

RPX Corp  
Form 10-Q  
August 07, 2014  
Table of Contents

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 June 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: 001-35146

---

RPX Corporation

(Exact Name of Registrant as Specified in Its Charter)

---

Delaware

(State or Other Jurisdiction of

Incorporation or Organization)

ONE MARKET PLAZA SUITE 800

SAN FRANCISCO, CALIFORNIA 94105

(Address of Principal Executive Offices and Zip Code)

Registrant's Telephone Number, Including Area Code: (866) 779-7641

---

26-2990113

(I.R.S. Employer

Identification No.)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90

days. YES ☒ NO ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 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. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☒

Non-accelerated filer ☐ (Do not check if a smaller reporting company) 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 ☒

There were 53,720,314 shares of the registrant's common stock issued and outstanding as of July 31, 2014.

---

Table of Contents

RPX Corporation  
Form 10-Q Quarterly Report

---

TABLE OF CONTENTS

	Page
<b><u>PART I FINANCIAL INFORMATION</u></b>	
Item 1. <u>Financial Statements (unaudited)</u>	
<u>Condensed Consolidated Balance Sheets as of June 30, 2014 and December 31, 2013 (unaudited)</u>	<u>1</u>
<u>Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2014 and 2013 (unaudited)</u>	<u>2</u>
<u>Condensed Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2014 and 2013 (unaudited)</u>	<u>3</u>
<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2014 and 2013 (unaudited)</u>	<u>4</u>
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	<u>6</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>15</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>21</u>
Item 4. <u>Controls and Procedures</u>	<u>22</u>
<b><u>PART II OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	<u>23</u>
Item 1A. <u>Risk Factors</u>	<u>23</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>35</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>35</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>35</u>
Item 5. <u>Other Information</u>	<u>35</u>
Item 6. <u>Exhibits</u>	<u>35</u>
<u>Signatures</u>	<u>36</u>

---

Table of Contents

## PART I. FINANCIAL INFORMATION

## Item I. Financial Statements (unaudited)

## RPX Corporation

## Condensed Consolidated Balance Sheets

(in thousands)

(unaudited)

	June 30, 2014	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	\$ 118,589	\$ 100,155
Short-term investments	198,965	190,567
Restricted cash	583	364
Accounts receivable	12,385	38,477
Prepaid expenses and other current assets	13,776	10,546
Deferred tax assets	4,082	3,817
Total current assets	348,380	343,926
Patent assets, net	235,501	219,954
Property and equipment, net	4,391	4,667
Intangible assets, net	4,441	1,718
Goodwill	19,978	16,460
Restricted cash, less current portion	1,091	1,454
Other assets	584	622
Total assets	\$ 614,366	\$ 588,801
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 343	\$ 332
Accrued liabilities	8,442	8,784
Deferred revenue	129,009	131,808
Deferred payment obligations	—	500
Other current liabilities	4,418	1,638
Total current liabilities	142,212	143,062
Deferred revenue, less current portion	2,198	5,935
Deferred tax liabilities	12,182	11,654
Other liabilities	3,086	3,227
Total liabilities	159,678	163,878
Commitments and contingencies (Note 12)		
Stockholders' equity:		
Common stock	5	5
Additional paid-in capital	315,868	305,343
Retained earnings	138,786	119,527
Accumulated other comprehensive income	29	48
Total stockholders' equity	454,688	424,923
Total liabilities and stockholders' equity	\$ 614,366	\$ 588,801

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



Table of Contents

RPX Corporation  
Condensed Consolidated Statements of Operations  
(in thousands, except per share data)  
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Revenue	\$64,293	\$57,481	\$126,181	\$118,675
Cost of revenue	31,542	24,694	60,462	48,364
Selling, general and administrative expenses	18,579	15,736	35,834	30,209
(Gain) loss on sale of patent assets, net	(699)	) 126	(699)	) 126
Operating income	14,871	16,925	30,584	39,976
Other income, net	94	63	193	114
Income before provision for income taxes	14,965	16,988	30,777	40,090
Provision for income taxes	5,566	6,291	11,518	14,698
Net income	\$9,399	\$10,697	\$19,259	\$25,392
Net income available to common stockholders	\$9,399	\$10,691	\$19,259	\$25,370
Net income available to common stockholders per common share:				
Basic	\$0.18	\$0.21	\$0.36	\$0.49
Diluted	\$0.17	\$0.20	\$0.35	\$0.48
Weighted-average shares used in computing net income available to common stockholders per common share:				
Basic	53,203	51,774	53,004	51,489
Diluted	54,776	53,463	54,622	53,055

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

2

---

Table of Contents

RPX Corporation  
Condensed Consolidated Statements of Comprehensive Income  
(in thousands)  
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income	\$9,399	\$10,697	\$19,259	\$25,392
Other comprehensive income, net of tax:				
Unrealized gains (losses) on available-for-sale securities:				
Unrealized holding gains (losses) arising during the period	(1	) (42	) (19	) 57
Less: reclassification adjustment for (gains) losses included in net income	—	—	—	1
Net unrealized gains (losses) on available-for-sale securities, net of tax	(1	) (42	) (19	) 58
Comprehensive income	\$9,398	\$10,655	\$19,240	\$25,450



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

3

---

Table of Contents

## RPX Corporation

## Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Six Months Ended June 30,	
	2014	2013
Cash flows from operating activities		
Net income	\$19,259	\$25,392
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	59,289	47,798
Stock-based compensation	8,868	8,186
Excess tax benefit from stock-based compensation	(2,006)	(2,009)
(Gain) loss on sale of patent assets, net	(699)	126
Amortization of premium on investments	3,380	2,995
Deferred taxes	(978)	(1,906)
Other	(500)	13
Changes in assets and liabilities:		
Accounts receivable	26,414	216
Other receivables	—	33,775
Prepaid expenses and other assets	(5,274)	(3,348)
Accounts payable	11	130
Accrued and other liabilities	(823)	(1,191)
Deferred revenue	(6,636)	13,202
Net cash provided by operating activities	100,305	123,379
Cash flows from investing activities		
Purchases of investments classified as available-for-sale	(106,618)	(98,950)
Maturities of investments classified as available-for-sale	98,920	65,787
Sales of investments classified as available-for-sale	—	1,099
Business acquisition, net of cash acquired	(2,169)	—
Decrease in restricted cash	144	—
Purchases of property and equipment	(790)	(874)
Acquisitions of patent assets	(73,948)	(69,637)
Proceeds from sale of patent assets	860	100
Net cash used in investing activities	(83,601)	(102,475)
Cash flows from financing activities		
Proceeds from exercise of stock options and other common stock issuances	2,399	2,727
Taxes paid related to net-share settlements of restricted stock units	(2,675)	—
Excess tax benefit from stock-based compensation	2,006	2,009
Net cash provided by financing activities	1,730	4,736
Net increase in cash and cash equivalents	18,434	25,640
Cash and cash equivalents at beginning of period	100,155	73,638
Cash and cash equivalents at end of period	\$118,589	\$99,278
Non-cash investing and financing activities		
Change in patent assets purchased and accrued but not paid	\$(500)	\$1,100
Change in fixed assets purchased and accrued but not paid	(166)	—
Change in other assets purchased and accrued but not paid	(63)	550
Unpaid cash consideration for business acquisition	542	—



Table of Contents

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

Table of Contents

RPX Corporation  
Notes to Condensed Consolidated Financial Statements  
(unaudited)

1. Nature of Business

RPX Corporation (also referred to herein as “RPX” or the “Company”) helps companies reduce patent-related risk and expense by providing a subscription-based patent risk management solution that facilitates more efficient exchanges of value between owners and users of patents compared to transactions driven by actual or threatened litigation. The core of the Company’s solution is defensive patent aggregation, in which it acquires patents or licenses to patents that are being or may be asserted against the Company’s current or prospective clients. The Company may occasionally enter into agreements to acquire covenants not to sue in order to further mitigate its clients’ litigation risk. The acquired patents, licenses to patents, patent rights and agreements for covenants not to sue are collectively referred to as “patent assets.” The Company’s clients pay an annual subscription fee and in return, receive a license from the Company to substantially all of its patent assets and access to its proprietary patent market intelligence and data. In addition to the Company’s core solution, in August 2012, the Company began underwriting patent infringement liability insurance policies to insure against certain costs of litigation from non-practicing entities (“NPEs”). In March 2014, the Company formed a reinsurance company to assume some portion of the underwriting risk on insurance policies that the Company issues on behalf of a Lloyd’s of London underwriting syndicate. The Company began placing new policies under the reinsurance model in May 2014. As of, and for the three and six months ended June 30, 2014, the effect of the insurance policies that the Company has issued or assumed through our reinsurance business was not material to the Company’s results of operations, financial condition or cash flows.

2. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

The accompanying condensed consolidated balance sheet as of June 30, 2014, the condensed consolidated statements of operations and the condensed consolidated statements of comprehensive income for the three and six months ended June 30, 2014 and 2013, and the condensed consolidated statements of cash flows for the six months ended June 30, 2014 and 2013, are unaudited. The condensed consolidated balance sheet as of December 31, 2013 was derived from the audited consolidated financial statements which are included in the Company’s Form 10-K for the fiscal year ended December 31, 2013, which was filed with the U.S. Securities and Exchange Commission (“SEC”) on March 10, 2014. The unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013.

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America and with the instructions for Form 10-Q and Regulation S-X for interim financial statements. Accordingly, they do not include all of the information and notes required for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring items, necessary to state fairly the results of the interim periods have been included in the accompanying financial statements. Operating results for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for any subsequent interim period or for the year ending December 31, 2014.

There have been no material changes to the Company’s significant accounting policies during the three and six months ended June 30, 2014, as compared to the significant accounting policies presented under the heading “Basis of Presentation and Significant Accounting Policies” in Note 2 of the Notes to Consolidated Financial Statements in Part II, Item 8 of the Company’s Annual Report on Form 10-K filed with the SEC on March 10, 2014.

Recently Issued Accounting Standards

In June 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (“ASU 2014-12”), which amends Compensation - Stock Compensation (Topic 718) in the Accounting Standards Codification (“ASC”). ASU 2014-12 requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Compensation - Stock Compensation (Topic 718) as it relates to awards with performance conditions that affect vesting to account for such awards. The amendments in ASU 2014-12 will be effective for annual and interim periods beginning after December 15, 2015 and early adoption is permitted. The adoption of ASU 2014-12 is not expected to have a material impact on the Company’s consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) (“ASU 2014-09”), which will supersede most existing revenue recognition guidance in U.S. generally accepted accounting principles (“U.S. GAAP”) once it becomes effective. ASU 2014-09 requires an entity to recognize revenues when promised goods or services are transferred to

Table of Contents

customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five-step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. ASU 2014-09 will be effective for annual and interim periods beginning after December 15, 2016 and early adoption is not permitted. The Company is currently evaluating the impact of the adoption of ASU 2014-12 on its consolidated financial statements.

In April 2014, the FASB issued ASU 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360) ("ASU 2014-08"), which amends the requirements for reporting discontinued operations and enhances disclosure requirements. The amendments in ASU 2014-08 will be effective for all disposals (or classifications as held for sale) of components of an entity beginning on or after December 15, 2014 and early adoption is permitted. The adoption of ASU 2014-08 is not expected to have a material impact on the Company's consolidated financial statements.

### 3. Net Income Available to Common Stockholders

Basic and diluted net income per share available to common stockholders are presented in conformity with the two-class method required for participating securities. The holders of restricted common stock are entitled to receive non-forfeitable dividends if declared.

Under the two-class method, basic net income per share available to common stockholders is computed by dividing the net income available to common stockholders by the weighted-average number of shares of common stock outstanding during the period. Net income available to common stockholders is determined by allocating undistributed earnings between common and restricted common stockholders. Diluted net income per share available to common stockholders is computed by using the weighted-average number of shares of common stock outstanding, including potential dilutive shares of common stock, assuming the dilutive effect of outstanding stock options and restricted stock units using the treasury stock method.

The following table presents the calculation of basic and diluted net income per share available to common stockholders (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income available to common stockholders:				
Numerator:				
Net income	\$9,399	\$10,697	\$19,259	\$25,392
Allocation of net income to participating stockholders	—	(6	) —	(22
Net income available to common stockholders	\$9,399	\$10,691	\$19,259	\$25,370
Denominator:				
Basic shares:				
Weighted-average shares used in computing basic net income available to common stockholders	53,203	51,774	53,004	51,489
Diluted shares:				
Weighted-average shares used in computing basic net income available to common stockholders	53,203	51,774	53,004	51,489
Dilutive effect of stock options and restricted stock units using the treasury-stock method	1,573	1,689	1,618	1,566
Weighted-average shares used in computing diluted net income available to common stockholders	54,776	53,463	54,622	53,055

Net income per common share available to common stockholders:

Basic	\$0.18	\$0.21	\$0.36	\$0.49
Diluted	\$0.17	\$0.20	\$0.35	\$0.48

The following securities were not included in the calculation of diluted shares outstanding as the effect would have been anti-dilutive (in thousands):

	Three Months Ended June 30, 2014	2013	Six Months Ended June 30, 2014	2013
Weighted-average:				
Stock options outstanding	757	1,354	762	1,586
Restricted stock units outstanding	46	211	37	267
Shares of common stock subject to repurchase	—	31	—	45

#### 4. Fair Value Measurements

The following tables present the Company's financial assets measured at fair value on a recurring basis (in thousands):

	June 30, 2014		
	Fair Value	Level 1	Level 2
Cash equivalents:			
Commercial paper	\$31,499	\$—	\$31,499
Money market funds	13,119	13,119	—
Municipal bonds	5,477	—	5,477
	\$50,095	\$13,119	\$36,976
Short-term investments:			
Municipal bonds	\$152,969	\$—	\$152,969
Corporate bonds	27,743	—	27,743
Commercial paper	11,243	—	11,243
U.S. government and agency securities	7,010	—	7,010
	\$198,965	\$—	\$198,965
	December 31, 2013		
	Fair Value	Level 1	Level 2
Cash equivalents:			
Commercial paper	\$34,498	\$—	\$34,498
U.S. government and agency securities	3,801	—	3,801
Money market funds	37	37	—
	\$38,336	\$37	\$38,299
Short-term investments:			
Municipal bonds	\$146,100	\$—	\$146,100
Commercial paper	31,597	—	31,597
Corporate bonds	7,875	—	7,875
U.S. government and agency securities	4,995	—	4,995
	\$190,567	\$—	\$190,567

As of June 30, 2014 and December 31, 2013, the Company did not use Level 3 inputs to measure financial assets or liabilities at fair value.



Table of Contents

## 5. Short-term Investments

The following tables present the Company's investments in available-for-sale securities (in thousands):

June 30, 2014				
	Amortized Cost	Unrealized Gains	Losses	Estimated Fair Value
Municipal bonds	\$152,912	\$63	\$(6	) \$152,969
Corporate bonds	27,771	2	(30	) 27,743
Commercial paper	11,244	—	(1	) 11,243
U.S. government and agency securities	7,008	2	—	7,010
	\$198,935	\$67	\$(37	) \$198,965

  

December 31, 2013				
	Amortized Cost	Unrealized Gains	Losses	Estimated Fair Value
Municipal bonds	\$146,047	\$56	\$(3	) \$146,100
Commercial paper	31,597	—	—	31,597
Corporate bonds	7,873	2	—	7,875
U.S. government and agency securities	5,002	—	(7	) 4,995
	\$190,519	\$58	\$(10	) \$190,567

Available-for-sale securities are reported at fair value, with unrealized gains and losses, net of tax, included as a separate component of stockholders' equity within accumulated other comprehensive income. Realized gains and losses on available-for-sale securities are included in other income, net in the Company's condensed consolidated statements of operations.

The weighted-average remaining maturity of the Company's investment portfolio was less than one year as of June 30, 2014 and December 31, 2013. As of June 30, 2014, no individual securities incurred continuous unrealized losses for greater than 12 months.

## 6. Patent Assets, Net

Patent assets, net, consisted of the following (in thousands):

	December 31, 2013	Additions	Disposals	June 30, 2014
Patent assets	\$529,526	\$73,448	\$(273	) \$602,701
Accumulated amortization	(309,572	) (57,740	) 112	(367,200
Patent assets, net	\$219,954			\$235,501

The Company's acquired patent assets relate to technologies used or supplied by companies in a variety of market sectors, including consumer electronics, e-commerce, financial services, media distribution, mobile communications, networking, semiconductors and software. The Company amortizes each acquired portfolio of patent assets on a straight-line basis over its estimated economic useful life. As of June 30, 2014, the estimated economic useful lives of the Company's patent assets generally ranged from 24 to 60 months. As of June 30, 2014, the weighted-average estimated economic useful life at the time of acquisition of all patents acquired since the Company's inception was 46 months.

Table of Contents

As of June 30, 2014, the Company expects amortization expense in future periods to be as follows (in thousands):

2014 (remainder)	\$56,211
2015	90,442
2016	61,538
2017	22,106
2018	5,013
Thereafter	191
Total estimated future amortization expense	\$235,501

Amortization expense was \$30.1 million and \$23.7 million for the three months ended June 30, 2014 and 2013, respectively, and \$57.7 million and \$46.3 million for the six months ended June 30, 2014 and 2013, respectively.

#### 7. Property and Equipment, Net

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

	June 30, 2014	December 31, 2013
Internal-use software	\$4,633	\$4,198
Leasehold improvements	1,799	1,700
Computer, equipment and software	1,188	1,096
Furniture and fixtures	818	813
Construction-in-progress	184	119
Total property and equipment, gross	8,622	7,926
Less: Accumulated depreciation and amortization	(4,231)	(3,259)
Total property and equipment, net	\$4,391	\$4,667

Depreciation and amortization expense was \$0.5 million and \$0.4 million for the three months ended June 30, 2014 and 2013, respectively, and \$1.0 million and \$0.8 million for the six months ended June 30, 2014 and 2013, respectively. Stock-based compensation capitalized as part of the cost of internal-use software was \$0.1 million and nil for the three months ended June 30, 2014 and 2013, respectively, and \$0.1 million and nil for the six months ended June 30, 2014 and 2013, respectively.

#### 8. Business Combinations

On June 19, 2014, the Company completed its acquisition of all of the issued and outstanding membership interests in DCML Services Corporation ("DCML"), a provider of data, intelligence and consulting on NPEs (operating under the trade name PatentFreedom). The final purchase price for DCML was approximately \$6.2 million, consisting of \$3.0 million in cash and 182,408 shares of the Company's common stock. The fair value of the equity component of the final purchase price of \$3.2 million was determined for accounting purposes based on the fair value of the Company's common stock on the closing date of the acquisition. As of June 30, 2014, the Company has paid \$2.5 million of the cash consideration. The shares of common stock were issued in July 2014 and are restricted pursuant to the terms of the agreement. The Company has preliminarily recorded \$3.3 million of intangible assets which includes covenant not to compete, proprietary data and customer relationships, \$1.1 million in net deferred tax liabilities, \$0.5 million in net tangible assets, and \$3.5 million of residual goodwill. As additional information becomes available, such as finalization of certain valuations of acquired assets and tax related matters, the Company may revise its preliminary purchase price allocation. The goodwill recorded pertains to the cost benefits and operational synergies realized by integrating DCML's data with the Company's proprietary database that cross-references all patent, litigation and entity information. Acquisition-related costs of \$0.1 million were expensed as incurred and included in the Company's selling, general and administrative expenses. The Company has included the financial results of DCML in its consolidated financial statements from the acquisition date and the results are not individually material to its consolidated financial statements.

#### 9. Goodwill

The changes in the carrying amounts of goodwill were as follows (in thousands):

Balance as of December 31, 2014	\$16,460
Goodwill from business acquisition	3,518
Balance as of June 30, 2014	\$19,978

Table of Contents

## 10. Intangible Assets, Net

Intangible assets, net, consisted of the following (in thousands):

	June 30, 2014			December 31, 2013		
	Carrying Amount	Accumulated Amortization	Net Carrying Amount	Carrying Amount	Accumulated Amortization	Net Carrying Amount
Covenant not to compete	\$ 1,900	\$ —	\$ 1,900	\$ 480	\$ (469)	\$ 11
Proprietary data and models	2,100	(825)	1,275	1,500	(637)	863
Customer relationships	1,050	(250)	800	250	(215)	35
Trademarks	1,890	(1,437)	453	1,890	(1,184)	706
Developed technology	728	(715)	13	728	(625)	103
	\$ 7,668	\$ (3,227)	\$ 4,441	\$ 4,848	\$ (3,130)	\$ 1,718

As of June 30, 2014, the Company expects amortization expense in future periods to be as follows (in thousands):

2014 (remainder)	\$915
2015	1,725
2016	1,288
2017	513
Total estimated future amortization expense	\$4,441

Amortization expense was \$0.3 million and \$0.4 million for the three months ended June 30, 2014 and 2013, respectively, and \$0.6 million and \$0.8 million for the six months ended June 30, 2014 and 2013, respectively.

## 11. Accrued and Other Current Liabilities

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

	June 30, 2014	December 31, 2013
Accrued payroll-related expenses	\$5,897	\$6,791
Accrued expenses	2,545	1,993
Total accrued liabilities	\$8,442	\$8,784
Other current liabilities	\$721	\$1,075
Consideration payable for business acquisition	3,697	—
Patent and other assets purchased but not paid	—	563
Total other current liabilities	\$4,418	\$1,638

## 12. Commitments and Contingencies

## Operating Lease Commitments

The Company generally does not enter into long-term minimum purchase commitments. Its principal long-term commitments consist of obligations under operating leases for office space. There were no substantial changes to the Company's contractual obligations or commitments during the six months ended June 30, 2014 as compared to those presented under the heading "Commitments and Contingencies" in Note 12 of the Notes to Consolidated Financial Statements in Part II, Item 8 of the Company's Annual Report on Form 10-K filed with the SEC on March 10, 2014.

Rent expense related to non-cancelable operating leases was \$0.9 million and \$0.8 million for the three months ended June 30, 2014 and 2013, respectively, net of sublease income of \$0.2 million and nil, respectively. Rent expense related to non-cancelable operating leases was \$1.8 million and \$1.4 million for the six months ended June 30, 2014 and 2013, respectively, net of sublease income of \$0.3 million and nil, respectively.

## Litigation

From time to time, the Company may be a party to various litigation claims in the normal course of business. Legal fees and other costs associated with such actions are expensed as incurred. The Company assesses, in conjunction with its legal counsel, the

## Table of Contents

need to record a liability for litigation or contingencies. A liability is recorded when and if it is determined that such a liability for litigation or contingencies is both probable and reasonably estimable. No liability for litigation or contingencies was recorded as of June 30, 2014 or December 31, 2013.

In June 2013, Kevin O'Halloran, as Trustee of the Liquidating Trust of Teltronics, Inc. (the "Debtor"), filed a complaint in the U.S. Bankruptcy Court for the Middle District of Florida against the Company and Harris Corporation (the "Defendants"). The complaint alleges that the Defendants are liable under federal and state bankruptcy law regarding fraudulent transfers for the value of a patent portfolio purchased by the Company from Harris Corporation pursuant to an agreement entered into in January 2009, and within four years of the date the Debtor filed its petition in bankruptcy. The Company is not currently able to determine whether there is a reasonable possibility that a loss has been incurred, nor can it estimate the potential loss or range of the potential loss that may result from this litigation.

In March 2012, Cascades Computer Innovations LLC filed a complaint in U.S. District Court for the Northern District of California (the "Court") against the Company and five of its clients (collectively the "Defendants"). The complaint alleges that the Defendants violated federal antitrust law, California antitrust law and California unfair competition law. The complaint further alleges that after the Company terminated its negotiations with the plaintiff to license certain patents held by the plaintiff, the Defendants violated the law by jointly refusing to negotiate or accept licenses under the plaintiff's patents. The plaintiff seeks unspecified monetary damages and injunctive relief. In January 2013, the Court dismissed the complaint against the Defendants and granted the plaintiff leave to amend its complaint. In February 2013, the plaintiff filed an amended lawsuit alleging that the Defendants violated federal antitrust law, California antitrust law and California unfair competition law. In March 2014, the Court entered an order staying the litigation pending the resolution of related litigation in the U.S. District Court for the Northern District of Illinois, and in July 2014 continued the stay. The Company is not currently able to determine whether there is a reasonable possibility that a loss has been incurred, nor can it estimate the potential loss or range of the potential loss that may result from this litigation.

### Guarantees and Indemnifications

The Company has, in connection with the sale of patent assets, agreed to indemnify and hold harmless the buyer of such patent assets for losses resulting from breaches of representations and warranties made by the Company. The terms of these indemnification agreements are generally perpetual. The maximum amount of potential future indemnification is unlimited. To date, the Company has not paid any amount to settle claims or defend lawsuits. The Company is unable to reasonably estimate the maximum amount that could be payable under these arrangements since these obligations are not capped but are conditional to the unique facts and circumstances involved. The Company had no liabilities recorded for these agreements as of June 30, 2014 or December 31, 2013. The Company has no reason to believe that there is any material liability related to such indemnification provisions. The Company does not indemnify its clients for patent infringement.

In accordance with its amended and restated bylaws, the Company also indemnifies certain officers and employees for losses incurred in connection with actions, suits or proceedings threatened or brought against such officer or employee arising from his or her service to the Company as an officer or employee, subject to certain limitations. The term of the indemnification period is indefinite. The maximum amount of potential future indemnification is unspecified. The Company has no reason to believe that there is any material liability for actions, events or occurrences that have occurred to date.

### Reserves for Known and Incurred but not Reported Claims

In August 2012, the Company began offering insurance to cover certain costs of litigation brought against its insured clients by NPEs. As of June 30, 2014, the Company had a total of 33 active policies and had recorded a reserve of \$0.9 million, net of amounts recoverable from reinsurers, for known and incurred but not reported claims that represent estimated claim costs and related expenses.

The Company regularly reviews its loss reserves using a variety of actuarial techniques and updates them as its loss experience develops.

Table of Contents

## 13. Stockholders' Equity

## Equity Plans

A summary of the Company's activity under its equity-settled award plans and related information is as follows (in thousands, except per share data):

	Shares Available for Grant	Options Outstanding Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life in Years	Aggregate Intrinsic Value
Balance - December 31, 2013	2,451	4,089	\$ 9.91		
Shares authorized <sup>(1)</sup>	1,000	—	—		
Options exercised	—	(467	) 5.14		
Options forfeited/canceled	45	(45	) 14.15		
Restricted stock units granted	(1,218	) —	—		
Restricted stock units forfeited	145	—	—		
Restricted stock units withheld related to net-share settlement of restricted stock units	166	—	—		
Balance - June 30, 2014	2,589	3,577	10.48	6.5	\$28,107
Vested and exercisable - June 30, 2014		2,286	10.90	6.4	17,678
Vested and expected to vest - June 30, 2014		3,415	10.52	6.5	26,785

<sup>(1)</sup> In March 2014, the Company reserved an additional 1,000,000 shares of its common stock for future issuance under the 2011 Plan.

The aggregate intrinsic value of stock options exercised during the three months ended June 30, 2014 and 2013 was \$3.6 million and \$4.7 million, respectively, and \$5.3 million and \$8.7 million for stock options exercised during the six months ended June 30, 2014 and 2013, respectively. The total fair value of stock options vested during the three months ended June 30, 2014 and 2013 was \$1.8 million and \$3.1 million, respectively, and \$3.5 million and \$5.3 million for stock options vested during the six months ended June 30, 2014 and 2013, respectively.

## Restricted Stock Units

The summary of restricted stock unit activity, which includes performance-based restricted stock units with a market condition ("PBRsUs"), is as follows (in thousands, except per share data):

	Number of Shares	Weighted-Average Grant Date Fair Value	Aggregate Intrinsic Value
Non-vested units - December 31, 2013	2,057	\$ 12.38	
Granted	1,218	14.28	
Vested	(485	) 13.18	
Forfeited	(145	) 13.84	
Non-vested units - June 30, 2014	2,645	13.03	\$46,949

The total fair value of restricted stock units ("RSUs") vested during the three months ended June 30, 2014 and 2013 was \$5.5 million and \$2.3 million, respectively, and \$7.9 million and \$2.7 million for RSUs vested during the six months ended June 30, 2014 and 2013, respectively.



In October 2013, the Board of Directors approved net-share settlement for tax withholdings on RSU vesting. During the six months ended June 30, 2014, the Company withheld issuing 166,020 shares of its common stock based on the value of the RSUs on their vesting dates as determined by the Company's closing common stock price. Total payments for the employees' minimum tax obligations to taxing authorities were \$2.7 million for the six months ended June 30, 2014, and were recorded as a reduction to additional paid-in capital and reflected as a financing activity within the condensed consolidated statements of cash flows. The net-share settlements reduced the number of shares that would have otherwise been issued on the vesting date and increased the number of shares reserved for future issuance under the 2011 Plan.

Table of Contents**Stock-Based Compensation Related to Employees and Directors**

The fair value of RSUs granted to employees and directors is measured by reference to the fair value of the underlying shares on the date of grant.

PBRsUs contain both service and market conditions that affect the quantity of awards that will vest. During the three months ended June 30, 2014 and 2013, the Company granted nil and 50,000 PBRsUs, respectively. During the six months ended June 30, 2014 and 2013, the Company granted 200,000 and 175,000 PBRsUs, respectively. The Company estimates the grant date fair value of PBRsUs using the Monte Carlo simulation model. The weighted-average assumptions used to estimate the fair value of PBRsUs and the resulting fair values are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,		
	2014	2013	2014	2013	
Dividend yield	n/a	—	% —	% —	%
Risk-free rate	n/a	0.53	% 0.11	% 0.59	%
Expected volatility	n/a	50	% 48	% 53	%
Grant date fair value	n/a	\$7.36	\$7.47	\$6.39	

Stock-based compensation expense related to stock options granted to employees and directors was \$1.5 million and \$2.4 million for the three months ended June 30, 2014 and 2013, respectively, and \$3.0 million and \$4.9 million for the six months ended June 30, 2014 and 2013, respectively. Stock-based compensation expense related to RSUs granted to employees and directors was \$3.4 million and \$1.8 million for the three months ended June 30, 2014 and 2013, respectively, and \$5.6 million and \$3.0 million for the six months ended June 30, 2014 and 2013, respectively. Stock-based compensation expense related to PBRsUs granted to employees was \$0.2 million for both the three months ended June 30, 2014 and 2013, respectively, and \$0.4 million and \$0.2 million for the six months ended June 30, 2014 and 2013, respectively.

As of June 30, 2014, there was \$7.2 million and \$32.3 million of unrecognized compensation cost related to stock options and RSUs, including PBRsUs, respectively, which is expected to be recognized over a weighted-average period of 1.8 years and 2.9 years, respectively. Future grants of equity awards will increase the amount of stock-based compensation expense to be recorded.

**Stock-Based Compensation Related to Non-Employees**

The Company periodically grants equity awards to non-employees in exchange for goods and services. No equity awards were granted to non-employees in exchange for goods and services during the three or six months ended June 30, 2014 and 2013.

Stock-based compensation expense for non-employees is based on the fair value of the award on the measurement date, which is the earlier of the date by which the commitment for performance by the non-employee to earn the award is reached and the date on which the non-employee's performance is complete. Each reporting period, the fair value of the unvested non-employee stock option or RSU is revalued until the award vests on the measurement date.

Non-employee stock-based compensation expense related to stock options was nil for both the three months ended June 30, 2014 and 2013, respectively, and nil and \$0.1 million for the six months ended June 30, 2014 and 2013, respectively. Non-employee stock-based compensation expense related to RSUs was nil and \$0.1 million for the three months ended June 30, 2014 and 2013, respectively, and nil and \$0.2 million for the six months ended June 30, 2014 and 2013, respectively.

**14. Income Taxes**

The Company uses an estimated annual effective tax rate based upon a projection of its annual fiscal year results to measure the income tax benefit or expense recognized in each interim period. The Company's effective tax rate,

including the impact of discrete benefit items, was 37% for each of the three and six months ended June 30, 2014 and 2013, respectively.

The Company's 2010 tax year is currently under examination by the State of California Franchise Tax Board. The Company does not expect a material impact on its condensed consolidated financial statements as a result of this examination. The 2010 through 2012 tax periods remain open to examination by the Internal Revenue Service and the 2009 through 2012 tax periods remain open to examination by most state tax authorities. For the Company's foreign jurisdictions, the 2009 through 2012 tax years remain open to examination by their respective tax authorities.

Table of Contents

## 15. Related-Party Transactions

During the three and six months ended June 30, 2014, five members of the Company's Board of Directors also served on the boards of directors of RPX clients. During the three and six months ended June 30, 2013, four members of the Company's Board of Directors also served on the boards of directors of RPX clients. The Company recognized subscription revenue from these clients in the amount of \$2.2 million and \$1.3 million for the three months ended June 30, 2014 and 2013, respectively, and \$4.3 million and \$2.5 million for the six months ended June 30, 2014 and 2013, respectively. As of December 31, 2013, there was \$4.4 million of receivables due from these clients. There were no receivables due from these clients on June 30, 2014.

## 16. Segment Reporting

Operating segments are components of an enterprise about which separate financial information is available.

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company's chief operating decision maker is its Chief Executive Officer. The Company's Chief Executive Officer reviews financial information presented on a consolidated basis and, as a result, the Company concluded that there is only one operating and reportable segment.

The Company markets its solution to companies around the world. Revenue is generally attributed to geographic areas based on the country in which the client is domiciled.

The following table presents revenue by location and revenue generated by country as a percentage of total revenue for the applicable period, for countries representing 10% or more of revenues for the periods presented (dollars in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,					
	2014		2013		2014		2013			
United States	\$40,839	64	% \$37,537	65	% \$77,944	62	% \$75,403	64	%	
Japan	9,293	14	9,432	17	18,849	15	19,792	17		
Other	14,161	22	10,512	18	29,388	23	23,480	19		
Total revenue	\$64,293	100	% \$57,481	100	% \$126,181	100	% \$118,675	100	%	

Long-lived assets information by location is presented below (in thousands):

	June 30, 2014	December 31, 2013
United States	\$4,373	\$4,646
Japan	18	21
Total long-lived assets	\$4,391	\$4,667

Table of Contents

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") on March 10, 2014.

This Quarterly Report on Form 10-Q contains "forward-looking statements" that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements are often identified by the use of words such as, but not limited to, "anticipate," "believe," "can," "continue," "could," "estimate," "expect," "intend," "may," "will," "plan," "project," "seek," "should," "target," "will," expressions or variations intended to identify forward-looking statements. Forward-looking statements include statements regarding our business strategies and business model, products, benefits to our clients, future financial results and expenses and patent acquisition spending. These statements are based on the beliefs and assumptions of our management based on information that is currently available. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include but are not limited to those identified below and those discussed in the section titled "Risk Factors" included in Part II, Item 1A of this Quarterly Report on Form 10-Q and elsewhere in this filing and our Annual Report on Form 10-K filed with the SEC on March 10, 2014. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Overview

We help companies reduce patent-related risk and expense by providing a subscription-based patent risk management solution that facilitates more efficient exchanges of value between owners and users of patents compared to transactions driven by actual or threatened litigation.

The core of our solution is defensive patent aggregation, in which we acquire patent assets that are being or may be asserted against our current or prospective clients. We then provide our clients with licenses to our patent assets to protect them from potential patent infringement assertions. We also provide our clients access to our proprietary patent market intelligence and data.

Our business model aligns our interests with those of our clients. We have not asserted and will not assert our patents, which enables us to develop strong and trusted relationships with our clients. Our clients include companies that design, make or sell technology-based products and services as well as companies that use technology in their businesses.

During the six months ended June 30, 2014, our revenue grew to \$126.2 million from \$118.7 million for the six months ended June 30, 2013. Our client count increased by 16 clients during the six months ended June 30, 2014, bringing our total client network to 184 as of June 30, 2014. At June 30, 2014, we had deferred revenue of \$131.2 million.

We believe that our acquisitions of patent assets are a key driver of the value that we create for our clients. We measure patent asset acquisition spend on both a "gross" and a "net" basis, whereby the "gross spend" represents the aggregate amount spent including amounts contributed by our clients in syndicated acquisitions above and beyond their subscription fees and the "net spend" represents only the net incremental investment of our own capital. During the

six months ended June 30, 2014, we completed 29 acquisitions of patent assets and our gross and net acquisition spend totaled \$77.4 million and \$73.4 million, respectively. From our inception through June 30, 2014, we have completed 196 acquisitions of patent assets with gross and net acquisition spend of \$833.2 million and \$606.3 million, respectively.

Insuring against the costs of non-practicing entity (“NPE”) litigation is a natural extension of our core defensive patent acquisition service. In August 2012, we started to offer NPE patent infringement liability insurance, which is a liability insurance policy for operating companies that covers certain costs associated with patent infringement lawsuits by NPEs. The insurance product complements our core defensive patent acquisition service, enabling policyholders, whom we historically have required to be members of our client network, to better manage and mitigate the risk of NPE patent litigation. As of June 30, 2014, we had a total of 33 active insurance policies. The effect of the insurance policies that have been issued was not material to our results of operations or financial condition for the six months ended June 30, 2014 or 2013. In connection with an evolution of the way that we will sell insurance policies, during March 2014 we formed a reinsurance company to assume some portion of the underwriting risk on insurance policies that we issue on behalf of a Lloyd’s of London underwriting syndicate. We began issuing new policies under the

## Table of Contents

reinsurance model in May 2014. As of, and for the three and six months ended June 30, 2014, the effect of the insurance policies issued under the reinsurance model was not material to our results of operations or financial condition.

### Key Components of Results of Operations

#### Revenue

Subscription revenue includes membership subscription services and premiums earned from insurance policies. Historically, the majority of our revenue has consisted of fees paid by our clients under subscription agreements. Subscription revenue will be positively or negatively impacted by the financial performance of our clients since their subscription fees typically reset annually based upon their most recently reported annual financial results. In August 2012, we launched our insurance product and started to recognize revenue from insurance premiums. We had been recognizing insurance premiums as revenue, however, under the new reinsurance model we only recognize the portion ceded to us. In addition, we receive management fees for marketing, underwriting, and claims management services. Although we expect this revenue to increase as we sell more policies in the future, for the three and six months ended June 30, 2014 and 2013, revenue from insurance premiums was not material to our results of operations. We also recognize revenue from the sale of licenses and advisory fee income in connection with syndicated acquisitions, which we collectively refer to as fee-related revenue. Although we expect to continue to generate fee-related revenue, these transactions are unpredictable and vary quarter to quarter. In the future, we may receive other revenue and fee income from newly introduced products and services. While we expect to continue to experience revenue growth on an annual basis, we do not believe that our rate of growth since inception is representative of anticipated future revenue growth.

#### Cost of Revenue

Cost of revenue primarily consists of amortization expense related to acquired patent assets. Acquired patent assets are capitalized and amortized ratably over their estimated useful lives which are typically derived based on the anticipated cash flows from clients and prospects that may benefit from the transaction. Also included in the cost of revenue are expenses incurred to maintain our patents and prosecute our patent applications and amortization expense for acquired intangible assets and internally developed software. With the launch of our insurance offering in August 2012, cost of revenue also includes premiums ceded to reinsurers and loss reserves. We began to issue new policies under the reinsurance model in May 2014 and as a result we will no longer be ceding premiums. We expect our cost of revenue to increase in the future as we add additional patent assets to our existing portfolio to support our existing and future clients and as our insurance business grows. Our cost of revenue is primarily driven by the amortization of previously acquired patent assets, which are typically amortized over an estimated useful life of 24 to 60 months. From time to time, we may acquire patent assets that we believe are valuable to our clients and prospects with an estimated useful life that is significantly less than the historical weighted-average of patent assets previously acquired, resulting in increased patent asset amortization expense in immediate periods following acquisition. Estimating the economic useful lives of our patent assets depends on various factors including the remaining statutory life of the underlying patents, which could result in shorter amortization periods. Recent trends suggest that amortization periods on patent assets acquired in future periods may be amortized over shorter periods than the historical weighted-average of 46 months.

#### Selling, General and Administrative Expenses

Selling, general and administrative expenses consist of salaries and related expenses, including stock-based compensation expense, cost of marketing programs, legal costs, professional fees, travel costs, facility costs and other corporate expenses. We expect that in the foreseeable future, as we seek to serve more clients and develop new products and services, selling, general and administrative expenses will continue to increase.

#### Other Income, Net

Other income, net primarily consists of interest income earned on our cash, cash equivalents and short-term investments.

#### Provision for Income Taxes

Income taxes are computed using the asset and liability method, under which deferred tax assets and liabilities are determined based on the difference between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Based on available information, we believe it is likely that our deferred tax assets will be fully realized. Accordingly, we have not applied a valuation allowance against our net deferred tax assets.

#### Critical Accounting Policies and Estimates

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, costs and expenses and related disclosures.



Table of Contents

There have been no material changes to our critical accounting policies and estimates during the six months ended June 30, 2014, as compared to the critical accounting policies and estimates presented under the heading “Critical Accounting Policies and Estimates” in Part II, Item 7 of the Company’s Annual Report on Form 10-K filed with the SEC on March 10, 2014.

**Recently Issued Accounting Standards**

In June 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (“ASU 2014-12”), which amends Compensation - Stock Compensation (Topic 718) in the Accounting Standards Codification (“ASC”). ASU 2014-12 requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Compensation - Stock Compensation (Topic 718) as it relates to awards with performance conditions that affect vesting to account for such awards. The amendments in ASU 2014-12 will be effective for annual and interim periods beginning after December 15, 2015 and early adoption is permitted. The adoption of ASU 2014-12 is not expected to have a material impact on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) (“ASU 2014-09”), which will supersede most existing revenue recognition guidance in U.S. generally accepted accounting principles (“U.S. GAAP”) once it becomes effective. ASU 2014-09 requires an entity to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five-step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. ASU 2014-09 will be effective for annual and interim periods beginning after December 15, 2016 and early adoption is not permitted. We are currently evaluating the impact of the adoption of ASU 2014-12 to our consolidated financial statements.

In April 2014, the FASB issued ASU 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360), (“ASU 2014-08”) which amends the requirements for reporting discontinued operations and enhances disclosure requirements. The amendments in ASU 2014-08 will be effective for all disposals (or classifications as held for sale) of components of an entity beginning on or after December 15, 2014 and early adoption is permitted. The adoption of ASU 2014-08 is not expected to have a material impact on our consolidated financial statements.

**Results of Operations**

The following table sets forth our condensed consolidated operations data for each of the periods indicated (in thousands). Our historical results are not necessarily indicative of our results of operations to be expected for any future period.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Revenue	\$64,293	\$57,481	\$126,181	\$118,675
Cost of revenue	31,542	24,694	60,462	48,364
Selling, general and administrative expenses	18,579	15,736	35,834	30,209
(Gain) loss on sale of patent assets, net	(699)	) 126	(699)	) 126
Operating income	14,871	16,925	30,584	39,976
Other income, net	94	63	193	114
Income before provision for income taxes	14,965	16,988	30,777	40,090
Provision for income taxes	5,566	6,291	11,518	14,698

Edgar Filing: RPX Corp - Form 10-Q

Net income	\$9,399	\$10,697	\$19,259	\$25,392
------------	---------	----------	----------	----------

17

---

Table of Contents

The following table sets forth our condensed consolidated operations data as a percentage of revenue.

	Three Months Ended June 30,		Six Months Ended June 30,		
	2014	2013	2014	2013	
Revenue	100	% 100	% 100	% 100	%
Cost of revenue	49	43	48	41	
Selling, general and administrative expenses	29	27	28	25	
(Gain) loss on sale of patent assets, net	(1	) —	(1	) —	
Operating income	23	30	25	34	
Other income, net	—	—	—	—	
Income before provision for income taxes	23	30	25	34	
Provision for income taxes	9	11	9	12	
Net income	14	% 19	% 16	% 22	%

**Revenue**

Our revenue for the three months ended June 30, 2014 was \$64.3 million compared to \$57.5 million during the same period a year ago, an increase of \$6.8 million, or 12%. Subscription revenue, which includes membership subscription services and premiums earned from insurance policies, for the three months ended June 30, 2014 was \$64.3 million compared to \$55.0 million for the three months ended June 30, 2013. The increase in subscription revenue was primarily attributable to an increase in membership fees and insurance premiums of \$7.7 million from new clients who joined our network subsequent to June 30, 2013 and \$1.6 million from clients who joined our network prior to June 30, 2013. This will increase or decrease over time as clients leave the network or we adjust their membership fees from the prior period. As of June 30, 2014, we had a total client network of 184 companies as compared to 157 as of June 30, 2013. Revenue for the three months ended June 30, 2013 also included fee-related revenue of \$2.5 million. There was no fee-related revenue recorded during the three months ended June 30, 2014.

Our revenue for the six months ended June 30, 2014 was \$126.2 million compared to \$118.7 million during the same period a year ago, an increase of \$7.5 million, or 6%. Subscription revenue, which includes membership subscription services and premiums earned from insurance policies, for the six months ended June 30, 2014 was \$125.1 million compared to \$109.0 million for the six months ended June 30, 2013. The increase in subscription revenue was primarily attributable to an increase in membership fees and insurance premiums of \$12.9 million from new clients who joined our network subsequent to June 30, 2013 and \$3.2 million from clients who joined our network prior to June 30, 2013. Revenue for the six months ended June 30, 2014 also included \$1.1 million of fee-related revenue compared to \$9.7 million in the same period in 2013.

**Cost of Revenue**

Our cost of revenue for the three months ended June 30, 2014 was \$31.5 million compared to \$24.7 million during the same period a year ago, an increase of \$6.8 million, or 28%. The increase was primarily attributable to a \$6.4 million increase in patent amortization expense as a result of an increase in our patent assets and shorter than historical amortization periods for certain patent assets acquired subsequent to June 30, 2013. Patent assets acquired during the three months ended June 30, 2014 had a weighted-average amortization period of 37 months compared with the historical weighted-average since our inception of 46 months. We also had a \$0.3 million increase in expenses incurred to maintain and prosecute patents and patent applications included in our portfolio.

Our cost of revenue for the six months ended June 30, 2014 was \$60.5 million compared to \$48.4 million during the same period a year ago, an increase of \$12.1 million, or 25%. The increase was primarily attributable to a \$11.4 million increase in patent amortization expense as a result of an increase in our patent assets, and shorter than historical amortization periods for certain patent assets acquired subsequent to June 30, 2013. We also had a \$0.7 million increase in expenses incurred to maintain and prosecute patents and patent applications included in our portfolio.

**Selling, General and Administrative Expenses**

Our selling, general and administrative expenses for the three months ended June 30, 2014 were \$18.6 million compared to \$15.7 million during the same period a year ago, an increase of \$2.8 million, or 18%. The increase was primarily due to a \$2.2 million increase in personnel-related costs, including a \$0.6 million increase in stock-based compensation expense, primarily attributable to increasing our headcount to 138 employees as of June 30, 2014.

Our selling, general and administrative expenses for the six months ended June 30, 2014 were \$35.8 million compared to \$30.2 million during the same period a year ago, an increase of \$5.6 million, or 19%. The increase was primarily due to a \$4.0 million increase in personnel-related costs, including a \$0.7 million increase in stock-based compensation expense, primarily attributable to

Table of Contents

increasing our headcount to 138 employees as of June 30, 2014, a \$0.5 million increase in legal and other professional services due to the growth of our business and a \$0.4 million increase in rent expense for leasing additional office space at our San Francisco headquarters.

**Provision for Income Taxes**

Our provision for income taxes was \$5.6 million and \$6.3 million for the three months ended June 30, 2014 and 2013, respectively, and \$11.5 million and \$14.7 million for the six months ended June 30, 2014 and 2013, respectively. Our effective tax rate, including the impact of discrete benefit items, was 37% for each of the three and six months ended June 30, 2014 and 2013, respectively.

**Liquidity and Capital Resources**

We have financed substantially all of our operations and patent asset acquisitions through the sale of equity securities and subscription and other fees collected from our clients. As of June 30, 2014, we had \$118.6 million of cash and cash equivalents and \$199.0 million in short-term investments. We believe our existing cash, cash equivalents and short-term investments will be sufficient to meet our working capital and capital expenditure needs for the foreseeable future. Our future capital needs will depend on many factors, including, among other things, our acquisition of patent assets, addition and renewal of client membership agreements, growth of our insurance business and development of new products and services. We anticipate an increased level of patent acquisition spending as our business grows. Additionally, we may enter into potential investments in, or acquisitions of, complementary businesses which could require us to seek additional debt or equity financing. Additional funds may not be available on terms favorable to us or at all.

The following table sets forth a summary of our cash flows for the periods indicated (in thousands):

	Six Months Ended June 30,	
	2014	2013
Net cash provided by operating activities	\$100,305	\$123,379
Net cash used in investing activities	(83,601)	(102,475)
Net cash provided by financing activities	1,730	4,736
Net increase in cash and cash equivalents	\$18,434	\$25,640

**Cash Flows from Operating Activities**

Cash provided by operating activities for the six months ended June 30, 2014 was \$100.3 million, consisting of adjustments for non-cash items of \$67.4 million, changes in working capital and non-current assets and liabilities of \$13.7 million and net income of \$19.3 million. Non-cash adjustments to net income primarily consisted of \$59.3 million of depreciation and amortization, \$8.9 million of stock-based compensation, \$3.4 million of amortization of premium on investments, a reduction of \$2.0 million due to excess tax benefit from stock-based compensation and a \$1.0 million net decrease in our deferred tax liabilities. The change in working capital and non-current assets and liabilities resulted primarily from a \$26.4 million decrease in accounts receivable, partially offset by a \$6.6 million decrease in deferred revenue, a \$5.3 million increase in prepaid expenses and other assets and a \$0.8 million decrease in our accrued and other liabilities. The decrease in accounts receivable was due to \$145.1 million in cash collections, partially offset by billings to new and existing clients of \$118.7 million. The decrease in deferred revenue was due to revenue and other adjustments recognized during the period of \$125.3 million, partially offset by \$118.7 million in billings to new and existing clients. The amount of deferred revenue in any given period varies with the addition of new clients, the mix of payment terms that we offer and the timing of invoicing existing clients.

Cash provided by operating activities for the six months ended June 30, 2013 was \$123.4 million, consisting of adjustments for non-cash items totaling \$55.2 million, changes in working capital and non-current assets and liabilities of \$42.8 million and net income of \$25.4 million. Non-cash adjustments to net income primarily consisted of \$47.8 million of depreciation and amortization, \$8.2 million of stock-based compensation, \$3.0 million of amortization of premium on investments, a reduction of \$2.0 million due to excess tax benefit from stock-based compensation and

a \$1.9 million net decrease in our deferred tax liabilities. The change in working capital resulted primarily from a \$33.8 million decrease in other receivables representing the collection of client contributions outstanding as a result of the completion of a syndicated patent acquisition and licensing transaction and a \$13.2 million increase in deferred revenue. The increase in deferred revenue was due to \$122.2 million in revenue billings to new and existing clients, partially offset by revenue recognized during the period of \$109.0 million.

#### Cash Flows from Investing Activities

Cash used in investing activities for the six months ended June 30, 2014 was \$83.6 million, of which \$73.9 million was used to acquire patent assets, \$7.7 million represented net purchases of short-term marketable securities, \$2.2 million was used in the acquisition of DCML Services Corporation, and \$0.8 million was used to acquire property and equipment. This decrease was partially

Table of Contents

offset by \$0.9 million in proceeds from the sale of patent assets. We expect our cash used in investing activities to increase in the future as we acquire additional patent assets.

Cash used in investing activities for the six months ended June 30, 2013 was \$102.5 million, of which \$69.6 million was used to acquire patent assets, \$32.1 million represented net purchases of short-term marketable securities and \$0.9 million was used to acquire property and equipment.

**Cash Flows from Financing Activities**

Cash provided by financing activities for the six months ended June 30, 2014 was \$1.7 million, of which \$2.4 million was the result of proceeds from the exercise of stock options and other common stock issuances and \$2.0 million was due to excess tax benefit from stock-based compensation. This increase was partially offset by \$2.7 million in taxes paid related to net-share settlements of restricted stock units.

Cash provided by financing activities for the six months ended June 30, 2013 was \$4.7 million, of which \$2.7 million was the result of proceeds from the exercise of stock options and other common stock issuances and \$2.0 million was due to excess tax benefit from stock-based compensation.

**Contractual Obligations and Commitments**

**Operating Lease Commitments**

We generally do not enter into long-term minimum purchase commitments. Our principal long-term commitments consist of obligations under operating leases for office space. There were no substantial changes to our contractual obligations and commitments during the six months ended June 30, 2014 as compared to our contractual obligations and commitments presented under the heading “Contractual Obligations and Commitments” in Part II, Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” or the heading “Commitments and Contingencies” in Note 12 of the Notes to Consolidated Financial Statements in Part II, Item 8 of our Annual Report on Form 10-K filed with the SEC on March 10, 2014.

**Off Balance Sheet Arrangements**

At June 30, 2014, we did not have any relationships with unconsolidated entities or financial partnerships, such as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance-sheet arrangements or other contractually narrow or limited purposes.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily a result of fluctuations in foreign currency exchange rates and interest rates. We do not hold or issue financial instruments for trading purposes.

Foreign Currency Exchange Risk

Our subscription agreements are denominated in U.S. Dollars and, therefore, our revenue is not currently subject to significant foreign currency risk. Our expenses are incurred primarily in the United States, with a small portion of expenses incurred and denominated in the currencies where our other international office is located. Our results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the Japanese Yen and European Euro relative to the U.S. Dollar. To date, we have not entered into any foreign currency hedging contracts.

Interest Rate Sensitivity

We had cash, cash equivalents and short-term investments of \$317.6 million as of June 30, 2014. Our cash balances deposited in U.S. banks are non-interest bearing and insured up to the Federal Deposit Insurance Corporation ("FDIC") limits. Cash equivalents consist of commercial paper, municipal bonds and institutional money market funds denominated primarily in U.S. Dollars. Interest rate fluctuations affect the returns on our invested funds.

As of June 30, 2014, our short-term investments of \$199.0 million were primarily invested in municipal and corporate bonds maturing between 90 days and 12 months, U.S. government and agency securities and commercial paper. As of June 30, 2014, our investments were classified as available-for-sale and, consequently, were recorded at fair value in the condensed consolidated balance sheets with unrealized gains or losses reported as a separate component of stockholders' equity. We review our investments for impairment when events and circumstances indicate that a decline in the fair value of an asset below its carrying value is other-than-temporary. As of June 30, 2014, we had not recorded an impairment related to our investments in the condensed consolidated statement of operations.

If overall interest rates had changed by 10% during the six months ended June 30, 2014, the fair value of our investments would not have been materially affected.

Effect of Inflation

We believe that inflation has not had a material impact on our results of operations for the six months ended June 30, 2014. There can be no assurance that future inflation will not have an adverse impact on our results of operations or financial condition.



Table of Contents

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2014. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. 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 the evaluation of our disclosure controls and procedures as of June 30, 2014, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, the Company’s disclosure controls and procedures were effective at the reasonable assurance level.

Internal Control over Financial Reporting

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting which occurred during the period covered by this Quarterly Report on Form 10-Q which has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls or our internal control over financial reporting will prevent all errors and all fraud. 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 the 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 a 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 controls. 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 policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

Refer to Note 12, "Commitments and Contingencies," in Notes to Condensed Consolidated Financial Statements (unaudited) in Part I, Item 1 of this Quarterly Report on Form 10-Q, which is hereby incorporated by reference.

Item 1A. Risk Factors.

Investing in our common stock involves a high degree of risk. You should consider carefully the risks and uncertainties described below before making a decision to buy our common stock. If any of the following risks actually occur, our business, financial condition, results of operations or growth prospects could be harmed. In that case, the trading price of our common stock could decline and you could lose all or part of your investment in our common stock. The risks described below are not the only risks facing us. Risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, operating results, and growth prospects.

Risks Related to Our Business and Industry

We may experience significant quarterly fluctuations in our operating results due to a number of factors, which make our future operating results difficult to predict and could cause our operating results to fall below expectations. Due to our limited operating history, our evolving business model and the unpredictability of our emerging industry, certain of our operating results have fluctuated significantly in the past and may fluctuate significantly in the future. Many of the factors that cause these fluctuations are outside of our control. The amount we spend to acquire patent assets, the characteristics of the assets acquired and the timing of those acquisitions may result in significant quarterly fluctuations in our capital expenditures and our financial results, and the amount and timing of our membership sales may result in significant fluctuations in our cash flow on a quarterly basis. As a result, comparing our operating results on a period-to-period basis may not be meaningful. You should not rely on our past results as an indication of our future performance.

In addition to the factors described above and elsewhere in this Item 1A, other factors that may affect our operating results include:

- increases in the prices we need to pay to acquire patent assets;
- increases in operating expenses, including those attributable to additional headcount and the costs of new business initiatives;
- our lengthy and unpredictable membership sales cycle, including delays in potential clients' decisions whether to subscribe to our solution;
- lower subscription fees from clients whose annual subscription fees decrease due to declining operating income or revenue of such clients;
- losses incurred as a result of claims made on insurance policies underwritten by us;
- non-renewals from existing clients for any reason;
- loss of clients, including through acquisitions or consolidations;
- changes in our subscription fee rates or changes in our own pricing and discounting policies or those of our competitors;
- our inability to acquire patent assets that are being asserted or may be asserted against our clients due to lack of availability, unfavorable pricing terms or otherwise;
- changes in patent law and regulations and other legislation, as well as United States Patent and Trademark Office procedures or court rulings, that reduce the value of our solution to our existing and potential clients;
- changes in the accounting treatment associated with our acquisitions of patent assets, how we amortize those patent assets and how we recognize revenue under subscription agreements;
- our acquisition of patent assets with a shorter estimated useful life that increases our near-term patent asset amortization expense and decreases our earnings;

- our inability to effectively develop and implement new solutions that meet client requirements in a timely manner;
- decreases in our clients' and prospective clients' costs of litigating patent infringement claims;
- our inability to retain key personnel;
- any significant changes in the competitive dynamics of our market, including new competitors or substantial discounting of services that are viewed by our target market as competitive to ours;

## Table of Contents

gains or losses realized as a result of our sale of patents, including upon the exercise by any of our clients of their limited right to purchase certain of our patent assets for defensive purposes in the event of a patent infringement suit brought against such client by a third party; and

- adverse economic conditions in the industries that we serve, particularly as they affect the intellectual property risk management and/or litigation budgets of our existing or potential clients.

If our operating results in a particular quarter do not meet the expectations of securities analysts or investors, our stock price could be substantially affected. In particular, if our operating results fall below expectations, our stock price could decline substantially.

The market for our patent risk management solution is evolving, and if our solution is not widely accepted or is accepted more slowly than we expect, our operating results will be adversely affected.

We have derived substantially all of our revenue from the sale of memberships to our patent risk management solution and we expect this will continue for the foreseeable future. As a result, widespread acceptance of this solution is critical to our future success. The market for patent risk management solutions is evolving and it is uncertain whether these solutions will achieve and sustain high levels of demand and market acceptance. Our success will depend, to a substantial extent, on the willingness of companies of all sizes to purchase and renew memberships as a way to reduce their patent litigation costs. If companies do not perceive the cost-savings benefits of patent risk management solutions, then wide market adoption of our solution will not develop, or it may develop more slowly than we expect. Either scenario would adversely affect our operating results in a significant way. Factors that may negatively affect wide market acceptance of our solution, as well as our ability to obtain new clients and renew existing clients, include:

- uncertainty about our ability to significantly reduce patent litigation costs for a particular company;
- reduced assertions from NPEs or decreased patent licensing fees owed to NPEs;
- limitations on the ability of NPEs to bring patent claims or limitations on the potential damages recoverable from such claims;
- reduced cost to our clients of defending patent assertion claims;
- lack of perceived relevance and value in our existing patent asset portfolio by existing or potential clients;
- concerns by existing or potential clients about our future ability to obtain rights to patent assets that are being or may be asserted against them;
- reduced incentives to renew memberships if clients have vested into perpetual licenses in all patent assets that they believe are materially relevant to their businesses;
- lack of sufficient interest by mid- and small-size companies in our patent risk management or insurance offerings;
- reduced incentive for companies to become clients because we do not assert our patent assets in litigation;
- concerns that we might change our current business model and assert our patent assets in litigation;
- budgetary limitations for existing or potential clients; and
- the belief that adequate coverage for the risks and expenses we attempt to reduce is available from alternative products or services.

Our limited operating history makes it difficult to evaluate our current business and future prospects, and potential clients may have concerns regarding the effectiveness of our business model in the future. If companies do not continue to subscribe to our solution, our business and operating results will be adversely affected.

We were incorporated in July 2008. We acquired our first patent assets in September 2008, sold our first membership in October 2008, and sold our first insurance policy in August 2012. Therefore, we have not only a limited operating history, but also a limited track record in executing our business model. Our future success depends on acceptance of our solutions by companies we target to become clients. Our efforts to sell our solutions to new and existing clients may not continue to be successful. We evaluate our business model from time to time in order to address the evolving needs of our clients and prospective clients, particularly in an industry that continues to develop and change. Our limited operating history may also make it difficult to evaluate our current business and future prospects. We have encountered and will continue to encounter risks and difficulties frequently experienced by companies in rapidly changing industries. If we do not manage these risks successfully, our business and operating results will be adversely

affected.

If the market for our solutions develops more slowly than we anticipate, or if competitors introduce new solutions that compete with ours, we may be unable to renew our memberships, sell insurance policies or attract new clients at favorable prices based on the same pricing model we have historically used. In the future, it is possible that competitive dynamics in our market may require us to change our pricing model, reduce our subscription fee rates, or consider adding new pricing programs or discounts, which would likely harm our operating results. If we introduce a higher fee schedule in the future, it may be more difficult for us to attract new

## Table of Contents

clients. In order to attract new clients and retain existing clients, in certain cases we have previously offered, and may in the future offer, discounts or other contractual incentives to clients who execute multi-year subscription agreements or who make client referrals.

Our membership sales cycles can be long and unpredictable, and our membership sales efforts require considerable time and expense. As a result, our membership sales are difficult to predict and will vary substantially from quarter to quarter, which may cause our cash flow to fluctuate significantly.

Because we operate in a relatively new and unproven market, our membership sales efforts involve educating potential clients about the benefit of our solution, including potential cost savings to a company. Potential clients typically undergo a lengthy decision-making process that has, in the past, generally resulted in a lengthy and unpredictable sales cycle. Mid- and small-size companies are generally subject to less patent litigation and we expect even lengthier sales cycles for such companies. We spend substantial time, effort and resources in our membership sales efforts without any assurance that our efforts will produce any membership sales. In addition, subscriptions are frequently subject to budget constraints, multiple approvals, and unplanned administrative, processing and other delays. As a result of these factors, our membership sales in any period are difficult to predict and will likely vary substantially between periods, which may cause our cash flow to fluctuate significantly between periods.

The success of our business depends on clients renewing their subscription agreements, and we do not have an adequate operating history to predict the rate of membership renewals. Any significant decline in our membership renewals could harm our operating results.

Our clients have no obligation to renew their subscriptions after the expiration of their initial membership period. We have limited historical data with respect to rates of subscription renewals, so we cannot accurately predict renewal rates. The weighted-average term of our subscription agreements in effect as of June 30, 2014 was 2.6 years. As our overall membership base grows, we expect our rate of client renewals to decline compared to our historical rate. Our clients may choose not to renew their memberships or, if they do renew, may choose to do so for shorter terms or seek a reduced subscription fee. Many of our subscription agreements provide for automatic one-year renewal periods. As a result, as more of our clients are in renewal periods, the weighted-average term of our subscription agreements may decrease. If our clients do not renew their subscriptions or renew for shorter terms or if we allow them to renew at reduced subscription fees, our revenue may decline and our business may be adversely affected.

Upon initial subscription, our clients receive a term license for the period of their membership to substantially all of the patent assets in our portfolio at the time of subscription. In addition, clients receive term licenses to substantially all of the patent assets we acquire during the period of their membership. Our subscription agreements also typically include a vesting provision that converts a client's term licenses into perpetual licenses on a delayed, rolling basis as long as the company remains a client. Accordingly, clients who continue to subscribe to our solution receive perpetual licenses to an increasing number of our patent assets over time. If we are unable to adequately show clients that we are continuing to obtain additional patent assets that are being or may be asserted against them, clients may choose not to renew their subscriptions once they have vested into a perpetual license to all patent assets they believe are materially relevant to their businesses.

Because we generally recognize revenue from membership subscriptions over the term of the membership, upturns or downturns in membership sales may not be immediately reflected in our operating results. As a result, our future operating results may be difficult to predict.

We generally recognize subscription fees received from clients ratably over the period of time to which those fees apply. Most of our clients are invoiced annually, and thus their fees are recognized as revenue over the course of 12 months. Consequently, a decline in new or renewed subscriptions in any one quarter will not be fully reflected in that quarter's revenue and will negatively affect our revenue in future quarters. In addition, we may be unable to adjust our cost structure quickly to reflect this reduced revenue. Accordingly, the effect of either significant downturns in membership sales or rapid market acceptance of our solution may not be fully reflected in our results of operations in

the period in which such events occur. Our membership subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any period, as subscription fees from new clients must generally be recognized over the applicable membership term.

Our subscription fees from clients may decrease due to factors outside of our control. Any reduction in subscription fees could harm our business and operating results.

Subscription fees are typically reset annually based on a client's reported revenue and operating income measured as of the end of its last fiscal year. If a client who is not already paying the minimum due under our fee schedule experiences reduced operating results, its subscription fee for the next year will decline. As a result, our revenue stream may be affected by conditions outside of our control that impact the operating results of our clients.

Our fee schedules generally provide that our subscription fee as a percentage of the client's operating income decreases as their operating income goes up. In addition, many of our clients' fee schedules are subject to an annual cap. As a result, if one of our clients

## Table of Contents

acquires another client, our future revenue could be reduced as a result of the application of our fee schedule to the combined entity rather than to each entity separately. Any reduction in subscription fees could harm our business and operating results.

We have very limited flexibility to change the pricing of our solution for existing clients and may not be able to respond effectively to changes in our market. This limited flexibility could have an adverse effect on our operating results.

Under many of our existing subscription agreements, our annual subscription fee is based on a published fee schedule applicable to all of our clients that commence their membership while that fee schedule is in effect. Clients under such agreements are able to renew their memberships perpetually under the fee schedule in effect at the time that they became members with periodic adjustments by us only based on changes in the Consumer Price Index. This means that any increases to our fee schedule generally apply only to clients that join after such increase. Accordingly, we have limited ability to change the economics of our business model with respect to existing clients in response to changes in the market in which we operate. This limited flexibility could have an adverse effect on our operating results. For example, if we increase our operating expenses as a result of changes in our market, we would have very limited ability to increase the subscription fees we charge to our existing clients to offset the increased operating expenses, and our operating results could be adversely affected.

If we are unable to successfully expand our membership base to include small and mid-size companies, we may not be able to maintain our growth and our business and results of operations may be harmed.

Many of our current clients are very large companies. The number of companies of that size is limited and, in order for us to continue our growth, we need to expand our membership base to include small and mid-size companies. There is no guarantee that we will be successful in those efforts. Small and mid-size companies often have more limited budgets available for solutions of the type we offer compared to large companies. Furthermore, small and mid-size companies are generally not subject to as much patent litigation as large companies and, therefore, may not perceive that the benefits of our solution justify its cost. They may also have concerns that we will focus our patent acquisition efforts on patent assets that are of more benefit to our larger clients who pay us higher subscription fees. If we are unable to successfully expand our membership base to include more small and mid-size companies, our growth may slow, and our business may be harmed.

We are investing management time and resources into developing products designed to provide insurance against NPE patent infringement claims. We have limited prior experience in designing or providing insurance products. If we are not successful in selling a significant amount of these insurance products, we will not realize the anticipated benefit of these investments, which could have an adverse effect on our growth prospects, and our business may be harmed. We are investing management time and financial resources in the development of products designed to provide insurance against some of the costs resulting from NPE patent claims. We are providing capital to develop and operate this business. We have limited prior experience in designing insurance products, operating an insurance business, attracting policyholders or establishing the pricing or terms of insurance policies and selling insurance policies in combination with membership subscriptions. We cannot assure you that our patent insurance products will appeal to a sufficient number of our existing clients or attract enough new clients to build a sustainable insurance business. If we are unsuccessful in managing this business, we may not realize the anticipated benefits of our investments of capital and management attention, which could have an adverse effect on our financial performance and growth prospects and our business may be harmed.

We rely on various actuarial models in pricing our insurance product and estimating the frequency and severity of related loss events, but actual results could differ materially from the model outputs. Incurring losses that exceed our predictions could adversely affect our financial condition and results of operations.

We employ various predictive modeling, stochastic modeling and/or actuarial techniques to analyze and estimate losses and the risks associated with insurance policies that we underwrite or reinsure. We use the modeled outputs and



related analyses to assist us in making underwriting, pricing and reinsurance decisions. The modeled outputs and related analyses are subject to numerous assumptions, uncertainties and the inherent limitations of any statistical analysis. Consequently, modeled results may differ materially from our actual experience. If, based upon these models or otherwise, we under price our products or underestimate the frequency and/or severity of loss events, our results of operations or financial condition may be adversely affected, which could have a material adverse effect on our results of operations. If, based upon these models or otherwise, we over price our products or overestimate the risks we are exposed to, new business growth and retention of our existing business may be adversely affected.

If we are unable either to identify patent assets that are being asserted or that could be asserted against existing and potential clients or to obtain such assets at prices that are economically supportable within our business model, we may not be able to attract or retain sufficient clients and our operating results would be harmed.

Our ability to attract new clients and renew the subscription agreements of existing clients depends on our ability to identify and acquire patent assets that are being asserted or that could be asserted against our existing or potential clients. There is no guarantee that we will be able to adequately identify those types of patent assets on an ongoing basis and, even if identified, that we will be able to acquire rights to those patent assets on terms that are favorable to us, or at all. As new technological advances occur, some or all of the

## Table of Contents

patent assets we have acquired may become less valuable or obsolete before we have had the opportunity to obtain significant value from those assets.

Our approach to acquiring patent assets generally involves acquiring ownership or a license at a fixed price. Other companies, such as NPEs, often offer contingent payments to sellers of patents that may provide the seller the opportunity to receive greater amounts in the future for the sale of its patents as compared to the fixed price we generally pay. As a result, we may not be able to compete effectively for the acquisition of certain patent assets.

If clients do not perceive that the patent assets we acquire are relevant to their businesses, we will have difficulty attracting new clients and retaining existing clients, and our operating results will be harmed. Similarly, if clients are not satisfied with the amount of capital we deploy to acquire patent assets, they may choose not to renew their subscriptions. These risks are greater if we elect to invest a significant amount of our capital in only a few acquisitions of patent assets.

We may not be able to compete effectively against others to attract new clients or acquire patent assets. Any failure to compete effectively could harm our business and results of operations.

In our efforts to attract new clients and retain existing clients, we compete primarily against established patent risk management strategies employed by those companies. Companies can choose from a variety of other strategies to attempt to manage their patent risk, including internal buying or licensing programs, cross-licensing arrangements, patent-buying consortiums or other patent-buying pools and engaging legal counsel to defend against patent assertions. As a result, we spend considerable resources educating our existing and prospective clients on the potential benefits of our solution and the value and cost savings it may provide.

In addition to competing for new clients, we also compete to acquire patent assets. Our primary competitors in the market for patent assets are varied and include other entities that seek to accumulate patent assets, including NPEs such as Acacia Research, Intellectual Ventures and IP Navigation. Many of our current or potential competitors have longer operating histories and significantly greater financial resources than we have. In addition, many NPEs that compete with us to acquire patent assets have complicated corporate structures that include a large number of subsidiaries, so it is difficult for us to know who the ultimate parent entity is and how much capital the related entities have available to acquire patent assets. We also face competition for patent assets from operating companies, including operating companies that are current or prospective clients. Many of these operating companies have significantly greater financial resources than we have and can acquire patent assets at prices that we may not be able to pay.

We expect to face more direct competition in the future from other established and emerging companies. In addition, as a relatively new company in the patent risk management market, we have limited insight into trends that may develop and affect our business. As a result, we may make errors in predicting and reacting to relevant business trends, making us unable to compete effectively against others.

Our current or potential competitors vary widely in size and in the scope and breadth of the products and services they offer. Many of our competitors have substantially greater financial resources and a larger client base and sales and marketing teams. The competition we face now and in the future could result in increased pricing pressure, reduced margins, increased sales and marketing expenses and a failure to increase, or the loss of, market share. We may not be able to maintain or improve our competitive position against our current or future competitors, and our failure to do so could seriously harm our business.

Certain of our acquisitions of patent assets are time consuming, complex and costly, which could adversely affect our operating results.

Certain of our acquisitions of patent assets are time consuming, complex and costly to consummate. We utilize many different transaction structures in our acquisitions and the terms of the acquisition agreements tend to be very heavily negotiated. As a result, we may incur significant operating expenses during the negotiations even where the acquisition is ultimately not consummated. Even if we successfully acquire particular patent assets, there is no guarantee that we will generate sufficient revenue related to those patent assets to offset the acquisition costs. While we conduct confirmatory due diligence on the patent assets we are considering for acquisition, we may acquire patent assets from a seller who does not have proper title to those assets. In those cases, we may be required to spend significant resources to defend our interests in the patent assets and, if we are not successful, our acquisition may be invalid, in which case we could lose part or all of our investment in the assets.

We occasionally identify patent assets that cost more than we are prepared to spend of our own capital resources or that may be relevant only to a very small number of clients. In these circumstances, we may structure and coordinate a transaction in which certain of our clients contribute funds that are in addition to their subscription fees in order to acquire those patent assets. These syndicated acquisitions are complex and can be large and high profile. We may incur significant costs to organize and negotiate a syndicated acquisition that does not ultimately result in an acquisition of any patent assets. These higher costs could adversely affect our operating results. Our roles in structuring the acquisition and managing the acquisition entity, if one is used, may expose us to financial and reputational risks.

Table of Contents

New legislation, regulations or court rulings related to enforcing patents could reduce the value of our solution to clients or potential clients and harm our business and operating results.

If Congress, the U.S. Patent and Trademark Office or courts implement additional legislation, regulations or rulings that impact the patent enforcement process or the rights of patent holders, these changes could negatively affect the operating results and business model for NPEs. This, in turn, could reduce the value of our solution to our current and potential clients. For example, limitations on the ability to bring patent enforcement claims, limitations on potential liability for patent infringement, lower evidentiary standards and new procedures for invalidating patents, increased difficulty for parties making patent assertions to obtain injunctions, reductions in the cost to resolve patent disputes and other similar developments could negatively affect an NPE's ability to assert its patent rights successfully, decrease the revenue associated with asserting or licensing an NPE's patent rights and increase the cost or risk of bringing patent enforcement actions. As a result, assertions and the threat of assertions by NPEs may decrease. If this occurs, companies may seek to resolve patent claims on an individual basis and be less willing to subscribe to our solution or renew their memberships. Furthermore, even if companies are interested in subscribing to our solution or maintaining their memberships, companies may be unwilling to pay the subscription fees that we propose. Any of these events could result in a material adverse effect on our business and operating results.

Our business model is new and complex, requiring estimates and judgments by our management. Our estimates and judgments are subject to changes that could adversely affect our operating results.

Our patent risk management business model is new and therefore our accounting and tax treatment has limited precedent. The determination of patent asset amortization expense for financial and income tax reporting requires estimates and judgments on the part of management. Some of our patent asset acquisitions are complex, requiring additional estimates and judgments on the part of our management. From time to time, we evaluate our estimates and judgments; however, such estimates and judgments are, by their nature, subject to risks, uncertainties and assumptions, and factors may arise that lead us to change our estimates or judgments. If this or any other changes occur, our operating results may be adversely affected. Furthermore, if the accounting or tax treatment is challenged, we may be required to spend considerable time and expense defending our position and we may be unable to successfully defend our accounting or tax treatment, any of which could adversely affect our business and operating results.

We plan to continue to increase our operating expenses to support and expand our operations, and those increased expenses may negatively impact our profitability.

We expect to increase future expenditures to develop and expand our business, including making substantial expenditures to develop new solutions. To further one of those new solutions, in August 2012 we formed a risk retention group which issues insurance policies to cover the costs of NPE patent claims, and in March 2014 we formed a reinsurance company to bear some underwriting risk on insurance policies that the Company issues on behalf of a Lloyd's of London underwriting syndicate. We began placing new policies under the reinsurance model in May 2014. Developing and offering these new solutions may cause us to incur substantial additional operating expenses. Our efforts to develop this and other new solutions will result in an increase in our operating expenses with no assurance that such solutions will result in additional revenue that is sufficient to offset the additional expenses we incur.

We also plan to incur additional operating expenses as we hire new personnel. Because we intend to continue to hire, we expect our operating expenses to increase. If we are not successful in generating additional revenue that is sufficient to offset these operating expense increases, our operating results may be harmed.

Following the launch of insurance products for NPE patent infringement claims, we now face the risks associated with operating an insurance business. If we fail to manage these risks, our results of operations and financial condition may be adversely affected.

In August 2012, we began to offer insurance products for NPE patent claims, and therefore face new risks associated with the operation of an insurance business. We have no prior experience in operating an insurance business, which includes assuming underwriting and reinsurance risk and setting premiums. There are many estimates and forecasts involved in predicting underwriting and reinsurance risk and setting premiums, many of which are subject to substantial uncertainty and which could cause our expenses and earnings to vary significantly from quarter to quarter. If we do not estimate our underwriting and reinsurance risks and set our premiums successfully, we may incur larger losses on our policies than we expect, which could have an adverse effect on our results of operations and financial condition. Under accounting principles generally accepted in the United States of America, while premiums earned from our insurance policies are recognized ratably, losses are recognized as incurred. This will increase the variability of our operating results until such time as our insurance business operates at scale. Furthermore, the insurance market is highly regulated, so operation of an insurance business will expose us to additional laws and regulations. Compliance with such laws and regulations may be costly, which could affect our results of operations.

## Table of Contents

If we are unable to enhance our current solution or to develop or acquire new solutions to provide additional value to our clients and potential clients, we may not be able to maintain our growth, and our business may be harmed. In order to attract new clients and retain existing clients, we need to enhance and improve our existing solution and introduce new solutions that meet the needs of our clients. We have in the past, and may in the future, seek to acquire or invest in businesses, products or technologies that we believe could complement or expand our service offerings, enhance our technical capabilities or otherwise offer growth opportunities. For example, we recently acquired DCML Services Corporation, a provider of data, intelligence and consulting on NPEs.

The development and implementation of new solutions will continue to require substantial time and resources, as well as require us to operate businesses that would be new to our organization. These or any other new solutions may not be introduced in a timely manner or at all. If we do introduce these or any other solutions, we may be unable to implement such solutions in a cost-effective manner, achieve wide market acceptance, meet client expectations or generate revenue sufficient to recoup the cost of developing such solutions. Any new solutions we introduce may expose us to additional laws, regulations and risks. If we are unable to develop these or other solutions successfully and enhance our existing solution to meet client requirements or expectations, we may not be able to attract or retain clients, and our business may be harmed.

If we are not perceived as a trusted defensive patent aggregator, our ability to gain wide market acceptance will be harmed, and our operating results could be adversely affected.

Our reputation, which depends on earning and maintaining the trust of existing and potential clients, is critical to our business. Our reputation is vulnerable to many threats that can be difficult or impossible to control and costly or impossible to remediate. For our business to be successful, we must continue to educate potential clients about our role as a trusted intermediary in the patent market. If our reputation is harmed, we may have more difficulty attracting new clients and retaining existing clients, and our operating results could be adversely affected.

We may acquire other companies or technologies, which could divert our management's attention, result in additional dilution to our stockholders and otherwise disrupt our operations and harm our operating results.

We have in the past and may in the future seek to acquire or invest in businesses, products or technologies that we believe could complement or expand our client offerings, enhance our technical capabilities or otherwise offer growth opportunities. The pursuit of potential acquisitions may divert the attention of management and cause us to incur various expenses in identifying, investigating and pursuing suitable acquisitions, whether or not they are consummated. We may not be able to integrate the acquired personnel, operations and technologies successfully or effectively manage the combined business following the completion of the acquisition.

We may not achieve the anticipated benefits from a business acquisition due to a number of factors, including:

- difficulties in integrating operations, technologies, services and personnel;
- unanticipated costs or liabilities associated with the acquisition;
- incurrence of acquisition-related costs;
- diversion of management's attention from other business concerns;
- potential loss of key employees;
- additional legal, financial and accounting challenges and complexities in areas such as tax planning, cash management and financial reporting;
- use of resources that are needed in other parts of our business; and
- use of substantial portions of our available cash to consummate the acquisition.

Future acquisitions could also result in dilutive issuances of equity securities or the incurrence of debt, which could adversely affect our operating results. In addition, if an acquired business fails to meet our expectations, our operating results, business and financial condition may suffer.

We may become involved in patent or other litigation proceedings related to our clients. Our involvement could cause us to expend significant resources. It could also require us to disclose information related to our clients, which could cause such clients not to renew their subscriptions with us.

The patent market is heavily impacted by litigation. As a result, we may be required, by subpoena or otherwise, to participate in patent or other litigation proceedings related to our clients. Our participation in any such proceedings could require us to expend significant resources and could also be perceived as adverse to the interests of our clients or potential clients if we are required to disclose any information about our clients that we have gathered in the course of their memberships. These additional expenditures and potential disclosures could make it more difficult for us to attract new clients and retain existing clients, and our results of operations could be harmed. We may incur significant costs in defending claims made against us and the result may not be favorable.

## Table of Contents

An unfavorable outcome of any claim could result in proliferation of similar claims against us. The expense and disclosure associated with our involvement in litigation could have an adverse effect on our business, prospects, financial condition, operating results and cash flows.

Interpretations of current laws and the passage of future laws could harm our business and operating results. Because of our limited operating history and our presence in an emerging industry, the application to us of existing United States and foreign laws is unclear. Many laws do not contemplate or address the specific issues associated with our patent risk management solution or other products and services we may provide in the future. It is possible that courts or other governmental authorities will interpret existing laws regulating risk management and insurance, competition and antitrust practices, taxation, the practice of law and patent usage and transfers in a manner that is inconsistent with our business practices. Our business, prospects, financial condition and results of operations may be harmed if our operations are found to be in violation of any existing laws or any other governmental regulations that may apply to us. Additionally, existing laws and regulations may restrict our ability to deliver services to our clients, limit our ability to grow and cause us to incur significant expenses in order to comply with such laws and regulations. Even if our business practices are ultimately not affected, we may incur significant cost to defend our actions, incur negative publicity and suffer substantial diversion of management time and effort. This could have a material adverse effect on our business, prospects, financial condition and results of operations.

Additionally, we face risks from laws that could be passed in the future. It is impossible to determine the extent of the impact of any new laws, regulations or initiatives that may be proposed, or whether any of the proposals will become law. Compliance with any new or existing laws or regulations could be difficult and expensive, affect the manner in which we conduct our business and negatively impact our business, prospects, financial condition and results of operations.

We receive a significant amount of our revenues from a limited number of clients, and if we are not able to obtain membership renewals from these clients, our revenue may decrease substantially.

We receive a significant amount of our revenue from a limited number of clients. For example, during the six months ended June 30, 2014, our 10 highest revenue-generating clients accounted for approximately 27% of our total revenue. We expect that a significant portion of our revenue will continue to come from a relatively small number of clients for the foreseeable future. If any of these clients chooses not to renew its membership, or if our subscription fees from one of these clients decline, our revenue may correspondingly decrease and our operating results may be adversely affected.

Any failure to maintain or protect our patent assets or other intellectual property rights could impair our ability to attract or retain clients and maintain our brand and could harm our business and operating results.

Our business is dependent on our ability to acquire patent assets that are valuable to our existing and potential clients. Following the acquisition of patent assets, we expend significant time and resources to maintain the effectiveness of those assets by paying maintenance fees and making filings with the United States Patent and Trademark Office. In some cases, the patent assets we acquire include patent applications which require us to invest resources to prosecute the applications with the United States Patent and Trademark Office. If we fail to maintain or prosecute our patent assets properly, the value of those assets to our clients would be reduced or eliminated, and our business would be harmed.

If we fail to develop widespread brand awareness cost-effectively, we may not attract new clients and our business and operating results may suffer.

We believe that developing and maintaining widespread awareness of our brand in a cost-effective manner is critical to achieving widespread acceptance of our solution and is an important element in attracting new clients. Furthermore, we believe that the importance of brand recognition will increase as competition in our market develops. Brand promotion activities may not generate client awareness or yield increased revenue, and even if they do, any increased



revenue may not offset the expenses we incurred in building our brand. If we fail to promote and maintain our brand successfully, or if we incur substantial expenses in an unsuccessful attempt to promote and maintain our brand, we may fail to attract or retain clients to the extent necessary to realize a sufficient return on our brand-building efforts.

We are dependent on our management team, and the loss of any key member of this team may prevent us from implementing our business plan, which could harm our future growth and operating results.

Our success depends largely upon the continued services of our executive officers and other key personnel. We do not have employment agreements with any of our executive officers or other key management personnel that require them to remain our employees. Therefore, they could terminate their employment with us at any time without penalty. We do not maintain key person life insurance policies on any of our employees. The loss of one or more of our key employees could seriously harm our business.

## Table of Contents

Our inability to identify, attract, train, integrate and retain highly qualified employees would harm our business. Our future success depends on our ability to identify, attract, train, integrate and retain highly qualified technical, sales and marketing, managerial and administrative personnel. In particular, our ability to increase our revenue is dependent on our ability to hire personnel who can identify and acquire valuable patent assets and attract new clients. Competition for highly skilled sales, business development and technical individuals is intense, and we continue to face difficulty identifying and hiring qualified personnel in some areas of our business. We may not be able to hire and retain such personnel at compensation levels consistent with our existing compensation and salary structure. Many of the companies with which we compete for hiring experienced employees have greater resources than we have. If we fail to identify, attract, train, integrate and retain highly qualified and motivated personnel, our reputation could suffer, and our business, financial condition and results of operations could be adversely affected.

If we fail to maintain proper and effective internal controls, our ability to produce accurate financial statements could be impaired, which could adversely affect our operating results, our ability to operate our business and investors' views of us.

Ensuring that we have internal financial and accounting controls and procedures adequate to produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. We have in the past discovered, and may in the future discover, areas of our internal financial and accounting controls and procedures that need improvement. The Sarbanes-Oxley Act of 2002 requires, among other things, that we maintain effective internal control over financial reporting and disclosure controls and procedures. In particular, we must perform system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002. Our compliance with Section 404 requires that we incur substantial accounting expense and expend significant management time on compliance-related issues. While neither we nor our independent registered public accounting firm have identified deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, there can be no assurance that material weaknesses will not subsequently be identified.

Weak global economic conditions may adversely affect demand for our solution or fees payable under our subscription agreements, which could adversely affect our financial condition and operating results. Our operations and performance depend significantly on worldwide economic conditions, and the United States and world economies have recently experienced weak economic conditions. Uncertainty about global economic conditions poses a risk as businesses may postpone spending in response to tighter credit, negative financial news and declines in income or asset values. This response could have a material negative effect on the demand for our solution. Furthermore, if our clients experience reduced operating income or revenues as a result of economic conditions or otherwise, it would reduce their subscription fees because those fees are generally reset annually based on the clients' operating income or revenue. If the subscription fees payable under our subscription agreements are reduced substantially, it would have an adverse effect on our business and results of operations.

As a public company, we incur significant increased costs that may adversely affect our operating results and financial condition.

As a public company, we incur significant accounting, legal and other expenses that we did not incur as a private company, including costs associated with our public company reporting requirements. We have also incurred, and anticipate that we will continue to incur, costs associated with corporate governance requirements, including requirements under the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Wall Street Reform and Consumer Protection Act, as well as rules implemented by the SEC and the NASDAQ Stock Market. Furthermore, these laws and regulations could make it more difficult or more costly for us to obtain certain types of insurance, including director and officer liability insurance, and we may be forced to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. The impact of these requirements could also make it more difficult for us to attract and retain qualified persons to serve on our Board of Directors, on our board

committees or as executive officers.

We are investing resources to comply with evolving laws and regulations, and this investment may result in increased general and administrative expenses and a diversion of management's time and attention from revenue-generating activities to compliance activities. Such increased expenses, the difficulty of attracting and retaining qualified officers and directors, and the diversion of management's attention could adversely affect our operating results and financial condition.

We might require additional capital to support our business growth and future patent asset acquisitions, and this capital might not be available on acceptable terms, or at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly limited.

We intend to continue to make investments to support our business growth and may require additional funds to respond to business challenges, including the need to acquire patent assets, develop new solutions or enhance our existing solution, enhance our operating infrastructure and acquire complementary businesses and technologies. Accordingly, we may need to engage in equity or debt financings or enter into credit agreements to secure additional funds. If we raise additional funds through further issuances of

## Table of Contents

equity or convertible debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock. Any debt financing secured by us in the future could involve restrictive covenants relating to our capital-raising activities and other financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. In addition, we may not be able to obtain additional financing on terms favorable to us, or at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly limited, which could have an adverse effect on our business and financial condition.

Our results of operations could vary as a result of the methods, estimates and judgments we use in applying our accounting policies.

The methods, estimates and judgments we use in applying our accounting policies have a significant impact on our results of operations, including the reported amounts of assets, liabilities, revenue and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, patent assets, other investments, income taxes, litigation and other intangibles, and other contingencies. Such methods, estimates and judgments are, by their nature, subject to substantial risks, uncertainties and assumptions, and factors may arise over time that lead us to change our methods, estimates and judgments. In addition, actual results may differ from these estimates under different assumptions or conditions. Changes in those methods, estimates and judgments could significantly affect our results of operations.

We may not be able to continue offering an “A” rated NPE insurance product.

In May 2014, we began offering an “A” rated NPE insurance product. If we are unable to maintain our relationship with one or more “A” rated insurance companies, we may be unable to continue offering an “A” rated NPE insurance product, which could have an adverse effect on new insurance business growth and retention of our existing insurance business.

Reinsurance coverage may not be available to us in the future at commercially reasonable rates or at all.

As of June 30, 2014, we had secured quota share reinsurance for 50% of the risk underwritten through our NPE insurance product offering. The availability and cost of reinsurance are subject to prevailing market conditions that are beyond our control. No assurances can be made that reinsurance will remain continuously available to us in amounts that we consider sufficient and at rates that we consider acceptable, which would cause us to increase the amount of risk we retain, reduce the amount of business we underwrite or look for alternatives to reinsurance. This, in turn, could have a material adverse effect on our financial condition or results of operations.

Our operations are subject to risks of natural disasters, acts of war, terrorism or widespread illness at our domestic and international locations, any one of which could result in a business stoppage and negatively affect our operating results.

Our business operations depend on our ability to maintain and protect our facility, computer systems and personnel, which are primarily located in the San Francisco Bay Area. The San Francisco Bay Area is in close proximity to known earthquake fault zones. Our facility and transportation for our employees are susceptible to damage from earthquakes and other natural disasters such as fires, floods and similar events. Should earthquakes or other catastrophes such as fires, floods, power outages, communication failures or similar events disable our facilities, we do not have readily available alternative facilities from which we could conduct our business, which stoppage could have a negative effect on our operating results. Acts of terrorism, widespread illness and war could also have a negative effect at our international and domestic facilities and on our operating results.

## Risks Related to Ownership of Our Common Stock

The trading price of our common stock has been volatile and is likely to be volatile in the future, and you might not be able to sell your shares at or above the price at which you purchased them.

Since our initial public offering in May 2011, our stock price has traded as high as \$31.41 per share and as low as \$8.55 per share. Further, our common stock has a limited trading history and an active trading market for our common stock may not be sustained in the future. The market price of our common stock could be subject to wide fluctuations in response to various factors, some of which are beyond our control. These factors include those discussed in this “Risk Factors” section of this Quarterly Report on Form 10-Q and others such as:

- variations in our financial condition and operating results;
- the financial projections we may provide to the public, any changes in these projections or our failure to meet these projections;
- changes in the estimates of our operating results or changes in recommendations by any securities analysts that elect to follow our common stock;
- addition or loss of significant clients;

## Table of Contents

• adoption or modification of laws, regulations, policies, procedures or programs applicable to our business, including those related to the enforcement of patent claims;

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

• recruitment or departure of members of our Board of Directors, management team or other key personnel;

• market conditions in our industry and the economy as a whole;

• price and volume fluctuations in the overall stock market or resulting from inconsistent trading volume levels of our shares;

• lawsuits threatened or filed against us;

• sales of our common stock by us or our stockholders; and

• the opening or closing of our employee trading window.

In recent years, the stock market has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the changes in the operating performance of the companies whose stock is experiencing those price and volume fluctuations. Broad market and industry factors may seriously affect the market price of our common stock, regardless of our actual operating performance.

If securities analysts do not continue to publish research or publish unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities analysts publish about us or our business. A limited number of securities analysts currently publish research reports on us. If one or more of the analysts who covers us downgrades our stock or publishes unfavorable research about our business, our stock price would likely decline. If one or more of these analysts ceases coverage of our company or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price and trading volume to decline.

Substantial future sales of shares by existing stockholders, or the perception that such sales may occur, could cause our stock price to decline, even if our business is doing well.

If our existing stockholders, particularly our directors and executive officers, sell substantial amounts of our common stock in the public market, or are perceived by the public market as intending to sell substantial amounts of our common stock, the trading price of our common stock could decline.

As of June 30, 2014, some of our existing stockholders have demand and piggyback rights to require us to register with the SEC approximately 1,850,000 shares of our common stock. If we register these shares of common stock, the stockholders would be able to sell those shares freely in the public market.

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

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

As a public company, our stock price has been volatile, and securities class action litigation has often been instituted against companies following periods of volatility of their stock price. Any such litigation, if instituted against us, could result in substantial costs and a diversion of our management's attention and resources.

In the past, following periods of volatility in the overall market and the market price of particular companies' securities, securities class action litigation has been instituted against these companies. Our stock has been volatile and may continue to be volatile. If instituted against us, securities litigation could result in substantial costs and a diversion

of our management's attention and resources, which could adversely affect our operating results, financial condition and stock price.

Table of Contents

Anti-takeover provisions in our charter documents and Delaware law could discourage, delay or prevent a change in control of our company and may affect the trading price of our common stock.

We are a Delaware corporation and the anti-takeover provisions of the Delaware General Corporation Law may discourage, delay or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a period of three years after the person becomes an interested stockholder, even if a change in control would be beneficial to our existing stockholders. In addition, our amended and restated certificate of incorporation and amended and restated bylaws may discourage, delay or prevent a change in our management or control over us that stockholders may consider favorable. Our amended and restated certificate of incorporation and amended and restated bylaws:

- authorize the issuance of “blank check” preferred stock that could be issued by our Board of Directors to thwart a takeover attempt;
- establish a classified Board of Directors, as a result of which the successors to the directors whose terms have expired will be elected to serve from the time of election and qualification until the third annual meeting following their election;
- require that directors only be removed from office for cause and only upon a majority stockholder vote;
- provide that vacancies on our Board of Directors, including newly created directorships, may be filled only by a majority vote of directors then in office;
- limit who may call special meetings of stockholders;
- prohibit stockholder action by written consent, requiring all actions to be taken at a meeting of the stockholders;
- do not provide stockholders with the ability to cumulate their votes;
- require supermajority stockholder voting to effect certain amendments to our amended and restated certificate of incorporation and amended and restated bylaws; and
- require advance notification of stockholder nominations and proposals.

We do not currently intend to pay dividends on our common stock in the foreseeable future, and consequently, your ability to achieve a return on your investment will depend on appreciation in the price of our common stock.

We have never declared or paid cash dividends on our common stock and do not anticipate paying any cash dividends to holders of our common stock in the foreseeable future. Consequently, investors must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investments. There is no guarantee that shares of our common stock will appreciate in value or even maintain the price at which our stockholders have purchased their shares.



Table of Contents

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

Not applicable.

Item 3. Defaults Upon Senior Securities.

Not applicable.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

Not applicable.

Item 6. Exhibits.

Exhibit Number	Exhibit Title	Incorporated by Reference			Filing Date	Provided Herewith
		Form	File No.	Exhibit No.		
3.1	Amended and Restated Certificate of Incorporation of RPX Corporation	S-1	333-171817	3.2	1/21/2011	
3.2	Amended and Restated Bylaws of RPX Corporation	S-1/A	333-171817	3.4	4/18/2011	
10.3	Amended and Restated RPX Corporation Compensation Program for Non-Employee Directors					X
31.1	Certification of Chief Executive Officer Pursuant to Rule 13-14(a) or 15(d)-14(a) of the Securities Exchange Act of 1934 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
31.2	Certification of Chief Financial Officer Pursuant to Rule 13-14(a) or 15(d)-14(a) of the Securities Exchange Act of 1934 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
101.INS+	XBRL Instance Document					X
101.SCH+	XBRL Taxonomy Extension Schema Document					X

101.CAL+	XBRL Taxonomy Extension Calculation Linkbase Document	X
101.DEF+	XBRL Taxonomy Extension Definition Linkbase Document	X
101.LAB+	XBRL Taxonomy Extension Label Linkbase Document	X
101.PRE+	XBRL Taxonomy Extension Presentation Linkbase Document	X

Table of Contents

SIGNATURES

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

RPX CORPORATION  
(Registrant)

Date: August 6, 2014

By: /s/ JOHN A. AMSTER  
John A. Amster  
Chief Executive Officer  
(Principal Executive Officer)

Date: August 6, 2014

By: /s/ NED D. SEGAL  
Ned D. Segal  
Senior Vice President and Chief Financial  
Officer  
(Principal Financial Officer)