

Synacor, Inc.  
Form 10-Q  
August 13, 2013  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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FORM 10-Q

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

For the quarterly period ended June 30, 2013

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 001-33843

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

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|                                                                   |                                         |
|-------------------------------------------------------------------|-----------------------------------------|
| Delaware                                                          | 16-1542712                              |
| (State or other jurisdiction of<br>incorporation or organization) | (I.R.S. Employer<br>Identification No.) |
| 40 La Riviere Drive, Suite 300                                    | 14202                                   |
| Buffalo, New York                                                 | (Zip Code)                              |
| (Address of principal executive offices)                          |                                         |
| (716) 853-1362                                                    |                                         |
| (Registrant's telephone number, including area code)              |                                         |

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

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

|                         |                                                                                |                           |                       |
|-------------------------|--------------------------------------------------------------------------------|---------------------------|-----------------------|
| Large accelerated filer | <input type="radio"/>                                                          | Accelerated filer         | <input type="radio"/> |
| Non-accelerated filer   | <input checked="" type="radio"/> (Do not check if a smaller reporting company) | Smaller Reporting Company | <input type="radio"/> |

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

As of July 31, 2013, there were 27,329,886 shares of the registrant’s common stock outstanding. All share and per share amounts in this Quarterly Report on Form 10-Q reflect the 1-for-2 reverse stock split of the registrant’s common stock which took effect immediately prior to the effectiveness of the registration statement for the registrant’s initial public offering.

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## PART I — FINANCIAL INFORMATION

## Item 1. Financial Statements

## SYNACOR, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS—UNAUDITED

AS OF DECEMBER 31, 2012 AND JUNE 30, 2013

(In thousands except for share and per share data)

|                                                                                                                                                                                                                                   | December 31,<br>2012 | June 30,<br>2013 |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------|------------------|
| ASSETS                                                                                                                                                                                                                            |                      |                  |
| CURRENT ASSETS:                                                                                                                                                                                                                   |                      |                  |
| Cash and cash equivalents                                                                                                                                                                                                         | \$41,944             | \$37,742         |
| Accounts receivable—net of allowance of \$25 and \$46                                                                                                                                                                             | 15,624               | 15,346           |
| Deferred income taxes                                                                                                                                                                                                             | 1,999                | 945              |
| Prepaid expenses and other current assets                                                                                                                                                                                         | 1,831                | 1,936            |
| Total current assets                                                                                                                                                                                                              | 61,398               | 55,969           |
| PROPERTY AND EQUIPMENT—Net                                                                                                                                                                                                        | 11,043               | 11,836           |
| DEFERRED INCOME TAXES, NON-CURRENT                                                                                                                                                                                                | 2,527                | 3,779            |
| OTHER LONG-TERM ASSETS                                                                                                                                                                                                            | 543                  | 560              |
| GOODWILL                                                                                                                                                                                                                          | 819                  | 819              |
| TOTAL ASSETS                                                                                                                                                                                                                      | \$76,330             | \$72,963         |
| LIABILITIES AND STOCKHOLDERS' EQUITY                                                                                                                                                                                              |                      |                  |
| CURRENT LIABILITIES:                                                                                                                                                                                                              |                      |                  |
| Accounts payable                                                                                                                                                                                                                  | \$14,204             | \$12,793         |
| Accrued expenses and other current liabilities                                                                                                                                                                                    | 7,328                | 5,866            |
| Current portion of capital lease obligations                                                                                                                                                                                      | 2,127                | 1,905            |
| Total current liabilities                                                                                                                                                                                                         | 23,659               | 20,564           |
| LONG-TERM PORTION OF CAPITAL LEASE OBLIGATIONS                                                                                                                                                                                    | 1,712                | 795              |
| OTHER LONG-TERM LIABILITIES                                                                                                                                                                                                       | 148                  | 177              |
| Total liabilities                                                                                                                                                                                                                 | 25,519               | 21,536           |
| COMMITMENTS AND CONTINGENCIES (Note 5)                                                                                                                                                                                            |                      |                  |
| STOCKHOLDERS' EQUITY:                                                                                                                                                                                                             |                      |                  |
| Preferred stock, \$0.01 par value—10,000,000 shares authorized, no shares issued and outstanding at December 31, 2012 and June 30, 2013                                                                                           | —                    | —                |
| Common stock, \$0.01 par value—100,000,000 shares authorized, 27,517,665 issued and 27,198,165 outstanding at December 31, 2012, and 100,000,000 authorized, 27,641,886 issued and 27,322,386 shares outstanding at June 30, 2013 | 275                  | 276              |
| Treasury stock—at cost, 319,500 shares at December 31, 2012 and June 30, 2013                                                                                                                                                     | (569)                | (569)            |
| Additional paid-in capital                                                                                                                                                                                                        | 99,449               | 100,764          |
| Accumulated deficit                                                                                                                                                                                                               | (48,338)             | (48,948)         |
| Accumulated other comprehensive income (loss)                                                                                                                                                                                     | (6)                  | 1                |
| Total Synacor, Inc. stockholders' equity                                                                                                                                                                                          | 50,811               | 51,524           |
| Noncontrolling interests                                                                                                                                                                                                          | —                    | (97)             |
| Total equity                                                                                                                                                                                                                      | 50,811               | 51,427           |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY                                                                                                                                                                                        | \$76,330             | \$72,963         |

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



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## SYNACOR, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS—UNAUDITED  
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2012 AND 2013

(In thousands except for share and per share data)

|                                                                               | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|-------------------------------------------------------------------------------|--------------------------------|------------|------------------------------|------------|
|                                                                               | 2012                           | 2013       | 2012                         | 2013       |
| REVENUE                                                                       | \$30,807                       | \$26,708   | \$61,477                     | \$55,851   |
| COSTS AND OPERATING EXPENSES:                                                 |                                |            |                              |            |
| Cost of revenue (exclusive of depreciation shown separately below)            | 16,876                         | 14,017     | 33,640                       | 29,781     |
| Research and development (exclusive of depreciation shown separately below)   | 6,123                          | 7,336      | 12,411                       | 14,201     |
| Sales and marketing                                                           | 2,399                          | 2,147      | 4,776                        | 4,277      |
| General and administrative (exclusive of depreciation shown separately below) | 2,868                          | 2,957      | 5,708                        | 6,101      |
| Depreciation                                                                  | 934                            | 1,138      | 1,715                        | 2,268      |
| Total costs and operating expenses                                            | 29,200                         | 27,595     | 58,250                       | 56,628     |
| INCOME (LOSS) FROM OPERATIONS                                                 | 1,607                          | (887 )     | 3,227                        | (777 )     |
| OTHER EXPENSE                                                                 | (18 )                          | (8 )       | (18 )                        | (15 )      |
| INTEREST EXPENSE                                                              | (89 )                          | (43 )      | (136 )                       | (101 )     |
| INCOME (LOSS) BEFORE INCOME TAXES                                             | 1,500                          | (938 )     | 3,073                        | (893 )     |
| PROVISION (BENEFIT) FOR INCOME TAXES                                          | 301                            | (204 )     | 700                          | (186 )     |
| NET INCOME (LOSS)                                                             | 1,199                          | (734 )     | 2,373                        | (707 )     |
| Net loss attributable to noncontrolling interests                             | —                              | 97         | —                            | 97         |
| NET INCOME (LOSS) ATTRIBUTABLE TO SYNACOR, INC.                               | \$1,199                        | \$(637 )   | \$2,373                      | \$(610 )   |
| NET INCOME (LOSS) ATTRIBUTABLE TO SYNACOR, INC. PER SHARE:                    |                                |            |                              |            |
| Basic                                                                         | \$0.04                         | \$(0.02 )  | \$0.11                       | \$(0.02 )  |
| Diluted                                                                       | \$0.04                         | \$(0.02 )  | \$0.08                       | \$(0.02 )  |
| WEIGHTED AVERAGE SHARES USED TO COMPUTE NET INCOME (LOSS) PER SHARE:          |                                |            |                              |            |
| Basic                                                                         | 27,212,105                     | 27,311,892 | 21,907,842                   | 27,273,671 |
| Diluted                                                                       | 29,592,108                     | 27,311,892 | 28,261,882                   | 27,273,671 |

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

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## SYNACOR, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)—UNAUDITED  
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2012 AND 2013

(In thousands)

|                                                                   | Three Months Ended<br>June 30, |         |   | Six Months Ended<br>June 30, |         |   |
|-------------------------------------------------------------------|--------------------------------|---------|---|------------------------------|---------|---|
|                                                                   | 2012                           | 2013    |   | 2012                         | 2013    |   |
| Net income (loss)                                                 | \$1,199                        | \$(734) | ) | \$2,373                      | \$(707) | ) |
| Other comprehensive income:                                       |                                |         |   |                              |         |   |
| Change in foreign currency translation adjustment                 | 9                              | 1       |   | 9                            | 7       |   |
| Comprehensive income (loss)                                       | 1,208                          | (733)   | ) | 2,382                        | (700)   | ) |
| Less: comprehensive loss attributable to noncontrolling interests | —                              | 97      |   | —                            | 97      |   |
| Comprehensive income (loss) attributable to Synacor, Inc.         | \$1,208                        | \$(636) | ) | \$2,382                      | \$(603) | ) |

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

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## SYNACOR, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS—UNAUDITED

FOR THE SIX MONTHS ENDED JUNE 30, 2012 AND 2013

(In thousands)

|                                                                                                    | Six Months Ended<br>June 30, |                 |
|----------------------------------------------------------------------------------------------------|------------------------------|-----------------|
|                                                                                                    | 2012                         | 2013            |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                                       |                              |                 |
| Net income (loss)                                                                                  | \$2,373                      | \$(707)         |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: |                              |                 |
| Depreciation                                                                                       | 1,715                        | 2,268           |
| Stock-based compensation expense                                                                   | 983                          | 1,179           |
| Deferred income taxes                                                                              | 616                          | (198)           |
| Change in assets and liabilities, net of effect of acquisition:                                    |                              |                 |
| Accounts receivable, net                                                                           | (1,171)                      | ) 278           |
| Prepaid expenses and other current assets                                                          | (528)                        | ) (105)         |
| Other long-term assets                                                                             | 120                          | (17)            |
| Accounts payable                                                                                   | 782                          | (1,657)         |
| Accrued expenses and other current liabilities                                                     | (155)                        | ) (1,269)       |
| Other long-term liabilities                                                                        | 64                           | 29              |
| Net cash provided by (used in) operating activities                                                | 4,799                        | (199)           |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                                       |                              |                 |
| Purchases of property and equipment                                                                | (2,040)                      | ) (2,502)       |
| Cash paid for business acquisition                                                                 | (600)                        | ) (500)         |
| Net cash used in investing activities                                                              | (2,640)                      | ) (3,002)       |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                                       |                              |                 |
| Repayment on bank financing                                                                        | (250)                        | ) —             |
| Repayments on capital lease obligations                                                            | (1,035)                      | ) (1,139)       |
| Proceeds from exercise of common stock options                                                     | 639                          | 131             |
| Proceeds from initial public offering                                                              | 25,364                       | —               |
| Initial public offering costs                                                                      | (2,753)                      | ) —             |
| Net cash provided by (used in) financing activities                                                | 21,965                       | (1,008)         |
| Effect of exchange rate changes on cash and cash equivalents                                       | 9                            | 7               |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>                                        | <b>24,133</b>                | <b>(4,202)</b>  |
| <b>CASH AND CASH EQUIVALENTS—Beginning of period</b>                                               | <b>10,925</b>                | <b>41,944</b>   |
| <b>CASH AND CASH EQUIVALENTS—End of period</b>                                                     | <b>\$35,058</b>              | <b>\$37,742</b> |
| <b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>                                          |                              |                 |
| Cash paid for interest                                                                             | \$121                        | \$91            |
| Cash paid for income taxes                                                                         | 83                           | 138             |
| <b>SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING TRANSACTIONS:</b>                  |                              |                 |
| Property and equipment acquired under capital lease obligations                                    | \$2,484                      | \$—             |
| Accrued business acquisition consideration                                                         | 500                          | —               |
| Accrued property and equipment expenditures                                                        | 152                          | 822             |

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





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SYNACOR, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—UNAUDITED

AS OF DECEMBER 31, 2012 AND JUNE 30, 2013, AND

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2012 AND 2013

(In thousands except for share and per share data)

1. The Company and Summary of Significant Accounting Policies

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

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

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

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

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

Concentrations of Risk — As of December 31, 2012 and June 30, 2013, and for the three and six months ended June 30, 2012 and 2013, the Company had concentrations equal to or exceeding 10% of the Company's accounts receivable and revenue as follows:

| Accounts Receivable  |                  |
|----------------------|------------------|
| December 31,<br>2012 | June 30,<br>2013 |

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|            |     |   |    |   |
|------------|-----|---|----|---|
| Google     | 40  | % | 30 | % |
| Customer A | N/A |   | 16 |   |

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|        | Revenue            |      |   |  | Six Months Ended |      |   |  |
|--------|--------------------|------|---|--|------------------|------|---|--|
|        | Three Months Ended |      |   |  | June 30,         |      |   |  |
|        | 2012               | 2013 |   |  | 2012             | 2013 |   |  |
| Google | 56                 | % 51 | % |  | 59               | % 53 | % |  |

For the three and six months ended June 30, 2012 and 2013, the following customers received revenue-share payments equal to or exceeding 10% of the Company's cost of revenue. The costs represent revenue share paid to them for their supply of Internet traffic on the Company's startpages.

|            | Cost of Revenue    |      |   |  | Six Months Ended |      |   |  |
|------------|--------------------|------|---|--|------------------|------|---|--|
|            | Three Months Ended |      |   |  | June 30,         |      |   |  |
|            | 2012               | 2013 |   |  | 2012             | 2013 |   |  |
| Customer A | 20                 | % 20 | % |  | 20               | % 20 | % |  |
| Customer B | 17                 | 13   |   |  | 17               | 14   |   |  |
| Customer C | 13                 | 10   |   |  | 13               | 12   |   |  |
| Customer D | 12                 | 11   |   |  | 12               | 12   |   |  |

**Fair Value Measurements** — The provisions of the Financial Accounting Standards Board (“FASB”) Accounting Standard Codification (“ASC”) 820, Fair Value Measurements and Disclosures, establish a framework for measuring the fair value in accounting principles generally accepted in the U.S. and establish a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value as follows:

Level 1 — Level 1 inputs are defined as observable inputs such as quoted prices in active markets.

Level 2 — Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (interest rates, yield curves, etc.), and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).

Level 3 — Level 3 inputs are unobservable inputs that reflect the Company's determination of assumptions that market participants would use in pricing the asset or liability. These inputs are developed based on the best information available, including the Company's own data.

**Acquisition** — In January 2012, the Company acquired the assets of Carbyn, Inc., or Carbyn, an Ontario, Canada-based company. The assets acquired are principally comprised of mobile device software and technology and other intellectual property, which the Company expects to enhance its efforts in the development of next generation web applications for

mobile devices. The aggregate purchase price was up to \$1,100 for the acquired assets, of which \$600 was paid upon consummation of the acquisition and the remaining \$500 was paid in April 2013. In addition, the Company hired seven employees from Carbyn who have accepted employment with Synacor Canada, Inc., a newly-formed and wholly-owned subsidiary of the Company. The acquisition and its impact on the consolidated financial statements are not material. The purchase price was allocated to the assets acquired based on their respective fair values as of the acquisition date, with the amount exceeding the fair value recorded as goodwill of \$819.

**Joint Venture**—In March 2013, the Company entered into a Joint Venture Agreement, pursuant to which it will initially own 50% of the newly formed Synacor China, Ltd, or the JV Company. In July 2013 the Company provided \$400 in initial funding and has agreed to provide up to \$1,600 in additional funding to the JV Company over the next two years. Subject to the completion of customary regulatory requirements, the JV Company will, through a wholly foreign-owned subsidiary in the People's Republic of China (the “PRC”), supply authentication and aggregation solutions for the delivery of online content and services to customers in the PRC.

The noncontrolling interests in the condensed consolidated financial statements represent the noncontrolling holders' percentage share of income or losses of the JV Company.

Subsequent Event—In July 2013 the Company made a \$1,000 investment (in the form of a convertible promissory note) in a privately held Delaware corporation called Blazer and Flip Flops, Inc., or B&FF (doing business as The Experience

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Engine). B&FF is a professional services company whose principals have experience integrating its customers systems with their consumers' devices, including smartphones and tablets. B&FF has customers in the U.S., Europe and Asia.

## 2. Property and Equipment—Net

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

|                                   | December 31,<br>2012 | June 30,<br>2013 |
|-----------------------------------|----------------------|------------------|
| Computer equipment (1)            | \$17,630             | \$18,167         |
| Computer software                 | 3,715                | 4,248            |
| Furniture and fixtures            | 1,050                | 1,071            |
| Leasehold improvements            | 732                  | 737              |
| Work in process (2)               | 226                  | 2,072            |
| Other                             | 173                  | 173              |
|                                   | 23,526               | 26,468           |
| Less accumulated depreciation (3) | (12,483)             | (14,632)         |
| Total property and equipment—net  | \$11,043             | \$11,836         |

Notes:

- (1) Includes equipment under capital lease obligations of approximately \$5,882 and \$5,229 as of December 31, 2012 and June 30, 2013, respectively.
- (2) Includes internal-use software development costs of \$40 and \$1,865 as of December 31, 2012 and June 30, 2013, respectively.
- (3) Includes \$1,834 and \$1,990 of accumulated depreciation of equipment under capital leases as of December 31, 2012 and June 30, 2013, respectively.

## 3. Accrued Expenses and Other Current Liabilities

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

|                                             | December 31,<br>2012 | June 30,<br>2013 |
|---------------------------------------------|----------------------|------------------|
| Accrued compensation                        | \$4,265              | \$2,515          |
| Accrued content fees                        | 555                  | 953              |
| Accrued property and equipment expenditures | 132                  | 439              |
| Accrued business acquisition consideration  | 500                  | —                |
| Unearned revenue on contracts               | 297                  | 554              |
| Other                                       | 1,579                | 1,405            |
| Total                                       | \$7,328              | \$5,866          |

## 4. Information About Segment and Geographic Areas

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

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|                                  | Three Months Ended |          | Six Months Ended |          |
|----------------------------------|--------------------|----------|------------------|----------|
|                                  | June 30,           |          | June 30,         |          |
|                                  | 2012               | 2013     | 2012             | 2013     |
| Revenue                          |                    |          |                  |          |
| United States                    | \$30,641           | \$26,531 | \$61,155         | \$55,497 |
| United Kingdom                   | 166                | 177      | 322              | 354      |
| Total revenue                    | \$30,807           | \$26,708 | \$61,477         | \$55,851 |
|                                  |                    |          | December 31,     | June 30, |
|                                  |                    |          | 2012             | 2013     |
| Long-lived tangible assets       |                    |          |                  |          |
| United States                    |                    |          | \$10,638         | \$11,532 |
| Netherlands                      |                    |          | 405              | 304      |
| Total long-lived tangible assets |                    |          | \$11,043         | \$11,836 |

## 5. Commitments and Contingencies

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

Contract Commitments — The Company is obligated to make payments under various contracts with vendors and other business partners, principally for revenue-share and content arrangements. Contract commitments as of June 30, 2013 are summarized as follows (in thousands):

Year ending December 31:

|                             |         |
|-----------------------------|---------|
| 2013 (remaining six months) | \$2,462 |
| 2014                        | 1,419   |
| 2015                        | 1,080   |
| 2016                        | 1,080   |
| 2017                        | 360     |
| Due after 5 years           | —       |
| Total contract commitments  | \$6,401 |

## 6. Equity

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

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

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

## 7. Stock-based Compensation





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The Company recorded \$425 and \$617 of stock-based compensation expense for the three months ended June 30, 2012 and 2013, respectively. Stock-based compensation expense for the six months ended June 30, 2012 and 2013, was \$983 and \$1,179, respectively. No income tax deduction is allowed for incentive stock options, or ISOs. Accordingly, no deferred income tax asset is recorded for the expense related to these options. Stock option grants of non-qualified stock options, or NQSOs, result in the creation of a deferred tax asset, which is a temporary difference, until the time that the option is exercised.

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

|                                        | Three Months Ended<br>June 30, |       | Six Months Ended<br>June 30, |         |
|----------------------------------------|--------------------------------|-------|------------------------------|---------|
|                                        | 2012                           | 2013  | 2012                         | 2013    |
| Research and development               | \$ 120                         | \$281 | \$227                        | \$542   |
| Sales and marketing                    | 99                             | 76    | 173                          | 152     |
| General and administrative             | 206                            | 260   | 583                          | 485     |
| Total stock-based compensation expense | \$425                          | \$617 | \$983                        | \$1,179 |

Stock Option Activity —A summary of the stock option activity for the six months ended June 30, 2013 is presented below:

|                                           | Number of<br>Stock<br>Options | Weighted<br>Average<br>Exercise<br>Price | Aggregate<br>Intrinsic Value<br>(in thousands) | Weighted<br>Average<br>Remaining<br>contractual<br>Term (in<br>years) |
|-------------------------------------------|-------------------------------|------------------------------------------|------------------------------------------------|-----------------------------------------------------------------------|
| Outstanding—January 1, 2013               | 4,510,807                     | \$4.06                                   |                                                |                                                                       |
| Granted                                   | 1,091,750                     | 3.67                                     |                                                |                                                                       |
| Exercised                                 | (124,221 )                    | 1.07                                     |                                                |                                                                       |
| Forfeited                                 | (73,702 )                     | 8.39                                     |                                                |                                                                       |
| Outstanding—June 30, 2013                 | 5,404,634                     | 3.95                                     | \$ 1,914                                       | 7.63                                                                  |
| Vested and expected to vest—June 30, 2013 | 4,943,064                     | 3.87                                     | \$ 2,047                                       | 7.50                                                                  |
| Vested and exercisable—June 30, 2013      | 2,327,257                     | 2.82                                     | \$ 2,800                                       | 5.82                                                                  |

Aggregate intrinsic value represents the difference between the Company's closing stock price of its common stock and the exercise price of outstanding, in-the-money options. The Company's closing stock price as reported on the NASDAQ as of June 30, 2013 was \$3.10. The total intrinsic value of options exercised was approximately \$30 and \$252 for the three and six months ended June 30, 2013, respectively.

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

| Grant Date       | Options<br>Granted | Weighted-<br>Average<br>Exercise<br>Price | Expected<br>Life of<br>Options<br>(In years) | Risk-Free<br>Interest<br>Rate | Expected<br>Volatility | Expected<br>Dividend<br>Yield |   |
|------------------|--------------------|-------------------------------------------|----------------------------------------------|-------------------------------|------------------------|-------------------------------|---|
| February 3, 2013 | 44,500             | \$5.55                                    | 6.25                                         | 1.43                          | % 61                   | % —                           | % |
| March 11, 2013   | 50,500             | \$3.12                                    | 6.25                                         | 1.43                          | % 60                   | % —                           | % |
| April 29, 2013   | 62,500             | \$2.88                                    | 6.25                                         | 1.10                          | % 60                   | % —                           | % |
| May 16, 2013     | 889,250            | \$3.68                                    | 6.25                                         | 1.25                          | % 60                   | % —                           | % |
| June 17, 2013    | 45,000             | \$3.23                                    | 6.25                                         | 1.57                          | % 60                   | % —                           | % |

As of June 30, 2013, the unrecognized compensation cost related to non-vested options granted, for which vesting is probable, under the plan was approximately \$6,483. This cost is expected to be recognized over a weighted-average period of 3.0 years. The total fair value of shares vested was \$419 and \$696 for the three and six months ended

June 30, 2013, respectively.

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RSU Activity—A summary of RSU activity for the six months ended June 30, 2013, is as follows:

|                                | Number of<br>Shares | Weighted-Average<br>Grant Date Fair<br>Value |
|--------------------------------|---------------------|----------------------------------------------|
| Unvested - January 1, 2013     | 50,000              | \$5.82                                       |
| Granted                        | 7,500               | 3.86                                         |
| Released                       | —                   | —                                            |
| Forfeited                      | —                   | —                                            |
| Unvested - June 30, 2013       | 57,500              | \$5.54                                       |
| Expected to vest—June 30, 2013 | 48,875              | \$5.54                                       |

As of June 30, 2013, total unrecognized compensation cost, adjusted for estimated forfeitures, related to RSUs was approximately \$239, which is expected to be recognized over the next 3.51 years.

#### 8. Net Income (Loss) Per Common Share Data

Basic net income (loss) per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per share is computed using the weighted-average number of common shares and, if dilutive, potential common shares outstanding during the period. The Company's potential common shares consist of the incremental common shares issuable upon the exercise of stock options, and to a lesser extent, shares issuable upon the release of RSUs. In addition, for the six months ended June 30, 2012, the potential common shares included the conversion of preferred stock on an as if converted basis prior to the Company's initial public offering in February 2012. The dilutive effect of these potential common shares is reflected in diluted earnings per share by application of the treasury stock method.

The following table presents the calculation of basic and diluted net income (loss) per share for the three and six month periods ended June 30, 2012 and 2013 (in thousands, except share and per share amounts):

|                                                       | Three Months Ended,<br>June 30, |            | Six Months Ended,<br>June 30, |            |
|-------------------------------------------------------|---------------------------------|------------|-------------------------------|------------|
|                                                       | 2012                            | 2013       | 2012                          | 2013       |
| Basic net income (loss) per share:                    |                                 |            |                               |            |
| Numerator:                                            |                                 |            |                               |            |
| Net income (loss)                                     | \$1,199                         | \$(637 )   | \$2,373                       | \$(610 )   |
| Denominator:                                          |                                 |            |                               |            |
| Weighted-average common shares outstanding            | 27,212,105                      | 27,311,892 | 21,907,842                    | 27,273,671 |
| Basic net income (loss) per share                     | \$0.04                          | \$(0.02 )  | \$0.11                        | \$(0.02 )  |
| Diluted net income (loss) per share:                  |                                 |            |                               |            |
| Numerator:                                            |                                 |            |                               |            |
| Net income (loss)                                     | \$1,199                         | \$(637 )   | \$2,373                       | \$(610 )   |
| Denominator:                                          |                                 |            |                               |            |
| Number of shares used in basic calculation            | 27,212,105                      | 27,311,892 | 21,907,842                    | 27,273,671 |
| Add weighted-average effect of dilutive securities:   |                                 |            |                               |            |
| Conversion of preferred stock (as if converted basis) | —                               | —          | 3,918,684                     | —          |
| Employee stock options and RSUs                       | 2,380,003                       | —          | 2,435,356                     | —          |
| Number of shares used in diluted calculation          | 29,592,108                      | 27,311,892 | 28,261,882                    | 27,273,671 |
| Diluted net income (loss) per share                   | \$0.04                          | \$(0.02 )  | \$0.08                        | \$(0.02 )  |

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

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|                             | Three Months Ended,<br>June 30, |           | Six Months Ended,<br>June 30, |           |
|-----------------------------|---------------------------------|-----------|-------------------------------|-----------|
|                             | 2012                            | 2013      | 2012                          | 2013      |
| Antidilutive equity awards: |                                 |           |                               |           |
| Stock options and RSUs      | 86,500                          | 5,462,134 | 86,500                        | 5,462,134 |
| * * * * *                   |                                 |           |                               |           |

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

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

#### Overview

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

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

For the three and six months ended June 30, 2013, search and display advertising revenue was \$21.4 million and \$45.5 million, a decrease of 16% and 11% compared to \$25.4 million and \$51.2 million for the three and six months ended June 30, 2012. Over the same periods, our unique visitors decreased by 1% and 3%, our search queries decreased by 26% and 24% and our advertising impressions remained the same and increased by 16%. Search revenue decreased by \$3.6 million and \$6.6 million for the three and six months ended June 30, 2013 compared to the same periods ended June 30, 2012. We believe a material portion of the decrease was due to the placement of our startpages on the second tab of the default Windows 8 Internet browser by our consumer electronics customers. In addition, and to a lesser extent, we believe the decrease was due to lower search activity associated with the increased usage of other devices such as tablets and smartphones generally across the consumer base. We anticipate that search activity will increase on

smartphones and tablets in the future and, although our search queries are down, we believe that our continuing investment in mobile products, such as our investment in Carbyn, will allow us to compete more effectively for search activity on smartphones and tablets. Display revenue decreased by \$0.4 million and increased \$0.9 million for the three and six months ended June 30, 2013 compared to the same periods ended June 30, 2012 consistent with changes in advertising impressions across our startpages. For the reasons described above, during the remainder of 2013, we may continue to experience decreases in our search and display advertising revenue from our existing customer base. However, we anticipate that the signing and launching of new customers and our mobile product initiatives will help add new search and display advertising revenue in future years.

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Our subscriber-based revenue consists of fees charged for the use of our proprietary technology and for the use of, or access to, services, such as e-mail, security, TV Everywhere, online games, music and other value added services and paid content. During the three and six months ended June 30, 2013, subscriber-based revenue was \$5.3 million and \$10.4 million which was consistent with the three and six months ended June 30, 2012. We believe there are opportunities to generate new sources of subscriber-based revenue, such as the introduction of new value added services, including those delivered on smartphones and tablets. We believe that the variety of value added services and the introduction of new value added services will also drive increased search and display advertising revenue. As new customers introduce our startpages to their consumers, usage of our solutions and our revenue from our startpages tends to increase over time. There are a variety of reasons for this ramp-up period. For example, a new customer may migrate its consumers from its existing technology to our technology over a period of time. Moreover, a new customer may initially launch a selection of our services and products, rather than our entire suite of offerings, and subsequently broaden their service and product offerings over time. When a customer launches a new service or product, marketing and promotional activities may be required to generate awareness and interest among consumers. Search and display advertising revenue typically grows significantly during the first one to three years after a customer launch, although there can be notable variances from customer to customer. Thereafter, changes in revenue tend to mirror changes in the consumer base of the applicable customer.

For the three and six months ended June 30, 2013, we derived revenue from nearly 50 customers, with revenue attributable to four customers, CenturyLink, Inc. or CenturyLink (including revenue attributable to Qwest Communications International, Inc., or Qwest, which merged with CenturyLink in April 2011), Charter Communications Inc., or Charter, Verizon Corporate Services Group, Inc., or Verizon, and Toshiba America Information Systems, Inc., or Toshiba, together accounting for approximately 67% and 69% of our revenue for the three and six months ended June 30, 2013, or \$18.0 million and \$38.3 million. One of these customers accounted for 20% or more of revenue in such periods, and revenue attributable to each of the other three customers accounted for more than 10% in such periods.

Revenue attributable to our customers includes the subscriber-based revenue earned directly from them, as well as the search and display advertising revenue generated through our relationships with our search and display advertising partners (such as Google Inc., or Google, for search advertising and advertising networks, advertising agencies and advertisers for display advertising). This revenue is attributable to our customers because it is produced from the traffic on our startpages. These partners provide us with advertisements that we then deliver with search results and other content on our startpages. Since our search advertising partner, Google, and our advertising network partners generate their revenue by selling those advertisements, we create a revenue stream for these partners. In the three and six months ended June 30, 2013, search advertising through our relationship with Google generated approximately 51% and 53% of our revenue, or \$13.6 million and \$29.4 million (all of which was attributable to our customers). The initiatives described below under “Key Initiatives” are expected to contribute to our ability to maintain and grow revenue and profitability via increases in advertising revenue, increases in customers and our consumer reach, and increases in availability of products across more devices. We expect the period in which we experience a return on future investments in each of these initiatives to differ. For example, more direct advertising at higher cost per thousand impressions (referred to as cost per mille, or CPM) would be expected to have an immediate and direct impact on profitability while expansion into international markets may require an investment that involves a longer term return. We intend to utilize some of the proceeds of our initial public offering to improve our ability to achieve consistent profitability in the future by enhancing our technology and our systems capabilities to more efficiently support our customers, develop new products and features and report upon, analyze and manage the financial performance of the business.

### Key Initiatives

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

- add new, and expand our existing offerings with current, cable, telecom, satellite and consumer electronics customers to increase our consumer reach;

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continue to expand our offerings of, and invest in, mobile technology and cloud-based services such as e-mail and TV Everywhere and increase the number of customers using our TV Everywhere technology;  
• extend the availability of our existing and new products and services to additional devices including tablets and smartphones;  
• enhance our direct advertising sales effort to increase the CPMs derived from advertising;

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- expand our presence into international markets; and
- invest in and acquire new technologies and products.

**Key Business Metrics**

In addition to the line items in our financial statements, we regularly review a number of business metrics related to Internet traffic and search and display advertising to evaluate our business, determine the allocation of resources and make decisions regarding business strategies. We believe disclosing these metrics is useful for investors and analysts to understand the underlying trends in our business. The following table summarizes our key business metrics, which are unaudited, for the three and six months ended June 30, 2012 and 2013:

|                              | Three Months Ended June 30, |                | Six Months Ended June 30, |                |
|------------------------------|-----------------------------|----------------|---------------------------|----------------|
|                              | 2012                        | 2013           | 2012                      | 2013           |
| <b>Key Business Metrics:</b> |                             |                |                           |                |
| Unique Visitors (1)          | 19,927,835                  | 19,686,182     | 20,610,455                | 19,973,574     |
| Search Queries (2)           | 238,348,816                 | 177,025,185    | 509,126,605               | 388,669,982    |
| Advertising Impressions (3)  | 10,337,928,948              | 10,292,927,243 | 18,823,156,330            | 21,775,961,313 |

**Notes:**

- (1) Reflects the number of unique visitors to our startpages computed on an average monthly basis during the applicable period.
- (2) Reflects the total number of search queries during the applicable period.
- (3) Reflects the total number of advertising impressions during the applicable period.

**Unique Visitors**

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

**Search Queries**

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

**Advertising Impressions**

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

**Components of our Results of Operations****Revenue**

We derive our revenue from two categories: revenue generated from search and display advertising activities and subscriber-based revenue, each of which is described below. We record our search and display advertising revenue on a gross basis, which includes the net amount received from Google under our agreement with them.

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The following table shows the revenue in each category, both in amount and as a percentage of revenue, for the three months ended June 30, 2012 and 2013:

|                                | Three Months Ended June 30, |          |   | Six Months Ended June 30, |          |   |
|--------------------------------|-----------------------------|----------|---|---------------------------|----------|---|
|                                | 2012                        | 2013     |   | 2012                      | 2013     |   |
|                                | (in thousands)              |          |   |                           |          |   |
| Revenue:                       |                             |          |   |                           |          |   |
| Search and display advertising | \$25,439                    | \$21,399 |   | \$51,219                  | \$45,485 |   |
| Subscriber-based               | 5,368                       | 5,309    |   | 10,258                    | 10,366   |   |
| Total revenue                  | \$30,807                    | \$26,708 |   | \$61,477                  | \$55,851 |   |
| Percentage of revenue:         |                             |          |   |                           |          |   |
| Search and display advertising | 83                          | % 80     | % | 83                        | % 81     | % |
| Subscriber-based               | 17                          | 20       |   | 17                        | 19       |   |
| Total revenue                  | 100                         | % 100    | % | 100                       | % 100    | % |

**Search and Display Advertising Revenue**

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

In the case of search advertising, we have a revenue-sharing relationship with Google, pursuant to which we include a Google-branded search tool on our startpages. When a consumer makes a search query using this tool, we deliver the query to Google and they return search results to consumers that include advertiser-sponsored links. If the consumer clicks on a sponsored link, Google receives payment from the sponsor of that link and shares a portion of that payment with us, which we in turn share with the applicable customer. The net payment we receive from Google is recognized as revenue.

We generate display advertising revenue when consumers view or click on a text, graphic or video advertisement that was delivered on a Synacor-operated startpage. We fill our advertising inventory with advertisements sourced by our direct salesforce, independent advertising sales representatives and advertising network partners. Revenue may be calculated differently depending on our agreements with our advertisers or the agreements between our advertising network partners and their advertisers. It may be calculated on a cost per impression basis, which means the advertiser pays based on the number of times its advertisements appear, or a cost per action basis, which means that an advertiser pays when a consumer performs an action after engaging one of its advertisements. Historically only a small percentage of our display advertising revenue has been calculated on a cost per action basis.

**Subscriber-Based Revenue**

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

**Costs and Expenses****Cost of Revenue**

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

**Research and Development**



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

Sales and Marketing

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

General and Administrative

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

Depreciation

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

Other Expense

Other expense consists primarily of foreign exchange gains and losses.

Interest Expense

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

Provision (benefit) for Income Taxes

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

Noncontrolling Interests

Noncontrolling interests represent the noncontrolling holders' percentage share of income or losses from the JV Company, the results of which are consolidated in our condensed consolidated financial statements.

Critical Accounting Policies and Estimates

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

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

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

Adjusted EBITDA

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



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

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

although depreciation is a non-cash charge, the assets being depreciated may have to be replaced in the future, and adjusted EBITDA does not reflect capital expenditure requirements for such replacements or for new capital expenditure requirements;

adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;

adjusted EBITDA does not consider the potentially dilutive impact of equity-based compensation;

adjusted EBITDA does not reflect tax payments that may represent a reduction in cash available to us; and

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

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

|                                                 | Three Months Ended June 30, |           | Six Months Ended June 30, |           |
|-------------------------------------------------|-----------------------------|-----------|---------------------------|-----------|
|                                                 | 2012                        | 2013      | 2012                      | 2013      |
|                                                 | (in thousands)              |           | (in thousands)            |           |
| Reconciliation of Adjusted EBITDA:              |                             |           |                           |           |
| Net income (loss) attributable to Synacor, Inc. | \$ 1,199                    | \$ (637 ) | \$ 2,373                  | \$ (610 ) |
| Provision (benefit) for income taxes            | 301                         | (204 )    | 700                       | (186 )    |
| Interest expense                                | 89                          | 43        | 136                       | 101       |
| Other expense                                   | 18                          | 8         | 18                        | 15        |
| Depreciation                                    | 934                         | 1,138     | 1,715                     | 2,268     |
| Stock-based compensation                        | 425                         | 617       | 983                       | 1,179     |
| Adjusted EBITDA                                 | \$ 2,966                    | \$ 965    | \$ 5,925                  | \$ 2,767  |

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## Results of Operations

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

|                                                   | Three Months Ended June 30, |           | Six Months Ended June 30, |           |
|---------------------------------------------------|-----------------------------|-----------|---------------------------|-----------|
|                                                   | 2012                        | 2013      | 2012                      | 2013      |
|                                                   | (in thousands)              |           | (in thousands)            |           |
| Revenue                                           | \$ 30,807                   | \$ 26,708 | \$ 61,477                 | \$ 55,851 |
| Costs and operating expenses:                     |                             |           |                           |           |
| Cost of revenue (1)                               | 16,876                      | 14,017    | 33,640                    | 29,781    |
| Research and development (1)(2)                   | 6,123                       | 7,336     | 12,411                    | 14,201    |
| Sales and marketing (2)                           | 2,399                       | 2,147     | 4,776                     | 4,277     |
| General and administrative (1)(2)                 | 2,868                       | 2,957     | 5,708                     | 6,101     |
| Depreciation                                      | 934                         | 1,138     | 1,715                     | 2,268     |
| Total costs and operating expenses                | 29,200                      | 27,595    | 58,250                    | 56,628    |
| Income (loss) from operations                     | 1,607                       | (887 )    | 3,227                     | (777 )    |
| Other expense                                     | (18 )                       | (8 )      | (18 )                     | (15 )     |
| Interest expense                                  | (89 )                       | (43 )     | (136 )                    | (101 )    |
| Income (loss) before income taxes                 | 1,500                       | (938 )    | 3,073                     | (893 )    |
| Provision (benefit) for income taxes              | 301                         | (204 )    | 700                       | (186 )    |
| Net income (loss)                                 | 1,199                       | (734 )    | 2,373                     | (707 )    |
| Net loss attributable to noncontrolling interests | —                           | 97        | —                         | 97        |
| Net income (loss) attributable to Synacor, Inc.   | \$ 1,199                    | \$ (637 ) | \$ 2,373                  | \$ (610 ) |

Notes:

(1) Exclusive of depreciation shown separately.

(2) Includes stock-based compensation as follows:

|                            | Three Months Ended June 30, |        | Six Months Ended June 30, |          |
|----------------------------|-----------------------------|--------|---------------------------|----------|
|                            | 2012                        | 2013   | 2012                      | 2013     |
|                            | (in thousands)              |        | (in thousands)            |          |
| Research and development   | \$ 120                      | \$ 281 | \$ 227                    | \$ 542   |
| Sales and marketing        | 99                          | 76     | 173                       | 152      |
| General and administrative | 206                         | 260    | 583                       | 485      |
|                            | \$ 425                      | \$ 617 | \$ 983                    | \$ 1,179 |



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|                                                   | Three Months Ended June 30, |   |      |    | Six Months Ended June 30, |   |      |    |
|---------------------------------------------------|-----------------------------|---|------|----|---------------------------|---|------|----|
|                                                   | 2012                        |   | 2013 |    | 2012                      |   | 2013 |    |
|                                                   | 100                         | % | 100  | %  | 100                       | % | 100  | %  |
| Revenue                                           |                             |   |      |    |                           |   |      |    |
| Costs and operating expenses:                     |                             |   |      |    |                           |   |      |    |
| Cost of revenue (1)                               | 55                          |   | 52   |    | 55                        |   | 53   |    |
| Research and development (1)                      | 20                          |   | 27   |    | 20                        |   | 25   |    |
| Sales and marketing                               | 8                           |   | 8    |    | 8                         |   | 8    |    |
| General and administrative (1)                    | 9                           |   | 11   |    | 9                         |   | 11   |    |
| Depreciation                                      | 3                           |   | 4    |    | 3                         |   | 4    |    |
| Total costs and operating expenses                | 95                          | % | 103  | %  | 95                        | % | 101  | %  |
| Income (loss) from operations                     | 5                           | % | (3)  | )% | 5                         | % | (1)  | )% |
| Other expense                                     | —                           |   | —    |    | —                         |   | —    |    |
| Interest expense                                  | —                           |   | —    |    | —                         |   | —    |    |
| Income (loss) before income taxes                 | 5                           |   | (4)  | )  | 5                         |   | (2)  | )  |
| Provision (benefit) for income taxes              | 1                           |   | (1)  | )  | 1                         |   | —    |    |
| Net income (loss)                                 | 4                           | % | (3)  | )% | 4                         | % | (1)  | )% |
| Net loss attributable to noncontrolling interests | —                           | % | —    | %  | —                         | % | —    | %  |
| Net income (loss) attributable to Synacor, Inc.   | 4                           | % | (3)  | )% | 4                         | % | (1)  | )% |

Note:

(1) Exclusive of depreciation shown separately.

Comparison of the Three and Six Months ended June 30, 2012 and 2013

Revenue

|                                | Three Months Ended<br>June 30, |          |          | Six Months Ended<br>June 30, |          |          |
|--------------------------------|--------------------------------|----------|----------|------------------------------|----------|----------|
|                                | 2012                           | 2013     | % Change | 2012                         | 2013     | % Change |
|                                | (in thousands)                 |          |          | (in thousands)               |          |          |
| Revenue:                       |                                |          |          |                              |          |          |
| Search and display advertising | \$25,439                       | \$21,399 | (16) %   | \$51,219                     | \$45,485 | (11) %   |
| Subscriber-based               | 5,368                          | 5,309    | (1) %    | 10,258                       | 10,366   | 1 %      |
| Total revenue                  | \$30,807                       | \$26,708 | (13) %   | \$61,477                     | \$55,851 | (9) %    |
| Percentage of revenue:         |                                |          |          |                              |          |          |
| Search and display advertising | 83 %                           | 80 %     |          | 83 %                         | 81 %     |          |
| Subscriber-based               | 17 %                           | 20 %     |          | 17 %                         | 19 %     |          |
| Total revenue                  | 100 %                          | 100 %    |          | 100 %                        | 100 %    |          |

Three months ended 2012 compared to 2013. Revenue decreased by \$4.1 million, or 13%, compared to the same period in 2012. Search revenue decreased by \$3.6 million. We believe a material portion of the decrease was due to the placement of our startpages on the second tab of the default Windows 8 Internet browser by our consumer electronics customers. In addition, and to a lesser extent, we believe the decrease was due to lower search activity associated with the increased usage of other devices such as tablets and smartphones generally across the consumer base and due to a change in the way we monetize searches through our startpages. Display revenue decreased slightly by \$0.4 million as advertising impressions decreased slightly across our startpages. Subscriber-based revenue remained relatively constant, decreasing \$0.1 million, or 1% compared to the same period in 2012.

Six months ended 2012 compared to 2013. Revenue decreased by \$5.6 million, or 9%, compared to the same period in 2012. Search revenue decreased by \$6.6 million. We believe a material portion of the decrease was due to the placement of our startpages on the second tab of the default Windows 8 Internet browser by our consumer electronics customers. In addition, and to a lesser extent, we believe the decrease was due to lower search activity associated with the increased usage of other devices such as tablets and smartphones generally across the consumer base and due to a change in the way we monetize searches through our startpages. Display revenue increased slightly by \$0.9 million as

advertising impressions increased across our startpages. Subscriber-based revenue remained relatively constant, increasing \$0.1 million, or 1% compared to the same period in 2012.

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## Cost of Revenue

|                       | Three Months Ended<br>June 30, |          |          |  | Six Months Ended<br>June 30, |          |          |
|-----------------------|--------------------------------|----------|----------|--|------------------------------|----------|----------|
|                       | 2012                           | 2013     | % Change |  | 2012                         | 2013     | % Change |
|                       | (in thousands)                 |          |          |  | (in thousands)               |          |          |
| Cost of revenue       | \$16,876                       | \$14,017 | (17 )%   |  | \$33,640                     | \$29,781 | (11 )%   |
| Percentage of revenue | 55                             | % 52     | %        |  | 55                           | % 53     | %        |

Three months ended 2012 compared to 2013. Our cost of revenue decreased by \$2.9 million, or 17%, compared to 2012. The decrease in our cost of revenue was driven by a decrease in revenue-sharing costs due to decreased search and display advertising. Cost of revenue as a percentage of revenue decreased to 52% of revenue from 55% of revenue because of changes in display advertising revenue attributable to the mix of customers with revenue-sharing arrangements.

Six months ended 2012 compared to 2013. Our cost of revenue decreased by \$3.9 million, or 11%, compared to 2012. The decrease in our cost of revenue was driven by a decrease in revenue-sharing costs due to decreased search and display advertising. Cost of revenue as a percentage of revenue decreased to 53% of revenue from 55% of revenue because of changes in display advertising revenue attributable to the mix of customers with revenue-sharing arrangements.

## Research and Development Expenses

|                          | Three Months Ended<br>June 30, |         |          |  | Six Months Ended<br>June 30, |          |          |
|--------------------------|--------------------------------|---------|----------|--|------------------------------|----------|----------|
|                          | 2012                           | 2013    | % Change |  | 2012                         | 2013     | % Change |
|                          | (in thousands)                 |         |          |  | (in thousands)               |          |          |
| Research and development | \$6,123                        | \$7,336 | 20 %     |  | \$12,411                     | \$14,201 | 14 %     |
| Percentage of revenue    | 20                             | % 27    | %        |  | 20                           | % 25     | %        |

Three months ended 2012 compared to 2013. Research and development expenses increased by \$1.2 million, or 20%, compared to 2012. The increase was primarily due to increases in employee-related costs as a result of the increase in headcount to support new product initiatives.

Six months ended 2012 compared to 2013. Research and development expenses increased by \$1.8 million, or 14%, compared to 2012. The increase was primarily due to increases in employee-related costs as a result of the increase in headcount to support new product initiatives.

## Sales and Marketing Expenses

|                       | Three Months Ended<br>June 30, |         |          |  | Six Months Ended<br>June 30, |         |          |
|-----------------------|--------------------------------|---------|----------|--|------------------------------|---------|----------|
|                       | 2012                           | 2013    | % Change |  | 2012                         | 2013    | % Change |
|                       | (in thousands)                 |         |          |  | (in thousands)               |         |          |
| Sales and marketing   | \$2,399                        | \$2,147 | (11 )%   |  | \$4,776                      | \$4,277 | (10 )%   |
| Percentage of revenue | 8                              | % 8     | %        |  | 8                            | % 8     | %        |

Three months ended 2012 compared to 2013. Sales and marketing expenses decreased by \$0.3 million, or 11%, compared to 2012. The decrease was primarily due to a decrease in compensation related expenses.

Six months ended 2012 compared to 2013. Sales and marketing expenses decreased by \$0.5 million, or 10%, compared to 2012. The decrease was primarily due to a decrease in compensation related expenses.

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## General and Administrative Expenses

|                            | Three Months Ended |         |   |        | Six Months Ended |         |   |        |
|----------------------------|--------------------|---------|---|--------|------------------|---------|---|--------|
|                            | June 30,           |         |   |        | June 30,         |         |   |        |
|                            | 2012               | 2013    | % | Change | 2012             | 2013    | % | Change |
|                            | (in thousands)     |         |   |        | (in thousands)   |         |   |        |
| General and administrative | \$2,868            | \$2,957 | 3 | %      | \$5,708          | \$6,101 | 7 | %      |
| Percentage of revenue      | 9                  | % 11    | % |        | 9                | % 11    | % |        |

Three months ended 2012 compared to 2013. General and administrative expenses remained relatively consistent, increasing by only \$0.1 million, or 3%, compared to 2012.

Six months ended 2012 compared to 2013. General and administrative expenses increased by \$0.4 million, or 7%, compared to 2012. The increase was primarily due to an increase in legal fees in connection with the formation of the JV Company and other administrative fees associated with being a publicly traded company.

## Depreciation

|                       | Three Months Ended<br>June 30, |         |          |   |  | Six Months Ended<br>June 30, |         |          |   |
|-----------------------|--------------------------------|---------|----------|---|--|------------------------------|---------|----------|---|
|                       | 2012                           | 2013    | % Change |   |  | 2012                         | 2013    | % Change |   |
|                       | (in thousands)                 |         |          |   |  | (in thousands)               |         |          |   |
| Depreciation          | \$934                          | \$1,138 | 22       | % |  | \$1,715                      | \$2,268 | 32       | % |
| Percentage of revenue | 3                              | % 4     | %        |   |  | 3                            | % 4     | %        |   |

Three months ended 2012 compared to 2013. Depreciation increased by \$0.2 million, or 22%, compared to 2012. This increase was driven by the purchase of assets during 2012 to support the high availability requirements of our customers.

Six months ended 2012 compared to 2013. Depreciation increased by \$0.6 million, or 32%, compared to 2012. This increase was driven by the purchase of assets during 2012 to support the high availability requirements of our customers.

## Interest Expense

|                  | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |           |
|------------------|--------------------------------|----------|------------------------------|-----------|
|                  | 2012                           | 2013     | 2012                         | 2013      |
|                  | (in thousands)                 |          | (in thousands)               |           |
| Interest expense | \$ (89                         | ) \$ (43 | ) \$ (136                    | ) \$ (101 |

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

## Provision (benefit) for Income Taxes

|                                      | Three Months Ended<br>June 30, |         |   | Six Months Ended<br>June 30, |         |   |
|--------------------------------------|--------------------------------|---------|---|------------------------------|---------|---|
|                                      | 2012                           | 2013    |   | 2012                         | 2013    |   |
|                                      | (in thousands)                 |         |   | (in thousands)               |         |   |
| Provision (benefit) for income taxes | \$301                          | \$(204) | ) | \$700                        | \$(186) | ) |

Our income tax expense for the three and six months ended June 30, 2012 included \$0.7 million and \$1.4 million of deferred income tax expense, partially offset by a tax benefit of \$0.4 million and \$0.7 million relating to a research and development credit.

As a result of incurring a net loss, we recorded a tax benefit of \$0.2 million for the three and six months ended June 30, 2013.

## Liquidity and Capital Resources



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

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

In July 2013 the term of the amended and restated loan and security agreement we entered into in July 2011 expired. As such, there is no outstanding principal balance under that agreement and we are no longer bound by the financial covenants that we agreed to in that agreement. We are currently negotiating a new line of credit and we expect to have an agreement in place during the third quarter of 2013.

As of June 30, 2013, we had approximately \$37.7 million of cash and cash equivalents. At that time, we did not have any short-term or long-term investments. Since that time we have made a \$1.0 million investment (in the form of a convertible promissory note) in a privately held Delaware corporation called Blazer and Flip Flops, Inc., or B&FF (doing business as The Experience Engine), a professional services company. We believe that our existing cash and cash equivalents will be sufficient to meet our anticipated working capital and capital expenditure requirements for at least the next 12 months.

Finally, under the terms of our joint venture agreement with Synacor China, Ltd., or the JV Company, we have agreed, upon the satisfaction of certain conditions, to provide up to \$1.6 million in additional funding to the JV Company over two years through the purchase of non-voting, non-convertible Series A preferred shares of the JV Company.

## Cash Flows

|                                                       | Six Months Ended June 30, |         |
|-------------------------------------------------------|---------------------------|---------|
|                                                       | 2012                      | 2013    |
|                                                       | (in thousands)            |         |
| Statements of Cash Flows Data:                        |                           |         |
| Cash flows provided by (used in) operating activities | \$4,799                   | \$(199) |
| Cash flows used in investing activities               | (2,640)                   | (3,002) |
| Cash flows provided by (used in) financing activities | 21,965                    | (1,008) |
| Cash Provided by (Used in) Operating Activities       |                           |         |

In the six months ended June 30, 2012, operating activities provided \$4.8 million of cash. The cash flow from operating activities primarily resulted from our net income, adjusted for non-cash items, and changes in our operating assets and liabilities. We had net income of \$2.4 million, which included a non-cash benefit from deferred income taxes of \$0.6 million, non-cash depreciation of \$1.7 million and non-cash stock-based compensation of \$1.0 million. Changes in our operating assets and liabilities used \$0.9 million of cash, primarily due to an increase of our accounts receivable of \$1.2 million, an increase of our prepaid expenses and other current assets of \$0.5 million, partially offset by an increase of our accounts payable of \$0.8 million. The increase in our accounts receivable was primarily due to our revenue growth. The increase in prepaid expenses and other current assets was primarily due to prepayments made to vendors for components of our cost of revenue. The increase in accounts payable was the result of increased spending due to the growth of our revenue-share payments associated with our revenue growth and the timing of such payments.

In the six months ended June 30, 2013 operating activities used \$0.2 million of cash. The cash flow from operating activities primarily resulted from our net loss, adjusted for non-cash items, and changes in our operating assets and liabilities. Net loss was \$0.7 million, which included a non-cash benefit from deferred income taxes of \$0.2 million,

non-cash depreciation of \$2.3 million and non-cash stock-based compensation of \$1.2 million. Changes in our operating assets and liabilities used \$2.7 million of cash, primarily due to a decrease of our accounts payable of \$1.7 million and a decrease of our accrued expenses and other current liabilities of \$1.3 million. The decrease in our accounts payable was primarily driven by lower revenue-share payments associated with our decrease in revenue. The decrease in accrued expenses and other current liabilities was primarily due to the decrease of accrued compensation costs of \$1.8 million primarily relating to bonuses earned

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and accrued in 2012 and paid in 2013, partially offset by a \$0.4 million increase in accrued costs to vendors for components of our cost of revenue due to the timing of payments made.

### Cash Used in Investing Activities

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

Cash used in investing activities in the six months ended June 30, 2012 was \$2.6 million consisting of \$2.0 million of purchases of property, equipment and software to build out our data centers and \$0.6 million paid for the acquisition of Carbyn.

Cash used in investing activities in the six months ended June 30, 2013 was \$3.0 million, consisting of \$2.5 million for purchases of property and equipment specifically related to the build out of our data centers and internal-use software development and \$0.5 million paid for the final payment for the acquisition of Carbyn.

### Cash Provided by (Used in) Financing Activities

For the six months ended June 30, 2012, net cash provided by financing activities was \$22.0 million, consisting of \$25.4 million of proceeds from issuance of common stock in our IPO, partially offset by cash paid for issuance costs of \$2.8 million, \$0.6 million of proceeds from the exercise of common stock options, offset by \$1.3 million for repayments on our capital lease obligations and bank financing.

For the six months ended June 30, 2013, net cash used in financing activities was \$1.0 million primarily for repayment of \$1.1 million on our capital lease obligations partially offset by proceeds of \$0.1 million from the exercise of common stock options.

### Off-Balance Sheet Arrangements

As of June 30, 2013, we did not have any off-balance sheet arrangements.

### Item 3. Quantitative and Qualitative Disclosure About Market Risk

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

#### Interest Rate Risk

Our cash and cash equivalents primarily consist of cash and money market funds. Other than our \$1.0 million investment in B&FF, we currently have no investments of any type. Our exposure to market risk for changes in interest rates is limited because nearly all of our cash and cash equivalents have a short-term maturity and are used primarily for working capital purposes.

#### Inflation Risk

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

### Item 4. Controls and Procedures

#### Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2013. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as



appropriate to allow timely decisions regarding required disclosure. Based upon the evaluation as

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of June 30, 2013, our Chief Executive Officer and Chief Financial Officer have concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

**Changes in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting identified in management's evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act during the quarter ended June 30, 2013 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II — OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

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

Risks Related to Our Business

Our search advertising partner, Google, accounts for a significant portion of our revenue, and any loss of, or diminution in, our business relationship with Google would materially and adversely affect our financial performance. We rely on traffic on our startpages to generate search and display advertising revenue, a substantial portion of which is derived from text-based links to advertisers' websites as a result of Internet searches. We have a revenue-sharing relationship with Google under which we include a Google-branded search tool on our startpages. When a consumer makes a search request using this tool, we deliver it to Google, and Google returns search results to us that include advertiser-sponsored links. If the consumer clicks on a sponsored link, Google receives payment from the sponsor of that link and shares a portion of that payment with us. We then typically share a portion of that payment with the applicable customer. Our Google-related search advertising revenue attributable to our customers, which consists of the portion of the payment from the sponsor that Google shares with us, accounted for approximately 49%, 57%, and 56% of our revenue in 2010, 2011, and 2012, or \$32.6 million, \$51.5 million, and \$68.5 million, respectively, and approximately 53% of our revenue in the six months ended June 30, 2013, or \$29.4 million. Our agreement with Google expires in February 2014 unless we and Google mutually elect to renew it. Additionally, Google may terminate our agreement if we experience a change in control, if we enter into an agreement providing for a change in control, if we do not maintain certain search and display advertising revenue levels or if we fail to conform to Google's search policies. If advertisers were to discontinue their advertising via Internet searches, if Google's revenue from search-based advertising were to decrease, if Google's share of the search revenue were to be increased or if our agreement with Google were to be terminated for any reason or renewed on less favorable terms, our business, financial condition and results of operations would be materially and adversely affected. Moreover, consumers' increased use of search tools other than the Google-branded search tool we provide would have similar effects. A loss of any significant customer could negatively affect our financial performance.

We derive a substantial portion of our revenue from a small number of customers. For example, revenue attributable to two customers, Charter and CenturyLink (including our revenue attributable to Qwest, which merged with CenturyLink in April 2011), together accounted for approximately 60% of our revenue for the year ended December 31, 2010, or \$39.8 million. Revenue attributable to each of these customers accounted for 20% or more of our revenue in 2010. Revenue attributable to Charter, CenturyLink (including our revenue attributable to Qwest) and Toshiba together accounted for approximately 62% of our revenue for the year ended December 31, 2011, or \$56.9 million, with revenue attributable to one of these customers accounting for 20% or more in such period and revenue attributable to each of the other two customers accounting for more than 10% in such period. Revenue attributable to Charter, CenturyLink (including revenue attributable to Qwest), Toshiba and Verizon together accounted for approximately 73% of our revenue for the year ended December 31, 2012, or \$88.4 million, with revenue attributable to one of these customers accounting for 20% or more in such period and revenue attributable to each of the other three customers accounting for more than 10% in such period. Revenue attributable to Charter, CenturyLink (including revenue attributable to Qwest), Toshiba and Verizon together accounted for approximately 69% of our revenue for the six months ended June 30, 2013, or \$38.3 million, with revenue attributable to one of these customers

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

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

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

We have incurred significant losses in each year of operation other than 2009, 2011, and 2012, including a net loss of \$5.8 million in 2008 and a net loss of \$3.6 million in 2010. Our net loss was \$0.7 million in the six months ended June 30, 2013 as compared to a net income of \$2.4 million for the six months ended June 30, 2012. Our net income in 2009, 2011, and 2012 was \$0.3 million, \$9.9 million, and \$3.8 million, respectively. We expect that our expenses will increase in future periods as we implement initiatives designed to grow our business including, among other things, the development and marketing of new services and products, licensing of content, expansion of our infrastructure, international expansion and general and administrative expenses associated with being a public company. If our revenue does not sufficiently increase to offset these expected increases in operating expenses, we may incur significant losses and may not be profitable. Our revenue growth in recent periods may not be indicative of our future performance. In fact, our revenue for the six months ended June 30, 2013 declined as compared to the same period in 2012. Accordingly, we may not be able to maintain profitability in the future. Any failure to maintain profitability may materially and adversely affect our business, financial condition and results of operations.

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

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

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

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

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

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

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

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

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

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

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

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

Our revenue from high-speed Internet service providers, including our search and display advertising revenue generated by online consumer traffic on our startpages, accounted for more than 95% of our revenue in 2010, 86% in 2011, 80% in 2012, and 81% in the six months ended June 30, 2013. The cable and telecommunications industries have experienced consolidation over the past several years, and we expect that this trend will continue. As a result of consolidation, some of our customers may be acquired by companies with which we do not have existing relationships and which may have relationships with one of our competitors or may have the in-house capacity to perform the services we provide. As a result, such acquisitions could cause us to lose customers and the associated subscriber-based and search and display advertising revenue. Under our agreements with some of our customers, including Charter, Verizon and CenturyLink, they have the right to terminate the agreement if we are acquired by one of their competitors.

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

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

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



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

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

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

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

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

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

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

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

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

As a result of the rapidly changing nature of the markets in which we compete, our quarterly and annual revenue and operating results are likely to fluctuate from period to period. These fluctuations may be caused by a number of factors, many of which are beyond our control, including but not limited to the various factors set forth in this "Risk Factors" section, as well as:

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

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

our ability to attract new customers;

our ability to increase sales of value added services and paid content to existing subscribers;

the timing and success of new service and product introductions by us, our customers or our competitors;

variations in the demand for our services and products and the implementation cycles of our services and products by our customers;

changes to Internet browser technology that renders our startpages less competitive;

changes in our pricing policies or those of our competitors;

changes in the prices our customers charge for value added services and paid content;

service outages, other technical difficulties or security breaches;

limitations relating to the capacity of our networks, systems and processes;

our failure to accurately estimate or control costs, including costs related to the initial launch of new customers;

maintaining appropriate staffing levels and capabilities relative to projected growth;

the timing of costs related to the development or acquisition of technologies, services or businesses to support our existing customers and potential growth opportunities; and

general economic, industry and market conditions and those conditions specific to Internet usage and online businesses.

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

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

We plan to expand our product offerings internationally, particularly in Asia, Latin America and Europe. For example, in March 2013 we announced that we entered into a joint venture with Maxit Technology Incorporated, or Maxit, to supply authentication and aggregation solutions for the delivery of online content and services to customers in the People's Republic of China, or the PRC. We have limited experience in marketing and operating our services and products in international markets, and we may not be able to successfully develop our business in these markets. Our success in these markets will be directly linked to the success of relationships with potential customers, content partners and other third parties.

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

supporting remote operations.

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

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

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

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

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

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

System failures or capacity constraints could harm our business and financial performance.

The provision of our services and products depends on the continuing operation of our information technology and communications systems. Any damage to or failure of our systems could result in interruptions in our service. Such interruptions could harm our business, financial condition and results of operations, and our reputation could be damaged if people believe our systems are unreliable. Our systems are vulnerable to damage or interruption from snow storms, terrorist attacks, floods, fires, power loss, telecommunications failures, security breaches, computer malware, computer hacking attacks, computer viruses, computer denial of service attacks or other attempts to, or events that, harm our systems. Our data center is also subject to break-ins, sabotage and intentional acts of vandalism and to potential disruptions if the operators of the facility have financial difficulties. Although we maintain insurance to cover a variety of risks, the scope and amount of our insurance coverage may not be sufficient to cover our losses resulting from system failures or other disruptions to our online operations. For example, the limit on our business interruption insurance is approximately \$26.1 million. Any system failure or disruption and any resulting losses that are not recoverable under our insurance policies may materially harm our business, financial condition and results of operations. To date, we have never experienced any material losses.

Although we regularly back-up our systems and store the system back-ups in Atlanta, Georgia, Lewis Center, Ohio, and Buffalo, New York, we do not have full second-site redundancy. If we were forced to relocate to an alternate site and to rely on our system back-ups to restore the systems, we would experience significant delays in restoring the functionality of our platform and could experience loss of data, which could materially harm our business and our operating results.

Security breaches, computer viruses and computer hacking attacks could harm our business, financial condition and results of operations.

Security breaches, computer malware and computer hacking attacks are prevalent in the technology industry. Any security breach caused by hacking, which involves efforts to gain unauthorized access to information or systems, or to cause intentional malfunctions or loss or corruption of data, software, hardware or other computer equipment, and the inadvertent transmission of computer viruses could harm our business, financial condition and results of operations. We have previously experienced hacking attacks on our systems, and may in the future experience hacking attacks. Though it is difficult to determine what harm may directly result from any specific interruption or breach, any failure to maintain performance, reliability, security and availability of our technology infrastructure to the satisfaction of our customers and their consumers may harm our reputation and our ability to retain existing customers and attract new customers.

We may not maintain acceptable website performance for our customers, which may negatively impact our relationships with our customers and harm our business, financial condition and results of operations.

A key element to our continued growth is the ability of our customers' consumers in all geographies to access our startpages within acceptable load times. We refer to this as website performance. We may in the future experience platform disruptions, outages and other performance problems due to a variety of factors, including infrastructure changes, human or

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software errors, capacity constraints due to an overwhelming number of users accessing our technology simultaneously, and denial of service or fraud or security attacks. In some instances, we may not be able to identify the cause or causes of these website performance problems within an acceptable period of time. It may become increasingly difficult to maintain and improve website performance, especially during peak usage times, and as our solutions become more complex and our user traffic increases. If our startpages are unavailable when consumers attempt to access them or do not load as quickly as they expect, consumers may seek other alternatives to obtain the information for which they are looking, and may not return to our startpages as often in the future, or at all. This would negatively impact our relationships with our customers. We expect to continue to make significant investments to maintain and improve website performance. To the extent that we do not effectively address capacity constraints, upgrade our systems as needed and continually develop our technology and network architecture to accommodate actual and anticipated changes in technology, our business and operating results may be harmed.

We rely on our management team and need additional personnel to expand our business, and the loss of key officers or an inability to attract and retain qualified personnel could harm our business, financial condition and results of operations.

We depend on the continued contributions of our senior management and other key personnel, especially Ronald N. Frankel, our Chief Executive Officer, George G. Chamoun, our Executive Vice President of Sales and Marketing, Scott A. Bailey, our Chief Operating Officer, and William J. Stuart, our Chief Financial Officer. The loss of the services of any of our executive officers or other key employees could harm our business and our prospects. All of our executive officers and key employees are at-will employees, which means they may terminate their employment relationship with us at any time.

Our future success also depends on our ability to identify, attract and retain highly skilled technical, managerial, finance, marketing and creative personnel. For example, we will need to hire personnel outside the United States to pursue an international expansion strategy, and we will need to hire additional advertising salespeople to sell more advertisements directly. We face intense competition for qualified individuals from numerous technology, marketing and media companies, and we may incur significant costs to attract them. We may be unable to attract and retain suitably qualified individuals, or we may be required to pay increased compensation in order to do so. If we were to be unable to attract and retain the qualified personnel we need to succeed, our business could suffer.

Volatility or lack of performance in the trading price of our common stock may also affect our ability to attract and retain qualified personnel. Many of our senior management personnel and other key employees have become, or will become, vested in a substantial amount of stock or stock options. Employees may be more likely to leave us if the shares they own or the shares underlying their options have significantly appreciated in value relative to the original purchase prices of the shares or the exercise prices of the options or if the exercise prices of the options that they hold are significantly above the trading price of our common stock. If we are unable to retain our employees, our business, financial condition and results of operations would be harmed.

If we fail to manage our growth effectively, our business, financial condition and results of operations may suffer.

Following the merger of our predecessor companies, Chek, Inc., or Chek, and MyPersonal.com, Inc., or MyPersonal, to form Synacor, we have expanded our business primarily through organic growth. We expect to continue to grow organically, and we may choose to grow through strategic acquisitions in the future. This growth has placed, and may continue to place, significant demands on our management and our operational and financial infrastructure. Our ability to manage our growth effectively and to integrate new technologies and acquisitions into our existing business will require us to continue to expand our operational, financial and management information systems and to continue to retain, attract, train, motivate and manage key employees. Continued growth could strain our ability to:

- develop and improve our operational, financial and management controls;

- enhance our reporting systems and procedures;

- recruit, train and retain highly skilled personnel;

- maintain our quality standards; and
- maintain customer and content owner satisfaction.

Managing our growth will require significant expenditures and allocation of valuable management resources. If we fail to achieve the necessary level of efficiency in our organization as it grows, our business, financial condition and results of operations would be harmed.



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We may expand our business through acquisitions of, or investments in, other companies or new technologies, or joint ventures or other strategic alliances with other companies, which may divert our management's attention or prove not to be successful.

In January 2012, we completed an acquisition of certain mobile device software and technology from Carbyn, and in March 2013, we entered into a Joint Venture Agreement with Maxit to form Synacor China, Ltd., a joint venture in China. We may decide to pursue other acquisitions of, investments in, or joint ventures involving other technologies and businesses in the future. Such transactions could divert our management's time and focus from operating our business.

Our ability as an organization to integrate acquisitions is unproven. Integrating an acquired company, business or technology is risky and may result in unforeseen operating difficulties and expenditures, including, among other things, with respect to:

- incorporating new technologies into our existing business infrastructure;
- consolidating corporate and administrative functions;
- coordinating our sales and marketing functions to incorporate the new business or technology;
- maintaining morale, retaining and integrating key employees to support the new business or technology and managing our expansion in capacity; and
- maintaining standards, controls, procedures and policies (including effective internal controls over financial reporting and disclosure controls and procedures).

In addition, a significant portion of the purchase price of companies we may acquire may be allocated to acquired goodwill and other intangible assets, which must be assessed for impairment at least annually. In the future, if our acquisitions do not yield expected returns, we may be required to take charges to our earnings based on this impairment assessment process, which could harm our operating results.

Future acquisitions could result in potentially dilutive issuances of our equity securities, including our common stock, or the incurrence of debt, contingent liabilities, amortization expenses or acquired in-process research and development expenses, any of which could harm our business, financial condition and results of operations. Future acquisitions may also require us to obtain additional financing, which may not be available on favorable terms or at all.

We face many risks in connection with our joint venture, including, among other things, with respect to:

- The JV Company not being able to obtain the approvals required from the PRC government for the establishment of a wholly foreign-owned subsidiary of the JV Company in the People's Republic of China, or the WFOE;
- Increasing competition in the industry and the WFOE's ability to compete in the Chinese market;
- The impact of regulatory changes in the industry;
- Potential difficulties associated with operating the joint venture and the WFOE;
- The joint venture's ability to obtain additional financing;
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The WFOE's ability to offer competitive services in the Chinese market at a favorable margin;

General business and economic conditions, including seasonality of the industry and growth trends in the industry;

Our ability to successfully enter the Chinese market and operate internationally;

Potential delays, including obtaining permits, licenses and other governmental approvals;

Trade barriers and potential duties; and

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Our and the joint venture's ability to protect intellectual property.

If we and the JV Company are not able to successfully manage these and other risks related to the joint venture, it could harm our business, financial condition and results of operations.

Finally, our skill at investing our funds in illiquid securities issued by other companies is untested. Although we review the results and prospects of such investments carefully, it is possible that our investments could result in a total loss. Additionally, we will typically have little or no control in the companies in which we invest, and we will be forced to rely on the management of companies in which we invest to make reasonable and sound business decisions. If the companies in which we invest are not successfully able to manage the risks facing them, such companies could suffer, and our own business, financial condition and results of operations could be harmed.

We may require additional capital to grow our business, and this capital may not be available on acceptable terms or at all.

The operation of our business and our growth strategy may require significant additional capital, especially if we were to accelerate our expansion and acquisition plans. If the cash generated from operations and otherwise available to us are not sufficient to meet our capital requirements, we will need to seek additional capital, potentially through debt or equity financings, to fund our growth. We may not be able to raise needed capital on terms acceptable to us or at all. Financings, if available, may be on terms that are dilutive or potentially dilutive to our stockholders, and the prices at which new investors would be willing to purchase our securities may cause our existing stockholders to suffer substantial dilution. The holders of new securities may also receive rights, preferences or privileges that are senior to those of existing holders of our common stock. Any debt financing obtained by us in the future could contain restrictive covenants that may potentially restrict our operations, and if we do not effectively manage our business to comply with those covenants, our business, financial condition and results of operations could be adversely affected. If new sources of financing are required but are insufficient or unavailable, we could be required to delay, abandon or otherwise modify our growth and operating plans to the extent of available funding, which would harm our ability to grow our business.

Our business depends, in part, on our ability to protect and enforce our intellectual property rights.

The protection of our intellectual property is critical to our success. We rely on copyright and service mark enforcement, contractual restrictions and trade secret laws to protect our proprietary rights. We have entered into confidentiality and invention assignment agreements with our employees and contractors, and nondisclosure agreements with certain parties with whom we conduct business to limit access to and disclosure of our proprietary information. However, if we are unable to adequately protect our intellectual property, our business may suffer from the piracy of our technology and the associated loss in revenue.

Protecting against the unauthorized use of our intellectual property and other proprietary rights is expensive, difficult and, in some cases, impossible. Litigation may be necessary in the future to enforce or defend our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Such litigation could be costly and divert management resources, either of which could harm our business. Furthermore, many of our current and potential competitors have the ability to dedicate substantially greater resources to enforce their intellectual property rights than we do. Accordingly, despite our efforts, we may not be able to prevent third parties from infringing upon or misappropriating our intellectual property.

We are not currently involved in any legal proceedings with respect to protecting our intellectual property; however, we may from time to time become a party to various legal proceedings with respect to protecting our intellectual property arising in the ordinary course of our business.

Any claims from a third party that we are infringing upon its intellectual property, whether valid or not, could subject us to costly and time-consuming litigation or expensive licenses or force us to curtail some services or products.

Companies in the Internet and technology industries tend to own large numbers of patents, copyrights, trademarks and trade secrets, and frequently enter into litigation based on allegations of infringement or other violations of intellectual

property rights. We have been subject to claims that the presentation of certain licensed content on our startpages infringes certain patents of a third party, none of which have resulted in direct settlement or payments by us or any determination of infringement by us, and as we face increasing competition, the possibility of further intellectual property rights claims against us grows. Our technologies may not be able to withstand any third party claims or rights against their use. Any intellectual property claims, with or without merit, could be time-consuming, expensive to litigate or settle and could divert management

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resources and attention. An adverse determination also could prevent us from offering our services and products to others and may require that we procure substitute products or services for our customers.

In the case of any intellectual property rights claim, we may have to pay damages or stop using technology found to be in violation of a third party's rights. We may have to seek a license for the technology, which may not be available to us on reasonable terms and may significantly increase our operating expenses. The technology also may not be available for license to us at all. As a result, we may also be required to develop alternative non-infringing technology, which could require significant effort and expense. If we cannot license or develop technology for the infringing aspects of our business, we may be forced to limit our service and product offerings and may be unable to compete effectively. Any of these consequences could harm our operating results.

In addition, we typically have contractual obligations to our customers to indemnify and defend them with respect to third-party intellectual property infringement claims that arise from our customers' use of our products or services. Such claims, whether valid or not, could harm our relationships with our customers, have resulted and could result in the future in us or our customers having to enter into licenses with the claimants and have caused and could cause us in the future to incur additional costs or suffer reduced revenues. To date, neither the increase in our costs nor any reductions in our revenue resulting from such claims have been material. Such claims could also subject us to costly and time-consuming litigation as well as diverting management attention and resources. Satisfying our contractual indemnification obligations could also give rise to significant liability, and thus harm our business and our operating results.

We are not currently subject to any material legal proceedings with respect to third party claims that we or our customers' use of our products and services are infringing upon their intellectual property; however, we may from time to time become a party to various legal proceedings with respect to such claims arising in the ordinary course of our business.

Any unauthorized disclosure or theft of personal information we gather could harm our reputation and subject us to claims or litigation.

We collect, and have access to, personal information of subscribers, including names, addresses, account numbers, credit card numbers and e-mail addresses. Unauthorized disclosure of personal information regarding website visitors, whether through breach of our systems by an unauthorized party, employee theft or misuse, or otherwise, could harm our business. If there were an inadvertent disclosure of personal information, or if a third party were to gain unauthorized access to the personal information we possess, our operations could be seriously disrupted and we could be subject to claims or litigation arising from damages suffered by subscribers or our customers. In addition, we could incur significant costs in complying with the multitude of state, federal and foreign laws regarding the unauthorized disclosure of personal information. Finally, any perceived or actual unauthorized disclosure of the information we collect could harm our reputation, substantially impair our ability to attract and retain customers and have an adverse impact on our business.

We collect and may access personal information and other data, which subjects us to governmental regulation and other legal obligations related to privacy, and our actual or perceived failure to comply with such obligations could harm our business.

We collect, and have access to, personal information of subscribers, including names, addresses, account numbers, credit card numbers and e-mail addresses. There are numerous federal, state and local laws around the world regarding privacy and the storing, sharing, use, processing, disclosure and protection of personal information and other subscriber data, the scope of which are changing, subject to differing interpretations, and may be inconsistent between countries or conflict with other rules. We generally comply with industry standards and are subject to the terms of our privacy policies and privacy-related obligations to third parties (including voluntary third-party certification bodies such as TRUSTe). We strive to comply with all applicable laws, policies, legal obligations and industry codes of conduct relating to privacy and data protection to the extent possible. However, it is possible that these obligations may be interpreted and applied in a manner that is inconsistent from one jurisdiction to another and may conflict with other rules or our practices. Any failure or perceived failure by us to comply with our privacy policies, our privacy-related obligations to users or other third parties, or our privacy-related legal obligations, or any compromise

of security that results in the unauthorized release or transfer of personal information or other subscriber data, may result in governmental enforcement actions, litigation or public statements against us by consumer advocacy groups or others and could cause our customers to lose trust in us, which could have an adverse effect on our business.

Additionally, if third parties we work with, such as customers, vendors or developers, violate applicable laws or our policies, such violations may also put subscriber information at risk and could in turn have an adverse effect on our business.

Any failure to convince advertisers of the benefits of advertising with us would harm our business, financial condition and results of operations.

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We have derived and expect to continue to derive a substantial portion of our revenue from display advertising on our startpages. Such advertising accounted for approximately 20%, 23%, and 27% of our revenue for the years ended December 31, 2010, 2011, and 2012, respectively, and 29% of our revenue in the six months ended June 30, 2013. Our ability to attract and retain advertisers and, ultimately, to generate advertising revenue depends on a number of factors, including:

- increasing the numbers of consumers using our startpages;
- maintaining consumer engagement on those startpages;
- competing effectively for advertising spending with other online and offline advertising providers; and
- continuing to grow our direct advertising sales force and develop and diversify our advertising capabilities.

If we are unable to provide high-quality advertising opportunities and convince advertisers and agencies of our value proposition, we may not be able to retain existing advertisers or attract new ones, which would harm our business, financial condition and results of operations.

Migration of high-speed Internet service providers' subscribers from one high-speed Internet service provider to another could adversely affect our business, financial condition and results of operations.

Our high-speed Internet service provider customers' subscribers may become dissatisfied with their current high-speed Internet service provider and may switch to another provider. In the event that there is substantial subscriber migration from our existing customers to service providers with which we do not have relationships, the fees that we receive on a per-subscriber basis, and the related search and display advertising revenue, could decline.

Our business and the trading price of our common stock may be adversely affected if our internal controls over financial reporting are found by management or by our independent registered public accounting firm not to be adequate.

Effective internal controls are necessary for us to provide reliable financial reports and prevent fraud. In addition, Section 404 of the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, requires our management to evaluate and report on our internal control over financial reporting. This report contains, among other matters, an assessment of the effectiveness of our internal control over financial reporting as of the end of our fiscal year, including a statement as to whether or not our internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by management. In addition, our independent registered public accounting firm will be required to formally attest to the effectiveness of our internal control over financial reporting beginning with the Annual Report on Form 10-K for the year in which we are no longer an "emerging growth company." At such time, our independent registered public accounting firm may issue a report that is adverse in the event it is not satisfied with the level at which our controls are documented, designed or operating.

While we have determined that our internal control over financial reporting was effective as of December 31, 2012, as indicated in our Management Report on Internal Control over Financial Reporting included in our Annual Report on Form 10-K for the year ended December 31, 2012, we must continue to monitor and assess our internal control over financial reporting. If our management identifies one or more material weaknesses in our internal control over financial reporting and such weakness remains uncorrected at fiscal year-end, we will be unable to assert such internal control is effective at fiscal year-end. If we are unable to assert that our internal control over financial reporting is effective at fiscal year-end, or if our independent registered public accounting firm, when required, is unable to express an opinion on the effectiveness of our internal controls or concludes that we have a material weakness in our internal controls, we could lose investor confidence in the accuracy and completeness of our financial reports, which would likely have an adverse effect on our business and stock price.

Even if we conclude our internal control over financial reporting provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Generally Accepted Accounting Principles, or GAAP, because of its inherent limitations, internal control over financial reporting may not prevent or detect fraud or misstatements. Failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations.

In addition, a delay in compliance with the auditor attestation provisions of Section 404, when applicable to us, could subject us to a variety of administrative sanctions, including ineligibility for short-form resale registration, action by the SEC,



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the suspension or delisting of our common stock and the inability of registered broker-dealers to make a market in our common stock, which would further reduce the trading price of our common stock and could harm our business.

We are an “emerging growth company” and we cannot be certain if the reduced disclosure requirements applicable to emerging growth companies will make our common stock less attractive to investors.

We are an “emerging growth company,” as defined in the JOBS Act, and we intend to take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not “emerging growth companies” including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. We cannot predict if investors will find our common stock less attractive because we will rely on these exemptions. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile.

Our ability to use our net operating loss carryforwards and certain other tax attributes may be limited.

As of December 31, 2012, we had substantial federal and state net operating loss carryforwards. Under Sections 382 and 383 of the Internal Revenue Code of 1986, as amended, or the Code, if a corporation undergoes an “ownership change,” the corporation's ability to use its pre-change net operating loss carryforwards to offset its post-change income and taxes may be limited. In general, an “ownership change” generally occurs if there is a cumulative change in our ownership by “five-percent stockholders” that exceeds 50 percentage points over a rolling three-year period. For these purposes, a five-percent stockholder is generally any person or group of persons that at any time during the applicable testing period has owned 5% or more of our outstanding stock. In addition, persons who own less than 5% of the outstanding stock are grouped together as one or more “public groups,” which are also treated as five-percent stockholders. Similar rules may apply under state tax laws. We may experience ownership changes in the future as a result of future transactions in our stock, some of which may be outside our control. As a result, our ability to use our pre-change net operating loss carryforwards to offset United States federal and state taxable income and taxes may be subject to limitations.

Our joint venture's business prospects in China are dependent on government telecommunications infrastructure and budgetary policies, particularly the allocation of funds to sustain the growth of the telecommunications industry in China.

Our joint venture's business prospects in China include telecommunication service operators, and telecommunication service operators in China are directly or indirectly owned or controlled by the government of China. Accordingly, our joint venture's business prospects in China will also be heavily dependent on these government policies. Insufficient future funding allocated to China's telecommunications industry by the government could directly reduce the market for our joint venture's software and services in China. Chinese government initiatives directed at the market could also significantly affect the market conditions for our joint venture's Chinese customers and influence their level of spending on the services we offer. While some of these initiatives may increase market competition and generate more demand for our services, the anticipated increase in demand may not materialize. Our joint venture's prospective customers may not adapt well to the market conditions under the evolving regulatory environment and their demand for our joint venture's software and services may decrease as a result. The telecommunications industry in China may also become less competitive over time, either as a result of market propelled consolidations or as a result of government efforts to curtail competition. A less competitive market may create fewer incentives for spending on technology innovations and upgrades, which may directly affect our joint venture's business prospects in China. Our proprietary rights may be inadequately protected and there is a risk of poor enforcement of intellectual property rights in China.

Our success and ability to compete depend substantially upon our intellectual property, which we protect through a combination of confidentiality arrangements and trademark registrations. We have registered several marks and filed

many other trademark applications in the U.S. We have not applied for copyright protection in any jurisdiction, including in the U.S. We enter into confidentiality agreements with most of our employees and consultants, and control access to, and distribution of, our documentation and other licensed information, including information licensed to the JV Company. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our technology without authorization, or to develop similar technology independently. Since the Chinese legal system in general and the intellectual property regime in particular, are relatively weak, it is often difficult to enforce intellectual property rights in China.

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Policing unauthorized use of our licensed technology is difficult and the steps we take may not prevent misappropriation or infringement of our proprietary rights. In addition, litigation may be necessary to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others, which could result in substantial costs and diversion of our resources.

Failure to comply with the United States Foreign Corrupt Practices Act could subject us to penalties and other adverse consequences.

We are subject to the United States Foreign Corrupt Practices Act, which generally prohibits U.S. companies from engaging in bribery or other prohibited payments to foreign officials for the purpose of obtaining or retaining business. Corruption, extortion, bribery, pay-offs, theft and other fraudulent practices may occur with respect to our expansion into international markets. Our employees or other agents may engage in such conduct for which we might be held responsible. If our employees or other agents are found to have engaged in such practices, we could suffer severe penalties and other consequences, including adverse publicity and damage to our reputation that may have a material adverse effect on our business, financial condition and results of operations.

### **Risks Related to Our Industry**

The growth of the market for our services and products depends on the continued growth of the Internet as a medium for content, advertising, commerce and communications.

Expansion in the sales of our services and products depends on the continued acceptance of the Internet as a platform for content, advertising, commerce and communications. The acceptance of the Internet as a medium for such uses could be adversely impacted by delays in the development or adoption of new standards and protocols to handle increased demands of Internet activity, security, privacy protection, reliability, cost, ease of use, accessibility and quality of service. The performance of the Internet and its acceptance as such a medium has been harmed by viruses, worms, and similar malicious programs, and the Internet has experienced a variety of outages and other delays as a result of damage to portions of its infrastructure. If for any reason the Internet does not remain a medium for widespread content, advertising, commerce and communications, the demand for our services and products would be significantly reduced, which would harm our business.

The growth of the market for our services and products depends on the development and maintenance of the Internet infrastructure.

Our business strategy depends on continued Internet and high-speed Internet access growth. Any downturn in the use or growth rate of the Internet or high-speed Internet access would be detrimental to our business. If the Internet continues to experience significant growth in number of users, frequency of use and amount of data transmitted, the Internet infrastructure might not be able to support the demands placed on it and the performance or reliability of the Internet may be adversely affected. The success of our business therefore depends on the development and maintenance of a sound Internet infrastructure. This includes maintenance of a reliable network backbone with the necessary speed, data capacity and security, as well as timely development of complementary products, such as routers, for providing reliable Internet access and services. Consequently, as Internet usage increases, the growth of the market for our products depends upon improvements made to the Internet as well as to individual customers' networking infrastructures to alleviate overloading and congestion. In addition, any delays in the adoption of new standards and protocols required to govern increased levels of Internet activity or increased governmental regulation may have a detrimental effect on the Internet infrastructure.

A substantial majority of our revenue is derived from search and display advertising; our revenue would decline if advertisers do not continue their usage of the Internet as an advertising medium.

We have derived and expect to continue to derive a substantial majority of our revenue from search and display advertising on our startpages. Such search and display advertising revenue accounted for approximately 69%, 79%, and 83% of our revenue for the years ended December 31, 2010, 2011, and 2012, or \$45.9 million, \$72.1 million, and \$101.6 million, respectively, and 81% of our revenue for the six months ended June 30, 2013, or \$45.5 million.

However, the prospects for continued demand and market acceptance for Internet advertising are uncertain. If advertisers do not continue to increase their usage of the Internet as an advertising medium, our revenue would decline. Advertisers that have traditionally relied on other advertising media may not advertise on the Internet. Most

advertising agencies and potential advertisers, particularly local advertisers, have only limited experience advertising on the Internet and devote only a small portion of their advertising expenditures to online advertising. As the Internet evolves, advertisers may find online advertising to be a less attractive or less effective means of promoting their services and products than traditional methods of advertising and may not continue to allocate funds for Internet advertising. Many historical predictions by industry analysts and others concerning the growth of the Internet as a commercial medium have overstated the growth of the Internet and you should not rely upon them. This growth may not occur or may occur more slowly than estimated.

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Most of our search revenue is based on the number of paid “clicks” on sponsored links that are included in search results generated from our startpages. Generally, each time a consumer clicks on a sponsored link, the search provider that provided the commercial search result receives a fee from the advertiser who paid for such commercial click and the search provider pays us a portion of that fee. We, in turn, typically share a portion of the fee we receive with our customer. If an advertiser receives what it perceives to be a large number of clicks for which it needs to pay, but that do not result in a desired activity or an increase in sales, the advertiser may reduce or eliminate its advertisements through the search provider that provided the commercial search result to us. This reaction would lead to a loss of revenue to our search providers and consequently to lesser fees paid to us, which would have a material negative effect on our financial results.

Market prices for online advertising may decrease due to competitive or other factors. In addition, if a large number of Internet users use filtering software programs that limit or remove advertising from the users' view, advertisers may perceive that Internet advertising is not effective and may choose not to advertise on the Internet.

The market for Internet-based services and products in which we operate is highly competitive, and if we cannot compete effectively, our sales may decline and our business may be harmed.

Competition in the market for Internet-based services and products in which we operate is intense and involves rapidly changing technologies and customer and subscriber requirements, as well as evolving industry standards and frequent product introductions. Our competitors may develop solutions that are similar or superior to our technology. Our primary competitors include high-speed Internet service providers with internal information technology staff capable of developing solutions similar to our technology. Other competitors include Yahoo!, Google, AOL and MSN, a division of Microsoft. Advantages some of our existing and potential competitors hold over us include the following:

- significantly greater revenue and financial resources;

- stronger brand and consumer recognition;

- the capacity to leverage their marketing expenditures across a broader portfolio of services and products;

- more extensive proprietary intellectual property from which they can develop or aggregate content without having to pay fees or paying significantly lower fees than we do;

- pre-existing relationships with content providers that afford them access to content while blocking the access of competitors to that same content;

- pre-existing relationships with high-speed Internet service providers that afford them the opportunity to convert such providers to competing services and products;

- lower labor and development costs; and

- broader global distribution and presence.

If we are unable to compete effectively or we are not as successful as our competitors in our target markets, our sales could decline, our margins could decline and we could lose market share, any of which would materially harm our business, financial condition and results of operations.

Government regulation of the Internet continues to evolve, and new laws and regulations could significantly harm our financial performance.

Today, there are relatively few laws specifically directed towards conducting business over the Internet. We expect more stringent laws and regulations relating to the Internet to be enacted. The adoption or modification of laws related to the Internet could harm our business, financial condition and results of operations by, among other things,

increasing our costs and administrative burdens. Due to the increasing popularity and use of the Internet, many laws and regulations relating to the Internet are being debated at the international, federal and state levels, which are likely to address a variety of issues such as:

- user privacy and expression;

- ability to collect and/or share necessary information that allows us to conduct business on the Internet;

- export compliance;

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pricing and taxation;

fraud;

advertising;

intellectual property rights;

consumer protection;

protection of minors;

content regulation;

information security; and

quality of services and products.

Several federal laws that could have an impact on our business have been adopted. The Digital Millennium Copyright Act of 1998 reduces the liability of online service providers of third-party content, including content that may infringe copyrights or rights of others. The Children's Online Privacy Protection Act imposes additional restrictions on the ability of online services to collect user information from minors. In addition, the Protection of Children from Sexual Predators Act requires online service providers to report evidence of violations of federal child pornography laws under certain circumstances.

It could be costly for us to comply with existing and potential laws and regulations, and they could harm our marketing efforts and our attractiveness to advertisers by, among other things, restricting our ability to collect demographic and personal information from consumers or to use or disclose that information in certain ways. If we were to violate these laws or regulations, or if it were alleged that we had, we could face private lawsuits, fines, penalties and injunctions and our business could be harmed.

Finally, the applicability to the Internet and other online services of existing laws in various jurisdictions governing issues such as property ownership, sales and other taxes, libel and personal privacy is uncertain. Any new legislation or regulation, the application of laws and regulations from jurisdictions whose laws do not currently apply to our business, or the application of existing laws and regulations to the Internet and other online services could also increase our costs of doing business, discourage Internet communications, reduce demand for our services and expose us to substantial liability.

Public scrutiny of Internet privacy issues may result in increased regulation and different industry standards, which could deter or prevent us from providing our current products and solutions to our customers, thereby harming our business.

The regulatory framework for privacy issues worldwide is currently in flux and is likely to remain so for the foreseeable future. Practices regarding the collection, use, storage, transmission and security of personal information by companies operating over the Internet have recently come under increased public scrutiny. The United States government, including the Federal Trade Commission and the Department of Commerce, has announced that it is reviewing the need for greater regulation for the collection of information concerning consumer behavior on the Internet, including regulation aimed at restricting certain targeted advertising practices. In addition, the European Union is in the process of proposing reforms to its existing data protection legal framework, which may result in a greater compliance burden for companies with users in Europe. Various government and consumer agencies have also called for new regulation and changes in industry practices.

Our business, including our ability to operate and expand internationally, could be adversely affected if legislation or regulations are adopted, interpreted or implemented in a manner that is inconsistent with our current business practices and that require changes to these practices, our services or our privacy policies.

**Risks Related to Ownership of Our Common Stock**

Concentration of ownership among our directors, officers, large stockholders and their respective affiliates could limit our other stockholders' ability to influence the outcome of key corporate decisions, such as an acquisition of our company.



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Our directors, executive officers and holders of more than 5% of our common stock, together with their affiliates, beneficially own or control, directly or indirectly, as of March 26, 2013 over 30% of our outstanding common stock. As a result, these stockholders, if they act together, would have the ability to influence significantly the outcome of matters submitted to our stockholders for approval, including the election of directors and any merger, consolidation or sale of all or substantially all of our assets. In addition, these stockholders, if they act together, would have the ability to influence significantly the management and affairs of our company. Accordingly, this concentration of ownership might harm the trading price of our common stock by:

- delaying, deferring or preventing a change in our control;
- impeding a merger, consolidation, takeover or other business combination involving us; or
- discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of us.

Future sales of our common stock may cause the trading price of our common stock to decline.

As of February 15, 2012, the closing date of our initial public offering, stockholders holding some 17,666,204 shares of our common stock had demand and piggyback rights to require us to register such shares with the SEC. If we register any of these shares of common stock, the stockholders would be able to sell those shares freely in the public market.

In addition, the shares that are either subject to outstanding options or that may be granted in the future under our 2012 Equity Incentive Plan will become eligible for sale in the public market to the extent permitted by the provisions of various vesting agreements and Rules 144 and 701 under the Securities Act.

As of February 22, 2012, we registered the shares of our common stock that we may issue under our equity plans. These shares can be freely sold in the public market upon issuance, subject to any vesting.

If a substantial number of any of these additional shares described are sold, or if it is perceived that a substantial number of such shares will be sold, in the public market, the trading price of our common stock could decline.

Some provisions of our certificate of incorporation, bylaws and Delaware law may discourage, delay or prevent a merger or acquisition or prevent the removal of our current board of directors and management.

Our amended and restated certificate of incorporation and amended and restated bylaws contain provisions that may discourage, delay or prevent a merger or acquisition or prevent the removal of our current board of directors and management. We have a number of anti-takeover devices in place that will hinder takeover attempts, including:

- our board of directors is classified into three classes of directors with staggered three-year terms;
- our directors may only be removed for cause, and only with the affirmative vote of a majority of the voting interest of stockholders entitled to vote;
- only our board of directors and not our stockholders will be able to fill vacancies on our board of directors;
- only our chairman of the board, our chief executive officer or a majority of our board of directors, and not our stockholders, are authorized to call a special meeting of stockholders;
- our stockholders will be able to take action only at a meeting of stockholders and not by written consent;
- our amended and restated certificate of incorporation authorizes undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval; and
-

advance notice procedures apply for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders.

These provisions and other provisions in our charter documents could discourage, delay or prevent a transaction involving a change in our control. Any delay or prevention of a change in control transaction could cause stockholders to lose a substantial premium over the then-current trading price of their shares. These provisions could also discourage proxy contests and could make it more difficult for our stockholders to elect directors of their choosing or to cause us to take other corporate actions such stockholders desire.

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In addition, we are subject to Section 203 of the Delaware General Corporation Law, which, subject to some exceptions, prohibits “business combinations” between a Delaware corporation and an “interested stockholder,” which is generally defined as a stockholder who becomes a beneficial owner of 15% or more of a Delaware corporation's voting stock, for a three-year period following the date that the stockholder became an interested stockholder. Section 203 could have the effect of delaying, deferring or preventing a change in control that our stockholders might consider to be in their best interests.

We have not paid cash dividends on our capital stock, and we do not expect to do so in the foreseeable future.

We have not historically paid cash dividends on our capital stock. We anticipate that we will retain all future earnings and cash resources for the future operation and development of our business, and as a result, we do not anticipate paying any cash dividends to holders of our capital stock for the foreseeable future. Any future determination regarding the payment of any dividends will be made at the discretion of our board of directors and will depend on our financial condition, results of operations, capital requirements, general business conditions and other factors that our board may deem relevant. Consequently, investors must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investment.

The trading price and volume of our common stock has been and will likely continue to be volatile, and the value of an investment in our common stock may decline.

The trading price of our common stock has been, and is likely to continue to be, volatile and could decline substantially within a short period of time. For example, since shares of our common stock were sold in our initial public offering in February 2012 at a price of \$5.00 per share through the close of business on July 31, 2013, our trading price has ranged from \$2.58 to \$18.00. The trading price of our common stock may be subject to wide fluctuations in response to various factors, some of which are beyond our control, including but not limited to the various factors set forth in this "Risk Factors" section, as well as:

- variations in our financial performance;

- announcements of technological innovations, new services and products, strategic alliances or significant agreements by us or by our competitors;

- recruitment or departure of key personnel;

- changes in the estimates of our operating results or changes in recommendations or withdrawal of research coverage by securities analysts;

- market conditions in our industry, the industries of our customers and the economy as a whole; and

- adoption or modification of laws, regulations, policies, procedures or programs applicable to our business or announcements relating to these matters.

In addition, if the market for technology stocks or the stock market in general experiences loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, financial condition or results of operations. The trading price of our common stock might also decline in reaction to events that affect other companies in our industry even if these events do not directly affect us. Some companies that have had volatile market prices for their securities have had securities class actions filed against them. Such a suit filed against us, regardless of its merits or outcome, could cause us to incur substantial costs and could divert management's attention.

If securities or industry analysts do not publish research or reports about our company, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business. If one or more of the analysts who cover us downgrade our stock or publish

inaccurate or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, demand for our stock could decrease, which might cause our stock price and trading volume to decline.

The requirements of being a public company, including increased costs and demands upon management as a result of complying with federal securities laws and regulations applicable to public companies, may adversely affect our financial performance and our ability to attract and retain directors.

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As a public company, we are subject to the reporting requirements of the Securities Exchange Act of 1934, as amended, or the Exchange Act, the Sarbanes-Oxley Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, and the rules and regulations of The NASDAQ Global Market. The Sarbanes-Oxley Act, as well as rules subsequently implemented by the SEC and NASDAQ, impose additional requirements on public companies, including enhanced corporate governance practices. For example, the NASDAQ listing requirements require that listed companies satisfy certain corporate governance requirements relating to independent directors, audit committees, distribution of annual and interim reports, stockholder meetings, stockholder approvals, solicitation of proxies, conflicts of interest, stockholder voting rights and codes of business conduct. Our management team has limited experience managing a publicly-traded company or complying with the increasingly complex laws pertaining to public companies. In addition, most of our current directors have limited experience serving on the boards of public companies.

The requirements of these rules and regulations have increased and will continue to increase our legal, accounting and financial compliance costs, make some activities more difficult, time-consuming and costly and may also place undue strain on our personnel, systems and resources. Our management and other personnel must devote a substantial amount of time to these requirements. These rules and regulations will also make it more difficult and more expensive for us to maintain directors' and officers' liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to maintain coverage. If we are unable to maintain adequate directors' and officers' insurance, our ability to recruit and retain qualified directors, especially those directors who may be considered independent for purposes of NASDAQ rules, and officers may be significantly curtailed.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Use of Proceeds

In February 2012, we completed the initial public offering of shares of our common stock, in which we issued and sold 5,454,545 shares of common stock at a price to the public of \$5.00 per share, for aggregate gross proceeds to the Company of \$27.3 million, in each case excluding shares of common stock sold by selling stockholders in the offering. The offer and sale of all of the shares in the IPO were registered under the Securities Act pursuant to a registration statement on Form S-1 (File No. 333-178049), which was declared effective by the SEC on February 9, 2012. The syndicate of underwriters was led by Merrill Lynch, Pierce, Fenner & Smith Incorporated and Citigroup Global Markets Inc. as joint book-running managers for the offering. Stifel Nicolaus & Company, Incorporated, BMO Capital Markets Corp., Needham & Company, LLC and Oppenheimer & Co. Inc. served as co-managers for the offering.

The net proceeds to the Company from the initial public offering were approximately \$22.4 million after deducting underwriting discounts of \$1.9 million and offering costs of \$3.0 million. No payments for such offering costs were made directly or indirectly to (i) any of our officers or directors or their associates, (ii) any persons owning 10% or more of any class of our equity securities or (iii) any of our affiliates other than the payment of certain legal expenses on behalf of our selling stockholders.

There has been no material change in the planned use of proceeds from our initial public offering as described in our final prospectus filed with the SEC on February 10, 2012 pursuant to Rule 424(b).

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

The exhibits listed in the Index to Exhibits (following the signatures page of this Quarterly Report on Form 10-Q) are filed with, or incorporated by reference in, this Quarterly Report on Form 10-Q.



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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: August 13, 2013

SYNACOR, INC.

By: /s/ RONALD N. FRANKEL

Ronald N. Frankel

President and Chief Executive Officer

(Principal Executive Officer)

Date: August 13, 2013

By: /s/ WILLIAM J. STUART

William J. Stuart

Chief Financial Officer and Secretary

(Principal Financial and Accounting Officer)

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EXHIBIT INDEX

| Exhibit No. | Exhibit                                                                                                                                                                                                                                                                                                                                                                                                                |
|-------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1.1*     | Amendment Two to Google Services Agreement between Google Inc. and Synacor, Inc. dated as of May 1, 2012.                                                                                                                                                                                                                                                                                                              |
| 10.1.2*     | Amendment Three to Google Services Agreement between Google Inc. and Synacor, Inc. dated as of May 1, 2013.                                                                                                                                                                                                                                                                                                            |
| 10.2*       | Amendment #4 to Amended and Restated Master Services Agreement between Charter Communications Operating, LLC and Synacor, Inc. dated as of April 1, 2013.                                                                                                                                                                                                                                                              |
| 10.3*       | Amendment #2 to Master Services Agreement between Verizon Corporate Services Group Inc. and Synacor, Inc. dated as of April 1, 2013.                                                                                                                                                                                                                                                                                   |
| 10.4        | Special Purpose Recruitment Plan (incorporated by reference to Appendix A of Registrant's Definitive Proxy Statement on Schedule 14A (File No. 001-33843), filed with the SEC on April 5, 2013).                                                                                                                                                                                                                       |
| 10.5        | Form of Stock Option Agreement (Early Exercise) under Special Purpose Recruitment Plan.                                                                                                                                                                                                                                                                                                                                |
| 10.6        | Letter agreement between Scott A. Bailey and Synacor, Inc. dated as of June 25, 2013.                                                                                                                                                                                                                                                                                                                                  |
| 31.1        | Certifications of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                               |
| 31.2        | Certifications of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                               |
| 32.1        | Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                    |
| 101.INS†    | XBRL Instance Document                                                                                                                                                                                                                                                                                                                                                                                                 |
| 101.SCH†    | XBRL Taxonomy Schema Linkbase Document                                                                                                                                                                                                                                                                                                                                                                                 |
| 101.CAL†    | XBRL Taxonomy Calculation Linkbase Document                                                                                                                                                                                                                                                                                                                                                                            |
| 101.DEF†    | XBRL Taxonomy Definition Linkbase Document                                                                                                                                                                                                                                                                                                                                                                             |
| 101.LAB†    | XBRL Taxonomy Labels Linkbase Document                                                                                                                                                                                                                                                                                                                                                                                 |
| 101.PRE†    | XBRL Taxonomy Presentation Linkbase Document                                                                                                                                                                                                                                                                                                                                                                           |
| *           | Confidential treatment requested for portions of this document. The omitted portions have been filed with the Securities and Exchange Commission.                                                                                                                                                                                                                                                                      |
| †           | Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections. |