DIGITAL RIVER INC /DE
Form 10-Q
October 31, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED September 30, 2014

OR

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

FOR THE TRANSITION PERIOD FROM TO

Commission file number 000-24643

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)

10380 BREN ROAD WEST
MINNETONKA, MINNESOTA 55343
(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 No

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

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 October 1, 2014, was 31,888,021 shares.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

DIGITAL RIVER, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	(Unaudited) September 30, 2014	December 31, 2013
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 233,405	$ 483,868
Short-term investments	152,424	115,652
Accounts receivable, net of allowance of $3,062 and $3,206	64,667	70,865
Deferred tax assets	1,455	1,479
Prepaid expenses and other	24,916	27,878
Total current assets	476,867	699,742
Property and equipment, net	47,386	53,770
Goodwill	133,638	139,318
Intangible assets, net	21,565	29,217
Long-term investments	52,965	56,023
Deferred income taxes	1,078	1,037
Other assets	879	2,067
TOTAL ASSETS	$ 734,378	$ 981,174
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 168,010	$ 187,635
Accrued payroll	15,468	20,058
Deferred revenue	4,522	6,904
Other current liabilities	42,169	55,899
Total current liabilities	230,169	270,496
NON-CURRENT LIABILITIES		
Senior convertible notes	135,180	295,795
Other liabilities	12,454	21,452
Total non-current liabilities	147,634	317,247
TOTAL LIABILITIES	377,803	587,743

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; 50,709,661 and 50,074,977 shares issued	507	501
Treasury stock at cost; 18,821,640 and 16,910,883 shares	(456,696)	(424,416)
Additional paid-in capital	775,704	761,560
Retained earnings	42,590	51,254
Accumulated other comprehensive income (loss)	(5,530)	4,532
Total stockholders’ equity	356,575	393,431
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 734,378	$ 981,174

See accompanying notes to consolidated financial statements.

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DIGITAL RIVER, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data; unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenue	$ 88,835	$ 87,260	$ 274,028	$ 288,444
Costs and expenses (exclusive of depreciation and amortization expense shown separately below):				
Direct cost of services	18,304	16,205	53,275	55,272
Network and infrastructure	13,775	14,648	41,712	44,049
Sales and marketing	25,060	25,013	73,585	80,415
Product research and development	18,297	18,108	55,220	52,967
General and administrative	10,669	12,011	35,310	44,040
Goodwill impairment	-	-	-	21,249
Depreciation and amortization	6,601	5,682	19,469	15,748
Amortization of acquisition-related intangibles	2,038	2,149	6,395	6,360
Total costs and expenses	94,744	93,816	284,966	320,100
Income (loss) from operations	(5,909)	(6,556)	(10,938)	(31,656)
Interest income	469	553	1,735	1,929
Interest expense	(890)	(1,941)	(3,387)	(5,884)
Other income (expense), net	2,063	(297)	1,859	16,717
Loss on extinguishment of debt	-	-	(5,605)	-
Income (loss) from continuing operations before income taxes	(4,267)	(8,241)	(16,336)	(18,894)
Income tax expense (benefit)	(8,278)	(645)	(7,355)	(408)
Income (loss) from continuing operations	4,011	(7,596)	(8,981)	(18,486)
Income (loss) from discontinued operations, net of tax	143	(4,891)	317	(6,238)
Net income (loss)	$ 4,154	$ (12,487)	$ (8,664)	$ (24,724)
Income (loss) per share - basic:				
Income (loss) from continuing operations	$ 0.14	$ (0.24)	$ (0.30)	$ (0.57)
Income (loss) from discontinued operations	-	(0.16)	0.01	(0.19)
Net income (loss) per share - basic	$ 0.14	$ (0.40)	$ (0.29)	$ (0.76)
Income (loss) per share - diluted:				
Income (loss) from continuing operations	$ 0.13	$ (0.24)	$ (0.30)	$ (0.57)
Income (loss) from discontinued operations	0.01	(0.16)	0.01	(0.19)
Net income (loss) per share - diluted	$ 0.14	$ (0.40)	$ (0.29)	$ (0.76)

Shares used in per share calculation - basic	29,665	31,487	30,050	32,435
Shares used in per share calculation - diluted	30,126	31,487	30,050	32,435

See accompanying notes to consolidated financial statements.

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DIGITAL RIVER, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands; unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income (loss)	$ 4,154	$ (12,487)	$ (8,664)	$ (24,724)
Other comprehensive income (loss):				
Unrealized foreign exchange gain (loss) on the revaluation of investments in foreign subsidiaries	(9,857)	8,749	(10,876)	524
Unrealized gain (loss) on investments	(107)	292	666	3,389
Tax benefit (expense)	437	1,053	148	-
Other comprehensive income (loss)	(9,527)	10,094	(10,062)	3,913
Comprehensive income (loss)	$ (5,373)	$ (2,393)	$ (18,726)	$ (20,811)

See accompanying notes to consolidated financial statements.

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DIGITAL RIVER, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands; unaudited)

	Nine Months Ended September 30,	
	2014	2013
OPERATING ACTIVITIES		
Net income (loss)	$ (8,664)	$ (24,724)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Loss (gain) on disposal of discontinued operations	(317)	2,110
Amortization of acquisition-related intangibles	6,395	6,360
Provision for doubtful accounts	599	1,400
Depreciation and amortization	19,469	15,831
Impairment of goodwill	-	21,249
Debt issuance cost amortization	730	1,278
Amortization of investment premiums	1,111	2,246
Loss (gain) on disposal of equipment	(358)	121
Gain on sale of investment	(2,209)	(17,526)
Loss on extinguishment of debt	5,605	-
Stock-based compensation expense	13,239	16,295
Deferred and other income taxes	120	1,715
Change in operating assets and liabilities, net of acquisitions:		
Accounts receivable	3,600	(2,856)
Prepaid and other assets	380	5,940
Accounts payable	(12,816)	(65,721)
Deferred revenue	(2,735)	(4,321)
Income tax payable	(9,630)	(2,151)
Other current liabilities	(6,320)	(2,801)
Net cash provided by (used in) operating activities	8,199	(45,555)
INVESTING ACTIVITIES		
Purchases of investments	(185,180)	(53,243)
Sales of investments	151,834	90,891
Cash received (paid) for cost method investments	1,551	39,636
Cash paid for acquisitions, net of cash received	-	(55,843)
Proceeds from sale of equipment	532	20
Purchases of equipment and capitalized software	(13,612)	(15,662)

Net cash provided by (used in) investing activities	(44,875)	5,799
FINANCING ACTIVITIES		
Repurchase of senior convertible notes	(173,298)	(5,354)
Exercise of stock options	-	1,273
Sales of common stock under employee stock purchase plan	1,015	1,183
Repurchase of common stock	(28,260)	(43,950)
Repurchase of restricted stock to satisfy tax withholding obligation	(4,124)	(4,328)
Net cash provided by (used in) financing activities	(204,667)	(51,176)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(9,120)	6,143
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(250,463)	(84,789)
CASH AND CASH EQUIVALENTS, beginning of period	483,868	542,851
CASH AND CASH EQUIVALENTS, end of period	$ 233,405	$ 458,062
SUPPLEMENTAL DISCLOSURES		
Cash paid for interest on senior convertible notes	$ 2,509	$ 3,123
Cash paid for income taxes	$ 3,663	$ 3,373

See accompanying notes to consolidated financial statements.

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1. BASIS OF PRESENTATION

The unaudited consolidated financial statements of Digital River, Inc. and our wholly owned subsidiaries (we, our, Digital River, or the Company) included herein have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) for interim financial information, and, accordingly, do not include all financial information and footnotes normally required for a complete set of financial statements. These consolidated financial statements should be read in conjunction with our audited consolidated financial statements included in our Form 10-K for the year ended December 31, 2013, as filed with the Securities and Exchange Commission.

The unaudited consolidated statements 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. The results of operations for the three and nine months ended September 30, 2014, are not necessarily indicative of the results to be expected for any subsequent quarter or for the entire fiscal year ending December 31, 2014, due to seasonality and other factors. The December 31, 2013, information was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP.

Summary of Significant Accounting Policies

A detailed description of our significant accounting policies can be found in our most recent Annual Report filed on Form 10-K for the fiscal year ended December 31, 2013. There were no material changes in significant accounting policies during the quarter ended September 30, 2014.

Recent Accounting Pronouncements

ASU 2014-09 – Revenue from Contracts with Customers: In May 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-09, which revises revenue recognition guidance in order to create a single standard that is intended to improve comparability over a range of industries, companies and geographic areas. The ASU is effective for reporting periods beginning after December 15, 2016, and will be applied retrospectively. We are currently reviewing the revised guidance and assessing the potential impact on our consolidated financial statements.

ASU 2013-11 - Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists: In July 2013, the FASB issued ASU 2013-11, which requires an entity to present unrecognized tax benefits as a reduction of the deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, if net settlement is required or expected. To the extent that net settlement is not required or expected, the unrecognized tax benefit must be presented as a liability. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. ASU No. 2013-11 is effective for reporting periods beginning after December 15, 2013, and should be applied prospectively to all unrecognized tax benefits that exist at the effective date. We adopted the new guidance in ASU 2013-11 as of the period ended March 31, 2014, and its adoption did not have a material impact on our Consolidated Financial Statements.

We have determined that all other recently issued accounting standards will not have a material impact on our Consolidated Financial Statements, or do not apply to our operations.

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2. NET INCOME (LOSS) PER SHARE

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Income (loss) from continuing operations per share - basic				
Income (loss) from continuing operations - basic	$ 4,011	$ (7,596)	$ (8,981)	$ (18,486)
Weighted average shares outstanding - basic	29,665	31,487	30,050	32,435
Income (loss) from continuing operations per share - basic	$ 0.14	$ (0.24)	$ (0.30)	$ (0.57)
Income (loss) from continuing operations per share - diluted				
Income (loss) from continuing operations - basic	$ 4,011	$ (7,596)	$ (8,981)	$ (18,486)
Exclude: Interest expense and amortized financing cost of convertible senior notes, net of tax benefit	-	-	-	-
Income (loss) from continuing operations - diluted	$ 4,011	$ (7,596)	$ (8,981)	$ (18,486)
Weighted average shares outstanding - basic	29,665	31,487	30,050	32,435
Dilutive impact of non-vested stock and options outstanding	461	-	-	-
Dilutive impact of 2004 senior convertible notes	-	-	-	-
Weighted average shares outstanding - diluted	30,126	31,487	30,050	32,435
Income (loss) from continuing operations per share - diluted	$ 0.13	$ (0.24)	$ (0.30)	$ (0.57)

Incremental shares of 544,629 for the three months ended September 30, 2013, and 492,244 and 313,695 incremental shares for the nine months ended September 30, 2014 and 2013, respectively, related to dilutive securities were not included in the diluted net income (loss) per share calculation because the Company reported a loss for these periods. Incremental shares related to dilutive securities have an anti-dilutive impact on net income (loss) per share when a net loss is reported and therefore are not included in the calculation.

Options to purchase 377,235 and 589,943 shares for the three months ended September 30, 2014 and 2013, respectively, and 377,235 and 589,943 shares for the nine months ended September 30, 2014 and 2013 were not included in the computation of diluted net income (loss) per share because their effect on diluted net income (loss) per share would have been anti-dilutive.

Our remaining 2004 senior convertible notes were repurchased in the second quarter of 2014. Prior to the repurchase, the unissued shares underlying our 2004 senior convertible notes, 199,828 weighted average shares for the three months ended September 30, 2013, and weighted average shares of 583 and 199,828 for the nine months ended September 30, 2014 and 2013, respectively, were excluded for the purposes of calculating diluted net income (loss) per share, because their effect on diluted net income (loss) per share would have been anti-dilutive.

The unissued shares underlying our 2010 senior convertible notes, 2,751,414 and 6,019,607 weighted average shares for the three months ended September 30, 2014 and 2013, respectively, and 3,499,945 and 6,070,600 weighted average shares for the nine months ended September 30, 2014 and 2013, respectively, were excluded for the purpose of calculating diluted net income (loss) per share, because their effect on diluted net income (loss) per share would have been anti-dilutive.

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3. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) includes revenues, expenses, and gains and losses that are excluded from net earnings under GAAP. Items of comprehensive income (loss) are unrealized gains and losses on investments and foreign currency translation adjustments which are added to net income (loss) to compute comprehensive income (loss). Comprehensive income (loss) related to cumulative translation adjustments has no tax expense or benefit as these funds are indefinitely invested.

The following table summarizes the changes in accumulated other comprehensive income (loss), net of tax, by component for the periods ended September 30, 2014 and 2013, (in thousands):

	Foreign currency translation adjustment	Unrealized gain (loss) on investments	Total
Balance as of December 31, 2013	$ 3,720	$ 812	$ 4,532
Other comprehensive income (loss) before reclassifications	(10,876)	810	(10,066)
Reclassified adjustment for net loss included in net income (loss)	-	4	4
Net current period other comprehensive income (loss)	(10,876)	814	(10,062)
Balance as of September 30, 2014	$ (7,156)	$ 1,626	$ (5,530)
Balance as of December 31, 2012	$ 2,565	$ (5,735)	$ (3,170)
Other comprehensive income (loss) before reclassifications	524	3,393	3,917
Reclassified adjustment for net gain included in net income (loss)	-	(4)	(4)
Net current period other comprehensive income (loss)	524	3,389	3,913
Balance as of September 30, 2013	$ 3,089	$ (2,346)	$ 743

The following table shows the gross amounts reclassified from accumulated other comprehensive income (loss) into the Consolidated Statements of Operations and the associated financial statement line item, for the periods ended September 30, 2014 (in thousands):

		September 30, 2014	
Reclassification out of accumulated other comprehensive income	Financial statement line item	Three Months Ended	Nine Months Ended
Realized gains (losses) on investments			
	Other income (expense), net	$ -	$ (7)
	Income tax benefit (expense)	-	3
	Net income (loss)	$ -	$ (4)

4. FAIR VALUE MEASUREMENTS

Financial assets and liabilities that are remeasured and reported at fair value at each reporting period are classified and disclosed in one of the following three categories:

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

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Level 2 — Other observable inputs available at the measurement date, other than quoted prices included in Level 1, either directly or indirectly, including:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets in less active markets than Level 1 investments;
- Inputs other than quoted prices that are observable for assets or liabilities; and
- Inputs that are derived principally from or corroborated by other observable market data.

Level 3 — Unobservable inputs that cannot be corroborated by observable market data and reflect the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management's estimate of market participant assumptions.

Assets and Liabilities that are Measured at Fair Value on a Recurring Basis

The following table sets forth by level within the fair value hierarchy, our financial assets that were accounted for at fair value on a recurring basis at September 30, 2014 and December 31, 2013, (in thousands):

	Fair Value Measurements			
	Total	Level 1	Level 2	Level 3
Balance as of September 30, 2014				
Cash and cash equivalents	$ 233,405	$ 233,405	$ -	$ -
Restricted cash	2,025	2,025	-	-
Certificate of deposit	1,500	1,500		
U.S. government sponsored entities	999	-	999	-
Corporate bonds	129,343	129,343	-	-
Asset backed securities	20,560	-	20,560	-
Market basis equity investments	2,455	2,455	-	-
Auction rate securities	39,102	-	-	39,102
Total assets measured at fair value	$ 429,389	$ 368,728	$ 21,559	$ 39,102
Balance as of December 31, 2013				
Cash and cash equivalents	$ 483,868	$ 483,868	$ -	$ -
Restricted cash	3,560	3,560	-	-
Commercial paper	9,992	9,992	-	-
U.S. government sponsored entities	4,000	-	4,000	-
Corporate bonds	101,660	101,660	-	-
Market basis equity investments	3,549	3,549	-	-

Auction rate securities	41,993	-	-	41,993
Total assets measured at fair value	$ 648,622	$ 602,629	$ 4,000	$ 41,993

The assets held at September 30, 2014 and December 31, 2013 had no transfers between levels of the hierarchy during the respective periods then ended.

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

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Auction rate securities
Balance as of December 31, 2012	$ 37,001
Total unrealized gains (losses) included in other comprehensive income	5,092
Settlements	(100)
Balance as of December 31, 2013	$ 41,993
Total unrealized gains (losses) included in other comprehensive income	2,109
Settlements	(5,000)
Balance as of September 30, 2014	$ 39,102

The following methods and assumptions were used to estimate the fair value of each class of financial instrument. There have been no changes in the valuation techniques used by the Company to fair value our financial instruments:

Cash and Cash equivalents. Consist of cash on hand in bank deposits, highly liquid investments and money market accounts. The fair value was measured using quoted market prices and is classified as Level 1. The carrying amount approximates fair value.

Restricted Cash. Consist of cash and cash equivalents that are held in escrow accounts and restricted by agreements with third parties for a particular purpose. The carrying amount approximates fair value and is classified as Level 1.

Certificate of deposits. Consist of bank deposits with a carrying amount that approximates fair value and is classified as Level 1. Maturity dates within one year.

Commercial Paper. Consist of primarily high grade commercial paper. The fair value of these investments was measured using quoted market prices and is classified as Level 1. As of December 31, 2013, the contractual maturities of these investments were within one year.

U.S government sponsored entities. Consist of Fannie Mae, Freddie Mac and Federal Home Loan Bank investment grade bonds that are traded in less active markets than Level 1 investments. The fair value of these bonds is classified as Level 2. The contractual maturities of these investments are within four years.

Corporate Bonds. Consist of investment grade corporate bonds that trade with sufficient frequency and volume to enable us to obtain pricing information on an ongoing basis. The fair value of these bonds was measured using quoted market prices and is classified as Level 1. The contractual maturities of these investments are within three years.

Asset Backed Securities. Consist of securities backed by automobile loan receivables that are traded in less active markets than our Level 1 investments. The fair value is classified as Level 2. The contractual maturity of these investments is within six years.

Market Basis Equity Investments. Consist of available-for-sale equity securities that trade with sufficient frequency and volume to enable us to obtain pricing information on an ongoing basis. The fair value of these investments was measured using quoted market prices and is classified as Level 1.

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Auction Rate Securities. As of September 30, 2014, we held $40.7 million of Auction Rate Securities (ARS) at par value which we have recorded at $39.1 million fair value. As of December 31, 2013, we held $45.7 million of ARS at par value which was recorded at $42.0 million fair value. As of September 30, 2014 the ARS are 105—142% over-collateralized and the underlying student loans are guaranteed by the U.S. government.

Due to the illiquid market conditions, the fair value of our ARS is recorded at a discount to par value of $1.6 million, or 4.0%, as of September 30, 2014. This reduction from par value is considered temporary and is recorded in "Accumulated other comprehensive income (loss)". The temporary reduction from par value recorded in "Accumulated other comprehensive income (loss)" was $3.7 million, 8.2%, as of December 31, 2013. For the three months ended September 30, 2014 and 2013, we recorded unrealized gains on our ARS of $0.2 million and $0.1 million, respectively. For the nine months ended September 30, 2014 and 2013, we recorded unrealized gains on our ARS of $2.1 million and $3.3 million. Unrealized gains on our ARS are recorded in "Unrealized gain (loss) on investments" in our Consolidated Statements of Comprehensive Income (Loss).

In evaluating our ARS portfolio, we note sustained performance of our securities, strong parity levels, observed market redemption activity, continued receipt of interest and penalty payments, and an increase in fair value at September 30, 2014 compared to December 31, 2013. As we expect to receive all contractual cash flows, we do not believe the unrealized losses to be credit related. We continue to believe that we will be able to liquidate at par over time. We also anticipate we will have sufficient cash flow from operations to execute our business strategy and fund our operational needs. We do not intend to sell, or believe we will be required to sell, these investments prior to recovery of their amortized cost basis. Accordingly, we treated the fair value decline as temporary.

The discounted cash flow model we used to value these securities included the following assumptions:

	September 30, 2014			December 31, 2013		
Unobservable inputs						
Redemption period (in years)		6			7	
Credit ratings		A- to AAA			BB+ to AAA	
Penalty coupon rate	1.0 %	to	1.5 %	1.0 %	to	1.5 %
Weighted average annualized yield			1.1 %			1.6 %
Risk adjusted discount rate	4.3 %	to	5.1 %	4.7 %	to	7.8 %

Management makes estimates and assumptions about the ARS, which can be sensitive to changes and effect the determination of fair value. An increase in the length of redemption period or an increase in the discount rate assumption would decrease our fair value. Also, a decrease in the securities' credit ratings would decrease our fair value.

The portfolio had a weighted average maturity of 30.1 years at September 30, 2014, and 29.8 years as of December 31, 2013.

We classify our ARS as Level 3 long-term investments until we receive a call or partial call on the securities. As of September 30, 2014 and December 31, 2013, our entire ARS portfolio was classified as Level 3 long-term investments. During the quarter ended September 30, 2014, we settled $5.0 million of ARS due to a call at par. During the year ended December 31, 2013, we settled $0.1 million of ARS due to a partial call at par. The amount of Level 3 assets as a percentage of total assets measured at fair value on a recurring basis was 9.1% and 6.5% as of September 30, 2014 and December 31, 2013, respectively.

Assets and Liabilities that are Measured at Fair Value on a Nonrecurring Basis

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, they are not measured at fair value on an ongoing basis but are subject to fair value adjustments only in certain circumstances

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like evidence of impairment. For the three and nine months ended September 30, 2014 and 2013, other than the goodwill impairment recorded during the first quarter of 2013, as further discussed in Note 6 — Goodwill, we had no significant fair value adjustments of assets or liabilities on a nonrecurring basis subsequent to their initial recognition. The inputs used in goodwill impairment fair value calculations fall within Level 3 inputs due to the significant unobservable inputs used to determine fair value.

5. INVESTMENTS

As of September 30, 2014 and December 31, 2013, our available-for-sale securities consisted of the following (in thousands):

	Cost	Gross Unrealized Gains	Gross Unrealized Losses Less than 12 Months	Gross Unrealized Losses Greater than 12 Months	Fair Value	Maturities/Reset Dates Less than 12 Months	Maturities/Reset Dates Greater than 12 Months
Balance as of September 30, 2014							
Certificate of deposit	$ 1,500	$ -	$ -	$ -	$ 1,500	$ 1,500	$ -
U.S. government sponsored entities	1,000	-	(1)	-	999	-	999
Corporate bonds	129,395	85	(137)	-	129,343	56,532	72,811
Market basis equity investments	1,563	895	(3)	-	2,455	-	2,455
Asset backed securities	20,563	20	(23)	-	20,560	-	20,560
Auction rate securities	40,725	-	-	(1,623)	39,102	-	39,102
Total available-for-sale securities	$ 194,746	$ 1,000	$ (164)	$ (1,623)	$ 193,959	$ 58,032	$ 135,927

Balance as of December 31, 2013							
Commercial paper	$ 9,992	$ -	$ -	$ -	$ 9,992	$ 9,992	$ -
U.S. government sponsored entities	4,000	-	-	-	4,000	-	4,000
Corporate bonds	101,400	281	(21)	-	101,660	58,280	43,380
Market basis equity investments	1,668	1,881	-	-	3,549	-	3,549
Auction rate securities	45,725	-	-	(3,732)	41,993	-	41,993
Total available-for-sale securities	$ 162,785	$ 2,162	$ (21)	$ (3,732)	$ 161,194	$ 68,272	$ 92,922

We consider the fair value decline of our investments to be temporary, as we do not intend to sell the investments and it is not likely that we will be required to sell the investments before recovery of their amortized cost basis. See Note 4 — Fair Value Measurements, for further discussion regarding the fair value of ARS. Temporary, unrealized, gains and losses on available for sale securities are recorded in “Accumulated other comprehensive income (loss)” within our Consolidated Balance Sheets.

Realized gains or losses on investments are recorded in our Consolidated Statements of Operations within “Other income (expense), net”. Upon the sale of a security classified as available for sale, the amount reclassified out of “Accumulated other comprehensive income (loss)” into earnings is based on the specific identification method.

As of September 30, 2014 and December 31, 2013, the balance of our cost method equity investment was $11.4 million and $10.5 million, respectively, which is included in “Long-term investments” in our Consolidated Balance Sheets. During the first quarter of 2014, we invested an additional $0.6 million and converted a note receivable of $0.3 million into shares in our cost method equity investment. We have not estimated the fair value of

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our cost method equity investment as of September 30, 2014 as we are not aware of any facts or circumstances that would indicate a decline in the fair value of this investment below its carrying value.

During the first quarter of 2013, we sold a cost method equity investment to a third party and recorded a gain of $11.1 million. During the second quarter of 2013, we received additional funds based on our sales agreement and as a result we recorded an additional gain of $6.5 million. In the third quarter of 2014, we received the third of four anticipated payments under the sales agreement and recorded a gain of $2.2 million. All gains related to this cost basis investment have been recorded in "Other income (expense), net" in our Consolidated Statements of Operations. The fourth and final payment under the sales agreement is due in the third quarter of 2017 and we may receive up to $0.9 million of additional sale proceeds at that time. We have concluded that these additional funds represent contingent gains and have not accounted for them in our consolidated financial statements in accordance with U.S. GAAP.

6. GOODWILL

In the fourth quarter 2012, we determined our goodwill was impaired and recorded a preliminary non-cash pretax goodwill impairment charge. During the first quarter of 2013, we completed our goodwill impairment analysis and recorded an additional non-cash pretax goodwill impairment charge of $21.2 million relating to our single reporting unit. The tax benefit associated with the first quarter impairment was offset by our tax valuation allowance. As previously disclosed, a blended income and market approach was used to determine the applicable impairment changes. The application of goodwill impairment tests is a level 3 fair value measurement and requires management judgment for many of the inputs. Goodwill impairment charges are included as a separate operating expense line item, "Goodwill impairment" within Continuing Operations in our Consolidated Statements of Operations.

7. STOCK-BASED COMPENSATION

The following table summarizes stock-based compensation expense recognized related to employee stock options, restricted and performance stock awards and employee stock purchases (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Costs and expenses				
Direct cost of services	$ 38	$ 35	$ 122	$ 124

Network and infrastructure	380	341	1,127	1,083
Sales and marketing	1,452	1,718	4,029	5,349
Product research and development	849	782	2,570	2,553
General and administrative	1,866	1,465	5,391	7,186
Stock-based compensation included in costs and expenses	$ 4,585	$ 4,341	$ 13,239	$ 16,295

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8. INCOME TAXES

The provision (benefit) for income taxes from continuing operations is composed of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Current tax expense (benefit):				
United States	$ (8,422)	$ (397)	$ (8,130)	$ 1,040
International	144	(248)	775	(1,448)
Total current provision for income taxes	$ (8,278)	$ (645)	$ (7,355)	$ (408)
Tax Rate	194.0 %	7.8 %	45.0 %	2.2 %

During the quarter ended September 30, 2014, $9.1 million of previously unrecognized tax benefits, including $1.4 million of related interest, were released due to the expiration of a statute of limitations. We have taken no new tax positions that result in unrecognized tax benefits during the three and nine month periods ended September 30, 2014. As of September 30, 2014, we had $2.7 million of remaining unrecognized tax benefits, excluding related interest. Approximately $2.1 million of these unrecognized tax benefits would affect our effective tax rate if recognized. As of September 30, 2014, we had approximately $0.4 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 $1.4 million.

Our quarterly estimate of our annual effective tax rate is subject to variation due to several factors, including our mix of earnings between tax jurisdictions and the corresponding statutory rates, discrete items and the non-recognition of tax benefits generated by net operating losses in jurisdictions with a valuation allowance.

On a quarterly basis, we assess whether a valuation allowance for net operating loss carryforwards and other deferred tax assets is needed. We concluded during the third quarter of 2014 evaluation that we are required to maintain a valuation allowance against our net U.S. tax assets and certain foreign tax assets.

9. COMMITMENTS AND CONTINGENCIES

Litigation

We are subject to legal proceedings, claims and litigation, and other disputes or regulatory inquires arising in the ordinary course of business. In addition, third parties have from time-to-time claimed, and others may claim in the future, that we have infringed their intellectual property rights. We have been notified of several potential patent disputes, and expect that we will increasingly be subject to patent infringement claims as our services expand in scope and complexity. While the final outcome of these matters is currently not determinable, we believe there is no ordinary course litigation or other matters that are currently pending against us that is likely to have, individually or in the aggregate, a material effect on our consolidated financial position, results of operations, stockholders' equity or cash flows. Because of the uncertainty inherent in litigation, disputes, and intellectual property matters, it is possible that unfavorable resolutions of these lawsuits, proceedings and claims could exceed the amount we have currently reserved for these matters.

On April 4, 2014, we settled two intellectual property lawsuits with DDR Holdings, LLC, each of which was dismissed with prejudice. The full settlement amount was paid in April 2014.

On March 31, 2014, the U.S. District Court for the District of Minnesota certified a class action against the Company of all persons in the United States who purchased Extended Download Service for Norton Products

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between January 24, 2005, and October 26, 2009. The plaintiffs have sued Symantec Corporation and the Company. The claims against the Company are for alleged violation of the Minnesota Consumer Fraud and False Statement in Advertising Acts and unjust enrichment, based on the Company's sale of Extended Download Service to purchasers of Norton products. We intend to continue to vigorously defend this matter, but cannot predict the timing or ultimate outcome, nor estimate a range of loss, if any, for this matter.

Indemnification Provisions

In the ordinary course of business we have included limited indemnification provisions in certain of our agreements with parties with whom we have commercial relations. Under these contracts, we generally indemnify, hold harmless and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party in connection with claims by any third party with respect to our domain names, trademarks, logos and other branding elements to the extent that such marks are applicable to our performance under the subject agreement. In certain agreements, including both agreements under which we have developed technology for certain commercial parties and agreements with our clients, we have provided an indemnity for other types of third-party claims.

In addition, we are required by our credit card processors to comply with credit card association operating rules, and we have agreed to indemnify 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 or Discover could adopt new operating rules or re-interpret existing rules that we or our credit card processors might find difficult to follow. We also could be subject to fines or increased fees from MasterCard and Visa.

To date, no significant costs have been incurred, either individually or collectively, in connection with our indemnification provisions

Commitments and Guarantees

At certain times, we enter into agreements where a letter of credit is required to ensure payment of future obligations by counterparties, such as our credit card processors and international taxing jurisdictions. Upon withdrawal, we are obligated to fund the executor bank on demand. We have not set aside specific funds to cover this potential obligation as we can generally recover these costs from our clients. If drawn upon, we expect to fund this commitment with cash and cash equivalents. There were $0.5 million and $0.6 million in undrawn letters of credit as of September 30, 2014 and December 31, 2013.

10. DEBT

2010 Senior Convertible Notes

For the nine months ended September 30, 2014, we repurchased $160.6 million of our 2.00% senior convertible notes (2010 Notes) in the open market for $164.5 million, excluding accrued interest. All repurchases occurred in March 2014. For the nine months ended September 30, 2014, the loss on extinguishment of debt, including the premium on repurchase and acceleration of the recognition of deferred financing fees was $5.5 million. For the nine months ended September 30, 2013, we repurchased $5.4 million of the 2010 Notes in the open market for $5.3 million excluding accrued interest. No repurchases were made in the third quarter of 2013. For the nine months ended September 30, 2013, the net gain on extinguishment of debt, which is the net of the gain on sale and the loss on acceleration of the recognition of deferred financing fees, was immaterial. Notes repurchased are deemed to be extinguished for accounting purposes.

As of September 30, 2014, the carrying value of our 2010 Notes was $135.2 million and the fair value was $134.8 million. As of December 31, 2013, the carrying value of our 2010 Notes was $295.8 million and the fair value was $298.3 million. Fair values are based on the quoted fair market values of the debt. Debt is classified as a level 3 fair value measurement. We determine fair value based on the market approach.

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2004 Senior Convertible Notes

On January 1, 2014, holders of $8.7 million of our 1.25% senior convertible notes (2004 Notes) exercised the option to require us to repurchase those notes at par. The acceleration of the recognition of deferred financing fees related to these repurchased Notes resulted in a $0.1 million charge. On June 6, 2014, the remaining balance of our 2004 Notes of $0.1 million was repurchased. The 2004 Notes that were repurchased on January 1, 2014, were classified as current in “Other current liabilities” in our December 31, 2013, Consolidated Balance Sheet due to the subsequent repurchase.

As of December 31, 2013, the carrying value of our 2004 Notes was $8.8 million and the fair value was $8.9 million. Fair values are based on the quoted fair market values of the debt. Debt is classified as a level 3 fair value measurement. We determine fair value based on the market approach.

11. DISCONTINUED OPERATIONS

On September 30, 2013, we sold CustomCD, Inc., which was based in Portland, Oregon in a stock sale to a former employee. On October 1, 2013, we sold Digital River Education Services, Inc., which was based in Plano, Texas in a stock sale to two former employees. The results of operations of these entities, including the income (losses) on their respective sales, have been excluded from the results of continuing operations and are reported as discontinued operations. We do not allocate interest income or interest expense to discontinued operations. The operating results of the discontinued operations included in our Consolidated Statements of Operations, including adjustments to loss on the respective sales, for the three and nine months ended September 30, 2014 and 2013, were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenue	$ -	$ 3,064	$ -	$ 8,044
Income (loss) on discontinued operations before taxes and loss on sales	-	(99)	-	(1,619)
Income (loss) on disposal of discontinued businesses before taxes	41	(2,110)	317	(2,110)
Provision (benefit) for income taxes	(102)	2,682	-	2,509
Income (loss) on discontinued operations, net of tax	$ 143	$ (4,891)	$ 317	$ (6,238)

12. SUBSEQUENT EVENTS

On October 23, 2014, the Company entered into a definitive merger agreement to be acquired by an investor group led by Siris Capital Group, LLC (Siris) in a transaction valued at approximately $840 million. Under the terms of the agreement, Siris will acquire all of the outstanding common shares of Digital River for $26.00 per share in cash. The Company may solicit alternative acquisition proposals from third parties during a 45-day "go-shop" period, following the date of execution of the merger agreement. The Company may be required to pay a termination fee of up to $27.3 million if the merger agreement is terminated under certain circumstances. If approved, the merger agreement is expected to be finalized in early 2015.

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. We have no obligation to update the matters set forth herein, whether as a result of new information, future events or otherwise.

Business Overview

Digital River is a leading provider of global Commerce-as-a-Service (CaaS) solutions. We provide commerce, payments and marketing solutions to business-to-business (B2B) and business-to-consumer (B2C) digital product and cloud service companies as well as branded manufacturers across a variety of vertical markets through our multi-tenant technology, platform and service offerings. Our customers range in size from small to mid-sized companies to multi-national enterprises that serve a wide variety of markets, including, software, consumer electronics, computer games, publishing, travel, music, video games, electronic toys, housewares, medical equipment, power tools and direct-selling, among others.

We offer our customers a broad range of solutions to quickly and cost effectively establish, manage and grow commerce sales channels via Internet-connected devices. We have invested substantial resources to develop our solutions, services, infrastructure and platforms, and to mitigate the risks our customers may encounter when conducting global commerce.

Commerce

Our Commerce-as-a-Service suite includes our commerce experience, tools and capabilities; Commerce Business Infrastructure (CBI), which we believe is a competitive differentiator; and marketing services. Our solutions allow our customers to focus on promoting and marketing their products and brands worldwide while leveraging our technology and global infrastructure investments to facilitate the purchase of products or services through e-commerce stores. We generate a significant proportion of our revenue based on the difference between the selling price and our wholesale purchase price, which can be expressed on a revenue-share basis, meaning that we earn as margin a percentage of the selling price of each product sold through our commerce solution. We believe this model aligns our interests with those of our clients. In addition, we also offer our customers transaction-based models and hybrid combinations of revenue share and transaction models.

- Commerce experience, tools and capabilities: With our commerce experience, tools and capabilities we create and manage world-class commerce sites and online experiences that include all of the classic components of a commerce operation, such as responsive and adaptive design, development and hosting of commerce stores, in-application and in-product commerce experiences, shopping carts, store merchandising and optimization, digital product or license key delivery via download, physical product fulfillment, subscription management, e-marketing services, international payment processing services, web store optimization, web analytics and reporting.

When shoppers decide to purchase a customer’s product or service online, they are transferred to a commerce store and/or shopping cart operated by us using our multi-tenant commerce platform. Once on our system, shoppers can browse for products and make purchases using connected devices such as PCs, tablet computers, smartphones and other similar devices. After a purchase is made, we deliver the product or license key digitally via download over the Internet, enable access to the product via a time- or —usage-

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based subscription model or transmit instructions to a third party partner for physical fulfillment of the order.

- Commerce business infrastructure (CBI): Our CBI is the underpinning for our Commerce-as-a-Service suite and our payments solution. We believe it is unique and differentiated, enabling us to manage the complexity of global commerce on behalf of our customers. It includes our merchant-of-record and seller-of-record capabilities, our fraud screening and management capabilities, our order management, business intelligence analytics, customer support services and our integration services capabilities as well as our local business entities, which enable us to have on-the-ground experts, strong localization capabilities and local payment methods and banking relationships; and it enables us to manage legal compliance requirements and export controls and management.

We have invested substantial resources to develop our CBI as part of our multi-tenant SaaS commerce and marketing platform and business processes. We provide access and use of our platform to our clients as a service as opposed to selling the software to be operated on our customers’ own in-house computer hardware.

Payments

Our Payments solutions offer our customers a global payments footprint, including a full range of domestic and international payment solutions, 180 global payment methods, 170 international currencies and 50 connections to local banks from across the globe. The payments services we provide ourselves or through third parties include transaction processing, global payment methods, fraud management, cloud-based billing, mobile payments services, and other payment optimization services. Our online payments solutions are designed to help our customers maximize credit card and transaction authorization rates, reduce online shopping cart abandonment, ease entry into new geographies and protect transactions from fraud on a global basis. Our payments offerings can function as independent online payment solutions and as fully integrated components of Digital River’s enterprise commerce solution.

Marketing

In addition to the services we provide that facilitate the completion of an online transaction, we also offer services designed to help our clients acquire customers more effectively, sell to those customers more often and more efficiently, and increase the lifetime value and retention of each customer. The e-marketing services we provide are supported through several channels. Our performance marketing services include:

- marketForce: Our marketForce™ digital marketing agency includes a global team of marketers that offer managed direct response e-marketing services. Digital River’s e-marketing experts offer managed services that span email and affiliate marketing management, search engine marketing, site optimization, multi-variate testing, mass dynamic personalization and contextual advertising.

· oneNetworkDirect: Through our large oneNetworkDirect™ affiliate network, we provide our customers access to a new sales channel, which can help grow their online businesses. Customers can offer any part of their product catalogs to our network of online channel partners, including online retailers and affiliates. This increases the exposure these products receive and can result in higher sales volumes.

· BlueHornet Email Marketing: Our BlueHornetTM enterprise email marketing service provides traditional as well as social and mobile email marketing capabilities. BlueHornet offers email marketing technology, a service model including account management by expert email marketers, and proactive inbox deliverability management.

We view our operations and manage our business as one reportable segment, providing solutions to companies that want to sell their products and services online.

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We were incorporated in Delaware in February 1994. Our headquarters are located at 10380 Bren Road West, Minnetonka, 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 or follow the Company on Twitter at twitter.com/digitalriverinc. Our annual report on Form 10-K, 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 such reports with the Securities and Exchange

Current Period Results

For the three months ended September 30, 2014, we recorded net income of $4.2 million, or $0.14 per diluted share, comprised of net income from continuing operations of $4.0 million, or $0.13 per diluted share and a $0.1 million gain from discontinued operations, $0.01 per diluted share. For the comparative period ended September 30, 2013, we recorded a net loss of $12.5 million, or loss of $0.40 per share, comprised of net loss from continuing operations of $7.6 million, or loss of $0.24 per share, and net loss from discontinued operations of $4.9 million, or loss of $0.16 per share. Revenue for the quarter ended September 30, 2014 was $88.8 million, compared to $87.3 million for the same period in the prior year. The 1.8% growth in revenue quarter over quarter was driven by the addition of new payments clients.

Total costs and expenses in continuing operations for the three months ended September 30, 2014 were $94.7 million compared to $93.8 million in the same period in the prior year, an increase of 1.0%.

As of September 30, 2014 and December 31, 2013, we had $385.8 million and $599.5 million in cash, cash equivalents and short-term investments, respectively.

Results of Operations

The results of the operations of CustomCD, Inc. (CustomCD) and Digital River Education Services, Inc. (DRES), which were sold on September 30, 2013 and October 1, 2013, respectively, have been classified within Discontinued Operations in our Consolidated Statements of Operations for all periods presented.

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The following table sets forth certain items from our Consolidated Statements of Operations as a percentage of total revenue for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenue	100.0 %	100.0 %	100.0 %	100.0 %
Costs and expenses (exclusive of depreciation and amortization expense shown separately below):				
Direct cost of services	20.6	18.5	19.4	19.1
Network and infrastructure	15.5	16.8	15.2	15.3
Sales and marketing	28.2	28.7	26.9	27.9
Product research and development	20.6	20.8	20.2	18.4
General and administrative	12.0	13.8	12.9	15.3
Goodwill impairment	-	-	-	7.4
Depreciation and amortization	7.5	6.5	7.1	5.4
Amortization of acquisition-related intangibles	2.3	2.4	2.3	2.2
Total costs and expenses	106.7	107.5	104.0	111.0
Income (loss) from operations	(6.7)	(7.5)	(4.0)	(11.0)
Interest income	0.5	0.6	0.6	0.6
Interest expense	(1.0)	(2.2)	(1.2)	(2.0)
Other income (expense), net	2.3	(0.3)	0.7	5.8
Gain (loss) on extinguishment of debt	-	-	(2.0)	-
Income (loss) from continuing operations before income taxes	(4.9)	(9.4)	(5.9)	(6.6)
Income tax expense (benefit)	(9.3)	(0.7)	(2.7)	(0.2)
Income (loss) from continuing operations	4.4	(8.7)	(3.2)	(6.4)
Income (loss) from discontinued operations, net of tax	0.2	(5.6)	0.1	(2.2)
Net income (loss)	4.6 %	(14.3) %	(3.1) %	(8.6) %

Revenue. Our revenue was $88.8 million and $87.3 million for the three months ended September 30, 2014 and 2013, respectively, an increase of $1.5 million or 1.8%. For the nine months ended September 30, 2014, revenue totaled $274.0 million, a decrease of $14.4 million or 5.0%, from revenue of $288.4 million for the same period in the prior year.

Our revenue is driven primarily by global commerce and payment services provided to a wide variety of companies in the software, consumer electronics, computer games and other markets.

Payments revenue for the three and nine months ended September 30, 2014, increased $1.8 million or 12.7%, and $4.6 million or 10.1%, respectively. The growth in both periods is mainly related to the addition of new clients.

Commerce revenue, including Microsoft, for the three months ended September 30, 2014 was consistent with the same period in the prior year, decreasing $0.3 million or 0.4%. For the nine months ended September 30, 2014, commerce revenue decreased $19.0 million or 7.8%, due primarily to client attrition, as well as one-time significant product launches that occurred in the first quarter of 2013.

International sales were approximately 46.4% and 47.6% of revenue from continuing operations in the three and nine month periods ended September 30, 2014, compared to 46.8% and 47.7% for the same periods in the prior year.

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Direct Cost of Services. Direct cost of services includes payment processing fees, chargeback expense, fraud detection and prevention, costs related to product fulfillment, delivery solutions and certain client-specific costs. Direct cost of services were $18.3 million for the three months ended September 30, 2014, compared to $16.2 million for the same period in the prior year. The increase was primarily related to higher payment processing costs. For the nine months ended September 30, 2014, direct cost of services was $53.3 million compared to $55.3 million for the same period in the prior year. Higher costs in 2013 were primarily due to CD costs related to one time significant product launches in the first quarter of 2013.

Network and Infrastructure. Our network and infrastructure expenses primarily include costs to operate and maintain our technology platforms, customer service, data communication and data center operations. Network and infrastructure expenses were $13.8 million and $14.6 million for the three months ended September 30, 2014 and 2013, respectively. For the nine months ended September 30, 2014 and 2013, network and infrastructure expenses were $41.7 million and $44.0 million, respectively. The decreases for both periods were primarily related to reductions in workforce, consulting, and overhead related expenses.

Sales and Marketing. Our sales and marketing expenses include personnel and related costs, advertising, promotional and product marketing expenses. Sales and marketing expenses were $25.1 million for the three months ended September 30, 2014, consistent with $25.0 million for the same period in the prior year. For the nine months ended September 30, 2014 and 2013, sales and marketing expenses were $73.6 million and $80.4 million, respectively. The decrease year-over year was driven by reductions in workforce costs, including severance and stock compensation expense incurred in 2013 as part of planned cost reduction strategies, and lower marketing expense, including the utilization of third parties.

Product Research and Development. Our product research and development expenses include costs associated with design, development and enhancement of our technology platforms and related systems. Research and development costs are expensed as incurred, except certain internal-use software development costs that are eligible for capitalization and costs directly associated with preparing a client website launch that are eligible to be deferred and amortized over the life of the site's associated revenue streams. Product research and development expenses were $18.3 million and $18.1 million for the three months ended September 30, 2014 and 2013, respectively, and $55.2 million and $53.0 million for the nine months ended September 30, 2014 and 2013, respectively. The increases for both periods were driven by employee and contractor expenses related to the continued investment in our platforms.

General and Administrative. Our general and administrative expenses primarily include executive, finance, human resources and other administrative workforce and other related expenses, fees for professional services, bank fees, litigation costs, insurance costs, acquisition and integration costs and non-income related taxes. General and administrative expenses were $10.7 million and $12.0 million for the three months ended September 30, 2014 and 2013, respectively. The decrease was primarily related to strategic consulting expenses incurred in 2013 associated with business transformation plans, as well as lower legal and professional services spending. For the nine months ended September 30, 2014 and 2013, general and administrative expenses were $35.3 million and $44.0 million, respectively. In addition to the quarter over quarter decreases, the nine months in 2013 included acquisition and integration costs associated with the acquisition of LML Payment Systems, Inc. and severance and stock compensation expense associated with an executive departure.

Goodwill Impairment. During the first quarter of 2013, we completed our fiscal year 2012 goodwill impairment analysis and recorded an additional non-cash pretax goodwill impairment charge of $21.2 million.

Depreciation and Amortization. Our depreciation and amortization expenses include the depreciation of computer equipment, office furniture and leasehold improvements and the amortization of purchased and internally developed software. Computer equipment, software and furniture are depreciated/amortized under the straight-line method using three to seven year lives and leasehold improvements are depreciated over the shorter of the life of the asset or the remaining length of the lease. Depreciation and amortization expense was $6.6 million and $5.7 million for the three months ended September 30, 2014 and 2013, respectively. Depreciation and amortization expense was $19.5 million and $15.7 million for the nine months ended September 30, 2014 and 2013, respectively. The increase in depreciation and amortization in both periods is primarily related to assets acquired for our new data center which were put into service during the third quarter of 2013.

Amortization of Acquisition-Related Intangibles. Acquisition-related intangibles consists of the assets such as customer relationships, technology and trade names acquired in business combinations. Amortization of acquisition-related intangible assets was $2.0 million for the three months ended September 30, 2014, consistent with the $2.1 million recognized in the three months ended September 30, 2013. Amortization of acquisition-related intangible assets was $6.4 million for both of the nine months ended September 30, 2014 and 2013.

Interest Income. Our interest income represents the total of interest income on our cash, cash equivalents, short-term investments and certain long-term investments. Interest income was $0.5 million and $0.6 million for the three months ended September 30, 2014 and 2013, respectively. Interest income was $1.7 million and $1.9 million for the nine months ended September 30, 2014 and 2013, respectively. The small decrease in interest income in both periods is related to lower total cash and cash equivalent and investment balances due to senior convertible note and stock repurchases over the past year.

Interest Expense. Our interest expense includes the total of cash and non-cash interest expense attributable to our outstanding convertible debt. For the three months ended September 30, 2014 and 2013, interest expense was $0.9 million and $1.9 million, respectively, which included $0.2 million and $0.4 million of debt financing cost amortization, respectively. For the nine months ended September 30, 2014 and 2013, interest expense was $3.4 million and $5.9 million, respectively, which included $0.7 million and $1.3 million of debt financing cost amortization, respectively. The decrease in interest expense in both periods was due to the repurchase of our senior convertible notes during 2013 and the first quarter of 2014.

Other Income (Expense), Net. Other income (expense), net includes foreign currency transaction gains and losses, gains and losses on investments or asset disposals (excluding disposals of businesses included in discontinued operations), and dividend income. Other income (expense), net was $2.1 million of income compared to $0.3 million of expense for the three months ended September 30, 2014 and 2013, respectively. Other income (expense), net was $1.9 million of income compared to $16.7 million of income for the nine months ended September 30, 2014 and 2013, respectively. The other income, net that was recognized in the three and nine months ended September 30, 2014 was primarily related to additional gains recognized on the sale of a cost method investment that occurred in the first quarter of 2013. These gains were contingent on the release of an escrow amount that occurred in the third quarter of 2014. The other income, net that was recorded for the nine months ended September 30, 2013 was related to the initial gain on the sale of the same cost method investment.

Gain (Loss) on Extinguishment of Debt. During the first quarter of 2014, we repurchased $160.6 million of our 2.00% senior convertible notes in the open market for $164.5 million, excluding accrued interest. The loss on extinguishment of this debt, including the premium on repurchase and acceleration of the recognition of deferred financing fees was $5.5 million. In addition, we repurchased $8.7 million of our 1.25% senior convertible notes at par in the first quarter of 2014 and recorded a $0.1 million charge related to the acceleration of the recognition of deferred financing fees.

Income Tax Expense. For the three months ended September 30, 2014 and 2013, our tax benefit related to continuing operations was $8.3 million and $0.6 million, respectively. For the three months ended September 30, 2014 our tax benefit related to discontinued operations was $0.1 million compared to a tax expense of $2.7 million for the three months ended September 30, 2013. For the three months ended September 30, 2014, our tax benefit related to continuing operations consisted of $8.4 million U.S. tax benefit and $0.1 million of foreign tax expense. For the three months ended September 30, 2013, our tax benefit related to continuing operations consisted of $0.4 million of U.S. tax benefit and $0.2 million of foreign tax benefit. For the three months ended September 30, 2014 and 2013, the tax rate was a benefit of 194.0% and 7.8%, respectively.

For the nine months ended September 30, 2014 and 2013, our tax benefit related to continuing operations was $7.4 million and $0.4 million, respectively. For the nine months ended September 30, 2014, we had no tax expense related to discontinued operations compared to tax expense of $2.5 million for the nine months ended September 30, 2013. For the nine months ended September 30, 2014, our tax expense related to continuing operations consisted of $8.1 million of U.S. tax benefit and $0.8 million of foreign tax expense. For the nine months ended September 30, 2013, our tax expense related continuing operations consisted of $1.0 million of U.S. tax

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expense and $1.4 million of foreign tax benefit. For the nine months ended September 30, 2014 and 2013, the tax rate was 45.0% and 2.2%, respectively.

The tax benefit for both the three and nine month periods ended September 30, 2014 was driven by $9.1 million of previously unrecognized tax benefits, including $1.4 million of related interest, which was released in the third quarter of 2014 due to the expiration of a statute of limitations.

Discontinued Operations. The pre-tax gain related to the disposal of discontinued operations recorded in the three months ended September 30, 2014 was immaterial compared to a pre-tax loss related to the operation of the discontinued entities of $0.1 million and pre-tax loss of $2.1 million related to the disposal of those entities for the three months ended September 30, 2013. Total net gain from discontinued operations was $0.1 million for the three months ended September 30, 2014, compared to a net loss of $4.9 million for the same period in the prior year. The pre-tax gain related to the disposal of discontinued operations recorded in the nine months ended September 30, 2014 was $0.3 million compared to a pre-tax loss of $3.7 million for the nine months ended September 30, 2013, which consists of $1.6 million of pre-tax loss on the operation of the discontinued entities and $2.1 million pre-tax loss on disposal. Total net gain from discontinued operations was $0.3 million for the nine months ended September 30, 2014, compared to a net loss of $6.2 million for the same period in the prior year.

Off Balance Sheet Arrangements

None.

Liquidity and Capital Resources

	Nine Months Ended September 30,	
	2014	2013
Cash provided by (used in):		
Operating activities	$ 8,199	$ (45,555)
Investing activities	(44,875)	5,799
Financing activities	(204,667)	(51,176)
Effect of exchange rate changes on cash and cash equivalents	(9,120)	6,143
Net increase (decrease) in cash and cash equivalents	$ (250,463)	$ (84,789)

As of September 30, 2014, we had $233.4 million of cash and cash equivalents, approximately 63.2% was held by our international subsidiaries. Cash and cash equivalents are sufficient to fund our current and anticipated operations and we do not anticipate any local liquidity restrictions that would preclude us from funding our expansion or operating needs.

Operating Activities

Net cash provided by operations for the nine months ended September 30, 2014, of $8.2 million was due to net add backs for non-cash operating expenses, offset by changes in working capital, a $27.5 million use of cash. Excluding the impact of working capital changes, our operating cash flow for the nine months ended September 30, 2014, was $35.7 million. Net cash used in operations for the nine months ended September 30, 2013, was $45.6 million, and was primarily the result of changes in working capital, a $71.9 million use of cash. Excluding the impact of working capital changes, our operating cash flow for the nine months ended September 30, 2013, was $26.4 million.

Investing Activities

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Net cash used in investing activities for the nine months ended September 30, 2014, was $44.9 million and was the result of net purchases of investments of $31.8 million and purchases of equipment and capitalized software of $13.6 million, offset by proceeds from sale of equipment of $0.5 million. Net cash provided by investing activities for the nine months ended September 30, 2013, was $5.8 million and was the result of net sales of investments of $77.3 million, offset by cash paid for acquisitions of $55.8 million and $15.7 million of purchases of equipment and capitalized software.

Financing Activities

Net cash used in financing activities for the nine months ended September 30, 2014, was $204.7 million and was due to $173.3 million in repurchases of our senior convertible notes, $28.3 million in repurchases of our common stock and $4.1 million in repurchases of restricted stock to satisfy tax withholding obligations, offset by $1.0 million of sales of common stock under our employee stock purchase plan. Net cash used in financing activities for the nine months ended September 30, 2013, was $51.2 million and was due to $44.0 million in repurchases of common stock, $4.3 million in repurchases of restricted stock to satisfy tax withholding obligations and $5.4 million in repurchases of our senior convertible notes, offset by proceeds of $1.3 million related to the exercise of stock options and $1.2 million of sales of common stock under our employee stock purchase plan.

Effect of Exchange Rate Changes

For the nine months ended September 30, 2014 changes in foreign currency rates resulted in a decrease in our cash and cash equivalents of $9.1 million. For the nine months ended September 30, 2013 changes in foreign currency rates resulted in an increase in our cash and cash equivalents of $6.1 million. The changes are due to foreign currency volatility on our international entity balance sheet exposures, primarily from the Euro.

Auction Rate Securities

Information regarding auction rate securities is included in Note 4 to the Consolidated Financial Statements in Part I, Item 1.

Commitments and Guarantees

At certain times, we enter into agreements where a letter of credit is required to ensure payment of future obligations by counterparties, such as our credit card processors and international taxing jurisdictions. Upon withdrawal, we are obligated to fund the executor bank on demand. We have not set aside specific funds to cover this potential obligation as we can generally recover these costs from our clients. If drawn upon, we expect to fund this commitment with cash and cash equivalents. There were \$0.5 million and \$0.6 million in undrawn letters of credit at September 30, 2014 and December 31, 2013, respectively.

Application of Critical Accounting Policies

Critical Accounting Estimates and Policies

A detailed description of our significant accounting policies can be found in our most recent Annual Report filed on Form 10-K for the fiscal year ended December 31, 2013. There were no material changes in significant accounting policies during the nine months ended September 30, 2014.

Recent Accounting Pronouncements

Information regarding recently issued accounting standards is included in Note 1 to the Consolidated Financial Statements in Part I, Item 1.

Item 3. Qualitative and Quantitative Disclosure about Market Risk

Interest Rate Risk

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Our portfolio of cash equivalents, short-term and long-term investments is maintained in a variety of securities, including government agency obligations, corporate bonds, asset backed securities 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. 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 purchase financial instruments for trading or speculative purposes.

At September 30, 2014, we had long-term debt of $135.2 million associated with our Senior Convertible Notes, which are fixed rate instruments. 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

Growth in our international operations will incrementally 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.

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 Statements of Operations. To the extent the U.S. dollar weakens against foreign currencies, the translation of these foreign currency-denominated transactions will result in increased net revenue and operating expenses. Conversely, our net revenue 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 income (expense), net”. Foreign currency transaction gains and losses were a loss of $0.1 million and a loss of $0.3 million for the three months ended September 30, 2014 and 2013, respectively. Foreign currency transaction gains and losses were a loss of $0.3 million and a loss of $0.8 million in the nine months ended September 30, 2014 and 2013, respectively.

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 Sheets. These gains or losses are recognized as an adjustment to stockholders' equity which is reflected in our Consolidated Balance Sheets under “Accumulated other comprehensive income (loss)”.

Other Market Risks

Investments in Auction Rate Securities

Information regarding auction rate securities is included in Note 4 to the Consolidated Financial Statements in Part I, Item 1. We may incur temporary unrealized losses, or other-than-temporary realized losses, in the future if we are unable to recover the investment principal in our ARS.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a – 15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2014. The term "disclosure controls and procedures" means controls and other procedures that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that such information is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate, to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on their evaluation of our disclosure controls and procedures as of September 30, 2014, our Chief Executive Officer and our Chief Financial Officer concluded that as of that date, our disclosure controls were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a – 15(f) and 15d – 15(f) under the Exchange Act) during the quarter ended September 30, 2014, that have materially affected, or are reasonably likely to materially affect, the Company's 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.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We have provided information about legal proceedings in which we are involved in Note 9 to the Consolidated Financial Statements in Part I, Item 1.

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, and you could lose all or part of the money you paid to buy our common stock. The following discussion of our risk factors should be read in conjunction with the consolidated financial statements and related notes thereto, and management's discussion and analysis, contained in this report, and the risk factors contained in our Annual Report on Form 10-K for the year ended December 31, 2013. Our business is also subject to general risks and uncertainties that affect many other companies. In addition, the current global economic climate amplifies many of these risks.

This 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 and in our Annual Report on Form 10-K for the year ended December 31, 2013.

Risks Related to the Agreement and Plan of Merger

There are risks and uncertainties associated with our proposed merger with and acquisition by an affiliate of Siris Capital Group, LLC.

On October 23, 2014, we entered into an agreement and plan of merger (the "Merger Agreement") providing for the acquisition of the Company by a newly formed affiliate of Siris Capital Group, LLC ("Siris"). Pursuant to the terms of the Merger Agreement and subject to the conditions thereof, the Siris affiliate will merge with and into the Company, and the Company will become a private company, wholly owned by the Siris affiliate.

There are a number of risks and uncertainties relating to the merger. For example, the merger may not be consummated or may not be consummated as currently anticipated, as a result of several factors. There can be no assurance that approval of our shareholders and requisite regulatory approvals will be obtained, that the other conditions to the closing of the merger will be satisfied or waived or that other events will not intervene to delay, or result in the termination of, the merger.

Our business could be adversely impacted as a result of uncertainty related to the proposed merger.

The proposed merger with and acquisition by an affiliate of Siris could cause disruptions in our business relationships and business generally, which could have an adverse effect on our business, financial condition, results of operations and cash flows. For example:

- the attention of our management may be directed to transaction-related considerations and may be diverted from the day-to-day operations of our business and the pursuit of our strategic initiatives;

- our key managers and other employees may experience uncertainty about their future roles at the Company, which might adversely affect our ability to retain and hire key managers and other employees; and

- customers and suppliers may experience uncertainty about the Company's future and seek alternative business relationships with third parties or seek to alter their business relationships with the Company.

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Under the Merger Agreement, we are subject to certain restrictions on the conduct of our business prior to completing the proposed merger, which restrictions could adversely affect our ability to realize certain of our business strategies or pursue opportunities that may arise prior to the closing of the merger.

In addition, we have incurred, and will continue to incur, significant costs, expenses and fees for professional services and other transaction costs in connection with the proposed merger, and we must pay many of these fees and costs regardless of whether or not we consummate the merger.

Failure to complete the proposed merger could negatively impact our business, financial condition, results of operations and stock price.

The completion of the proposed merger is subject to a number of conditions, and there can be no assurance that the conditions to the completion of the proposed merger will be satisfied or that the proposed merger will otherwise occur. If the proposed merger is not completed, we will be subject to several risks, including:

- the current price of our common stock may reflect a market assumption that the proposed merger will occur, meaning that a failure to complete the proposed merger could result in a decline in the price of our common stock;
- we may be required to pay a termination fee of at least $12.6 million and up to $27.3 million if the Merger Agreement is terminated under certain circumstances, and any such payment would negatively affect our liquidity;
- we expect to incur substantial transaction costs in connection with the proposed merger, whether or not it is completed; and
- we would not realize any of the anticipated benefits of having completed the proposed merger.

The Company will no longer exist as an independent public company following the merger and the Company's stockholders will forego any increase in our value.

If the merger is completed, the Company will be a subsidiary of Siris and will no longer be a publicly held corporation, and our stockholders will forego any increase in our value that might have otherwise resulted from our possible growth.

The Merger Agreement contains provisions that could discourage or make it difficult for a third party to acquire us prior to the completion of the proposed merger.

The Merger Agreement contains provisions that restrict our ability to solicit third party proposals to acquire us. These provisions include the general prohibition after the 45-day Go-Shop Period on our soliciting or engaging in discussions or negotiations regarding any alternative acquisition proposal, subject to certain exceptions, and the requirement that we pay a significant termination fee if the Merger Agreement is terminated in specified circumstances. These provisions might discourage an otherwise-interested third party from considering or proposing to acquire us, even one that may be deemed of greater value than the proposed merger to our stockholders. Furthermore, even if a third party elects to propose an acquisition, the concept of a termination fee may result in that third party offering a lower value to our stockholders than such third party might otherwise have offered.

Risks Related to Our Business

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

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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.

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

§ Client Development and Retention. We generate revenue by providing services to a wide variety of companies, primarily in the software and high-tech products markets and in industries requiring payment processing services. Therefore, it is important to our ongoing success that we maintain our key client relationships and, at the same time, both develop new client relationships and increase the number and type of products offered through our services. If we cannot successfully market our products and services, 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, or if clients elect to end their relationships with us and we are unable to generate sufficient additional revenue to compensate for the loss of those relationships, we will likely experience a decline in revenue and operating profit. New product verticals or market segments, and further penetration of existing product verticals and market segments, may require us to work with companies which have a limited operating history or greater risks than more established companies. This may result in the engagement with clients and offering of products which are subject to higher chargeback rates or legal exposure and may generally expose us to greater legal and/or business risk. We may not be able to fully anticipate, mitigate or control all such risks. In the event claims are brought against us in connection with products offered by clients, especially clients with a limited operating history, weak sales, or who are or may become insolvent or bankrupt, we may not be successful in seeking indemnification for such claims from such clients and may be ultimately responsible for such claims. In the event a client becomes insolvent or bankrupt, we may not be successful in obtaining and retaining all amounts owed to us by that client, and the client may cease offering products for sale through our commerce services resulting in a decline in revenue and operating profit.

§ We also depend on our clients to create and support products that consumers will purchase. We generally purchase products for resale from consignment or from distributors at the time of the resale to the consumer, and do not maintain an inventory of products available for sale. 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. Some of our contracts are for longer periods, but may provide for early termination upon certain notice. For example, we recently amended our contract with Microsoft to extend the term through March 1, 2015, but the amendment did not modify the previously negotiated termination provisions. 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. Clients may elect to cease offering certain products through online commerce, or cease allowing us to resell certain of their products. A client who believes we have failed to deliver the contractually-required services and benefits could terminate their agreements and bring claims against us for substantial damages, these claims could exceed the level of any insurance coverage that may be available to us, and if successful could adversely affect our operating results and financial condition. If an existing significant customer elects to end their relationship with us or if our sales of a significant customer's products materially decreases, our revenue would decline and it may have a material adverse effect on our business, financial condition, results of operations, growth rate and stock price.

§ In addition, a limited number of our 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. For example, please see the risk factor

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below regarding the impact that may result from a termination of Microsoft's e-commerce agreement with us.

§ Dependence on Key Personnel and Employee Turnover. 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. This also applies to additional technical resources required for our platform evolution. Our performance also depends on our ability to attract, retain and motivate our key technical and other employees who are skilled in maintaining our proprietary technology platforms and business offerings. The loss of the services of any of our executive officers or other 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. Employee turnover may also increase in light of the risks, uncertainties, expenses, delays and difficulties associated with operating a business in a relatively rapidly changing industry and environment.

§ Organizational Changes. In order to remain competitive and to control our costs, we have implemented in the past, and may be required to implement in the future, organizational changes within our company, such as the consolidation of e-commerce platforms or offices, utilization of subcontractors or outsourcing relationships, reorganization of our business, and reductions in force. We may incur significant costs in order to implement organizational changes to achieve efficiencies in our cost structure in the long term. Failure to effectively manage our subcontractors and outsourcing relationships may harm our business. These organizational changes may impact our ability to execute our business plans and could affect our operating results.

§ 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. The introduction by us of new websites, web stores or services, new features and functionality, our utilization of new third-party Infrastructure-as-a-Service (IaaS), Platform-as-a-Service (PaaS), and Software-as-a-Service (SaaS) "cloud" computing services, and the continued upgrading, development and maintenance of our systems and infrastructure to meet emerging market needs, support 24x7 online commerce, 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 and expose us to additional risk and legal liability despite efforts to control such risks and liabilities.

§ 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 personal computer software and consumer electronics. In particular, sales of personal computer software represented a significant portion of our revenues in recent years, and continue to be very important to our business. The introduction of products and services competitive to those offered by our current clients may materially adversely affect our revenues. In addition, revenue generated by our software and digital commerce services is likely to fluctuate on a seasonal basis that is typical for the markets for our clients' products, including the software publishing, consumer electronics, 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 Payments Industries. The nature of our business and the e-commerce and payments industries in which we operate has undergone, and continues to undergo, rapid development and change. For example, new protocols or technologies and new rules and regulations applicable to our business and the e-commerce and payments industries can be introduced which could affect the ways in which e-commerce operates and products are sold online; online commerce and payments continues to experience a rapid shift towards mobile and multi-channel commerce and payments; the payments industry continues to experience growth in new technologies such as the introduction of mobile-based payment systems; and consumers may continue to shift from traditional computing platforms to mobile and tablet-based computing platforms. It may be difficult for us to predict or adjust our business in light of such developments. Thus, our chances of financial and operational success should be evaluated in light of the risks, uncertainties, expenses,

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delays and difficulties associated with operating a business in a relatively rapidly changing industry and environment. If we are unable to address these issues, we may not be financially or operationally successful.

§ Other Factors. Additional industry risks 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 relationships by our competitors;

o Changes that affect our clients or the viability of their product lines, and client decisions to delay new product launches, invest in e-commerce initiatives, utilize the services of a competitor, or internalize their currently outsourced e-commerce operations;

o The cost of compliance with U.S. and foreign laws, rules and regulations relating to our business, including the potential effect of new laws, rules and regulations, or interpretations of existing laws, rules and regulations, that affect our business operations or otherwise restrict or affect online commerce and/or the Internet as a whole, as well as our compliance with the rules and policies of entities whose services are critical for our continued operations, such as banks and credit card associations;

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

o Required changes in generally accepted accounting principles and disclosures;

o Sales or other transactions involving our common stock or our convertible notes;

o General macroeconomic conditions, including severe downturns or recessions in the United States and elsewhere, global unrest, terrorist activities, adverse effects of the ongoing sovereign debt crisis in Europe, potential impact of automatic sequesters, spending reductions, tax increases, and other austerity measures in the United States, and particularly those economic conditions affecting the e-commerce and retailer industries and affecting demand for products and services; and

o Conditions or trends in the Internet and online commerce industries in the United States and around the world, including slower-than-anticipated growth of the online market as a vehicle for the purchase of software products, changes in consumer confidence in the safety and security of online commerce, and changes in the usage of the Internet and e-commerce.

The following risks may also have a material adverse impact on our business, financial condition, results of operations and stock price:

Our stock price is volatile.

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.

The market price for our common stock has varied between a high of $16.04 and a low of $13.61 in the three months ended September 30, 2014. This volatility may affect the price at which you could sell your common stock. Our stock price is likely to continue to be volatile and subject to significant price and volume fluctuations in response to market and other factors; variations in our quarterly operating results from our expectations or those of securities analysts or investors; downward revisions in estimates by us or security analysts; and announcement by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments.

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In addition, the price of our common stock 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 the price of our common stock. Further, the price of our common stock may be impacted by the announcement of the financial results or other decisions by our larger clients whose products represent a significant portion of our sales.

A material decline in the price of our common stock may result in the assertion of certain claims against us, and/or the commencement of inquiries and/or investigations against us. A prolonged decline in the price of our common stock could result in:

- A reduction in the liquidity of our common stock and a reduction in our ability to raise capital and the inability for you to obtain a favorable selling price for your shares;
- An event or circumstance that drives us to determine that it is more likely than not that the fair value of our one reporting unit is less than its carrying amount and record an impairment to our goodwill.

Any reduction in our ability to raise equity capital in the future may force us to reallocate funds from other planned uses and could have a significant negative effect on our business plans and operations.

The termination of our e-commerce agreement with Microsoft may materially adversely affect our business, financial condition or results of operations and stock price.

Sales of products for one client, Microsoft, accounted for a significant portion of our revenue in the quarter ended September 30, 2014. 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 Microsoft is renegotiated, not renewed, or is otherwise terminated, or if revenues from Microsoft decline for any other reason, our revenue and our ability to sustain profitability could be materially adversely impaired.

Loss of our credit card acceptance privileges, or changes to the fees, rules or practices of payment and card associations, networks and banks, would seriously hamper our ability to process the sale of merchandise and materially adversely affect our business.

The payment by consumers for the purchase of goods and services through our e-commerce systems is typically made by credit or debit card or similar payment method across many countries. As a result, we must rely on domestic and international banks and payment processors to process transactions, and must pay a fee for this service. From time to time, banks and credit card associations may increase the per-transaction fees that they charge or change surcharge or comparable rules. In addition, reductions in the volume of transactions processed by us may result in increased per-transaction processing fees. 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 and other card associations whose cards we accept could adopt new operating rules or re-interpret existing rules that we, or our processors, might find difficult to follow.

Although we have been able to successfully switch to new payment processors in the past, such migrations require significant attention from our personnel, and may not achieve the anticipated cost savings or other desired results. Any disputes or problems associated with our payment processors could impair our ability to give customers the option of using credit or debit cards to fund their payments. If we were unable to accept credit or debit cards or other widely accepted forms of payment, our business would be seriously damaged. Any change to our business practices due to the adoption of card association operating rules or the re-interpretation of existing rules that reduces the attractiveness of our services to our clients or restricts our ability to offer our services may materially adversely affect our revenues and operating results. While we do screen new merchants and monitor their site activities for export and sanctions compliance, we also could be subject to fines or increased fees from Visa and MasterCard if we fail to detect that our clients are engaging in activities that are illegal or activities that are considered “high risk,” primarily the sale of certain types of digital content, or if the percentage of our sales transactions subject to chargeback increases as an absolute percentage of our overall transaction volume. We may be required to expend significant capital and other resources to monitor these activities.

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Excessive chargeback losses could significantly affect our results of operations and liquidity.

Our agreements with our sponsoring financial institutions and certain payment processors require us to assume and bear the risk of "chargeback" losses. Under the rules of card network associations (including without limitation Visa and MasterCard), when a merchant processor acquires card transactions, it has certain contingent liabilities for the transactions processed. This contingent liability arises in the event of a billing dispute between the merchant and a cardholder that is ultimately resolved in the cardholder's favor. In such a case, the disputed transaction is charged back to the merchant and the disputed amount is credited or otherwise refunded to the cardholder. If we are unable to collect this amount from the merchant's account, or if the merchant refuses or is unable to reimburse us for the chargeback due to merchant fraud, breach of contract, bankruptcy, insolvency or other reasons, we will bear the loss for the amount of the refund paid to the cardholders. In addition, if we are unable to recover these chargeback amounts from merchants, the obligation to pay the aggregate of any such amounts could have a material adverse effect on our results of operations and liquidity.

If our payments-related services are found to be in violation of, or subject to, applicable laws, rules or regulations or bank or card network rules or operating procedures, we may become subject to liability, licensing requirements, and regulatory approval, and may be required to change our business practices.

Our business is subject to various laws, rules and regulations in the U.S. and other countries where we provide payments-related services, including those laws, rules and regulations governing money transmission, export and sanctions compliance, electronic funds transfers, terrorist financing, money laundering, and consumer protection. The legal and regulatory requirements that apply to our business vary in the markets in which we operate. For our payment service provider business, we may be required to perform "know-your-customer" and other underwriting responsibilities, and may be subject to fines, penalties, financial reserves, or other enforcement actions from banks and payment card networks if we fail to detect improper use of our payment systems by our clients. While we have a compliance program focused on compliance with applicable laws, rules and regulations, we cannot ensure that we will not become subject to fines, penalties or other enforcement actions in one or more jurisdictions, or be required to make changes to our business practices or compliance programs to comply in the future. If we were found to be in violation of laws, rules or regulations, or bank or card network rules or operating procedures, we could become subject to liability and/or additional restrictions, forced to cease doing business or restrict the payment types we can offer in certain states or jurisdictions, forced to change business practices, or required to obtain additional licenses or regulatory approvals that could impose a substantial cost on us. We may not be able to pass such liabilities, fines and penalties to our clients or bank partners. Any change to our business practices that reduces the attractiveness of our services to our clients or restricts our ability to offer our services may materially adversely affect the revenues and operating results for our business.

Merchant fraud with respect to Internet-based bankcard and EFT transactions could cause us to incur significant losses.

We believe that we have significant experience in assessing the risks associated with providing payment processing services to small and medium-sized merchants through our Digital River World Payments and LML subsidiaries. These risks include the limited operating history of many of the small and medium-sized merchants we serve and the risk that these merchants could be subject to a higher rate of insolvency, which could adversely affect us financially. We apply varying levels of scrutiny in our application evaluation and underwriting of prospective merchant accounts, ranging from basic due diligence for merchants with a low risk profile to a more thorough and detailed review for higher risk merchants.

As a result of our exposure to potential liability for merchant fraud, chargebacks, reject and other losses created by our merchant services business, we view our risk management and fraud avoidance practices as integral to our operations and overall success.

For our merchant clients conducting card-not-present transactions, which we view as having a higher risk profile, we employ an extended underwriting and due diligence period and special account monitoring procedures. Through the underwriting process, we evaluate the applicants' financials, previous processing history and credit reports.

Effective risk management helps us minimize merchant losses for the mutual benefit of our merchants and ourselves. Our risk management procedures also help protect us from fraud perpetrated by our merchants. We believe our knowledge and experience in dealing with attempted fraud has resulted in our development and implementation of effective risk management and fraud prevention systems and procedures for the types of fraud discussed in this section.

We have potential liability for fraudulent bankcard transactions initiated by merchants. Merchant fraud occurs when a merchant knowingly uses a stolen or counterfeit bankcard or card number to record a false sales transaction, processes an invalid bankcard or intentionally fails to deliver the merchandise or services sold in an otherwise valid transaction. We rely significantly on the processing revenue derived from bankcard and EFT transactions and, as a result, if any merchant or customer were to submit or process unauthorized or fraudulent bankcard or EFT transactions, depending on the dollar amount, we could incur significant losses which could have a material adverse effect on our business and results of operations and liquidity.

In addition, criminals are using increasingly sophisticated methods to engage in illegal activities such as counterfeit and fraud and, while we have systems and procedures designed to manage such risk and detect and reduce the impact of fraud, we cannot guarantee that our systems will prevent fraudulent transactions from being submitted and processed or that the funds set aside to address such activity will be adequate to cover all potential situations that might occur. We do not have insurance to protect us from these losses. There is no assurance that any chargeback or processing reserve will be adequate to offset against any unauthorized or fraudulent processing losses that we may incur. Accordingly, should we experience such fraudulent activity and such losses, our results of operations could be immediately and materially adversely affected.

Our business is subject to online and physical security risks, including security breaches.

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 customer 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. Our servers are vulnerable to computer viruses, physical or electronic break-ins, "denial of service" attacks, and similar disruptions. Because techniques used to disable or impair systems, obtain unauthorized access to systems, or engage in other breaches of security change rapidly and are often not recognized until utilized against a target, we may be unable to anticipate these techniques or prevent them.

Any actual or perceived breach or compromise of our security or one of our clients, vendors or service providers could have a material adverse effect on consumer confidence in the safety and security of transactions processed through our systems, our reputation, business operations, 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 or the security measures of our clients, vendors or service providers 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. Security breaches could expose us to lawsuits from affected persons and companies, and to governmental inquiries. 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, inhibiting the growth of our business.

We are exposed to foreign currency exchange risk.

As we generate a significant portion of our revenues outside the U.S. but report our financial results in U.S. dollars, we are exposed to adverse movements in currency exchange rates. Sales outside the United States accounted for approximately 46.4% of our total sales for the three months ended September 30, 2014. A significant portion of our cash and marketable securities are held in non-U.S domiciled countries, primarily Ireland and Germany. 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 re-measurement 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, for example, as a result of the ongoing sovereign debt crisis in Europe. 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.

Failure to enhance and expand our technology, systems and business offerings to accommodate increased traffic and to remain competitive 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 and spikes in the volume of traffic on our technology platforms due to factors including launches of new products and new commerce websites on our technology platforms, and seasonal fluctuations in consumer demand. 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, and develop and introduce new business offerings and programs. Any inability to enhance and expand our existing technology, transaction-processing systems or network infrastructure to manage such increased traffic and traffic spikes may cause unanticipated system disruptions, slower response times and degradation in client services, including impaired quality and speed of order fulfillment. Failure to manage increased traffic and traffic spikes or an inability to maintain our competitiveness could harm our reputation and significantly reduce demand for our services, which would impair the growth of our business. 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. We may be unable to improve and increase the capacity of our network infrastructure sufficiently or to anticipate and react to expected or unexpected increases in the use of the platform to handle increased volume, or to obtain needed related services from third party suppliers. Our network and our suppliers' networks may be unable to maintain an acceptable data transmission capability, especially if demands on our platform increase. We may fail to use new technologies effectively or fail to adapt our proprietary technology and systems to client requirements or emerging industry standards.

We rely upon cloud-based service providers and other third party subcontractors in connection with our business operations, and any disruption of or interference with our use of the services provided by these providers would impact our operations and materially adversely affect our business.

We utilize, and may increase our utilization of, third-party Infrastructure-as-a-Service (IaaS), Platform-as-a-Service (PaaS), and Software-as-a-Service (SaaS) offerings, commonly referred to as "cloud" computing services. We also utilize third parties to support other aspects of our business operations, such as bandwidth providers, data center services, and fulfillment providers. While we seek to implement contractual obligations and indemnities in our agreements with our global cloud providers and other third party providers, we may not be successful in obtaining contractual terms sufficient to mitigate all risks. Problems faced by our third-party cloud computing and service providers, or our other third party providers, including technological or business-related disruptions and security breaches within a provider's service layer, could result in the loss or unauthorized disclosure of confidential information or otherwise adversely impact our business. In addition, fires, floods, earthquakes, power losses, telecommunications failures, break-ins and similar events could damage these third party systems, facilities and hardware or cause them to fail completely. A disrupting event could result in prolonged downtime of our operations and could adversely affect our business.

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If we are unable to enter into, achieve desired results from, or maintain our marketing and promotional agreements with third party marketing or technology providers to generate sales traffic and sales for our clients, our ability to generate revenue and our business could be adversely affected.

We have entered into multiple marketing and promotional agreements and operate certain affiliate networks and programs which are designed to increase both traffic to the e-commerce stores we operate and the number of customers purchasing products through such stores, including agreements with search engine providers, display advertising networks, comparison shopping engines, affiliate networks, operators of websites and marketing technology providers. Our ability to attract new clients and retain existing clients is based in part on our ability to generate increased traffic or better conversion rates resulting in increased online sales of their products through these agreements and programs. If we are unable to enter into such agreements on favorable terms, are unable to achieve the desired results under these agreements and programs, are unable to maintain these relationships, or fail to generate sufficient traffic or generate sufficient revenue from purchases pursuant to these agreements and programs, our ability to generate sales and our ability to attract and retain our clients may be impacted, negatively affecting our business and operating results.

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 tax, use tax, 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 on certain product and service offerings 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.

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.

Additional valuation allowances may be needed as we may not generate sufficient taxable income to utilize our deferred income tax assets.

We periodically assess whether we will generate sufficient taxable income to realize our deferred income tax assets. Valuation allowances are established if it is not likely that we will realize our deferred income tax assets. In making this determination, we consider all available positive and negative evidence and make certain assumptions. We consider, among other things, our deferred tax liabilities, the overall business environment, our historical financial results, and potential current and future tax planning strategies. We concluded during the third quarter of 2014 evaluation that we are required to maintain a valuation allowance against our net U.S. tax assets and certain foreign tax assets. Our assessment is ongoing and may conclude that we require additional valuation allowances in the future. Any release of the valuation allowance would reduce income tax expense.

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,

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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.

Failure to properly manage and execute our plans to offer certain of our products and services on a modular basis could strain our resources and may not be successful in generating additional revenue.

We plan to offer certain of our product and service offerings on a modular basis. Offering product and services on a modular basis may require increases in costs of technology, marketing and business operations, and in the complexity of our business. This may place additional strain on our technical, operational and financial resources, and there can be no assurance that we will be able to manage or execute these plans effectively. Our personnel, systems, procedures and controls may not be adequate to effectively manage our future operations, especially as we seek to offer certain aspects of our products and services as standalone product and service offerings to clients and to implement a "go-to-market" strategy for our modular offerings. We have not fully evaluated the market opportunity and demand for the use of our products and services on a modular basis. As we implement our plan, we may incur additional expenses without a corresponding increase in revenue. If we fail to effectively manage and execute our plans to modularize our product and service offerings, or fail to adequately market and generate demand for our modular offerings, we may not be able to successfully compete with other providers and may not be successful in generating additional revenue, which could harm our operating results and financial condition.

Our international expansion efforts may not be successful in generating additional revenue.

We sell products and services to consumers outside the United States and we intend to continue expanding our international presence. For the three months ended September 30, 2014, our sales to international consumers represented approximately 46.4% of our total sales. Continued expansion into international markets, particularly the European and Asia-Pacific regions, requires significant resources that we may fail to recover through generating additional revenue. Conducting business internationally is subject to risks that may have a material adverse effect on our ability to increase or maintain foreign sales, including:

§ Changes in regulatory requirements and tariffs;
§ Difficulties in staffing and managing foreign subsidiary operations, and the increased costs of international operations;
§ Uncertainty of application of, and the burden and cost of complying with, local, commercial, tax, privacy and other laws and regulations;
§ Reduced protection of intellectual property rights;
§ Difficulties in physical distribution and logistics for international sales;
§ Higher incidences of credit card fraud and difficulties in accounts receivable collection;
§ Difficulties in transferring funds from certain countries;
§ Difficulties in enforcing contracts against international clients, especially in emerging markets;
§ Lower rates of Internet usage in certain countries, especially in emerging markets;
§ Different employer/employee relationships, the existence of workers' councils, and 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.

We may be unable to successfully and cost-effectively market, sell and distribute our services in foreign markets due to 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. As international e-commerce grows, our competition will continue to intensify. If we are unable to successfully expand our international operations, or manage this expansion, our operating results and financial condition could be harmed.

Implementing our acquisition and strategic partnership strategy could result in dilution and operating difficulties leading to a decline in revenue and operating profit.

An element of our business strategy involves expansion through the acquisition 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. We evaluate and explore other strategic opportunities

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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.

Acquisitions, strategic investments and strategic partnership agreements may require significant capital infusions, typically entail many risks, and could result in unforeseen difficulties, disruptions, distractions, and expenditures in assimilating and integrating with 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 completion of such activities. 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 or strategic investment 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, and amortization of intangible assets or impairment of goodwill. Acquisitions could also result in a dilutive impact to our earnings.

Our clients' sales cycles and the implementation process for our commerce solution are time-consuming, 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, online retailers, consumer electronics companies 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, the signing of a contract, and the launch of a revenue-generating commerce store. 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, and completion of the implementation process typically ranges from one to four 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 and implementation process may be impaired. We can incur substantial front-end costs to launch client sites and it may require a substantial time before those costs are recouped by us, if at all.

We may become liable for fraudulent, improper or illegal uses of our platforms and services.

Our "self-service" 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. Failure to detect inappropriate or illegal uses of our platforms by third parties could 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 governmental investigations, and civil and criminal penalties.

Compliance with and changes to applicable laws, rules, regulations, and certification requirements, may substantially increase our costs of doing business, limit our 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. 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, rules and regulations. 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

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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. 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. 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. Laws, rules and regulations applicable to our business include areas 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;
§ Recycling of consumer products; and
§ Our investments in other companies.

Our acceptance of credit cards and similar payment methods requires us to maintain certain certifications, most notably Payment Card Industry (PCI) Level 1 compliance. Maintaining this certification requires an annual audit by a qualified third party auditor and a review and assessment of our security controls and a significant commitment of internal resources. Our loss of such certification may result in our inability to process credit card transactions and other payments, and would have a material adverse effect on our ability to do business.

Violation of any laws, rules or regulations applicable to our business could result in fines or other actions by regulatory agencies, increased costs of doing business, reduced profits, or restrictions on our ability to conduct business such as our ability to export products or bans on our ability to offer certain services. In addition, any significant changes, developments, or new interpretations of laws, rules, and regulations applicable to our business will increase our costs of compliance and may further restrict our overseas client base, may require significant management and other resources to respond appropriately, and may harm our operating results.

Failure to protect our intellectual property may jeopardize our competitive position and require us to incur significant expenses to enforce our rights.

We rely on a combination of patent, copyright, trademark, service mark and trade secret laws, and contractual restrictions with our employees and other parties with which we do business, to protect our proprietary rights and to limit access to and disclosure of our proprietary information. 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, and the registration of our trademarks and service marks in the U.S. and internationally.

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. Our 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 may not be able to successfully obtain patents or trademarks for our technologies or brands. Effective protection of our intellectual property rights may not be available in every country in which our services are made available online, or cost-effective for us to obtain on a worldwide basis. 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, by our products and services or the products we resell or deliver, could require us to expend significant resources, enter into unfavorable licenses, pay damages, prevent us from using certain technology, or require us to change our business plans.

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From time to time we are notified of potential patent disputes, and expect that we will increasingly be subject to the assertion of patent infringement claims against us and/or our customers as our services expand in scope and complexity. We have been, and from time-to-time may be, named as a defendant in lawsuits claiming that we have, in some way, violated the intellectual property rights of others. For example, we were named as a defendant in a patent litigation in the United States District Court for the Eastern District of Texas brought against us and various other defendants by DDR Holdings, LLC, seeking injunctive and monetary relief. In April 2014, we reached a final settlement with DDR Holdings, LLC.

Litigation over patents and other intellectual property rights is not uncommon with respect to e-commerce technologies, and often involves patent holding companies or other adverse patent owners who have no relevant product revenues and against whom our own patents may therefore provide little or no deterrence.

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 or tangible goods that we deliver electronically and physically. Because we did not create these products, we are generally not in a position to know the quality or nature of the content of these products.

Any assertions or prosecutions of intellectual property claims could require us to expend significant financial, managerial and personnel resources. Although we carry general liability insurance and typically require that our customers indemnify us against consumer 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. We may elect to self-insure against certain claims. 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 continue to pursue our current business plan. We expect that we will increasingly be subject to patent infringement claims as our services expand in scope and complexity, and our results of operations and financial condition could be materially adversely affected.

We are subject to regulations relating to consumer privacy and the protection of personal information.

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 and transfer of personal user information or require online service providers to establish privacy policies. In addition, the U.S. Federal Trade Commission (FTC) has urged Congress to adopt legislation regarding the collection and use of personal identifying information obtained from individuals when accessing websites, including both adults and minors. The FTC and certain states, such as California, have released guidance for privacy practices associated with applications used on mobile devices such as smartphones and tablets.

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 (Directive 95/46/EC). In general, according to the Directive, personal data should not be processed at all, except when certain conditions are met. These conditions fall into three categories: transparency, legitimate purpose, and proportionality. This being said, the Directive and its regulations inhibit or prohibit the collection and sharing of personal information to a certain extent and in ways that could harm our clients or us.

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Failure to comply with member state implementations of the Directive 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.

We have and post on our websites our own privacy statements, policies and practices concerning our collection, use and disclosure of user information. The FTC, state and international regulatory agencies continue to be aggressive in enforcing privacy and data protection laws and regulations. Any actual or perceived failure by us to comply with our posted privacy statements, policies and practices or with federal, state or international data privacy laws, rules and regulations could reduce consumer confidence in conducting transactions processed through our systems, and could result in actions or proceedings against us by governmental entities, individual or class action litigation, subject us to significant penalties and negative publicity, require us to change our business practices, increase our costs and adversely affect our business.

Our business is highly dependent on the efficient and uninterrupted operation of our computer network systems and data centers, and system failures, outages or errors could reduce the attractiveness of our service offerings.

We provide commerce, payments, marketing, and delivery services to our clients and consumers through our proprietary technology transaction processing, and client management systems and payment gateway connections. These systems also maintain an electronic inventory of products and gather consumer marketing information. Our ability to operate our business largely depends on the efficient and uninterrupted operation of our computer network systems and data centers. 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 and have identified errors, affecting all or a portion of our systems, which we believe will continue to occur from time-to-time. While we attempt to correct every system error we identify, not all errors may be identified or corrected. The measures we have enacted, such as the implementation of security access and disaster recovery plans, may not be successful and we may experience problems other than system failures, or delays in restoring system availability when an outage occurs. We may be unable to prevent unanticipated system disruptions due to the failure of network or hardware components in our underlying network infrastructure. Any significant downtime interruptions in our facilities, computer networks, firewalls and databases could result in an immediate loss of revenue to us, harm our business and reputation, result in a loss of customers, and expose us to potential liability and increased operating expenses.

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

§ Fire, flood, natural disasters, and other events beyond our control;
§ Defects introduced by third party technology;
§ Banking connections;
§ Defects introduced by outsourced services;
§ Third party and outsourced services technology failure due to defects in hardware and or firmware;
§ Catastrophic hardware failure of a third party;
§ Catastrophic hardware failure of an outsourced or cloud-based service provider;
§ Errors introduced by software and or hardware maintenance;
§ Operator negligence, improper operation by, or supervision of, employees, physical and electronic break-ins, misappropriation, computer viruses and similar events; and

§ Power loss, computer systems failures, denial-of-service attacks and Internet and telecommunications failure.
We may not carry sufficient business interruption insurance to fully compensate us for losses that may occur.

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.

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. Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our internal control over financial reporting will prevent all errors 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. Implementation of new technology related to the control system may result in misstatements due to errors that are not detected and corrected during testing. 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 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.

Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of us, which may be beneficial to our stockholders, more difficult and may prevent attempts by our stockholders to replace or remove our current management.

We are incorporated in Delaware. Certain anti-takeover provisions under Delaware law and in our certificate of incorporation and amended and restated bylaws, as currently in effect, may make a change of control of our company more difficult, even if a change in control would be beneficial to our stockholders. Our anti-takeover provisions include provisions such as a prohibition on stockholder actions by written consent, a classified board of directors and the authority of our board of directors to issue preferred stock without stockholder approval. In addition, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which generally prohibits stockholders owning 15% or more of our outstanding voting stock from merging or combining with us in certain circumstances. These provisions may delay or prevent an acquisition of us, even if the acquisition may be considered beneficial by some of our stockholders. In addition, they may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management.

Risks Related to Our Industry

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 and partners may become competitors in the future. Increased competition is likely to result in price

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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 Oracle Corporation (which acquired Art Technology Group, Inc.), IBM Corporation, Demandware, Inc. and SAP hybris GmbH, or through internally developed solutions;
§ E-Commerce capabilities custom-developed by companies, such as IBM Global Services and Accenture, Inc.;
§ New e-commerce models through which consumers can purchase software products for their computers and computing devices, such as app stores;
§ Other providers of outsourced e-commerce solutions, such as cleverbridge AG, eBay, Inc. (which acquired GSI Commerce, Inc. and Magento, Inc.), Demandware Inc., Avangate BV, asknet AG and arvato Systems, a division of Bertelsmann AG;
§ Companies that provide technologies, services or products that support a portion of the e-commerce process, such as payment processing, including WorldPay Ltd., GlobalCollect, CyberSource Corporation (a subsidiary of Visa, Inc.), Chase Paymentech, Stripe, Square, Inc., and PayPal Corporation and Braintree (subsidiaries of eBay, Inc.);
§ Companies that offer various online marketing services, technologies and products, including ValueClick, Inc. and Microsoft Advertising (formerly aQuantive, 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 Buy.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, Web.com Group, Inc., Shopify, Inc., PrestaShop, Inc., Akamai Technologies, Inc., Yahoo!, Inc., eBay, Inc. and Hostopia.com, Inc.

The online channel partners and the other companies described above may compete directly with us by adopting a business model similar to ours. 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. Some of our clients may also compete with us. In addition, competitors or our clients 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, which could result in the loss of existing clients and/or our inability to pursue and sign new clients. 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.

The pace of recovery of U.S. and global economies, political and economic conditions, and the debt crisis in the United States and other countries may adversely affect our revenue and results of operations and stock price.

The U.S. and other global economies continue to experience slow recovery from the recent recession that affected the economy as a whole, resulting in continued issues with the pace of economic growth, loss of consumer confidence and uncertainty about economic stability, and increased unemployment. U.S. and foreign credit and financial markets continue to experience instability, resulting in increased volatility in the stock market and reduced availability of credit. The U.S. continues to face budgetary issues and constraints which may result in a failure to raise the "debt ceiling" and austerity measures such as automatic sequesters, cuts in government spending and programs, increased taxes, and other related actions or inactions by the U.S. government. Other countries and economies continue to experience adverse effects of sovereign debt crises and related austerity measures. These issues may cause a cascading effect impacting other countries and economies. Our revenue and growth is dependent on the continued growth in demand for our clients' products and the continued growth of Internet commerce, and depends significantly on geopolitical economic and business conditions. The continuing effects of instability in the credit and financial markets, general economic conditions, and the approach to addressing debt crises and austerity measures in the U.S. and other countries may continue to negatively impact our business and our clients, demand for our clients products, and consumer spending, 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

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client bankruptcies and/or interruption or cessation of business, which may have a negative impact on our business, operating results and financial condition. These factors could have a negative and adverse impact on companies with which we do business, which in turn could have a negative and adverse effect on our business. Continuing geopolitical instability in certain countries and regions may affect consumer spending behavior in those countries and regions. Instability in the credit and equity markets 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 macroeconomic and market conditions affecting us or our clients remain uncertain, weaken further, or otherwise fail to improve, they may have a material adverse effect on our business, operating results, financial condition and stock price.

Risks Related to the Securities Markets

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 February 2009, we filed a shelf registration that would allow us to sell an undetermined amount of equity or debt securities in accordance with the rules applying to "well-known seasoned issuers." In addition, we filed an acquisition shelf registration statement for up to approximately 1.5 million shares. On November 1, 2010, we sold and issued $345.0 million in aggregate principal amount of senior convertible notes (2010 Notes), in a private, unregistered offering. 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. 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.

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 September 30, 2014, we held $40.7 million of auction rate securities (ARS) at par value which we have recorded at $39.1 million fair value. As of September 30, 2014 the ARS are 105–142% over-collateralized and the underlying student loans are guaranteed by the U.S. government.

Due to the illiquid market conditions, the fair value of our ARS is recorded at a discount to par value of $1.6 million, or 4.0%, as of September 30, 2014. This reduction from par value is considered temporary and is recorded in

"Accumulated other comprehensive income (loss)".

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.

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

Set forth below is information regarding the Company’s stock repurchases during the three months ended September 30, 2014.

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plan	Approximate dollar value of shares that may yet be purchased under the plan (in millions)
July 1, 2014 - July 31, 2014	3,700	$ 13.88	3,700	$ 18.1
August 1, 2014 - August 31, 2014	-	$ -	-	$ 18.1
September 1, 2014 - September 30, 2014	-	$ -	-	$ 18.1
Total	3,700		3,700	

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

(a)Exhibits

See exhibits listed under the Exhibit Index below.

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SIGNATURES

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

Date: October 31, 2014		DIGITAL RIVER, INC.
	By:	/s/ Stefan B. Schulz
		Stefan B. Schulz Chief Financial Officer (Principal Financial Officer)

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EXHIBIT INDEX

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)	Indenture dated as of September 1, 2004 between Digital River, Inc. and Wells Fargo Bank, N.A. as trustee, including therein the form of the 2004 Note.
4.3	(5)	Indenture dated as of November 1, 2010, between Digital River, Inc. and Wells Fargo Bank, N.A. as trustee, including therein the form of the 2010 Note.
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.
101		The following financial information from Digital River, Inc.'s Quarterly Report on Form 10-Q for the period ended September 30, 2014, formatted in Extensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Cash Flows, and (iv) Notes to Consolidated Financial Statements.*

(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) Incorporated by reference from the Company's Current Report on Form 8-K filed on July 13, 2004.
(5) Filed as an exhibit to the Company's Current Report on Form 8-K filed on November 1, 2010, and incorporated herein by reference.
* Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed part of a registration statement, prospectus or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filings.