

BLUCORA, INC.
Form 10-K
March 08, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2012

OR

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

For the transition period from _____ to _____

Commission File Number 000-25131

BLUCORA, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of

91-1718107
(IRS Employer

incorporation or organization)

Identification No.)

10900 NE 8th Street, Suite 800, Bellevue, Washington 98004

(Address of principal executive offices) (Zip code)

Registrant's telephone number, including area code:

(425) 201-6100

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

Title of each class
Common Stock, par value \$0.0001 per share

Name of each exchange on which registered
NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

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(Title of Class)

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

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

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

Indicate by check mark 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

The aggregate market value of the Common Stock held by non-affiliates of the registrant outstanding as of June 30, 2012, based upon the closing price of Common Stock on June 30, 2012 as reported on the NASDAQ Global Select Market, was \$470.4 million. Common Stock held by each officer and director has been excluded because such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 1, 2013, 40,969,769 shares of the registrant's Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates certain information by reference from the definitive proxy statement to be filed by the registrant in connection with the 2013 Annual Meeting of Stockholders (the *Proxy Statement*).

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This report contains forward-looking statements that involve risks and uncertainties. The statements in this report that are not purely historical are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. Words such as anticipate, believe, plan, expect, future, intend, may, will, should, estimate, predict, potential, continue, and similar are forward-looking statements, but the absence of these words does not mean that the statement is not forward looking. These forward-looking statements include, but are not limited to, statements regarding projections of our future financial performance; trends in our businesses; our future business plans and growth strategy, including our plans to expand, develop, or acquire particular operations or businesses; and the sufficiency of our cash balances and cash generated from operating, investing, and financing activities for our future liquidity and capital resource needs.

Forward-looking statements are subject to known and unknown risks, uncertainties, and other factors that may cause our results, levels of activity, performance, achievements, and prospects, and those of the Internet search and tax preparation industries generally, to be materially different from those expressed or implied by such forward-looking statements. These risks, uncertainties, and other factors include, among others, those identified under Item 1A, Risk Factors and elsewhere in this report. You should not rely on forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. We do not undertake any obligation to update any forward-looking statement to reflect new information, events, or circumstances after the date of this Annual Report on Form 10-K or to reflect the occurrence of unanticipated events.

ITEM 1. Business

Overview

Blucora, Inc. s (*Blucora s* or *our*) operations consist primarily of two businesses: an internet search business and an online tax preparation business. Our search business, InfoSpace, consists primarily of a B2B offering that provides our search technology, aggregated content, and services to our distribution partners. Our search business also offers search services directly to consumers through our own internet search properties. Our tax preparation business consists of the operations of the TaxACT tax preparation online service and software business that we acquired on January 31, 2012.

Our InfoSpace search business primarily offers search services through the web properties of its distribution partners, which are generally private-labeled and customized to address the unique requirements of each distribution partner. The search business also distributes aggregated search content through its own websites, such as Dogpile.com and WebCrawler.com. The search business does not generate its own search content, but instead aggregates search content from a number of content providers. Some of these content providers, such as Google and Yahoo!, pay us to distribute their content. We refer to those providers as Search Customers.

On January 31, 2012, we acquired TaxACT Holdings, Inc. (*TaxACT Holdings*) and its wholly-owned subsidiary, ² Story Software, Inc. (*2 Story*), which operates the TaxACT tax preparation online service and software business. Our TaxACT business consists of an online tax preparation service for individuals, tax preparation software for individuals and professional tax preparers, and ancillary services. The majority of our TaxACT business s revenue is generated by the online service at www.taxact.com.

We are currently focused on the following areas:

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improving the search services offered to our end users and to our distribution partners and through our owned and operated properties;

maintaining our current distribution partners and adding new distribution partners for our search services;

enhancements to the customer experience for our tax preparation services and products, including expanding our product offerings;
and

retaining current tax preparation customers and attracting new ones.

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Additionally, an important component of our strategy for future growth is to acquire technology and internet businesses. In the ordinary course of business, we are continuously engaged in various stages of diligence, discussion, and negotiation with regard to acquisition targets, including companies and assets that complement our search and tax preparation businesses, as well as companies and assets that are unrelated to our existing businesses. Potential acquisitions may be material to our business, financial condition, and results of operations.

As a result of the acquisition of our TaxACT business, we have determined that we have two reporting segments: Search and Tax Preparation. Our Search segment is the InfoSpace business and our Tax Preparation segment is the TaxACT business. Unless the context indicates otherwise, we use the term `search` to represent search services and we use the term `tax preparation` to represent services and products sold through the TaxACT business (see Note 14: Segment Information of the Notes to Consolidated Financial Statements in Item 8 of Part II of this report).

We were founded in 1996 and are incorporated in the state of Delaware. We changed our name from InfoSpace, Inc. to Blucora, Inc. in June 2012. Our principal corporate office is located in Bellevue, Washington. Our common stock is listed on the NASDAQ Global Select Market under the symbol `BCOR`.

Search Revenue Sources

Our search revenue is primarily derived from search content providers who provide paid search links for display as part of our search services. From these content providers, whom we refer to as our Search Customers, we license rights to certain search products and services, including both non-paid and paid search links. We receive revenues from our Search Customers when an end user of our web search services clicks on a paid search link that is provided by that Search Customer and displayed on one of our owned and operated web properties or displayed on the web property of one of our search distribution partners. Revenues are recognized in the period in which such paid clicks occur and are based on the amounts earned and remitted to us by our Search Customers for such clicks. We derive a significant portion of our revenue from Google and we expect this concentration to continue in the foreseeable future. Google accounted for 77% of our total revenues in 2012. If Google reduces or eliminates the services it provides to us or our distribution partners, or if Google is unwilling to pay us amounts they owe us, it could materially harm our business and financial results.

Our main Search Customer agreements are with Google and Yahoo!. Our agreement with Yahoo! runs through December 31, 2013 and our agreement with Google runs through March 31, 2014. Both Google and Yahoo! have requirements and guidelines regarding, and reserve certain rights of approval over, the use and distribution of their respective search products and services. Both Google and Yahoo! may modify certain requirements and guidelines of their agreements with us at their discretion, and even when unmodified, we occasionally disagree with our Search Customers on interpretations of these requirements and guidelines. If Google or Yahoo! believe that we or our search distribution partners have failed to meet the requirements and guidelines or the Search Customer agreements, they may suspend or terminate our or our distribution partners' use and distribution of their search products and services, with or without notice, and in the event of certain violations, may terminate their agreements with us. We and our distribution partners have limited rights to cure breaches of the requirements and guidelines.

Google and Yahoo! each make certain representations and warranties to us in the agreements regarding the content and operation of their search services, and we make certain representations and warranties in the agreements regarding our use and distribution of their search services. Under these agreements, the parties also provide for some indemnification relating to these representations and warranties: Google and Yahoo! provide certain indemnification with respect to ownership of the content and technology provided by their search services, and we provide certain indemnification with respect to our, and our distribution partners', use and distribution of Google and Yahoo!'s search services.

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Our partners for distribution of our online search services include software application providers, web portals, and internet service providers. Our largest distribution partners constitute a significant percentage of our

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search revenue. In 2012, our top five distribution partners for the year were responsible for 47% of our online search revenues, and this percentage was 47% in 2011 and 35% in 2010. Our agreements with many of our distribution partners come up for renewal in 2013, and we plan to negotiate renewals for many of these agreements. In addition, our agreements with some of our distribution partners are not exclusive, meaning that they have the right to shift some or all of the search traffic that they send to us to our competitors. Our distribution partners also have the right to terminate their agreements immediately in the event of certain breaches. We anticipate that our content and distribution costs for our relationships with our distribution partners will increase as revenues grow, and may increase as a percentage of revenues to the extent that there are changes to existing arrangements or we enter into new arrangements on less favorable terms. We also face competition from our Search Customers seeking to enter into content provider agreements directly with our existing or potential distribution partners, making it increasingly difficult for us to renew agreements with existing major distribution partners or to enter into distribution agreements with new partners on favorable terms.

For additional information on our search services and revenue, see Note 2: Summary of Significant Accounting Policies of the Notes to Consolidated Financial Statements in Item 8 of Part II of this report.

Tax Preparation Revenue Sources

Our Tax Preparation segment generates revenue primarily in three ways: the sale of state and upgraded federal online income tax preparation services and software to consumers and small businesses, the sale of ancillary services to consumers, and the sale of its professional edition income tax preparation software to professional tax preparers. The majority of our Tax Preparation revenue is generated by the online service at www.taxact.com and, as a highly seasonal business, almost all of that revenue is generated in the first four months of the calendar year. The TaxACT business's basic federal tax preparation online software service is free for everyone, meaning that any taxpayer can use the services to e-file his or her federal income return without paying for upgraded services, and may do so for every form that the IRS allows to be e-filed. This free offer differentiates TaxACT's offerings from many of its competitors who limit their free software and/or services offerings to certain categories of customers or certain forms. The TaxACT business generates revenue from a percentage of these free users who choose to upgrade for a fee to the deluxe product, which includes additional support and tools, and ancillary services and/or to file their state income tax returns, which are not free, with TaxACT. The ancillary services include, among other things, taxpayer phone support, data archiving, a deferred payment option, a bank card product, and e-filing services for professional tax preparers. TaxACT is the recognized value player in the digital do it yourself space, offering comparable software and/or services at a lower cost to the end-user compared to larger competitors. This, coupled with its free for everyone offer, provides TaxACT a valuable marketing position. TaxACT's professional tax preparer software allows professional tax preparers to file individual returns for their clients. Revenue from professional tax preparers has historically constituted a relatively small percentage of the TaxACT business's overall revenue, and requires relatively modest incremental development costs as the basic software is substantially similar to the consumer-facing software and online service.

Research and Development

We believe that our technology is essential to expand and enhance our products and services and maintain their attractiveness and competitiveness. Research and development expenses were \$6.1 million in 2012, \$4.1 million in 2011, and \$6.0 million in 2010. These amounts exclude any amounts spent by the TaxACT business on research and development prior to our acquisition of that business in January 2012.

Intellectual Property

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Our success depends significantly upon our technology and intellectual property rights. To protect our rights and the value of our corporate brands and reputation, we rely on a combination of domain name registrations, confidentiality agreements with employees and third parties, protective contractual provisions, and laws

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regarding copyrights, patents, trademarks, and trade secrets. We generally require employees and contractors to execute confidentiality and non-use agreements that prohibit the unauthorized disclosure and use of our confidential and proprietary information and, if applicable, that transfer to us any rights they may have in inventions and discoveries, including but not limited to trade secrets, copyrightable works, or patentable technologies that they may develop while employed or engaged by us. In addition, prior to entering into discussions with third parties regarding our business and technologies, we generally require that such parties enter into confidentiality and non-use agreements with us. If these discussions result in a license or other business relationship, we also generally require that the agreement setting forth the parties' respective rights and obligations include provisions for the protection of our intellectual property rights. For example, the standard language in our agreements with distribution partners provides that we retain ownership of our intellectual property in our technologies and requires them to display our intellectual property ownership notices, as appropriate.

We hold multiple active trademark registrations in the United States and in various foreign countries, including some related to our TaxACT business. We also have applied for registration of certain additional trademarks in the United States and in other countries, and will seek to register additional marks, as appropriate. We may not be successful in obtaining registration for these trademark applications or in maintaining the registration of existing marks. In addition, if we are unable to acquire and/or maintain domain names associated with those trademarks (for example, www.taxact.com, www.dogpile.com, www.webcrawler.com, www.metacrawler.com, and www.infospace.com), the value of our trademarks may be diminished.

We hold 8 U.S. patents relating to online search, online advertisements, and location services, among others. We believe that the duration of the applicable patents is adequate relative to the expected lives of their impact on our services. We may initiate additional patent application activity in the future, but any such applications may not be issued, and, if issued, may be challenged or invalidated by third parties. In addition, issued patents may not provide us with any competitive advantages.

We may be unable to adequately or cost-effectively protect or enforce our intellectual property rights, and failure to do so could weaken our competitive position and negatively impact our business and financial results. If others claim that our products infringe their intellectual property rights, we may be forced to seek expensive licenses, reengineer our products, engage in expensive and time-consuming litigation, or stop marketing and licensing our products. See the section entitled "Risk Factors" in Part I, Item 1A of this report for additional information regarding protecting and enforcing intellectual property rights by us and third parties against us.

Competition

We face intense competition in both the search and tax preparation markets. Many of our competitors or potential competitors in both industries have substantially greater financial, technical, and marketing resources, larger customer bases, longer operating histories, more developed infrastructures, greater brand recognition, better access to vendors, or more established relationships in the industry than we have. Our competitors may be able to adopt more aggressive pricing policies, develop and expand their product and service offerings more rapidly, adapt to new or emerging technologies and changes in Search Customer and distribution partner requirements more quickly, take advantage of acquisitions and other opportunities more readily, achieve greater economies of scale, and devote greater resources to the marketing and sale of their products and services than we can. In addition, we may face increasing competition for market share from new startups, mobile providers, and social media sites and applications. If we are unable to match or exceed our competitors' marketing reach and customer service experience, our business may not be successful. Because of these competitive factors and due to our relatively small size and financial resources, we may be unable to compete successfully in the search and tax preparation markets.

In the online search market, we face competition for various elements of our search business from multiple sources, including our Search Customers. In particular, Google, Yahoo!, and Bing (Microsoft) collectively

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control a significant majority of the consumer-facing online search market serviced by our owned and operated sites and those of our distribution partners. Each of these three companies provides search results to our search services in addition to competing for internet users. Our distribution partners also compete with us for internet users. We also compete with our Search Customers and other content providers for contracts with new and existing distribution partners. We believe that the primary competitive factors in the market for online search services are:

the ability to continue to meet the evolving information, content, and service demands of Internet users and our distribution partners;

the ability to offer our distribution partners competitive rates and comprehensive search and advertising content that they can effectively monetize;

the cost-effectiveness, reliability, and security of the search applications and services;

the ability to attract Internet users to search services in a cost effective way;

the ability to provide programs or services, such as embedded search browsers, default search provider settings within the search browsers, or downloadable applications, that may displace competing search services; and

the ability to develop innovative products and services that enhance the appearance and utility of search services, both to Internet users and to current and potential distribution partners.

Our TaxACT business operates in a very competitive marketplace. There are many competing software products and online services, including two competitors who have a significant percentage of the software and online service market: Intuit's TurboTax and H&R Block's products and services. Our TaxACT business must also compete with alternate methods of tax preparation, including pencil and paper do-it-yourself return preparation by individual filers and storefront tax preparation services, including both local tax preparers and large chains such as H&R Block, Liberty, and Jackson Hewitt. Finally, our TaxACT business faces the risk that state or federal taxing agencies will offer software or systems to provide direct access for individual filers that will reduce the need for TaxACT's software and services. We believe that the primary competitive factors in the market for tax preparation software and services are:

the ability to continue to offer software and services that have quality and ease-of-use that are compelling to consumers;

the ability to market the software and services in a cost effective way;

the ability to offer ancillary services that are attractive to users; and

the ability to develop the software and services at a low enough cost to be able to offer them at a competitive price point.

Governmental Regulation

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We face increasing governmental regulation in both our search and tax preparation businesses. U.S. and foreign governments have adopted or may in the future adopt, applicable laws and regulations addressing issues such as consumer protection, user privacy, security, pricing, age verification, content, taxation, copyrights and other intellectual property, distribution, advertising, and product and services quality. These or other laws or regulations that may be enacted in the future could have adverse effects on our business, including higher regulatory compliance costs, limitations on our ability to provide some services in some states or countries, and liabilities that might be incurred through lawsuits or regulatory penalties. See the section entitled "Risk Factors" in Part I, Item 1A of this report for additional information regarding the potential impact of governmental regulation on our operations and results.

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Seasonality

Revenue from our tax preparation online service and software is highly seasonal, with the significant majority of its annual revenue earned in the first four months of our fiscal year. Our owned and operated search services are affected by seasonal fluctuations in internet usage, which generally decline in the summer months. However, these seasonal impacts have become less meaningful over time as revenue from these owned and operated services have constituted a smaller portion of our revenue.

Employees

As of March 1, 2013, we had 225 full-time employees. None of our employees are represented by a labor union and we consider employee relations to be positive. There is significant competition for qualified personnel in our industry, particularly for software development and other technical staff. We believe that our future success will depend in part on our continued ability to hire and retain qualified personnel.

Acquisitions and Dispositions

As noted above, on January 31, 2012, we acquired the TaxACT tax preparation business. On April 1, 2010, we purchased assets from Make the Web Better consisting of web properties and licenses for content and technology. On May 10, 2010, we purchased the Mercantila e-commerce business, which we later sold on June 22, 2011. For further detail on our acquisition and disposition of these businesses, see the discussion in Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7, of Part II of this report.

Company Internet Site and Availability of SEC Filings

Our corporate website is located at www.blucora.com. We make available on that site, as soon as reasonably practicable, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K, as well as any amendments to those filings and other reports filed with or furnished to the U.S. Securities and Exchange Commission (the "SEC"). Our SEC filings, as well as our Code of Conduct and Ethics and other corporate governance documents, can be found in the Investor Relations section of our site and are available free of charge. Information on our website is not part of this Annual Report on Form 10-K. In addition, the SEC maintains a website at www.sec.gov that contains reports, proxy and information statements, and other information regarding us and other issuers that file electronically with the SEC.

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ITEM 1A. Risk Factors

RISKS COMMON TO BOTH OF OUR BUSINESSES

Future revenue growth depends upon our ability to adapt to technological change and successfully introduce new and enhanced products and services.

The online service and software industries are characterized by rapidly changing technology, evolving industry standards, and frequent new product introductions. Our competitors in both the Search and Tax Preparation segments offer new and enhanced products and services every year, and customer expectations change as a result. We must successfully innovate and develop new products and features to meet changing customer needs and expectations. We will need to devote significant resources to continue to develop our skills, tools, and capabilities to capitalize on existing and emerging technologies. Our inability to successfully introduce new and enhanced products and services on a timely basis could harm our business and financial results.

Our products and services have historically been provided through desktop computers, but the number of people who access similar products and services through mobile devices such as smartphones and tablets has increased dramatically in the past few years. We have limited experience to date in developing products and services for users of these alternative devices, and the versions of our products and services developed for these devices may not be compelling to users. As new devices and new platforms are continually being released, it is difficult to predict the problems we may encounter in developing versions of our products and services for use on these alternative devices and we may need to devote significant resources to the creation, support, and maintenance of such offerings. If we are slow to develop products and services that are compatible with these alternative devices, particularly if we cannot do so as quickly as our competitors, we will fail to maintain or grow our share of the markets in which we compete. In addition, such new products and services may not succeed in the marketplace, resulting in lost market share, wasted development costs, and damage to our brands.

Our business depends on our strong reputation and the value of our brands.

Developing and maintaining awareness of our brands is critical to achieving widespread acceptance of our existing and future products and services and is an important element in attracting new customers. Adverse publicity (whether or not justified) relating to events or activities attributed to our businesses, our employees, our vendors, or our partners may tarnish our reputation and reduce the value of our brands. Damage to our reputation and loss of brand equity may reduce demand for our products and services and have an adverse effect on our future financial results. Such damage will also require additional resources to rebuild our reputation and restore the value of the brands.

Our website and transaction management software, data center systems, or the systems of third-party co-location facilities and cloud service providers could fail or become unavailable, which could harm our reputation and result in a loss of revenues and current or potential customers.

Any system interruptions that result in the unavailability or unreliability of our websites, transaction processing systems, or network infrastructure could reduce our revenue and impair our ability to properly process transactions. We use internally developed and third-party systems, including cloud computing and storage systems, for our online services and certain aspects of transaction processing. Some of our systems are relatively new and untested, and thus may be subject to failure or unreliability. Any system unavailability or unreliability may cause unanticipated system disruptions, slower response times, degradation in customer satisfaction, additional expense, or delays in reporting accurate

financial information.

Our data centers could be susceptible to damage or disruption, which could have a material adverse effect on our business. We provide our own data center services for our Search business from two geographically diverse third-party co-location facilities. Although the two data centers provide some redundancy, not all of our systems and operations have backup redundancy. Our TaxACT business has a disaster recovery center which we

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built in late 2012 and have tested, but if the primary data center fails and the disaster recovery center fails to fully restore the failed environments, our TaxACT business will suffer, particularly if such interruption occurs during the tax season.

Our systems and operations, and those of our third-party service providers, could be damaged or interrupted by fire, flood, earthquakes, other natural disasters, power loss, telecommunications failure, Internet breakdown, break-in, human error, software bugs, hardware failures, malicious attacks, computer viruses, computer denial of service attacks, terrorist attacks, or other events beyond our control. Such damage or interruption may affect internal and external systems that we rely upon to provide our services, take and fulfill customer orders, handle customer service requests, and host other products and services. During the period in which services are unavailable, we will be unable or severely limited in our ability to generate revenues, and we may also be exposed to liability from those third parties to whom we provide services. We could face significant losses as a result of these events, and our business interruption insurance may not be adequate to compensate us for all potential losses. For these reasons, our business and financial results could be materially harmed if our systems and operations are damaged or interrupted.

If the volume of traffic to our infrastructure increases substantially, we must respond in a timely fashion by expanding our systems, which may entail upgrading our technology, transaction processing systems, and network infrastructure. Our ability to support our expansion and upgrade requirements may be constrained due to our business demands or constraints of our third-party co-location facility providers and cloud service providers. Due to the number of our customers and the services that we offer, we could experience periodic capacity constraints that may cause temporary unanticipated system disruptions, slower response times and lower levels of customer service, and limit our ability to develop, offer, or release new or enhanced products and services. Our business could be harmed if we are unable to accurately project the rate or timing of increases, if any, in the use of our services or we fail to adequately expand and upgrade our systems and infrastructure to accommodate these increases.

The security measures we have implemented to secure confidential and personal information may be breached, and such a breach may pose risks to the uninterrupted operation of our systems, expose us to mitigation costs, litigation, potential investigation and penalties by authorities, potential claims by persons whose information was disclosed, and damage our reputation.

Our networks and those from our third-party service providers may be vulnerable to unauthorized access by hackers, rogue employees or contractors, computer viruses, and other disruptive problems. A person who is able to circumvent security measures could misappropriate proprietary information or personal information or cause interruptions in our operations. Unauthorized access to, or abuse of, this information could result in significant harm to our business.

We collect and retain certain sensitive personal data. Our TaxACT business collects, uses, and retains large amounts of customer personal and financial information, including information regarding income, family members, credit cards, tax returns, bank accounts, social security numbers, and healthcare. Our search services receive, retain, and transmit certain personal information about our website visitors. Subscribers to some of our search services are required to provide information that may be considered to be personally identifiable or private information.

We are subject to laws, regulations, and industry rules, relating to the collection, use, and security of user data. We expect regulation in this area to increase. As a result of such new regulation, our current data protection policies and practices may not be sufficient and may require modification. New regulations may also impose burdens that may require notification to customers or employees of a security breach, restrict our use of personal information, and hinder our ability to acquire new customers or market to existing customers. As our business continues to expand to new industry segments that may be more highly regulated for privacy and data security, our compliance requirements and costs may increase. We have incurred, and may continue to incur, significant expenses to comply with privacy and security standards and protocols imposed by law, regulation, industry standards, and contractual obligations.

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A major breach of our systems or those of our third-party service providers may have serious negative consequences for our businesses, including possible fines, penalties and damages, reduced customer demand for our services, harm to our reputation and brands, further regulation and oversight by federal or state agencies, and loss of our ability to provide financial transaction services or accept and process customer credit card orders or tax returns. We may detect, or receive notices from customers or public or private agencies that they have detected, vulnerabilities in our servers, our software or third-party software components that are distributed with our products. The existence of vulnerabilities, even if they do not result in a security breach, may harm customer confidence and require substantial resources to address, and we may not be able to discover or remediate such security vulnerabilities before they are exploited. In addition, hackers develop and deploy viruses, worms and other malicious software programs that may attack our offerings. Although we deploy network and application security measures, internal control measures, and physical security procedures to safeguard our systems, there can be no assurance that a security breach, intrusion, loss or theft of personal information will not occur, which may harm our business, customer reputation and future financial results and may require us to expend significant resources to address these problems, including notification under data privacy regulations.

We rely on the infrastructure of the Internet over which we have no control and the failure of which could substantially undermine our operations.

The success of both our Search and Tax Preparation businesses depends on the maintenance and expansion of the infrastructure of the Internet. In particular, we rely on other companies to maintain reliable network systems that provide adequate speed, data capacity, and security. As the Internet continues to experience growth in the number of users, frequency of use, and amount of data transmitted, the segments of the internet infrastructure that we rely on may be unable to support the demands placed upon it. The failure of any parts of the internet infrastructure that we rely on, even for a short period of time, would substantially undermine our operations and would have a material adverse effect on our business and financial results.

Our financial and operating results may suffer if we are unsuccessful in completing and integrating acquisitions. If we are successful in acquiring new businesses or technologies, they may not be complementary to our current operations or leverage our current infrastructure and operational experience.

We intend to acquire and develop new businesses or technologies, and our future success may depend on our ability to successfully identify, acquire, and integrate such businesses and technologies. Potential acquisition targets range in size from relatively small to a size comparable to our own, and therefore may be material to our business, financial condition, and results of operations. If we are successful in identifying and acquiring targets, those targets may not be complementary to our current operations and may not leverage our existing infrastructure or operational experience. In addition, any acquisitions or developments of businesses or technologies may not prove successful. In the past, we have experienced negative financial results as the result of impairment charges of goodwill and other intangible assets related to certain acquisitions.

The process of identifying, acquiring, and integrating new businesses and technologies involves numerous risks that could materially and adversely affect our results of operations or stock price, including:

expenses related to the acquisition process, both for consummated and unconsummated transactions;

diversion of management's other key personnel's attention from current operations and other business concerns and potential strain on financial and managerial controls and reporting systems and procedures;

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disruption of our ongoing business or the ongoing acquired business, including impairment of existing relationships with the employees, distributors, suppliers, or customers of our existing businesses or those of the acquired companies;

difficulties in assimilating the operations, products, technology, information systems, and management and other personnel of acquired companies that result in unanticipated allocation of resources, costs, or delays;

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the dilutive effect on earnings per share as a result of issuances of stock, incurring operating losses, and the amortization of intangible assets for the acquired business;

stock volatility due to the perceived value of the acquired business by investors;

any debt incurred to finance acquisitions would increase costs, may increase volatility in our stock price, and could accelerate a decline in stockholder equity in the event of poor financial performance;

diversion of capital from other uses;

failure to achieve the anticipated benefits of the acquisitions in a timely manner, or at all;

difficulties in acquiring foreign companies, including risks related to integrating operations across different cultures and languages, currency risks, and the particular economic, political, and regulatory risks associated with specific countries; and

adverse outcome of litigation matters or other contingent liabilities assumed in or arising out of the acquisitions.

Developing or acquiring a business or technology, and then integrating it with our other operations, will be complex, time consuming, and expensive. The successful integration of an acquisition requires, among other things, that we: retain key personnel; maintain and support preexisting supplier, distribution, and customer relationships; and integrate accounting and support functions. The complexity of the technologies and operations being integrated and the disparate corporate cultures and/or industries being combined, may increase the difficulties of integrating an acquired technology or business. If our integration of acquired or internally developed technologies or businesses, including our recent acquisition of the TaxACT business, is not successful, we may experience adverse financial or competitive effects. There can be no assurance that the short- or long-term value of any business or technology that we develop or acquire will be equal to the value of the cash and other consideration that we paid or expenses we incurred.

Our stock price has been highly volatile and such volatility may continue.

The trading price of our common stock has been highly volatile. Between January 1, 2011 and December 31, 2012, our stock price ranged from \$7.94 to \$18.25. On March 1, 2013, the closing price of our common stock was \$15.53. Our stock price could decline or fluctuate wildly in response to many factors, including the other risks discussed in this report and the following:

actual or anticipated variations in quarterly and annual results of operations;

announcements of significant acquisitions, dispositions, charges, changes in or loss of material contracts and relationships, or other business developments by us, our partners, or our competitors;

conditions or trends in the search services or tax preparation markets;

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changes in general conditions in the U.S. and global economies or financial markets;

announcements of technological innovations or new services by us or our competitors;

changes in financial estimates or recommendations by securities analysts;

disclosures of any accounting issues, such as restatements or material weaknesses in internal control over financial reporting;

equity issuances resulting in the dilution of stockholders;

the adoption of new regulations or accounting standards; and

announcements or publicity relating to litigation or governmental enforcement actions.

In addition, the market for technology company securities has experienced extreme price and volume fluctuations, and our stock has been particularly susceptible to such fluctuations. Often, class action litigation has been instituted against companies after periods of volatility in the price of such companies' stock. If such litigation were to be instituted against us, even if we were to prevail, it could result in substantial cost and diversion of management's attention and resources.

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Our financial results may fluctuate, which could cause our stock price to be volatile or decline.

Our financial results have varied on a quarterly basis and are likely to continue to fluctuate in the future. These fluctuations could cause our stock price to be volatile or decline. Many factors could cause our quarterly results to fluctuate materially, including but not limited to:

changes or potential changes in our relationships with Google or Yahoo! or future significant Search Customers, such as the effects of changes to their requirements or guidelines or their measurement of the quality of traffic that we send to their advertiser networks, and any resulting loss or reduction of content that we can use or provide to our distribution partners;

the loss, termination, or reduction in scope of key search distribution relationships as a result of, for example, distribution partners licensing content directly from content providers, or any suspension by our Search Customers (particularly Google) of the right to use or distribute content on the web properties of our distribution partners;

the inability of our TaxACT business to meet our expectations;

the extreme seasonality of our TaxACT business and the resulting large quarterly fluctuations in our revenues;

the success or failure of our strategic initiatives and our ability to implement those initiatives in a cost effective manner;

the mix of search services revenue generated by our owned and operated web properties versus our distribution partners' web properties;

the mix of revenues generated by our Search business versus our Tax Preparation business or other businesses we develop or acquire;

our , and our distribution partners' , ability to attract and retain quality traffic for our search services;

gains or losses driven by mark to market fair value accounting, particularly with respect to the warrant we issued in August 2011, the value of which varies from quarter to quarter based on our stock price (see General and administrative expenses under Item 7 of Part II of this report);

litigation expenses and settlement costs;

expenses incurred in finding, negotiating, consummating, and integrating acquisitions;

variable demand for our services, rapidly evolving technologies and markets, and consumer preferences;

any restructuring charges we may incur;

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any economic downturn, which may lead to lower online advertising revenue from advertisers;

new court rulings, or the adoption of new laws, rules, or regulations, that adversely affect our ability to acquire content and distribute our search services, that adversely affect our tax preparation products and services, or that otherwise increase our potential liability;

impairment in the value of long-lived assets or the value of acquired assets, including goodwill, core technology, and acquired contracts and relationships; and

the effect of changes in accounting principles or standards or in our accounting treatment of revenues or expenses.

For these reasons, among others, you should not rely on period-to-period comparisons of our financial results to forecast our future performance. Furthermore, our fluctuating operating results may fall below the expectations of securities analysts or investors and financial results volatility could make us less attractive to investors, either of which could cause the trading price of our stock to decline.

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Existing cash and cash equivalents, short-term investments, and cash generated from operations may not be sufficient to meet our anticipated cash needs for working capital and capital expenditures.

Although we believe that existing cash and cash equivalents, short-term investments, and cash generated from operations will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next 12 months, the underlying levels of revenues and expenses that we project may not prove to be accurate. In addition, we evaluate acquisitions of businesses, products, or technologies from time to time. Any such transactions, if completed, may use a significant portion of our cash balances and marketable investments. If we are unable to liquidate our investments when we need liquidity for acquisitions or business purposes, we may need to change or postpone such acquisitions or find alternative financing for such acquisitions. We may seek additional funding through public or private financings, through sales of equity, or through other arrangements. Our ability to raise funds may be adversely affected by a number of factors, including factors beyond our control, such as economic conditions in the markets in which we operate and increased uncertainty in the financial, capital, and credit markets. Adequate funds may not be available when needed or may not be available on favorable terms. If we raise additional funds by issuing equity securities, dilution to existing stockholders may result. If funding is insufficient at any time in the future, we may be unable, or delayed in our ability, to develop or enhance our products or services, take advantage of business opportunities, or respond to competitive pressures, any of which could harm our business.

We incurred debt as part of our acquisition of the TaxACT business, and we may incur other debt in the future, which may adversely affect our financial condition and future financial results.

Our indirect subsidiary, 2nd Story, operator of the TaxACT business, incurred debt as part of our acquisition of that business, of which \$74.5 million remains outstanding. This debt is non-recourse debt that is guaranteed by TaxACT Holdings, Blucora's direct subsidiary, and 2nd Story's direct parent. This debt may adversely affect our financial condition and future financial results by, among other things:

increasing 2nd Story's vulnerability to downturns in its business, to competitive pressures, and to adverse economic and industry conditions;

requiring the dedication of a portion of our expected cash from 2nd Story's operations to service this indebtedness, thereby reducing the amount of expected cash flow available for other purposes, including capital expenditures and acquisitions;

requiring cash infusions from Blucora to 2nd Story if 2nd Story is unable to meet its debt obligations;

increasing our interest payment obligations in the event that interest rates rise dramatically (including on the portion of the debt that has an interest rate hedge if such hedge becomes ineffective); and

limiting our flexibility in planning for, or reacting to, changes in our businesses and our industries.

This credit facility imposes restrictions on 2nd Story, including restrictions on 2nd Story's ability to create liens on its assets and on our ability to incur indebtedness, and requires 2nd Story to maintain compliance with specified financial ratios. 2nd Story's ability to comply with these ratios may be affected by events beyond its control. In addition, this credit facility includes covenants, the breach of which may cause the outstanding indebtedness to be declared immediately due and payable. This debt, and our ability to repay it, may also negatively impact our ability to obtain additional financing in the future and may affect the terms of any such financing.

If others claim that our services infringe their intellectual property rights, we may be forced to seek expensive licenses, reengineer our services, engage in expensive and time-consuming litigation, or stop marketing and licensing our services.

Companies and individuals with rights relating to the software and online services industries have frequently resorted to litigation regarding intellectual property rights. In some cases, the ownership or scope of an entity's or person's rights is unclear and may also change over time, including through changes in U.S. or international

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intellectual property laws or regulations or through court decisions or decisions by agencies or regulatory boards that manage such rights. These parties have in the past, and may in the future, make claims against us alleging infringement of patents, copyrights, trademarks, trade secrets, or other intellectual property or proprietary rights, or alleging unfair competition or violations of privacy or publicity rights. Responding to any such claims could be time-consuming, result in costly litigation, divert management's attention, cause product or service release delays, require us to redesign our services, or require us to enter into royalty or licensing agreements. Our technology and services may not be able to withstand any third-party claims or rights against their use. If a successful claim of infringement was made against us and we could not develop non-infringing technology or content, or license the infringed or similar technology or content on a timely and cost-effective basis, our business could suffer.

We do not regularly conduct patent searches to determine whether the technology used in our services infringes patents held by third parties. Patent searches may not return every issued patent or patent application that may be deemed relevant to a particular product or service. It is therefore difficult to determine, with any level of certainty, whether a particular product or service may be construed as infringing a current or future U.S. or foreign patent.

We rely heavily on our technology and intellectual property, but we may be unable to adequately or cost-effectively protect or enforce our intellectual property rights, thus weakening our competitive position and negatively impacting our business and financial results. We may have to litigate to enforce our intellectual property rights, which can be time consuming, expensive, and difficult to predict.

To protect our rights in our services and technology, we rely on a combination of copyright and trademark laws, patents, trade secrets, confidentiality agreements with employees and third parties, and protective contractual provisions. We also rely on laws pertaining to trademarks and domain names to protect the value of our corporate brands and reputation. Despite our efforts to protect our proprietary rights, unauthorized parties may copy aspects of our services or technology, obtain and use information, marks, or technology that we regard as proprietary, or otherwise violate or infringe our intellectual property rights. In addition, it is possible that others could independently develop substantially equivalent intellectual property. If we do not effectively protect our intellectual property, or if others independently develop substantially equivalent intellectual property, our competitive position could be weakened.

Effectively policing the unauthorized use of our services and technology is time-consuming and costly, and the steps taken by us may not prevent misappropriation of our technology or other proprietary assets. The efforts we have taken to protect our proprietary rights may not be sufficient or effective, and unauthorized parties may obtain and use information, marks, or technology that we regard as proprietary, copy aspects of our services, or use similar marks or domain names. In some cases, the ownership or scope of an entity's or person's rights is unclear and may also change over time, including through changes in U.S. or international intellectual property laws or regulations or through court decisions or decisions by agencies or regulatory boards that manage such rights. Our intellectual property may be subject to even greater risk in foreign jurisdictions, as protection is not sought or obtained in every country in which our services and technology are available and it is often more difficult and costly to obtain, register, or enforce our rights in foreign jurisdictions.

We may have to litigate to enforce our intellectual property rights, to protect our trade secrets, or to determine the validity and scope of others' proprietary rights, which are sometimes not clear or may change. Litigation can be time consuming and expensive, and the outcome can be difficult to predict.

Delaware law and our charter documents may impede or discourage a takeover, which could cause the market price of our shares to decline.

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We are a Delaware corporation and the anti-takeover provisions of Delaware law impose various impediments to the ability of a third party to acquire us, even if a change of control would be beneficial to our existing stockholders. For example, Section 203 of the Delaware General Corporation Law may discourage,

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delay, or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a period of three years after the person becomes an interested stockholder. In addition, our certificate of incorporation and bylaws contain provisions that may discourage, delay, or prevent a third party from acquiring us without the consent of our board of directors, even if doing so would be beneficial to our stockholders. Provisions of our charter documents that could have an anti-takeover effect include:

the classification of our board of directors into three groups so that directors serve staggered three-year terms, which may make it difficult for a potential acquirer to gain control of our board of directors;

the requirement for supermajority approval by stockholders for certain business combinations;

the ability of our board of directors to authorize the issuance of shares of undesignated preferred stock without a vote by stockholders;

the ability of our board of directors to amend or repeal the bylaws;

limitations on the removal of directors;

limitations on stockholders' ability to call special stockholder meetings;

advance notice requirements for nominating candidates for election to our board of directors or for proposing matters that can be acted upon by stockholders at stockholder meetings; and

certain restrictions in our charter on transfers of our common stock designed to preserve our federal net operating loss carryforwards (*NOLs*).

At our 2009 annual meeting, our stockholders approved an amendment to our certificate of incorporation that restricts any person or entity from attempting to transfer our stock, without prior permission from the Board of Directors, to the extent that such transfer would (i) create or result in an individual or entity becoming a five-percent stockholder of our stock, or (ii) increase the stock ownership percentage of any existing five-percent stockholder. This amendment provides that any transfer that violates its provisions shall be null and void and would require the purported transferee to, upon our demand, transfer the shares that exceed the five percent limit to an agent designated by us for the purpose of conducting a sale of such excess shares. This provision in our certificate of incorporation may make the acquisition of Blucora more expensive to the acquirer and could significantly delay, discourage, or prevent third parties from acquiring Blucora without the approval of our board of directors.

If there is a change in our ownership within the meaning of Section 382 of the Internal Revenue Code, our ability to use our NOLs may be severely limited or potentially eliminated.

As of December 31, 2012, we had NOLs of \$723.3 million that will expire primarily over an eight to twelve year period. If we were to have a change of ownership within the meaning of Section 382 of the Internal Revenue Code (defined as a cumulative change of 50 percentage points or more in the ownership positions of certain stockholders owning five percent or more of a company's common stock over a three-year rolling period), then under certain conditions, the amount of NOLs we could use in any one year could be limited to an amount equal to our market capitalization, net of substantial non-business assets, at the time of the ownership change multiplied by the federal long-term tax exempt

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rate. Our certificate of incorporation imposes certain limited transfer restrictions on our common stock that we expect will assist us in preventing a change of ownership and preserving our NOLs, but there can be no assurance that these restrictions will be sufficient. In addition, other restrictions on our ability to use the NOLs may be triggered by a merger or acquisition, depending on the structure of such a transaction. It is our intention to limit the potential impact of these restrictions, but there can be no guarantee that such efforts will be successful. If we are unable to use our NOLs before they expire, or if the use of this tax benefit is severely limited or eliminated, there could be a material reduction in the amount of after-tax income and cash flow from operations, and it could have an effect on our ability to engage in certain transactions.

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If we are unable to hire, retain, and motivate highly qualified employees, including our key employees, we may not be able to successfully manage our business.

Our future success depends on our ability to identify, attract, hire, retain, and motivate highly skilled management, technical, sales and marketing, and corporate development personnel. Qualified personnel with experience relevant to our businesses are scarce and competition to recruit them is intense. If we fail to successfully hire and retain a sufficient number of highly qualified employees, we may have difficulties in supporting or expanding our businesses. Realignment of resources, reductions in workforce, or other operational decisions have created and could continue to create an unstable work environment and may have a negative effect on our ability to hire, retain, and motivate employees.

Our business and operations are substantially dependent on the performance of our key employees. Changes of management or key employees may cause disruption to our operations, which may materially and adversely affect our business and financial results or delay achievement of our business objectives. In addition, if we lose the services of one or more key employees and are unable to recruit and retain a suitable successor, we may not be able to successfully and timely manage our business or achieve our business objectives. For example, the success of our Search business is partially dependent on key personnel who have long-term relationships with our Search Customers and distribution partners. There can be no assurance that any retention program we initiate will be successful at retaining employees, including key employees.

Like many technology companies, we use stock options, restricted stock units, and other equity-based awards to recruit and retain senior level employees. With respect to those employees to whom we issue such equity-based awards, we face a significant challenge in retaining them if the value of equity-based awards in aggregate or individually is either not deemed by the employee to be substantial enough or deemed so substantial that the employee leaves after their equity-based awards vest. If our stock price does not increase significantly above the exercise prices of our options or does not increase significantly above the comparative index price for our market stock units, we may need to issue new equity-based awards in order to motivate and retain our executives. We may undertake or seek stockholder approval to undertake other equity-based programs to retain our employees, which may be viewed as dilutive to our stockholders or may increase our compensation costs. Additionally, there can be no assurance that any such programs, or any other incentive programs, we undertake will be successful in motivating and retaining our employees.

Restructuring and streamlining our business, including implementing reductions in workforce, discretionary spending, and other expense reductions, may harm our business.

We have in the past and may in the future find it advisable to take measures to streamline operations and reduce expenses, including, without limitation, reducing our workforce or discontinuing products or businesses. Such measures may place significant strains on our management and employees, and could impair our development, marketing, sales, and customer support efforts. We may also incur liabilities from these measures, including liabilities from early termination or assignment of contracts, potential failure to meet obligations due to loss of employees or resources, and resulting litigation. Such effects from restructuring and streamlining could have a negative impact on our business and financial results.

RISKS RELATED TO OUR SEARCH BUSINESS

We may be unable to compete successfully in the search market.

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We face intense competition in the search market. Many of our competitors have substantially greater financial, technical, and marketing resources, larger customer bases, longer operating histories, more developed infrastructures, greater brand recognition, better access to vendors, or more established relationships in the industry than we have. Our competitors may be able to adopt more aggressive pricing policies, develop and expand their product and service offerings more rapidly, adapt to new or emerging technologies and changes in content provider and distribution partner requirements more quickly, achieve greater economies of scale, and

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devote greater resources to the marketing and sale of their products and services than we can. Some of the companies that we compete with in the search market are currently Search Customers of ours, the loss of any of which could harm our business. In addition, we may face increasing competition for search market share from new search startups, mobile search providers, and social media sites and applications. If we are unable to match or exceed our competitors' marketing reach and customer service experience, our business may not be successful. Because of these competitive factors and due to our relatively small size and financial resources, we may be unable to compete successfully in the search market and, to the extent that these competitive factors apply to other markets that we pursue, in such other markets.

Failure by us or our search distribution partners to comply with the guidelines promulgated by Google and Yahoo! may cause that Search Customer to temporarily or permanently suspend the use of its content or terminate its agreement with us, or may require us to modify or terminate certain distribution relationships.

If we or our search distribution partners fail to meet the guidelines promulgated by Google or Yahoo! for the use of their content, we may not be able to continue to use their content or provide the content to such distribution partners. Our agreements with Google and Yahoo! give them the ability to suspend the use and the distribution of their content for non-compliance with their requirements and guidelines and, in the case of breaches of certain other provisions of their agreements, to terminate their agreements with us immediately, regardless of whether such breaches could be cured.

The terms of the Search Customer agreements with Google and Yahoo! and the related guidelines are subject to differing interpretations by the parties. Google and Yahoo! have in the past suspended, and may in the future, suspend their content provided to our websites and the websites of our distribution partners, without notice, when they believe that we or our distribution partners are not in compliance with their guidelines or are in breach of the terms of their agreements. During such suspension we will not receive any revenue from any property of ours or a distribution partner that is affected by the suspended content, and the loss of such revenue could harm our business and financial results.

Additionally, as our business evolves, we expect that the guidelines of Google and Yahoo!, as well as the parties' interpretations of compliance, breach, and sufficient justification for suspension of use of content will change. Both Yahoo! and Google regularly change their guidelines and requirements, both as part of our renegotiation of our agreements with them and generally as they manage their networks of distribution partners. These changes in the guidelines and any changes in the parties' interpretations of those guidelines may result in restrictions on our use of the Google and Yahoo! search services, and may require us to terminate our agreement with distribution partners or forego entering into agreements with distribution partners. The loss or reduction of content that we can use or make available to our distribution partners as a result of suspension, termination, or modification of distribution or Search Customer agreements could have a material adverse effect on our business and financial results.

Restrictions on our ability, and the ability of our search distribution partners, to distribute, market, or offer search-related applications, products, and services may impact our financial results.

A significant portion of our Search revenue is dependent on business models that can be negatively impacted by changes in policies or technology. For example, many of our Search distribution partners distribute applications, extensions, or toolbars that are monetized through the search services that we provide. Our Search Customers require that such applications, extensions, or toolbars, and the distribution of those applications, extensions, or toolbars, comply with certain guidelines. Our Search Customers can and do modify these guidelines from time to time, and recent modifications of these guidelines may impact the distribution of applications, extensions, or toolbars that drive traffic and revenue to our search services. In addition, our Search Customers' guidelines have in the past, and may in the future, negatively affected our ability, and the ability of our search distribution partners, to drive traffic to our search services through the use of search engine marketing.

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Further, certain third parties have introduced, and can be expected to continue to introduce, new or updated technologies, applications, and policies that may interfere with the ability of users of search services provided directly by us or by our search distribution partners to access those services. For example third parties have introduced technologies and applications (including new and enhanced web browsers) that prevent users from downloading the extensions or toolbars provided by some of our search partners. Those applications may also have features and policies that interfere with the functionality of search boxes embedded within extensions and toolbars and the maintenance of home page and other settings previously selected by users.

Any changes in technologies, applications, and policies that restrict the distribution, marketing, and offering of search-related applications, extensions, toolbars, products, and services may impact our operating and financial results.

Most of our search services revenue is attributable to Google, and the loss of, or a payment dispute with, Google or any other significant Search Customer would harm our business and financial results.

If Google, Yahoo!, or any future significant Search Customer were to substantially reduce or eliminate the content it provides to us or to our distribution partners, our business results could materially suffer if we are unable to establish and maintain new Search Customer relationships, or expand our remaining Search Customer relationships, to replace the lost or disputed revenue. Google accounted for approximately 77% of our total revenues in 2012. Yahoo! remains an important partner and contributes to our value proposition as a metasearch provider, but over the past several years, Yahoo!'s percentage of our revenue has declined, and we expect this trend to continue. We continue to believe that if our Google relationship ended or was impaired, we could replace a portion of the lost revenue with revenue from Yahoo!, but because of the increased importance of Google to our search operations, these two Search Customers are no longer interchangeable. In addition, Yahoo! has entered into an agreement with Microsoft's Bing search service, under which Bing provides all of Yahoo!'s algorithmic search results and some of its paid search results. If Yahoo! cannot maintain an agreement with Bing on favorable terms, or if Bing is unable to adequately perform its obligations to Yahoo!, then Yahoo!'s ability to provide us with algorithmic and paid search results may be impaired. If a Search Customer is unwilling to pay us amounts that it owes us, or if it disputes amounts it owes us or has previously paid to us for any reason (including for the reasons described in the risk factors below), our business and financial results could materially suffer.

Our Search business will suffer if we are unable to negotiate the extension of our Search Customer agreements on favorable terms. Our agreement with Yahoo! runs to December 31, 2013 and our agreement with Google runs to March 31, 2014.

A substantial portion of our search services revenue is dependent on our relationships with a small number of distribution partners who distribute our search services, the loss of which could have a material adverse effect on our business and financial results.

We rely on our relationships with search distribution partners, including Internet service providers, web portals, and software application providers, for distribution of our search services. In 2012, 75% of our total revenues came from searches conducted by end users on the web properties of our search distribution partners. Approximately 40% of our total revenues in 2012 was generated through relationships with our top five distribution partners. There can be no assurance that these relationships will continue or will result in benefits to us that outweigh their cost. Moreover, as the proportion of our revenue generated by distribution partners has increased in previous quarters, we have experienced, and expect to continue to experience, less control and visibility over performance. One of our challenges is providing our distribution partners with relevant services at competitive prices in rapidly evolving markets. Distribution partners may create their own services or may seek to license services from our Search Customers or other competitors or replace the services that we provide. Also, many of our distribution partners have limited operating histories and evolving business models that may prove unsuccessful even if our services are relevant and our prices competitive. If we are unable to maintain relationships with our distribution partners, our business and financial results could be materially adversely affected.

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Our agreements with many of our distribution partners come up for renewal in 2013. In addition, some of our distributors have the right to immediately terminate their agreements in the event of certain breaches. Such agreements may be terminated, may not be renewed, or may not be renewed on favorable terms, any of which could adversely impact our business and financial results. We anticipate that our distribution costs for our revenue sharing arrangements with our distribution partners will increase as revenue grows, and may increase as a percentage of revenues to the extent that there are changes to existing arrangements or we enter into new arrangements on less favorable terms.

In addition, competition continues for quality consumer traffic in the search market. We have experienced increased competition from our Search Customers as they seek to enter into content provider agreements directly with our existing or potential distribution partners, making it increasingly difficult for us to renew agreements with existing major distribution partners or to enter into distribution agreements with new partners on favorable terms. Any difficulties that we experience with maintaining or strengthening our business relationships with our major distribution partners could have an adverse effect on our business and financial results.

If advertisers perceive that they are not receiving quality traffic to their sites through their paid-per-click advertisements, they may reduce or eliminate their advertising through the Internet, which could have a negative material impact on our business and financial results.

Most of our revenue from our search business is based on the number of clicks on paid search results that are served on our web properties or those of our distribution partners. Each time a user clicks on a paid search result, the Search Customer that provided the paid search result receives a fee from the advertiser who paid for the click and the Search Customer pays us a portion of that fee. If the click originated from one of our distribution partners' web properties, we share a portion of the fee we receive with such partner. If an advertiser receives what it perceives to be poor quality traffic, meaning that the advertiser's objectives are not met for a sufficient percentage of clicks for which it pays, the advertiser may reduce or eliminate its advertisements through the Search Customer that provided the commercial search result to us. This leads to a loss of revenue for our Search Customers and consequently lower fees paid to us. Also, if a Search Customer perceives that the traffic originating from one of our web properties or the web property of a distribution partner is of poor quality, the Search Customer may discount the amount it charged all advertisers whose paid click advertisements appeared on such website or web property, and accordingly may reduce the amount it pays us. The Search Customer may also suspend or terminate our ability to provide its content through such websites or web properties if such activities are not modified to satisfy the Search Customer's concerns.

Poor quality traffic may be a result of invalid click activity. Such invalid click activity occurs, for example, when a person or automated click generation program clicks on a commercial search result to generate fees for the web property displaying the commercial search result rather than to view the webpage underlying the commercial search result. Some of this invalid click activity is referred to as click fraud. When such invalid click activity is detected, the Search Customer may not charge the advertiser or may refund the fee paid by the advertiser for such invalid clicks. If the invalid click activity originated from one of our distribution partners' web properties or our owned and operated properties, such non-charge or refund of the fees paid by the advertisers in turn reduces the amount of fees the Search Customer pays us.

Initiatives we undertake to improve the quality of the traffic that we send to our Search Customers may not be successful and, even if successful, may result in loss of revenue in a given reporting period. For example, during the first half of 2010, we removed certain traffic from some distribution partners in an effort to improve traffic quality, and these actions, while successful in improving traffic quality, had a material negative impact on our revenues for the first and second quarters of 2010.

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We may be subject to liability for our use or distribution of information that we gather or receive from third parties and indemnity protections or insurance coverage may be inadequate to cover such liability.

Our search services obtain content and commerce information from third parties and link users, either directly through our own websites or indirectly through the web properties of our distribution partners, to third-party webpages and content in response to search queries and other requests. These services could expose us to legal liability from claims relating to such third-party content and sites, the manner in which these services are distributed and displayed by us or our distribution partners, or how the content provided by our Search Customers was obtained or provided by our Search Customers. This could subject us to legal liability for such things as defamation, negligence, intellectual property infringement, violation of privacy or publicity rights, and product or service liability, among others. Laws or regulations of certain jurisdictions may also deem some content illegal, which may expose us to legal liability as well. Regardless of the legal merits of any such claims, they could result in costly litigation, be time consuming to defend, and divert management's attention and resources. If there was a determination that we had violated third-party rights or applicable law, we could incur substantial monetary liability, be required to enter into costly royalty or licensing arrangements (if available), or be required to change our business practices. We are also subject to laws and regulations, both in the United States and abroad, regarding the collection and use of end user information and search related data. If we do not comply with these laws and regulations, we may be exposed to legal liability.

Although the agreements by which we obtain content contain indemnity provisions, these provisions may not cover a particular claim or type of claim or the party giving the indemnity may not have the financial resources to cover the claim. Our insurance coverage may be inadequate to cover fully the amounts or types of claims that might be made against us. In addition, we may also have an obligation to indemnify and hold harmless certain of our Search Customers or distribution partners from damages they suffer for such violations under our contracts with them. Implementing measures to reduce our exposure to such claims could require us to expend substantial resources and limit the attractiveness of our services. As a result, these claims could result in material harm to our business. Any liability that we incur as a result of content we receive from third parties could harm our financial results.

Governmental regulation and the application of existing laws may slow business growth, increase our costs of doing business, and create potential liability.

The growth and development of the Internet has led to new laws and regulations, as well as the application of existing laws to the Internet, in both the U.S. and foreign jurisdictions. Application of these laws can be unclear. For example, it is unclear how many existing laws regulating or requiring licenses for certain businesses (such as gambling, online auctions, distribution of pharmaceuticals, alcohol, tobacco, firearms, insurance, securities brokerage, or legal services) apply to search services, online advertising, and our business. The costs of complying or failure to comply with these laws and regulations could limit our ability to operate in our market (including limiting our ability to distribute our services; conduct targeted advertising; collect, use, or transfer user information; or comply with new data security requirements), expose us to compliance costs and substantial liability, and result in costly and time-consuming litigation. It is impossible to predict whether or when any new legislation may be adopted or existing legislation or regulatory requirements will be deemed applicable to us, any of which could materially and adversely affect our business.

Any failure by us to comply with our posted privacy policies, Federal Trade Commission (*FTC*) requirements, or other privacy-related laws and regulations could result in proceedings by the FTC or others, including potential class action litigation, which could potentially have an adverse effect on our business, results of operations, and financial condition. For example, there are a large number of legislative proposals before the U.S. Congress and various state legislative bodies regarding privacy and data protection issues related to our businesses. It is not possible to predict whether or when such legislation may be adopted and certain proposals, if adopted, could materially and adversely affect our business through a decrease in user registrations and revenues. This could be caused by, among other possible provisions, the required use of disclaimers or other requirements before users can utilize our services.

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The FTC has recommended that search engine providers delineate paid-ranking search results from non-paid results. To the extent that we are required to modify presentation of search results as a result of specific regulations or requirements that may be issued in the future by the FTC or other state or federal agencies or legislative bodies with respect to the nature of such delineation or other aspects of advertising in connection with search services, revenue from the affected search engines could be negatively impacted. Addressing these regulations may require us to develop additional technology or otherwise expend significant time and expense.

Due to the nature of the Internet, it is possible that the governments of states and foreign countries might attempt to regulate Internet transmissions, through data protection laws amongst others, or institute proceedings for violations of their laws. We might unintentionally violate such laws, such laws may be modified, and new laws may be enacted in the future. Any such developments (or developments stemming from enactment or modification of other laws) could increase the costs of regulatory compliance for us or force us to change our business practices.

RISKS RELATED TO OUR TAX PREPARATION BUSINESS

The tax preparation market is very competitive, and failure to effectively compete will adversely affect our financial results.

Our TaxACT business operates in a very competitive marketplace. There are many competing software products and online services, including two competitors who have a significant percentage of the software and online service market: Intuit's TurboTax and H&R Block's products and services. Our TaxACT business must also compete with alternate methods of tax preparation, including pencil and paper do-it-yourself return preparation by individual filers and storefront tax preparation services, including both local tax preparers and large chains such as H&R Block, Liberty, and Jackson Hewitt. Finally, our TaxACT business faces the risk that state or federal taxing agencies will offer software or systems to provide direct access for individual filers that will reduce the need for TaxACT's software and services. Our financial results will suffer if we cannot continue to offer software and services that have quality and ease-of-use that are compelling to consumers; market the software and services in a cost effective way; offer ancillary services that are attractive to users; and develop the software and services at a low enough cost to be able to offer them at a competitive price point.

The seasonality of our tax preparation business requires a precise development and release schedule and any delays or issues with accuracy or quality may damage our reputation and harm our future financial results.

Our tax preparation software and online service must be ready to launch in final form near the beginning of each calendar year to take advantage of the full tax season. We must update the code for our software and service each year to account for annual changes in tax laws and regulations. Delayed and unpredictable changes to federal and state tax laws and regulations can cause an already tight development cycle to become even more challenging. We must develop our code on a precise schedule that both incorporates all such changes and ensures that the software and service are accurate. If we are unable to meet this precise schedule and we launch our software and service late, we risk losing customers to our competitors. If we cannot develop our software with a high degree of accuracy and quality, we risk errors in the tax returns that are generated. Such errors could result in loss of reputation, lower customer retention, or legal fees and payouts related to the warranty on our software and service.

The hosting, collection, use, and retention of personal customer information and data by our TaxACT business creates risk that may harm our business.

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Our TaxACT business collects, uses, and retains large amounts of customer personal and financial information, including information regarding income, family members, credit cards, tax returns, bank accounts, social security numbers, and healthcare. Some of this personal customer information is held by third-party vendors that process certain transactions. In addition, as many of our products and services are web-based, the amount of data we store for our users on our servers (including personal information) has been increasing and

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will continue to increase as we further evolve our businesses. We and our vendors use security technologies to protect transactions and personal information and use security and business controls to limit access and use of personal information. However, individuals or third parties, including rogue employees, contractors, temporary workers, vendors, business partners, or hackers, may be able to circumvent these security and business measures. In addition, our clients may access our online tax preparation services from their computers and mobile devices, install and use our tax preparation software on their computers and mobile devices, and access online banking services from their computers and mobile devices. Because our business model relies on our clients' use of their own personal computers, mobile devices, and the Internet, computer viruses and other attacks on our clients' personal computer systems and mobile devices could create losses for our clients even without any breach in the security of our systems, and could thereby harm our business and our reputation.

If we are unable to develop, manage, and maintain critical third party business relationships for our TaxACT business, it may be adversely affected.

Our TaxACT business is dependent on the strength of our business relationships and our ability to continue to develop, maintain, and leverage new and existing relationships. We rely on various third party partners, including software and service providers, suppliers, vendors, distributors, contractors, financial institutions, licensing partners, among others, in many areas of this business to deliver our services and products. In certain instances, the products or services provided through these third party relationships may be difficult to replace or substitute, depending on the level of integration of the third party's products or services into, or with, our offerings and/or the general availability of such third party's products and services. In addition, there may be few or no alternative third party providers or vendors in the market. The failure of third parties to provide acceptable and high quality products, services, and technologies or to update their products, services, and technologies may result in a disruption to our business operations, which may reduce our revenues and profits, cause us to lose customers, and damage our reputation. Alternative arrangements and services may not be available to us on commercially reasonable terms or we may experience business interruptions upon a transition to an alternative partner.

In particular, our TaxACT business has relationships with banks, credit unions or other financial institutions, both as customers and as suppliers of certain critical services we offer to our other customers. If any of these institutions fail, consolidate, stop providing certain services, or institute cost-cutting efforts, our results may suffer and we may be unable to offer those services to our customers.

We may be unable to effectively adapt to changing government regulations relating to tax preparation, which may harm our operating results.

The tax preparation industry is heavily regulated at the state and federal level, and is frequently subject to significant new and revised laws and regulations. The application of these laws and regulations to our businesses is often unclear and compliance with these regulations may involve significant costs or require changes to our business practices. Any changes to our business practices that result from a change to laws or regulations, or from any change in the interpretation of a law or regulation (for example due to a court ruling or an administrative ruling or interpretation) may result in a negative impact on our operating results. We are also required to comply with a variety of IRS and state revenue agency standards in order to successfully operate our tax preparation and electronic filing services. Changes in these requirements, including the required use of specific technologies or technology standards, may significantly increase the costs of providing those services to our customers and may prevent us from delivering a quality product to our customers in a timely manner.

In order to meet regulatory standards, we may be required to increase investment in compliance and auditing functions or new technologies. In addition, government authorities may enact other laws, rules or regulations that place new burdens or restrictions on our business or determine that our operations are directly subject to existing rules or regulations, such as requirements related to data collection, use, transmission, retention, processing and security, which may make our business more costly, less efficient or impossible to conduct, and may require us to modify our current or future products or services, which may harm our future financial results.

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Restrictions on our ability to offer certain financial products related to our tax preparation services may harm our financial results.

We offer certain financial products related to our tax preparation software and services, and we generate some of our Tax Preparation segment revenue from such products. These products include prepaid debit cards on which a tax filer may receive his or her tax return and the ability of certain of our users to have the fees for our services deducted from their tax return. Any regulation of these products by state or federal governments, or any competing products offered by state and federal tax collection agencies could impact our revenue from these financial products. In addition, litigation brought by consumers or state or federal agencies relating to these products may result in additional restrictions on the offering of these products. To the extent that any additional restrictions on our tax preparation related financial products restrict our ability to offer such products, our financial results may suffer.

Unanticipated changes in income tax rates, deduction types, or the taxation structure may adversely affect our TaxACT business.

Changes in the way that the state and federal governments structure their taxation regimes may affect our results. The introduction of a simplified or flattened taxation structure may make our services less necessary or attractive to individual filers. We also face risk from the possibility of increased complexity in taxation structures, which may encourage some of our customers to seek professional tax advice instead of using our software or services. In the event that such changes to tax structures cause us to lose market share, our results may suffer.

If our TaxACT business fails to process transactions effectively or fails to adequately protect against disputed or potential fraudulent activities, our revenue and earnings may be harmed.

Our TaxACT business processes a significant volume and dollar value of transactions on a daily basis. Due to the size and volume of transactions that we handle, effective processing systems and controls are essential to ensure that transactions are handled appropriately. Despite our efforts, it is possible that we may make errors or that fraudulent activity may affect our services. In addition to any direct damages and fines that any such problems may create, which may be substantial, a loss of confidence in our controls may seriously harm our business and damage our brand. The systems supporting our business are comprised of multiple technology platforms that are difficult to scale. If we are unable to effectively manage our systems and processes we may be unable to process customer data in an accurate, reliable, and timely manner, which may harm our business.

ITEM 1B. Unresolved Staff Comments

None.

ITEM 2. Properties

Our principal corporate office is located in Bellevue, Washington. We provide data center services for our search operations from third-party co-location facilities located in Tukwila, Washington and Reston, Virginia. The headquarters and data center facility for our TaxACT business is in Cedar Rapids, Iowa and we have a disaster recovery center for our TaxACT business in Waukee, Iowa. All of our facilities are leased. We believe our properties are suitable and adequate for our present and anticipated near-term needs.

ITEM 3. Legal Proceedings

See Note 9: Commitments and Contingencies of the Notes to Consolidated Financial Statements in Item 8, of Part II of this report for information regarding legal proceedings.

ITEM 4. Mine Safety Disclosures

None.

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Our common stock trades on the NASDAQ Global Select Market under the symbol BCOR. The following table sets forth, for the periods indicated, the high and low sales prices for our common stock as reported by the NASDAQ Global Select Market.

	High	Low
Fiscal year ended December 31, 2012:		
First Quarter	\$ 13.68	\$ 10.99
Second Quarter	\$ 13.45	\$ 10.98
Third Quarter	\$ 18.25	\$ 12.07
Fourth Quarter	\$ 18.24	\$ 14.09
Fiscal year ended December 31, 2011:		
First Quarter	\$ 8.89	\$ 7.94
Second Quarter	\$ 9.39	\$ 8.31
Third Quarter	\$ 9.81	\$ 8.36
Fourth Quarter	\$ 11.76	\$ 8.04

On March 1, 2013, the last reported sale price for our common stock on the NASDAQ Global Select Market was \$15.53 per share.

 Holders

As of March 1, 2013, there were 455 holders of record of our common stock. A substantially greater number of holders are beneficial owners whose shares are held of record by banks, brokers, and other financial institutions.

 Dividends

There were no dividends paid in 2011 or 2012. We currently intend to retain our earnings to finance future growth and therefore do not anticipate paying any cash dividends on our common stock in the foreseeable future.

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The following selected consolidated financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, our consolidated financial statements and notes thereto and other financial information included elsewhere in this report. The selected consolidated statements of operations data and the consolidated balance sheet data are derived from our audited consolidated financial statements.

	Years ended December 31,				
	2012 ⁽¹⁾⁽⁶⁾	2011 ⁽¹⁾	2010 ⁽¹⁾	2009 ⁽¹⁾	2008 ⁽¹⁾
	(in thousands, except per share data)				
Consolidated Statements of Operations Data:					
Revenues	\$ 406,919	\$ 228,813	\$ 214,343	\$ 207,646	\$ 156,727
Cost of sales (includes amortization of acquired intangible assets of \$7,580, \$2,595, \$9,197, \$111, and \$0)	267,451	154,962	138,995	136,623	87,130
Gross profit	139,468	73,851	75,348	71,023	69,597
Expenses and other income:					
Engineering and technology	9,969	7,158	8,471	9,129	13,846
Sales and marketing	44,138	21,510	28,145	25,378	24,644
General and administrative	27,418	21,542	32,843	23,617	24,228
Depreciation	2,119	2,162	3,138	3,283	3,264
Amortization of intangible assets	11,619				
Restructuring					17
Other, net					(1,897)
Loss on investments, net ⁽²⁾				4,714	28,520
Other loss (income), net ⁽³⁾	6,677	1,246	(15,247)	(2,682)	(7,149)
Total expenses and other income	101,940	53,618	57,350	63,439	85,473
Income (loss) from continuing operations before income taxes	37,528	20,233	17,998	7,584	(15,876)
Income tax benefit (expense) ⁽³⁾⁽⁴⁾	(15,002)	11,288	(8,725)	(181)	(598)
Income (loss) from continuing operations	22,526	31,521	9,273	7,403	(16,474)
Discontinued operations ⁽⁵⁾ :					
Loss from discontinued operations, net of taxes		(2,253)	(4,593)		(1,455)
Loss on sale of discontinued operations, net of taxes		(7,674)			(770)
Net income (loss)	\$ 22,526	\$ 21,594	\$ 4,680	\$ 7,403	\$ (18,699)
Basic income (loss) per share:					
Income (loss) from continuing operations	\$ 0.56	\$ 0.83	\$ 0.26	\$ 0.21	\$ (0.48)
Loss from discontinued operations		(0.06)	(0.13)		(0.04)
Loss on sale of discontinued operations		(0.20)			(0.02)
Basic net income (loss) per share	\$ 0.56	\$ 0.57	\$ 0.13	\$ 0.21	\$ (0.54)
Shares used in computing basic income (loss) per share	40,279	37,954	35,886	34,983	34,415
Diluted income (loss) per share:					
Income (loss) from continuing operations	\$ 0.54	\$ 0.82	\$ 0.25	\$ 0.21	\$ (0.48)
Loss from discontinued operations		(0.06)	(0.12)		(0.04)
Loss on sale of discontinued operations		(0.20)			(0.02)

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Diluted net income (loss) per share	\$ 0.54	\$ 0.56	\$ 0.13	\$ 0.21	\$ (0.54)
Shares used in computing diluted income (loss) per share	41,672	38,621	36,829	35,431	34,415

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	2012	2011	As of December 31,		2008
			2010	2009	
			(in thousands)		
Consolidated Balance Sheet Data:					
Cash, cash equivalents, short-term and long-term investments	\$ 162,288	\$ 293,551	\$ 253,736	\$ 226,397	\$ 205,444
Working capital	144,385	281,873	242,440	219,475	182,733
Total assets	585,293	395,139	352,720	322,216	291,133
Total stockholders' equity	415,450	355,105	301,771	279,835	262,324

Special dividend announced	Special dividend paid	Special dividend amount per share	Total dividends (in thousands)
November 14, 2007	January 8, 2008	\$9.00	\$299,296

- (1) We expense the fair value of awards of equity instruments as stock-based compensation expense over the period in which the award vests. Operating expenses include stock-based compensation expense allocated as follows (in thousands):

	Years ended December 31,				
	2012	2011	2010	2009	2008
Cost of sales	\$ 558	\$ 286	\$ 461	\$ 535	\$ 1,043
Engineering and technology	1,180	821	1,298	1,423	3,373
Sales and marketing	1,909	1,002	2,631	2,038	3,934
General and administrative	9,576	5,579	9,528	6,572	5,954
Discontinued operations		(159)	833		
Total	\$ 13,223	\$ 7,529	\$ 14,751	\$ 10,568	\$ 14,304

- (2) In 2009 and 2008, we recorded other-than-temporary impairment charges of \$5.4 million and \$24.3 million, respectively, related to available-for-sale investments that we purchased for \$40.4 million, became illiquid in 2007, and were sold for net proceeds of \$9.2 million in 2009.
- (3) In 2010, we recorded a \$19.0 million net gain on a litigation settlement. The net gain allowed us to use a portion of our net operating loss carryforwards resulting in a net income tax expense of \$6.6 million.
- (4) In 2011, we recorded a reversal of \$18.9 million of the valuation allowance related to our deferred tax assets.
- (5) We completed the sale of our e-commerce business on June 22, 2011, and operating results of this business has been presented as discontinued operations for 2011 and 2010. We completed the sale of our directory business on October 31, 2007 and the sale of our mobile business on December 28, 2007. The operating results and losses from the sales of these businesses have been presented as discontinued operations for 2008.
- (6) On January 31, 2012, we acquired TaxACT Holdings and its subsidiary, 2nd Story, operator of the TaxACT income tax preparation business, which generated \$62.1 million of revenue in 2012.

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ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion and analysis in conjunction with the Selected Consolidated Financial Data and our consolidated financial statements and notes thereto included elsewhere in this report.

Overview

We operate two primary businesses: the InfoSpace online search business and the TaxACT tax preparation software and online service business. The InfoSpace business is primarily a B2B service that provides search technology, aggregated search content, and monetization solutions to partner sites. InfoSpace also offers search services directly to consumers through its owned internet search properties. Blucora acquired the TaxACT tax preparation business on January 31, 2012. The TaxACT business consists of an online tax preparation service for individuals, tax preparation software for individuals and professional tax preparers, and ancillary services. Following the acquisition of the TaxACT business, we determined that we have two reporting segments: Search and Tax Preparation.

Search

The majority of the Blucora's revenues are generated by our Search segment. Our Search business primarily offers search services through the web properties of its distribution partners, which are generally private-labeled and customized to address the unique requirements of each distribution partner. The Search business also distributes aggregated search content through its own websites, such as Dogpile.com and WebCrawler.com. The InfoSpace search business does not generate its own search content, but instead aggregates search content from a number of content providers. Our metasearch technology selects search results from several search engine content providers, including Google, Yahoo!, and Bing, among others, and aggregates, filters, and prioritizes the results. This combination provides a more relevant search results page and leverages the investments made by our search engine content providers to continually improve the user experience. Some of these content providers, such as Google and Yahoo!, pay us to distribute their content. We refer to those providers as Search Customers.

Revenue from our Search segment is generated primarily as a result of end users of our services clicking on paid search results displayed on our own branded websites or those of our distribution partners. These paid search results are provided to us by our Search Customers. The Search Customer that provided the paid search result receives a fee from the advertiser who paid for the click and the Search Customer pays us a portion of that fee. If the click originated from one of our distribution partners' web properties, we share a portion of the fee we receive with that distribution partner. Revenue is recognized in the period in which such paid clicks occur and is based on the amounts earned and remitted to us by our Search Customers for such clicks. For the year ended December 31, 2012, revenue from Google accounted for approximately 91% of our Search segment revenue and 77% of our total revenue.

Tax Preparation

On January 31, 2012, we acquired TaxACT Holdings and its subsidiary, 2nd Story, operator of the TaxACT income tax preparation business for \$287.5 million in cash, less certain transaction expenses, and subject to certain specified working capital adjustments. The TaxACT business consists of tax preparation software for individuals and professional tax preparers, an online tax preparation service for individuals, and ancillary data storage and financial services. The TaxACT acquisition was funded from our cash reserves and from the net proceeds of a \$105 million credit facility (of which \$100 million was drawn).

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Our Tax Preparation segment generates revenue primarily in three ways: the sale of state and upgraded online federal income tax preparation services and software to consumers and small businesses, the sale of ancillary services to consumers, and the sale of its professional edition income tax preparation software to professional tax preparers. The majority of our Tax Preparation revenue is generated by our online service at www.taxact.com and, as a highly seasonal business, almost all of that revenue is generated in the first four

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months of the calendar year. Our basic federal tax preparation online software service is free for everyone, meaning that any taxpayer can use the services to e-file his or her federal income return, including all forms that the IRS allows to be e-filed, without paying for upgraded services. This free offer differentiates TaxACT's offerings from many of its competitors who have limited free software and/or services offerings or limitations on the forms that may be e-filed for free. We generate revenue from a percentage of these free users who choose to upgrade for a fee to our deluxe product, which includes additional support and tools, and ancillary services and/or to file their state income tax returns, which are not free, with TaxACT. The ancillary services include, among other things, taxpayer phone support, data archiving, a deferred payment option, a bank card product, and e-filing services for professional tax preparers. TaxACT is the recognized value player in the digital-do-it-yourself space, offering comparable software and/or services at a lower cost to the end-user compared to larger competitors. This, coupled with its free for everyone offer, provides TaxACT a valuable marketing position. TaxACT's professional tax preparer software allows professional tax preparers to file individual returns for their clients. Revenue from professional tax preparers has historically constituted a relatively small percentage of the TaxACT business's overall revenue, and requires relatively modest incremental development costs as the basic software is substantially similar to the consumer-facing software and online service.

Use of Cash

As of December 31, 2012, we had \$162.3 million in cash, cash equivalents, and short term investments. We may purchase up to \$50 million of our common stock in open-market transactions in the 24 month period succeeding February 6, 2013, which was the date that our board of directors approved the share repurchase plan. We may also use these amounts in the future on investment in our current businesses, in acquiring new businesses or assets, or for repayment of debt. Such businesses or assets may not be related to search or tax preparation, and such acquisitions will result in us incurring further transaction related costs. We are currently focused on the following areas: improving the search services offered to our end users and to our distribution partners and through our owned and operated properties, improving the customer experience for our tax preparation products, maintaining our current distribution partners and adding new distribution partners for our search services, retaining current tax preparation customers and attracting new ones, and seeking opportunities to use our resources to acquire and integrate new businesses and assets. Within our search and tax preparation businesses, engineering, operations, and product management personnel remain paramount to our ability to deliver high quality search and tax preparation services, enhance our current technology, and increase our distribution network and customer reach. As a result, we expect to continue to invest in our workforce and research and development operations.

Overview of 2012 Operating Results

The following is an overview of our operating results for the year ended December 31, 2012 compared to the prior year. A more detailed discussion of our operating results, comparing our operating results for the years ended December 31, 2012, 2011, and 2010, is included under the heading "Historical Results of Operations" in this Management's Discussion and Analysis of Financial Condition and Results of Operations.

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Several of our key operating financial measures for the years ended December 31, 2012 and 2011 in total dollars (in thousands) and as a percentage of segment revenue are presented below.

	Years ended December 31,	
	2012	2011
Revenues	\$ 406,919	\$ 228,813
	% of revenues	% of revenues
Gross profit	\$ 139,468	\$ 73,851
Income from continuing operations	\$ 22,526	\$ 31,521
Net income	\$ 22,526	\$ 21,594
Adjusted EBITDA ⁽¹⁾	\$ 80,439	\$ 36,623
Non-GAAP net income ⁽¹⁾	\$ 70,760	\$ 28,764
	% of search services revenue	% of search services revenue
Search Services Revenue:		
Revenue from distribution partners	88%	80%
Revenue from existing distribution partners (launched prior to the then-current year)	77%	75%
Revenue from new distribution partners (launched during the then-current year)	11%	5%
Revenue from owned and operated properties	12%	20%
Tax Preparation Revenue:		
Revenue ⁽²⁾	\$ 62,105	
Tax Preparation TaxACT consumer e-files ⁽³⁾	5,209	

(1) Adjusted EBITDA and Non-GAAP net income are non-GAAP measures, defined below in Non-GAAP Financial Measures.

(2) The Company acquired the TaxACT business on January 31, 2012, and this amount only includes the period from February 1, 2012 through December 31, 2012.

(3) (in thousands) Amount represents the number of accepted federal tax e-filings made through the TaxACT software and services, which we refer to as consumer e-files, for the 2011 tax season through December 31, 2012.

Table of Contents**Historical Results of Operations**

The following table sets forth the historical results of our operations (in thousands and as percent of revenues).

	Years ended December 31,			Years ended December 31,		
	2012	2011	2010	2012	2011	2010
	(in thousands)			(as a percent of revenues)		
Total revenues	\$ 406,919	\$ 228,813	\$ 214,343	100.0%	100.0%	100.0%
Total cost of sales	267,451	154,962	138,995	65.7	67.8	64.8
Gross profit	139,468	73,851	75,348	34.3	32.2	35.2
Operating expenses and other income:						
Engineering and technology	9,969	7,158	8,471	2.5	3.1	4.0
Sales and marketing	44,138	21,510	28,145	10.9	9.4	13.1
General and administrative	27,418	21,542	32,843	6.7	9.4	15.3
Depreciation	2,119	2,162	3,138	0.5	0.9	1.5
Amortization of intangible assets	11,619			2.9		
Other loss (income), net	6,677	1,246	(15,247)	1.6	0.6	(7.1)
Total expenses and other loss (income)	101,940	53,618	57,350	25.1	23.4	26.8
Income from continuing operations before income taxes	37,528	20,233	17,998	9.2	8.8	8.4
Income tax benefit (expense)	(15,002)	11,288	(8,725)	(3.7)	4.9	(4.1)
Income from continuing operations	22,526	31,521	9,273	5.5	13.7	4.3
Loss from discontinued operations, net of taxes		(2,253)	(4,593)		(1.0)	(2.1)
Loss on sale of discontinued operations, net of taxes		(7,674)			(3.3)	0.0
Net income	\$ 22,526	\$ 21,594	\$ 4,680	5.5%	9.4%	2.2%

Results of Operations for 2012, 2011, and 2010

The following information presents the results of operations of our two reporting segments. Segment expenses do not include certain costs such as certain general, administrative, and overhead costs, stock-based compensation, depreciation, amortization of intangible assets, other loss, net, income tax expense, or results from discontinued operations to the reportable segments.

Search

Search segment results for the years 2012, 2011, and 2010 are presented below (in thousands):

2012	Change	2011	Change	2010
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Revenue	\$ 344,814	116,001	\$ 228,813	\$ 14,470	\$ 214,343
Cost of revenue	245,135	101,248	143,887	24,006	119,881
Operating expense	37,494	(1,226)	38,720	(6,323)	45,043
Segment income	\$ 62,185	\$ 15,979	\$ 46,206	\$ (3,213)	49,419

In order to increase the revenue generated from our distribution partners web properties, we must attract and retain distribution partners. Our ability to attract and retain distribution partners depends to a significant extent on our ability to provide a satisfying end user experience and an attractive monetization proposition to our distribution partners. Traffic to our owned and operated search properties has declined in recent years, and our ability to slow this decline and the resulting decline in the revenue generated by our owned and operated search

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properties depends in part on the extent to which we are able to attract and retain end users by providing a satisfying user experience. We manage our online direct marketing initiatives by seeking a margin and volume mix that optimizes the gross dollar return on our marketing expenditures. Revenue growth for our online direct marketing initiatives is dependent on our ability to attain that optimal return.

The increase in search services revenues for 2012 as compared to 2011 was due to increases in revenue generated by our distribution partners, which was partially offset by a decline in revenue from our owned and operated web properties. Revenue from existing distribution partners (i.e., distribution partners launched before the then-current year) increased in 2012 as compared to 2011 by \$96.0 million (57%) and revenue from new distribution partners (i.e., distribution partners launched during the then-current year) in 2012 as compared to 2011 increased by \$26.5 million (224%). While we expect to continue year-over-year growth, our most significant search customer, Google, has instituted policy changes that will have a negative impact in the near term to certain of our distribution partners. We believe the impacts will be most pronounced in the late first quarter and carry into the second quarter, after which point we expect to begin to grow distribution sequentially in the second half of the year. The decrease of \$6.5 million (14%) in revenue generated by our owned and operated properties for 2012 as compared to 2011 was primarily a result of the expected attrition in the installed user base from our 2010 acquisition of Make the Web Better, resulting in fewer paid clicks. We generated 47% of our search services revenue through our top five distribution partners in both 2012 and 2011. The web properties of our top five distribution partners for 2012 generated 46% of our search services revenue in 2011.

The increase in search services revenues for 2011 as compared to 2010 was due to increases in revenue generated by our distribution partners, which was partially offset by a decline in revenue from our owned and operated web properties. Revenue from existing distribution partners increased in 2011 as compared to 2010 by \$26.0 million (18%) and revenue from new distribution partners in 2011 as compared to 2010 increased by \$8.6 million (270%), but these trends were offset by a decline of \$9.4 million from existing distribution partner Make The Web Better as we acquired its search services revenue generating assets on April 1, 2010. The decrease of \$16.6 million (26%) in revenue generated by our owned and operated properties for 2011 as compared to 2010 was primarily due to the operation of the acquired Make The Web Better assets, which generated \$8.2 million of revenue as an owned and operated web property in 2011, down from \$16.4 million in 2010. There was also a decrease in revenue of \$5.1 million from our revenue generated through our owned and operated metasearch engine site, (excluding the revenue from the Make The Web Better purchased assets).

For 2012, 88% of our search services revenue was generated through our search distribution partners' web properties, compared to 80% and 70% of our search services revenue, respectively, generated through our search distribution partners' web properties in 2011 and 2010.

We expect that search services revenue from searches conducted by end users on sites of our distribution partners will continue to represent the dominant majority of our search services revenue for the foreseeable future. Our owned and operated properties are affected by seasonal fluctuations in Internet usage, which generally decline in the summer months, although revenue from these sites makes up a proportionally smaller portion of our revenue, so seasonal impacts have become less meaningful, and are expected to become a smaller portion over time.

The search segment's cost of revenue primarily consists of amounts paid under our revenue sharing arrangements with our distribution partners and usage-based content fees. The increase in cost of revenue for 2012 as compared to 2011 is primarily due to an increase in the revenue generated from our distribution partners' web properties, with the resulting increase in shared revenue.

The dollar increase in cost of revenue for 2011 as compared to 2010 was primarily due to the increase in revenue sharing expenses related to an increase in revenue generated through the web properties of our distribution partners, and was partially offset by the effect of no longer paying distribution expense for revenue generated by Make The Web Better's assets (after we acquired them on April 1, 2010), by the decrease in the

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amortization of acquired intangible assets acquired from Make The Web Better, and by the decline in cost of revenue for our Hagggle business, which was suspended in 2010.

The search segment's cost of revenue will increase if search services revenue generated through our distribution partners' web properties increases at a greater rate than revenue generated through our owned and operated web properties. In addition, cost of revenue from distribution can be impacted by the mix of revenue generated by distribution partners. We expect that revenue from searches conducted by end users on sites of our distribution partners will continue to be an increasing majority of our search services revenue.

The decrease in search segment operating expense for 2012 as compared to 2011 was primarily due to a decrease in professional service fees and business taxes. The decrease in search segment operating expense for 2011 as compared to 2010 was primarily due to decreases in our direct marketing initiatives associated with traffic acquisition to our owned and operated metasearch engine sites, software license costs, and personnel costs.

Tax Preparation

Tax Preparation segment results for the years 2012 is presented below (in thousands):

	2012
Revenue	\$ 62,105
Cost of revenue	4,729
Operating expense	27,324
Segment income	\$ 30,052

The Tax Preparation segment was new in 2012 due to our acquisition of the TaxACT business on January 31, 2012. Unless otherwise indicated, figures in this annual report reflect the results from the date of the acquisition through December 31, 2012.

Our ability to generate tax preparation revenue is dependent on our ability to effectively market our consumer tax preparation software and online services and our ability to sell the related deluxe and ancillary services to our customers. We also generate revenue through the professional tax preparer software that we sell to professional tax preparers, who use it to prepare and file individual returns for their clients. Revenue from professional tax preparers has historically constituted a relatively small percentage of the overall revenue for the TaxACT business.

Consumer tax preparation revenue is largely driven by our ability to acquire new users of the service, retain existing users, and upsell users to paid products and services. We measure our individual tax preparation customers using the number of accepted federal tax e-filings made through our software and services, and we refer to such tax filings as e-files. We consider growth in the number of e-files to be the most important non-financial metric in measuring the performance of the tax preparation business. Overall revenue is driven more by growth in e-files than by growth in revenue per user, which has historically grown modestly, because we have not made significant pricing adjustments. Because we acquired the TaxACT business during the course of the 2012 tax season, we believe that presenting e-file metrics covering the same time periods as the financial results presented (and comparable period) would not accurately reflect segment results of operations. Accordingly, we

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are presenting these metrics for e-filings made during each tax season's filing year through the end of the calendar year as follows (in thousands):

	E-filings during the calendar year (in thousands)		% change
	2012	2011	
Total TaxACT consumer e-files	5,209	4,828	8%

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We derive revenue from the professional tax preparation product in two ways: from the per-unit licensing of the software and from amounts that we charge to e-file through the software. Thus professional tax preparation revenue is dependent upon both the number of tax professionals purchasing the product and the number of e-filed returns submitted through this product. For the 2012 tax season, the number of tax professional units sold grew modestly compared to the prior year and the number of e-filed returns grew in excess of 20%. We believe that these trends were impacted by new IRS requirements regarding professional tax preparers' qualifications, which limited the unit sales growth by reducing the total number of preparers, and by new IRS e-file requirements for professional tax preparers, which accelerated e-file growth. As a result, the current year trends may not be indicative of future performance.

The Tax Preparation segment cost of revenue primarily consists of royalties, payment processing fees for customer transactions, and bank service fees. Operating expenses for the tax preparation segment consists primarily of personnel related costs and marketing expenses.

Consolidated Results

Cost of sales. Cost of sales consists of the Search and Tax Preparation segments' cost of revenue, amortization of acquired intangible assets, and certain costs associated with customer service and the operation of the data centers that serve our businesses, which include personnel expenses (which include salaries, benefits and other employee related costs, and stock-based compensation expense), bandwidth costs, and depreciation. Cost of sales in total dollars (in thousands) and as a percentage of total revenues for the years 2012, 2011, and 2010 are presented below:

	2012	Change	2011	Change	2010
Search segment cost of revenue	\$ 245,135	\$ 101,248	\$ 143,887	\$ 24,006	\$ 119,881
Tax Preparation segment cost of revenue	4,729	4,729			
Amortization of acquired intangible assets	7,580	4,985	2,595	(6,602)	9,197
Data center operations	8,314	2,533	5,781	(678)	6,459
Depreciation	1,693	(1,006)	2,699	(759)	3,458
Total cost of sales	\$ 267,451	\$ 112,489	\$ 154,962	\$ 15,967	\$ 138,995
Percentage of revenues	65.7%		67.8%		64.8%

The dollar increase for expenses not related to segment costs of sales for 2012 as compared to 2011 resulted primarily from an increase in amortization of acquired intangible assets primarily attributable to TaxACT assets acquired, an increase of \$1.4 million in personnel costs in data center operations, and an increase of \$887,000 in contractor expenses, both of which were primarily attributable to TaxACT operations. These increases were partially offset by a decrease in data center asset depreciation of \$1.0 million.

The dollar increase in cost of sales for 2011 as compared to 2010 was primarily due to the increase in revenue sharing expenses related to an increase in revenue generated through the web properties of our distribution partners, and was partially offset by the effect of no longer paying distribution expense for revenue generated by Make The Web Better's assets after we acquired them on April 1, 2010, by the decrease in the amortization of acquired intangible assets acquired from Make The Web Better, and by the decline in cost of sales for our Haggly business, after we suspended its operations in 2010.

Engineering and technology expenses. Engineering and technology expenses are associated with the research, development, support, and ongoing enhancements of our offerings, including personnel expenses (which include salaries, stock-based compensation expense, and benefits

and other employee related costs),

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software support and maintenance, and professional service fees. Engineering and technology expenses in total dollars (in thousands) and as a percentage of total revenues for the years 2012, 2011, and 2010 are presented below:

	2012	Change	2011	Change	2010
Engineering and technology expenses	\$ 9,969	\$ 2,811	\$ 7,158	\$ (1,313)	\$ 8,471
Percentage of total revenues	2.5%		3.1%		4.0%

The dollar increase for 2012 as compared to 2011 was primarily attributable to an increase of \$3.0 million in personnel costs, which includes a \$2.5 million increase in salaries and benefits related to the acquisition of TaxACT in 2012, of which \$519,000 was in stock-based compensation expense.

The dollar decrease for 2011 as compared to 2010 was primarily attributable to decreases in stock-based compensation expense of \$477,000 and software support and maintenance costs of \$394,000.

Sales and marketing expenses. Sales and marketing expenses consist principally of marketing expenses associated with our tax preparation business (which includes the following channels: television, radio, online banner ads, and email), our owned and operated web search properties (which consist of traffic acquisition, including our online direct marketing initiatives, which involve the purchase of online advertisements that drive traffic to an owned and operated website, agency fees, brand promotion expense, and market research expense), personnel costs (which include salaries, stock-based compensation expense, and benefits and other employee related costs), and the cost of temporary help and contractors to augment our staffing. Sales and marketing expenses in total dollars (in thousands) and as a percentage of total revenues for the years 2012, 2011, and 2010 are presented below:

	2012	Change	2011	Change	2010
Sales and marketing expenses	\$ 44,138	\$ 22,628	\$ 21,510	\$ (6,635)	\$ 28,145
Percentage of total revenues	10.9%		9.4%		13.1%

The dollar increase for 2012 as compared to 2011 was primarily attributable to increases of \$17.5 million in advertising costs, primarily due to the acquisition of TaxACT in 2012, \$4.5 million in personnel costs, which includes \$3.2 million in personnel costs related to the acquisition of TaxACT in 2012, which includes \$647,000 in stock-based compensation, and an increase of \$691,000 in bonuses, primarily due to increased revenue generated by our distribution partners.

The dollar decrease for 2011 as compared to 2010 was primarily attributable to decreases of \$4.1 million in advertising costs for our direct marketing initiatives associated with traffic acquisition to our owned and operated metasearch engine sites, \$1.6 million in stock-based compensation expense, and \$741,000 in personnel-related costs, not including stock-based compensation expense and including costs for temporary help and contractors to augment our staffing.

To the extent we achieve returns on marketing expenditures, we will continue to invest in our direct marketing initiatives to drive traffic to an owned and operated web property and invest in advertising and marketing efforts to attract new tax preparation customers.

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General and administrative expenses. General and administrative expenses consist primarily of personnel expenses (which include salaries, stock-based compensation expense, and benefits and other employee related costs), professional service fees (which include legal, audit, and tax fees), general business development and management expenses, occupancy and general office expenses, taxes, and insurance expenses. General and administrative expenses in total dollars (in thousands) and as a percentage of total revenues for the years 2012, 2011, and 2010 are presented below:

	2012	Change	2011	Change	2010
General and administrative expenses	\$ 27,418	\$ 5,876	\$ 21,542	\$ (11,301)	\$ 32,843
Percentage of total revenues	6.7%		9.4%		15.3%

The dollar increase for 2012 as compared to 2011 was primarily attributable to an increase of \$2.4 million in stock-based compensation related to the modification of a warrant issued in August 2011 (the *Warrant*) in connection with an investment by Cambridge Information Group I LLC, an increase of \$914,000 related to the vesting of non-employee stock options due to the acquisition of the TaxACT business, and an increase in personnel costs of \$2.1 million partially offset by a decrease of \$513,000 in taxes and licenses expense. (For further detail on the stock-based compensation expense related to the Warrant modification and the vesting of non-employee stock options due to the TaxACT acquisition, see

Note 8: Stock-based Compensation Expense of the Notes to Consolidated Financial Statements in Item 8 of Part II of this report.) The increase in personnel costs of \$2.1 million includes a \$1.2 million increase in personnel costs related to the acquisition of TaxACT in 2012, and a \$868,000 increase in salaries and benefits due to an increase in headcount and bonus related expenses.

The dollar decrease for 2011 as compared to 2010 was primarily attributable to decreases in stock-based compensation expense unrelated to the Warrant of \$5.9 million, legal fees of \$2.2 million, employee separation costs of \$3.5 million, and professional service fees of \$1.5 million. These decreases were partially offset by stock-based compensation expense of \$1.9 million related to issuing the Warrant. See Note 8: Stock-based Compensation Expense of the Notes to Consolidated Financial Statements in Item 8 of Part II of this report.

Depreciation and amortization of intangible assets. Depreciation of property and equipment includes depreciation of computers, software, office equipment and fixtures, and leasehold improvements not recognized in cost of sales. Amortization of definite-lived intangible assets represents the amortization of customer relationships, which are amortized over their estimated lives of eight years. Depreciation for the years ended December 31, 2012, 2011, and 2010 are presented below (in thousands):

	2012	Change	2011	Change	2010
Depreciation expenses	\$ 2,119	\$ (43)	\$ 2,162	\$ (976)	\$ 3,138
Amortization of intangible assets	11,619	11,619			
Total depreciation and amortization of intangible assets	\$ 13,738	\$ 11,576	\$ 2,162	\$ (976)	\$ 3,138
Percentage of revenues	3.4%		0.9%		1.5%

The dollar increase in amortization of intangible assets for 2012 as compared to 2011 was due to the amortization of intangible assets acquired as a result of the TaxACT acquisition.

The only material variances in depreciation expense for the periods presented above were decreases in the depreciation of capitalized internal software development costs for 2011 compared to 2010 of \$535,000.

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Other loss (income), net. Other loss (income), net is comprised of the following for the years 2012, 2011, and 2010 (in thousands):

	2012	Change	2011	Change	2010
Interest expense	\$ 3,522	\$ 3,522	\$	\$	\$
Interest income	(131)	238	(369)	(38)	(331)
Amortization of debt issuance costs	820	820			
Accretion of debt discount	325	325			
Loss on derivative instrument	2,346	2,346			
Gain on contingency resolution		1,500	(1,500)	(1,500)	
Increase in fair value of earn-out contingent liability		(3,000)	3,000	(2,000)	5,000
Foreign currency exchange loss (gain), net	48	28	20	1,355	(1,335)
Litigation settlement gain				18,965	(18,965)
Loss (gain) on disposal of assets	(1)	(47)	46	(968)	1,014
Other	(252)	(301)	49	679	(630)
Other loss (income), net	\$ 6,677	\$ 5,431	\$ 1,246	\$ 16,493	\$ (15,247)

In 2012, we recorded in other loss (income), net, interest payments and amortization of debt origination costs related to the \$105 million credit facility entered into by 2nd Story to finance the acquisition of the TaxACT business (for further detail, see Note 10: Debt of the Notes to Consolidated Financial Statements in Item 8 of Part II of this report). In addition, in 2012, we recorded a loss on the increase of the fair value of the Warrant outstanding, which we classified as a derivative instrument subsequent to its modification triggered on the date of the acquisition of the TaxACT business (for further detail, see Note 8: Stock-based compensation of the Notes to Consolidated Financial Statements in Item 8 of Part II of this report).

Other loss (income), net decreased in 2011 compared to 2010. The expense related to the increase in fair value of earn-out contingent liability for the periods presented above was to adjust the estimated contingent payments to be made by us under the agreement related to our acquisition of the Make The Web Better assets and a gain of \$1.5 million related to the resolution of a contingent liability recorded in 2011. Additionally in 2011, the financial performance of the operation of the Make The Web Better assets acquired in April 2010 was better than expected; as a consequence, we estimated that the fair value of the related earn-out contingent liability had increased and we recorded a charge of \$3.0 million.

Income tax expense (benefit). During 2012, we recorded an income tax expense on continuing operations of \$15.0 million. During 2011, we recorded an income tax benefit on continuing operations of \$11.3 million. During 2010, we recorded an income tax expense on continuing operations of \$8.7 million. The 2012 income tax expense of \$15.0 million was primarily attributable to a \$13.1 million tax expense from current year operations, a \$2.4 million tax expense from non-deductible compensation cost and loss on the derivative instrument, both in connection with the Warrant to purchase common stock granted to Cambridge Information Group I LLC, dated August 23, 2011, a \$369,000 tax expense from nondeductible acquisition costs and a \$804,000 tax benefit from deductible domestic production costs. The 2011 income tax benefit of \$11.3 million was primarily attributable to a \$7.1 million tax expense from 2011 operations, a \$675,000 tax expense from non-deductible compensation cost in connection with the Warrant and a \$19.3 million tax benefit for the change in the valuation allowance against the deferred tax assets. The 2010 income tax expense of \$8.7 million was primarily attributable to a \$6.3 million tax expense from current year operations and a \$3.2 million tax expense for the net increase in the valuation allowance against the deferred tax assets. These expenses were partially offset by a \$566,000 income tax benefit from the decrease in unrecognized tax benefits pertaining to state income taxes and a \$516,000 tax benefit attributable to foreign exchange gains.

At December 31, 2012, we had gross temporary differences representing future tax deductions of \$782.1 million, primarily comprised of \$723.3 million of accumulated net operating loss carryforwards, which

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represent deferred tax assets. We applied a valuation allowance against the net operating loss carry forward deferred tax assets and certain other deferred tax assets. If, in the future, we determine that the realization of any additional portion of the deferred tax assets is more likely than not to be realized, we will record a benefit to the income statement or additional paid-in-capital, as appropriate.

Loss from discontinued operations and loss on sale of discontinued operations. On June 22, 2011, we sold our Mercantila e-commerce business to Zoo Stores, Inc. The results of operations from the business are reflected in the Consolidated Financial Statements as discontinued operations for all periods presented. Revenue, loss before taxes, income tax benefit, and loss from discontinued operations, net of taxes, and loss on sale of discontinued operations, net of taxes, for the year ended December 31, 2011 is presented below (in thousands):

	Year ended December 31, 2011
Revenue from discontinued operations	\$ 16,894
Loss from discontinued operations before taxes	\$ (3,506)
Income tax benefit	1,253
Loss from discontinued operations, net of taxes	\$ (2,253)
Loss on sale of discontinued operations, net of an income tax benefit of \$5,092	\$ (7,674)

Loss from discontinued operations includes previously unallocated depreciation, amortization, stock-based compensation expense, income taxes, and other corporate expenses that were attributable to the e-commerce business.

Non-GAAP Financial Measures

We define Adjusted EBITDA as net income, determined in accordance with the accounting principles generally accepted in the United States of America (*GAAP*), excluding the effects of discontinued operations (which includes loss from discontinued operations, net of taxes, and loss on sale of discontinued operations, net of taxes), income taxes, depreciation, amortization of intangible assets, stock-based compensation expense, and other loss (income), net (which includes such items as interest expense, interest income, derivative instrument gains or losses, foreign currency gains or losses, and gains or losses from the disposal of assets, adjustments to the fair values of contingent liabilities related to business combinations, gains on resolution of contingencies, and litigation settlements).

We believe that Adjusted EBITDA provides meaningful supplemental information regarding our performance. We use this non-GAAP financial measure for internal management and compensation purposes, when publicly providing guidance on possible future results, and as a means to evaluate period-to-period comparisons. We believe that Adjusted EBITDA is a common measure used by investors and analysts to evaluate our performance, that it provides a more complete understanding of the results of operations and trends affecting our business when viewed together with GAAP results, and that management and investors benefit from referring to this non-GAAP financial measure. Items excluded from Adjusted EBITDA are significant and necessary components to the operations of our business and, therefore, Adjusted EBITDA should be considered as a supplement to, and not as a substitute for or superior to, GAAP net income. Other companies may calculate Adjusted EBITDA differently and, therefore, our Adjusted EBITDA may not be comparable to similarly titled

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measures of other companies. A reconciliation of our Adjusted EBITDA to net income, which we believe to be the most comparable GAAP measure, is presented for the years 2012, 2011, and 2010 below (in thousands):

	2012	2011	2010
Net income	\$ 22,526	\$ 21,594	\$ 4,680
Discontinued operations		9,927	4,593
Depreciation and amortization of intangible assets	23,011	7,456	15,793
Stock-based compensation	13,223	7,688	13,918
Other loss (income), net	6,677	1,246	(15,247)
Income tax expense (benefit)	15,002	(11,288)	8,725
Adjusted EBITDA	\$ 80,439	\$ 36,623	\$ 32,462

We define non-GAAP net income as net income, determined in accordance with GAAP, excluding the effects of loss from discontinued operations (which includes loss from discontinued operations, net of taxes, and loss on sale of discontinued operations, net of taxes), stock-based compensation expense, amortization of acquired intangible assets, gain or loss on derivative instruments, the cash tax impact of those adjustments, and non-cash income taxes from continuing operations. Non-cash income tax expense represents a reduction to cash taxes payable associated with the utilization of deferred tax assets, which primarily consist of U.S. federal net operating losses. The majority of these deferred tax assets will expire in 2020 if unutilized.

We believe that non-GAAP net income and non-GAAP earnings per share provide meaningful supplemental information to management, investors, and analysts regarding our performance and the valuation of our business by excluding items in the statement of operations that we do not consider part of our ongoing operations or have not been, or are not expected to be, settled in cash. Additionally, we believe non-GAAP net income and non-GAAP earnings per share are common measures used by investors and analysts to evaluate our performance and the valuation of our business. Non-GAAP net income should be evaluated in light of our financial results prepared in accordance with GAAP, and should be considered as a supplement to, and not as a substitute for or superior to, GAAP net income. Other companies may calculate non-GAAP net income differently, and therefore our non-GAAP net income may not be comparable to similarly titled measures of other companies. The amounts in the reconciliation of our non-GAAP net income to net income for the year ended December 31, 2010 are revised from amounts previously reported to conform to the current presentation. A reconciliation of our non-GAAP net income to net income, which we believe to be the most comparable GAAP measure, is presented for the years 2012, 2011, and 2010 below (in thousands, except per share amounts):

	2012	2011	2010
Net income	\$ 22,526	\$ 21,594	\$ 4,680
Discontinued operations		9,927	4,593
Income from continuing operations	22,526	31,521	9,273
Stock-based compensation	13,223	7,688	13,918
Amortization of acquired intangible assets	19,199	2,595	9,197
Loss on derivative instruments	2,346		
Cash tax impact of adjustments to GAAP net income	(93)	(40)	(154)
Non-cash income tax expense (benefit) from continuing operations	13,559	(13,000)	8,530
Non-GAAP net income	70,760	28,764	40,764
Per share amounts:			
Income from continuing operations - diluted	\$ 0.54	\$ 0.82	\$ 0.25
Stock-based compensation - diluted	0.32	0.19	0.38
Amortization of acquired intangible assets - diluted	0.46	0.07	0.25

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Loss on derivative instruments - diluted	0.06		
Cash tax impact of adjustments to GAAP net income - diluted	0.00	0.00	0.00
Non-cash income tax expense (benefit) per share - diluted	0.32	(0.34)	0.23
Non-GAAP income per share - diluted	\$ 1.70	\$ 0.74	\$ 1.11

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Our principal source of liquidity is our cash, cash equivalents and short-term investments. As of December 31, 2012, we had cash and short-term investments of \$162.3 million, consisting of cash and cash equivalents of \$68.3 million and available-for-sale short-term investments of \$94.0 million. We generally invest our excess cash in high quality marketable investments. These investments include securities issued by U.S. government agencies, commercial paper, money market funds, municipal bonds and time deposits. All of our financial instrument investments held at December 31, 2012 have minimal default risk and short-term maturities.

On January 31, 2012, we acquired TaxACT Holdings and its subsidiary, 2nd Story, operator of the TaxACT income tax preparation business for \$287.5 million in cash, less certain transaction expenses, and subject to certain specified working capital adjustments. The acquisition of the TaxACT business was funded from our cash reserves and from the net proceeds of borrowings under a \$105 million credit facility (of which \$100 million was drawn at the transaction's close), which facility consists of a \$95 million term loan and a \$10.0 million revolving credit facility. The credit facility is secured by the TaxACT business's operations and the equity of 2nd Story Software, Inc. The terms of the credit facility allow us to repay amounts owed before its term is complete, and during the year ended December 31, 2012, we repaid \$25.5 million outstanding under the credit facility, including all of the amounts owed under the revolving credit facility portion of the debt. Although we do not currently anticipate drawing on the revolving credit facility in the future, all \$10 million of that revolving credit facility is available for future use. The terms of the credit facility required us to hedge a portion of the interest rate risk associated with the amounts outstanding under the term loan, and that requirement was met on May 1, 2012 (for further detail, see Note 10: Debt of the Notes to Consolidated Financial Statements in Item 8 of Part II of this report).

We plan to use our cash to fund operations, develop technology, advertise, market and distribute our products and services, and continue the enhancement of our network infrastructure. An important component of our strategy for future growth is to acquire technologies and businesses, and we plan to use our cash to acquire and integrate acceptable targets that we may identify. These targets may include businesses, products, or technologies unrelated to search or tax preparation. We may use a portion of our cash for dividends or for common stock repurchases (for further detail, see the Events Subsequent to December 31, 2012 section below).

We believe that existing cash, cash equivalents, short-term investments, and cash generated from operations will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next 12 months, but the underlying levels of revenues and expenses that we project may not prove to be accurate. For further discussion of the risks to our business related to liquidity, see the paragraph in our Risk Factors (Part I, Item 1A of this annual report) under the heading Existing cash and cash equivalents, short-term investments, and cash generated from operations may not be sufficient to meet our anticipated cash needs for working capital and capital expenditures.

Contractual Obligations and Commitments

Our contractual commitments are as follows for the following years ending December 31 (in thousands):

	2013	2014	2015	2016	2017	Thereafter	Total
Operating lease commitments	\$ 919	\$ 1,770	\$ 1,599	\$ 1,222	\$ 1,259	\$ 3,649	\$ 10,418

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Less sublease income	(36)						(36)
Net lease payments required	883	1,770	1,599	1,222	1,259	3,649	10,382
Purchase commitments	1,272	581	423	92	61		2,429
Debt commitments	4,750	9,500	13,062	14,250	32,934		74,496
Total	\$ 6,905	\$ 11,851	\$ 15,084	\$ 15,564	\$ 34,254	\$ 3,649	\$ 87,307

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Operating lease commitments. The Company has noncancellable operating leases for its corporate facilities. The leases run through 2020. Rent expense under operating leases totaled \$1.8 million, \$1.8 million, and \$1.3 million for the years ended December 31, 2012, 2011, and 2010, respectively.

Purchase commitments. Our purchase commitments are primarily comprised of non-cancelable service agreements for our data centers.

We have pledged a portion of our cash as collateral for standby letters of credit and bank guaranties for certain of our property leases and banking arrangements. At December 31, 2012, the total amount of collateral pledged under these agreements was \$3.4 million.

The above table does not reflect unrecognized tax benefits of approximately \$1.2 million, the timing of which is uncertain. For additional discussion on unrecognized tax benefits see Note 12: Income Taxes of the Notes to Consolidated Financial Statements (Item 8 of Part II of this report).

Debt commitments: Our debt commitments consist of the minimum scheduled loan payments related to the credit facility that 2nd Story entered into to help finance the acquisition of the TaxACT business. We may repay the amounts outstanding under the credit facility before its term is complete, depending on the cash generated by the TaxACT business's operations.

Off-balance sheet arrangements. We have no off-balance sheet arrangements other than operating leases. We do not believe that these operating leases are material to our current or future financial position, results of operations, revenues or expenses, liquidity, capital expenditures or capital resources.

Cash Flows

Our net cash flows are comprised of the following for the years 2012, 2011, and 2010 (in thousands):

	2012	2011	2010
Net cash provided by operating activities	\$ 48,831	\$ 25,263	\$ 49,906
Net cash provided (used) by investing activities	(165,073)	(115,473)	33,927
Net cash provided by financing activities	102,623	23,256	206
Net cash used by discontinued operations		(6,794)	(12,144)
Net increase (decrease) in cash and cash equivalents	\$ (13,619)	\$ (73,748)	\$ 71,895

Net Cash Provided by Operating Activities

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Net cash provided by operating activities consists of net income offset by certain adjustments not affecting current-period cash flows and the effect of changes in our operating assets and liabilities.

Net cash provided by operating activities was \$48.8 million in 2012, consisting of our net income of \$22.5 million, adjustments to net income not affecting cash to determine cash flows used by operating activities of \$39.8 million (consisting primarily of depreciation and amortization of intangible assets, stock-based compensation expense, warrant-related stock-based compensation expense, amortization of debt-related items, and a loss on a derivative instrument), and cash provided by changes in our operating assets and liabilities of \$27.2 million (consisting primarily of increases in accrued expenses and other current and long-term liabilities and decreases in other long-term assets). Partially offsetting the increase were adjustments not affecting cash flows used by operating activities of \$32.0 million (consisting primarily of excess tax benefits from stock-based award activity and deferred income taxes) and cash used by changes in our operating assets and liabilities of \$8.7 million (consisting primarily of decreases in accounts payable and increases in prepaid expenses and other current assets, accounts receivable, and other receivables).

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Net cash provided by operating activities was \$25.3 million in 2011, consisting of our net income of \$21.6 million, adjustments to net income not affecting cash to determine cash flows provided by operating activities of \$28.1 million (consisting primarily of depreciation and amortization, stock-based compensation, increase in the fair value of an earn-out contingent liability, and loss on disposals of assets), and cash provided by changes in our operating assets and liabilities of \$27.2 million (consisting of decreases in accounts payable other receivables, and in prepaid expenses and other current assets). Partially offsetting the increase were adjustments not affecting cash flows used by operating activities of \$21.7 million (consisting primarily of deferred income taxes, excess tax benefits from stock-based award activity, a gain on the resolution of a contingent liability, and amortization of premium on investments) and cash used by changes in our operating assets and liabilities of \$29.9 million (consisting primarily of decreases in accrued expenses and other current and long-term liabilities and increases in accounts receivable).

Net cash provided by operating activities was \$49.9 million in 2010, consisting of adjustments to net income not affecting cash to determine cash flows provided by operating activities of \$41.0 million (consisting primarily of depreciation and amortization, stock-based compensation, increase in the fair value of an earn-out contingent liability, loss on disposals of assets, and amortization of premium on investments), cash provided by changes in our operating assets and liabilities of \$18.5 million (consisting of decreases in accounts receivable, increases in accrued expenses and other current and long-term liabilities, and decreases in other receivables and in prepaid expenses and other current assets), and our net income of \$4.7 million. Partially offsetting the increase were adjustments not affecting cash flows used by operating activities of \$10.6 million (consisting primarily of excess tax benefits from stock-based award activity, fair value of common stock retired relating to a litigation settlement, and the realized foreign currency translation gains) and cash used by changes in our operating assets and liabilities of \$3.7 million (consisting primarily of decreases in accounts payable).

Net Cash Provided (Used) by Investing Activities

Net cash provided by investing activities consists primarily of transactions related to our investments, purchases of property and equipment, proceeds from the sale of certain assets, and cash used in business acquisitions.

Net cash used by investing activities was \$165.1 million in 2012, consisting of \$279.4 million in business acquisitions, net of cash acquired, and purchases of investments of \$122.4 million, partially offset by proceeds of \$203.5 million from the sales of marketable investments and \$36.8 million from the maturities of our marketable investments.

Net cash used by investing activities was \$115.5 million in 2011, consisting primarily of the purchase of \$336.8 million of marketable investments and \$2.7 million of property and equipment purchases, partially offset by the proceeds from the sale or maturity of marketable investments of \$223.3 million.

Net cash provided by investing activities was \$33.9 million in 2010, consisting primarily of the proceeds from the sale or maturity of our marketable investments of \$244.8 million and proceeds from the sale of assets of \$307,000, partially offset by the purchase of \$200.5 million of marketable investments, \$8.0 million used for business acquisitions, and \$2.9 million of property and equipment purchases.

Net Cash Provided Financing Activities

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Net cash provided by financing activities consists of proceeds from the issuance of stock through the exercise of stock options and our employee stock purchase plan, tax payments from shares withheld upon vesting of restricted stock units, repayments of capital lease obligations, excess tax benefits from stock-based award activity, and special dividends paid to our shareholders.

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Net cash provided by financing activities totaled \$102.6 million for 2012 and consisted primarily of loan proceeds of \$99.0 million, less debt issuance costs of \$2.3 million, proceeds of \$23.0 million from excess tax benefits from stock-based award activity due primarily to the utilization of equity net operating loss carryforwards from prior years, and \$9.7 million from the exercise of options and the issuance of stock through our employee stock purchase plan. Partially offsetting cash provided by financing activities were cash payments of \$25.5 million for the repayment of debt under the credit facility entered into to help finance the acquisition of the TaxACT business, and \$1.3 million in tax payments from shares withheld upon vesting of restricted stock units.

Net cash provided by financing activities in 2011 was \$23.3 million, consisting primarily of \$17.4 million in proceeds from the exercise of stock options and the sale of shares through our employee stock purchase plan, \$7.0 million in proceeds from the sale of common stock, and \$1.3 million in excess tax benefits generated by stock-based award activity. Cash provided by financing activities was partially offset by \$1.8 million in tax payments from shares withheld upon vesting of restricted stock units, and \$423,000 of earn-out payments related to business acquisitions.

Net cash provided by financing activities in 2010 was \$206,000, consisting primarily of \$7.0 million in excess tax benefits generated by stock-based award activity and proceeds of \$2.5 million from the exercise of stock options and the sale of shares through our employee stock purchase plan. Cash provided by financing activities was partially offset by \$4.6 million of earn-out payments related to business acquisitions, \$4.2 million in tax payments from shares withheld upon vesting of restricted stock units, and \$589,000 used for the repayment of capital lease obligations.

Net Cash Used by Discontinued Operations

Net cash used by operating activities attributable to discontinued operations in 2011 was \$6.8 million and in 2010 was \$12.1 million.

Acquisitions

TaxACT. On January 31, 2012, we acquired TaxACT Holdings, Inc. and its subsidiary, 2nd Story Software, Inc., operator of the TaxACT income tax preparation business for \$287.5 million in cash, less certain transaction expenses, and subject to certain specified working capital adjustments. The TaxACT acquisition was funded from our cash reserves and from the net proceeds of a \$105 million credit facility (of which \$100 million was drawn at the transaction's close).

Mercantila. On May 10, 2010, we acquired certain assets from Mercantila, Inc., an internet e-commerce company, at a cost of \$7.8 million in cash, plus \$8.2 million in liabilities assumed, and later sold our Mercantila operations to Zoo Stores, Inc. on June 22, 2011, for \$250,000 upon completion of the sale, plus we received the right to receive additional consideration of up to \$3.0 million contingent on liquidity or other events, which we recorded at a fair value of \$0 as of June 30, 2011.

Make The Web Better. On April 1, 2010, we purchased assets consisting of web properties and licenses for content and technology from Make The Web Better, a search distribution partner and privately-held developer of online products used on social networking sites, for \$13.0 million. The purchase consideration included an initial cash payment of \$8.0 million, with an initial \$5.0 million in estimated additional consideration payable in cash contingent on expected financial performance. The financial performance of the operation of the Make The Web Better assets in 2011 and 2010 was greater than was expected when the assets were acquired. As a consequence, our estimate of the fair value of the related contingent consideration increased to \$13.0 million and we recorded charges of \$3.0 million and \$5.0 million to other loss (income), net in the

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years ended December 31, 2011 and 2010, respectively.

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Critical Accounting Policies and Estimates

This Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as the disclosures included elsewhere in this Annual Report on Form 10-K, is based upon our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses and disclosures of contingencies. In some cases, we could have reasonably used different accounting policies and estimates.

The Securities and Exchange Commission has defined a company's most critical accounting policies as the ones that are the most important to the portrayal of the company's financial condition and results of operations, and which require the company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. On an ongoing basis, we evaluate the estimates used, including those related to revenue recognition, cost of sales, impairment of goodwill and indefinite-lived intangible assets, accounting for business combinations, stock-based compensation, and the valuation allowance for our deferred tax assets. We base our estimates on historical experience, current conditions, and on various other assumptions that we believe to be reasonable under the circumstances and, based on information available to us at that time, we make judgments about the carrying values of assets and liabilities that are not readily apparent from other sources as well as identify and assess our accounting treatment with respect to commitments and contingencies. Actual results may differ significantly from these estimates under different assumptions, judgments, or conditions. We believe the following critical accounting policies involve the more significant judgments and estimates used in the preparation of our consolidated financial statements. We also have other accounting policies that involve the use of estimates, judgments, and assumptions and that are significant to understanding our results. For additional information see Note 2: Summary of Significant Accounting Policies of the Notes to Consolidated Financial Statements in Item 8 of Part II of this report.

Search Services Revenue Recognition

Our revenues are generated primarily from our web search services. We generate search services revenue when an end user of such services clicks on a paid search link provided by a Search Customer and displayed on a distribution partners' web property or on one of our owned and operated web properties. The Search Customer that provided the paid search link receives a fee from the advertiser who paid for the click and the Search Customer pays us a portion of that fee. Revenue is recognized in the period in which the services are provided (e.g., a paid search occurs) and is based on the amounts earned by and ultimately remitted to us. We record this revenue in our Search segment.

Under our agreements with our Search Customers and our distribution partners, we are the primary obligor, separately negotiate each revenue or unit pricing contract independent of any revenue sharing arrangements, and assume the credit risk for amounts invoiced to our Search Customers. For search services, we determine the paid search results, content, and information directed to its owned and operated websites and its distribution partners' web properties.

The Company earns revenue from its Search Customers by providing paid search results generated from its owned and operated web properties and from its distribution partners' web properties based on separately negotiated and agreed-upon terms with each distribution partner. Consequently, the Company records search services revenue on a gross basis.

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Tax Preparation Revenue Recognition

We derive revenue from the sale of tax preparation online services, ancillary service offerings, tax preparation packaged software products, and multiple element arrangements that may include a combination of these items. Ancillary service offerings include tax preparation support services, data archive services, bank or reloadable pre-paid debit card services, and e-filing services. We record this revenue in our Tax Preparation segment.

Our tax preparation segment service revenue consists primarily of hosted tax preparation online services, tax preparation support services, data archive services, and e-filing services. We recognize revenue from these services as the services are performed and the revenue recognition criteria are met as described in Note 2: Summary of Significant Accounting Policies of the Notes to Consolidated Financial Statements in Item 8 of Part II of this report.

We recognize revenue from the sale of our packaged software products when legal title transfers. This is generally when its customers download products from the Web or when the products ship.

The bank or reloadable prepaid debit card services are offered to taxpayers as an option to receive their tax refunds in the form of a prepaid bank card or to have the fees for the product and/or services purchased by the customers deducted from their refunds. Revenue for this fee is recognized when the four revenue recognition criteria are met; for some arrangements that is upon filing and for other arrangements that is upon cash receipt.

For products and/or services that consist of multiple elements, we must: (1) determine whether and when each element has been delivered; (2) determine the fair value of each element using the selling price hierarchy of vendor-specific objective evidence (*VSOE*) of fair value if available, third-party evidence (*TPE*) of fair value if VSOE is not available, and estimated selling price (*ESP*) if neither VSOE nor TPE is available; and (3) allocate the total price among the various elements based on the relative selling price method. Once we have allocated the total price among the various elements, we recognize revenue when the revenue recognition criteria are met for each element.

VSOE generally exists when we sell the deliverable separately and are normally able to establish VSOE for all deliverables in these multiple element arrangements; however, in certain limited instances VSOE cannot be established. This may be because we infrequently sell each element separately, or have a limited sales history. When VSOE cannot be established we attempt to establish a selling price for each element based on TPE. TPE is determined based on competitor prices for similar deliverables when sold separately. When we are unable to establish selling price using VSOE or TPE, we use ESP in our allocation of arrangement consideration. ESP is the estimated price at which we would sell a product or service if it were sold on a stand-alone basis. We determine ESP for a product or service by considering multiple factors including, but not limited to, historical stand-alone sales, pricing practices, market conditions, competitive landscape, internal costs, and gross margin objectives.

In some situations, we receive advance payments from our customers. We defer revenue associated with these advance payments and recognize the allocated consideration for each element when we ship the products or perform the services, as appropriate. Advance payments related to data archive services are deferred and recognized over the related contractual term.

Debt Issuance Costs and Debt Discount

Debt issuance costs and debt discounts are deferred and amortized as interest expense under the effective interest method over the contractual term of the related debt, adjusted for prepayments.

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Hedging

We use a derivative financial instrument in the form of an interest rate swap agreement for the purpose of minimizing exposure to changes in interest rates. This swap agreement is accounted for as a cash flow hedge and changes in the fair value of the hedge instrument are included in other comprehensive income.

Cost of Sales

We record the cost of sales when the related revenue is recognized. Cost of sales consists of costs related to revenue sharing arrangements with our distribution partners, usage-based content fees, certain costs associated with the operation of our data centers that serve our search and tax preparation businesses, including amortization of intangible assets, depreciation, personnel expenses (which include salaries, benefits and other employee related costs, and stock-based compensation expense), bandwidth costs, customer payment processing fees, bank service fees, and royalties.

Business Combinations and Intangible Assets Including Goodwill

We account for business combinations using the acquisition method and, accordingly, the identifiable assets acquired and liabilities assumed are recorded at their acquisition date fair values. Goodwill is calculated as the excess of the purchase price over the fair value of net assets, including the amount assigned to identifiable intangible assets. Identifiable intangible assets with finite lives are amortized over their useful lives. Acquisition-related costs, including advisory, legal, accounting, valuation, and other costs, are expensed in the periods in which the costs are incurred. The results of operations of acquired businesses are included in the consolidated financial statements from the acquisition date.

Accounting for Goodwill and Intangible Assets

We evaluate the carrying value of our goodwill and indefinite-lived intangible assets at least annually on November 30, and evaluate all intangible assets for impairment whenever events or changes in circumstances, including material changes in the fair value of our outstanding common stock, indicate that the carrying amounts of any of those assets may not be recoverable.

In the evaluation of goodwill, we first perform a qualitative assessment to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount. If so, we perform a quantitative assessment and compare the fair value of the reporting unit to the carrying amount. We determine the reporting unit fair values by using a combination of projections of future discounted cash flows and EBITDA and revenue multiple comparisons with comparable publicly-held companies. If we determined that the fair value of a reporting unit is less than its carrying amount, we would record an impairment loss equal to the excess of the carrying amount of the reporting unit's goodwill over its fair value.

In the evaluation of indefinite-lived intangible assets, we first perform a qualitative assessment to determine whether it is more likely than not that the fair value of an asset is less than the carrying amount. If so, we perform a quantitative assessment and compare the fair value of the asset

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to its carrying amount. We base our measurement of fair value of indefinite-lived intangible assets, which primarily consist of trade name and trademarks, using the relief-from-royalty method. This method assumes that the trade name and trademarks have value to the extent that their owner is relieved of the obligation to pay royalties for the benefits received from them. This method requires us to estimate the future revenue for the related brands, the appropriate royalty rate and the weighted average cost of capital. If we determined that the fair value of an indefinite-lived intangible asset is less than its carrying amount, we would record an impairment loss equal to the excess of the carrying amount over its fair value.

As of November 30, 2012 and 2011, the Company had no impairments.

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In the dynamic search and tax preparation software industries, there is significant uncertainty about the future. Unforeseen events such as market disruptions and deterioration of the macroeconomic environment, or internal challenges such as reorganizations, employee and management turnover, operational cash flows, and other trends that could have material negative impacts on our key assumptions in determining fair values, could lead to a decision to impair goodwill in future periods.

At December 31, 2012, we had \$230.3 million of goodwill and \$19.8 million of indefinite-lived intangible assets and on our balance sheet.

Stock-Based Compensation

We record stock-based compensation expense for equity-based awards granted, including stock options, restricted stock unit grants, market stock unit grants, and a warrant, over the service period of the equity-based award based on the fair value of the award at the date of grant. During 2012, 2011, and 2010, we recognized \$13.2 million, \$7.7 million, and \$13.9 million, respectively, of stock-based compensation expense in continuing operations. For further information regarding our stock plan activities and our methods of accounting for them, see Note 2: Summary of Significant Accounting Policies, Note 7: Stockholders' Equity, and Note 8: Stock-based Compensation Expense of the Notes to Consolidated Financial Statements in Item 8 of Part II of this report.

Calculating stock-based compensation expense relies upon certain assumptions, including the expected term of the stock-based awards, expected stock price volatility, expected interest rate, number and types of stock-based awards, and the pre-vesting forfeiture rate. If we use different assumptions due to changes in our business or other factors, our stock-based compensation expense could vary materially in the future.

The stock based compensation expense for 2011 includes \$1.9 million fair value classified to general and administrative expenses for the Warrant issued in August 2011. The acquisition of the TaxACT business on January 31, 2012 fulfilled the Warrant's remaining performance condition and extended the Warrant's expiration date. The extension of the Warrant's term was a modification that resulted in a \$4.3 million charge to stock-based compensation expense equal to the increase in the Warrant's fair value and was recognized in general and administrative expenses in the first quarter of 2012. Additionally, subsequent to the modification, we treated the award as a derivative instrument, and the modification date fair value previously recognized in paid in capital was classified as a current liability. The Warrant's fair value will be determined each reporting period until settled, with gains or losses related to the change in fair value recorded in other loss (income), net. We recorded a loss in other loss (income), net of \$2.3 million from derivative instruments relating to the Warrant in the year ended December 31, 2012. We recorded \$6.6 million in total expense relating to the modification and change in fair value for the Warrant for the year ended December 31, 2012.

Income Taxes

We account for income taxes under the asset and liability method, under which deferred tax assets, including net operating loss carryforwards, and liabilities are determined based on temporary differences between the book and tax bases of assets and liabilities. We periodically evaluate the likelihood of the realization of deferred tax assets, and reduce the carrying amount of the deferred tax assets by a valuation allowance to the extent we believe a portion will not be realized. We consider many factors when assessing the likelihood of future realization of our deferred tax assets, including our recent cumulative earnings experience by taxing jurisdiction, expectations of future taxable income, the carryforward periods available to us for tax reporting purposes, and other relevant factors. There is a wide range of possible judgments relating to the valuation of our deferred tax assets.

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During the year ended December 31, 2012, we provided a full valuation allowance against certain net deferred tax assets. During the fourth quarter of 2011, based on the weight of available evidence, we determined that it was more likely than not that we would realize \$18.9 million of our deferred tax assets in the foreseeable future. Accordingly we released the valuation allowance against this portion of our deferred tax assets and retained the valuation allowance against the remainder at year end. During the year ended December 31, 2010, we provided a full valuation allowance against our net deferred tax assets. For further information regarding our income taxes, see Note 12: Income Taxes of the Notes to Consolidated Financial Statements in Item 8 of Part II of this report.

Recent Accounting Pronouncements

Changes to GAAP are established by the Financial Accounting Standards Board (*FASB*) in the form of accounting standards updates (*ASUs*) to the FASB's Accounting Standards Codification. We consider the applicability and impact of all recent ASUs. ASUs not listed below were assessed and determined to be either not applicable or are expected to have minimal impact on our consolidated financial position and results of operations.

In July 2012, the FASB issued an ASU to simplify how entities test indefinite-lived intangible assets for impairment to improve consistency in impairment testing requirements among long-lived asset categories. The ASU permits an assessment of qualitative factors to determine whether it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying value. For assets for which this assessment concludes it is more likely than not that the fair value is more than its carrying value, this ASU eliminates the requirement to perform quantitative impairment testing as outlined in the previously issued standards. We early adopted the new standard on October 1, 2012. The adoption of this ASU did not materially impact our consolidated condensed financial statements.

Events Subsequent to December 31, 2012

On January 7, 2013, we completed a \$4 million equity investment in a privately-owned company.

On February 6, 2013, our board of directors approved a plan whereby we may repurchase up to \$50 million of our common stock in open-market transactions during the succeeding 24 month period. Repurchased shares will be retired and resume the status of authorized but unissued shares of common stock.

Table of Contents**Quarterly Results of Operations (Unaudited)**

The following table presents a summary of our unaudited consolidated results of operations for the eight quarters ended December 31, 2012. The information for each of these quarters has been prepared on a basis consistent with our annual audited consolidated financial statements. You should read this information in conjunction with our consolidated financial statements and notes thereto. The operating results for any quarter are not necessarily indicative of results for any future period.

	March 31, 2011	June 30, 2011	September 30, 2011	December 31, 2011	March 31, 2012	June 30, 2012	September 30, 2012	December 31, 2012
	(in thousands except per share data)							
Revenues	\$ 51,650	\$ 54,292	\$ 56,257	\$ 66,614	\$ 115,696	\$ 100,883	\$ 92,870	\$ 97,470
Cost of sales	32,674	36,579	38,755	46,954	59,547	64,227	69,973	73,704
Gross profit	18,976	17,713	17,502	19,660	56,149	36,656	22,897	23,766
Expenses and other income:								
Engineering and technology	1,664	1,784	1,806	1,904	2,573	2,448	2,410	2,538
Sales and marketing	6,967	4,902	4,888	4,753	19,443	8,869	7,741	8,085
General and administrative	5,160	4,970	6,513	4,899	11,066	5,356	5,283	5,713
Depreciation	662	552	475	473	535	532	560	492
Amortization of intangible assets					2,113	3,168	3,169	3,169
Other loss (income), net	(75)	(107)	456	972	1,555	930	5,196	(1,004)
Total expenses and other income	14,378	12,101	14,138	13,001	37,285	21,303	24,359	18,993
Income (loss) from continuing operations before income taxes	4,598	5,612	3,364	6,659	18,864	15,353	(1,462)	4,773
Income tax benefit (expense)	(1,702)	(1,936)	(1,289)	16,215	(7,458)	(5,655)	(936)	(953)

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	March 31, 2011	June 30, 2011	September 30, 2011	December 31, 2011	March 31, 2012	June 30, 2012	September 30, 2012	December 31, 2012
	(in thousands except per share data)							
Income (loss) from continuing operations	2,896	3,676	2,075	22,874	11,406	9,698	(2,398)	3,820
Loss from discontinued operations, net of taxes	(1,573)	(8,354)						
Net income (loss)	\$ 1,323	\$ (4,678)	\$ 2,075	\$ 22,874	\$ 11,406	\$ 9,698	\$ (2,398)	\$ 3,820
Net income (loss) per share Basic:								
Income (loss) from continuing operations	\$ 0.08	\$ 0.10	\$ 0.05	\$ 0.58	\$ 0.29	\$ 0.24	\$ (0.06)	\$ 0.09
Loss from discontinued operations	(0.04)	(0.22)						
Net income (loss) per share Basic	\$ 0.04	\$ (0.12)	\$ 0.05	\$ 0.58	\$ 0.29	\$ 0.24	\$ (0.06)	\$ 0.09
Weighted average shares outstanding used in computing basic income (loss) per share								
	36,339	37,422	38,568	39,448	39,692	40,116	40,511	40,789
Net income (loss) per share Diluted:								
Income (loss) from continuing operations	\$ 0.08	\$ 0.10	\$ 0.05	\$ 0.57	\$ 0.28	\$ 0.23	\$ (0.06)	\$ 0.04
Loss from discontinued operations	(0.04)	(0.22)						
Net income (loss) per share Diluted	\$ 0.04	\$ (0.12)	\$ 0.05	\$ 0.57	\$ 0.28	\$ 0.23	\$ (0.06)	\$ 0.04
Weighted average shares outstanding used in computing diluted income (loss) per share								
	37,084	38,128	39,158	40,074	40,978	41,245	40,511	42,411

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	March 31, 2011	June 30, 2011	September 30 2011	December 31, 2011	March 31, 2012	June 30, 2012	September 30, 2012	December 31, 2012
Revenues	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of sales	63.3	67.4	68.9	70.5	51.5	63.7	75.3	75.6
Gross profit	36.7	32.6	31.1	29.5	48.5	36.3	24.7	24.4
Expenses and other income:								
Engineering and technology	3.2	3.3	3.2	2.9	2.2	2.4	2.6	2.5
Sales and marketing	13.5	9.0	8.7	7.1	16.8	8.8	8.3	8.3
General and administrative	10.0	9.2	11.6	7.4	9.6	5.3	5.7	5.9
Depreciation	1.3	1.0	0.8	0.7	0.5	0.5	0.6	0.5
Amortization of intangible assets					1.8	3.1	3.4	3.3
Other loss (income), net	(0.1)	(0.2)	0.8	1.4	1.3	1.0	5.7	(1.0)
Total expenses and other loss (income)	27.9	22.3	25.1	19.5	32.2	21.1	26.3	19.5
Income (loss) from continuing operations before income taxes	8.8	10.3	6.0	10.0	16.3	15.2	(1.6)	4.9
Income tax benefit (expense)	(3.2)	(3.5)	(2.3)	24.3	(6.4)	(5.6)	(1.0)	(1.0)
Income (loss) from continuing operations	5.6	6.8	3.7	34.3	9.9	9.6	(2.6)	3.9
Loss from discontinued operations, net of taxes	(3.0)	(15.4)						
Net income (loss)	2.6%	(8.6)%	3.7%	34.3%	9.9%	9.6%	(2.6)%	3.9%

Table of Contents**ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to financial market risks, including changes in the market values of our debt investments and interest rates.

Financial market risk. We do not invest in financial instruments or their derivatives for trading or speculative purposes. By policy, we limit our credit exposure to any one issuer, other than securities issued by the U.S. federal government and its agencies, and do not have any derivative instruments in our investment portfolio. The three primary goals that guide our investment decisions, with the first being the most important, are: preserve capital, maintain ease of conversion into immediate liquidity, and achieve a rate of return over a predetermined benchmark. Our investment portfolio at December 31, 2012 included debt instruments issued by the U.S. federal government and its agencies, publicly-held corporations, municipalities, insured time deposits with commercial banks, and money market funds invested in securities issued by agencies of the U.S. federal government. As of December 31, 2012, we invested exclusively in debt instruments with minimal default risk and maturity dates of less than one year from the end of any of our quarterly accounting periods. We consider the market value, default, and liquidity risks of our investments to be low at December 31, 2012.

Interest rate risk. As of December 31, 2012, all of the debt securities that we held were fixed-rate earning instruments that carry a degree of interest rate risk. Fixed-rate securities may have their fair market value adversely impacted due to a rise in interest rates. We may suffer losses in principal if we are forced to sell securities that have declined in market value due to changes in interest rates. At December 31, 2012, our cash equivalent balances of \$37.7 million were primarily held in money market funds and taxable municipal bonds, and our short-term investment balances of \$94.0 million were primarily held in U.S. government securities and taxable municipal bonds. We consider the interest rate risk for our cash equivalent and marketable fixed-income securities held at December 31, 2012 to be low. For further detail on our cash equivalent and short-term investment holdings, please see Note 6: Fair Value Measurements of the Notes to Consolidated Financial Statements in Item 8 of Part II of this report.

In addition, as of December 31, 2012, we have \$74.5 million of term debt outstanding, which carries a degree of interest rate risk. The debt has a floating portion of its interest rate, tied to the London Interbank Offered Rate (LIBOR). To maintain compliance with our debt agreement, we entered into an interest rate swap. For further information on our swap and debt outstanding see Note 10: Debt of the Notes to Consolidated Financial Statements in Item 8 of Part II of this report. That interest rate swap mitigated about half of our risk of increasing LIBOR rates, while the other half remains unhedged. A hypothetical 100 basis point increase in LIBOR on December 31, 2012 would result in a \$2.4 million increase in our interest expense until the scheduled maturity date on January 31, 2017, partially offset by an increase in the fair value of our swap of \$1.0 million on December 31, 2012.

The following table provides information about our cash equivalent and marketable fixed-income securities, including principal cash flows for 2012 and thereafter and the related weighted average interest rates. The change in fair values during 2012 was approximately \$50,000 for our cash equivalent and marketable fixed-income securities, and was recorded in other comprehensive income. Note 2: Summary of Significant Accounting Policies of the Notes to Consolidated Financial Statements in Item 8 of Part II of this report. Principal amounts and weighted average interest rates by expected year of maturity as of December 31, 2012 are as follows (in thousands, except percentages):

	2013		Thereafter		Total	Fair Value	
U.S. government securities	\$ 48,130	0.20%			\$ 48,130	0.20%	\$ 48,302
Commercial paper	16,400	0.19%			16,400	0.19%	16,395
Money market funds	13,723	0.00%			13,723	0.00%	13,723
Time deposits	8,414	0.39%			8,414	0.39%	8,414
Taxable municipal bonds	44,274	0.43%			44,274	0.43%	44,837

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Cash equivalents and marketable fixed-income securities	\$ 130,941	\$	\$ 130,941	\$ 131,671
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ITEM 8. Financial Statements and Supplementary Data

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

Blucora, Inc.

Bellevue, Washington

We have audited the accompanying consolidated balance sheet of Blucora, Inc. as of December 31, 2012 and the related consolidated statements of comprehensive income, stockholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Blucora, Inc. at December 31, 2012, and the consolidated results of its operations and its cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Blucora, Inc.'s internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 7, 2012 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Seattle, Washington

March 7, 2013

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

Blucora, Inc.

Bellevue, Washington

We have audited the accompanying consolidated balance sheet of Blucora, Inc. and subsidiaries (the Company) as of December 31, 2011, and the related consolidated statements of comprehensive income, stockholders' equity, and cash flows for each of the two years in the period ended December 31, 2011. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respect, the financial position of Blucora, Inc. and its subsidiaries as of December 31, 2011, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington

March 9, 2012 (March 7, 2013 as to the 2011 and 2010

amounts in Note 13)

Table of Contents**BLUCORA, INC.****CONSOLIDATED BALANCE SHEETS**

(amounts in thousands, except share and per share data)

	December 31,	
	2012	2011
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 68,278	\$ 81,897
Short-term investments, available-for-sale	94,010	211,654
Accounts receivable, net of allowance of \$10 and \$10	34,932	25,019
Other receivables	3,942	542
Prepaid expenses and other current assets, net	10,911	1,958
Total current assets	212,073	321,070
Property and equipment, net	7,533	5,277
Goodwill	230,290	44,815
Other intangible assets, net	132,815	1,315
Deferred tax asset, net		19,102
Other long-term assets	2,582	3,560
Total assets	\$ 585,293	\$ 395,139
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Current liabilities:		
Accounts payable	\$ 37,687	\$ 28,947
Accrued expenses and other current liabilities	13,280	10,249
Deferred revenue	3,157	1
Short-term portion of long-term debt, net of discount of \$160 and \$0	4,590	
Derivative instruments	8,974	
Total current liabilities	67,688	39,197
Long-term liabilities:		
Long-term debt, net of discount of \$468 and \$0	69,278	
Deferred tax liability, net	29,333	21
Deferred revenue	1,319	
Other long-term liabilities	2,225	816
Total long-term liabilities	102,155	837
Total liabilities	169,843	40,034
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Common stock, par value \$.0001 authorized, 900,000,000 shares; issued and outstanding, 40,832,393 and 39,533,570 shares	4	4
Additional paid-in capital	1,392,098	1,353,971
Accumulated deficit	(976,376)	(998,902)
Accumulated other comprehensive income (loss)	(276)	32
Total stockholders' equity	415,450	355,105

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Total liabilities and stockholders' equity	\$ 585,293	\$ 395,139
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See notes to consolidated financial statements.

Table of Contents**BLUCORA, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(amounts in thousands, except per share data)

	Years ended December 31,		
	2012	2011	2010
Revenues	\$ 406,919	\$ 228,813	\$ 214,343
Cost of sales (includes amortization of acquired intangible assets of \$7,580, \$2,595, and \$9,197)	267,451	154,962	138,995
Gross Profit	139,468	73,851	75,348
Expenses and other loss (income):			
Engineering and technology	9,969	7,158	8,471
Sales and marketing	44,138	21,510	28,145
General and administrative	27,418	21,542	32,843
Depreciation	2,119	2,162	3,138
Amortization of intangible assets	11,619		
Other loss (income), net	6,677	1,246	(15,247)
Total expenses and other loss (income)	101,940	53,618	57,350
Income from continuing operations before income taxes	37,528	20,233	17,998
Income tax benefit (expense)	(15,002)	11,288	(8,725)
Income from continuing operations	22,526	31,521	9,273
Discontinued operations:			
Loss from discontinued operations, net of taxes		(2,253)	(4,593)
Loss on sale of discontinued operations, net of taxes		(7,674)	
Net income	\$ 22,526	\$ 21,594	\$ 4,680
Income per share Basic:			
Income from continuing operations	\$ 0.56	\$ 0.83	\$ 0.26
Loss from discontinued operations		(0.06)	(0.13)
Loss on sale of discontinued operations		(0.20)	
Basic net income per share	\$ 0.56	\$ 0.57	\$ 0.13
Weighted average shares outstanding used in computing basic income per share	40,279	37,954	35,886
Income per share Diluted:			
Income from continuing operations	\$ 0.54	\$ 0.82	\$ 0.25
Loss from discontinued operations		(0.06)	(0.12)
Loss on sale of discontinued operations		(0.20)	
Diluted net income per share	\$ 0.54	\$ 0.56	\$ 0.13
Weighted average shares outstanding used in computing diluted income per share	41,672	38,621	36,829
Other comprehensive income:			
Net income	\$ 22,526	\$ 21,594	\$ 4,680

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Foreign currency translation adjustment			(74)
Reclassification adjustment for realized foreign currency gains, net, included in net income			(1,362)
Unrealized gain (loss) on investments, available-for-sale	(16)	34	94
Unrealized loss on derivative instrument	(266)		
Reclassification adjustment for realized gains on investments, available-for-sale, included in net income	(26)		
Other comprehensive income (loss)	(308)	34	(1,342)
Comprehensive income	\$ 22,218	\$ 21,628	\$ 3,338

See notes to consolidated financial statements.

Table of Contents**BLUCORA, INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

Years Ended December 31, 2012, 2011, and 2010

(in thousands)

	Common stock		Additional- paid-in capital	Accumulated deficit	Accumulated other comprehensive income	Total
	Shares	Amount				
Balance, December 31, 2009	35,391	\$ 4	\$ 1,303,667	\$ (1,025,176)	\$ 1,340	\$ 279,835
Common stock issued for stock options and restricted stock units	962		2,191			2,191
Common stock issued for employee stock purchase plan	54		350			350
Common stock retired	(318)		(2,099)			(2,099)
Unrealized loss on available-for-sale investments					94	94
Foreign currency transaction adjustment					(74)	(74)
Foreign currency translation adjustment for disposition of foreign subsidiaries					(1,362)	(1,362)
Tax effect of equity compensation			7,032			7,032
Stock-based compensation			15,010			15,010
Taxes paid on stock issued for equity awards			(3,886)			(3,886)
Net income				4,680		4,680
Balance, December 31, 2010	36,089	\$ 4	\$ 1,322,265	\$ (1,020,496)	\$ (2)	\$ 301,771
Common stock issued for stock options and restricted stock units	2,627		17,121			17,121
Common stock issued for employee stock purchase plan	54		377			377
Sale of common stock	764		7,000			7,000
Unrealized loss on available-for-sale investments					34	34
Tax effect of equity compensation			1,260			1,260
Stock-based compensation			7,734			7,734
Taxes paid on stock issued for equity awards			(1,786)			(1,786)
Net income				21,594		21,594
Balance, December 31, 2011	39,534	\$ 4	\$ 1,353,971	\$ (998,902)	\$ 32	\$ 355,105
Common stock issued for stock options and restricted stock units	1,236		9,025			9,025
Common stock issued for employee stock purchase plan	62		601			601
Unrealized loss on available-for-sale investments					(42)	(42)
Unrealized loss on derivative instrument					(266)	(266)
Tax effect of equity compensation			22,693			22,693
Stock-based compensation			13,344			13,344
Taxes paid on stock issued for equity awards			(1,318)			(1,318)
Reclassification of equity award to liability award			(6,218)			(6,218)
Net income				22,526		22,526

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Balance, December 31, 2012	40,832	4	1,392,098	(976,376)	(276)	415,450
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See notes to consolidated financial statements.

Table of Contents**BLUCORA, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)**

	Years ended December 31,		
	2012	2011	2010
Operating Activities:			
Net income	\$ 22,526	\$ 21,594	\$ 4,680
Loss from discontinued operations		2,253	4,593
Loss on sale of discontinued operations		7,674	
Income from continuing operations	22,526	31,521	9,273
Adjustments to reconcile income from continuing operations to net cash provided by operating activities of continuing operations:			
Stock-based compensation	8,937	5,756	13,918
Warrant-related stock-based compensation	4,286	1,932	
Depreciation and amortization	23,011	7,456	15,793
Excess tax benefits from stock-based award activity	(23,041)	(1,260)	(7,032)
Earn-out contingent liability adjustments		3,000	5,000
Gain on resolution of contingent liability		(1,500)	
Common stock retired relating to litigation settlement			(2,099)
Unrealized amortization of premium or accretion of discount on investments, net	(194)	(89)	365
Loss on disposal of assets, net		46	1,262
Foreign currency translation gains, net			(1,436)
Deferred income taxes	(8,738)	(18,870)	19
Amortization of debt origination costs	820		
Accretion of debt discount	325		
Loss on derivative instrument	2,346		
Other	31	(28)	3
Changes in operating assets and liabilities:			
Accounts receivable	(597)	(5,734)	9,274
Other receivables	(665)	643	1,852
Prepaid expenses and other current assets	(5,862)	284	636
Other long-term assets	1,981	(258)	(201)
Accounts payable	(1,600)	26,253	(3,506)
Accrued expenses and other current and long-term liabilities	25,265	(23,889)	6,785
Net cash provided by operating activities	48,831	25,263	49,906
Investing Activities:			
Business acquisitions, net of cash acquired	(279,386)		(8,000)
Purchases of property and equipment	(3,756)	(2,679)	(2,894)
Change in restricted cash	252	649	230
Proceeds from sale of assets	4		307
Proceeds from sales of investments	203,493	63,166	52,801
Proceeds from maturities of investments	36,753	160,161	191,976
Purchases of investments	(122,433)	(336,770)	(200,493)
Net cash provided (used) by investing activities	(165,073)	(115,473)	33,927
Financing Activities:			
Proceeds from loan, net of debt issuance costs of \$2,343 and debt discount of \$953	96,704		
Repayment of debt	(25,504)		
Excess tax benefits from stock-based award activity	23,041	1,260	7,032
Proceeds from stock option exercises	9,099	17,049	2,191
Proceeds from issuance of stock through employee stock purchase plan	601	377	350
Proceeds from sale of common stock		7,000	
Repayment of capital lease obligation		(221)	(589)

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Tax payments from shares withheld upon vesting of restricted stock units	(1,318)	(1,786)	(4,201)
Earn-out payments for business acquisitions		(423)	(4,577)
Net cash provided by financing activities	102,623	23,256	206
Discontinued operations:			
Net cash used by operating activities of discontinued operations		(6,156)	(4,034)
Net cash used by investing activities of discontinued operations		(638)	(8,110)
Net cash used by discontinued operations		(6,794)	(12,144)
Net increase (decrease) in cash and cash equivalents	(13,619)	(73,748)	71,895
Cash and cash equivalents, beginning of period	81,897	155,645	83,750
Cash and cash equivalents, end of period	\$ 68,278	\$ 81,897	\$ 155,645
Supplemental disclosure of non-cash investing activities:			
Liabilities assumed in purchase transaction	\$	\$	\$ (8,231)
Purchases of assets through leasehold incentives	\$ 841	\$	\$
Supplemental disclosure of non-cash financing activities:			
Contingent earn-out consideration from acquisition	\$	\$ (3,000)	\$ (5,000)
Cash paid (received) for:			
Income tax expense (benefit) for continuing operations	\$ 3,071	\$ 809	\$ (364)
Interest expense for continuing operations	\$ 3,527	\$ 48	\$ 24

See notes to consolidated financial statements.

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BLUCORA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2012, 2011, and 2010

Note 1: The Company and Basis of Presentation

Description of the business: Blucora, Inc. (the *Company* or *Blucora*) operates two primary businesses: an internet search business and an online tax preparation business. The Company's search business, InfoSpace, consists primarily of a B2B offering that provides its search technology, aggregated content, and services to its distribution partners. The search business also offers search services directly to consumers through its internet search properties. The tax preparation business consists of the operations of the TaxACT tax preparation online service and software business that the Company acquired on January 31, 2012.

The InfoSpace search business primarily offers search services through the web properties of its distribution partners, which are generally private-labeled and customized to address the unique requirements of each distribution partner. The search business also distributes aggregated search content through its own websites, such as Dogpile.com and WebCrawler.com. The search business does not generate its own search content, but instead aggregates search content from a number of content providers. Some of these content providers, such as Google and Yahoo!, pay the Company to distribute their content, and those providers are referred to as Search Customers.

On January 31, 2012, the Company acquired TaxACT Holdings, Inc. (*TaxACT Holdings*) and its wholly-owned subsidiary, Story Software, Inc. (*Story*), which operates the TaxACT tax preparation online service and software business. The TaxACT business consists of an online tax preparation service for individuals, tax preparation software for individuals and professional tax preparers, and ancillary services. The majority of the TaxACT business's revenue is generated by the online service at www.taxact.com. As a highly seasonal business, almost all of the TaxACT revenue is generated in the first four months of the calendar year.

Segments: As a result of the acquisition of the TaxACT business, the Company has determined that it has two reporting segments: Search and Tax Preparation. The Search segment is the InfoSpace business and the Tax Preparation segment is the TaxACT business. Unless the context indicates otherwise, the Company uses the term *search* to represent search services and uses the term *tax preparation* to represent services and products sold through the TaxACT business (see Note 13: Segment Information).

Principles of consolidation: The consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany accounts and transactions have been eliminated.

Basis of presentation: On June 22, 2011, the Company sold its Mercantila e-commerce business to Zoo Stores, Inc., and the results of operations from the Mercantila business are reflected as discontinued operations for all periods presented.

Note 2: Summary of Significant Accounting Policies

Cash equivalents: The Company considers all highly liquid debt instruments with an original maturity of ninety days or less at date of acquisition to be cash equivalents, which are carried at fair value.

Accounts receivable: Accounts receivable are stated at amounts due from customers net of an allowance for doubtful accounts.

Short-term investments: The Company principally invests its available cash in investment-grade income securities, AAA-rated money market funds, and insured time deposits with commercial banks. Such investments are included in Cash and cash equivalents and Short-term investments, available for sale, on the consolidated

Table of Contents**BLUCORA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2012, 2011, and 2010**

balance sheets, and reported at fair value with unrealized gains and losses included in Accumulated other comprehensive income (loss) on the consolidated balance sheets.

Property and equipment: Property and equipment are stated at cost. Depreciation is computed under the straight-line method over the following estimated useful lives:

Computer equipment and software	3 years
Data center servers	3 years
Internally developed software	15 months 3 years
Office equipment	7 years
Office furniture	7 years
Leasehold improvements	Shorter of lease term or economic life

The Company capitalizes certain internal-use software development costs, consisting primarily of employee salaries and benefits allocated on a project or product basis. The Company capitalized \$952,000, \$1.2 million, and \$1.0 million of internal-use software costs in the years ended December 31, 2012, 2011, and 2010, respectively.

Business combinations and intangible assets including goodwill: The Company accounts for business combinations using the acquisition method and, accordingly, the identifiable assets acquired and liabilities assumed are recorded at their acquisition date fair values. Goodwill is calculated as the excess of the purchase price over the fair value of net assets, including the amount assigned to identifiable intangible assets. Acquisition-related costs, including advisory, legal, accounting, valuation and other costs, are expensed in the periods in which the costs are incurred. The results of operations of acquired businesses are included in the consolidated financial statements from the acquisition date.

Valuation of goodwill and intangible assets: The Company evaluates goodwill and indefinite-lived intangible assets at least annually, and evaluates all intangible assets for impairment whenever events or changes in circumstances, including material changes in the fair value of the Company's outstanding common stock, indicate that the carrying amount of the Company's assets might not be recoverable.

The Company tests for goodwill impairment at the reporting unit level. In the evaluation of goodwill, the Company first performs a qualitative assessment to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount. If so, the Company performs a quantitative assessment and compares the fair value of the reporting unit to the carrying amount. The reporting unit fair values are determined for each reporting unit by using a combination of projections of future discounted cash flows, and EBITDA and revenue multiple comparisons with comparable publicly-held companies. If the fair value of a reporting unit was determined to be less than its carrying amount, the Company would record an impairment loss equal to the excess of the carrying amount of the reporting unit's goodwill over its fair

value.

In the evaluation of indefinite-lived intangible assets, the Company first performs a qualitative assessment to determine whether it is more likely than not that the fair value of an asset is less than the carrying amount. If so, the Company performs a quantitative assessment and compares the fair value of the asset to its carrying amount. The Company bases its measurement of fair value of indefinite-lived intangible assets, which primarily consist of trade name and trademarks, using the relief-from-royalty method. This method assumes that the trade name and trademarks have value to the extent that their owner is relieved of the obligation to pay royalties for the benefits received from them. This method requires us to estimate the future revenue for the related brands, the appropriate royalty rate and the weighted average cost of capital.

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BLUCORA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2012, 2011, and 2010

If the fair value of an indefinite-lived intangible asset was determined to be less than its carrying amount, the Company would record an impairment loss equal to the excess of the carrying amount of the reporting unit's goodwill over its fair value.

Other investments: Included in other long-term assets are the Company's investment in equity investments of privately-held companies for business and strategic purposes. The Company currently holds equity securities and warrants to purchase equity securities in companies whose securities are not publicly traded. The Company's equity investments were carried at a fair value of \$0 at December 31, 2012 and 2011.

Revenue recognition: The Company recognizes revenue when all four revenue recognition criteria have been met: persuasive evidence of an arrangement exists, the Company has delivered the product or performed the service, the fee is fixed or determinable, and collectability is probable. Determining whether and when these criteria have been satisfied involves exercising judgment and using estimates and assumptions that can have an impact on the timing and amount of revenue that the Company recognizes.

The Company also evaluates whether revenue should be presented on a gross basis, which is the amount that a customer pays for the service or product, or on a net basis, which is the customer payment less amounts the Company pays to suppliers. In making that evaluation, the Company considers indicators such as whether the Company is the primary obligor in the arrangement and assumes the risks and rewards as a principal in the customer transaction, including the credit risk, and whether the Company can set the sales price and select suppliers. The accounting principles generally accepted in the United States of America (*GAAP*) clearly indicates that the evaluations of these factors, which at times can be contradictory, are subject to significant judgment and subjectivity.

Search services revenue recognition: The Company's revenues are generated primarily from its web search services. The Company generates search services revenue when an end user of such services clicks on a paid search link provided by a Search Customer and displayed on a distribution partners' web property or on one of the Company's owned and operated web properties. The Search Customer that provided the paid search link receives a fee from the advertiser who paid for the click and the Search Customer pays the Company a portion of that fee. Revenue is recognized in the period in which the services are provided (e.g., a paid search occurs) and is based on the amounts earned by and ultimately remitted to the Company. This revenue is recorded in the Search segment.

Under the Company's agreements with its Search Customers and its distribution partners, the Company is the primary obligor, separately negotiates each revenue or unit pricing contract independent of any revenue sharing arrangements, and assumes the credit risk for amounts invoiced to its Search Customers. For search services, the Company determines the paid search results, content, and information directed to its owned and operated websites and its distribution partners' web properties.

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The Company earns revenue from its Search Customers by providing paid search results generated from its owned and operated web properties and from its distribution partners' web properties based on separately negotiated and agreed-upon terms with each distribution partner. Consequently, the Company records search services revenue on a gross basis.

Tax preparation revenue recognition: The Company derives revenue from the sale of tax preparation online services, ancillary service offerings, tax preparation packaged software products, and multiple element arrangements that may include a combination of these items. Ancillary service offerings include tax preparation

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BLUCORA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2012, 2011, and 2010

support services, data archive services, bank or reloadable pre-paid debit card services, and e-filing services. This revenue is recorded in the Tax Preparation segment.

The Company's tax preparation segment service revenue consists primarily of hosted tax preparation online services, tax preparation support services, data archive services, and e-filing services. The Company recognizes revenue from these services as the services are performed and the four revenue recognition criteria described above are met.

The Company recognizes revenue from the sale of its packaged software products when legal title transfers. This is generally when its customers download products from the Web or when the products ship.

The bank or reloadable prepaid debit card services are offered to taxpayers as an option to receive their tax refunds in the form of a prepaid bank card or to have the fees for the product and/or services purchased by the customers deducted from their refunds. Revenue for this fee is recognized when the four revenue recognition criteria described above are met; for some arrangements that is upon filing and for other arrangements that is upon cash receipt.

For products and/or services that consist of multiple elements, the Company must: (1) determine whether and when each element has been delivered; (2) determine the fair value of each element using the selling price hierarchy of vendor-specific objective evidence (*VSOE*) of fair value if available, third-party evidence (*TPE*) of fair value if VSOE is not available, and estimated selling price (*ESP*) if neither VSOE nor TPE is available; and (3) allocate the total price among the various elements based on the relative selling price method. Once the Company has allocated the total price among the various elements, it recognizes revenue when the revenue recognition criteria described above are met for each element.

VSOE generally exists when the Company sells the deliverable separately and is normally able to establish VSOE for all deliverables in these multiple element arrangements; however, in certain limited instances VSOE cannot be established. This may be because the Company infrequently sells each element separately, or has a limited sales history. When VSOE cannot be established the Company attempts to establish a selling price for each element based on TPE. TPE is determined based on competitor prices for similar deliverables when sold separately. When the Company is unable to establish selling price using VSOE or TPE, it uses ESP in its allocation of arrangement consideration. ESP is the estimated price at which the Company would sell a product or service if it were sold on a stand-alone basis. The Company determines ESP for a product or service by considering multiple factors including, but not limited to, historical stand-alone sales, pricing practices, market conditions, competitive landscape, internal costs, and gross margin objectives.

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In some situations, the Company receives advance payments from its customers. The Company defers revenue associated with these advance payments and recognizes the allocated consideration for each element when the Company ships the products or performs the services, as appropriate. Advance payments related to data archive services are deferred and recognized over the related contractual term.

Cost of sales: Cost of sales consists of costs related to revenue sharing arrangements with the Company's distribution partners, usage-based content fees, certain costs associated with the operation of the Company's data centers that serve its search and tax preparation businesses, including amortization of intangible assets, depreciation, personnel expenses (which include salaries, benefits and other employee related costs, and stock-based compensation expense), bandwidth costs, customer payment processing fees, bank service fees, and royalties.

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BLUCORA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2012, 2011, and 2010

Engineering and technology expenses: Engineering and technology expenses are associated with the research, development, support, and ongoing enhancements of the Company's offerings, including personnel expenses (which include salaries, stock-based compensation expense, and benefits and other employee related costs), software support and maintenance, and professional service fees.

Sales and marketing expenses: Sales and marketing expenses consist primarily of marketing expenses associated with the Company's tax preparation business (which includes the following channels: television, radio, online banner ads, internet search, and email), the Company's owned and operated web properties (which consist of traffic acquisition, including online direct marketing initiatives, which involve the purchase of online advertisements that drive traffic to an owned and operated website, agency fees, brand promotion expense, and market research expense), personnel costs (which include salaries, stock-based compensation expense, and benefits and other employee related costs), and the cost of temporary help and contractors to augment the Company's staffing.

Costs for advertising are recorded as expense when the advertisement appears or electronic impressions are recorded. Advertising expense totaled \$31.8 million, \$14.4 million, and \$18.5 million for the years ended December 31, 2012, 2011, and 2010, respectively. Prepaid advertising costs were \$2.5 million at December 31, 2012.

General and administrative expenses: General and administrative expenses consist primarily of personnel expenses (which include salaries, stock-based compensation expense, and benefits and other employee related costs), professional service fees (which include legal, audit, and tax fees), general business development and management expenses, occupancy and general office expenses, taxes, and insurance expenses.

Stock-based compensation: The Company measures and recognizes its compensation expense for all stock-based payment awards made to employees and directors, including stock option, restricted stock unit grants, and market stock unit grants and purchases of stock made pursuant to the Company's 1998 Employee Stock Purchase Plan (the *ESPP*), based on estimated fair values. Expense is recognized on a straight-line basis over the requisite vesting period for each separately vesting portion of the award, adjusted for an estimated forfeiture rate.

To determine the stock-based compensation expense that was recognized with respect to restricted stock units (*RSU*), market stock units (*MSU*), which are a form of share price performance-based restricted stock units granted under the Company's 2011 long-term executive compensation plan, employee and non-employee director stock options, and the Warrant issued to Cambridge Information Group I LLC (*CIG*), the Company used the fair value at date of grant for RSUs, the Monte Carlo valuation method for the MSU grants, and the Black-Scholes-Merton option-pricing model for stock option grants and the Warrant. An option award to a non-employee was valued by the Black-Scholes-Merton method upon the completion of a qualified business acquisition by the Company in 2012. For each of the above awards, the value of the portion that is ultimately expected to vest is recognized as expense over the requisite service periods in the accompanying consolidated financial statements for the years ended December 31, 2012, 2011, and 2010.

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Debt Issuance Costs and Debt Discount: Debt issuance costs and debt discounts are deferred and amortized as interest expense under the effective interest method over the contractual term of the related debt, adjusted for prepayments.

Hedging: The Company uses a derivative financial instrument in the form of an interest rate swap agreement for the purpose of minimizing exposure to changes in interest rates. This swap agreement is accounted

Table of Contents**BLUCORA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2012, 2011, and 2010**

for as a cash flow hedge and changes in the fair value of the hedge instrument are included in other comprehensive income while the hedge is perfectly effective, and any ineffectiveness would be recorded to other income (loss), net in the Statement of operations and comprehensive income.

Employee benefit plan: The Company has a 401(k) savings plan covering its employees. Eligible employees may contribute through payroll deductions. The Company may match the employees' 401(k) contributions at the discretion of the Company's Board of Directors. Pursuant to a continuing resolution, in 2012, 2011, and 2010, the Company has matched a portion of the 401(k) contributions made by its employees. The amount contributed by the Company is equal to a maximum of 50% of employee contributions up to a maximum of 3% of an employee's salary. For the years ended December 31, 2012, 2011, and 2010, the Company contributed \$374,000, \$288,000, and \$309,000, respectively, for employees.

Other loss (income), net: Other loss (income), net for the years ended December 31, 2012, 2011, and 2010, consists of the following (in thousands):

	2012	2011	2010
Interest expense	\$ 3,522	\$	\$
Interest income	(131)	(369)	(331)
Amortization of debt issuance costs	820		
Accretion of debt discount	325		
Loss on derivative instrument	2,346		
Gain on contingency resolution		(1,500)	
Increase in fair value of earn-out contingent liability		3,000	5,000
Foreign currency exchange loss (gain), net	48	20	(1,335)
Litigation settlement gain			(18,965)
Loss (gain) on disposal of assets	(1)	46	1,014
Other	(252)	49	(630)
Other loss (income), net	\$ 6,677	\$ 1,246	\$ (15,247)

In 2012, the Company incurred interest expenses of \$3.5 million and a loss on a derivative instrument of \$2.3 million. The financial performance of Make The Web Better, acquired on April 1, 2010, was greater than expected; as a consequence, the fair value of the related contingent consideration increased and additional charges of \$3.0 million and \$5.0 million were recorded in the years ended December 31, 2011 and 2010, respectively. Also in 2011, the Company recorded a gain of \$1.5 million related to the resolution of a contingent liability. In 2010, the Company recognized a \$19.0 million gain related to a litigation settlement and recorded \$1.4 million in recognition of foreign currency translation gains, primarily related to the sale or substantial liquidation of wholly-owned subsidiaries.

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Loss from discontinued operations and loss on sale of discontinued operations: On June 22, 2011, the Company sold its Mercantila e-commerce business to Zoo Stores, Inc. The results of operations from the business are reflected as discontinued operations for all periods presented. Revenue, loss before taxes, income tax benefit, and loss from discontinued operations, net of taxes, and loss on sale of discontinued operations, net of taxes, for the year ended December 31, 2011 are presented below (in thousands):

	Years ended December 31,	
	2011	2010
Revenue from discontinued operations	\$ 16,894	\$ 32,492
Loss from discontinued operations before taxes	\$ (3,506)	\$ (5,908)
Income tax benefit	1,253	1,315
Loss from discontinued operations, net of taxes	\$ (2,253)	\$ (4,593)
Loss on sale of discontinued operations, net of an income tax benefit of \$5,092	\$ (7,674)	\$

Loss from discontinued operations includes previously unallocated depreciation, amortization, stock-based compensation expense, income taxes, and other corporate expenses that were attributable to the e-commerce business.

Net income per share: Basic net income per share is computed using the weighted average number of common shares outstanding during the period. Diluted net income per share is computed using the weighted average number of common shares outstanding plus the number of potentially dilutive shares outstanding during the period. Potentially dilutive shares consist of the incremental common shares issuable upon the exercise of outstanding stock options, a warrant issued in August 2011 (the **Warrant**), and unvested RSUs and MSUs, using the treasury stock method. Performance-based stock options for which performance has not yet been achieved are excluded from the calculation of potentially dilutive shares. Potentially dilutive shares are excluded from the computation of earnings per share if their effect is antidilutive. The treasury stock method calculates the dilutive effect for awards with an exercise price less than the average stock price during the period presented (in thousands):

In thousands	Years ended December 31,		
	2012	2011	2010
Weighted average common shares outstanding, basic	40,279	37,954	35,886
Dilutive stock options, RSUs, MSUs, and the Warrant	1,393	667	943
Weighted average common shares outstanding, diluted	41,672	38,621	36,829
Antidilutive awards with an exercise price less than the average price during the applicable period excluded from dilutive share calculation	200	876	1,199

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Outstanding awards with an exercise price greater than the average price during the applicable period not included in dilutive share calculation	804	2,927	4,282
Outstanding awards with performance conditions not completed during the applicable period not included in dilutive share calculation	168		

Other comprehensive income: Comprehensive income includes net income, plus items that are recorded directly to stockholders' equity, including foreign currency translation adjustments and the net change in unrealized gains and losses on cash equivalents, short-term and long-term investments. Included in the net change in unrealized gains and losses are realized gains or losses included in the determination of net income in

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the period realized. Amounts reclassified out of other comprehensive income into net income were determined on the basis of specific identification.

The following table provides information about activity in other comprehensive income during the period from January 1, 2010 to December 31, 2012 (in thousands):

	Foreign currency translation adjustment	Unrealized gain (loss) on investment	Unrealized loss on derivative instrument	Total
Balance as of January 1, 2010	\$ 1,436	\$ (96)		\$ 1,340
Other comprehensive loss	(1,436)	94		(1,342)
Balance as of December 31, 2010		(2)		(2)
Other comprehensive income		34		34
Balance as of December 31, 2011		32		32
Other comprehensive loss		(42)	(266)	(308)
Balance as of December 31, 2012	\$	\$ (10)	\$ (266)	\$ (276)

Foreign currencies: Foreign subsidiary financial statements are denominated in foreign currencies and are translated at the exchange rate on the balance sheet date. Realized gains and losses on foreign currency transactions are included in other loss (income), net. In 2010, substantially all of Blucora's foreign subsidiaries were sold or liquidated.

Concentration of credit risk: Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash equivalents, short-term investments, and trade receivables. These instruments are generally unsecured and uninsured. The Company places its cash equivalents and investments with major financial institutions. Accounts receivable are typically unsecured and are derived from revenues earned from Search Customers primarily located in the United States operating in a variety of industries and geographic areas. The Company performs ongoing credit evaluations of its Search Customers and maintains allowances for potential credit losses.

The Company attempts to manage exposure to counterparty credit risk by only entering into agreements with major financial institutions which are expected to be able to fully perform under the terms of the agreement.

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Revenue concentration: The Company derives a significant portion of its revenues from two Search Customers. Revenues from the top two Search Customers represented 84%, 99%, and 97% of revenues in each of the years ended December 31, 2012, 2011, and 2010, respectively. At December 31, 2012 and 2011, two Search Customers accounted for more than 90% of the Company's accounts receivable balance.

Geographic revenue information, as determined by the location of the customer, is presented below (in thousands):

	Years ended December 31,		
	2012	2011	2010
United States	\$ 402,656	\$ 226,229	\$ 209,029
International	4,263	2,584	5,314
Total	\$ 406,919	\$ 228,813	\$ 214,343

Fair value of financial instruments: The Company does not measure the fair value of any financial instrument other than cash equivalents, available-for-sale investments, derivative instruments, and its investment

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BLUCORA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2012, 2011, and 2010

in a privately-held company. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The carrying values of other financial instruments (accounts receivable, other receivables, and accounts payable), other current assets and accrued expenses, and other current liabilities are not recorded at fair value but approximate fair values primarily due to their short-term nature.

If quoted prices in active markets for identical assets or liabilities are not available to determine fair value, then the Company uses quoted prices for similar assets and liabilities or inputs other than the quoted prices that are observable either directly or indirectly. This pricing methodology applies to the Company's Level 2 instruments such as corporate notes and bonds, agency securities, municipal bonds, money market funds, and insured time deposits. Level 3 instruments are valued using internally developed models with unobservable inputs, which will vary based on the instrument. The Company values the Warrant, classified within Level 3 by using the Black-Scholes valuation model which has significant unobservable marketable inputs; those unobservable inputs are based on historical and observable information, primarily the Company's stock price, and are not expected to vary materially unless the stock price varies materially. If the Company's stock price at December 31, 2012 had been twenty percent higher at that date, the fair value of the Warrant would have been thirty-two percent higher, resulting in an increase in the Company's loss on derivative instrument for the year ended December 31, 2012, of \$2.7 million.

The Company's Level 2 investments are priced based on similar investments or assets without applying significant adjustments. In addition, all of the Company's Level 2 investments have a sufficient level of trading volume to demonstrate that the fair values used are appropriate for these investments.

Income taxes: The Company accounts for income taxes under the asset and liability method, under which deferred tax assets, including net operating loss carryforwards, and liabilities are determined based on temporary differences between the book and tax bases of assets and liabilities. The Company periodically evaluates the likelihood of the realization of deferred tax assets, and reduces the carrying amount of the deferred tax assets by a valuation allowance to the extent the Company believes a portion will not be realized. The Company considers many factors when assessing the likelihood of future realization of the deferred tax assets, including the recent cumulative earnings experience by taxing jurisdiction, expectations of future taxable income, the carryforward periods available for tax reporting purposes, and other relevant factors. There is a wide range of possible judgments relating to the valuation of the Company's deferred tax assets.

During the year ended December 31, 2012, the Company provided a valuation allowance against certain net deferred tax assets. During the year ended December 31, 2011, based on the weight of available evidence, the Company determined that it was more likely than not that it would realize \$18.9 million of its deferred tax assets in the foreseeable future. Accordingly the Company released the valuation allowance against this portion of its deferred tax assets and retained the valuation allowance against the remainder at year end. During the year ended December 31, 2010, the Company provided a full valuation allowance against its net deferred tax assets.

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Lease accounting: The Company leases office space and computer equipment used in its data centers. These leases are classified as either capital leases or operating leases, as appropriate. The amortization of assets under capital leases is included in depreciation expense. For the years ended December 31, 2012, 2011, and 2010, \$0, \$188,000, and \$537,000, respectively, of amortization for assets acquired under capital leases was included in depreciation expense.

Use of estimates: The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates include those used for impairment of goodwill and other intangible assets, useful lives of other intangible assets, purchase accounting, valuation of investments, valuation

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of the Warrant and interest rate swap derivatives, revenue recognition, the estimated allowance for sales returns and doubtful accounts, internally developed software, accrued contingencies, stock option valuation, and valuation allowance for deferred tax assets. Actual amounts may differ from estimates.

Recent accounting pronouncements: Changes to GAAP are established by the FASB in the form of ASUs to the FASB's Accounting Standards Codification. The Company considers the applicability and impact of all recent ASUs. ASUs not listed below were assessed and determined to be either not applicable or are expected to have minimal impact on the Company's consolidated financial position and results of operations.

In July 2012, the FASB issued an ASU to simplify how entities test indefinite-lived intangible assets for impairment to improve consistency in impairment testing requirements among long-lived asset categories. The ASU permits an assessment of qualitative factors to determine whether it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying value. For assets for which this assessment concludes it is more likely than not that the fair value is more than its carrying value, this ASU eliminates the requirement to perform quantitative impairment testing as outlined in the previously issued standards. The Company early adopted the new standard on October 1, 2012. The adoption of this ASU did not materially impact the Company's consolidated condensed financial statements.

Note 3: Business Combinations

Presented below is information regarding the Company's business combinations during the years ended December 31, 2012, 2011, and 2010, including information about the purchase price accounting from these transactions.

TaxACT Holdings. On January 31, 2012, the Company acquired all of the outstanding stock of TaxACT Holdings and its wholly-owned subsidiary, 2nd Story, which operates the TaxACT tax preparation online service and software business. The Company paid \$287.5 million in cash for this acquisition, less certain transaction expenses, and subject to certain specified working capital adjustments. The acquisition of the TaxACT business was funded from the Company's cash reserves and from the net proceeds of a \$105 million credit facility (of which \$100 million was drawn at the transaction's close). See Note 10 for further discussion of the credit facility. The acquisition was intended to diversify the Company's business model and expand its operations. Under the acquisition method, assets acquired and liabilities assumed are recorded at their fair values as of the acquisition date. Any excess of the purchase price over the fair values of the net assets acquired is recorded as goodwill. Final valuations are as follows (in thousands):

	Fair Value
Tangible assets acquired	\$ 22,465

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Liabilities assumed	17,759
Identifiable net assets acquired	\$ 4,706
Fair value adjustments to intangible assets	
Customer relationships	\$ 101,400
Proprietary technology	29,800
Trade name	19,499
Fair value of intangible assets acquired	\$ 150,699
Purchase price:	
Cash paid	\$ 287,500
Less identifiable net assets acquired	(4,706)
Plus deferred tax liability related to intangible assets	53,380
Less fair value of intangible assets acquired	(150,699)
Excess of purchase price over net assets acquired, allocated to goodwill	\$ 185,475

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BLUCORA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2012, 2011, and 2010

The Company recorded acquisition costs of \$1.1 million in 2012 and \$305,000 in 2011, which were recognized in general and administrative expenses. The Company incurred \$2.3 million of debt origination costs related to the credit facility used to help fund the acquisition, which the Company plans to amortize to interest expense over the term of the credit facility. The Company did not assume any equity awards or plans from 2nd Story. Following the completion of the acquisition, the Company issued 380,000 options and 167,000 RSUs to 2nd Story's employees as an incentive for future services and at levels consistent with other employee awards.

The Company's estimates of the economic lives of the acquired assets are eight years for the customer relationships, four years for the proprietary technology, approximately three years for the personal property assets, and the trade name is estimated to have an indefinite-life. The Company plans to amortize the assets over their respective estimated lives.

The goodwill arising from the TaxACT acquisition consists largely of the ability to attract new customers and develop new technologies post acquisition, which do not qualify for separate recognition. The Company determined that no portion of the goodwill arising from the TaxACT acquisition will be deductible for income tax purposes, except in one state where the Company made an election to recognize the gain on a deemed asset acquisition. The goodwill and the trade name will be tested for impairment at least annually.

The gross contractual amount of trade accounts receivable acquired was \$9.4 million, all of which has been collected. The Company recorded a fair value of \$304,000 for deferred revenue associated with the TaxACT business's data storage and retrieval service, which 2nd Story, prior to the acquisition, had recorded at \$5.1 million as of the acquisition date.

Since the acquisition date, the Company has included in its consolidated results the financial results of operations of the TaxACT business, which included total revenue of \$62.1 million and a contribution to the Tax Preparation segment income of \$30.1 million.

Pro Forma Financial Information of Acquisitions (unaudited)

The financial information in the table below summarizes the combined results of operations of Blucora and 2nd Story on a pro forma basis, as though they had been combined as of the beginning of each period presented. This pro forma financial information is presented for informational purposes only and is not necessarily indicative of the results of operations that would have been achieved had the acquisition occurred at the beginning of each period presented. The pro forma revenues and income from continuing operations for the years ended December 31, 2012 and 2011 combines the historical results of operations of the Company and 2nd Story for the year ended December 31, 2011, and combines the historical results of the Company for the year ended December 31, 2012 with the results of 2nd Story for the month ended January 31, 2012.

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The following amounts are in thousands:

	Year ended December 31,	
	2012	2011
Revenues	\$ 427,809	\$ 307,594
Income from continuing operations	\$ 26,819	\$ 11,251

Mercantila

On May 10, 2010, the Company acquired certain assets from Mercantila, Inc., an e-commerce company. The acquisition was intended to diversify the Company's business model and expand its operations into the online retail industry. On June 22, 2011, the Company sold its Mercantila e-commerce business to Zoo Stores, Inc., and the results of operations from the Mercantila business are reflected as discontinued operations for all

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periods presented in the Company's Annual Report on Form 10-K. Nikhil Behl, a former Named Executive Officer of Blucora, owned a majority interest in Zoo Stores at the time of the transaction, and Mr. Behl ceased to be an officer of, or otherwise affiliated with, Blucora upon the closing of the transaction.

Since the acquisition date, the Company has included in its consolidated results the financial results of the operation of its acquired Mercantila, Inc. assets, which included \$49.4 million of revenue, a contribution to loss from discontinued operations of \$6.8 million, and a loss on sale of \$7.7 million.

The purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair values at their date of acquisition as follows (in thousands):

Tangible assets acquired	\$ 2,234
Liabilities assumed	(8,231)
Identifiable net liabilities assumed	\$ (5,997)
Fair value adjustments to intangible assets	
License for use of developed core technology	\$ 893
Internet domain names	452
Customer relationships	39
Fair value of net liabilities assumed	\$ (4,613)
Purchase price:	
Cash paid	\$ 7,800
Plus identifiable net liabilities assumed	5,997
Less fair value of intangible assets acquired	(1,384)
Excess of purchase price over net assets acquired, allocated to goodwill	\$ 12,413

The Company expected that goodwill would be deductible for tax purposes.

The customer relationships had estimated useful lives of 12 months and were amortized over their lives under the straight-line method. The developed core technology had an estimated useful life of 24 months, after which the Company assumed that substantial modifications and

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enhancements would be required for the technology to remain competitive. The license was amortized over its life proportionately to the estimated total revenue to be generated through the acquired technology. The Company determined that the acquired Internet domain names had indefinite lives, and, therefore, these intangible assets were not amortized to expense.

Direct transaction costs of approximately \$337,000 include estimated investment banking and legal fees directly related to the acquisition and the Company recorded a charge to general and administrative expenses in the year ended December 31, 2010.

Make The Web Better

On April 1, 2010, the Company purchased assets consisting of web properties and licenses for content and technology from Make The Web Better, a search distribution partner and privately-held developer of online products used on social networking sites, for \$13.0 million. The purchase was intended to increase profitability and increase the proportion of the search services revenue generated through the Company's owned and operated properties. The purchase consideration included an initial cash payment of \$8.0 million, with the remaining consideration payable in cash and contingent on future financial performance.

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The purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair values at their date of acquisition as follows (in thousands):

Installed code base technology	\$ 12,650
License for use of developed core technology	235
Prepaid hosting services	115
Identifiable assets acquired	\$ 13,000
Purchase price:	
Cash paid	\$ 8,000
Contingent consideration	5,000
Purchase price	\$ 13,000
Less identifiable assets acquired	(13,000)
Excess of purchase price over net assets acquired, allocated to goodwill	\$

The installed code base technology, technology license, and prepaid hosting services have estimated useful lives of 57 months, 33 months, and five months, respectively. The installed code base technology and the license are amortized proportionately over their lives based on the estimated total revenue to be generated through the acquired technology, adjusted for revisions in the estimated total revenue expected to be generated. The prepaid hosting services is amortized over its life under the straight-line method. The Company expects that any consideration paid in excess of the original \$5.0 million contingent consideration will be deductible for tax purposes.

Revenue generated from search traffic on the Make The Web Better site was \$3.1 million in 2012, \$8.2 million in 2011, and \$16.4 million in 2010. Other than the amortization expense of \$752,000 in 2012, \$2.6 million in 2011, and \$9.0 million in 2010 associated with the recognized code base intangible asset, direct operating costs associated with the revenue generated by this site are not significant. Additionally, see Note 2 for costs related to a contingent consideration arrangement with the former owners of Make The Web Better.

Note 4: Goodwill and Other Intangible Assets

The following table presents the changes in goodwill by reportable segment during the period from January 1, 2011 to December 31, 2012 (in thousands):

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	Search	Tax Preparation	Total
Goodwill as of January 1, 2011 and 2012	\$ 44,815	\$	\$ 44,815
Additions		185,475	185,475
Goodwill as of December 31, 2012	\$ 44,815	\$ 185,475	\$ 230,290

In 2012, the additions to goodwill relate to the Company's acquisition of TaxACT as described in Note 3.

Impairment Assessments: The Company performs its annual assessment of possible impairment of goodwill and other indefinite-lived intangible assets as of November 30, or more frequently if events and circumstances indicate that impairment may have occurred. As of November 30, 2012 and 2011, the Company had no impairments.

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Intangible assets other than goodwill consisted of the following (in thousands):

	December 31, 2012			December 31, 2011		Other intangible assets, net
	Gross carrying amount	Accumulated amortization	Other intangible assets, net	Gross carrying amount	Accumulated amortization	
Definite-lived intangible assets:						
Installed code base technology	\$ 12,650	\$ (12,369)	\$ 281	\$ 12,650	\$ (11,618)	\$ 1,032
Core technology	1,085	(1,085)		1,085	(1,085)	
Tax Preparation customer relationships	101,400	(11,619)	89,781			
Tax Preparation proprietary technology	29,800	(6,829)	22,971			
Other	6,667	(6,667)		6,667	(6,667)	
Total definite-lived intangible assets	151,602	(38,569)	113,033	20,402	(19,370)	1,032
Indefinite-lived intangible assets	19,782		19,782	283		283
Total	\$ 171,384	\$ (38,569)	\$ 132,815	\$ 20,685	\$ (19,370)	\$ 1,315

Indefinite-lived intangible assets other than goodwill relate primarily to trade names associated with the 2012 acquisition of TaxACT.

The Company amortizes definite-lived intangible assets over their expected useful lives under the straight-line method, except for the installed code base technology, which is amortized proportional to expected revenue. Information about expected amortization of definite-lived intangible assets held as of December 31, 2012 in the next five years is presented in the below table (in thousands):

	2013	2014	2015	2016	2017	Total
Statement of operations location of amortization:						
Cost of sales	\$ 7,668	\$ 7,513	\$ 7,450	\$ 621	\$	\$ 23,252
Amortization of intangible assets	12,675	12,675	12,675	12,675	12,675	63,375
Total	\$ 20,343	\$ 20,188	\$ 20,125	\$ 13,296	\$ 12,675	\$ 86,627

The weighted average amortization period for definite-lived intangible assets is 75 months.

Note 5: Balance Sheet Components

Short-term investments classified as available-for-sale at December 31, 2012 and 2011 consisted of the following, stated at fair value (in thousands):

	December 31,	
	2012	2011
U.S. government securities	\$ 41,402	\$ 162,170
Taxable municipal bonds	36,043	
Commercial paper	9,396	49,484
Time deposits	7,169	
Total short-term investments available-for-sale	\$ 94,010	\$ 211,654

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BLUCORA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2012, 2011, and 2010

Maturity information was as follows for investments classified as available-for-sale at December 31, 2012 (in thousands):

	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Fair value
Within one year	\$ 94,029	\$ 36	\$ (55)	\$ 94,010
Greater than one year				
Total	\$ 94,029	\$ 36	\$ (55)	\$ 94,010

Maturity information was as follows for investments classified as available-for-sale at December 31, 2011 (in thousands):

	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Fair value
Within one year	\$ 211,622	\$ 34	\$ (2)	\$ 211,654
Greater than one year				
Total	\$ 211,622	\$ 34	\$ (2)	\$ 211,654

Prepaid expenses and other current assets, net consisted of the following as of December 31, 2012 and 2011 (in thousands):

	December 31,	
	2012	2011
Prepaid expenses and other current assets, net		
Prepaid expenses	\$ 5,268	\$ 1,878
Other current assets, net	5,643	80
Total prepaid expenses and other current assets, net	\$ 10,911	\$ 1,958

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Property and equipment consisted of the following as of December 31, 2012 and 2011 (in thousands):

	December 31,	
	2012	2011
Property and equipment		
Computer equipment and data center	\$ 13,262	\$ 10,712
Purchased software	5,046	4,594
Internally developed software	4,691	3,972
Office equipment	1,758	1,665
Office furniture	612	462
Leasehold improvements and other	3,400	3,133
	28,769	24,538
Accumulated depreciation	(22,636)	(19,261)
	6,133	5,277
Capital projects in progress	1,400	
Total property and equipment	\$ 7,533	\$ 5,277

At December 31, 2012 and 2011, unamortized internally-developed software was \$1.4 million and \$1.6 million, respectively, and for the years ended December 31, 2012 and 2011, the Company recorded depreciation expense for internally-developed software of \$947,000 and \$877,000, respectively.

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BLUCORA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2012, 2011, and 2010

Accrued expenses and other current liabilities consisted of the following as of December 31, 2012 and 2011 (in thousands):

	December 31,	
	2012	2011
Accrued expenses and other current liabilities		
Salaries and related expenses	\$ 5,185	\$ 4,014
Accrued content costs	3,017	1,141
Business acquisition contingent liability	1,101	3,184
Other	3,977	1,910
 Total accrued expenses and other current liabilities	 \$ 13,280	 \$ 10,249

Note 6: Fair Value Measurements

The Company measures its investments and derivative instruments at fair value under GAAP. The fair value hierarchy of the Company's financial assets and liabilities carried at fair value and measured on a recurring basis is as follows (in thousands):

	Fair value measurements at the reporting date using			
	December 31, 2012	Quoted prices in active markets using identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Cash equivalents:				
U.S. government securities	\$ 6,900	\$	\$ 6,900	\$
Money market and other funds	13,723		13,723	
Commercial paper	6,999		6,999	
Time deposits	1,245		1,245	
Taxable municipal bonds	8,794		8,794	

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Total cash equivalents	37,661	37,661	
<u>Available-for-sale securities:</u>			
U.S. government securities	41,402	41,402	
Commercial paper	9,396	9,396	
Time deposits	7,169	7,169	
Taxable municipal bonds	36,043	36,043	
Total available-for-sale securities	94,010	94,010	
Total assets	131,671	131,671	
<u>Liabilities</u>			
<u>Derivative instruments</u>			
Warrant (see Note 8)	(8,564)		(8,564)
Interest rate swap (see Note 10)	(410)	(410)	
Total liabilities	(8,974)	(410)	(8,564)
Total assets and liabilities at fair value	\$ 122,697	\$ 131,261	\$ (8,564)

Table of Contents**BLUCORA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2012, 2011, and 2010**

	December 31, 2011	Fair value measurements at the reporting date using		
		Quoted prices in active markets using identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<u>Assets</u>				
Cash equivalents:				
Money market funds	\$ 32,637	\$	\$ 32,637	\$
Commercial paper	20,000		20,000	
Total cash equivalents	52,637		52,637	
Available-for-sale securities:				
U.S. government securities	162,170		162,170	
Commercial paper	49,484		49,484	
Total available-for-sale securities	211,654		211,654	
Total assets at fair value	\$ 264,291	\$	\$ 264,291	\$

There were no financial assets measured on a recurring basis by using significant Level 3 inputs during the year ended December 31, 2011. The Company reviews the impairments of its available-for-sale investments and classifies the impairment of any individual available-for-sale investment as either temporary or other-than-temporary. The differentiating factors between temporary and other-than-temporary impairments are primarily the length of the time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Note 7: Stockholders Equity*Stock Incentive Plans*

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The Company's stock incentive plans generally provide employees, officers, directors, independent contractors, and consultants of the Company an opportunity to purchase shares of stock by exercising nonqualified stock options (which are options that are not described in Section 422 of the Internal Revenue Code of 1986, as amended). The plans also provide for the sale or granting of stock and RSUs to eligible individuals in connection with the performance of service for the Company. Finally, the plans authorize the grant of stock appreciation rights, either separately or in tandem with stock options, which entitle holders to cash compensation measured by appreciation in the value of the stock. The stock incentive plans are administered by the Compensation Committee of the Board of Directors, which is composed of non-employee directors. The Company issues new shares upon exercise of options and upon the vesting of RSUs.

1996 Plan: The Company primarily has one stock plan, the Restated 1996 Flexible Stock Incentive Program (the **1996 Plan**), that was used for grants during 2012, 2011, and 2010. RSUs and options granted under the 1996 Plan typically are scheduled to vest over three years or less, with 33 1/3% vesting one year from the date of grant and the remainder vesting ratably thereafter on a semi-annual basis. Options and RSUs granted in 2012, 2011, and 2010 under the 1996 Plan generally, with a few exceptions, vest over a period of three years, with 33 1/3% vesting one year from the date of grant and the remainder vesting ratably thereafter on a semi-

Table of Contents**BLUCORA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2012, 2011, and 2010**

annual basis, and expire seven years from the date of grant. There are a few exceptions to this vesting schedule, which provide for vesting at different rates or based on achievement of performance targets.

Through January 1, 2011, the number of shares available for grant pursuant to securities issued under the 1996 Plan increased annually on the first day of January by an amount equal to the lesser of (A) five percent of the Company's outstanding shares at the end of the Company's preceding fiscal year or (B) a lesser amount determined by the Board of Directors. This evergreen provision subsequently expired and was removed from the plan. The 1996 Plan limits the number of shares of common stock that may be granted to any one individual pursuant to stock options in any fiscal year of the Company to 800,000 shares, plus an additional 800,000 shares in connection with his or her initial employment with the Company, which initial grant does not count against the limit.

In 2011, the Company granted MSUs under the 1996 Plan. The actual amount of MSUs earned was 150% of the target award, based on the change in the Company's total stockholder return relative to the change in the closing value of the iShares Russell 2000 Index. Each MSU represents the right to receive one share of Blucora common stock upon satisfaction of the performance measure and vesting. One-third of the earned MSUs vested on April 1, 2012, and the remaining earned MSUs are scheduled to vest in equal installments on each of April 1, 2013 and 2014. If an option, RSU, or MSU award is surrendered or for any other reason unused, in whole or in part, the shares that were subject to the award shall continue to be available under the 1996 Plan.

2001 Plan: In 2012, the Company terminated its 2001 Nonstatutory Stock Option Plan, under which nonqualified stock options to purchase common stock or shares of restricted stock could be granted to employees. At December 31, 2012, no awards remained available for grant from that plan.

Plans and awards assumed through acquisition: In addition to the plans described above, the Company has assumed stock incentive plans and awards through acquisitions. The majority of the plans assumed have expired; one plan has options outstanding although the plan has expired. There are no shares available for grant as of December 31, 2012 under any plan assumed through acquisition.

A summary of the general terms of options to purchase common stock, RSUs and MSUs previously granted under these plans, including options outstanding and available for grant at December 31, 2012, is as follows:

	1996 Plan	2001 Plan
Requisite service period in years	4 or less	3 or less
Life in years	7 or 10	7 or 10

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Options, RSUs, and MSUs outstanding at December 31, 2012	4,583,627	65,550
Options, RSUs, and MSUs available for grant at December 31, 2012	4,953,656	

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	Options	Weighted average exercise price
Outstanding December 31, 2009	6,175,979	\$ 13.74
Granted	1,755,600	9.74
Forfeited	(605,032)	11.41
Expired	(1,006,259)	20.32
Exercised	(274,495)	8.53
Outstanding December 31, 2010	6,045,793	11.95
Granted	1,540,350	8.71
Forfeited	(764,354)	8.93
Expired	(701,082)	18.64
Exercised	(2,153,410)	7.95
Outstanding December 31, 2011	3,967,297	12.26
Granted	1,014,200	12.16
Forfeited	(150,000)	9.61
Expired	(130,958)	34.18
Exercised	(956,900)	9.43
Outstanding December 31, 2012	3,743,639	\$ 12.29
Options exercisable, December 31, 2012	2,228,437	\$ 13.33
Options exercisable and expected to vest after December 31, 2012*	3,495,256	\$ 12.39

* Options expected to vest reflect an estimated forfeiture rate.

All grants in 2012, 2011, and 2010 were made at an exercise price equal to the market price at the date of grant. Additional information regarding options outstanding for all plans as of December 31, 2012, is as follows:

Range of exercise prices	Options outstanding			Options exercisable	
	Number outstanding	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable	Weighted average exercise price

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		(yrs.)					
\$7.10	8.63	503,262	4.70	\$ 7.88	322,860	\$ 7.52	
\$8.70	8.70	200,000	5.82	8.70	200,000	8.70	
\$8.74	8.74	855,500	5.38	8.74	455,500	8.74	
\$8.80	10.78	443,400	3.84	9.63	393,239	9.64	
\$11.01	11.39	539,227	4.46	11.25	168,788	11.24	
\$11.82	12.31	423,100	5.51	12.26	63,500	12.20	
\$12.76	23.45	207,600	5.02	16.28	53,000	21.91	
\$24.29	24.29	450,000	0.01	24.29	450,000	24.29	
\$24.47	25.43	120,550	0.64	24.71	120,550	24.71	
\$27.17	27.17	1,000	0.31	27.17	1,000	27.17	
Total		3,743,639	4.19	\$ 12.29	2,228,437	\$ 13.33	

Table of Contents**BLUCORA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2012, 2011, and 2010**

Restricted stock units: Activity and weighted average grant date fair value information regarding all RSU grants are summarized as follows:

	Restricted stock	Weighted average grant date fair value
Outstanding December 31, 2009	1,578,269	\$ 8.46
Granted	1,239,959	9.92
Forfeited	(374,288)	8.81
Vested	(1,066,455)	9.01
Outstanding December 31, 2010	1,377,485	9.26
Granted	291,500	8.86
Forfeited	(377,825)	9.07
Vested	(676,680)	9.30
Outstanding December 31, 2011	614,480	9.14
Granted	656,850	13.19
Forfeited	(111,706)	9.13
Vested	(334,336)	9.12
Outstanding December 31, 2012	825,288	\$ 12.38
Expected to vest after December 31, 2012*	706,018	\$ 12.38

* RSUs expected to vest reflect an estimated forfeiture rate.

Market stock units: Activity and weighted average grant date fair value information regarding all MSU grants are summarized as follows:

	Market stock units	Weighted average grant date fair value
Outstanding December 31, 2010		\$
Granted	155,250	9.28
Forfeited	(52,750)	9.28
Outstanding December 31, 2011	102,500	9.28

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Performance adjustment	40,125		9.28
Cancelled	(22,250)		9.28
Vested	(40,125)		9.28
Outstanding December 31, 2012	80,250	\$	9.28
Expected to vest after December 31, 2012*	70,142	\$	9.28

* MSUs expected to vest reflect an estimated forfeiture rate.

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BLUCORA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2012, 2011, and 2010

Other Plans:

1998 Employee Stock Purchase Plan: The Company adopted the ESPP in August 1998. The ESPP is intended to qualify under Section 423 of the Code and permits eligible employees of the Company and its subsidiaries to purchase common stock through payroll deductions of up to 15% of their compensation. Under the ESPP, no employee may purchase common stock worth more than \$25,000 in any calendar year, valued as of the first day of each offering period. In addition, owners of 5% or more of the Company's or one of its subsidiary's common stock may not participate in the ESPP. An aggregate of 1,360,000 shares of common stock are authorized for issuance under the ESPP. The ESPP was implemented with six-month offering periods that begin on each February 1 and August 1. The price of common stock purchased under the ESPP is the lesser of 85% of the fair market value on the first day of an offering period or 85% of the fair market value on the last day of an offering period. The ESPP does not have a fixed expiration date, but may be terminated by the Company's Board of Directors at any time. There were 62,058, 54,289, and 53,596 shares issued for the ESPP periods that ended in 2012, 2011, and 2010, respectively. During the year ended December 31, 2012, financing cash generated from the purchase of shares through the ESPP amounted to \$601,000. The Company issues new shares upon purchase through the ESPP.

Stock Sale and Warrant:

On August 23, 2011, as part of a negotiated agreement, the Company added Andrew M. Snyder to its Board of Directors and entered into agreements to sell stock and issue a warrant to CIG, the investment entity that Mr. Snyder heads as President. In connection with those agreements, the details of which were disclosed under Items 1.01 and 3.02 in the Current Report on Form 8-K filed on August 23, 2011, Blucora sold to CIG 764,192 newly-issued shares of unregistered Blucora common stock at a purchase price of \$9.16 per share and issued to CIG a warrant to purchase one million shares of Blucora common stock, exercisable at a price of \$9.62 per share. The Warrant was originally scheduled to expire on August 23, 2014, but the completion of the acquisition of the TaxACT business on January 31, 2012, as discussed in Note 8, was an event under the Warrant's terms that extended the expiration date to the earlier of August 23, 2017 or the effective date of a change of control of Blucora.

Table of Contents**BLUCORA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2012, 2011, and 2010****Note 8: Stock-based Compensation Expense**

For the years ended December 31, 2012, 2011, and 2010, the Company recognized compensation expense related to stock options, RSUs and MSUs in continuing operations of \$13.2 million, \$7.7 million, and \$13.9 million, respectively. To estimate the compensation cost that was recognized for the years ended December 31, 2012, 2011, and 2010, the Company used the Black-Scholes-Merton option-pricing model with the following weighted-average assumptions for equity awards granted:

	Years ended December 31,		
	2012	2011	2010
Stock option grants:			
Risk-free interest rate	0.26% - 1.57%	0.25% - 1.58%	0.44% - 1.94%
Expected dividend yield	0%	0%	0%
Expected volatility	40% - 48%	40% - 50%	48% - 53%
Expected life	3.3 years	3.0 years	3.1 years
Non-employee stock option grant:			
Risk-free interest rate	0.26%		
Expected dividend yield	0%		
Expected volatility	38% - 41%		
Expected life	1.6 - 2.2 years		
Market stock unit grants			
Risk-free interest rate		0.15%	
Blucora expected dividend yield		0%	
iShares Russell 2000 Index expected dividend yield		1.08%	
Blucora closing stock price		\$8.74	
iShares Russell 2000 Index closing price		\$82.29	
Blucora expected volatility		37.4%	
iShares Russell 2000 Index expected volatility		20.3%	
Measurement period		1.0 years	
Warrant grant:			
Risk-free interest rate	0.68% - 0.89%	0.46%	
Expected dividend yield	0%	0%	
Expected volatility	46% - 48%	39%	
Expected life	4.6 - 5.4 years	2.0 years	

The risk-free interest rate is based on the implied yield available on U.S. Treasury issues with an equivalent remaining term. The Company paid a special dividend in January 2008, and may pay special dividends in the future, but does not expect to pay recurring dividends. The expected volatility is based on historical volatility of the Company's stock for the related expected life of the option. The expected life of the equity award is based on historical experience.

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As of December 31, 2012, total unrecognized stock-based compensation cost related to unvested stock options, unvested RSUs and unvested MSUs was \$6.2 million, based on the Company's estimate of its pre-vesting forfeiture rate. The balance at December 31, 2012 is expected to be recognized over a weighted average period of approximately 16 months. Total unrecognized stock-based compensation cost related to unvested stock options was \$1.8 million, which is expected to be recognized over a weighted average period of approximately 15 months. Total unrecognized stock-based compensation cost related to unvested RSU grants was \$4.3 million,

Table of Contents**BLUCORA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2012, 2011, and 2010**

which is expected to be recognized over a weighted average period of approximately 16 months. Total unrecognized stock-based compensation cost related to unvested MSU grants was \$133,000, which is expected to be recognized over a weighted average period of approximately 13 months.

The Company has included the following amounts for stock-based compensation cost, including the cost related to the ESPP, in the accompanying Statement of operations and comprehensive income for the years ended December 31, 2012, 2011, and 2010 (amounts in thousands):

	Years ended December 31,		
	2012	2011	2010
Cost of sales	\$ 558	\$ 286	\$ 461
Engineering and technology	1,180	821	1,298
Sales and marketing	1,909	1,002	2,631
General and administrative	9,576	5,579	9,528
Total	13,223	\$ 7,688	\$ 13,918

Financing cash flow generated by tax benefits from stock-based award activity was \$23.0 million in 2012. Excluded from the amounts recorded in the above categories of operating expense for the years ended December 31, 2012, 2011, and 2010 are the following amounts that were capitalized as part of internally developed software, and amounts that were reclassified as discontinued operations (amounts in thousands):

	Years ended December 31,		
	2012	2011	2010
Internally developed software	\$ 121	\$ 206	\$ 259
Discontinued operations		(159)	833
Total	\$ 121	\$ 47	\$ 1,092

The stock based compensation expense for year ended December 31, 2011 includes \$1.9 million fair value classified to general and administrative expenses for the Warrant issued in August 2011. The acquisition of the TaxACT business on January 31, 2012 fulfilled the Warrant agreement's remaining performance condition and extended the Warrant's expiration date. The extension of the Warrant's term was a modification that resulted in a \$4.3 million charge to stock-based compensation expense equal to the increase in the Warrant's fair value and was recognized in general and administrative expenses in the first quarter of 2012. Additionally, subsequent to the modification, the Company treated the award as a derivative instrument, and the modification date fair value previously recognized in paid in capital of \$6.2 million was classified

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as a current liability. The Warrant's fair value will be determined each reporting period until settled, with gains or losses related to the change in fair value recorded in other loss (income), net. The Warrant's fair value at December 31, 2012 is \$8.5 million and the Company recorded a loss of \$2.3 million in the year ended December 31, 2012. The Company recorded \$6.6 million in total expense relating to the modification and subsequent change in fair value for the Warrant for the year ended December 31, 2012.

In October 2011, the Company granted 200,000 stock options to a non-employee who performed acquisition-related activities, and the award's vesting was predicated on completing a qualified acquisition per the terms of the award. No expense was recognized in 2011 as a qualified acquisition did not occur. The expense for the award was recognized in 2012, due to the completion of the TaxACT acquisition on January 31, 2012,

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which, as discussed in Note 3, was considered to be a qualifying acquisition. The modification of the award resulted in a charge to stock-based compensation expense in 2012 of \$914,000.

In May 2012, the Company granted 190,000 performance-based stock options to certain employees who perform acquisition-related activities, and the awards vestings are predicated on completing qualified acquisitions per the terms of the awards. No expense was recognized in 2012, as a qualified acquisition did not occur.

Stock-based compensation expense recognized during the years ended December 31, 2012, 2011, and 2010 is based on the grant date fair values estimated using the Black-Scholes-Merton option pricing model for options granted, the fair value at date of grant for RSUs and the Monte Carlo valuation method for the MSU grants. The Company has historically disclosed and currently recognizes stock-based compensation expense over the vesting period for each separately vesting portion of a share-based award as if they were, in substance, individual share-based awards. The Company estimates forfeitures at the time of grant and revises those estimates, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The weighted average fair value for options granted in the years ended December 31, 2012, 2011, and 2010 was \$3.84, \$2.80, and \$3.47 per share, respectively. The Company issues new shares upon exercise of options to purchase common stock and vesting of RSUs.

The total intrinsic value of RSUs vested, MSUs vested, options exercised, and shares purchased pursuant to the ESPP during the years ended December 31, 2012, 2011, and 2010 is supplemental information for the consolidated statements of cash flows and is presented below (amounts in thousands):

	Years ended December 31,		
	2012	2011	2010
RSUs vested	\$ 4,663	\$ 5,945	\$ 10,097
MSUs vested	\$ 511	\$	\$
Options exercised	\$ 3,886	\$ 2,474	\$ 436
Shares purchased pursuant to ESPP	\$ 277	\$ 100	\$ 107

Awards outstanding at December 31, 2012 have the following total intrinsic value and weighted average remaining contractual terms:

	Outstanding at December 31, 2012	Intrinsic value (in thousands)	Weighted average remaining contractual term (in years)
Options outstanding	3,743,639	\$ 18,126	4.2
Options exercisable and outstanding	2,228,437	\$ 10,585	3.4
Restricted stock units outstanding	825,288	\$ 12,965	1.0
Market stock units outstanding	80,250	\$ 1,261	0.9

Options vested and outstanding at December 31, 2012 and expected to vest in the future, based on the Company's estimate of its pre-vesting forfeiture rate, have an intrinsic value of \$16.9 million and weighted average remaining contractual term of 4.1 years. RSUs expected to vest after December 31, 2012, based on the Company's estimate of its pre-vesting forfeiture rate, have an intrinsic value of \$11.1 million and weighted average remaining contractual term of 11 months. MSUs expected to vest after December 31, 2012, based on the Company's estimate of its pre-vesting forfeiture rate, have an intrinsic value of \$1.1 million and weighted average remaining contractual term of 10 months. Cash generated from the exercise of stock options amounted to \$9.1 million for the year ended December 31, 2012.

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BLUCORA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2012, 2011, and 2010

Note 9: Commitments and Contingencies

The Company has noncancellable operating leases for its corporate facilities. The leases run through 2020. Rent expense under operating leases totaled \$1.8 million, \$1.8 million, and \$1.3 million for the years ended December 31, 2012, 2011, and 2010, respectively.

The Company's debt commitments are included in the Company's consolidated balance sheets. The Company's contractual commitments are as follows for the following years ending December 31 (in thousands):

	2013	2014	2015	2016	2017	Thereafter	Total
Operating lease commitments	\$ 919	\$ 1,770	\$ 1,599	\$ 1,222	\$ 1,259	\$ 3,649	\$ 10,418
Less sublease income	(36)						(36)
Net lease payments required	883	1,770	1,599	1,222	1,259	3,649	10,382
Purchase commitments	1,272	581	423	92	61		2,429
Debt commitments	4,750	9,500	13,062	14,250	32,934		74,496
Total	\$ 6,905	\$ 11,851	\$ 15,084	\$ 15,564	\$ 34,254	\$ 3,649	\$ 87,307

Purchase commitments. The Company's purchase commitments are primarily comprised of non-cancelable service agreements for its data centers.

The Company has pledged a portion of its cash as collateral for standby letters of credit and bank guaranties for certain of its property leases and banking arrangements. At December 31, 2012, the total amount of collateral pledged under these agreements was \$3.4 million.

The above table does not reflect unrecognized tax benefits of approximately \$1.2 million, the timing of which is uncertain. For additional discussion on unrecognized tax benefits see Note 12.

Debt commitments: The Company's debt commitments consist of the minimum scheduled loan payments related to the credit facility that 2nd Story entered into to help finance the acquisition of the TaxACT business. 2nd Story may repay the amounts outstanding under the credit facility

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before its term is complete, depending on the cash generated by the TaxACT business's operations.

Off-balance sheet arrangements. The Company has no off-balance sheet arrangements other than operating leases. The Company does not believe that these operating leases are material to its current or future financial position, results of operations, revenues or expenses, liquidity, capital expenditures or capital resources.

Litigation

From time to time the Company is subject to various legal proceedings or claims that arise in the ordinary course of business. Although the Company cannot predict the outcome of these matters with certainty, the Company's management does not believe that the disposition of these ordinary course matters will have a material adverse effect on the Company's financial position, results of operations or cash flows.

Note 10: Debt

On January 31, 2012 in conjunction with closing the Company's acquisition of the TaxACT business, ²¹ Story entered into an agreement with a syndicate of lenders for a \$105 million credit facility, consisting of \$95

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BLUCORA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2012, 2011, and 2010

million term loan and up to \$10 million under a revolving credit facility. 2nd Story's obligations under the credit agreement are guaranteed by TaxACT Holdings, a direct subsidiary of the Company and the direct parent of 2nd Story, and are secured by the assets of the TaxACT business and the 2nd Story equity owned by TaxACT Holdings. On January 31, 2012, 2nd Story borrowed \$95 million of term debt and \$5 million under the revolving credit facility.

The \$95 million term loan requires quarterly principal payments and matures on January 31, 2017. See the loan repayment schedule in Note 9. The interest rate on amounts borrowed under the term loan and the revolving loan is variable and payable as of the end of each interest period or, if more frequent, quarterly, based upon, at the election of 2nd Story, the Alternate Base Rate or the LIBOR Rate, plus the Applicable Margin (as such terms are defined in the credit agreement). The Applicable Margin is dependent on the consolidated Total Leverage Ratio (as defined in the credit agreement) of TaxACT Holdings and ranges from 2.0% to 3.5% for borrowings tied to the Alternative Base Rate and 3.0% to 4.5% for borrowings tied to the LIBOR Rate.

A portion of any excess cash flows, as the term is defined in the credit agreement, must be used to make a mandatory prepayment on the term loan within ninety days of June 30, 2013 and thereafter within 90 days of June 30th in succeeding years in the event that the leverage ratio is more than two-to-one on June 30th of that year. Amounts outstanding under the term loan may be prepaid without penalty. In 2012, 2nd Story repaid \$25.5 million of the debt, including the balance of revolving credit facility. The remaining amount of debt outstanding under the term loan as of December 31, 2012 was \$74.5 million. The credit agreement covenants limit 2nd Story and its parent, TaxACT Holdings, from, in certain circumstances, incurring additional indebtedness, incurring liens, paying dividends to the Company, making capital expenditures over stipulated maximums, allowing the consolidated Total Leverage Ratio (as defined in the credit agreement) to exceed stipulated levels over the debt term, and allowing the Fixed Charge Coverage Ratio to be less than stipulated levels.

As of December 31, 2012, the term loan's gross carrying value of \$74.5 million approximates its fair value as it is a variable rate instrument and the current applicable margin approximates current market conditions.

Additionally, the Company was required to hedge a portion of the interest rate risk associated with the term debt 90 days after its inception, and that requirement was met on May 1, 2012 by the purchase of an interest rate swap with a financial institution which fixed the LIBOR Rate portion at 0.85% for \$37.5 million of the amount outstanding under the term loan. The swap's terms are scheduled to fix the interest rate on a declining amount outstanding under the term loan, approximating half of the debt balance, until the credit agreement's termination on January 31, 2017.

Note 11: Derivative Instruments and Hedging Activities

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During 2012, the interest rate swap purchased by 2nd Story, as further described in Note 10, was intended to reduce the risk that the Company's cash flows and earnings would be adversely affected by interest rate fluctuations. The Company recognizes derivative instruments as either assets or liabilities on its consolidated balance sheets at fair value. The Company records changes in the fair value of the derivative instruments as gains or losses in the consolidated statements of comprehensive income in other loss (income), net, or to accumulated other comprehensive income in the consolidated balance sheets.

Table of Contents**BLUCORA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2012, 2011, and 2010**

The fair values of outstanding derivative instruments were as follows (in thousands):

	Balance Sheet Location	As of December 31, 2012
Derivative liabilities		
Derivative designated as a hedging instrument:		
Interest rate contract (interest rate swap)	Current liabilities - derivative instruments	\$ 410
Derivative not designated as a hedging instrument:		
Equity contract (the Warrant)	Current liabilities - derivative instruments	8,564
		\$ 8,974

The derivative instrument in a hedging relationship had no effect on income for any and all periods presented, as it did not have any hedging ineffectiveness. The effect of the derivative instrument not designated as hedging instruments on income is summarized below for the year ended December 31, 2012 (in thousands):

Derivative not designated as hedging instrument	Location	Loss recognized in other loss (income), net
Equity contract (the Warrant)	Other loss (income), net	\$ 2,346

Note 12: Income Taxes

Income tax expense (benefit) from continuing operations consists of the following for the years ended December 31, 2012, 2011, and 2010 (in thousands):

	Years ended December 31,		
	2012	2011	2010
Current			

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U.S. federal	\$ 23,303	\$ 7,416	\$ 9,010
State	437	166	(316)
Foreign			12
Total current benefit	\$ 23,740	\$ 7,582	\$ 8,706
Deferred			
U.S. federal	\$ (8,234)	\$ (18,654)	\$ 19
State	(504)	(216)	
Total deferred expense (benefit)	(8,738)	(18,870)	19
Income tax expense (benefit), net	\$ 15,002	\$ (11,288)	\$ 8,725

Table of Contents**BLUCORA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2012, 2011, and 2010**

The income tax expense (benefit) from continuing operations differs from the amount computed by applying the statutory federal income tax rate for the years ended December 31, 2012, 2011, and 2010 as follows (in thousands):

	Years ended December 31,		
	2012	2011	2010
Income tax expense at federal statutory rate of 35%	\$ 13,135	\$ 7,082	\$ 6,299
Nondeductible compensation	1,621	675	
Deductible domestic production costs	(804)		
Nondeductible loss on derivative instrument	821		
Foreign exchange gain			(516)
Change in liabilities for uncertain tax positions	(75)	79	(566)
Change in valuation allowance		(19,272)	3,235
Other	304		