DIGITAL RIVER INC /DE
Form 10-Q
May 08, 2009

Table of Contents

**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

# FORM 10-Q

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

**FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2009**

**OR**

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

**FOR THE TRANSITION PERIOD FROM TO**

**Commission file number 000-24643**

**DIGITAL RIVER, INC.**

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **DELAWARE** | **41-1901640** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |

**9625 WEST 76TH STREET**
**EDEN PRAIRIE, MINNESOTA 55344**
(Address of principal executive offices)
**(952) 253-1234**
(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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 þ | Accelerated filer o | Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

The number of shares of common stock outstanding at April 1, 2009 was 38,176,234 shares.

DIGITAL RIVER, INC.
Form 10-Q
Index

Table of Contents

**PART I. FINANCIAL INFORMATION**
**Item 1. Financial Statements**

**DIGITAL RIVER, INC.**
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

| | (Unaudited) March 31, 2009 | December 31, 2008 |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 347,863 | $ 490,335 |
| Short-term investments | 7,000 | 10,000 |
| Accounts receivable, net of allowance of $3,017 and $2,457 | 61,411 | 53,216 |
| Deferred income taxes | 7,606 | 7,613 |
| Prepaid expenses and other | 19,299 | 42,522 |
| Total current assets | 443,179 | 603,686 |
| Property and equipment, net | 44,417 | 41,733 |
| Goodwill | 264,643 | 273,788 |
| Intangible assets, net of accumulated amortization of $67,138 and $66,345 | 29,380 | 32,222 |
| Long-term investments | 91,967 | 93,213 |
| Deferred income taxes | 22,686 | 24,824 |
| Other assets | 744 | 786 |
| TOTAL ASSETS | $ 897,016 | $ 1,070,252 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| CURRENT LIABILITIES: | | |
| Convertible senior notes | $ | $ 186,195 |
| Accounts payable | 202,603 | 184,361 |
| Accrued payroll | 11,979 | 14,841 |
| Deferred revenue | 15,530 | 13,651 |
| Accrued acquisition costs | 255 | 3,278 |
| Other accrued liabilities | 36,845 | 41,336 |
| Total current liabilities | 267,212 | 443,662 |
| NON-CURRENT LIABILITIES: | | |
| Convertible senior notes | 8,805 | 8,805 |
| Other liabilities | 15,612 | 15,712 |
| Total non-current liabilities | 24,417 | 24,517 |

| | | |
|---|---|---|
| TOTAL LIABILITIES | 291,629 | 468,179 |
| | | |
| COMMITMENTS AND CONTINGENCIES | | |
| | | |
| STOCKHOLDERS EQUITY: | | |
| Preferred Stock, $.01 par value; 5,000,000 shares authorized; no shares issued or outstanding | | |
| Common Stock, $.01 par value; 120,000,000 shares authorized; 44,405,401 and 43,225,401 shares issued | 444 | 432 |
| Treasury stock at cost; 6,229,167 and 6,211,477 shares | (216,600) | (216,163) |
| Additional paid-in capital | 622,630 | 623,778 |
| Retained earnings | 205,687 | 189,096 |
| Accumulated other comprehensive (loss)/income | (6,774) | 4,930 |
| | | |
| Total stockholders equity | 605,387 | 602,073 |
| | | |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | $ 897,016 | $ 1,070,252 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents

**DIGITAL RIVER, INC.**
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data; unaudited)

| | Three Months Ended March 31, | |
|---|---|---|
| | **2009** | **2008** |
| Revenue | $ 102,931 | $ 103,634 |
| Costs and expenses | | |
| Direct cost of services | 3,942 | 4,175 |
| Network and infrastructure | 10,313 | 10,188 |
| Sales and marketing | 38,447 | 39,730 |
| Product research and development | 12,335 | 12,670 |
| General and administrative | 9,129 | 10,244 |
| Depreciation and amortization | 3,844 | 3,834 |
| Amortization of acquisition-related intangibles | 2,003 | 2,176 |
| Total costs and expenses | 80,013 | 83,017 |
| Income from operations | 22,918 | 20,617 |
| Interest Income | 1,189 | 6,246 |
| Other expense, net | (1,348) | (749) |
| Income before income tax expense | 22,759 | 26,114 |
| Income tax expense | 6,168 | 7,831 |
| Net income | $ 16,591 | $ 18,283 |
| Net income per share basic | $ 0.45 | $ 0.47 |
| Net income per share diluted | $ 0.45 | $ 0.43 |
| Shares used in per-share calculation basic | 36,706 | 38,528 |
| Shares used in per-share calculation diluted | 37,227 | 43,506 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents

**DIGITAL RIVER, INC.**
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands; unaudited)

| | Three Months Ended March 31, 2009 | Three Months Ended March 31, 2008 |
|---|---|---|
| OPERATING ACTIVITIES | | |
| Net income | $ 16,591 | $ 18,283 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Amortization of acquisition-related intangibles | 2,003 | 2,176 |
| Change in accounts receivable allowance, net of acquisitions | 580 | 411 |
| Depreciation and amortization | 3,844 | 3,834 |
| Stock-based compensation expense related to stock-based compensation plans | 3,711 | 3,031 |
| Excess tax benefits from stock-based compensation | (96) | (412) |
| Deferred and other income taxes | 1,555 | 5,345 |
| Change in operating assets and liabilities (net of acquisitions) | | |
| Accounts receivable | (10,607) | 4,374 |
| Prepaid and other assets | 17,399 | 3,732 |
| Accounts payable | 23,129 | 4,798 |
| Deferred revenue | 2,191 | 1,248 |
| Income tax payable | 2,020 | (7,357) |
| Other accrued liabilities | (7,729) | 5,190 |
| Net cash provided by operating activities | 54,591 | 44,653 |
| INVESTING ACTIVITIES | | |
| Purchases of investments | (2,122) | (94,714) |
| Sales of investments | 10,000 | 122,050 |
| Cash paid for acquisitions, net of cash received | (3,017) | (16,481) |
| Purchases of equipment and capitalized software | (6,894) | (4,192) |
| Net cash (used in)/provided by investing activities | (2,033) | 6,663 |
| FINANCING ACTIVITIES | | |
| Cash paid for convertible senior notes | (186,660) | |
| Exercise of stock options | 943 | 1,985 |
| Repurchase of common stock | | (137,858) |
| Repurchase of restricted stock to satisfy tax withholding obligation | (436) | (355) |
| Excess tax benefits from stock-based compensation | 96 | 412 |
| Net cash used in financing activities | (186,057) | (135,816) |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH | (8,973) | 8,512 |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (142,472) | (75,988) |
| CASH AND CASH EQUIVALENTS, beginning of period | 490,335 | 381,788 |

| | | |
|---|---|---|
| CASH AND CASH EQUIVALENTS, end of period | $ 347,863 | $ 305,800 |
| SUPPLEMENTAL DISCLOSURES: | | |
| Cash paid for interest on convertible senior notes | $ 1,219 | $ 1,219 |
| Cash paid for income taxes | $ 4,947 | $ 8,772 |

See accompanying notes to condensed consolidated financial statements.

5

## DIGITAL RIVER, INC.
## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

### 1. BASIS OF PRESENTATION

The unaudited condensed consolidated financial statements included herein reflect all adjustments, including normal recurring adjustments, which in our opinion are necessary to fairly state our consolidated financial position, results of operations and cash flows for the periods presented. These condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements included in our Forms 10-K and 10-K/A for the year ended December 31, 2008, as filed with the Securities and Exchange Commission. The results of operations for the three months ended March 31, 2009, are not necessarily indicative of the results to be expected for any subsequent quarter or for the entire fiscal year ending December 31, 2009. The December 31, 2008, balance sheet was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles in the United States.

***Summary of Significant Accounting Policies***

A detailed description of our significant accounting policies can be found in our most recent Annual Report filed on Forms 10-K and 10-K/A for the fiscal year ended December 31, 2008.

***Software Development***

Costs to develop software for internal use are required to be capitalized and amortized over the estimated useful life of the software in accordance with AICPA Statement of Position No. 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. We capitalized $5.6 million related to software development during the three months ended March 31, 2009. We did not capitalize any costs related to software development during the three months ended March 31, 2008.

***Stock-Based Compensation Expense***

On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (Revised 2004), Share-Based Payment, ( SFAS 123(R) ) which requires the measurement and recognition of compensation expense for all share-based payments made to employees and directors including stock options, restricted stock grants and employee stock purchases made through our Employee Stock Purchase Plan based on estimated fair values.

We have adopted SFAS 123(R) using the modified prospective transition method under which prior periods are not revised. Stock-based compensation expense recognized during the period is based on the value of the portion of share-based awards that are ultimately expected to vest during the period. The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option pricing model. The fair value of restricted stock is determined based on the number of shares granted and the closing price of our common stock on the date of grant. Compensation expense for all share-based payment awards is recognized using the straight-line amortization method over the vesting period. As stock-based compensation expense recognized in our Condensed Consolidated Statement of Income is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

SFAS 123(R) also requires the benefits of tax deductions in excess of recognized stock-based compensation expense be reported as a financing cash flow, rather than an operating cash flow as required prior to adoption of SFAS 123(R) in our Condensed Consolidated Statement of Cash Flows.

See Note 4 in the Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q for further information regarding our stock-based compensation plans.

***Comprehensive Income***

Comprehensive income includes revenues, expenses, gains and losses that are excluded from net earnings under GAAP. Items of comprehensive income are unrealized gains and losses on short-term investments and foreign currency translation adjustments which are added to net income to compute comprehensive income.

Table of Contents

**DIGITAL RIVER, INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Unaudited)

The components of comprehensive income are (in thousands):

| | Three Months Ended March 31, | |
|---|---|---|
| | **2009** | **2008** |
| Net Income | $ 16,591 | $ 18,283 |
| Other comprehensive income: | | |
| Unrealized foreign exchange (loss)/gain on the revaluation of investments in foreign subsidiaries | (15,336) | 15,233 |
| Reduction in temporary impairment of auction rate securities | 5,754 | |
| Unrealized (loss)/gain on investments | (7) | 1,312 |
| Tax expense | (2,115) | |
| Other comprehensive income | (11,704) | 16,545 |
| Comprehensive income | $ 4,887 | $ 34,828 |

***Foreign Currency***

We have adopted SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FAS 133* ( SFAS 161 ). SFAS 161 applies to all derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items accounted for under SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities* ( SFAS 133 ). The Statement does not affect amounts reported in the financial statements; it only expands the disclosure requirements of SFAS 133.

We are exposed to market risk from changes in foreign currency exchange rates. Our primary risk is the effect of foreign currency exchange rate fluctuations on the US dollar value of foreign currency denominated operating sales and expenses. At March 31, 2009, these exposures were mitigated by the use of foreign exchange forward contracts with maturities of approximately one week. The principal currency exposure being mitigated was the euro. Our foreign currency contracts contain credit risk to the extent that our bank counterparties may be unable to meet the terms of the agreements. See Appendix 1A Risk Factors, for additional information.

Substantially all of our foreign subsidiaries use the local currency of their respective countries as their functional currency. We enter into foreign currency forward exchange contracts with bank counterparties. In general, these contracts mature one week from the date we entered into them. All of our derivatives are not designated as hedges under the provisions of SFAS 133 and are adjusted to fair value through income each period.

Assets and liabilities are translated at exchange rates prevailing at the balance sheet dates. Revenues, costs and expenses are translated at the average exchange rates for the reported period. Gains and losses resulting from translation are recorded as a component of equity. Gains and losses resulting from foreign currency transactions are recognized as other expense, net . For the three months ended March 31, 2009, derivative activity was immaterial.

**2. NET INCOME PER SHARE**

Basic income per common share is computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per common share is calculated by dividing net income, adjusted to exclude interest expense and financing cost amortization related to potentially dilutive securities, by the weighted average number of common shares outstanding during the period, plus any additional common shares that would have been outstanding if potentially dilutive common shares had been issued during the period.

The following table summarizes the computation of basic and diluted net income per share (in thousands, except per share amounts):

Table of Contents

**DIGITAL RIVER, INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Unaudited)

| | Three Months Ended March 31, 2009 | 2008 |
|---|---|---|
| Earnings per share basic | | |
| Net income basic | $ 16,591 | $ 18,283 |
| Weighted average shares outstanding basic | 36,706 | 38,528 |
| Earnings per share basic | $ 0.45 | $ 0.47 |
| Earnings per share diluted | | |
| Net income basic | $ 16,591 | $ 18,283 |
| Exclude: Interest expense and amortized financing cost of convertible senior notes, net of tax benefit | 21 | 434 |
| Net income diluted | $ 16,612 | $ 18,717 |
| Weighted average shares outstanding basic | 36,706 | 38,528 |
| Dilutive impact of non-vested stock and options outstanding | 321 | 553 |
| Dilutive impact of convertible senior notes | 200 | 4,425 |
| Weighted average shares outstanding diluted | 37,227 | 43,506 |
| Net income per share diluted | $ 0.45 | $ 0.43 |

Options to purchase 1,849,000 and 820,600 shares for the three months ended March 31, 2009 and 2008, respectively, were not included in the computation of diluted EPS, because their effect on diluted EPS would have been anti-dilutive.

In accordance with the Emerging Issues Task Force (EITF), Issue No. 04-8, the unissued shares underlying contingent convertible notes are treated as if such shares were issued and outstanding for the purposes of calculating GAAP diluted earnings per share beginning with the issuance of our 1.25% convertible senior notes on June 1, 2004.

**3. BUSINESS COMBINATIONS, GOODWILL AND INTANGIBLE ASSETS**

***Business Combinations***

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), Business Combinations. This revised Statement, which we refer to as SFAS No. 141(R), is intended to simplify existing guidance and converge rulemaking under U.S. GAAP with international accounting rules. SFAS No. 141(R) will significantly change the accounting for business combinations in a number of areas, including the treatment of contingent consideration, contingencies, acquisition costs and restructuring costs. Also under this Statement, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008. We adopted FAS 141(R) as of January 1, 2009 and the impact was immaterial to our financial statements.

***Acquisitions completed in 2008***

On September 1, 2008, we acquired all of the capital stock of Think Subscription, Inc. (Think Subscription), a privately-held company based in Provo, Utah, for approximately $5.1 million in cash. Think Subscription provides subscription management and fulfillment software to content publishers, online service providers, media vendors and other subscription-based businesses. The agreement provides Think Subscription shareholders with an earn-out opportunity based on Think Subscription achieving certain revenue and earnings targets during the first three years subsequent to the acquisition. Any future earn-out will result in additional goodwill.

On January 1, 2008, we acquired all of the capital stock of DigitalSwift Corporation (DigitalSwift), a privately-held company based in Madison, Georgia, for approximately $9.2 million in cash. DigitalSwift is a manufacturer and fulfiller of on-demand, dynamic and build-to-order CDs and DVDs to consumers. The agreement provides DigitalSwift shareholders with an earn-out opportunity based on DigitalSwift achieving certain revenue and earnings targets during the first year subsequent to the acquisition. In 2008, we paid earn-outs of $1.0 million and accrued $3.0 million for future earn-out payments. Earn-outs totaling $3.0 million were paid during the first quarter of 2009. These earn-outs have been recorded as goodwill in 2008 as they were considered incremental to the purchase price.

**DIGITAL RIVER, INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Unaudited)

On January 1, 2008, we acquired the assets of IA Users Club d.b.a. CustomCD, Inc. (CustomCD), a privately-held company based in Portland, Oregon and Krefeld, Germany, for approximately $7.0 million in cash. This acquisition involved an asset purchase of the US-based business and a stock purchase of the business located in Germany. CustomCD creates, sells and delivers to consumers custom CDs and DVDs containing software, games, and other licensed content. The agreement provides CustomCD shareholders with an earn-out opportunity based on CustomCD achieving certain revenue and earnings targets during the first two years subsequent to the acquisition. In 2008, we paid earn-outs of $1.3 million. Earn-outs were recorded as goodwill in 2008 as they were considered incremental to the purchase price. Any future earn-out will result in additional goodwill.

***Future Earn-outs***

As of March 31, 2009, there were no future earn-outs in accrued acquisition liabilities.

***Pro Forma Operating Results (Unaudited)***

The consolidated financial statements include the operating results of each business from the date of acquisition. The following unaudited pro forma condensed results of operations for the three months ended March 31, 2009 and 2008 have been prepared as if each of the acquisitions in 2008 had occurred on January 1, 2008, there were no acquisitions in 2009 (in thousands, except per share amounts):

| | Three Months Ended March 31, | |
|---|---|---|
| | **2009** | **2008** |
| Revenue | $102,931 | $104,232 |
| Income from operations | 22,918 | 20,360 |
| Net income | 16,591 | 18,028 |
| | | |
| Basic net income per share | $ 0.45 | $ 0.47 |
| Diluted net income per share | $ 0.45 | $ 0.42 |

This pro forma financial information does not purport to represent results that would actually have been obtained if the transactions had been completed on January 1, 2008, or any future results that may be realized.

***Goodwill and Other Intangible Assets***

We account for our goodwill in accordance with SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 142 precludes the amortization of goodwill and intangible assets with indefinite lives, but these assets are reviewed quarterly (or more frequently if impairment indicators arise) for impairment.

We complete our quarterly impairment test using a two-step approach and reassess any intangible assets, including goodwill, recorded in connection with earlier acquisitions. There was no material impairment of goodwill or other intangible assets in the three months ended March 31, 2009 and 2008.

Information regarding our other intangible assets is as follows (in thousands):

Table of Contents

**DIGITAL RIVER, INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Unaudited)

| | As of March 31, 2009 | | |
|---|---|---|---|
| | Carrying Amount Gross | Accumulated Amortization | Carrying Amount Net |
| Customer relationships | $ 60,955 | 38,392 | $ 22,563 |
| Non-compete agreements | 5,253 | 5,244 | 9 |
| Technology/tradename | 30,310 | 23,502 | 6,808 |
| Total | $ 96,518 | $ 67,138 | $ 29,380 |

| | As of December 31, 2008 | | |
|---|---|---|---|
| | Carrying Amount Gross | Accumulated Amortization | Carrying Amount Net |
| Customer relationships | $ 62,265 | $ 37,931 | $ 24,334 |
| Non-compete agreements | 5,312 | 5,301 | 11 |
| Technology/tradename | 30,991 | 23,114 | 7,877 |
| Total | $ 98,568 | $ 66,346 | $ 32,222 |

Amortization expense for the three months ended March 31, 2009 and 2008 was $2.0 million and $2.2 million, respectively. The result of the allocation of the purchase price between amortizable costs and goodwill could have an impact on our future operating results. Estimated amortization expense for the remaining life of the intangible assets, based on intangible assets as of March 31, 2009, is as follows (in thousands):

| Year | |
|---|---|
| 2009 | $ 5,352 |
| 2010 | 5,677 |
| 2011 | 4,600 |
| 2012 | 4,442 |
| 2013 | 2,522 |
| 2014 | 2,388 |
| Thereafter | 4,399 |
| Total | $ 29,380 |

**4. STOCKHOLDERS EQUITY**

***Option and Restricted Stock Awards***

*2007 Plan*

Our stockholders approved the Digital River, Inc. 2007 Equity Incentive Plan (the 2007 Plan ) at the Company s annual stockholder meeting held on May 31, 2007. The number of shares issuable under the 2007 Plan equals 2,000,000 shares of our common stock. In addition, shares not issued under the 1998 Plan shall become available for issuance under the 2007 Plan to the extent a stock option or other stock award under the 1998 Plan expires or terminates before shares of common stock are issued under the award. Under our 2007 Equity Incentive Plan we have the flexibility to grant incentive and non-statutory stock options, restricted stock awards, restricted stock unit awards and performance shares to our directors, employees, and consultants.

*1998 Plan*

The 1998 Equity Incentive Plan expired in June 2008 except as to options still outstanding under the Plan.

*General Stock Award Information*

As of March 31, 2009, there were 279,135 shares available for future awards under our 2007 Plan. The number of shares available has been reduced by three shares for every two shares of restricted stock awards granted under the Plans.

Table of Contents

**DIGITAL RIVER, INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Unaudited)

Options granted to employees typically expire no later than ten years after the date of grant. Incentive stock option grants must have an exercise price of at least 100% of the fair market value of a share of common stock on the grant date. Incentive stock options granted to employees who, immediately before such grant, owned stock directly or indirectly representing more than 10% of the voting power of our stock, will have an exercise price of 110% of the fair market value of a share of common stock on the grant date and will expire no later than five years from the date of grant.

A summary of the changes in outstanding options is as follows:

| | Shares Available for Grant | Options Outstanding | Options Price Per Share | Weighted Average Price Per Share |
|---|---|---|---|---|
| Balance, December 31, 2007 | 2,848,728 | 2,778,310 | $ 2.59 - $57.36 | $ 28.41 |
| Granted | (807,000) | 807,000 | 19.28-41.44 | 31.10 |
| Restricted stock effect on shares available for grant | (278,952) | N/A | N/A | N/A |
| Exercised | | (425,774) | 4.56-38.17 | 16.84 |
| Canceled/expired | 213,686 | (213,686) | 9.13-56.61 | 38.59 |
| Balance, December 31, 2008 | 1,976,462 | 2,945,850 | $ 2.59 - $57.36 | $ 30.08 |
| Granted | (40,000) | 40,000 | 24.07 - 25.61 | 24.99 |
| Restricted stock effect on shares available for grant | (1,701,453) | N/A | N/A | N/A |
| Exercised | | (46,823) | 6.37 - 27.28 | 20.13 |
| Canceled/expired | 44,126 | (44,126) | 4.65 - 55.39 | 38.86 |
| Balance, March 31, 2009 | 279,135 | 2,894,901 | $ 2.59 - $57.36 | $ 30.04 |

The total pretax intrinsic value of options exercised during the three months ended March 31, 2009, was $0.3 million.

The following table summarizes significant ranges of outstanding and exercisable options under our 1998 Plan and 2007 Plan as of March 31, 2009:

| | Options Outstanding | | | | Options Exercisable | | |
|---|---|---|---|---|---|---|---|
| Exercise Price | Number Outstanding | Weighted Average Life Remaining | Weighted Average Price | Aggregate Intrinsic Value | Number Exercisable | Weighted Average Price | Aggregate Intrinsic Value |
| $2.59 - $3.88 | 19,187 | 1.8 years | $ 2.74 | $ 519,489 | 19,187 | $ 2.74 | $ 519,489 |
| 4.56 - 7.55 | 146,195 | 2.2 years | 5.37 | 3,573,927 | 146,195 | 5.37 | 3,573,927 |
| 9.55 - 13.92 | 336,021 | 3.5 years | 11.76 | 6,068,234 | 295,845 | 11.88 | 5,308,104 |
| 16.72 - 22.98 | 383,314 | 5.1 years | 22.01 | 2,994,752 | 327,242 | 22.48 | 2,400,860 |
| 23.01 - 30.69 | 647,017 | 6.6 years | 27.84 | 1,470,126 | 458,124 | 28.45 | 803,873 |
| 31.84 - 57.36 | 1,363,167 | 8.2 years | 40.87 | | 540,678 | 43.17 | |
| $2.59 - $57.36 | 2,894,901 | 6.6 years | $ 30.04 | $ 14,626,528 | 1,787,271 | $ 26.90 | $ 12,606,253 |

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on options with an exercise price less than the Company s closing stock price of $29.82 as of March 31, 2009, which would have been received by the option holders had those option holders exercised their options as of that date.

A summary of the changes in restricted stock under our 1998 Plan and 2007 Plan as of March 31, 2009, is as follows:

**DIGITAL RIVER, INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Unaudited)

| | Restricted Stock | | Weighted Average Intrinsic Value |
|---|---|---|---|
| Non-Vested Balance, December 31, 2007 | 233,404 | $ | 50.64 |
| Granted | 498,550 | | 29.04 |
| Vested | (66,010) | | 49.42 |
| Forfeited | (312,582) | | 33.61 |
| Non-Vested Balance, December 31, 2008 | 353,362 | $ | 35.45 |
| Granted | 1,137,250 | | 25.18 |
| Vested | (85,806) | | 38.26 |
| Forfeited | (2,948) | | 30.89 |
| Non-Vested Balance,March 31, 2009 | 1,401,858 | $ | 26.96 |

***Inducement Equity Incentive Plan***

Effective on December 14, 2005, in connection with our acquisition of Commerce5, Inc., we adopted an Inducement Equity Incentive Plan (the Inducement Plan ) initially for Commerce5, Inc. executives who joined Digital River as a result of the acquisition, or other personnel who join us after the date of the Inducement Plan adoption. A total of 87,500 restricted shares of Digital River stock may be issued under the Inducement Plan, subject to vesting. In accordance with the NASDAQ rules, no stockholder approval was required for the Inducement Plan.

***Employee Stock Purchase Plan***

We also sponsor an employee stock purchase plan ( ESPP ) under which 1,200,000 shares have been reserved for purchase by employees. The purchase price of the shares under the ESPP is the lesser of 85% of the fair market value on the first or last day of the offering period. Offering periods are currently every six months ending on June 30 and December 31. Employees may designate up to ten percent of their compensation for the purchase of shares under the ESPP. Total shares purchased by employees under the ESPP were 111,640 shares and 76,436 shares in the years ended December 31, 2008 and 2007, respectively. There were 368,777 shares still reserved under the ESPP as of March 31, 2009.

***Expense Information under SFAS 123(R)***

The following table summarizes stock-based compensation expense, net of tax, related to employee stock options and employee stock purchases recognized under SFAS 123(R) (in thousands):

| | Three Months Ended March 31, 2009 | Three Months Ended March 31, 2008 |
|---|---|---|
| Costs and expenses | | |
| Direct cost of services | $ 169 | $ 192 |
| Network and infrastructure | 113 | 32 |
| Sales and marketing | 1,517 | 1,102 |
| Product research and development | 456 | 262 |
| General and administrative | 1,456 | 1,443 |
| Stock-based compensation included in costs and expenses | 3,711 | 3,031 |

| | | |
|---|---|---|
| Tax benefit | (1,287) | (1,040) |
| Stock-based compensation expense, net of tax | $ 2,424 | $ 1,991 |

***Valuation Information under SFAS 123(R)***

The weighted-average fair value of stock options granted during the three months ended March 31, 2009 and 2008 were $8.03 and $11.23 per share, respectively, using the Black-Scholes option pricing model with the following weighted average assumptions:

**DIGITAL RIVER, INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Unaudited)

| | Three Months Ended March 31, | |
|---|---|---|
| | **2009** | **2008** |
| Risk-free interest rate | 1.2% | 2.0% |
| Expected life (years) | 3.1 | 3.5 |
| Volatility factor | 0.45 | 0.46 |
| Expected dividends | | |

The risk-free interest rate assumption is based on observed interest rates appropriate for the term of our stock options. The expected life of stock options represents the weighted-average period the stock options are expected to remain outstanding and is based on historical exercise patterns. We used historical closing stock price volatility for a period equal to the expected term of the options granted. The dividend yield assumption is based on our history and expectation of future dividend payouts.

As stock-based compensation expense recognized in the Condensed Consolidated Statement of Income for the three months ended March 31, 2009 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience.

At March 31, 2009, there was approximately $43.2 million of total unrecognized stock-based compensation expense, adjusted for estimated forfeitures, related to unvested share-based awards. Unrecognized stock-based compensation expense is expected to be recognized over the next 3.1 years on a weighted average basis and will be adjusted for any future changes in estimated forfeitures.

**5. INCOME TAXES**

For the three months ended March 31, 2009 and 2008, our tax expense was $6.2 million and $7.8 million, respectively. For the three months ended March 31, 2009, our tax expense consisted of approximately $4.9 million of U.S. tax expense and $1.3 million of foreign tax expense. For the three months ended March 31, 2009 and 2008, the tax rate was 27.1% and 30.0%, respectively. Differences in our effective tax rate from the US statutory rate are primarily due to our mix of earnings from international operations and the differences in statutory rates in these countries from the US rate.

There is uncertainty of future realization of the deferred tax assets resulting from acquired tax loss carryforwards due to anticipated limitations. Therefore a valuation allowance was recorded against the tax effect of such tax loss carryforwards. At March 31, 2009, the Company has a valuation allowance on approximately $3.1 million of deferred tax assets related to acquired operating losses and other tax attributes as we believe it is more likely than not that these deferred tax assets will not be realized.

As of March 31, 2009, we had $7.7 million of unrecognized tax benefits. All of these unrecognized tax benefits would affect our effective tax rate if recognized. Gross unrecognized tax benefits increased by $0.5 million for other items identified during the quarter. As of March 31, 2009, we had approximately $0.9 million of accrued interest related to uncertain tax positions.

Due to the potential resolution of examinations currently being performed by taxing authorities, and the expiration of various statutes of limitation, it is reasonably possible that the balance of our gross unrecognized tax benefits may change within the next twelve months by a range of zero to $2.2 million.

**6. DEBT**

In 2004 we sold and issued $195.0 million in aggregate principal amount of 1.25% convertible senior notes due January 1, 2024 (Notes), in a private, unregistered offering. The Notes were sold at 100% of their principal amount.

Table of Contents

**DIGITAL RIVER, INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Unaudited)

We are required to pay interest on the Notes on January 1 and July 1 of each year so long as the Notes are outstanding. The Notes bear interest at a rate of 1.25% and, if specified conditions are met, are convertible into our common stock at a conversion price of $44.063 per share. The Notes may be surrendered for conversion under certain circumstances, including the satisfaction of a market price condition, such that the price of our common stock reaches a specified threshold; the satisfaction of a trading price condition, such that the trading price of the Notes falls below a specified level; the redemption of the Notes by us, the occurrence of specified corporate transactions, as defined in the related indenture; and the occurrence of a fundamental change, as defined in the related indenture. The initial conversion price is equivalent to a conversion rate of approximately 22.6948 shares per $1,000 of principal amount of the Notes. We will adjust the conversion price if certain events occur, as specified in the related indenture, such as the issuance of our common stock as a dividend or distribution or the occurrence of a stock subdivision or combination. If a fundamental change, such as a change in our control, as defined in the related indenture, occurs on or before January 1, 2009, we may also be required to purchase the Notes for cash and pay an additional make whole premium payable in our common stock upon the repurchase or conversion of the Notes in connection with the fundamental change.

Holders of the Notes have the right to require us to repurchase their Notes prior to maturity on January 1, 2009, 2014 and 2019. We have the right to redeem the Notes at any time on or after January 1, 2009. On January 5, 2009, we announced that holders of 95.5% of the Notes exercised the option to require us to repurchase those Notes on January 2, 2009 at a purchase price of 100.25% of the principal amount of each tendered Note. Notes with an aggregate principal amount of approximately $8.8 million remain outstanding. In light of the right of holders to require us to redeem the Notes on January 1, 2009, on January 1, 2008, we reclassified the Notes as short-term debt. As such right has expired and the exercise of the next right to require us to redeem the Notes will not occur until January 1, 2014, we have reclassified the remaining Notes as long-term debt.

In the first quarter of 2009 and 2008, we incurred interest expense of $0.0 million and $0.6 million, respectively, on the Notes and made $1.2 million interest payments in each of the first quarters of 2009 and 2008.

**7. FAIR VALUE MEASUREMENTS**

Effective January 1, 2008, we adopted the provisions of Statement of Financial Accounting Standards No. 157, Fair Value Measurements , (FAS 157) for financial instruments. FAS 157 defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and requires enhanced disclosures about fair value measurements. FAS 157 does not require any new fair value measurements; rather it specifies valuation methods and disclosures to be applied when fair value measurements are required under existing or future accounting pronouncements.

FAS 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, FAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1 Observable inputs such as quoted prices in active markets;

Level 2 Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

Level 3 Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumption.

As of March 31, 2009, we held certain assets that are required to be measured at fair value on a recurring basis. These included cash equivalents and short and long-term investments.

As of March 31, 2009, Digital River held $109.5 million of investments at par value, $99.0 million fair value, in auction-rate securities (ARS), all are AAA/Aaa-rated and 105%-115% over collateralized by student loans guaranteed by the U.S. government with the exception of one security which is rated A3/AAA. All the securities are 100% guaranteed by the Department of Education or the Federal Family Education Loan Program (FFELP) with the exception of two securities which are 82.5% and 99% guaranteed by FFELP. Almost all of these securities continue to fail at auction due to illiquid market conditions. On April 9, 2009, an auction of $7.0 million of our ARS was successful and we liquidated this investment at par value.

**DIGITAL RIVER, INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Unaudited)

We did determine a market value discount, due to current illiquid market conditions, of $10.5 million (9.6% of par value) existed as of March 31, 2009 and adjusted the temporary fair value reduction of $16.3 million recorded to Other Comprehensive Income on the December 31, 2008 balance sheet to $10.5 million as of March 31, 2009. We believe the securities will continue to yield the coupon rates.

The determination of fair value required management to make estimates and assumptions about the securities. The discounted cash flow model we used to value the securities included the following assumptions:

- determination of the penalty coupon rate, frequency of reset period associated with each ARS
- an average redemption period of seven years
- a contribution of the ARS paying its contractually stated interest rate
- determination of the risk adjusted discount rate based on LIBOR rates for these maturities plus market information on student loan credit spreads

In aggregate the ARS portfolio is yielding 1.8% and we continue to receive 100% of the contractually required interest payments. We continue to believe that we will be able to liquidate at par over time. Accordingly, we treated the fair value decline as temporary. We anticipate we have sufficient cash flow from operations to execute our business strategy and fund our operational needs. We believe that capital markets are also available if we need to finance other investing alternatives.

The table below presents our assets measured at fair value on a recurring basis as of March 31, 2009 (in thousands):

| | Fair Value Measurements As of March 31, 2009 | | | |
|---|---|---|---|---|
| | **Total** | **Level 1** | **Level 2** | **Level 3** |
| Cash equivalents | $ 347,863 | $ 347,863 | $ | $ |
| Short-term investments | 7,000 | 7,000 | | |
| Long-term investments | 91,967 | | | 91,967 |
| Total assets measured at fair value | $ 446,830 | $ 354,863 | $ | $ 91,967 |

Based on market conditions, we have classified almost all auction rate securities as Level 3 within FAS 157 s hierarchy since our initial adoption of FAS 157 at January 1, 2008. On April 9, 2009, an auction of $7.0 million of our ARS was successful and we liquidated this investment at par value. As of March 31, 2009, this long-term Level 3 investment was reclassified to Level 1 short-term investments. As of March 31, 2009, the difference between fair value and par value of these securities was $10.5 million, or 2.4% of total assets measured at fair value or 1.7% of total assets reported in our financial statements.

The following is a reconciliation of assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3 inputs) (in thousands):

Table of Contents

**DIGITAL RIVER, INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
(Unaudited)

| | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) | | |
|---|---|---|---|
| | Short-term Investments | Long-term Investments | Total |
| Balance as of December 31, 2007 | $ 119,750 | $ | $ 119,750 |
| Total gains or losses (realized/unrealized) | | | |
| Included in other comprehensive income | | (16,287) | (16,287) |
| Purchases, issuances, and settlements | (10,250) | | (10,250) |
| Transfers in and/or out of Level 3 | (109,500) | 109,500 | |
| Balance as of December 31, 2008 | $ | $ 93,213 | $ 93,213 |
| Total gains or losses (realized/unrealized) | | | |
| Included in other comprehensive income | | 5,754 | 5,754 |
| Purchases, issuances, and settlements | | | |
| Transfers in and/or out of Level 3 | | (7,000) | (7,000) |
| Balance as of March 31, 2009 | $ | $ 91,967 | $ 91,967 |

**8. LITIGATION**

We are subject to legal proceedings, claims and litigation arising in the ordinary course of business. While the final outcome of these matters is currently not determinable, we believe there is no litigation pending against us that is likely to have, individually or in the aggregate, a material adverse effect on our consolidated financial position, results of operations or cash flows. Because of the uncertainty inherent in litigation, it is possible that unfavorable resolutions of these lawsuits, proceedings and claims could exceed the amount we have currently reserved for these matters. For more information on legal proceedings, please see Item 1 of Part II of this Quarterly Report on Form 10-Q.

Table of Contents

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

*The discussion in this Quarterly Report contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those discussed below. Additional factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section entitled Risk Factors, included in Item 1A of Part II of this Quarterly Report. When used in this document, the words believes, expects, anticipates, intends, plans, and similar expressions, are intended to identify certain of these forward-looking statements. However, these words are not the exclusive means of identifying such statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. The cautionary statements made in this document should be read as being applicable to all related forward-looking statements wherever they appear in this document.*

### Overview

We provide end-to-end global e-commerce and marketing solutions to a wide variety of companies in software, consumer electronics, computer games, video games, and other markets. We were incorporated in 1994 and began building and operating online stores for our clients in 1996. We offer our clients a broad range of services that enable them to quickly and cost effectively establish an online sales channel capability and to subsequently manage and grow online sales on a global basis while mitigating risks. Our services include design, development and hosting of online stores and shopping carts, store merchandising and optimization, order management, denied parties screening, export controls and management, tax compliance and management, fraud management, digital product delivery via download, physical product fulfillment, subscription management, multi-lingual customer service, online marketing including e-mail marketing, management of paid search programs, payment processing services, website optimization, web analytics and reporting, and CD production and delivery.

Our products and services allow our clients to focus on promoting and marketing their products and brands while leveraging our investments in technology and infrastructure to facilitate the purchase of products through their online websites. When shoppers visit one of our clients branded websites and purchase goods, they are transferred to an e-commerce store and /or shopping cart operated by us on our e-commerce platforms. Once on our system, shoppers can browse for products and make purchases online. We typically are the seller of record for transactions through our client branded stores. After a purchase is made, we either deliver the product digitally via download over the Internet or transmit instructions to a third party for physical fulfillment of the order. We also process the buyer s payment as the merchant of record, including collection and remittance of applicable taxes, and can provide customer service in multiple languages to handle order-related questions. We have invested substantial resources to develop our e-commerce and marketing platforms and we provide access and use of our platforms to our clients as a service as opposed to selling the software to be operated on their own in-house computer hardware.

In addition to the services we provide that facilitate the completion of an online transaction, we also offer services designed to increase traffic to our clients websites and the associated online stores and to improve the sales productivity of those stores. Our services include paid search advertising, search engine optimization, affiliate marketing, store optimization, multi-variant testing, web analytic services and e-mail optimization. All of our services are designed to help our clients acquire customers more effectively, sell to those customers more often and more efficiently, and increase the lifetime value of each customer.

Our clients include many of the largest software, consumer electronics, computer and video game companies, including Absolute Software Corporation, Adobe Systems, Inc., Aspyr Media, Inc., Autodesk, Inc., Canon Europa N.V., Computer Associates, Cyber Patrol, LLC, Eastman Kodak Company, Electronic Arts, Inc., Lexmark, Inc., Microsoft Corporation, Nuance Communications Inc, SanDisk Corporation, Smith Micro Software, Inc., Symantec Corporation, and Trend Micro, Inc.

We were incorporated in Delaware in February 1994. Our headquarters are located at 9625 West 76th Street, Eden Prairie, Minnesota and our telephone number is 952-253-1234.

General information about us can be found at www.digitalriver.com under the Company/Investor Relations link. Our annual report on Forms 10-K and 10-K/A, quarterly reports on Form 10-Q and current reports on Form 8-K, as well as any amendments or exhibits to those reports, are available free of charge through our website as soon as reasonably practicable after we file them with the Securities and Exchange Commission.

Table of Contents

## Critical Accounting Policies

We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. As such, we are required to make certain estimates, judgments and assumptions that we believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. The significant accounting policies that we believe are the most critical in fully understanding and evaluating our reported financial results are the following:

*Revenue Recognition.* We recognize revenue in accordance with Staff Accounting Bulletin No. 104, Revenue Recognition , from services rendered once all the following criteria for revenue recognition have been met: (1) persuasive evidence of an agreement exists; (2) the services have been rendered; (3) the fee is fixed and determinable; and (4) collection of the amounts due is reasonably assured.

We evaluate the criteria outlined in Emerging Issues Task Force, ( EITF ) Issues No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent, in determining whether it is appropriate to record the gross amount of product sales and related costs or the net amount earned as net revenue. We act as the merchant of record on most of the transactions processed and have contractual relationships with our clients, which obligate us to pay to the client a specified percentage of each sale. We derive our revenue primarily from transaction fees based on a percentage of the products sale price and fees from services rendered associated with the e-commerce and other services provided to our clients and end customers. Our revenue is recorded as net as generally our clients are subject to inventory risks and control customers product choices. We sell both physical and digital products. Revenue is recognized upon fulfillment and based upon when products are shipped and title and significant risk of ownership passes to the customer.

We also provide customers with various proprietary software backup services. We recognize revenue for these backup services based upon historical usage within the contract period of the digital backup services when this information is available. Digital backup services are recognized straight-line over the life of the backup service when historical usage information is unavailable. Shipping revenues are recorded net of any associated costs.

We also, to a lesser extent, provide fee-based client services, which include website design, custom development and integration, analytical marketing, affiliate marketing and email marketing services. If we receive payments for fee-based services in advance of delivery, these amounts, if significant, are deferred and recognized over the service period.

Provisions for doubtful accounts and transaction losses and authorized credits are made at the time of revenue recognition based upon our historical experience. The provision for doubtful accounts and transaction losses are recorded as charges to operating expense, while the provision for authorized credits is recognized as a reduction of net revenues.

In June 2006, the EITF reached a consensus on EITF Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation) ( EIFT 06-3 ). EITF 06-3 provides that the presentation of taxes assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer on either a gross basis (included in revenues and costs) or on a net basis (excluded from revenues) is an accounting policy decision that should be disclosed. The Company presents these taxes on a net basis.

*Allowance for Doubtful Accounts.* We must make estimates and assumptions that can affect the amount of assets and liabilities and the amounts of revenues and expenses we report in any financial reporting period. We use estimates in determining our allowance for doubtful accounts, which are based on our historical experience and current trends. We must estimate the collectability of our billed accounts receivable. We analyze accounts receivable and consider our historical bad debt experience, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. We must make significant judgments and estimates in connection with the allowance in any accounting period. There may be material differences in our operating results for any period if we change our estimates or if the estimates are not accurate.

*Credit Card Chargeback Reserve.* We use estimates based on historical experience and current trends to determine accrued chargeback expenses. Significant management judgments are used and estimates made in connection with these expenses in any accounting period. There may be material differences in our operating results for any period if we change our estimates or if the estimates are not accurate.

**Table of Contents**

*Goodwill, Intangibles and Other Long-Lived Assets.* We depreciate property, plant and equipment; amortize certain intangibles and certain other long-lived assets with definite lives over their useful lives. Useful lives are based on our estimates of the period of time over which the assets will generate revenue or benefit our business. We review assets with definite lives for impairment whenever events or changes in circumstances indicate that the value we are carrying on our financial statements for an asset may not be recoverable. Our evaluation considers non-financial data such as changes in the operating environment and business strategy, competitive information, market trends and operating performance. If there are indications that impairment may be necessary, we use an undiscounted cash flow analysis to determine the impairment amount, if any. Assets with indefinite lives are reviewed for impairment quarterly (or more frequently if there are indications that an impairment may be necessary) utilizing the two-step approach prescribed in Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets. There have been no material impairments of goodwill and other intangible assets for the three months ended March 31, 2009 and 2008.

*Income Taxes and Deferred Taxes*. Deferred income taxes reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. We record deferred tax assets for favorable tax attributes, including tax loss carryforwards. We currently have tax loss carryforwards, consisting solely of acquired operating tax loss carryforwards. A portion of the benefit of the acquired tax loss carryforwards has been reserved by a valuation allowance pursuant to United States generally accepted accounting principles. These valuation allowances of the deferred tax asset will be reversed if and when it is more likely than not that the deferred tax asset will be realized. We evaluate the need for a valuation allowance of the deferred tax asset on a quarterly basis.

*Stock-Based Compensation Expense*. Stock-based compensation expense recognized during the period is based on the value of the portion of share-based awards that are ultimately expected to vest during the period. The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option pricing model. The fair value of restricted stock is determined based on the number of shares granted and the closing price of our common stock on the date of grant. Compensation expense for all share-based payment awards is recognized using the straight-line amortization method over the vesting period. As stock-based compensation expense recognized in our Condensed Consolidated Statement of Income is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

SFAS 123(R) also requires the benefits of tax deductions in excess of recognized stock-based compensation expense be reported as a financing cash flow, rather than an operating cash flow as required prior to adoption of SFAS 123(R) in our Condensed Consolidated Statement of Cash Flows.

See Note 4 in the Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q for further information regarding our stock-based compensation plans.

*Business Combinations*. On January 1, 2009, we adopted FAS No. 141(R), Business Combinations (FAS 141(R)). This Statement is intended to simplify existing guidance and converge rulemaking under U.S. GAAP with international accounting rules. SFAS No. 141(R) will significantly change the accounting for business combinations in a number of areas, including the treatment of contingent consideration, contingencies, acquisition costs and restructuring costs. Also under this Statement, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008. We adopted FAS 141(R) as of January 1, 2009 and the impact was immaterial to our financial statements.

**Results of Operations**

The following table sets forth certain items from our condensed consolidated statements of income as a percentage of total revenue for the periods indicated:

| | Three Months Ended March 31, | |
|---|---|---|
| | **2009** | **2008** |
| Revenue | 100.0% | 100.0% |
| Cost of Revenue (exclusive of depreciation and amortization expense shown separately below): | | |
| Direct cost of services | 3.8 | 4.0 |
| Network and infrastructure | 10.0 | 9.8 |
| Sales and marketing | 37.4 | 38.3 |
| Product research and development | 12.0 | 12.3 |
| General and administrative | 8.9 | 9.9 |
| Depreciation and amortization | 3.7 | 3.7 |
| Amortization of acquisition-related costs | 1.9 | 2.1 |
| Total costs and expenses | 77.7 | 80.1 |
| Income from operations | 22.3 | 19.9 |
| Interest Income | 1.1 | 6.0 |
| Other expense, net | (1.3) | (0.7) |
| Income before income tax expense | 22.1 | 25.2 |
| Income tax expense | 6.0 | 7.6 |
| Net income | 16.1% | 17.6% |

We acquired Think Subscription, Inc. on September 1, 2008. The results of this acquisition must be factored into any comparison of our 2009 results to the results for 2008. See Note 3 of our Consolidated Financial Statements in this Form 10-Q for pro forma financial information as if this entity had been acquired on January 1, 2008

***REVENUE.*** Our revenue was $102.9 million for the three months ended March 31, 2009 compared to $103.6 million for the same period in the prior year, a decrease of $0.7 million or 1%. The revenue decrease was attributed to foreign currency impact year over year offset by an increase due to increased traffic, growth in the number of online game and consumer electronic clients we served and expanded strategic marketing activities with a larger number of clients. Sales of security software products for PCs represent the largest contributor to our revenues.

International e-commerce sales decreased to 36% of total sales in the three month period ended March 31, 2009 compared to 43% for the same period in 2008. This decrease was driven by increased sales by key US clients.

***DIRECT COST OF SERVICES.*** Direct cost of services primarily includes costs related to personnel, product fulfillment, backup CD production and delivery solutions and certain client-specific costs. Direct cost of service expense decreased to $3.9 million for the three months ended March 31, 2009, compared to $4.2 million for the same period in the prior year. The decrease was primarily attributable to lower CD production and delivery costs realized from the integration of our CD production companies acquired in January 2008. As a percentage of revenue, direct cost of services decreased to 3.8% for the three months ended March 31, 2009, compared to 4.0% in the same period of the prior year.

We currently believe 2009 direct costs of services will remain relatively flat compared to 2008 in absolute dollars as costs associated with moderately higher CD sales volume are offset by lower costs and efficiencies related to the full integration of our CD companies. This outlook assumes continued financial challenges for consumers and macroeconomic uncertainty which is expected to temper our revenue performance indefinitely. If economic conditions improve or further deteriorate or we complete any future acquisitions we expect a correlating increase or decrease in

direct cost of services in line with revenue.
***NETWORK AND INFRASTRUCTURE.*** Our network and infrastructure expenses primarily include personnel related expenses and costs to operate and maintain our technology platforms, customer service, data communication and data center operations. Network and infrastructure expenses were $10.3 million and $10.2 million for the three months ended March 31, 2009 and 2008, respectively. The increase for the three months ended March 31, 2009, compared to the same period in the prior year was mainly due to increased data communication expenses and higher client website traffic as a result of various marketing campaigns.
As a percentage of revenue, network and infrastructure increased to 10.0% for the three months ended March 31, 2009, compared to 9.8% in the same period of the prior year.

Table of Contents

We currently believe network and infrastructure expenses will increase in absolute dollars in 2009 compared to 2008 as we continue to expand our global data center and customer service capacity. However, if global economic conditions further deteriorate, cost containment actions may result in lower network and infrastructure costs in 2009 as compared to 2008 to allow us to invest in higher opportunity areas of the business.

***SALES AND MARKETING.*** Our sales and marketing expenses mainly include credit card transaction and other payment processing fees, personnel and related costs, advertising, promotional and product marketing expenses, credit card chargeback s and bad debt expense. Sales and marketing expenses decreased to $38.4 million for the three months ended March 31, 2009 from $39.7 million for the same period in the prior year. The decrease in sales and marketing for the three months ended March 31, 2009 was mainly due to lower payment processing costs and the favorable impact of foreign currency translation on our European transactions. This favorability was partially offset by increased personnel and consulting costs to support our global sales expansion efforts.

As a percentage of revenue, sales and marketing expenses decreased to 37.4% in the three months ended March 31, 2009, compared to 38.3% for the same period in the prior year.

We currently believe sales and marketing expenses will increase in absolute dollars in 2009 compared to 2008. We plan to support the expansion of our client relationships through investments in subscriptions, international payment processing and strategic marketing services. We also expect to continue our investments in key vertical markets, in particular consumer electronics and games. This outlook assumes continued financial challenges for consumers and macroeconomic uncertainty which is expected to temper our revenue performance indefinitely. If economic conditions improve or further deteriorate or we complete any future acquisitions we expect a correlating increase or decrease in sales and marketing expenses.

***PRODUCT RESEARCH AND DEVELOPMENT.*** Our product research and development expenses include the costs of personnel and related expenses associated with developing, maintaining and enhancing our technology platforms and related systems. Product research and development expense was $12.3 million for the three months ended March 31, 2009 compared to $12.7 million for the same period in the prior year. The decrease in research and development costs for the three months ended March 31, 2009, compared to the same period in the prior year primarily related to increased capitalization of internal and consulting labor costs to support on-going initiatives in our e-commerce infrastructure. These activities advance global system scalability, our e-marketing capabilities, data management and client reporting. We capitalized $5.2 million of internal software development employee and consultant labor costs for the three month period ended March 31, 2009. This capitalization was primarily related to the development of our new enterprise resource planning system and new data management and reporting infrastructure. We expect these investments to drive long-term operational efficiencies across the organization and provide further competitive differentiation. We did not capitalize any significant internal software development labor costs in the same period of the prior year. Increased personnel costs related to Think Subscription, Inc. acquired in September 2008 partially offset the lower costs related to the increased research and development capitalization for the period ended March 31, 2009. As a percentage of revenue, product research and development expenses were 12.0% and 12.3% for the three month periods ended March 31, 2009 and 2008, respectively.

We currently believe that product research and development expenses will increase moderately in absolute dollars in 2009 compared to 2008, as a result of continued investments in product development required to remain competitive and drive increased revenue. However, if global economic conditions continue to deteriorate, cost containment actions may result in lower product research and development spending in 2009 as compared to 2008. If we complete any future acquisitions we expect research and development expenses to increase in line with higher revenue.

***GENERAL AND ADMINISTRATIVE.*** Our general and administrative expenses primarily include the costs of executive, accounting and administrative personnel and related expenses, professional fees for legal, tax and audit services, bank fees and insurance. General and administrative expenses were $9.1 million and $10.2 million for the three months ended March 31, 2009 and 2008, respectively. The decrease in general and administrative costs for the three months ended March 31 2009, compared to the same period in 2008 was mainly due to lower personnel related costs as a result of targeted cost control measures. As a percentage of revenue, general and administrative expenses declined to 8.9% for the three months ended March 31, 2009, from 9.9% for the same period of the prior year.

We currently believe that general and administrative expenses will decrease in absolute dollars in 2009 compared to 2008. We plan to continue to invest in our infrastructure to support continued organic growth. However, we expect these incremental expenses will be offset by efficiencies gained through the implementation of our new

21

Enterprise Resource Planning (ERP) system, client reporting enhancements and cost containment measures. If we complete any future acquisitions we expect a correlating increase in our general and administrative expenses in line with increased revenue.

***DEPRECIATION AND AMORTIZATION.*** Our depreciation and amortization expenses include the depreciation of computer equipment and office furniture and the amortization of purchased and internally developed software, leasehold improvements made to our leased facilities and debt financing costs. Computer equipment, software and furniture are depreciated under the straight-line method using three to seven year lives and leasehold improvements are amortized over the shorter of the life of the asset or the remaining length of the lease. Depreciation and amortization expense was $3.8 million for both the three months ended March 31, 2009 and March 31, 2008.

We currently believe depreciation and amortization expenses will increase in absolute dollars in 2009 compared to 2008 as we have and will continue to expand our worldwide customer support capacity and the number of operating global data centers. In 2009, we also expect to complete significant data management and client reporting projects to support our business initiatives and begin the amortization of our new ERP system and the depreciation of the associated equipment.

***AMORTIZATION OF ACQUISITION-RELATED INTANGIBLES.*** For the period ended March 31, 2009 our amortization of acquisition-related intangibles line item consisted of amortization of intangible assets recorded from eight acquisitions in the past four years. Amortization of acquisition-related intangible assets was $2.0 million and $2.2 million for the three months ended March 31, 2009 and March 31, 2008, respectively. The decrease was primarily due to the benefit of foreign currency translation on our NetGiro acquisition. We also benefitted from the full amortization of one acquisition in mid-2008 and from lower monthly amortization costs on other acquisitions. These instances of lower amortization of acquisition costs were partially offset by the addition of amortization of acquisition costs related to THINK Subscription, Inc. which was acquired in September 2008.

We have purchased, and expect to continue purchasing assets or businesses which may include the purchase of intangible assets. We intend to pursue partnerships and acquisitions that can help strengthen and broaden our e-commerce platform, expand our geographical footprint and grow our client base.

***INTEREST INCOME.*** Our interest income represents the total of interest income on our cash, cash equivalents, short-term investments and long-term investments. Interest income was $1.2 million for the three months ended March 31, 2009, compared to $6.2 million for the same period in the prior year. The significant decrease in interest income was primarily due to the use of approximately $188 million of cash in January 2009, which included accrued interest of $1.2 million; to satisfy the majority of holders of our 1.25% Convertible Senior Notes due 2024 who exercised their put option to require the company to repurchase their notes. Interest income also declined in 2009 due to lower yields on our portfolio. We currently anticipate interest income will continue to decline in 2009 due to lower cash balances and lower market yields when compared to 2008.

***OTHER EXPENSE, NET.*** Our other expense, net line item includes the total of interest expense on our debt, foreign currency transaction gains and losses and asset disposal gains and losses. Interest expense was $0.0 million and $0.7 million for the three months ended March 31, 2009 and March 31, 2008, respectively. The decrease in other interest expense was due to the significant decrease in our outstanding Convertible Senior Notes in January 2009. Foreign currency re-measurement was a loss of $1.3 million for the three months ended March 31, 2009 compared to a loss of $0.1 million for the same period in the prior year. Gains and losses on asset disposals were immaterial for the three months ended March 31, 2009 and for the same period in the prior year.

***INCOME TAXES.*** For the three months ended March 31, 2009 and 2008, our tax expense was $6.2 million and $7.8 million, respectively. For the three months ended March 31, 2009, our tax expense consisted of approximately $4.9 million of U.S. tax expense and $1.3 million of foreign tax expense. For the three months ended March 31, 2009 and 2008, the tax rate was 27.1% and 30.0%, respectively. Differences in our effective tax rate from the US statutory rate are primarily due to our mix of earnings from international operations and the differences in statutory rates in these countries from the US rate.

**Off Balance Sheet Arrangements**

None

Table of Contents

**Liquidity and Capital Resources**

As of March 31, 2009, we had $347.9 million of cash and cash equivalents, and $7.0 million of short-term investments. Our primary source of internal liquidity is our operating activities. Net cash provided by operations during the first quarter of 2009 was primarily the result of net income adjusted for non-cash expenses and balance sheet changes such as increases in accounts receivable and accounts payable offset by a decrease in prepaid and other assets. Net cash provided by operations during the first quarter of 2008 was primarily the result of net income adjusted for non-cash expenses and balance sheet changes such as a decrease in income tax payable.

Net cash used for investing activities for the three months ended March 31, 2009, was $2.0 million and was the result of net sales of investments of $7.9 million, cash paid for acquisitions net of cash received of $3.0 million, and purchases of capital equipment of $6.9 million. Net cash provided by investing activities for the three months ended March 31, 2008 was $6.7 million and was the result of net sales of investments of $27.3 million, cash paid for acquisitions net of cash received of $16.5 million, and purchases of capital equipment of $4.2 million.

Net cash used for financing activities during the three months ended March 31, 2009, was $186.1 million. Cash paid for convertible senior notes was $186.7 million, proceeds of $1.0 million were provided by the sale of stock through the exercise of stock options, and cash used in the repurchase of restricted stock to satisfy tax withholding obligation was $0.4 million. Net cash used for financing activities during the three months ended March 31, 2008, was $135.8 million. Proceeds of $2.0 million were provided by the sale of stock through the exercise of stock options, cash used in the repurchase of restricted stock to satisfy tax withholding obligation was $0.4 million, and proceeds of $0.4 million were provided by the excess tax benefit from stock-based compensation. In 2008, we repurchased $137.9 million of common stock, which reduced our net cash provided by financing activities.

As of March 31, 2009, Digital River held $109.5 million of investments at par value, $99.0 million fair value, in auction-rate securities (ARS), all are AAA/Aaa-rated and 105%-115% over collateralized by student loans guaranteed by the U.S. government with the exception of one security which is rated A3/AAA. All the securities are 100% guaranteed by the Department of Education or the Federal Family Education Loan Program (FFELP) with the exception of two securities which are 82.5% and 99% guaranteed by FFELP. Almost all of these securities continue to fail at auction due to illiquid market conditions. On April 9, 2009, an auction of $7.0 million of our ARS was successful and we liquidated this investment at par value.

We did determine a market value discount, due to current illiquid market conditions, of $10.5 million (9.6% of par value) existed as of March 31, 2009 and adjusted the temporary fair value reduction of $16.3 million recorded to Other Comprehensive Income on the December 31, 2008 balance sheet to $10.5 million as of March 31, 2009. We believe the securities will continue to yield the coupon rates.

The determination of fair value required management to make estimates and assumptions about the securities. The discounted cash flow model we used to value the securities included the following assumptions:

- determination of the penalty coupon rate, frequency of reset period associated with each ARS
- an average redemption period of seven years
- a contribution of the ARS paying its contractually stated interest rate
- determination of the risk adjusted discount rate based on LIBOR rates for these maturities plus market information on student loan credit spreads

In aggregate the ARS portfolio is yielding 1.8% and we continue to receive 100% of the contractually required interest payments. We continue to believe that we will be able to liquidate at par over time. Accordingly, we treated the fair value decline as temporary. We anticipate we have sufficient cash flow from operations to execute our business strategy and fund our operational needs. We believe that capital markets are also available if we need to finance other investing alternatives. See Note 7 for further information.

Our principal commitments consist of interest and principal on our convertible senior notes and long-term obligations outstanding under operating leases. Although we have no material commitments for capital expenditures, we anticipate continued capital expenditures consistent with our anticipated growth in operations, infrastructure and personnel. We expect that our operating expenses will continue to grow as our overall business grows and that operating expenses will be a material use of our cash resources.

The following table summarizes our principal contractual commitments as of March 31, 2009:

| Contractual Obligations | Total Amount Committed | Payment due by period (in thousands) Apr-Dec 2009 | 2010-2011 | 2012-2013 | 2014 and Thereafter |
|---|---|---|---|---|---|
| Operating Lease Obligations | $12,071 | $3,912 | $6,563 | $1,505 | $ 91 |
| Convertible Senior Notes | 10,456 | 55 | 220 | 220 | 9,961 |
| Total | $22,527 | $3,967 | $6,783 | $1,725 | $10,052 |

We expect to continue to evaluate and consider a wide array of potential strategic transactions, including business combinations and acquisitions of businesses, products, services and other assets as well as licenses of technology related to our current business. At any given time, we may be engaged in discussions or negotiations with respect to one or more such transactions. Any such transactions could have a material impact on our financial position, results of operations, or cash flows. There is no assurance that any such discussions or negotiations will result in the consummation of any transaction. The process of integrating any acquisition may create unforeseen challenges for our operational, financial and management information systems, as well as unforeseen expenditures and other risks, including diversion of management s attention from other business concerns, the potential loss of key customers, employees and business partners, difficulties in managing facilities and employees in different geographic areas, and difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions. In addition, an acquisition may cause us to assume liabilities or become subject to litigation. Further, there can be no assurance that we will realize a positive return on any acquisition or that future acquisitions will not be dilutive to our current shareholders percentage ownership or to earnings. We have allocated significant valuation in the form of goodwill and intangibles for the companies we acquired in the past, which is subject to impairment testing on a regular basis. If the individual businesses do not perform as expected at the acquisition dates, we may incur impairment charges for goodwill, accelerated amortization of definite-lived intangible assets due to shortened expected lives of those assets, immediate write-offs and restructuring or other related expenses.

With respect to our 1.25% convertible senior notes due January 1, 2024 (the Notes ), we are required to pay interest on the Notes on January 1 and July 1 of each year so long as the Notes are outstanding. On July 1, 2008, we paid $1.2 million in interest for the period January 1 through June 30, 2008. The Notes bear interest at a rate of 1.25% and, if specified conditions are met, are convertible into our common stock at a conversion price of $44.063 per share. The Notes may be surrendered for conversion under certain circumstances, including the satisfaction of a market price condition, such that the price of our common stock reaches a specified threshold; the satisfaction of a trading price condition, such that the trading price of the Notes falls below a specified level; the redemption of the Notes by us, the occurrence of specified corporate transactions, as defined in the related indenture; and the occurrence of a fundamental change, as defined in the related indenture. The initial conversion price is equivalent to a conversion rate of approximately 22.6948 shares per $1,000 of principal amount of the Notes. We will adjust the conversion price if certain events occur, as specified in the related indenture, such as the issuance of our common stock as a dividend or distribution or the occurrence of a stock subdivision or combination. In addition, contingent interest is required to be paid to holders if certain conditions are met. If a fundamental change, such as a change in our control, as defined in the related indenture, occurs on or before January 1, 2009, we may also be required to purchase the Notes for cash and pay an additional make whole premium payable in our common stock upon the repurchase or conversion of the Notes in connection with the fundamental change.

Holders of the Notes have the right to require us to repurchase their Notes prior to maturity on January 1, 2009, 2014 and 2019. We have the right to redeem the Notes at any time on or after January 1, 2009. On January 5, 2009, we announced that holders of 95.5% of the Notes exercised the option to require us to repurchase those Notes on January 2, 2009 at a purchase price of 100.25% of the principal amount of each tendered Note. We paid an aggregate of approximately $187.9 million in connection with this repurchase, which includes $1.2 million in interest. Notes with an aggregate principal amount of approximately $8.8 million remain outstanding, which have been classified as long-term as of March 31, 2009.

We believe that existing sources of liquidity and the results of our operations will provide adequate cash to fund our operations although we may seek to raise additional capital. In January 2005, we filed a registration statement to increase our available shelf registration amount and we have approximately $82 million available for future use. In addition, we filed an acquisition shelf registration statement for up to approximately 1.5 million shares. In February 2006, we filed a shelf registration that would allow us to sell an undetermined amount of equity or debt securities in accordance with the recently approved rules applying to well known seasoned issuers. These filings were made to provide future flexibility for acquisition and financing purposes. The sale of additional equity or convertible debt securities could result in additional dilution to our stockholders. There can be no assurances that financing will be available in amounts or on terms acceptable to us, if at all.

Table of Contents

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

### Interest Rate Risk

Our portfolio of cash equivalents, short-term investments and long-term investments is maintained in a variety of securities, including government agency obligations and money market funds. Investments are classified as available-for-sale securities and carried at their market value with cumulative unrealized gains or losses recorded as a component of accumulated other comprehensive income/(loss) within stockholders equity. At March 31, 2009, all securities held had maturities or reset dates of less than three years. A sharp rise in interest rates could have an adverse impact on the market value of certain securities in our portfolio. We do not currently hedge our interest rate exposure and do not enter into financial instruments for trading or speculative purposes or utilize derivative financial instruments.

At March 31, 2009, we had long-term debt of $8.8 million associated with our Notes. The market value of our long-term debt will fluctuate with movements of interest rates, increasing in periods of declining rates of interest and declining in periods of increasing rates of interest.

### Foreign Currency Risk

Any growth in our international operations will increase our exposure to foreign currency fluctuations as well as other risks typical of international operations, including, but not limited to, differing economic conditions, changes in political climate, differing tax structures and other regulations and restrictions. Further, in September 2007 we acquired NetGiro Systems, a payment processor based in Stockholm, Sweden that processes international transactions, and the anticipated growth of this company will increase our exposure to foreign currency fluctuations. Accordingly, our future results could be materially adversely impacted by changes in these or other factors.

Foreign exchange rate fluctuations may adversely impact our consolidated results of operations as exchange rate fluctuations on transactions denominated in currencies other than our functional currencies result in gains and losses that are reflected in our Consolidated Statement of Income. To the extent the U.S. dollar weakens against foreign currencies, the translation of these foreign currency-denominated transactions will result in increased net revenues and operating expenses. Conversely, our net revenues and operating expenses will decrease when the U.S. dollar strengthens against foreign currencies.

***Transaction Exposure***

The Company enters into short term foreign currency forward contracts to offset the foreign exchange gains and losses generated by the re-measurement of certain assets and liabilities recorded in non-functional currencies. Changes in the fair value of these derivatives, as well as re-measurement gains and losses, are recognized in current earnings in other expense, net .

***Translation Exposure***

Foreign exchange rate fluctuations may adversely impact our consolidated financial position as the assets and liabilities of our foreign operations are translated into U.S. dollars in preparing our consolidated balance sheet. These gains or losses are recognized as an adjustment to stockholders equity through accumulated other comprehensive income/(loss) net of tax benefit or expense.

### Other Market Risks

***Investments in auction-rate securities***

At March 31, 2009, we held approximately $109.5 million of auction rate securities. Given current conditions in the auction rate securities market as described in Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations, in this Quarterly Report on Form 10-Q, we may incur temporary unrealized losses, or other-than-temporary realized losses, in the future if market conditions persist and we are unable to recover the investment principal in our auction rate securities.

Table of Contents

**Item 4. Controls and Procedures**

(a) We are committed to maintaining disclosure controls and procedures designed to ensure that information required to be disclosed in our periodic reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2009. Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) promulgated under the Securities Exchange Act of 1934) were effective in providing reasonable assurance that material information required to be disclosed by us in this Form 10-Q was recorded, processed, summarized and reported in a timely manner.

(b) During the quarter ended March 31, 2009, there was no change in our internal control over financial reporting that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Limitations on the Effectiveness of Controls**

Our management, including the Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining an adequate system of internal control over financial reporting. This system of internal accounting controls is designed to provide reasonable assurance that assets are safeguarded, transactions are properly recorded and executed in accordance with management s authorization and financial statements are prepared in accordance with generally accepted accounting principles. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Table of Contents

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

DDR Holdings, LLC has brought a claim against us and several other defendants regarding US Patents No. 6,629,135 (the 135 patent ) and 6,993,572 (the 572 patent ), which are owned by DDR Holdings. These patents claim e-commerce outsourcing systems and methods relating to the provision of outsourced e-commerce support pages having a common look and feel with a host s website. The case was filed in the U.S. District Court for the Eastern District of Texas on January 31, 2006. The complaint seeks injunctive relief, declaratory relief, damages and attorneys fees. We have denied infringement of any valid claim of the patents-in-suit, and have asserted counter-claims which seek a judicial declaration that the patents are invalid and not infringed. In September 2006, DDR Holdings filed an application for reexamination of its patents based upon the prior art produced by us and the other defendants in the case. As part of that application, DDR Holdings asserted that this prior art raised a substantial question as to the patentability of the inventions claimed in the patents. In December 2006, the Court stayed the litigation pending a decision on the reexamination application. In February 2007, the US Patent and Trademark Office ordered reexamination of DDR s patents. On January 5, 2009, the US Patent and Trademark Office issued a final office action rejecting the claims in the 135 patent which were subject to reexamination. On January 14, 2009, the US Patent and Trademark Office issued a final office action rejecting all but two of the claims in the 572 patent which were subject to reexamination. Should the stay of litigation be lifted, we intend to vigorously defend ourselves in this matter.

We are subject to legal proceedings, claims and litigation arising in the ordinary course of business. While the final outcome of these matters is currently not determinable, we believe there is no litigation pending against us that is likely to have, individually or in the aggregate, a material adverse effect on our consolidated financial position, results of operations or cash flows. Because of the uncertainty inherent in litigation, it is possible that unfavorable resolutions of these lawsuits, proceedings and claims could exceed the amount we have currently reserved for these matters.

Third parties have from time-to-time claimed, and others may claim in the future, that we have infringed their intellectual property rights, or that certain products and services we resell infringed their intellectual property rights. We have been notified of several potential intellectual property disputes, and expect that we will increasingly be subject to intellectual property infringement claims as our services expand in scope and complexity. We have in the past been forced to litigate such claims in some instances. We also may become more vulnerable to third-party claims as laws, such as the Digital Millennium Copyright Act, the Lanham Act and the Communications Decency Act are interpreted by the courts and as we expand geographically into jurisdictions where the underlying laws with respect to the potential liability of online intermediaries like ourselves are either unclear or less favorable. These claims, whether meritorious or not, could be time-consuming and costly to resolve, cause service upgrade delays, require expensive changes in our methods of doing business, or could require us to enter into costly royalty or licensing agreements.

## Item 1A. Risk Factors

*The risks described below are not the only ones facing our company. Additional risks not presently known to us or that we currently deem immaterial also may impair our business operations. Our business financial condition or results of operations could be materially adversely affected by any of these risks and the value of our common stock could decline due to any of these risks. This quarterly report also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including the risks faced by us described below and elsewhere in this report.*

**We may experience significant fluctuations in our revenues, operating results, growth rate, and stock price.**

Our quarterly and annual revenues, operating results, and growth rate have fluctuated significantly in the past and are likely to do so in the future due to a variety of factors, some of which are outside our control. As a result, we believe that quarter-to-quarter and year-to-year comparisons of our revenue and operating results are not necessarily meaningful, and that these comparisons may not be accurate indicators of future performance. If our annual or quarterly operating results fail to meet the guidance we provide to securities analysts and investors or otherwise fail to meet their expectations the trading price of our common stock may be impacted.

The stock market as a whole and the trading prices of companies in the electronic commerce industry in particular, has been notably volatile. The operating results of companies in the electronic commerce industry have experienced significant quarter-to-quarter fluctuations. This broad market and industry volatility could significantly reduce the price of our common stock at any time, without regard to our own operating performance. In addition, our stock price may be impacted by the short sales and actions of other parties who may disseminate misleading information about us in an effort to profit from fluctuations in our stock price.

Factors that may affect our revenues, operating results, continued growth, and our stock price include the risks described elsewhere in this Item 1A, as well as the following:

*Client Development, Retention and Satisfaction*. We generate revenue by providing services to a wide variety of companies, primarily in the software and high-tech products markets. Therefore, it is important to our ongoing success that we maintain our key client relationships and, at the same time, develop new client relationships. If we cannot develop and maintain satisfactory relationships with software and digital products publishers, manufacturers of consumer electronics and other goods, online retailers and online channel partners on acceptable commercial terms, we will likely experience a decline in revenue and operating profit. We also depend on our clients creating and supporting products that consumers will purchase. If we are unable to obtain sufficient quantities of products for any reason, or if the quality of service provided by these publishers and manufacturers falls below a satisfactory level, we could also experience a decline in revenue, operating profit and consumer satisfaction, and our reputation could be harmed. Our contracts with our clients are generally one to two years in duration, with an automatic renewal provision for additional one-year periods, unless we are provided with a written notice before the end of the contract. We have no material long-term or exclusive contracts or arrangements with any clients that guarantee the availability of products. Clients that currently supply products to us may not continue to do so, and we may be unable to establish new relationships with clients to supplement or replace existing relationships. Defects in the e-commerce solutions we develop could result in delayed or lost revenue, adverse end-user and/or client reaction, negative publicity, and/or claims brought against us, which could require expensive corrections and liability and negatively affect our revenues, operating results and stock price.

Sales of products for one client, Symantec Corporation, accounted for approximately 23.8% of our revenue in the first quarter of 2009. In addition, revenues derived from proprietary Digital River services sold to Symantec consumers and sales of Symantec products through our oneNetworkDirect retail and affiliate channel together accounted for approximately 8.3% of total Digital River revenue in the first quarter of 2009. In addition, a limited number of other software and physical goods clients contribute a large portion of our annual revenue. If any one of these key contracts is not renewed or otherwise terminates, or if revenues from these clients decline for any other reason (such as competitive developments), our revenue would decline and our ability to sustain profitability would be impaired. If our contract with Symantec is not renewed, renegotiated or otherwise terminated, or if revenues from Symantec and Symantec-related services decline for any other reason, our revenue and our ability to sustain profitability could be materially adversely impaired.

*Fluctuations in Demand*. Our quarterly and annual operating results are subject to fluctuations in demand for the products or services offered by us or our clients, such as anti-virus software and anti-spyware software and consumer electronics. In particular, sales of anti-virus software represented a significant portion of our revenues in recent years, and continue to be very important to our business. Demand for anti-virus software is subject to the unpredictable introduction of significant computer viruses. To the extent that software publishers successfully introduce products or services not sold through our platform that are competitive with the products and services offered by our current clients (including anti-virus products and services), our revenues could be materially adversely affected.

*Seasonal Fluctuations*. Our revenue is likely to fluctuate on a seasonal basis that is typical for the software publishing market, consumer electronics market, and computer and video games markets. Softening or weakening of traditionally high-volume periods, such as the holiday season, can materially adversely affect our revenues and operating results.

*Changes in the E-commerce and Marketing Industries*. The nature of our business and the e-commerce industry in which we operate has undergone, and continues to undergo, rapid development and change. Thus, our chances of financial and operational success should be evaluated in light of the risks, uncertainties, expenses, delays and difficulties associated with operating a business in a relatively rapidly changing industry. If we are unable to address these issues, we may not be financially or operationally successful.

*Dependence on Key Personnel*. Our future success significantly depends on our ability to continue to identify, attract, hire, train, retain and motivate highly skilled personnel, including the continued services and performance of our senior management. Competition for these personnel is intense, particularly in the Internet industry. Our performance also depends on our ability to retain and motivate our key technical employees who are skilled in maintaining our proprietary technology platforms. The loss of the services of any of our executive officers or key employees could harm our business if we are unable to effectively replace that officer or employee, or if that person should decide to join a competitor or otherwise directly or indirectly compete with us. Further, we may need to incur additional operating expenses and divert other management time in order to search for a replacement.

*Operating Expenses*. Our operating expenses are based on our expectations of future revenue. These expenses are relatively fixed in the short-term. If our revenue for a quarter falls below our expectations and we are unable to quickly reduce spending in response, our operating results for that quarter would be harmed.

*Infrastructure and Operations*. The introduction by us of new websites, web stores or services, and the continued upgrading, development and maintenance of our systems, infrastructure and operations to meet emerging market needs, leverage technical innovations, and remain competitive in our service and product offerings, may require a substantial investment of our resources and result in significant capital expenditures and operating costs. In addition, a disruption in our systems, infrastructure and/or operations, including hardware, software, network and Internet failures or outages, force majeure events, and similar events, could result in damage or interruption to our services, loss of sales, and materially and adversely affect our business, results of operations and financial condition.

*Chargebacks*. Digital River incurs chargeback processing fees on chargebacks associated with the products and services we sell. We use estimates based on historical experience and current trends to determine accrued chargeback expenses. If we change our estimates or if our estimates are not accurate due to a higher-than-anticipated number of actual chargebacks, our revenues and operating results may be affected.

*Other Factors*. Our revenues, operating results, continued growth, and stock price may be affected by factors generally affecting all businesses offering the same or similar services to those offered by us, located in similar geographic locations as our offices, and operating in similar industries as the e-commerce, payment processing, retailer, and other industries in which we operate, including changes in general macroeconomic conditions, global unrest and terrorism, changes in consumer spending, conditions or trends in the Internet and online commerce industries in the United States and around the world, changes to U.S. and foreign laws, rules and regulations relating and/or applicable to our business and related changes in the costs of compliance, and changes to generally accepted accounting principles and disclosures.

Additional factors that may affect our revenues, operating results, continued growth, and our stock price include:

- o Competitive developments, including the introduction of new products and services and the announcement of new client and strategic acquisitions, partnerships and relationships by our competitors;

- o Changes that affect our clients or the viability of their product lines, including changes to the financial and operational health and stability of our clients, competition in the markets for our clients products, acquisitions of and by our clients and third parties, and client decisions to delay new product launches or to invest in e-commerce initiatives;

- o Changes in our relationships with third party partners whose services are integral to our service offering, including warehousing relationships, distributors, and service providers;

- o Our announcement of significant acquisitions, strategic partnerships, joint ventures or capital commitments or results of operations or other developments related to those acquisitions, and our ability to successfully integrate and manage acquired businesses;

- o Sales or other transactions involving our common stock or our convertible notes.

**Failure to properly manage and sustain our expansion efforts could strain our management and other resources.**

Through acquisitions and organic growth, we are rapidly and significantly expanding our operations, both domestically and internationally. We will continue to expand further to pursue growth of our service offerings and customer base. This expansion increases the complexity of our business and places a significant strain on our management, operations, technical performance, financial resources, and internal financial control and reporting functions, and there can be no assurance that we will be able to manage it effectively. Our personnel, systems, procedures and controls may not be adequate to effectively manage our future operations, especially as we employ personnel in multiple domestic and international locations. We may not be able to hire, train, retain and manage the personnel required to address our growth. Failure to effectively manage our growth opportunities could damage our reputation, limit our future growth, negatively affect our operating results and harm our business.

**Our international operations and these efforts may not be successful in generating additional revenue.**

We sell products and services to end-users outside the United States and we intend to continue expanding our international presence. In the first quarter of 2009, our e-commerce sales to international consumers represented approximately 36.0% of our total sales. Expansion into international markets, particularly the European and Asia-Pacific regions, requires significant resources that we may fail to recover by generating additional revenue. Conducting business outside of the United States is subject to risks, including:

- § Changes in regulatory requirements and tariffs;

- § Uncertainty of application of local commercial, tax, privacy and other laws and regulations;

- § Reduced protection of intellectual property rights;

- § Difficulties in physical distribution for international sales;

- § Higher incidences of credit card and other payment-related fraud and difficulties in accounts receivable collection;

- § The burden and cost of complying with a variety of foreign laws, rules and regulations;

- § The possibility of unionization of our workforce outside the United States, particularly in Europe;

- § Political, social and economic instability and constraints on international trade and;

- § Import and export license requirements and restrictions of the United States and every other country in which we operate.

Any of the factors described above, as well as other risks of doing business outside the United States, may have a material adverse effect on our ability to increase or maintain foreign sales.

We may be unable to successfully and cost-effectively market, sell and distribute our services in foreign markets. Doing so may be more difficult or take longer than anticipated especially due to international challenges, such as language barriers, currency exchange issues and the fact that the Internet infrastructure in some foreign countries may be less advanced than the U.S. Internet infrastructure. If we are unable to successfully expand our international operations, or manage this expansion, our operating results and financial condition could be harmed.

**New obligations to collect or pay transaction taxes could substantially increase the cost to us of doing business.**
Many of the laws and regulations regarding the application of sales, use, value-added tax (VAT) or other similar transaction taxes predate the growth of the Internet and online commerce. The application of transaction taxes to interstate and international sales over the Internet is complex and evolving. We currently collect taxes with respect to electronic software download and physical delivery of products in tax jurisdictions where we have taxable presence. A successful assertion by one or more tax jurisdictions that we should collect or were obligated to collect transaction taxes on the products we sell could harm our results of operations. The imposition by state and local governments of various taxes upon Internet commerce and related e-commerce activities could create administrative burdens for us, put us at a competitive disadvantage if they do not impose similar obligations on all of our online competitors, and decrease our future sales.

**We could be liable for fraudulent, improper or illegal uses of our platforms.**
In recent years revenues from our "remote control platforms have grown as a percentage of our overall business, and we plan to continue to emphasize our self service e-commerce solutions. These platforms typically have an automated structure that allows customers to sign up for and use our e-commerce services without significant participation from Digital River personnel. Despite our efforts to contractually prohibit the sale of inappropriate and illegal goods and services and our efforts to detect the same, the remote control nature of these platforms increases the risk that transactions involving the sale of unlawful goods or services or the violation of the proprietary rights of others may occur before we become aware of them. Furthermore, unscrupulous individuals may offer for sale, or attempt to purchase, illegal products via such platforms under innocuous names, further frustrating our attempts to prevent inappropriate use of our services.

Our failure to detect inappropriate or illegal uses of our platforms by third parties could increase our expenses and expose us to a number of risks, including fines, increased fees or termination of services by payment processors or credit card associations, risks of lawsuits, and civil and criminal penalties.

**Loss of our credit card acceptance privileges would seriously hamper our ability to process the sale of merchandise.**
The payment by consumers for the purchase of digital or physical goods that we process is typically made by credit card or similar payment method. As a result, we must rely on banks or payment processors to process transactions, and must pay a fee for this service. From time to time, credit card associations may increase the interchange fees that they charge for each transaction using one of their cards. Any such increased fees will increase our operating costs and reduce our profit margins. We also are required by our processors to comply with credit card association operating rules, and we have agreed to reimburse our processors for any fines they are assessed by credit card associations as a result of processing payments for us. The credit card associations and their member banks set and interpret the credit card rules. Visa, MasterCard, American Express, Discover, or other card associations could adopt new operating rules or re-interpret existing rules that we, or our processors, might find difficult to follow. We have had payment processing agreements with certain of our payment processors terminated due to violations of their rules, and although we have been able to successfully migrate to new processors, such migrations require significant attention from our personnel, and often result in higher fees and customer dissatisfaction. Any disputes or problems associated with our payment processors could impair our ability to give customers the option of using credit cards to fund their payments. If we were unable to accept credit cards or other widely accepted forms of payment, our business would be seriously damaged. We also could be subject to fines or increased fees from MasterCard and Visa if we fail to detect that merchants are engaging in activities that are illegal or activities that are considered high risk, primarily the sale of certain types of digital content. We may be required to expend significant capital and other resources to monitor these activities.

**Implementing our acquisition strategy could result in dilution and operating difficulties leading to a decline in revenue and operating profit.**
A key element of our business strategy involves expansion through the acquisitions of businesses, assets, products or technologies that allow us to complement our existing product offerings, expand our market coverage, increase our engineering workforce or enhance our technological capabilities. Between January 1, 1999 and March 31, 2009, we acquired 30 companies. We continually evaluate and explore strategic opportunities as they arise, including business

combination transactions, strategic partnerships, and the purchase or sale of assets, including tangible and intangible assets such as intellectual property. We have acquired, and intend to continue engaging in strategic acquisitions of businesses, technologies, services and products. Since December 2007, we have acquired three businesses, IA Users Club d.b.a. CustomCD, Inc., DigitalSwift Corporation, and THINK Subscription, Inc.

Table of Contents

Acquisitions may require significant capital infusions, typically entail many risks, and could result in unforeseen difficulties and expenditures in assimilating and integrating the operations, personnel, technologies, products and information systems of acquired companies or businesses. We have in the past and may in the future experience delays in the timing and successful integration of an acquired company s technologies and product development, unanticipated costs and expenditures, changing relationships with customers, suppliers and strategic partners, or contractual, intellectual property or employment issues. Integration of an acquired business also may disrupt our ongoing business, distract management and make it difficult to maintain standards, controls and procedures. These challenges are magnified as the size of the acquisition increases. Furthermore, these challenges would be even greater if we acquired a business or entered into a business combination transaction with a company that was larger and more difficult to integrate than the companies we have historically acquired. Moreover, the anticipated benefits of any acquisition may not be realized. If a significant number of clients of the acquired businesses cease doing business with us, we would experience lost revenue and operating profit, and any synergies from the acquisition may be lost. In addition, key personnel of an acquired company may decide not to work for us. The acquisition of another company or its products and technologies may also require us to enter into a geographic or business market in which we have little or no prior experience. Future acquisitions could result in potentially dilutive issuances of equity securities, the incurrence of debt, contingent liabilities, amortization of intangible assets or impairment of goodwill. Acquisitions could also result in a dilutive impact to our earnings.

**We may need to raise additional capital to achieve our business objectives, which could result in dilution to existing investors or increase our debt obligations.**

We require substantial working capital to fund our business. In January 2005, we filed a registration statement to increase our available shelf registration amount and we have $82 million available for future use. In addition, we filed an acquisition shelf for up to approximately 1.5 million shares. In February 2006, we filed a shelf registration that would allow us to sell an undetermined amount of equity or debt securities in accordance with the recently approved rules applying to well-known seasoned issuers. If additional funds are raised through the issuance of equity securities, the percentage ownership of our stockholders will be reduced and these equity securities may have rights, preferences or privileges senior to those of our common stock. In June 2004, we issued 1.25% convertible notes (of which an aggregate principal amount of $8.8 million remain outstanding as of March 31, 2009) which require us to make interest payments and will require us to pay principal when the notes become due in 2024 or in the event of acceleration under certain circumstances, unless the notes are converted into our common stock prior to that. We may not have sufficient capital to service this or any future debt securities that we may issue, further, the conversion of the remaining notes into our common stock would result in further dilution to our stockholders. Our capital requirements depend on several factors, including the rate of market acceptance of our products, the ability to expand our client base, the growth of sales and marketing, and opportunities for acquisitions of other businesses. We have experienced significant operating losses and negative cash flow from operations during our operating history and may do so in the future. Additional financing may not be available when needed, on terms favorable to us or at all. If adequate funds are not available or are not available on acceptable terms, we may be unable to develop or enhance our services, take advantage of future opportunities or respond to competitive pressures, which would harm our operating results and adversely affect our ability to sustain profitability.

**Security breaches could hinder our ability to securely transmit confidential information and could materially affect our reputation, business operations, operating results and financial condition.**

Our business depends in large part on the secure transmission of confidential information over public networks, including customers credit card and other payment account information, and the secure storage of confidential information. We rely on encryption and authentication technology licensed from third parties to provide the security and authentication necessary for secure transmission of confidential information, such as end-user credit and debit card numbers. While we take significant steps to protect the security of confidential information in our possession, we cannot guarantee our security measures will prevent security breaches, or that future advances in computer and software capabilities and encryption technology, new cryptography tools and discoveries, and other events will enable us to prevent the breach or compromise of our security even if implemented by us. Further, the technology utilized in credit and debit cards, and the systems used for the transmission of payment card transactions, are controlled by the payment card industry, and vulnerabilities in these systems and technology can place payment card data at risk.

Any breach or compromise of our security could have a material adverse effect on our reputation, business, operating results and financial condition, dissuade existing and new clients from using our services, dissuade customers from transacting business through our systems, and expose us to significant costs, fines, losses, litigation, governmental investigations, and liabilities. A party who circumvents our security measures could misappropriate proprietary information or interrupt our operations. We may be required to expend significant capital and other resources to protect against security breaches or address problems caused by such breaches. Concerns over the security of the Internet and other online transactions and the privacy of users could deter people from using the Internet to conduct transactions that involve transmitting personally identifiable and other confidential information, thereby inhibiting the growth of our business.

**Protecting our intellectual property is critical to our success.**

We regard the protection of our trademarks, copyrights, trade secrets and other intellectual property as critical to our success. We rely on a combination of patent, copyright, trademark, service mark and trade secret laws and contractual restrictions to protect our proprietary rights. We have entered into confidentiality and invention assignment agreements with our employees and contractors, and nondisclosure agreements with parties with whom we conduct business, in order to limit access to and disclosure of our proprietary information. These contractual arrangements and the other steps taken by us to protect our intellectual property may not prevent misappropriation of our technology or deter independent third-party development of similar technologies. We also seek to protect our proprietary position by filing U.S. patent applications related to our proprietary technology, inventions and improvements that are important to the development of our business. Proprietary rights relating to our technologies will be protected from unauthorized use by third parties only to the extent they are covered by valid and enforceable patents or are effectively maintained as trade secrets. We pursue the registration of our trademarks and service marks in the U.S. and internationally. However, effective trademark, service mark, copyright and trade secret protection may not be available in every country in which our services are made available online.

The steps we have taken to protect our proprietary rights may be inadequate and third parties may infringe or misappropriate our trade secrets, trademarks and similar proprietary rights. Any significant failure on our part to protect our intellectual property could make it easier for our competitors to offer similar services and thereby adversely affect our market opportunities. In addition, litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Litigation could result in substantial costs and diversion of management and technical resources.

**Claims against us related to infringement of other parties intellectual property rights, or other products we deliver, could require us to expend significant resources, enter into unfavorable licenses or require us to change our business plans.**

From time to time, we are named as a defendant in lawsuits claiming that we have, in some way, violated the intellectual property rights of others. We expect that we will increasingly be subject to intellectual property infringement claims as our services expand in scope and complexity. We have in the past been forced to litigate such claims in some instances. Any assertions or prosecutions of claims like these could require us to expend significant financial and managerial resources. The defense of any claims, with or without merit, could be time-consuming, result in costly litigation and diversion of technical and management personnel, cause product enhancement delays or require that we develop non-infringing technology or enter into royalty or licensing agreements. Royalty or licensing agreements, if required, may be unavailable on terms acceptable to us or at all. In the event of a successful claim of infringement against us and our failure or inability to develop non-infringing technology or license the infringed or similar technology on a timely basis, we may be unable to pursue our current business plan. We expect that we will increasingly be subject to intellectual property infringement claims as our services expand in scope and complexity, and our results of operations and financial condition could be materially adversely affected.

We may become more vulnerable to third party claims as laws such as the Digital Millennium Copyright Act, the Lanham Act and the Communications Decency Act are interpreted by the courts. Claims may be made against us for negligence, copyright or trademark infringement, products liability or other theories based on the nature and content of software products, services, and/or tangible goods that we resell and/or deliver electronically and physically. Because we did not create these products and services, we are generally not in a position to know the quality or nature of the content of these products and services. Although we carry general liability insurance and require that our customers indemnify us against end-user claims, our insurance and indemnification measures may not cover potential claims of this type, may not adequately cover all costs incurred in defense of potential claims, or may not reimburse us for all liability that may be imposed. Any costs or imposition of liability that are not covered by insurance or indemnification measures could be expensive and time-consuming to address, distract management and delay product deliveries, even if we are ultimately successful in the defense of these claims.

**If our internal control over financial reporting or disclosure controls and procedures are not effective, there may be errors in our financial statements that could require a restatement or our filings may not be timely and investors may lose confidence in our reported financial information, which could lead to a decline in our stock price.**

Section 404 of the Sarbanes-Oxley Act of 2002 requires us to evaluate the effectiveness of our internal control over financial reporting as of the end of each year, and to include a management report assessing the effectiveness of our internal control over financial reporting in each Annual Report on Form 10-K. Section 404 also requires our independent registered public accounting firm to attest to, and report on, management s assessment of our internal control over financial reporting.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system s objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. Over time, controls may become inadequate because changes in conditions or deterioration in the degree of compliance with policies or procedures may occur. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected.

As a result, we cannot assure you that significant deficiencies or material weaknesses in our internal control over financial reporting will not be identified in the future. Any failure to maintain or implement required new or improved controls, or any difficulties we encounter in their implementation, could result in significant deficiencies or material weaknesses, cause us to fail to timely meet our periodic reporting obligations, or result in material misstatements in our financial statements. Any such failure could also adversely affect the results of periodic management evaluations and annual auditor attestation reports regarding disclosure controls and the effectiveness of our internal control over financial reporting required under Section 404 of the Sarbanes-Oxley Act of 2002 and the rules proclaimed after that. The existence of a material weakness could result in errors in our financial statements that could result in a restatement of financial statements, cause us to fail to timely meet our reporting obligations and cause investors to lose confidence in our reported financial information, leading to a decline in our stock price.

**Political and economic conditions, and current turmoil in United States and global markets, may adversely affect our revenue and results of operations.**

Our revenue, growth, operations and performance is dependent on the continued growth in demand for our clients products, which in turn depends significantly on general geopolitical economic and business conditions, conditions in the financial services markets, the overall demand for consumer goods and services. A decrease in demand for our clients products, whether due to conditions in the economies where we sell products or changes in consumer spending resulting from the macroeconomic and political climate, could result in a decline in our revenue and impair our ability to sustain profitability. The effect of the macroeconomic and political climate could also negatively impact our clients, such as causing delays in new product introductions, changes in client s outsourcing behavior, increasing our difficulty in collecting client receivables, and increasing the risk of client bankruptcies and/or interruption or cessation of business, which may have a negative impact on our own business, operating results, and financial condition.

Recent turmoil in U.S. and foreign economies as a whole, and in U.S. and foreign credit markets, equity markets, and in the global financial services industry, including the bankruptcy, failure, collapse or sale of various financial institutions, the continued tightness in credit markets, and an unprecedented level of intervention from the U.S. and foreign governments, may continue to place pressure on the global economy and affect overall consumer spending and the availability of credit to us, our clients, and our customers. This turmoil increases the risk that the actual amounts realized in the future on our financial instruments and investments may significantly differ from the fair values currently assigned to them. If conditions in the global economy, U.S. economy or other key vertical or geographic markets remain uncertain or weaken further, they may have a material adverse effect on our business, operating results, and financial condition. Continued uncertainty in general geopolitical economic and business conditions may result in increased or continued volatility in our stock price.

**Because the e-commerce industry is highly competitive and has low barriers to entry, we may be unable to compete effectively.**

The market for e-commerce solutions is extremely competitive and we may find ourselves unable to compete effectively. Because there are relatively low barriers to entry in the e-commerce market, we expect continued intense competition as current competitors expand their product offerings and new competitors enter the market. In addition, our clients may become competitors in the future. Increased competition is likely to result in price reductions, reduced margins, longer sales cycles and a decrease or loss of our market share, any of which could negatively impact our revenue and earnings. We face competition from the following sources:

§ In-house development of e-commerce capabilities using tools or applications from companies, such as Art Technology Group, Inc. and IBM Corporation;

§ E-Commerce capabilities custom-developed by companies, such as IBM Global Services and Accenture, Inc.;

§ Other providers of outsourced e-commerce solutions, such as GSI Commerce, Inc. and asknet Inc.;

§ Companies that provide technologies, services or products that support a portion of the e-commerce process, such as payment processing, including CyberSource Corporation and PayPal Corp.;

§ Companies that offer various online marketing services, technologies and products, including ValueClick, Inc., aQuantive, Inc. and Omniture, Inc.;

§ High-traffic, branded websites that generate a substantial portion of their revenue from e-commerce and may offer or provide to others the means to offer their products for sale, such as Amazon.com, Inc.; and

§ Web hosting, web services and infrastructure companies that offer portions of our solution and are seeking to expand the range of their offering, such as Network Solutions, LLC, Akamai Technologies, Inc., Yahoo!, Inc., eBay, Inc. and Hostopia.com, Inc.

We believe that the principal competitive factors for a participant in our market are the breadth of products and services offered, proven global platforms, the number of clients and online channel partnerships a participant has, brand recognition, system reliability and scalability, price, customer service, ease of use, speed to market, convenience and quality of delivery. The online channel partners and the other companies described above may compete directly with us by adopting a similar business model. Moreover, while some of these companies also are clients or potential clients of ours, they may compete with our e-commerce outsourcing solution to the extent that they develop e-commerce systems or acquire such systems from other software vendors or service providers.

Many of our competitors have, and new potential competitors may have, more experience developing Internet-based software and e-commerce solutions, larger technical staffs, larger customer bases, more established distribution channels and customer relationships, greater brand recognition and greater financial, marketing and other resources than we have. In addition, competitors may be able to develop services that are superior to our services, achieve greater customer acceptance or have significantly improved functionality as compared to our existing and future products and services. Our competitors may be able to respond more quickly to technological developments and changes in customers needs. Our inability to compete successfully against current and future competitors could cause our revenue and earnings to decline.

**Compliance with laws, rules and regulations, and changes in applicable laws, rules and regulations, may substantially increase our costs of doing business, limit our Internet activities, or otherwise adversely affect our ability to offer our services.**

We are subject to the same international, federal, state and local laws as other companies conducting business over the Internet. We are subject to United States laws governing the conduct of business with other countries, such as export control laws, which prohibit or restrict the export of goods, services and technology to designated countries, denied persons or denied entities from the United States. Violation of these laws could result in fines or other actions by regulatory agencies and result in increased costs of doing business and reduced profits. In addition, any significant changes in these laws, particularly an expansion in export control laws, will increase our costs of compliance and may further restrict our overseas client base.

Because our services are accessible worldwide, and we facilitate sales of products to customers worldwide, international jurisdictions may claim that we are required to comply with their laws. Laws regulating Internet companies outside of the United States may be less favorable than those in the United States, giving greater rights to consumers, content owners and users. Compliance with international, federal, state and local laws may be costly or may require us to change our business practices or restrict our service offerings relative to those provided in the United States. Any failure to comply with foreign laws could subject us to penalties ranging from fines to bans on our ability to offer our services.

Table of Contents

As our services are available over the Internet in multiple states and foreign countries, these jurisdictions may claim that we are required to qualify to do business as a foreign corporation in each state or foreign country. We and/or our subsidiaries are qualified to do business only in certain states. Failure to qualify as a foreign corporation in a required jurisdiction could subject us to taxes and penalties and could result in our inability to enforce contracts in these jurisdictions.

Today, there are relatively few laws specifically directed towards conducting business over the Internet. The adoption or modification of laws related to the Internet could harm our business, operating results and financial condition by 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. These laws and regulations could cover issues such as:

- User privacy with respect to adults and minors;
- Our ability to collect and/or share necessary information that allows us to conduct business on the Internet;
- Export compliance;
- Pricing, taxation, and regulatory fees;
- Fraud;
- Advertising;
- Intellectual property rights;
- Information security;
- Quality of products and services;
- Taxes; and
- Recycling of consumer products.

Applicability to the Internet of existing laws, rules and regulations governing issues such as property ownership, copyrights and other intellectual property issues, taxation, libel, obscenity and personal privacy, continue to be interpreted by the courts, and the applicability and reach of such laws are therefore uncertain. The vast majority of these laws were adopted prior to the advent of the Internet, and do not contemplate or address the unique issues raised thereby. Developments in the applicability of existing laws, rules and regulations, and the impact of new laws, rules and regulations, to our business could harm our operating results and substantially increase the cost to us of doing business. Any change in laws, rules or regulations applicable to the Internet and to our business might require significant management and other resources to respond appropriately.

**We are subject to regulations relating to consumer privacy.**

We collect and maintain customer data from our customers, which subjects us to increasing international, federal and state regulations related to online privacy and the use of personal user information. Congress has enacted anti-SPAM legislation with which we must comply when providing email campaigns for our clients. Legislation and regulations are pending in various domestic and international governmental bodies that address online privacy protections. Several governments have proposed, and some have enacted, legislation that would limit the use of personal user information or require online services to establish privacy policies. In addition, the U.S. Federal Trade Commission, or FTC, has urged Congress to adopt legislation regarding the collection and use of personal identifying information obtained from individuals when accessing websites. In the past, the emphasis has been on information obtained from minors. Focus has now shifted to include online privacy protection for minors and adults.

Even in the absence of laws requiring companies to establish these procedures, the FTC has settled several proceedings resulting in consent decrees in which Internet companies have been required to establish programs regarding the manner in which personal information is collected from users and provided to third parties. We could become a party to a similar enforcement proceeding. These regulatory and enforcement efforts could limit our collection of and/or ability to share with our clients demographic and personal information from customers, which could adversely affect our ability to comprehensively serve our clients.

The European Union has adopted a privacy directive that regulates the collection and use of information that identifies an individual person. These regulations may inhibit or prohibit the collection and sharing of personal information in ways that could harm our clients or us. Failure to comply with member state implementations of these directives may result in fines, private lawsuits and enforcement actions. These enforcement actions can include interruption or shutdown of operations relating to the collection and sharing of information pertaining to citizens of the European Union.

**Failure to develop our technology to accommodate increased traffic could reduce demand for our services and impair the growth of our business.**

We periodically enhance and expand our technology and transaction-processing systems, network infrastructure and other technologies to accommodate increases in the volume of traffic on our technology platforms. Any inability to add software and hardware or to develop and upgrade existing technology, transaction-processing systems or network infrastructure to manage increased traffic on this platform, or to anticipate spikes in traffic, may cause unanticipated systems disruptions, slower response times and degradation in client services, including impaired quality and speed of order fulfillment. Failure to manage increased traffic could harm our reputation and significantly reduce demand for our services, which would impair the growth of our business. We may be unable to improve and increase the capacity of our network infrastructure sufficiently or anticipate and react to expected increases in the use of the platform to handle increased volume. Further, additional network capacity may not be available from third-party suppliers when we need it. Our network and our suppliers networks may be unable to maintain an acceptable data transmission capability, especially if demands on the platform increase.

To remain competitive, we must continue to enhance and improve the responsiveness, functionality and features of our e-commerce platforms and the underlying network infrastructure. If we incur significant costs without adequate results, or are unable to adapt rapidly to technological changes, we may fail to achieve our business plan. The Internet and the e-commerce industry are characterized by rapid technological changes, changes in user and client requirements and preferences, frequent new product and service introductions embodying new technologies and the emergence of new industry standards and practices that could render our technology and systems obsolete. To be successful, we must adapt to rapid technological changes by licensing and internally developing leading technologies to enhance our existing services, developing new products, services and technologies that address the increasingly sophisticated and varied needs of our clients, and responding to technological advances and emerging industry standards and practices on a cost-effective and timely basis. The development of our proprietary technologies involves significant technical and business risks. We may fail to use new technologies effectively or fail to adapt our proprietary technology and systems to client requirements or emerging industry standards.

**System failures could reduce the attractiveness of our service offerings.**

We provide commerce, marketing and delivery services to our clients and end-users through our proprietary technology transaction processing and client management systems. These systems also maintain an electronic inventory of products and gather consumer marketing information. The satisfactory performance, reliability and availability of the technology and the underlying network infrastructure are critical to our operations, level of client service, reputation and ability to attract and retain clients. We have experienced periodic interruptions, affecting all or a portion of our systems, which we believe will continue to occur from time-to-time. Any systems damage or interruption that impairs our ability to accept and fill client orders could result in an immediate loss of revenue to us, and could cause some clients to purchase services offered by our competitors. In addition, frequent systems failures could harm our reputation.

Although we maintain system redundancies in multiple physical locations, our systems and operations are vulnerable to damage or interruption from:

§ Fire, flood and other natural disasters;

§ Operator negligence, improper operation by, or supervision of, employees, physical and electronic break-ins, misappropriation, computer viruses and similar events;

§ Power loss, computer systems failures, and Internet and telecommunications failure; and

§ Other events beyond our control.

We may not carry sufficient business interruption insurance to fully compensate us for losses that may occur.

**Our clients sales cycles are lengthy, which may cause us to incur substantial expenses and expend management time without generating corresponding consumer revenue, which would impair our cash flow.**

We market our services directly to software publishers, consumer electronics manufacturers, online retailers and other prospective customers. These relationships are typically complex and take time to finalize. Due to operating procedures in many organizations, a significant amount of time may pass between selection of our products and services by key decision-makers and the signing of a contract. The period between the initial client sales call and the signing of a contract with significant sales potential is difficult to predict and typically ranges from six to twelve months. If at the end of a sales effort a prospective client does not purchase our products or services, we may have incurred substantial expenses and expended management time that cannot be recovered and that will not generate corresponding revenue. As a result, our cash flow and our ability to fund expenditures incurred during the sales cycle may be impaired. We can incur substantial front-end cost to launch client sites and it may require a substantial time before those costs are recouped by us.

Table of Contents

**The listing of our network addresses on anti-spam lists could harm our ability to service our clients and deliver goods over the Internet.**

Certain privacy and anti-email proponents have engaged in a practice of gathering, and publicly listing, network addresses that they believe have been involved in sending unwanted, unsolicited emails commonly known as spam. In response to user complaints about spam, Internet service providers have, from time to time, blocked such network addresses from sending emails to their users. If our network addresses mistakenly end up on these spam lists, our ability to provide services for our clients and consummate the sales of digital and physical goods over the Internet could be harmed.

**We are exposed to foreign currency exchange risk.**

Sales outside the United States accounted for approximately 36.0% of our total sales in the first quarter of 2009. The results of operations of, and certain of our intercompany balances associated with, our internationally focused websites are exposed to foreign exchange rate fluctuations. Upon translation, net sales and other operating results from our international operations may differ materially from expectations, and we may record significant gains or losses on the remeasurement of intercompany balances. If the U.S. dollar weakens against foreign currencies, the translation of these foreign currency-denominated transactions will result in increased net revenues and operating expenses. Similarly, our net revenues and operating expenses will decrease if the U.S. dollar strengthens against foreign currencies. As we have expanded our international operations, our exposure to exchange rate fluctuations has become more pronounced. We may enter into short-term currency forward contracts to offset the foreign exchange gains and losses generated by the re-measurement of certain assets and liabilities recorded in non-functional currencies. The use of such hedging activities may not offset more than a portion of the adverse financial impact resulting from unfavorable movements in foreign exchange rates. See Item 7A of Part II in our Annual Report on Forms 10-K and 10-K/A for the year ended December 31, 2008, which was filed on February 19, 2009, for information demonstrating the effect on our consolidated statements of income from changes in exchange rates versus the U.S. dollar.

**Changes in our tax rates could affect our future results.**

Our future effective tax rates could be favorably or unfavorably affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws or their interpretation. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse effect on our results of operations and financial condition.

**Developments in accounting standards may cause us to increase our recorded expenses, which in turn would jeopardize our ability to demonstrate sustained profitability.**

In January 2002, we adopted Statement of Financial Accounting Standard No. 142, Goodwill and Other Intangible Assets (SFAS No. 142). The statement generally establishes that goodwill and intangible assets with indefinite lives are not amortized, but are to be tested on an annual basis for impairment and, if impaired, are recorded as an impairment charge in income from operations. As of March 31, 2009, we had goodwill with an indefinite life of $264.6 million from our acquisitions. If our goodwill is determined for any reason to be impaired, the subsequent accounting of the impaired portion as an expense would lower our earnings and jeopardize our ability to demonstrate sustained profitability. On January 1, 2006, we adopted SFAS 123(R) which requires the measurement and recognition of compensation expense for all stock-based compensation based on estimated fair values. Our operating results contain a charge for stock-based compensation related to stock options, restricted stock grants and employee stock purchases.

**Provisions of our charter documents, other agreements and Delaware law may inhibit potential acquisition bids for us.**

Certain provisions of our amended and restated certificate of incorporation, bylaws, other agreements and Delaware law could make it more difficult for a third party to acquire us, even if a change in control would be beneficial to our stockholders.

38

Table of Contents

**The investment of our substantial cash balance and our investments in marketable debt securities are subject to risks which may cause losses and affect the liquidity of these investments.**

As of March 31, 2009, Digital River held $109.5 million of investments at par value, $99.0 million fair value, in auction-rate securities (ARS), all are AAA/Aaa-rated and 105%-115% over collateralized by student loans guaranteed by the U.S. government with the exception of one security which is rated A3/AAA. All the securities are 100% guaranteed by the Department of Education or the Federal Family Education Loan Program (FFELP) with the exception of two securities which are 82.5% and 99% guaranteed by FFELP.

Substantially all of these securities continue to fail at auction due to illiquid market conditions. Because of this, we have recorded a $10.5 million temporary fair value reduction to Other Comprehensive Income as of March 31, 2009. The investment principal associated with failed auctions will not be accessible until successful auctions occur, a buyer is found outside of the auction process, the issuers establish a different form of financing to replace these securities, or final payments come due according to the contractual maturities of the debt issues. If none of these events occur or if the credit markets deteriorate, we may in the future be required to take a larger fair value discount and may be required to take a permanent impairment resulting in a reduction of earnings and liquidity. We intend to hold our auction-rate securities until we can recover the full principal amount and have the ability to do so based on our other sources of liquidity. Based on our expected operating cash flows, and our other sources of cash, we do not anticipate the potential lack of liquidity on these investments will affect our ability to execute our current business plan.

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

**None**

Table of Contents

**Item 6. Exhibits**
(a) Exhibits

| EXHIBIT NUMBER | | DESCRIPTION OF DOCUMENTS |
|---|---|---|
| 3.1 | (1) | Amended and Restated Certificate of Incorporation, as amended, as currently in effect. |
| 3.2 | (2) | Amended and Restated Bylaws, as currently in effect. |
| 4.1 | (3) | Specimen of Common Stock Certificate. |
| 4.2 | (4) | Form of Senior Debt Indenture. |
| 4.3 | (4) | Form of Subordinated Debt Indenture. |
| 4.4 | | References are made to Exhibits 3.1 and 3.2. |
| 4.5 | (5) | Indenture dated as of June 1, 2004 between Digital River, Inc. and Wells Fargo Bank, N.A. as trustee, including therein the form of the Note. |
| 12.1 | | Computation of Ratio of Earnings to Fixed Charges. |
| 31.1 | | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

(1) Filed as an exhibit to the Company s Current Report on Form 8-K, filed on June 1, 2006, and incorporated herein by reference.

(2) Filed as an exhibit to our Annual Report on Form 10-K for the year ended December 31, 2000, filed on

March 27, 2001, and incorporated herein by reference.

(3) Filed as an exhibit to our Registration Statement on Form S-1, File No. 333-56787, declared effective on August 11, 1998, and incorporated herein by reference.

(4) Filed as exhibits 4.2 and 4.3 to our Registration Statement on Form S-3, File No. 333-56787, declared effective on February 12, 2002, and incorporated herein by reference.

(5) Filed as exhibit 99.1 to our Current Report on Form 8-K, filed on July 13, 2004 and incorporated herein by reference.

**Table of Contents**

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: May 8, 2009 | | DIGITAL RIVER, INC. |
| | By: | /s/ Thomas M. Donnelly |
| | | Thomas M. Donnelly |
| | | *Chief Financial Officer* |
| | | *(Principal Financial and Accounting Officer)* |

Table of Contents

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