholders in our IPO and their respective affiliates. As a result, only a relatively small number of our ordinary shares are actively traded in the public market. Reduced liquidity may have a material adverse effect on the price of our ordinary shares.

***Our ordinary shares are not traded on any exchange outside the United States.***

Our ordinary shares are listed only in the United States on the NYSE and we have no plans to list our ordinary shares in any other jurisdiction. As a result, a holder of our ordinary shares outside the United States may not be able to effect transactions in our ordinary shares as readily as the holder may if our securities were listed on an exchange in that holder's home jurisdiction.

***We may not be able and currently have no intention to pay further dividends for the foreseeable future.***

Payment of future dividends may be made only if our equity exceeds the amount of the paid-in and called-up part of the issued share capital, increased by the reserves required to be maintained by law or by our articles of association. We currently intend to retain future earnings, if any, to finance the growth and development of our business. Also, our credit agreement restricts the payment of dividends to holders of our ordinary shares. As a result, we currently have no intention to pay dividends. Accordingly, investors cannot rely on dividend income from our ordinary shares and any returns on an investment in our ordinary shares will likely depend entirely upon any future appreciation in the price of our ordinary shares.

***Raising additional capital by issuing securities may cause dilution to existing shareholders, restrict our operations or require us to relinquish proprietary rights.***

We may in the future seek the additional capital necessary to fund acquisitions through public or private equity offerings. To the extent that we raise additional capital through the sale of equity or convertible debt securities, the ownership interest of our existing shareholders will be diluted, unless pre-emptive rights are granted, and the terms of such securities may include liquidation or other preferences that adversely affect the rights of our shareholders. Debt financing, if available, may involve agreements that include covenants limiting or restricting our ability to take specific actions such as incurring additional debt, making capital expenditures or declaring dividends.

*Certain holders of our ordinary shares may not be able to exercise pre-emptive rights and as a result may experience substantial dilution upon future issuances of ordinary shares.*

Holders of our ordinary shares in principle have a pre-emptive right with respect to any issue of ordinary shares or the granting of rights to subscribe for ordinary shares, unless explicitly provided otherwise in a resolution

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by the general meeting of shareholders or by a resolution of our management board with the approval by our supervisory board. Our general meeting of shareholders has empowered our management board, with the approval by our supervisory board, to limit or exclude pre-emptive rights on shares for a period of eighteen months from the closing of our IPO, which could cause existing shareholders to experience substantial dilution of their interest in us.

### ***Claims of U.S. civil liabilities may not be enforceable against us.***

We are incorporated under the laws of the Netherlands and substantial portions of our assets are located outside of the United States. In addition, the members of our management board, certain members of our supervisory board, certain members of our senior management and certain experts named herein reside outside the United States. As a result, it may be difficult for investors to effect service of process within the United States upon us or such other persons residing outside the United States, or to enforce outside the United States judgments obtained against such persons in U.S. courts in any action, including actions predicated upon the civil liability provisions of the U.S. federal securities laws. In addition, it may be difficult for investors to enforce, in original actions brought in courts in jurisdictions located outside the United States, rights predicated upon the U.S. federal securities laws.

There is no treaty between the United States and the Netherlands for the mutual recognition and enforcement of judgments (other than arbitration awards) in civil and commercial matters. Therefore, a final judgment for the payment of money rendered by any federal or state court in the United States based on civil liability, whether or not predicated solely upon the U.S. federal securities laws, would not be enforceable in the Netherlands unless the underlying claim is re-litigated before a Dutch court of competent jurisdiction. Under current practice however, a Dutch court may be expected to recognize the binding effect of a final, conclusive and enforceable money judgment of a federal or state court in the United States without re-examination or re-litigation of the substantive matters adjudicated thereby, if (i) that judgment resulted from legal proceedings compatible with Dutch notions of due process, (ii) that judgment does not contravene public policy of the Netherlands and (iii) the jurisdiction of the U.S. federal or state court has been based on internationally accepted principles of private international law.

Based on the foregoing, there can be no assurance that U.S. investors will be able to enforce against us or members of our management board or supervisory board, officers or certain experts named herein who are residents of the Netherlands or countries other than the United States any judgments obtained in U.S. courts in civil and commercial matters, including judgments under the U.S. federal securities laws.

In addition, there is doubt as to whether a Dutch court would impose civil liability on us, the members of our management board or supervisory board, our officers or certain experts named herein in an original action predicated solely upon the U.S. federal securities laws brought in a court of competent jurisdiction in the Netherlands against us or such members, officers or experts, respectively.

### ***We may not be able to make distributions or repurchase shares without subjecting our shareholders to Dutch withholding tax.***

Dutch dividend withholding tax may be levied on dividends and similar distributions made by us to our shareholders at the statutory rate of 15%. If dividend distributions are structured as a repayment of capital or a repurchase of shares, Dutch withholding tax may still be due at 15%. Such repayment of capital or repurchase of shares will be exempt from dividend withholding tax only in limited circumstances. See also Item 10. Additional Information E. Taxation below.

## **ITEM 4. INFORMATION ON THE COMPANY**

***A. HISTORY AND DEVELOPMENT OF THE COMPANY***

Our legal name is AVG Technologies N.V. and our commercial name is AVG or AVG Technologies. We are a public company with limited liability (*naamloze vennootschap*) incorporated under the laws of the Netherlands. We are registered with the Trade Register of the Chamber of Commerce of Amsterdam under

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number 52197204 and have an official seat in Amsterdam, the Netherlands. Our registered office address is at Gatwickstraat 9-39, 1043 GL Amsterdam, the Netherlands, with telephone number +31 (0)20 522 6210. Our principal executive offices are located at that address and at Karla Engli e 3219/4, 150 00 Praha 5, Czech Republic, with telephone number +42 (0)72 569 5114. Our principal website address is www.avg.com. The information contained in our website or that can be accessed through our website neither constitutes a part of this annual report nor is incorporated by reference herein.

We were incorporated in the Netherlands on March 3, 2011 by a notarial deed of incorporation as a cooperative (*coöperatie*) under the laws of the Netherlands under the name AVG Holding Coöperatief U.A. On November 25, 2011, we entered into a legal merger with our predecessor company and wholly owned subsidiary AVG Technologies N.V., and on November 25, 2011, we were converted into a public company with limited liability (*naamloze vennootschap*). Upon this conversion, the membership rights held by the members of the cooperative were converted into shares. For a discussion of our capital expenditures, see Item 5. Operating and Financial Review and Prospects B. Liquidity and Capital Resources.

## **B. BUSINESS OVERVIEW**

### **Our Business**

We provide software and online services that deliver peace of mind to users by simplifying, optimizing and securing their Internet experiences. Our business model, based on delivering high-quality solutions in high volume and at no cost to our users, enables us to rapidly acquire new users. Through our large user community, we are able to better understand the needs of our users, become a trusted provider of peace-of-mind software solutions, and thereby intelligently monetize our user base through premium products and value-added online services. Our solutions, which today range from desktop, laptop and mobile security software to dynamic secure Internet search solutions, can be accessed and utilized with minimal effort and limited technical know-how from the user. In choosing our solutions, which can be downloaded from the Internet, users become part of a trusted global community that benefits from network effects such as the mutual protection and support of a large user base. Our sales and marketing activities benefit from word-of-mouth recommendations from our large user network to create a viral marketing effect, which is amplified by the speed and ease of use of our products and allows us to gain new customers at a low acquisition cost. This strategy has allowed us to grow our user base to approximately 108 million active users as of December 31, 2011.

We believe that our community of approximately 108 million active users is one of our most valuable assets. We establish a trusted relationship with our community through our solutions with the goal of driving greater user engagement. Community engagement provides important contributions to our product development initiatives, enables rapid response to online threats and assists in our customer support initiatives, enabling us to accurately deliver compelling products and online services that meet the evolving needs of our users. The contributions from our community lower our costs, enabling us to offer free and low-cost offerings that further build upon the value we can deliver. We believe further monetization of our user base through online services represents a significant market opportunity for us.

Our product portfolio targets the consumer and small business markets and includes Internet security, PC performance optimization, online backup, mobile security, identity protection and family safety software. While a significant majority of our active users have been users of our free products and online services, we also offer products with premium functionality and enhanced customer support when customers purchase an annual or multi-year subscription. As of December 31, 2011, we had approximately 15 million subscription users. In addition, our online services, accessed primarily through our browser toolbar, provide dynamic secure search capabilities through agreements with leading Internet search providers. We have been successful in growing our product portfolio over time through internal development and select acquisitions.





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We employ a differentiated business model focused on monetizing and expanding our user base through (i) subscription revenue from the sale of premium products and (ii) platform-derived revenue from value-add online services that are free to our users. While users often download our subscription solutions directly from our websites, we also utilize resellers and distributors globally, including CNET, Ingram Micro and Wal-Mart. In 2011, 74.9% of our revenue was generated online, with the remainder generated through resellers and distributors. In addition, we have entered into agreements with companies such as Google, Microsoft and VeriSign that may support our efforts to increase our brand awareness and user penetration. AVG Antivirus Free Edition has been downloaded more times than any other software on CNET's Download.com website. Today, we derive substantially all of our platform-derived revenue through agreements with leading Internet search providers, in particular, Google. Our success has been built on our innovative, proven and self-reinforcing business model, which leverages our large and engaged user base, low-cost Internet-based distribution and cost-effective research and development.

We were founded in 1991 as a consumer-focused IT security company. While we have increased the breadth of our solutions over the years, we remain focused on our core mission of providing our users with differentiated solutions that simplify, optimize and secure their Internet experience, collectively providing peace of mind to a connected world. Our development and business milestones include:

In 2000, after nearly a decade of operations selling anti-virus software as Grisoft, we introduced a free version of our anti-virus product to consumers, giving rise to our free-to-paid business model.

In 2006, we acquired the business and assets of Ewido and integrated its anti-spyware product into our portfolio as part of AVG Anti-Malware. This acquisition enabled us to launch AVG Internet Security, our first endpoint security solution deployed as a suite.

In 2007, we acquired Exploit Prevention Labs, which provided the technology for our AVG LinkScanner product. We also acquired F1 Services, an AVG distributor in the United Kingdom, which operated its own web-based distribution platform.

In 2008, we developed an e-commerce platform to sell and distribute our software. We also entered into a search agreement with Yahoo!, allowing us to recognize platform-derived revenue from our large user base without charging our users. We introduced AVG Small Business Server (SBS) Edition to address the needs of small businesses.

From 2009 through 2011, we expanded our management team and hired additional professional staff to build a leadership team comprised of experienced software industry veterans.

In 2009, we acquired Sana Security, a developer of behavioral technology security software to block attackers from accessing sensitive information. We also launched AVG 9.0.

In 2010, we entered into a new search agreement with Google, replacing Yahoo! as our primary search provider.

In 2011, we acquired iMedix (also known as Visionize), a leading provider of toolbars for web browsers, DroidSecurity, a developer of cloud-based mobile security solutions, which enabled us to enter the mobile security market, TuneUp, a leading provider of PC optimization software, and Bsecure, a provider of applications for cloud-based management of information technology, and acquired a non-controlling minority stake in Scene (also known as Ookla), which provides network performance solutions. We launched AVG Mobilation for Android, as well as the first security solution for tablet devices. In addition, we launched AVG LiveKive, a cloud-based storage, sync and share solution, and MultiMi, an innovative solution to streamline the various ways our users engage in online communication across social media, email and web channels.

In 2012, we acquired OpenInstall, which provides a cloud-based software installation platform.



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Other than the initial start-up capital provided by our founder, we did not raise equity financing for our operations until our IPO, as our net cash provided by operations has historically been sufficient to fund our growth. As of December 31, 2011, our total shareholders' deficit was \$322.3 million, with the shareholders' deficit being principally a result of the aggregate of \$575.7 million in dividends and distributions in excess of capital paid since inception of the company. We currently expect to retain future earnings, if any, to finance the growth and development of our business and to provide additional liquidity. See the section titled "Item 8 Financial Information - A. Consolidated Statements and Other Financial Information - Dividend Policy" in this annual report.

## **Our Business Model**

We believe our business model affords us a significant competitive advantage. We employ a business model that leverages our large and engaged user base, low-cost Internet-based distribution and cost-effective research and development. Benefiting from viral marketing, user-generated product feedback and community support, we continuously improve product quality and user experience and add new users at a low cost of acquisition. This, in turn, improves our monetization potential and allows for incremental investment in product innovation and marketing for future growth. These business model characteristics drive scalable growth, robust operating margins and strong cash flow generation.

Key components of our business model are:

*Large and growing user base driving tangible benefits.* The size and growth of our user base and the amount of information generated by our users increase the value of our offerings and drive tangible business results. We seek to drive greater user engagement with our solutions by delivering peace of mind and, over the long term, building a relationship based on trust. We believe this is critical to building a user base that can be monetized effectively. As our users are actively engaging with each other, they provide a first level of community support as well as real-time product feedback that contributes to product innovation, as reflected in our slogan, "We Protect Us." Our business model has enabled us to build a user base of approximately 108 million active users.

*Easy-to-use, high-quality free and premium products that enable the business model.* Our business model is built on high-quality products that can be deployed or accessed with minimal effort, while providing a compelling and robust user experience. We focus on developing products that spread virally, that are highly sticky and ultimately drive increased user engagement with our platform. We provide no- or low-cost solutions to facilitate rapid user adoption. We then seek to up-sell or cross-sell to our free users once these free products have brought them into our user community. Even if users do not purchase our premium products, they are able to download and install our free solutions, expanding our user base and our monetization potential over time.

*Monetization and expansion of our user base through value-added free online services.* Since March 2008, we have deployed our dynamic secure search solution to our online community as part of a value-added service enabling secure search of the Internet. While our dynamic secure search is free to our users, we generate revenue through agreements with search providers such as Google to which we direct search queries to generate search results. Recently, we acquired iMedix, a leading toolbar provider, to enhance our technical capabilities in this area and to expand our market reach to additional distribution channels. We continuously seek to develop new, free online services that allow us to monetize and expand our user base without additional cost to our users.

*Cost-effective marketing and low customer acquisition cost.* Our business benefits from cost-effective marketing and online distribution channels. By leveraging our large user base and high customer satisfaction, we are able to achieve powerful viral marketing at low cost. Our large user base, coupled with low customer acquisition costs, results in a scalable, high-margin business model that is strengthened as our user base grows. We also distribute through resellers and distributors, which we refer to as our reseller network. The end-sellers of our solutions in this reseller network vary from large



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retail stores, such as Wal-Mart, to small individual retailers, both online and offline. This reseller network forms a part of our brand marketing strategy and generates the majority of our small business sales. We believe that our presence among retailers contributes significantly to consumer awareness of our brand. In 2011, we generated 25.1% of our revenue through our reseller network.

*Proven track record of execution, monetization and innovation.* As one of the largest software vendors employing a free-to-pay model, we have a proven track record of execution over two decades. Whether through organic development or technology acquisitions, we continue to add products and online services that simplify, optimize and secure our users' Internet experience, while delivering operating leverage. In particular, we have completed several acquisitions, including Prevention Labs and Sana Security, which we rapidly integrated successfully into our product portfolio. This enabled us to leverage our large user base to quickly adopt these solutions as part of the AVG product suite, thereby driving greater revenue from these products.

Our business model of platform monetization enables us to target multiple end markets as we broaden our products and online services, including endpoint security software and secure search. Taken together, these elements enable revenue and user base growth at relatively low cost and also allow us to acquire, maintain and support customers at low overall operating and acquisition costs while leveraging multiple, large, high-growth product markets.

**Our Solutions**

Our solutions, including software and online services, include security, PC management, online backup and other products. While our AVG AntiVirus Free Edition is provided free of charge to our users, the majority of our products are provided for a fee on a subscription basis. Our software products are currently available in various languages, used in over 185 countries around the world and sold under software license agreements. They are generally sold and downloaded over the Internet or sold as packaged products through multi-tiered distribution channels. These software license agreements generally include product maintenance, which provides technical services to our customers over the license period and regular updates of the software solutions purchased.

We have historically leveraged our security products and technology to grow our user base. As the threat landscape has evolved from viruses to more sophisticated and multi-faceted computer attacks, we have developed a broad suite of security solutions that protect against viruses, trojans, malware, suspicious code and other threats, and offer a layered approach to threat detection, including behavioral monitoring, signature-based threat detection and real-time threat detection with our LinkScanner technology. We have continued to evolve our portfolio of solutions to address not only security threats but also other online applications that are increasingly relevant to our large and growing user base. Our portfolio includes the following solutions for the consumer and business end markets:

***Consumer Solutions***

<b>Products</b>	<b>Functionalities</b>
Anti-Virus suite	Prevents receiving or unintentionally spreading viruses and other threats
	Protects from spyware, adware, rootkits and fake anti-virus
	Scans files for viruses before downloading and sharing

Checks links exchanged on social networks for viruses

Checks web pages in real time with AVG LinkScanner

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<b>Products</b>	<b>Functionalities</b>
Internet Security suite	<p>Includes the following additional features in addition to the Anti-Virus suite:</p> <ul style="list-style-type: none"><li>Provides firewall and identity protection</li><li>Blocks spam emails</li><li>Checks for viruses on downloaded executable binaries from the Internet</li><li>Advises on applications slowing the PC</li></ul>
Premium Security suite	<p>Accelerates download speed of video and executable binaries from selected sites Includes the following additional features in addition to the Internet Security suite:</p> <ul style="list-style-type: none"><li>Identity theft and misuse surveillance and alerts</li><li>Optimizes PC performance</li></ul>
AVG Mobilation	<p>Security software for Android smartphones and tablets</p> <ul style="list-style-type: none"><li>Checks apps, web content and SMS for malware before downloading</li><li>Theft protection enabling users to locate lost devices using GPS and remote access when lost or stolen to lock device or wipe content</li></ul>
AVG Threatlabs	<ul style="list-style-type: none"><li>Backup feature protecting contacts, call logs, bookmarks, messages and applications</li><li>Provides safety rating for websites</li></ul>
Family Safety	<ul style="list-style-type: none"><li>Unique logins and accounts for every child</li><li>Blocks, warns and monitors Internet content</li></ul>

	Tracks and filters social media activity
	Schedules or limits PC games and Internet access
	Sends reports and updates about children's online activity
	Remote control from any web-enabled device
TuneUp Utilities and PC Tuneup	Fixes registry problems that cause freezing and crashing
	Optimizes Internet settings and connection for speed
	File recovery after accidental deletion
	File shredder and disk wiper to permanently erase files
	Improves disk speed
LiveKive	Automatic online backup of data
	Share files, folders, photos and music with other people
	Enables automatic syncs
	Remote access to files from web and mobile devices
MultiMi	Desktop application that provides easy access to different social network contacts, including contacts in Facebook, LinkedIn and Twitter
	Provides an integrated and centralized inbox making sharing and socializing across email accounts and social networks easier



Centralizes contacts and calendars in one location

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We offer consumers four security suites, one of which provides free basic protection for Internet surfing, searching and social networking. Paid suites provide more extensive protection and other additional features:

<b>Consumer suites</b>	<b>Description</b>	<b>Anti-Virus Free Edition 2012</b>	<b>Anti-Virus 2012</b>	<b>Internet Security 2012</b>	<b>Premium Security 2012</b>
<i>Core Protection</i>					
Anti-Virus, Anti-Spyware,		.	.	.	.
Anti-Rootkit	Prevents infection and spread of viruses, worms, Trojan horses, spyware and malware				
Social Networking Protection	Automatically checks links exchanged on social networks for threats	.	.	.	.
LinkScanner	Instantaneous, real-time scanning of web pages visited for threats	.	.	.	.
<i>Chatting and Downloading</i>					
Shield for safe chatting	Protects against infections when exchanging files using chat services	.	.	.	.
Online Shield for safe downloading	Checks for viruses when downloading, sharing or exchanging files		.	.	.
<i>Support</i>					
Expert technical support	24 hour/day technical support is offered through telephone, chat and FAQ	.	.	.	.
Receive priority updates	Automatically receives more frequent updates for latest threats		.	.	.
<i>Shopping and Banking</i>					
Identity Protection	Protects personal information	.	.	.	.
Firewall	Keeps hackers out of the network			.	.
Anti-Spam	Blocks spam and scam emails			.	.
<i>Network Safety</i>					
Intrusion Detection	Protects from remote attacks when connected to networks			.	.
<i>Performance</i>					
System Tools	Allows management of start-up applications, PC monitoring and Internet browser plug-ins			.	.
Quick Tune	Optimizes PC performance				.
Identity Alert	Identity theft and misuse surveillance				.

**Customer Support and Service**

Customer support and service forms a key part of our solution offering and we offer different levels of online community support to our users.

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Our users have access to online resources, including documentation, FAQs, video tutorials and the user community in the free AVG user forum. In addition, our Facebook page and Twitter feed, with over 59,000 Twitter followers as of March 2012, have become support forums for both free and subscription users, as well as alternative ways to disseminate important threat information to our user base. In particular, our Facebook site has grown substantially in popularity. As of March 2012, over 864,000 people have liked our Facebook page.

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In addition to these resources, for some issues our free users are able to access expert technical support free of charge via toll-free phone numbers in the United States and United Kingdom, which operates 24 hours a day. AVG agents diagnose customers' requests and provide guidelines on how to use AVG products or resolve potential issues. Customers are then able to help themselves following given instructions.

We include expert technical support for all of our paid subscribers as part of the product suite subscription fee. We offer support to our subscription users with a broad range of pre-sales and post-sales services through the Internet, telephone, chat, email and remote connection for more complex cases and in a variety of languages. We have nine call centers, two in the Czech Republic, two in the Philippines, and one each in India, Canada, France, the United Kingdom and the United States. The call centers in the Philippines, India and Canada and one in the Czech Republic are outsourced. We operate the remaining four call centers. As of December 31, 2011, we had 72 employees and 147 contractors in our own and outsourced call centers. All services operated directly by AVG or by our outsourcing partners are available 24 hours a day.

We also provide premium technical support for AVG as well as non-AVG customers for a fee under the AVG TechBuddy brand. The support scope includes PC and other general device troubleshooting. The premium service is provided via remote connection to a customer's PC or telephonically. One-time fixes as well as annual support packages are offered. The service is provided by our outsourcing partner under the AVG brand.

## **Technology**

Our technology platform is designed to create simple and secure Internet experiences for our user base. We design our software to be modular, allowing us to integrate new technologies quickly into our product suites and minimize the additional use of system resources as we add new functionalities. We also design our software architecture specifically for consumers and small businesses, which we believe provides a superior foundation for developing solutions for our customers than does architecture designed for larger enterprises.

### ***Security technology***

Our security products utilize multiple protection layer architecture where each layer provides additional protection. We believe that by adding layers we strengthen our solutions' capabilities to protect users. Depending on the product and license type, we enable additional security layers for the benefit of the user, so not all of our security layers are available in all our products. For example, the free version, of our product has fewer protection layers than the paid version.

The protection layers we offer include:

*Protection against known malicious computer programs.* This layer of protection scans for malicious computer programs previously identified by the AVG security lab.

*Protection against known malicious computer program families (heuristic analysis).* This layer of protection identifies malicious computer programs based on common attributes associated with a known family of malicious programs.

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*Protection against unknown malicious computer programs (behavior analysis).* This layer of protection identifies malicious computer programs based on what they do, even if the AVG security lab has not seen such programs before.

*Protection against web exploits.* This layer of protection identifies web exploits by searching for known exploit codes previously seen on web pages and common attributes associated with known exploit families.

*Protection against known malicious or phishing web address.* This layer of protection identifies web addresses that are known to serve malicious code or to use phishing attacks.

*Protection against network attacks.* This layer of protection inspects incoming and outgoing network communication to identify computer programs connecting to remote servers or remote connections asking to connect to the computer.

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The above protection layers are offered to our users via multiple components in our products, such as Anti-virus, Anti-spyware, Anti-Rootkit, Online Shield, LinkScanner, email protection, Anti-spam, Identity protection, firewall, IM and P2P protection.

### *Non-security technology*

We have a systems infrastructure that is built and proven to scale to a massive user base. This infrastructure enables product downloads, product updates that are distributed multiple times per day, and the collection of threat data from user machines to assist us in continually tuning our threat protection algorithms and heuristics as well as improving our products quality.

## **Marketing and Sales**

### *Online marketing optimization group*

Our web lab manages our online customer acquisition and retention and active user base monetization activities. It is a core part of our overall distribution and marketing strategies. The web lab focuses on converting visitors to our websites to become either free or subscription users and it then works to maximize the lifetime value of these customers. It also drives some traffic to our websites through a range of activities including paid search and search engine optimization. Specifically, the web lab optimizes the effectiveness of our web marketing through initiatives that include: evaluating customer behavior; testing and optimizing website configurations, pricing and merchandizing to maximize conversion rates and order values; monetizing our free and paid user bases through targeted up-sell and cross-sell campaigns; monitoring the competitive landscape in order to maintain competitiveness and product differentiation; and helping to drive brand awareness and product visibility in our key markets. Given our focus on increasing web traffic and revenue, we expect our web lab to become an area of increasing importance in the future.

### *Other channel marketing*

In addition to our web lab activities, our marketing operations are supported by a dedicated general marketing team as well as a social media team. Our general marketing team focuses on developing and sustaining a strategic, appealing and differentiated positioning for our solutions through driving brand awareness and product visibility in our key markets. Key activities of our general marketing team include branding, customer insights, social media, segment and product marketing activities and channel marketing.

### *Sales*

We sell most of our products either directly through our website (74.9% of revenue including search agreements in 2011) or indirectly through resellers and distributors (25.1% of revenue in 2011). We also sell products through other direct and indirect distribution channels such as software development kit, or SDK, arrangements with other software developers.

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In the United States and Canada, we sell boxed AVG software through our distribution network to retail stores such as Wal-Mart, Office Depot, Office Max and Staples. We believe that our retail presence helps generate brand awareness for our solutions as well as a direct financial contribution. In the United Kingdom we sell boxed software through our distribution network in stores such as PC World and online via Amazon UK.

In addition to direct sales and sales through resellers and distributors, we sell to software developers through SDK arrangements, under which we provide the security component for software produced by those developers.

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### ***Google contract***

In September 2010, we signed a contract with Google for search and advertising services, through which we generate revenue whenever our users use our browser toolbar which is installed along with some of our products and which carries out searches through the Google search engine.

In most jurisdictions, we may only use Google as our search service provider until our contract with Google expires in September 2012. This contract was implemented in November 2010, at which time all of our new users began to be offered solely the Google sourced search through our toolbar. Under our previous Yahoo! contract there was a transition period ending in May 2011, during which users of our Yahoo! sourced search could continue to use Yahoo! sourced search through our toolbar, thereby still generating revenue under our Yahoo! contract, until they chose to switch to our Google sourced search. We no longer have any users searching Yahoo! via our toolbar.

### **Acquisitions**

#### ***Technology Acquisitions***

We have also added functionality to our product offering through strategic acquisitions and integration of complementary technologies. We intend to continue expanding and developing our products through targeted acquisitions.

Our key technology acquisitions to date include:

*Ewido.* In March 2006, we acquired the business and assets of Ewido, a Germany-based developer of security software, and integrated its anti-spyware product into our portfolio as part of AVG Anti-Malware.

*Exploit Prevention Labs.* In December 2007, we acquired the technology behind our LinkScanner product through our acquisition of Exploit Prevention Labs, a provider of real-time web search and surf protection technology based in the United States.

*Sana Security.* In January 2009, we acquired the business and assets of Sana Security, a developer of security software based in the United States, which developed a behavioral technology to block attackers from procuring sensitive information.

*DroidSecurity.* In January 2011, we acquired DroidSecurity, an Israel-based developer of cloud-based mobile security solutions.

*iMedix.* In May 2011, we acquired iMedix Web Technologies, an Israel-based developer of a platform for the creation and management and monitoring of toolbar applications.



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*TuneUp.* In August 2011, we acquired TuneUp, a Germany-based developer of intelligent software tools that enable users to get optimal use of their operating systems and programs. In connection with the acquisition, we are obligated to make a certain one-time earn-out payment, up to a maximum of 10.0 million in cash, which will be determined, in accordance with the acquisition agreement, based on TuneUp meeting certain EBITDA and revenue targets for the full year 2011. As of April 25, 2012 the final amount of the earn-out payment had not yet been determined. In addition, as part of the consideration for the acquisition, we are obligated to issue 851,576 ordinary shares to the sellers of TuneUp (based on our IPO price of \$16.00 per share and a euro/U.S. dollar exchange rate of \$1.32 per euro), which shares will remain in escrow subject to satisfaction of certain vesting criteria, including continuing employment by TuneUp of the sellers of TuneUp.

*Bsecure.* In November 2011, we acquired substantially all of the assets of Bsecure Solutions, a provider based in the United States of application service offerings featuring internet filtering and/or cloud-based management of information technology solutions.

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*Scene.* In November 2011, we also acquired a non-controlling minority stake in Scene, a technology company based in the United States that provides network performance solutions complementary to AVG's performance optimization offerings. In addition, we executed a commercial agreement with Scene pursuant to which Scene will exclusively promote our products in certain product categories.

*OpenInstall.* In January 2012, we acquired OpenInstall, Inc., a technology company based in the United States that provides a cloud-based software installation platform that allows for more efficient distribution of software products, provides related analytics and is complementary to AVG's secure search, performance optimization and other software offerings. Consideration for the acquisition consisted of a \$4.0 million up-front payment, which was paid from our currently available cash, and a deferred payment of approximately \$1.6 million to be paid at the end of calendar year 2012. In addition, we entered into employment agreements with certain employee former shareholders of OpenInstall for up to \$22.5 million in payments contingent upon achieving certain profit targets over three years commencing in 2012, and additional incentive compensation consisting of \$2.5 million in cash over two years for employees of OpenInstall for retentive purposes.

### ***Marketing and sales acquisitions***

We plan to add additional channels and sales capabilities through strategic acquisitions and as part of our expansion strategy we particularly look to acquire distributors in our most active and profitable markets.

Recent sales and marketing acquisitions include:

*F1 Services.* In August 2007, we acquired F1 Services, one of our distributors in the United Kingdom that operated its own web-based distribution platform.

*Square.* In late 2009, we acquired Square, a software distributor based in France that had served as AVG's exclusive distributor in France and several other francophone countries.

*Walling Data Systems.* In June 2010, we acquired the business and assets of Walling Data Systems, a provider based in the United States of computer, network and information technology solutions to businesses, educational institutions and home users.

*AVG Distribution Switzerland AG.* On October 31, 2011, we acquired AVG Distribution Switzerland AG, or AVG DACH, one of our resellers in Germany, Austria and Switzerland, based in Switzerland.

### **Government Legislation and Regulation**

#### ***Background***

The laws and regulations applicable to us, in particular laws relating to doing business on the Internet, consumer protection and information and communication technology, or ICT, are evolving rapidly. In some cases, it is not possible to ascertain with certainty how existing laws will apply in the online context, where laws have not kept pace with technological change and do not contemplate or adequately address certain unique

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issues raised by the Internet and ICT (e.g., laws relating to intellectual property, sales and other taxes; and data protection and privacy).

To date, we have earned a majority of our revenue in Europe and the United States. However, our revenue in jurisdictions outside of Europe and the United States, both in an aggregate amount and as a percentage of our overall revenue, may grow in the future. Each jurisdiction has unique regulatory bodies and levels of oversight. While over time there may be a convergence in certain regulatory areas relevant to our business, we anticipate that individual jurisdictions will still continue to exercise substantial independent influence over laws and regulations affecting our industries. The summary set forth below, while focusing on the European Union and the United States, is not intended to imply that regulation outside of these areas is not important to our business. Rather, we have found the issues that we present here to be generally applicable across jurisdictions, although the

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precise terminology and manner in which they are addressed may differ from jurisdiction to jurisdiction. We have an overall international compliance program established to achieve a high level of compliance with the regulations of the individual jurisdictions in which we have operations as well as the broader international regulatory framework.

### *EU regulatory environment*

#### *Applicable law*

We are subject to specific laws and regulations with respect to the processing of personal data, including user, customer, contractor, partner, supplier data and employee data, in many jurisdictions in which we operate. Data protection laws within the European Union derived from Directive 95/46/EC with regard to the processing of personal data and on the free movement of such data, or the EU Data Protection Directive. We are subject to certain national data protection legislation in certain member states of the European Union, which implement the EU Data Protection Directive. We are a data controller in relation to personal data collected and processed by us. We do not generally process any sensitive personal data.

#### *Key legal obligations*

The principles under applicable data protection laws in the European Union require us to ensure, among other things, the following:

*Lawfulness.* This requires, for example, that we must satisfy certain conditions in order to lawfully process personal data;

*Fairness.* This requires, for example, that we provide users with a fair processing notice ;

*Notification.* We are required to register/notify as a data controller, if processing personal data in the context of an establishment in a member state;

*Proportionality.* This requires, for example, that we must ensure that user data is only processed if and to the extent such processing is proportional in relation to the purposes of providing services to users;

*Data quality/accuracy.* This requires, for example, that we ensure that inaccurate data is corrected;

*Data retention.* This requires, for example, that we only retain data for so long as is necessary, whether to comply with applicable laws or to provide services to the user;

*Data security.* This requires, for example, that we implement appropriate technical and organizational measures to guard against unauthorized or unlawful processing of personal data and against loss or destruction of, or damage to, personal data;

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*Data transfers.* This requires, for example, that we do not transfer data outside the European Economic Area to jurisdictions which do not ensure an adequate level of protection of personal data, without taking certain steps (e.g., implementation of model contractual clauses, obtaining data subject consent or carrying out an adequacy assessment); and

*Data subject rights.* This requires, for example, that we respond to subject access requests from data subjects, to provide information about the nature and scope of processing undertaken.

Steps taken by us to ensure compliance with the above requirements are set out below. Certain of the personal data and online commerce laws and regulations in the European Union are as follows:

*EU Data Protection Regulatory Framework.* The European Commission released proposals to revise the European data protection regulatory framework on January 25, 2012. Under these proposals, the EU Data Protection Directive (Directive 95/46/EC) would be replaced with a general data protection Regulation (together with a Directive which sets out rules on protecting personal data processed to prevent, investigate or prosecute criminal offences and related matters). The Regulation would be directly applicable across all EU member states without the need for national implementing legislation, although it is not likely to enter into force until the end of 2014 at the earliest. The Regulation replaces the current data protection authority notification requirements with an obligation to conduct a data

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protection impact assessment for risky processing operations, and includes stronger requirements for consent and data breach notification and restrictions on the collection and use of sensitive personal data, as well as stricter enforcement (including, in some circumstances, the power to impose fines of up to 2% of annual worldwide turnover). It also introduces the concepts of privacy by design and the right to be forgotten. The Regulation will be directly applicable across the EU, harmonizing data protection laws and regulations among EU member states. However, the Regulation's more stringent requirements on privacy user notifications and data handling, for example, might present implementation and compliance challenges in the online and information technology fields. The Regulation does not replace the e-Privacy Directive (2002/58/EC), discussed below.

*2009 EU e-Privacy Directive.* In addition to the EU Data Protection Directive, Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector (as amended), or the e-Privacy Directive, obliges member states to introduce certain national laws regulating privacy in the electronic communications sector. Pursuant to the requirements of the e-Privacy Directive, companies must, among other things, obtain consent to store information or access information already stored, on a user's terminal equipment (e.g., computer or mobile device). These requirements predominantly regulate the use by companies of cookies and similar technologies. Prior to providing such consent, users must receive clear and comprehensive information in accordance with the EU Data Protection Directive about the access and storage of information. Certain exemptions to these requirements on which we rely are available for technical storage or access for the sole purpose of carrying out the transmission of a communication over an electronic communications network or as strictly necessary to provide a service explicitly requested by the user. Our privacy policy and fair processing notices inform users about our practices, and we routinely monitor our compliance with this legislative and regulatory framework.

*EU Consumer Rights Directive.* The EU Consumer Rights Directive, which is anticipated to be implemented in the member states in 2013, restricts the use of automatic renewals and prohibits pre-ticked boxes online. It also regulates many other aspects of online commerce, such as provision of information to consumers and refund requirements, which regulation could also result in requirements to modify certain of our business practices.

***U.S. regulatory environment***

*Privacy.* Data privacy and security with respect to the collection of personally identifiable consumer information continues to be a focus of legislation, regulation and compliance review in the United States. The Federal Trade Commission, or FTC, has begun to exercise greater authority over privacy protections generally, using its existing authority over unfair and deceptive practices and other public proceedings to apply greater restrictions on the collection and use of personally identifiable and other information relating to consumers. In December 2010, the FTC staff issued a draft recommendation that privacy rules should address consumer concerns over the collection and use of personal and profiling information, even in the absence of demonstrated consumer harm. In a December 2010 report, the Commerce Department also suggested an expansion of privacy protections, although with greater reliance on enforceable industry codes. Legislation has also been introduced in Congress that would regulate the use of personal and profiling information for advertising. Other examples of the increased legislative focus on data privacy issues include statutes adopted by the State of California that require online services to report certain breaches of the security of personal data, and to report to California customers when their personal data might be disclosed to direct marketers.

*Information security.* We are also subject to state and federal rules and laws regarding information security. Most of these rules and laws apply to customer information that could be used to commit identity theft. Substantially all of the U.S. states and the District of Columbia have enacted security breach notification laws. These laws generally require that a business give notice to its customers whose financial account or similarly sensitive information has been accessed without authorization due to a security breach.

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*Do Not Track law.* The proposed U.S. Do Not Track law would allow users to opt out of online monitoring and would thereby block even monitoring conducted with benign intent, such as monitoring to increase the efficacy of security software.

*Automatic renewals.* Proposals are under consideration that would restrict the use of automatic renewals and that would prohibit the inference of consent by using opt-out systems.

We anticipate that regulation of our business generally will increase and that we will be required to devote increasingly more legal and other resources to address these regulations. Any existing or new legislation, regulations or industry standards applicable to our business could expose us to substantial liability, including significant expenses necessary for compliance, and could hamper growth in the use of the Internet in general and our services in particular if applied in an overbroad or ineffective manner. We may also run the risk of retroactive application of new laws to our business practices that could result in liability or losses. As we expand into new territories and jurisdictions, we anticipate that legal and regulatory issues similar to those summarized above may apply to this expansion, as well as new regulatory issues that will arise in these territories and jurisdictions. As a result, as a standard part of our acquisition process, we review data privacy compliance and the applicable legal and regulatory environment.

### ***Our data protection compliance program***

We have implemented certain policies and procedures to address data protection and privacy matters and ensure compliance across the business. We maintain an online privacy policy, which describes, among other things, the categories of data collected, the purposes for which data are collected and how to access and rectify personal data held by us. Users can contact us with requests related to that data by email. As part of our purchase and installation process, we notify users about how user data is handled by providing such users with our privacy policy and fair processing notices, which provide information about our data privacy policies, including the categories of data we collect, the purposes of such data collection, and how users may access such data and, to the extent necessary, correct any inaccuracies. To further enhance our ability to comply with the various data privacy laws and regulations, we regularly review our policies and we provide education and training to our employees. We have also established a privacy committee composed of members of senior management and employees from functions across the company, including research and development, product management investor relations, marketing and sales, legal and security, which provides an information, discussion and awareness platform to help us stay abreast of the trends and developments in the data privacy area. This committee helps facilitate communication and compliance on data privacy issues throughout our company.

### **Legal Proceedings and Regulatory Matters**

In August 2011, we filed initial voluntary self-disclosures with the U.S. Treasury Department's Office of Foreign Assets Control, or OFAC, and the U.S. Commerce Department's Bureau of Industry and Security, or BIS, in connection with the inadvertent sale or provision of licenses for use of our software products to a small number of users (relative to our active and subscription user bases) in Cuba, Iran, North Korea, Sudan and Syria. We have completed an investigation to determine the scope of possible violations over the past five years of the U.S. export control laws and economic sanctions administered by OFAC and BIS. While we had and continue to have certain controls in place to prevent sales into, and have not actively marketed our products in, any of the jurisdictions that are the target of economic sanctions, we have determined that some sales took place to users in those jurisdictions resulting in revenue to us constituting less than one half of one percent of total paid license fee revenues over the past three years. We have implemented a remediation plan that includes having terminated access to licenses and blocked updates and upgrades of our products to all users with a geographic internet protocol (GEOIP) address in Cuba, Iran, North Korea, Sudan or Syria. We filed our supplemental report concerning the results of our investigation with OFAC and BIS in November 2011. In December 2011, we received a cautionary letter from OFAC indicating that it has closed its investigation without imposing any penalty and without a final agency determination on whether a violation has occurred. We cannot predict when

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BIS will complete its review and determination. If we are found to be in violation of BIS regulations, we may face criminal and/or civil penalties and/or reputational harm, which could have a material adverse effect on our business and financial results.

In addition, we are from time to time subject to certain claims and party to certain legal proceedings incidental to the normal course of our business. In view of the inherent difficulty of predicting the outcome of legal matters, we cannot state with confidence what the eventual outcome of these pending matters will be, what the timing of the ultimate resolution of these matters will be or what the eventual loss, fines or penalties related to each pending matter may be. We believe that we have made adequate reserves related to the costs anticipated to be incurred in connection with these various claims and legal proceedings and believe that liabilities related to such claims and proceedings should not have, in the aggregate, a material adverse effect on our business, financial condition or results of operations.

## **Competition**

We face significant competition in all aspects of our business. The market for consumer and small business software is fragmented and highly competitive. Barriers to entry are low, so to be effective our solutions will have to provide functionality and quality at a compelling cost relative to our competitors, among other elements. The market for consumer and small business security and associated software solutions is rapidly evolving.

Our main competitors fall into the following categories:

vendors with freemium pricing like our own, such as Avast!, Avira, PC Tools (which was acquired by Symantec), Carbonite and Dropbox;

traditional vendors such as McAfee (which was acquired by Intel Corporation), Symantec and Trend Micro (which primarily provide software solutions, including security software, for large enterprises) and Eset, Kaspersky Labs, Panda Software, Sophos, Rising, Kingsoft, Check Point and F-Secure (which offer more customized and segment-focused products);

vendors offering tune-up products, such as UniBlue; and

large corporations offering a wide variety of products, only a few of which compete with ours, such as Microsoft, Google, which recently introduced free security software solutions, Apple, which offers cloud-based data protection, Qihoo, Tencent and Facebook.

We believe the principal competitive factors in our markets can be categorized as set forth below:

product ease of use;

new features and functionality;



product interoperability and reliability;

integration with third-party applications or web user interfaces;

pace of innovation and product roadmap;

extent of active user base;

user trust and overall community engagement;

brand awareness;

price of products and online services;

strength of customer service organization;

customer support and training;

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ability to scale operations; and

size and financial stability of operations.

***C. ORGANIZATIONAL STRUCTURE***

A list of our subsidiaries, including name, country of incorporation or residence and proportion of ownership interest and voting power is provided in Item 19. Exhibits Exhibit 8.1, which is incorporated herein by reference.

***D. PROPERTY, PLANT AND EQUIPMENT***

Our principal registered office is located in Amsterdam, the Netherlands, with certain operating functions being carried out in Prague and Brno, Czech Republic. We lease approximately 7,991 square meters of space for our corporate offices in Brno. We also lease office space for our offices in Amsterdam and Prague and for our regional facilities in the San Francisco Bay Area in California; the Pensacola area in Florida; the Atlanta area in Georgia; the Boston area in Massachusetts; the Charlotte area in North Carolina; Beijing and Hong Kong, China; Nicosia, Cyprus; the Biarritz area in France; Darmstadt and Munich, Germany; Herzliya and Tel Aviv, Israel; and Newark and London, United Kingdom. Our leases expire at various times during the current and coming years. We believe that our current facilities are suitable and adequate to meet our current needs and that suitable additional or substitute space will be available as needed to accommodate expansion of our operations.

**ITEM 4A. UNRESOLVED STAFF COMMENTS**

Not Applicable.

**ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

***A. OPERATING RESULTS***

**Revenue Generation**

We generate our revenue by selling our premium products and by monetizing our active user base through online services. The sources of our revenue are geographically diversified. In 2011, Europe, Middle East and Africa (EMEA) and the Americas represented 34.9% and 60.0% of our total revenue, respectively, with the balance of our total revenue attributable to other geographic regions.

The following table summarizes the growth in our subscription revenue and our platform-derived revenue for the years ended December 31, 2009, 2010 and 2011:

	Year ended December 31,		
	2009	2010	2011
	(in thousands, except percentages)		
<b>Revenue by type:</b>			
Subscription revenue	\$ 151,365	\$ 166,904	\$ 175,654
Platform-derived revenue	30,603	50,314	96,738
Total revenue	\$ 181,968	\$ 217,218	\$ 272,392
<b>Percentage of total revenue by type:</b>			
Subscription revenue	83.2%	76.8%	64.5%
Platform-derived revenue	16.8%	23.2%	35.5%
Total revenue	100.0%	100.0%	100.0%

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### ***Subscription revenue***

The primary component of our subscription revenue is derived from the sale of premium products and online services. Payments are made upfront for the ability to access our premium products or online services, usually for a term of one or two years. These solutions include end market products offerings in security, online data backup, PC performance optimization and messaging consolidation, among others. Our premium products and solutions include additional features as well as maintenance and support services (including the right to receive unspecified future upgrades/enhancements of our products, when and if available) during the fixed term of the license. Subscription revenue is generated from the sale of fixed-term software license arrangements, which are generally sold and downloaded over the Internet or sold as packaged products through multi-tiered distribution channels. This subscription revenue is recognized ratably over the term of the related license agreement. Due to the upfront nature of the cash payments for these products, the majority of this subscription revenue is released from deferred revenue on the balance sheet.

The Company also sells perpetual software licenses primarily through indirect sales with partners, distributors and resellers and, to a lesser extent, through direct sales to customers. The perpetual license agreements include free maintenance and support services (which include the right to bug fixes, but exclude the right to receive unspecified upgrades/enhancements of the Company's product on a when-and-if-available basis), for which vendor-specific objective evidence of the fair value of undelivered elements does not exist. The Company recognizes all revenue from arrangements ratably over the expected term for providing maintenance and support services.

We also sell through our reseller network. The sales through our reseller network are undertaken by intermediaries and we offer these intermediaries a discount on our products. As a result, we receive less revenue per customer from sales through our reseller network than we do through our online channel. We recognize revenue for products sold through our reseller network on a sell-through basis.

Growth in our subscription revenue will largely depend on our ability to sell premium versions of our software products to new users as well as our ability to sell new and additional solutions and upgrades to our existing users. This growth will also depend on our continued ability to develop new solutions for our customers.

### ***Platform-derived revenue***

To date, our platform-derived revenue consists primarily of revenue generated via our dynamic secure search solution and to a lesser extent, the sale of threat analysis data. While the searches conducted by users via our dynamic secure search solution are free to our users, we receive a proportion of the revenue generated by search providers from our users' search activity. We intend to continue our monetization initiatives to drive a greater percentage of our active users to utilize our services more broadly and regularly and to offer services to users outside of our current user base. This platform-derived revenue is recognized at the time the service is provided. While search on mobile devices remains a small proportion of the total search market, and although we believe that our strategy for online growth will allow us to grow our revenues independent of this trend, we also believe mobile search represents an opportunity for us, and we will seek to develop it through a combination of product development and partnerships.

We have used our dynamic secure search solution to generate revenue through our search agreements with Yahoo!, from February 2008 to November 2010, and, since the implementation of our agreement in November 2010, with Google. Users of our free and paid Internet security solutions have been able to conduct dynamic secure Internet searches via Yahoo!, until May 2011, and Google, beginning in November 2010, through a search field we place in our toolbar, among other routes. In exchange for directing our active users' search queries to search providers, we earn a percentage of the search revenue generated by such search providers. We launched our Yahoo! commercial arrangement in February

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2008. We terminated our agreement with Yahoo! effective November 2010 and entered into an agreement with Google, implemented in November 2010, to serve as our primary search provider. Our platform segment is thus predominantly dependent on revenue generated by a

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single search results provider, which was Yahoo! from February 2008 to November 2010, and has been Google from November 2010. Our revenue generated by Google accounted for 28% of our revenue in 2011. Under our previous Yahoo! contract there was a transition period ending in May 2011, during which users of Yahoo! sourced search through our toolbar could continue to use Yahoo! sourced search, thereby still generating revenue under our Yahoo! contract, until they chose to switch to our Google sourced search.

Growth in our platform-derived revenue will depend on our ability to effectively monetize and expand our user base through additional online services and search agreements, greater user engagement and extended overall lifetimes of our products.

## **Key Metrics**

We monitor a number of metrics to evaluate our business, measure our performance, identify trends affecting our business, formulate financial projections and make strategic decisions.

### ***Active and subscription users***

Active users are those who (i) have downloaded and installed our free software on a PC or mobile device and have connected to our server twice in the preceding 30-day period or (ii) have a valid subscription license for our software. Subscription users are active users who subscribe to our premium products and online services, the primary component of our subscription revenue. We include in the number of free users trial licenses and licenses distributed for promotional purposes. We believe that our methodology for counting our user base is more conservative than methodologies used by other software companies, some of which count users with less frequent interaction.

We believe that the number of active users is the most accurate depiction of our user engagement and that active users are the most likely users of the new products and cloud-based services we intend to offer in the future. The active user metric is calculated on a per device basis, so in some cases, a single user may use multiple devices, which may increase this number, while in other cases multiple people may use a single device, which may decrease this number.

Our number of subscription users equals our number of eligible license sales multiplied by the numbers of devices protected per license. If the license is sold through the web-based channel, subscription users are counted at the time of purchase. If the license is sold through the retail channel, all subscription users under a license are counted the first time any installation under that license occurs. For example, if a user purchases a three-device license and protects only two devices, this would be counted as three users for our subscription user calculation. We apply this method consistently as we exclude unlicensed or unauthorized devices of abusing users (those users who are protecting more devices than authorized under their license) from our user base calculations. We also exclude illegal users (those who use manufactured or illicit license keys). Although we incur costs to support these users and provide them with updates we believe they form an important part of our viral marketing. Subscription users are counted as such for the entirety of their valid license period, irrespective of their connectivity to our servers. They are converted to free users upon the expiration of the license, unless the license is renewed.

While our system for measuring active users has been consistent since 2008, we have sought to continuously refine the accuracy of this measurement. The most significant improvement was the introduction of a license server in the first half of 2009. Prior to this, active users were calculated using the same methodology as described above (i.e., on the basis of at least two software update requests in the previous 30 days) but without certain detailed information, which adversely affected the accuracy of the calculation. For example, prior to our introduction of the

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license server, when we upgraded our product offering, our inability to track individual users or devices would result in double-counting of active users during the transition phase in which both the previous and upgraded solution were active. Accordingly, user numbers as of periods prior to June 30, 2009 should be

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viewed as being indicative only and as management's best estimate of our total user numbers. In addition, at times during the second half of 2009 and the first nine months of 2010, we also experienced double-counting issues due to the launch of new products and related issues with service capacity caused by high download volumes.

We recognize that potential flaws in our user metrics may exist and we will continue to assess opportunities to improve our methodology of calculating these metrics. See Item 3. Key Information D. Risk Factors Accurately measuring the number of our active and subscription users is difficult. While we recently introduced two new systems for counting user numbers, these systems will not be fully implemented until all users have migrated to the new version of our products. Once these counting systems are fully implemented, based on initial results we expect that we will have greater confidence in the accuracy of our user counts, but these systems remain new and have not been tested over time, and there can be no assurance that they will meet our expectations. We may choose in the future to alter this calculation methodology to reflect changing circumstances or additional information.

In this annual report, unless otherwise indicated, user base numbers have been rounded to the nearest million. Active users as of December 31, 2011, includes approximately five million users of products and services added upon our recent acquisition of TuneUp. Subscription users as of December 31, 2011, includes approximately three million subscription users of products and services added upon our recent acquisition of TuneUp.

### ***Revenue per active user***

Revenue per active user is defined as total revenue divided by the average number of active users in that period. The increasing revenue per active user is a reflection of our success in increasing the monetization of our active user base. We monitor revenue per active user because we believe it reflects whether we have been successful in our strategies to increase the combined platform and subscription revenue from each user. We monitor total revenue per active user, rather than monitoring platform revenue per active user or subscription revenue per active user in isolation, because each active user provides opportunities for us to realize both platform and subscription revenue through our platform monetization initiatives, such as our dynamic secure search solution, and through our multiple product strategy of up-selling and cross-selling our expanding set of premium products and online services to all of our users. We monitor revenue per active user to assist us in making strategic decisions primarily in three ways:

seeking to optimize the revenue per user we currently receive from our existing user base in order to increase our revenue per active user in the near term, including by optimizing the monetization methods used with different user base segments;

determining whether to invest in increasing the size of different user base segments to the extent that we have current opportunities to monetize them; and

determining whether to invest in increasing the size of different user base segments to the extent that we have identified opportunities to monetize them in the future.

As a result, revenue per active user represents the outcome of our strategic priorities and may vary across periods depending on the extent to which we are pursuing each of the strategies described above.



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	For the year ended or as of December 31,		
	2009	2010	2011
Total revenue (in thousands)	\$ 181,968	\$ 217,218	\$ 272,392
Active users at period end (in millions)	99	98	108
Average active users <sup>(1)</sup> (in millions)	91	98	103
Revenue per average active user	\$ 2.00	\$ 2.21	\$ 2.65

- (1) The number of average active users is calculated as the simple average of active users at the beginning of a period and the end of a period.

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### **Non-U.S. GAAP Measures**

Adjusted net income and free cash flow and their related ratios are non-U.S. GAAP measures and should not be considered alternatives to the applicable U.S. GAAP measures. In particular, adjusted net income and free cash flow, and their related ratios, should not be considered as measurements of our financial performance or liquidity under U.S. GAAP, as alternatives to income, operating income or any other performance measures derived in accordance with U.S. GAAP or as alternatives to cash flow from operating activities as a measure of our liquidity.

Adjusted net income and free cash flow are measures of financial performance or liquidity and have limitations as analytical tools, and should not be considered in isolation from, or as substitutes for, analysis of our results of operations, including our cash flows, as reported under U.S. GAAP. We use them in evaluating our business as supplemental measures of our operating performance and liquidity. Some of the limitations of adjusted net income and free cash flow and their related ratios as measures are:

they do not reflect our cash expenditure or future requirements for capital expenditure or contractual commitments, nor do they reflect the actual cash contributions received from customers;

they do not reflect changes in, or cash requirements for, our working capital needs;

they do not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our debt;

although amortization and share-based compensation are non-cash charges, the assets being amortized will often have to be replaced in the future and such measures do not reflect any cash requirements for such replacements; and

other companies in our industry may calculate these measures differently than we do, limiting their usefulness as comparative measures.

Because of these limitations, investors should rely on our consolidated financial statements prepared in accordance with U.S. GAAP and treat our adjusted net income and free cash flow as supplemental information only.

### ***Adjusted net income***

Adjusted net income is defined as net income for the period, adding back: share-based payments; acquisition-related intangible asset amortization expense; settlement of pre-existing relationships with a reseller on acquisition in 2011; and benefit (provision) for income taxes and deducting from adjusted profit before taxes the impact of a normalized tax rate of 14% in 2010 and 2011 and a blended rate of 11.1% in 2009 based on the effective tax rates of the relevant jurisdictions for the applicable adjustments. We have included adjusted net income in this annual report because it is a basis upon which our management assesses our financial performance. In addition, we present this measure because it is used by securities analysts, investors and other interested parties as a measure of the financial performance of companies in our industry. Adjusted net income is helpful as it eliminates the impact of items that we do not consider indicative of our core operating performance, facilitating comparison of operating performance from period to period and company to company by backing out potential variations in items such non-cash expenses as share-based compensation and the amortization of acquired intangibles.

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Adjusted net income as disclosed in this annual report reflects an adjustment to normalize tax as stated above, which includes an adjustment to remove the non-recurring tax benefit taken to our statement of comprehensive income created by our entry into the innovation box tax regime in the Netherlands. This additional adjustment to adjusted net income had no effect or a marginal effect on our adjusted net income for 2009 and 2010, but decreased the 2011 adjusted net income significantly by removing the impact of the benefit for income taxes shown in our statement of comprehensive income in 2011 of \$49.3 million. Our profit and loss tax charge varies from period to period and has shown significant variations from our cash tax charge in

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particular caused by our entry into a beneficial tax regime known as the innovation box tax regime in the Netherlands which resulted in a significant tax credit in June 2011. In order to remove the period to period impact of these variations, we have used an estimated normalized tax rate of 14% in our calculation of adjusted net income for 2010 and 2011 to better reflect the core operational changes in our business. The normalized tax rate of 14% is based on an estimate of our future cash tax rate as well as our recent cash and income statement tax charges. The tax rate reflected on our income statement for 2009 and 2010 was on average approximately 12.7% and the tax paid reflected on our cash flow statement in 2011 was approximately 13% with the tax paid as reflected on the cash flow statement over the last three years being approximately 17%.

In the quarter ended December 31, 2011, we made an adjustment to adjusted net income and free cash flow of \$3.7 million (net of tax \$3.2 million) related to the settlement of pre-existing relationships with a reseller on purchase of a reseller based in Germany which serviced the Germany, Austria and Switzerland region, or the DACH reseller. In total, we paid \$9.1 million for the DACH reseller including an amount of \$3.7 million that was ultimately determined to be in connection with the settlement of pre-existing relationships between the parties, separate from the acquisition. We believe that the amount attributable to settling the pre-existing relationships of \$3.7 million (net of tax \$3.2 million) should be excluded from adjusted net income and free cash flow.

In evaluating adjusted net income, you should be aware that in the future we will incur expenses similar to the adjustments reflected below. For example, while share-based compensation is a component of cost of revenue and operating expenses, the impact to our consolidated financial statements compared to other companies can vary significantly due to such factors as assumed life of the options and assumed volatility of our ordinary shares. Our presentation of adjusted net income should not be construed as an inference that our future results will be unaffected by amortization, share-based compensation or any unusual or non-recurring items. Furthermore, we may in future periods make additional adjustments to the definition of adjusted net income to reduce the impact of any unusual or non-recurring items.

The following table presents a reconciliation of adjusted net income to net income, the most comparable U.S. GAAP measure, for each of the periods indicated.

	Year ended December 31,		
	2009	2010	2011
	(in thousands)		
<b>Adjusted net income:</b>			
Net income	\$ 52,485	\$ 57,912	\$ 100,432
Add back: Share compensation	8,289	6,773	6,396
Add back: Acquisition amortization <sup>(1)</sup>	2,435	2,951	4,466
Add back: Adjustment for reseller acquisition <sup>(2)</sup>			3,673
Add back: Benefit (provision) for income taxes	6,538	9,394	(49,260)
Adjusted profit before taxes	69,747	77,030	65,707
Less: Tax effect <sup>(3)</sup>	(6,951)	(10,784)	(9,199)
Adjusted net income	\$ 62,796	\$ 66,246	\$ 56,508

(1) Includes amortization of acquired intangibles.

(2) Represents incremental payments to a reseller based in Germany, for approximately \$3.7 million (Euro 2.6 million) in cash as an amount attributable to settling pre-existing relationships, including settling disputes with the former owners of the reseller as part of the acquisition of the reseller in October 2011. The amount attributable to settling the pre-existing relationships was included as a charge to General and administration expense in our statement of comprehensive income.

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- (3) Adjusted for impact of normalized tax rate of 14% in 2010 and 2011. The normalized tax rate of 14% is based on an estimate of our future cash tax rate as well as our recent cash and income statement tax charges. In 2009 we made the adjustments for the tax based on the effective tax rates of the relevant jurisdictions for the applicable adjustments at a blended rate of 11.1%.

**Table of Contents****Free cash flow**

Free cash flow is defined as net cash provided by operating activities less capital expenditures (which we define as being made up of payments for property and equipment and intangible assets) less interest income (expense), net (which includes amortization of financing costs and loan discount) and in 2011 adding an adjustment net of taxes for the settlement of pre-existing relationships as a result of the acquisition of a reseller. See **Adjusted net income** above for a discussion of this adjustment for reseller acquisition. We have included free cash flow in this annual report because we believe free cash flow reflects the actual net cash surplus available to fund the operation and expansion of our business after payment of capital expenditures related to IT infrastructure required to maintain or expand our asset base.

In evaluating free cash flow, you should be aware that in the future we will incur expenses similar to the adjustments reflected below. Our presentation of free cash flow should not be construed as an inference that our future results will be unaffected by these expenses or any unusual or non-recurring items. Furthermore, we may in future periods make additional adjustments to the definition of free cash flow to reduce the impact of any unusual or non-recurring items.

The following table presents a reconciliation of free cash flow to net cash provided by operations, the most comparable U.S. GAAP measure, for each of the periods indicated.

	Year ended December 31,		
	2009	2010	2011
	(in thousands)		
Net cash provided by operating activities	\$ 79,483	\$ 87,911	\$ 82,911
Less: Payments for property and equipment and intangible assets	(6,632)	(11,686)	(11,373)
Less: Interest income (expense), net <sup>(1)</sup>	(171)	(29)	14,861
Add back: Adjustment for reseller acquisition <sup>(2)</sup>			3,159
<b>Free cash flow</b>	<b>\$ 72,680</b>	<b>\$ 76,196</b>	<b>\$ 89,558</b>

- (1) The tax adjustment for interest income (expense), net in 2011 is based on an assumed tax rate of approximately 10%, which is a blended rate based on internal estimates of what our effective tax rate was for that period in the Netherlands. In 2009 and 2010 the adjustments were immaterial.
- (2) Represents incremental payments to a reseller based in Germany, for approximately \$3.7 million (Euro 2.6 million) in cash as an amount attributable to settling pre-existing relationships, including settling disputes with the former owners of the reseller as part of the acquisition of the reseller in October 2011. The amount attributable to settling the pre-existing relationships was included as a charge to General and administration expense in our statement of comprehensive income. This settlement has been adjusted for the impact of a normalized tax rate of 14% for the group, showing a net adjustment after tax of \$3.2 million. The normalized tax rate of 14% is based on an estimate of our future cash tax rate as well as our recent cash and income statement tax charges

**Key Factors Affecting Our Performance**

The following discussion highlights the key factors we believe affect our results of operations.

*Increasing platform monetization of our active user base*

A key element of our anticipated growth is our ability to increasingly monetize our platform by providing new premium products and online services that drive subscription and platform-derived revenue. We believe platform-derived revenue will represent an increasing percentage of our overall revenue in the near term as we pursue additional search agreements. The primary component of platform-derived revenue is from search agreements, whereby we deliver user Internet search requests submitted into our dynamic secure search solution to our search providers. Our subscription revenue includes the sale of premium products and solutions, including our premium Internet Suite, identity protection, system optimization and PC optimization software, among others.

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Platform-derived revenue is dependent upon the volume of Internet searches conducted. We have formed a number of strategic alliances and agreements that allow us to market and cross-sell products and online services to our active users. If we are not able to provide additional products and online services that enable us to further monetize our platform, grow the number of users who use our dynamic secure search solution, increase the amount of premium products sold, or continue and extend key agreements that provide a substantial portion of our platform-derived revenue our revenue and profitability could be adversely affected. Further, currently our search revenues are derived solely from PC-based search partnerships. Products and solutions that will allow us to monetize search from mobile and tablet devices are currently under development. Our revenue and profitability will be harmed if these products and solutions are unsuccessful. Given the anticipated growth in the overall search market, including the mobile segment, we believe that our opportunity will continue to grow provided that we execute our plans for products and solutions targeting these new markets. However, failure to expand successfully into mobile and tablet search could negatively impact the rate of growth we may achieve.

### ***Growth of our user base***

Growth of our user base is a primary driver of our revenue. Growth in our subscription user base is the primary driver of our subscription revenue and growth in our active user base, along with aggregate paid clicks and cost per click, drives platform-derived revenue.

#### ***Active users***

The primary driver of growth of our active user base has been increasing user awareness of our solutions and the AVG brand, which we promote through online viral marketing, including word-of-mouth advertising, blogs and other media referrals. In addition, periodic enhancements and functionality additions made to our free solutions also contribute to overall active user base growth. Growth of our active user base also reflects our general strategy toward localization, i.e., producing versions of our products in local languages and in some cases adapted for specific markets. We build a presence in new markets through the introduction of our free Internet security software in advance of our premium products. If these various strategies do not work and we are not able to grow our active user base over the long term, our business and profitability could be adversely affected.

#### ***Subscription users***

Subscription users are those who subscribe to premium products, the primary component of subscription revenue. Growth in our subscription user base is driven by increasing user awareness of our premium products and brand, leading to both greater numbers of visits to our website and increasing traffic to our web-based distribution platform, which generates direct sales (i.e., without an upgrade from the free product). Enhancements and functionality additions to our premium solutions (as compared with our free product) have contributed to the growth of our subscription user base, particularly as those solutions have evolved to more comprehensive software suites. The growth of our active user base has also contributed to growth of our subscription user base by increasing the pool of users who may potentially upgrade to our premium solutions (and are accordingly converted into subscription users). As with direct sales, this dynamic is driven by the enhancements and additional functionality of our premium solutions. If users do not recognize the value of our premium solutions, or do not find our solutions compelling relative to the cost of these solutions, they may choose to utilize our free solutions. If users choose not to purchase or renew access to our premium solutions and we experience a significant decline in our subscription user base, our revenue and profitability may suffer.

#### ***User retention***



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One variable affecting the growth and stability of our user base is our ability to retain existing users, which is influenced by a variety of factors. For example, our ability to retain both subscription users and active users is affected by the frequency with which our users replace their personal computers, as free trial versions of antivirus and other software are typically preinstalled on new personal computers. In addition, due to our limited ability to

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track users based on personally identifiable information, even if existing users continue using our products on new personal computers, it historically has appeared to us as the loss of an existing customer and the addition of a new customer. Assessment of retention of free users is particularly difficult as we collect little or no identifiable information on these users. User retention also depends on the mix of products sold to consumers versus small businesses, as different user types have different retention characteristics. Another factor affecting subscription user retention is the extent to which we invest in various marketing and customer loyalty programs, such as discounted pricing for renewals and two-year subscriptions. We may adjust our pricing strategy from time to time with the objective of increasing our revenue per active user, which may cause decreases in our subscription renewal rates even if it increases overall revenue. For example, we may reduce discounts given to renewing users, which could increase overall revenue if the increase in revenue from each renewing user is not fully offset by the decrease in revenue caused by the resulting decline in renewal rates. We have begun implementing auto-renewals for subscription users (an opt-in option selected by the user at the time of purchase to automatically renew the relevant subscription and to charge the user's pre-designated debit or credit card) where possible and permitted by law to increase our retention of subscription users. Approximately 43% of subscription users purchasing a license online in 2011 have opted for auto-renewal. However, certain proposed regulations in the European Union and the United States may not allow for auto-renewal in the future, which may result in a lower renewal rate by our existing subscription users. Finally, many of our products and services apart from anti-virus software were introduced recently, so we have little information on retention of users of these products and services. Additional factors relating to these products and services may also prove to impact retention.

### ***Advertising clicks and revenue per click***

The substantial majority of our platform-derived business to date and expected for the near term is based on secure Internet searches. When users install our toolbar or various other applications, we provide them with our dynamic secure Internet search functionality. Except for DNS-error-page-related queries, which are sent to Yahoo!, each request for an Internet search query by a user is generally sent to our primary search provider, which is currently Google. Google's advertisers pay Google a fee each time a user clicks on one of the advertisers' ads displayed on Google's sponsored links. We receive a percentage of the fee Google receives as platform-derived revenue, which in turn is dependent on the fees Google receives from the click-through of a user. The fees per click are based on a variety of factors that are beyond our control and our revenue and profitability may be harmed if these factors do not move in our favor. If we are not able to grow the aggregate number of clicks or searches, conversion of search queries to click-throughs, number of toolbar installations and lifetime value of the toolbar, our platform-derived revenue may be impacted.

### ***Security demand and awareness***

Our free Internet security software serves as our primary customer acquisition vehicle. Internet users view security software as a prerequisite for a secure, safe Internet experience.

The size of our user base, and consequently our result of operations, are influenced by general growth in the consumer and small business security market, broader interest in security software and changes in the awareness among consumers and small businesses as to the need for Internet security. The growing use and popularity of the Internet has led to increased demand for Internet security solutions, including our products. In addition, newsworthy events involving or predicting harm caused by significant and extensive breaches of Internet security, cause demand for our products to increase. As cybercrime has increased in both frequency and sophistication, our users have demanded more comprehensive Internet security solutions. We believe that as online activity and the interconnectivity of devices continues to increase, the security requirements of our users will also increase.

### ***Online marketing and distribution***

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Our business model benefits our profitability by facilitating and encouraging viral marketing and soliciting product development ideas from our active users, which can reduce operating expenses. In particular, our model helps to limit the growth in our sales and marketing and customer acquisition expenses.

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From 2009 to 2011, our revenue was increasingly derived from our own online channels, including sales of our software solutions through our own web-based distribution platform and our platform-derived revenue, as opposed to our reseller network (which includes offline sales and sales through third-party distributors (whether in retail stores or on the Internet)). Growth in our web-based distribution has had the effect of increasing the percentage contribution of our sales to our overall profitability by eliminating costs incurred with respect to third-party distributors and lowering our own cost of sales. Over the near term, we expect sales from online channels to increase as a percentage of total revenue.

The following table summarizes our revenue by distribution channel for each of the years ended December 31, 2009, 2010 and 2011:

	Year ended December 31,		
	2009	2010	2011
	(in thousands)		
Reseller network	\$ 58,126	\$ 68,886	\$ 68,246
Web-based and platform-derived	123,841	148,332	204,146
<b>Total</b>	<b>\$ 181,968</b>	<b>\$ 217,218</b>	<b>\$ 272,392</b>

***Currency fluctuations***

Our reporting currency is the U.S. dollar, notwithstanding that we are organized under the laws of the Netherlands. In 2011, 77% of our revenue was generated in U.S. dollars, while 9% was generated in British pounds sterling, 2% in Czech crowns and 11% in euros. In addition, in 2011 we incurred 25% of our costs in Czech crowns. As a result, we have both transaction and translation currency exposures to the pound sterling, Czech crown and euro. In 2008, we began to hedge our transaction currency exposure to the pound sterling, Czech crown and euro. The effects of these hedges are accounted for in our finance income and expenses.

In addition, due to Czech regulations, the functional currency of our primary Czech operating subsidiary is the Czech crown. This gives rise to a profit and loss revaluation charge on our U.S. dollar assets of that Czech subsidiary denominated in U.S. dollars. The same applies to certain other subsidiaries in other jurisdictions, such as Germany and the United Kingdom, although to a lesser extent. We manage this balance sheet exposure but do not use financial instruments to hedge these positions as we believe these are technical accounting exposures only. In 2011, the effect of this exposure was immaterial.

***Effective tax rate***

Through May 31, 2011, our effective tax rate was mainly determined by the nominal corporate tax rate of 10% in Cyprus and the corporate tax rate in the Czech Republic, where we benefit from a relatively low corporate tax rate. In 2007, the Czech corporate tax rate was 24%, and by 2011, that rate had declined to 19%. As a result, our effective tax rate was 11.1% in 2009, 13.9% in 2010 and (96.3)% in 2011. The Company's profit and loss tax charge varies from period to period and has shown significant variations from its cash tax charge. On June 1, 2011, we entered into an innovation tax regime in the Netherlands and recognized tax benefits (deferred tax assets) which significantly impacted our effective tax rate. As a result, we received a credit, or a benefit to our income statement of \$56.3 million in June 2011, and then an offsetting charge of \$7.0 million in the third and fourth quarters of 2011 as this balance was released.

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As of June 1, 2011, we reorganized our operating model by centralizing the ownership of certain intangible intellectual property rights (and the future development of those rights) in the Netherlands. As a result of this group tax restructuring our effective tax rate will in future mainly be determined by the innovation box tax regime in the Netherlands, the nominal corporate tax rate of 10% in Cyprus and the corporate tax rate in the Czech Republic. Effective January 1, 2007, and as further amended on January 1, 2010, Dutch corporate tax legislation provides for a specific tax benefit for income generated by the exploitation of technology that results,

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among other things, from research and development activities, generally referred to as the innovation box. On May 31, 2011, we entered into an agreement with the Dutch tax authorities regarding the application of this regime to AVG. The agreement confirms the application of the tax incentive to the Dutch operations, and establishes the methodology to be used to determine our income from the technology. In addition, this agreement confirms the amount of depreciation deduction that we may take each year and also confirms the tax deductible depreciation of the intellectual property rights centralized in the Netherlands which have an agreed tax base increased to fair market value as per June 1, 2011, and tax deductibility of certain related expenses, including interest expenses. As a result, income attributable to certain research and development activities is subject to an effective tax rate of 5%, in lieu of the Dutch statutory corporate income tax rate of 25%. Our effective tax rate is subject to the uncertainties described under Item 3. Key Information D. Risk Factors Challenges by various tax authorities to our international structure may, if successful, increase our effective tax rate and adversely affect our earnings and Item 3. Key Information D. Risk Factors Changes in tax laws or in the channels in which we distribute our solutions may adversely affect our reported results.

## **Cost of Sales and Operating Expenses**

### *Cost of sales*

Cost of sales primarily consists of customer support, costs of electronic downloads, commissions to payment providers, amortization of purchased technology, software development costs, costs of packaging and license fees for technologies implemented into our software product.

### *Operating expenses*

We classify our operating expenses into three categories: sales and marketing, research and development and general and administration. These categories correspond to different departments within our company.

Our operating expenses primarily consist of personnel costs, contract research and development costs, marketing costs, professional service fees and depreciation and amortization costs. Personnel costs for each category of operating expenses include salaries, bonuses, social and health insurance, other employee benefits and share-based compensation for personnel in that category, as well as an allocation of our facilities costs. We allocate share-based compensation expense resulting from the amortization of the fair value of options. We allocate overhead, such as rent, computer and other technology costs, to each expense category based on worldwide headcount in that category.

### *Sales and marketing*

Sales and marketing expense primarily consists of personnel costs for our sales, marketing, business development and customer support employees and executives; commissions earned by our sales personnel; the cost of marketing programs such as online lead generation; promotional events and webinars; the cost of business development programs; and outsourced customer support costs. We also include the distribution of updates for our free product in this category. From 2009 to 2011, we made investments to expand our sales operations in the United Kingdom, the United States and France. We intend to increase our sales and marketing expense as a percentage of revenue and on a dollar basis, particularly in the United States and Europe, to increase brand awareness, product adoption and user growth.

*Research and development*

Research and development expense primarily consists of personnel costs for our product development, product management employees and fees to our contract development vendors. We have devoted our development initiatives primarily to expanding our product line, building out a larger product management organization and increasing the functionality and enhancing the ease of use of our solutions. Our primary research and development operations are in the Czech Republic, where we are able to take advantage of strong

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technical talent. Recent technology acquisitions have seen us increase our development base in Israel. We recently started an innovation center in Amsterdam and intend to increase operational investments in the Netherlands. We expect to increase research and development expense, as a percentage of revenue and on a dollar basis, reflecting investments in our new Amsterdam innovation center.

*General and administration*

General and administration expense primarily consists of personnel costs for our executive, information technology, finance, legal, human resources, corporate development and administrative personnel, as well as legal, accounting and other professional service fees, other corporate expenses, merger and acquisition costs that are charged to the profit and loss account and depreciation and amortization. We expect to increase general and administrative expense, as a percentage of revenue and on a dollar basis, reflecting investments in our public company infrastructure.

*Income tax expense*

Income tax expense consists of the taxes we pay in several countries on our taxable income as well as deferred tax with respect to timing differences relating to our deferred revenue. For further information on the breakdown of our income tax components, see our consolidated financial statements included in this annual report beginning on page F-1.



**Table of Contents****Results of Operations**

The following table summarizes our consolidated results of operations for the years ended December 31, 2009, 2010 and 2011:

	Year ended December 31,		
	2009	2010	2011
	(in thousands)		
<b>Statement of Comprehensive Income Data and Other Key Metrics:</b>			
Revenue:			
Subscription	\$ 151,365	\$ 166,904	\$ 175,654
Platform-derived	30,603	50,314	96,738
<b>Total revenue</b>	<b>181,968</b>	<b>217,218</b>	<b>272,392</b>
Cost of revenue: <sup>(1)</sup>			
Subscription	30,112	26,686	23,374
Platform-derived	1,308	2,293	7,849
<b>Total cost of revenue</b>	<b>31,420</b>	<b>28,979</b>	<b>31,223</b>
<b>Gross profit</b>	<b>150,548</b>	<b>188,239</b>	<b>241,169</b>
Operating expenses: <sup>(1)</sup>			
Sales and marketing	45,988	58,562	76,933
Research and development	19,533	23,364	35,008
General and administrative	24,404	40,683	60,710
<b>Total operating expenses</b>	<b>89,925</b>	<b>122,609</b>	<b>172,651</b>
<b>Operating income</b>	<b>60,623</b>	<b>65,630</b>	<b>68,518</b>
<b>Other income (expense), net</b>	<b>(1,600)</b>	<b>1,722</b>	<b>(17,104)</b>
<b>Income before income taxes and loss from investment in equity affiliate</b>	<b>59,023</b>	<b>67,352</b>	<b>51,414</b>
<b>Benefit (provision) for income taxes</b>	<b>(6,538)</b>	<b>(9,394)</b>	<b>49,260</b>
<b>Loss from investment in equity affiliate</b>		<b>(46)</b>	<b>(242)</b>
<b>Net income</b>	<b>52,485</b>	<b>57,912</b>	<b>100,432</b>
<b>Other operating metrics:</b>			
<b>Adjusted net income<sup>(2)</sup> (unaudited)</b>	<b>\$ 62,796</b>	<b>\$ 66,246</b>	<b>\$ 56,508</b>
<b>Net cash provided by operating activities</b>	<b>\$ 79,483</b>	<b>\$ 87,911</b>	<b>\$ 82,911</b>
<b>Net cash used in investing activities</b>	<b>\$ (19,157)</b>	<b>\$ (15,340)</b>	<b>\$ (69,544)</b>
<b>Net cash used in financing activities</b>	<b>\$ (71,702)</b>	<b>\$ (54,367)</b>	<b>\$ (15,329)</b>
<b>Free cash flow<sup>(3)</sup> (unaudited)</b>	<b>\$ 72,680</b>	<b>\$ 76,196</b>	<b>\$ 89,558</b>

(1) We have recognized employee share-based compensation in the consolidated statements of comprehensive income as follows:

Year ended December 31,

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	2009	2010	2011
	(in thousands)		
Cost of revenue	\$ 178	\$ 61	\$ 21
Sales and marketing	2,520	2,049	949
Research and development	1,108	1,008	1,116
General and administrative	4,483	3,655	4,310
Total share-based compensation expense	\$ 8,289	\$ 6,773	\$ 6,396

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- (2) Adjusted net income is defined as net income for the period, adding back: share-based payments; acquisition-related intangible asset amortization expense; settlement of pre-existing relationships with a reseller on acquisition in 2011; and benefit (provision) for income taxes and deducting from adjusted profit before taxes the impact of a normalized tax rate of 14% in 2010 and 2011 and a blended rate of 11.1% in 2009 based on the effective tax rates of the relevant jurisdictions for the applicable adjustments. In addition, in 2011 there was an adjustment for our acquisition of one of our resellers, adjusted by the impact of a 14% normalized tax rate. For a reconciliation of adjusted net income to net income, the most comparable U.S. GAAP measure, see [Non-U.S. GAAP Measures](#) Adjusted net income.
- (3) Free cash flow is defined as net cash provided by operating activities less capital expenditures (which we define as being made up of payments for property and equipment and intangible assets) less interest income (expense), net (which includes amortization of financing costs and loan discount) and in 2011 adding an adjustment net of taxes for the settlement of pre-existing relationships as a result of the acquisition of a reseller. For a reconciliation of free cash flow to net cash provided by operating activities, the most directly comparable U.S. GAAP financial measure, see [Non-U.S. GAAP Measures](#) Free cash flow.

	For the year ended or as of December 31,		
	2009	2010	2011
	(unaudited, users in millions)		
<b>User metrics:</b>			
Active users <sup>(1)</sup>	99	98	108
Subscription users <sup>(2)</sup>	10	12	15
Revenue per average active user <sup>(3)</sup>	\$ 2.00	\$ 2.21	\$ 2.65

- (1) Active users are those who (i) have downloaded and installed our free software on a PC or mobile device and have connected to our server twice in the preceding 30-day period or (ii) have a valid subscription license for our software. For further detail on our definition and counting of active users, see [Key Metrics](#) Active and subscription users.
- (2) Subscription users are a subset of active users who subscribe to one or more of our premium products. Payments from subscription users make up the substantial majority of subscription revenue. For further detail on our definition and counting of subscription users, see [Key Metrics](#) Active and subscription users.
- (3) The number of average active users is calculated as the simple average of active users at the beginning of a period and the end of a period.

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The following table presents our consolidated results of operations for the periods indicated as a percentage of total revenue. Percentages from certain line items do not sum to the subtotal or total line items due to rounding. The period-to-period comparisons of results are not necessarily indicative of results for future periods.

	Year ended December 31,		
	2009	2010	2011
<b>Consolidated Income Statement:</b>			
Revenue:			
Subscription	83.2%	76.8%	64.5%
Platform-derived	16.8	23.2	35.5
Total revenue	100.0	100.0	100.0
Cost of revenue:			
Subscription	16.5	12.3	8.6
Platform-derived	0.7	1.1	2.9
Total cost of revenue	17.3	13.3	11.5
Gross profit	82.7	86.7	88.5
Operating expenses:			
Sales and marketing	25.3	27.0	28.2
Research and development	10.7	10.8	12.9
General and administrative	13.4	18.7	22.3
Total operating expenses	49.4	56.4	63.4
Operating income	33.3	30.2	25.2
Other income (expense), net	(0.9)	0.8	(6.3)
Income before income taxes and loss from investment in equity affiliate	32.4	31.0	18.9
Benefit (provision) for income taxes	(3.6)	(4.3)	18.1
Loss from investment in equity affiliate			(0.1)
Net income	28.8%	26.7%	36.9%

**Years ended December 31, 2009, 2010 and 2011***Revenue*

	Year ended December 31,			Change 2009 vs. 2010		Change 2010 vs. 2011	
	2009	2010	2011	In dollars	Percentage	In dollars	Percentage
Subscription revenue (in thousands)	\$ 151,365	\$ 166,904	\$ 175,654	\$ 15,539	10.3%	\$ 8,750	5.2%
Percentage of total revenue	83.2%	76.8%	64.5%				
Platform-derived revenue (in thousands)	\$ 30,603	\$ 50,314	\$ 96,738	\$ 19,711	64.4%	\$ 46,424	92.3%

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Percentage of total revenue	16.8%	23.2%	34.5%				
Total revenue (in thousands)	\$ 181,968	\$ 217,218	\$ 272,392	\$ 35,250	19.4%	\$ 55,174	25.4%
Average active users <sup>(1)</sup> (in millions)	91	98	103		7.9%		5.1%
Revenue per average active user	\$ 2.00	\$ 2.21	\$ 2.65	\$ 0.21	10.6%	\$ 0.44	19.9%

- (1) The number of average active users is calculated as the simple average of active users at the beginning of a period and the end of a period.

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The increase in subscription revenue in 2011 compared to 2010 was primarily attributable to increased renewals, revenue from which increased by 25% to \$66 million, offset by lower first purchases. The increased renewal level was assisted by the impact of auto-renewal, which had a 38% adoption rate from first-time online purchase sales in 2011. Renewal rates for users who had previously adopted auto-renewal were 65% in 2011. We believe that our subscription revenue growth will be sustainable and may accelerate in 2012 due to the multiple product strategy we have started to implement during 2011, which involves expanding our platform beyond internet security to include a variety of other products and online services. As discussed in Item 4. Information on the Company B. Business Overview Our Growth Strategy, our goals in implementing this strategy include up-selling or cross-selling our various products to our user base, expanding our user base and driving greater user engagement, which could increase monetization of our user base. However, we are only at the early stages of implementing this strategy and there can be no assurance that we will succeed.

The increase in subscription revenue in 2010 compared to 2009 was primarily attributable to an increase in sales driven by an increase in the renewal rates for our products, which increased subscription revenue from renewing users from \$34.8 million to \$52.7 million. These renewal increases were partially offset by a decrease in sales to first-time subscription users, which reduced subscription revenue from first-time users from \$116.6 million to \$114.2 million, and negative pricing pressure on our premium products.

The increase in platform-derived revenue in 2011 compared to 2010 was primarily due to increased monetization from our dynamic secure search solution. This increase was driven by our transition from Yahoo! to Google as our primary search provider, which we successfully completed in May 2011, and product improvements that we believe are leading to greater customer retention, both of which are driving increased numbers of searches. We have seen a significant increase in the platform-derived revenue per average active user as a result of these developments from \$0.51 per user in 2010 to \$0.94 in 2011. We will see the benefits of the transition to Google until May 2012.

The increase in platform-derived revenue in 2010 compared to 2009 was primarily due to an increase in revenue generated by our search agreements driven by greater utilization of our dynamic secure search solution, growth in the number of our active users throughout the period, as average active users increased from 91 million in 2009 to 98 million in 2010, and our diversification into adjacent product areas. As of November 2010, Google replaced Yahoo! as our search provider for all new and upgrading users. We believe that the additional revenue earned from increased utilization of our search feature was partly attributable to enhancements that we made to the user interface and functionality of our search platform. We intend to continue our diversification into adjacent product areas. See Item 4. Information on the Company B. Business Overview Our Growth Strategy.

The increases in revenue per average active user in 2011 compared to 2010 and in 2010 compared to 2009 were driven by the same factors that drove the increases in subscription revenue and platform-derived revenue discussed above, apart from the changes in the size of our user base, which impact absolute amounts of subscription revenue and platform-derived revenue and do not impact revenue per average active user.

*Cost of revenue*

	Year ended December 31,			Change 2009 vs. 2010		Change 2010 vs. 2011	
	2009	2010	2011	In dollars	Percentage	In dollars	Percentage
				(in thousands, except percentages)			
Cost of revenue	\$ 31,420	\$ 28,979	\$ 31,223	\$ (2,441)	(7.8)%	\$ 2,244	7.7%
Percentage of total revenue	17.3%	13.3%	11.5%				

The increase in the cost of revenue in 2011 compared to 2010 reflects increased bookings offset by ongoing cost optimization with current providers. Payments to third parties for using their intellectual property increased 86% (\$4.8 million) year over year primarily due to our toolbar provider costs increasing during the period, but we expect these to decrease as the purchase of a search technology partner, iMedix, will reduce

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cost on the cost of revenue line and will instead be reflected as operating expense from the purchased entity. We also continued to optimize our customer services costs, which decreased by 13% year over year to \$8.2 million, as we transitioned to a new customer services provider. We also reduced transaction processing fees for our electronic distribution by 22% during the period as we reduced our reliance on third-party providers. While we have been successful in reducing costs of revenue historically, we anticipate that our move into search distribution will increase our cost of revenue in future periods and we estimate that in future periods these costs may constitute up to 15% of revenues.

The decrease in the cost of revenue from 2009 to 2010 reflects favorable changes to our payment processor terms of \$3.5 million and reductions in product distribution costs of \$1.4 million following our negotiation of more favorable terms with our third party customer support providers. This was offset by increasing license fees of \$2.2 million reflecting increased product sales.

The optimization of our web-based distribution platform and renegotiation of the primary contracts with our web distribution providers throughout the period resulted in improved terms and as a result, we experienced substantial reductions in costs per sale, which offset much of the increase from additional overall sales and third-party license fees.

In 2009, we also began to pay search provider fees to third parties. The revenue from search had been booked on a net basis in early 2009 until we changed our business partner and the nature of our relationship with this partner meant that we booked license fees on this product for the first time.

Although our cost of sales grew as our volume of sales increased, our gross profit margins have increased over all three years (82.7%, 86.7% and 88.5% in 2009, 2010 and 2011, respectively). We anticipate that we will undertake more agreements to sell third-party products in the future and the success of these product sales may cause this margin to decline in future years.

*Sales and marketing*

	Year ended December 31,			Change 2009 vs. 2010		Change 2010 vs. 2011	
	2009	2010	2011	In dollars	Percentage	In dollars	Percentage
	(in thousands, except percentages)						
Sales and marketing	\$ 45,988	\$ 58,562	\$ 76,933	\$ 12,574	27.3%	\$ 18,371	31.4%
Percentage of total revenue	25.3%	27.0%	28.2%				

The increase in sales and marketing expenses in 2011 compared to 2010 was due to an increase in marketing spend of \$13.3 million and additional payroll costs of \$4.7 million from growth in sales and marketing headcount. The increased marketing spend reflects our commitment to both brand advertising and specific online advertising campaigns as well as company's move from a single to a multi-product portfolio and new initiatives to drive top line growth and market share, particularly in the tune up, mobile and search distribution areas. Sales and marketing expenses are expected to increase as a percentage of revenue in 2012 as a result of continuous investment in these areas which is expected to deliver higher margins in the future as these businesses mature, although no assurances can be made.

The increase in sales and marketing expenses in 2010 compared to 2009 was due to an increase in payroll expenses of \$8.7 million as a result of hiring additional employees who were brought in from acquisitions as well as adding members to our management team, and \$2.1 million of incremental direct marketing spend.





**Table of Contents***Research and development*

	Year ended December 31,			Change 2009 vs. 2010		Change 2010 vs. 2011	
	2009	2010	2011	In dollars	Percentage	In dollars	Percentage
				(in thousands, except percentages)			
Research and development	\$ 19,533	\$ 23,364	\$ 35,008	\$ 3,831	19.6%	\$ 11,644	49.8%
Percentage of total revenue	10.7%	10.8%	12.9%				

The increase in research and development expenses in 2011 compared to 2010 was primarily the result of research and development headcount with the acquisition of the mobile platform company, Droid, and our acquisition of the iMedix search team. We have also grown our product management team organically to allow us to support our multi-product strategy with the addition of TuneUp Software and investments in online back-up and mobile solutions. Total payroll costs increased \$8.2 million year over year. As of December 31, 2010, we had 229 employees in research and development compared to 343 employees as of December 31, 2011. This expansion occurred primarily in the Czech Republic, but we also added key personnel in the United States, the Netherlands and other locations through acquisitions. As we continue to expand our activities in research and development and our product management requirements increase, we anticipate research and development headcount will continue to increase with the associated increase in costs. The increase in research and development expenses in 2010 compared to 2009 was due to an increase in payroll expenses of \$1.3 million as a result of the hiring of additional employees in the product management and development teams and increased spending on outsourced research and development services provided by consultants and other third parties of \$1.4 million.

*General and administration*

	Year ended December 31,			Change 2009 vs. 2010		Change 2010 vs. 2011	
	2009	2010	2011	In dollars	Percentage	In dollars	Percentage
				(in thousands, except percentages)			
General and administration	\$ 24,404	\$ 40,683	\$ 60,710	\$ 16,279	66.7%	\$ 20,027	49.2%
Percentage of total revenue	13.4%	18.7%	22.3%				

The increase in general and administration expenses in 2011 compared to 2010 was due primarily to two factors. Payroll expenses increased by \$8.2 million as we continued to strengthen the management team and added key personnel in the United States, the Netherlands, Germany and other locations. We also incurred significant expenditures including those related to our conversion to U.S. GAAP, controls procedure assessments, implementation related to our IPO and future public reporting as a U.S. listed company; these costs totaled \$3.5 million in 2011. General and administrative expenses further included significant acquisition-related transaction costs from the various acquisitions we concluded in 2011.

On October 31, 2011, we acquired one of our resellers, a German reseller of AVG products in Germany, Austria and Switzerland, or AVG DACH, for approximately \$9.1 million in cash. The payment of \$9.1 million that we made to acquire AVG DACH was split into (1) an amount attributable to settling pre-existing relationships, including settling disputes with the former owners of the acquiree and (2) an amount attributable to consideration for the transaction. The amount attributable to settling pre-existing relationships, including settling disputes with the former owners of the acquiree, was determined at \$3.7 million and was included as a charge to General and administration expense in our statement of comprehensive income.

We expect that general and administrative expenses will decline in 2012 on a percentage of revenue basis. The increase in general and administration expenses from 2009 to 2010 was due to certain costs that we incurred in 2010, including a \$3.6 million write-off relating to direct expenses for our efforts at listing on Euronext Amsterdam, a further \$1.3 million in consulting fees primarily related to this listing, \$2.9 million

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in additional payroll expenses in connection with the build out of the management team and \$1.9 million in costs associated with merger and acquisition activities.

**Table of Contents***Other income (expense), net*

	Year ended December 31,			Change 2009 vs. 2010		Change 2010 vs. 2011	
	2009	2010	2011	In dollars	Percentage	In dollars	Percentage
Other income (expense), net	\$ (1,600)	\$ 1,722	\$ (17,104)	\$ 3,322	NM	\$ (18,826)	NM
Percentage of total revenue	(0.9)%	0.8%	(6.3)%				

NM Not meaningful.

Other income in 2011 decreased by \$18.8 million over 2010 mainly due to an increase in interest costs of \$16.5 million (including amortization of financing costs and loan discount) due to outstanding borrowings under our new term loan facility in the first quarter of 2011. We anticipate interest expense to remain at this higher level, which was \$5.2 million (including amortization of financing costs and loan discount) for the three months ended December 31, 2011, until we commence repaying capital in March 2012. In addition, we had foreign exchange losses of \$(0.1) million in the period compared to a \$2.2 million gain in the prior period. The functional currency of our operating subsidiary in the Czech Republic is the Czech crown. Changes in that subsidiary's assets and liabilities denominated in other currencies that are due to exchange rate fluctuations are recognized as foreign exchange gains or losses in our income statement. The majority of foreign currency denominated assets in this subsidiary are in U.S. dollars, and we typically do not utilize hedge instruments to cover exposure which may arise as a result of balance sheet accounting exposure. The same applies to certain other subsidiaries in other jurisdictions, such as Germany and the United Kingdom, although to a lesser extent.

The increase in other income in 2010 compared to 2009 was primarily attributable to gains resulting from foreign exchange fluctuations to the extent that these are recognized through the profit and loss account.

As a result of all the above factors, our income before income taxes and loss from investment in equity affiliate, as a percentage of total revenue, for each of 2009, 2010 and 2011 was 32.4%, 31.0% and 18.9% respectively.

*Provision for income taxes and loss from investment in affiliate*

	Year ended December 31,			Change 2009 vs. 2010		Change 2010 vs. 2011	
	2009	2010	2011	In dollars	Percentage	In dollars	Percentage
Provision for income taxes	\$ (6,538)	\$ (9,394)	\$ 49,260	\$ (2,856)	43.7%	\$ 58,654	NM
Percentage of total revenue	(3.6)%	(4.3)%	(18.1)%				
Loss from investment in equity affiliate		\$ (46)	\$ (242)	\$ (46)		\$ (196)	NM
Percentage of total revenue			(0.1)%				

NM Not meaningful.

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The majority of our revenue from our web distribution channel is recognized in Cyprus and this country has a tax rate of 10%, which gives a strong cash flow benefit to our business. Similarly, our Czech entity is also highly profitable as a result of direct sales and royalty payments from indirect sales. The Czech Republic has a low tax rate which fell below 20% on corporate rates in 2010.

Our effective tax rate was (96.3)% in 2011, as we received a credit, or a benefit to our income statement, of \$49.3 million for 2011. The decrease in income tax expense was largely a result of a group reorganization identified more fully under Key Factors Affecting Our Performance Effective tax rate. We have transferred intellectual property to an entity in the Netherlands as part of a group reorganization, which was cleared with the Dutch tax authorities and has resulted in significant tax advantage. This has given rise to a deferred tax asset of \$56.3 million, which led to a tax credit in June 2011. We expect that our cash tax rate will

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be lower over the following years as a result of this change. Our effective tax rate increased from 11.1% in 2009 to 13.9% in 2010. The increase in income tax expense in 2010 compared to 2009 was largely a result of an increase in taxable income of our subsidiaries operating in tax jurisdictions with a relatively higher tax rate.

*Net income*

	Year ended December 31,			Change 2009 vs. 2010		Change 2010 vs. 2011	
	2009	2010	2011	In dollars	Percentage	In dollars	Percentage
Net income	\$ 52,485	\$ 57,912	\$ 100,432	\$ 5,427	10.3%	\$ 42,520	73.4%
Percentage of total revenue	28.8%	26.7%	36.9%				

In 2011 net income increased compared to 2010 primarily due to optimization in our revenue streams and the decrease in our effective tax rate. This decrease in our effective tax rate was primarily driven by the deferred tax asset, which gave rise to a credit of \$56.3 million in June 2011, and then an offsetting charge of \$8.0 million in the second half of 2011 as this balance was released. This balance will continue to be released in future periods over an estimated five years, and will increase our tax payable line in our income statement although our cash tax rate is expected to be reduced as a result of our group reorganization. The increase in net income due to the decrease in our effective tax rate was partially offset by increased headcount, increased investment in new products and initiatives, including marketing spend, intended to drive long-term growth, increased general and administrative expenses including an acquisition adjustment for our German reseller, acquisition-related transaction costs, certain professional costs including those related to our conversion to U.S. GAAP and control procedure assessments and implementation related to our IPO and future public reporting as a U.S. listed company, and interest costs. Also, our net income in 2011 was adversely affected by the impact of acquisition accounting for TuneUp.

In 2010 net income increased compared to 2009 primarily due to an increase in total revenue offset by margin compression due to investment in the planned future growth of the business.

*Adjusted net income*

	Year ended December 31,			Change 2009 vs. 2010		Change 2010 vs. 2011	
	2009	2010	2011	In dollars	Percentage	In dollars	Percentage
Adjusted net income	\$ 62,796	\$ 66,246	\$ 56,508	\$ 3,450	5.5%	\$ (9,738)	(14.7)%
Percentage of total revenue	34.5%	30.5%	20.7%				

In 2011 adjusted net income decreased compared to 2010 primarily due to the increased costs noted above, offset by on-going optimization of our revenue streams. The adjustment for the tax effect in the adjusted net income calculation for 2009 is based on the effective tax rates of the relevant jurisdictions for the applicable adjustments at a blended rate of 11.1%. For 2010 and 2011 we are using in our calculations a normalized tax rate of 14%. The normalized tax rate of 14% is based on an estimate of our future cash tax rate as well as our recent cash and income statement tax charges.

In 2010 adjusted net income increased compared to 2009 primarily due to an increase in net income of \$5.4 million which was partially offset by a decrease in share-based compensation of \$1.5 million.

For a reconciliation of adjusted net income to net income, the most comparable U.S. GAAP measure, see [Non-U.S. GAAP Measures](#) Adjusted net income.

***B. LIQUIDITY AND CAPITAL RESOURCES***

To date, all of our working capital has been generated by operations. As of December 31, 2011, we had \$225.4 million of debt, which was primarily incurred to pay a distribution to all of our shareholders, as described below, and cash and cash equivalents of \$60.7 million.

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We generate an increasing proportion of our cash through online sales of our premium products and online services as well as through the platform-derived revenue generated primarily via our dynamic secure search solution. We also benefit from a strong working capital cycle, such that our license fees are paid at the beginning of the subscription period, regardless of whether those subscriptions are for one or two years. The majority of our platform sales are paid within 60 days of the revenue-generating activity. We generate cash from sales through our reseller network in substantially the same manner as through our online sales. While sales through our reseller network are paid over slightly longer periods than our online distribution channel, we generally collect our reseller network sales within 60 days. The majority of sales through our reseller network are undertaken by intermediaries and we offer these intermediaries a discount. As a result, we receive less revenue per customer from sales through our reseller network than we do through our online distribution channel.

On March 15, 2011, we entered into a \$235 million term loan facility with a syndicate of various banks and other financial institutions as lenders. We entered into the term loan facility in order to return capital to our shareholders through the payment of a distribution and provide ourselves with additional funds and liquidity. We paid a distribution of \$183.4 million with a portion of the proceeds of the loan to all of our shareholders, on a pro rata basis. In addition to the initial term loan, we may also borrow up to \$100 million under one or more additional loans under the same facility with the approval of the lenders and compliance with covenants. An affiliate of J.P. Morgan Securities LLC is the administrative agent and an affiliate of Morgan Stanley & Co. LLC is the syndication agent. At our option, amounts under the term loan and incremental term loans, if any, will bear an interest rate of either (i) the Eurodollar rate plus 6.00% and certain costs (as defined in the term loan facility) or (ii) an alternate base rate (described below) plus 5.00%. The Eurodollar rate is the greater of (a) 1.50% and (b) the rate obtained by dividing (x) LIBOR for such interest period, by (y) a percentage equal to (i) 100% minus (ii) Eurocurrency reserve requirements for such interest period. The alternate base rate is the greater of (i) the prime rate (as defined in the term loan facility), (ii) the federal funds effective rate plus 0.50%, and (iii) the Eurodollar rate plus 1.00% and (iv) 2.50%. The term loan facility matures on March 15, 2016. As of December 31, 2011, we had \$235 million aggregate principal amount borrowed under the term loan facility and the interest rate on the outstanding amount was 7.5%. The term loan facility contains customary events of default, conditions to borrowing and covenants, including restrictions on our ability to incur additional debt, incur liens and make distributions to shareholders. The term loan facility also requires compliance with certain financial covenants, including the maintenance of a maximum consolidated leverage ratio as of the last day of each fiscal quarter at levels set forth in the term loan facility. During the continuance of an event of a default, the lenders may accelerate amounts outstanding, terminate the term loan facility and foreclose on all collateral.

We have historically incurred costs ratably throughout the year. We do not currently rely upon our term loan facility to finance our working capital needs. Our marketing expenditures are generally linked to our marketing campaigns. Some staff bonuses are paid quarterly while the majority of bonuses including management bonuses are paid bi-annually. Our primary uses for cash have been to pay dividends to our shareholders, develop our products, acquire new technologies, invest in infrastructure and people to drive growth and pay income tax. However, our term loan facility restricts the payment of dividends to holders of our ordinary shares. Going forward, we expect our primary need for cash to be continued acquisitions and similar investments in the business.



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We believe that our financial reserves will be sufficient to fund our anticipated cash needs for working capital, capital expenditures and debt service for at least the next 12 months. Uncertainty regarding our ability to sustain and increase the number of our active and subscription users and our revenue per active user, as well as uncertainty regarding development costs and the costs of potential acquisitions as we consider further diversification of our product line, may have a material effect on liquidity in the future, particularly beyond the next 12 months.

	Year ended December 31,		
	2009	2010	2011
	(in thousands)		
<b>Consolidated Statements of Cash Flows Data:</b>			
Net cash provided by operating activities	\$ 79,483	\$ 87,911	\$ 82,911
Net cash used in investing activities	(19,157)	(15,340)	(69,544)
Net cash used in financing activities	(71,702)	(54,367)	(15,329)
Effect of exchange rate fluctuations on cash and cash equivalents	502	(2,769)	(444)
Change in cash and cash equivalents	\$ (10,874)	\$ 15,435	\$ (2,406)

**Operating activities**

In 2011, net cash flow provided by operating activities was \$82.9 million, including our profit for the period of \$100.4 million and adjustments of \$(34.9) million before movements in working capital. An increase in our deferred tax asset of \$(56.3) million was a significant non-cash item as a result of the AVG group reorganization in June 2011. Cash inflows included an increase in deferred revenue of \$15.0 million reflecting an increase in our subscription product sales. In 2010, net cash flow provided by operating activities was \$87.9 million, including our profit for the year of \$57.9 million and adjustments of \$13.1 million before movements in working capital. Cash inflows included an increase in deferred revenue of \$7.5 million, reflecting a reduction in our rate of growth of product sales.

In 2009, net cash flow provided by operating activities was \$79.5 million, including our profit for the year of \$52.5 million and adjustments of \$10.2 million before movements in working capital. Cash inflows included an increase in deferred revenue of only \$20.5 million compared to \$41.8 million in the prior year, reflecting a change from selling two-year licenses to one-year licenses as well as a lower rate of sales growth in the year.

**Investing activities**

Cash used in investing activities in 2011 was \$69.5 million. Capital expenditures were \$11.4 million for increased capital equipment to continue to support the infrastructure requirements of our growing business. We also spent \$48.5 million acquiring TuneUp (a PC optimization software firm), iMedix (a former search partner), Droid (a mobile phone security software company), AVG DACH (one of our resellers) and Bsecure (a provider of application service offerings featuring internet filtering and/or cloud-based management of information technology solutions).

We further consummated a unit purchase agreement with Scene (a provider of broadband speed testing and web-based network diagnostic applications), pursuant to which AVG acquired a 15% interest in Scene for a cash consideration of \$9.8 million.

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Cash used in investing activities in 2010 was \$15.3 million consisting primarily of capital expenditures of \$11.7 million, primarily for development and capital equipment to support our business development.

Cash used in investing activities in 2009 was \$19.2 million consisting primarily of acquisition costs of \$12.5 million, due to the acquisition of Sana Security for \$10.2 million and the acquisition of Square for \$2.3 million, and capital equipment spending of \$6.6 million.

**Table of Contents*****Financing activities***

Cash used in financing activities in 2011 was \$15.3 million consisting primarily of the receipt of the loan and the distributions associated with that loan, as well as additional dividends resulting in total dividends paid of \$229.9 million during the period. We incurred costs in taking on this loan of \$11.7 million. See Item 5. Operating and Financial Review and Prospectus F. Tabular Disclosure of Contractual Obligations for points regarding the impact of this loan on our future cash commitments.

Cash used in financing activities in 2010 was \$54.4 million consisting primarily of \$47.2 million of distributions paid to our shareholders.

Cash used in financing activities in 2009 was \$71.7 million consisting primarily of distributions paid to our shareholders of \$118.1 million, partially offset by \$47.8 million from the acquisition of a minority stake in us by TA Coöperatief that resulted in a share capital issuance.

***Capital expenditure and other investments***

Our net capital expenditure in 2009, 2010 and 2011 amounted to approximately \$6.6 million, \$11.7 million and \$11.4 million, respectively. We have historically incurred capital expenditure costs in relation to the acquisition of technology and the development of our Internet security solutions. We expect to continue to invest in technology acquisitions and information technology infrastructure through 2012 and thereafter and may spend a significant amount of cash on acquisitions and the further development of our solutions. To date, we have been able to finance all of our investments and capital expenditures out of cash generated from operations.

***Free cash flow***

	Year ended December 31,			Change 2009 vs. 2010		Change 2010 vs. 2011	
	2009	2010	2011	In dollars	Percentage	In dollars	Percentage
Free cash flow	\$ 72,680	\$ 76,196	\$ 89,558	\$ 3,516	4.8%	\$ 13,362	17.5%

In 2011, free cash flow increased compared to 2010 due to increased sales, driven by growth in platform-derived revenues as well as subscription bookings, the latter increased in part by the TuneUp acquisition. This was offset by spending on activities to drive those bookings and other increased costs as noted above, resulting in a decrease in net cash from operating activities of \$5.0 million ((5.7)% or increase of 11.3% when excluding the impact of \$14.9 million of net interest expense). There were no unusual movements in working capital during the period and no material changes in our capital expenditure compared to the prior period. We made a one-off adjustment to free cash flow (related to purchase of our reseller) in the amount of \$3.2 million (net of tax). The total purchase price of \$9.1 million for this company included a payment of \$3.7 million, which has been determined to be a settlement of pre-existing relationships. We believe that this settlement payment, net of the tax adjustment, should be excluded from the free cash flow calculation.

In 2010, free cash flow increased compared to 2009 due to an increase in operating cash flows of \$8.4 million offset by an increase in capital expenditure of \$5.0 million.

For a reconciliation of free cash flow to net cash provided by operating activities, the most directly comparable U.S. GAAP financial measure, see Non-U.S. GAAP Measures Free cash flow.

### **Critical Accounting Policies**

Our consolidated financial statements are prepared in accordance with U.S. GAAP. The preparation of these consolidated financial statements requires us to make estimates, assumptions and judgments that can have a significant impact on the reported amounts of assets and liabilities, revenue and expenses and related disclosure of contingent assets and liabilities, at the respective dates of our financial statements. We base our estimates,

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assumptions and judgments on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. We evaluate our estimates, assumptions and judgments on a regular basis and make changes accordingly. We also discuss our critical accounting estimates with our supervisory board.

We believe the following to be critical accounting policies because they are important to the portrayal of our financial condition or results of operations and they require critical management estimates and judgments about matters that are uncertain:

goodwill impairment;

impairment of long-lived assets;

research and development costs;

loss contingencies;

share-based compensation; and

income taxes.

### ***Goodwill impairment***

Goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis in the fourth quarter and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. These events or circumstances could include a significant change in the business climate, legal factors, operating performance indicators, competition, or sale or disposition of a significant portion of a reporting unit.

Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units and determination of the fair value of each reporting unit. The fair value of each reporting unit is estimated using the income approach, on a discounted cash flow methodology. This analysis requires significant judgments, including estimation of future cash flows, which is dependent on internal forecasts, estimation of the long-term rate of growth for our business, estimation of the useful life over which cash flows will occur and determination of our weighted-average cost of capital. The carrying value of our goodwill was \$71.4 million as of December 31, 2011.

The estimates used to calculate the fair value of a reporting unit change from year to year based on operating results and market conditions. Changes in these estimates and assumptions could materially affect the determination of fair value and goodwill impairment for each reporting unit. Based on the analysis performed, there was no impairment through December 31, 2011.

*Impairment of long-lived assets*

We periodically evaluate long-lived assets held for use and held for sale whenever events or changes in circumstances indicate that the carrying amount of those assets may not be recoverable. Assets are grouped and evaluated for impairment at the lowest level of which there are identifiable cash flows, which is generally at a boutique level. Boutique assets are reviewed for impairment using factors including, but not limited to, our future operating plans and projected cash flows. The determination of whether impairment has occurred is based on an estimate of undiscounted future cash flows directly related to that boutique, compared to the carrying value of the assets. We recognize impairment if the sum of the undiscounted future cash flows of a boutique does not exceed the carrying value of the assets. For impaired assets, we recognize a loss equal to the difference between the net book value of the asset and its estimated fair value. Fair value is based on discounted future cash flows of the asset using a discount rate commensurate with the risk. In addition, at the time a decision is made to close a boutique, we record an impairment charge, if appropriate, or accelerates depreciation over the revised useful life of the asset. Based on the analysis performed, there was no impairment through December 31, 2011.

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### ***Research and development costs***

Costs incurred internally in researching and developing a computer software products are charged to expense until technological feasibility has been established for the product. Authoritative literature requires that once technological feasibility is established, all software costs are capitalized until the product is available for general release to customers. Judgment is required in determining when technological feasibility of a product is established. We have determined that technological feasibility for our software products is reached shortly before the release of those products and as a result, the development costs incurred after the establishment of technological feasibility and before release of products have historically not been material.

### ***Loss contingencies***

We are subject to the possibility of various losses arising in the ordinary course of business. We consider the likelihood of loss or impairment of an asset or the incurrence of a liability, as well as our ability to reasonably estimate the amount of loss, in determining loss contingencies. An estimated loss contingency is accrued when it is probable that an asset has been impaired or a liability has been incurred and the amount of loss can be reasonably estimated. We regularly evaluate current information available to us to determine whether such accruals should be adjusted and whether new accruals are required.

Third parties, including customers, have in the past and may in the future assert claims or initiate litigation related to exclusive patent, copyright, trademark and other intellectual property rights to technologies and related standards that are relevant to us. These assertions have increased over time as a result of our growth and the general increase in the pace of patent claims assertions. If any infringement or other intellectual property claim made against us by any third party is successful, or if we fail to develop non-infringing technology or license the proprietary rights on commercially reasonable terms and conditions, our business, operating results and financial condition could be materially and adversely affected.

### ***Share-based compensation***

Under U.S. GAAP, we account for our share-based compensation for employees in accordance with the provisions of the Financial Accounting Standards Board's Accounting Standards Codification Topic 718 (formerly Statement of Financial Accounting Standards No. 123(R)), which requires us to measure the cost of employee services received in exchange for the options on our ordinary shares, or options, based on the fair value of the award on the grant date. We selected the Black-Scholes-Merton option pricing model as the most appropriate method for determining the estimated fair value of our share-based awards without market conditions. For performance-based options that include vesting conditions relating to the market performance of our ordinary shares, a Barrier option pricing model was used in order to reflect the valuation impact of price hurdles that have to be met as conditions to vesting. The resulting cost of an equity incentive award is recognized as expense over the requisite service period of the award, which is usually the vesting period. We recognize compensation expense over the vesting period using the straight-line method and classify these amounts in the consolidated statements of comprehensive income based on the department to which the related employee reports.

We account for share-based compensation for non-employees in accordance with the authoritative guidance for equity-based payments to non-employees. Share-based awards issued to non-employees are accounted for at their estimated fair value, which is also determined using the Black-Scholes-Merton and Barrier option pricing models. We believe that the fair value of options is more reliably measured than the fair value of the services received. As such, the fair value of options granted to non-employees is re-measured as the options vest, and the resulting increase in value, if any, is recognized as expense during the period the related services are rendered.

*Income tax*

We are subject to income taxes in the United States and numerous foreign jurisdictions. Our effective tax rates differ from the statutory rates, primarily due to the foreign tax rate differential, tax exempt revenue and



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non-deductible expenses and as further described in the notes to our consolidated financial statements included in this annual report. Our effective tax rate was 11.1%, 13.9% and (96.3%) in 2009, 2010 and 2011, respectively. We received for 2011 a credit, or a benefit to our income statement, of \$56.3 million in June 2011, and then an offsetting charge of \$7.0 million in the third and fourth quarters of 2011 as this balance was released.

Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. Although we believe our reserves are reasonable, no assurance can be given that the final tax outcome of these matters will not be different from that which is reflected in our historical income tax provisions and accruals. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact t