

DIGITAL RIVER INC /DE

Form 10-K/A

March 09, 2009

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-K/A**

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the fiscal year ended December 31, 2008**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**Commission File Number: 000-24643**

**DIGITAL RIVER, INC.**  
*(Exact name of registrant as specified in its charter)*

**DELAWARE**  
*(State or other jurisdiction of  
Incorporation or organization)*

**41-1901640**  
*(I.R.S. Employer  
Identification No.)*

**9625 WEST 76TH STREET  
EDEN PRAIRIE, MINNESOTA 55344**  
*(Address of principal executive offices)*

**(952) 253-1234**  
*(Registrant's telephone number, including area code)*

**Securities registered pursuant to Section 12(b) of the Act:**  
**Name of each Exchange on which registered:**  
**Common Stock \$0.01 par value Nasdaq Global Select Market**

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

Indicate by checkmark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. Yes  No

Indicated by checkmark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

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

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

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

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

As of June 30, 2008, there were 36,959,613 shares of Digital River, Inc. common stock, issued and outstanding. As of such date, based on the closing sales price as quoted by The Nasdaq Global Select Market, 36,352,219 shares of common stock, having an aggregate market value of approximately \$1,402,469,000 were held by non-affiliates. For purposes of the above statement only, all directors and executive officers of the registrant are assumed to be affiliates.

The number of shares of common stock outstanding at February 2, 2009 was 37,034,913 shares.

**DOCUMENTS INCORPORATED BY REFERENCE**

Certain sections of the Registrant's definitive Proxy Statement for the 2009 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K to the extent stated herein.

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**EXPLANATORY NOTE**

This Amendment No. 1 on Form 10-K/A amends the Company's Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Securities and Exchange Commission on February 19, 2009. We are amending Item 15 solely to correct a clerical error in the Consolidated Statement of Cash Flows.

In addition, as required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended, new certifications by our principal executive officer and principal financial officer are filed as exhibits to this Form 10-K/A under Item 15 of Part IV hereof.

This Amendment No. 1 does not reflect events occurring after the original filing date of the 2008 10-K or otherwise modify or update the disclosures set forth in the 2008 10-K, including the financial statements and notes to financial statements set forth in the 2008 10-K.

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**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a) The following documents are filed as part of this report:

(1) *Financial Statements.*

The consolidated financial statements required by this item are submitted in a separate section beginning on page 6 of this report.

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(2) *Financial Statement Schedules.*

All schedules for which provision is made in the applicable accounting regulations of the SEC have been omitted as not required or not applicable, or the information required has been included elsewhere by reference in the financial statements and related notes, except for Schedule II, which is included with this Form 10-K, as filed with the SEC.

(3) *Exhibits.*

| <b>Exhibit Number</b> | <b>Description of Document</b>   |
|-----------------------|--|
| 3.1(2)                | Amended and Restated Certificate of Incorporation of the Registrant, as currently in effect.   |
| 3.2(4)                | Amended and Restated Bylaws of the Registrant, as currently in effect.   |
| 4.1(5)                | Specimen Stock Certificate.  |
| 4.2(9)                | Indenture dated as of June 1, 2004, between Digital River, Inc. and Wells Fargo Bank, N.A. as trustee, including therein the form of the Note.   |
| 10.1(5)               | Form of Indemnity Agreement between Registrant and each of its directors and executive officers.   |
| 10.3(5)               | Consent to Assignment and Assumption of Lease dated April 22, 1998, by and between CSM Investors, Inc., IntraNet Integration Group, Inc. and Registrant.                                   |
| 10.4(3)               | Assignment of Lease dated April 21, 1998, by and between Intranet Integration Group, Inc. and Registrant.  |
| 10.5(3)               | Lease Agreement dated January 18, 2000, between Property Reserve, Inc. and Registrant.   |
| 10.6(4)               | First Amendment of Lease dated January 31, 2001, to that certain Lease dated April 24, 1996, between CSM Investors, Inc. and Registrant (as assignee of Intranet Integration Group, Inc.). |
| 10.7(6)               | 1998 Stock Option Plan, as amended and superseded by Exhibit 10.18.*   |
| 10.8(7)               |  |

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1999 Stock Option Plan, formerly known as the 1999 Non-Officer Stock Option Plan, as amended and superseded by Exhibit 10.18.\*

- 10.9(6) 2000 Employee Stock Purchase Plan, as amended, and offering.\*
- 10.11(8) Second Amendment of Lease dated April 22, 2002, to that certain Lease dated April 24, 1996, between CSM Investors, Inc. and Registrant (as assignee of Intranet Integration Group, Inc.) as amended.
- 10.12(8) Second Amendment of Lease dated April 28, 2003, to that certain Lease dated January 18, 2000, between Property Reserve Inc. and Registrant.
- 10.15(9) Registration Rights Agreement dated as of June 1, 2004, between Digital River, Inc. and the initial purchasers of Senior Convertible Notes due January 1, 2024.

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| <b>Exhibit<br/>Number</b> | <b>Description of Document</b>  |
|---------------------------|---|
| 10.16(13)                 | Summary of Compensation Program for Non-Employee Directors.   |
| 10.17(14)                 | Second Amended and Restated Symantec Online Store Agreement, by and among Symantec Corporation, Symantec Limited, Digital River, Inc. and Digital River Ireland Limited effective April 1, 2006 |
| 10.18(10)                 | 1998 Equity Incentive Plan (formerly known as 1998 Stock Option Plan).*   |
| 10.19(13)                 | Amended and Restated Employment Agreement for Joel A. Ronning.*   |
| 10.20(13)                 | Change of Control and Severance Agreement for Thomas M. Donnelly.*  |
| 10.21(11)                 | Form of Amendment to Non-Qualified Stock Option Agreement.*   |
| 10.22(12)                 | Inducement Equity Incentive Plan.*  |
| 10.23(15)                 | 2007 Equity Incentive Plan.*  |
| 10.24(13)                 | Change of Control and Severance Agreement for Kevin L. Crudden.*  |
| 12.1(16)                  | Computation of Ratio of Earnings to Fixed Charges.  |
| 21.1(16)                  | Subsidiaries of Digital River, Inc.   |
| 23.1++                    | Consent of Independent Registered Public Accounting Firm, dated February 19, 2009.  |
| 24.1(16)                  | Power of Attorney, pursuant to which amendments to this Annual Report on Form 10-K may be filed, is included on the signature pages of this Annual Report on Form 10-K.                         |
| 31.1++                    | Certification of Digital River, Inc. s Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2++                    | Certification of Digital River, Inc. s Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32++                      | Certification of Digital River, Inc. s Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |

++ Filed herewith.

\* Management contract or compensatory plan.

Confidential treatment has been requested for portions of this agreement, which portions have been filed separately with the SEC.

- (1) Incorporated by reference from the Company s Current Report on Form 8-K filed on May 4, 2004.
- (2) Incorporated by reference from the Company s Current Report on Form 8-K filed on June 1, 2006.
- (3) Incorporated by reference from the Company s Annual Report on Form 10-K for the year ended December 31, 1999, filed on March 30, 2000.
- (4) Incorporated by reference from the Company s Annual Report on Form 10-K for the year ended December 31, 2000, filed on March 27, 2001.
- (5) Incorporated by reference from the Company s Registration Statement on Form S-1 (File No. 333-56787), declared effective on August 11, 1998.
- (6)



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Incorporated by reference from the Company's Registration Statement on Form S-8 (File No. 333-105864) filed on June 5, 2003.

- (7) Incorporated by reference from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003, filed on August 14, 2003.
- (8) Incorporated by reference from the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2003, filed on May 15, 2003.
- (9) Incorporated by reference from the Company's Current Report on Form 8-K filed on July 13, 2004.
- (10) Incorporated by reference from the Company's Current Report on Form 8-K filed on May 31, 2005.

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- (11) Incorporated by reference from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005, filed on August 9, 2005.
- (12) Incorporated by reference from the Company's Current Report on Form 8-K filed on December 20, 2005.
- (13) Incorporated by reference from the Company's Current Report on Form 8-K filed on March 10, 2008.
- (14) Incorporated by reference from the Company's Annual Report on Form 10-K for the year ended December 31, 2006, filed on March 1, 2007.
- (15) Incorporated by reference from the Company's Annual Report on Form 10-K for the year ended December 31, 2007, filed on February 29, 2008.
- (16) Incorporated by reference from the Company's Annual Report on Form 10-K for the year ended December 31, 2008, filed on February 19, 2009.

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders  
Digital River, Inc.

We have audited the accompanying consolidated balance sheets of Digital River, Inc. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. Our audits also included the financial statement schedule listed in Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Digital River, Inc. and subsidiaries at December 31, 2008 and 2007, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth herein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Digital River, Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 19, 2009 expressed an unqualified opinion thereon.

**/s/ Ernst & Young LLP**

Minneapolis, Minnesota  
February 19, 2009

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**DIGITAL RIVER, INC.**  
**Consolidated Balance Sheets**

|   | <b>December 31,<br/>2008</b> | <b>December 31,<br/>2007</b> |
|---|------------------------------|------------------------------|
|   | <b>(In thousands)</b>        |                              |
| <b>ASSETS</b>   |                              |                              |
| <b>CURRENT ASSETS:</b>  |                              |                              |
| Cash and cash equivalents   | \$ 490,335                   | \$ 381,788                   |
| Short-term investments  | 10,000                       | 315,636                      |
| Accounts receivable, net of allowance of \$2,457 and \$2,489                | 53,216                       | 64,914                       |
| Deferred income taxes   | 7,613                        | 7,899                        |
| Prepaid expenses and other  | 42,522                       | 4,577                        |
| <b>Total current assets</b>   | <b>603,686</b>               | <b>774,814</b>               |
| Property and equipment, net   | 41,733                       | 31,102                       |
| Goodwill  | 273,788                      | 261,885                      |
| Intangible assets, net of accumulated amortization of \$66,345 and \$59,493 | 32,222                       | 32,382                       |
| Long-term investments   | 93,213                       |                              |
| Deferred income taxes   | 24,824                       | 15,606                       |
| Other assets  | 786                          | 11,955                       |
| <b>TOTAL ASSETS</b>   | <b>\$ 1,070,252</b>          | <b>\$ 1,127,744</b>          |

**LIABILITIES AND STOCKHOLDERS EQUITY**

|                                      |                |                |
|--------------------------------------|----------------|----------------|
| <b>CURRENT LIABILITIES:</b>          |                |                |
| Convertible senior notes             | \$ 186,195     | \$             |
| Accounts payable                     | 184,361        | 180,386        |
| Accrued payroll                      | 14,841         | 12,704         |
| Deferred revenue                     | 13,651         | 10,384         |
| Accrued acquisition costs            | 3,278          | 399            |
| Other accrued liabilities            | 41,336         | 41,229         |
| <b>Total current liabilities</b>     | <b>443,662</b> | <b>245,102</b> |
| <b>NON-CURRENT LIABILITIES:</b>      |                |                |
| Convertible senior notes             | 8,805          | 195,000        |
| Other liabilities                    | 15,712         | 11,362         |
| <b>Total non-current liabilities</b> | <b>24,517</b>  | <b>206,362</b> |
| <b>TOTAL LIABILITIES</b>             | <b>468,179</b> | <b>451,464</b> |

**COMMITMENTS AND CONTINGENCIES**

STOCKHOLDERS EQUITY:

|   |              |              |
|---|--------------|--------------|
| Preferred Stock, \$.01 par value; 5,000,000 shares authorized; no shares issued or outstanding        |              |              |
| Common Stock, \$.01 par value; 120,000,000 shares authorized; 43,225,401 and 42,502,019 shares issued | 432          | 425          |
| Treasury stock at cost; 6,211,477 and 1,952,884 shares  | (216,163)    | (77,707)     |
| Additional paid-in capital  | 623,778      | 597,128      |
| Retained earnings   | 189,096      | 125,501      |
| Accumulated other comprehensive income  | 4,930        | 30,933       |
| Total stockholders equity   | 602,073      | 676,280      |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY   | \$ 1,070,252 | \$ 1,127,744 |

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

**Table of Contents****DIGITAL RIVER, INC.****Consolidated Statements of Income**

|   | <b>For the Years Ended December 31</b>      |             |             |
|---|---|-------------|-------------|
|   | <b>2008</b>                                 | <b>2007</b> | <b>2006</b> |
|   | <b>(In thousands except per share data)</b> |             |             |
| Revenue   | \$ 394,226                                  | \$ 349,275  | \$ 307,632  |
| Costs and expenses                              |   |             |             |
| Direct cost of services                         | 16,417                                      | 10,243      | 7,709       |
| Network and infrastructure                      | 41,040                                      | 32,309      | 29,250      |
| Sales and marketing                             | 150,118                                     | 134,401     | 113,462     |
| Product research and development                | 51,184                                      | 39,179      | 32,341      |
| General and administrative                      | 39,525                                      | 38,937      | 34,158      |
| Depreciation and amortization                   | 15,980                                      | 12,706      | 10,983      |
| Amortization of acquisition-related intangibles | 8,391                                       | 7,586       | 12,134      |
| Total costs and expenses                        | 322,655                                     | 275,361     | 240,037     |
| Income from operations                          | 71,571                                      | 73,914      | 67,595      |
| Interest Income                                 | 18,019                                      | 32,167      | 22,836      |
| Other expense, net                              | (3,319)                                     | (3,006)     | (949)       |
| Income before income tax expense                | 86,271                                      | 103,075     | 89,482      |
| Income tax expense                              | 22,676                                      | 32,261      | 28,672      |
| Net income                                      | \$ 63,595                                   | \$ 70,814   | \$ 60,810   |
| Net income per share basic                      | \$ 1.72                                     | \$ 1.75     | \$ 1.58     |
| Net income per share diluted                    | \$ 1.55                                     | \$ 1.58     | \$ 1.40     |
| Shares used in per-share calculation basic      | 37,016                                      | 40,444      | 38,593      |
| Shares used in per-share calculation diluted    | 42,106                                      | 45,914      | 44,642      |

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

**Table of Contents****DIGITAL RIVER, INC.****Consolidated Statements of Stockholders' Equity**

|                               | Common Stock |        | Treasury    | Additional | Deferred       | Accumulated   | Retained     | Total         |        |
|-------------------------------|--------------|--------|-------------|------------|----------------|---------------|--------------|---------------|--------|
|                               | Shares       | Amount | Stock       | Paid-In    | Compensation   | Comprehensive | Earnings     | Stockholders' | Compre |
|                               |              |        |             | Capital    | (In thousands) | (Loss)        | (Accumulated | Equity        | Income |
|                               |              |        |             |            |                |               | Deficit)     |               | (Lo    |
| NCE, December 31,             | 35,034       | \$ 355 | \$ (13,586) | \$ 329,327 | \$ (1,990)     | \$ (2,431)    | \$ (6,123)   | \$ 305,552    | \$ 54  |
| Income                        |              |        |             |            |                |               | 60,810       | 60,810        | 60     |
| Classification of deferred    |              |        |             |            |                |               |              |               |        |
| Contribution balance upon     |              |        |             |            |                |               |              |               |        |
| Adoption of SFAS 123(R)       |              |        |             | (1,990)    | 1,990          |               |              |               |        |
| Realized gain on              |              |        |             |            |                |               |              |               |        |
| Investments                   |              |        |             |            |                | 576           |              | 576           |        |
| Change in currency            |              |        |             |            |                |               |              |               |        |
| Translation gain              |              |        |             |            |                | 13,463        |              | 13,463        | 13     |
| Issuance of common stock      | 4,000        | 40     |             | 172,740    |                |               |              | 172,780       |        |
| Repurchased for               |              |        |             |            |                |               |              |               |        |
| Retirement                    | 28           |        | (12)        | 1,184      |                |               |              | 1,172         |        |
| Exercise of stock options     | 1,220        | 12     |             | 21,106     |                |               |              | 21,118        |        |
| Share-based compensation      | 113          | 1      |             | 13,903     |                |               |              | 13,904        |        |
| Shares withheld in restricted |              |        |             |            |                |               |              |               |        |
| Investing                     | (8)          |        | (426)       |            |                |               |              | (426)         |        |
| Benefit of stock-based        |              |        |             |            |                |               |              |               |        |
| Contribution                  |              |        |             | 12,700     |                |               |              | 12,700        |        |
| Issuance of common stock      |              |        |             |            |                |               |              |               |        |
| Under the Employee Stock      |              |        |             |            |                |               |              |               |        |
| Ownership Plan                | 71           | 1      |             | 2,110      |                |               |              | 2,111         |        |
| NCE, December 31,             | 40,458       | \$ 409 | \$ (14,024) | \$ 551,080 | \$             | \$ 11,608     | \$ 54,687    | \$ 603,760    | \$ 74  |
| Income                        |              |        |             |            |                |               | 70,814       | 70,814        | 70     |
| Realized gain on              |              |        |             |            |                |               |              |               |        |
| Investments                   |              |        |             |            |                | 1,006         |              | 1,006         | 1      |
| Change in currency            |              |        |             |            |                |               |              |               |        |
| Translation gain              |              |        |             |            |                | 18,319        |              | 18,319        | 18     |
| Repurchase of common          | (1,372)      |        | (62,968)    |            |                |               |              | (62,968)      |        |
| Repurchased for               |              |        |             |            |                |               |              |               |        |
| Retirement                    | 44           | 1      | (189)       | 2,337      |                |               |              | 2,149         |        |
| Exercise of stock options     | 1,220        | 12     |             | 13,498     |                |               |              | 13,510        |        |

|                        |         |        |              |            |    |           |            |            |       |
|------------------------|---------|--------|--------------|------------|----|-----------|------------|------------|-------|
| based compensation     |         |        |              | 13,742     |    |           |            | 13,742     |       |
| ected stock issued     |         |        |              |            |    |           |            |            |       |
| equity incentive       |         |        |              |            |    |           |            |            |       |
| net of forfeitures     | 135     | 2      |              | (2)        |    |           |            |            |       |
| withheld in restricted |         |        |              |            |    |           |            |            |       |
| vesting                | (11)    |        | (526)        |            |    |           |            | (526)      |       |
| enefit of stock-based  |         |        |              |            |    |           |            |            |       |
| nsation                |         |        |              | 13,990     |    |           |            | 13,990     |       |
| on stock issued        |         |        |              |            |    |           |            |            |       |
| the Employee Stock     |         |        |              |            |    |           |            |            |       |
| se Plan                | 76      | 1      |              | 2,483      |    |           |            | 2,484      |       |
|                        |         |        |              |            |    |           |            |            |       |
| NCE, December 31,      | 40,550  | \$ 425 | \$ (77,707)  | \$ 597,128 | \$ | \$ 30,933 | \$ 125,501 | \$ 676,280 | \$ 90 |
|                        |         |        |              |            |    |           |            |            |       |
| come                   |         |        |              |            |    |           | 63,595     | 63,595     | 63    |
| ized loss on           |         |        |              |            |    |           |            |            |       |
| ments                  |         |        |              |            |    | (10,822)  |            | (10,822)   | (10   |
| n currency             |         |        |              |            |    |           |            |            |       |
| tion loss              |         |        |              |            |    | (15,181)  |            | (15,181)   | (15   |
| hase of common         |         |        |              |            |    |           |            |            |       |
|                        | (4,239) |        | (137,858)    |            |    |           |            | (137,858)  |       |
| se of stock options    | 426     | 4      |              | 7,167      |    |           |            | 7,171      |       |
| based compensation     |         |        |              | 12,548     |    |           |            | 12,548     |       |
| ected stock issued     |         |        |              |            |    |           |            |            |       |
| equity incentive       |         |        |              |            |    |           |            |            |       |
| net of forfeitures     | 186     | 2      |              | (2)        |    |           |            |            |       |
| withheld in restricted |         |        |              |            |    |           |            |            |       |
| vesting                | (19)    |        | (598)        |            |    |           |            | (598)      |       |
| enefit of stock-based  |         |        |              |            |    |           |            |            |       |
| nsation                |         |        |              | 4,223      |    |           |            | 4,223      |       |
| on stock issued        |         |        |              |            |    |           |            |            |       |
| the Employee Stock     |         |        |              |            |    |           |            |            |       |
| se Plan                | 112     | 1      |              | 2,714      |    |           |            | 2,715      |       |
|                        |         |        |              |            |    |           |            |            |       |
| NCE, December 31,      | 37,016  | \$ 432 | \$ (216,163) | \$ 623,778 | \$ | \$ 4,930  | \$ 189,096 | \$ 602,073 | \$ 37 |

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



**Table of Contents****DIGITAL RIVER, INC.****Consolidated Statements of Cash Flows**

|   | <b>For the Years Ended December 31,</b> |             |             |
|---|---|-------------|-------------|
|   | <b>2008</b>                             | <b>2007</b> | <b>2006</b> |
|   | <b>(In thousands)</b>                   |             |             |
| <b>OPERATING ACTIVITIES:</b>  |   |             |             |
| Net income  | \$ 63,595                               | \$ 70,814   | \$ 60,810   |
| Adjustments to reconcile net income to net cash provided by operating activities: |   |             |             |
| Amortization of acquisition-related intangibles                                   | 8,391                                   | 7,586       | 12,134      |
| Change in accounts receivable allowance, net of acquisitions                      | 434                                     | (174)       | 1,215       |
| Depreciation and amortization   | 15,980                                  | 12,706      | 10,983      |
| Stock-based compensation expense related to stock-based compensation plans        | 12,548                                  | 13,742      | 13,904      |
| Excess tax benefits from stock-based compensation                                 | (4,390)                                 | (12,030)    | (8,980)     |
| Deferred income taxes and other   | 4,971                                   | 27,522      | 19,583      |
| Change in operating assets and liabilities (net of acquisitions):                 |   |             |             |
| Accounts receivable   | 11,332                                  | (6,863)     | (14,678)    |
| Prepaid and other assets  | (26,505)                                | 1,325       | (1,293)     |
| Accounts payable  | 6,531                                   | 32,181      | 3,701       |
| Deferred revenue  | 3,235                                   | 3,046       | 811         |
| Income tax payable  | (5,366)                                 | (7,076)     | 8,126       |
| Accrued payroll and other accrued liabilities                                     | 4,478                                   | 3,609       | 11,190      |
| Net cash provided by operating activities   | 95,234                                  | 146,388     | 117,506     |
| <b>INVESTING ACTIVITIES:</b>  |   |             |             |
| Purchases of investments  | (480,917)                               | (436,806)   | (193,609)   |
| Sales of investments  | 676,108                                 | 358,470     | 179,296     |
| Cash paid for acquisitions, net of cash received                                  | (23,465)                                | (31,625)    | (37,800)    |
| Purchases of equipment and capitalized software                                   | (26,898)                                | (18,722)    | (15,907)    |
| Net cash provided by/(used for) investing activities                              | 144,828                                 | (128,683)   | (68,020)    |
| <b>FINANCING ACTIVITIES:</b>  |   |             |             |
| Proceeds from sales of common stock   |   |             | 172,780     |
| Exercise of stock options   | 7,171                                   | 13,510      | 21,118      |
| Sales of common stock under employee stock purchase plan                          | 2,715                                   | 2,483       | 2,109       |
| Repurchase of common stock  | (137,858)                               | (62,968)    |             |
| Repurchase of restricted stock to satisfy tax withholding obligation              | (598)                                   | (528)       | (426)       |
| Excess tax benefits from stock-based compensation                                 | 4,390                                   | 12,030      | 8,980       |
| Net cash (used for)/provided by financing activities                              | (124,180)                               | (35,473)    | 204,561     |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH   | (7,335)                                 | 9,313       | 4,426       |

|  |            |            |            |
|--|------------|------------|------------|
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 108,547    | (8,455)    | 258,473    |
| CASH AND CASH EQUIVALENTS, beginning of year         | 381,788    | 390,243    | 131,770    |
| CASH AND CASH EQUIVALENTS, end of year               | \$ 490,335 | \$ 381,788 | \$ 390,243 |
| SUPPLEMENTAL DISCLOSURES:                            |            |            |            |
| Cash paid for interest on Convertible Senior Notes   | \$ 2,438   | \$ 2,438   | \$ 2,438   |
| Cash paid for income taxes                           | \$ 20,503  | \$ 8,232   | \$ 2,006   |
| Noncash investing and financing activities:          |            |            |            |
| Common stock issued in acquisitions and earn-outs    | \$         | \$ 2,150   | \$ 1,172   |

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

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**DIGITAL RIVER, INC.**

**Notes to Consolidated Financial Statements  
December 31, 2008 and 2007**

**1. Nature of Operations and Summary of Significant Accounting Policies**

We provide outsourced e-commerce solutions globally to a wide variety of companies primarily in the software, consumer electronics, computer game and video game markets. We were incorporated in 1994 and began building and operating online stores for our clients in 1996. We generate revenue primarily based on the sales of products made in those stores, and in addition, offer services designed to increase traffic to our clients' online stores and to improve the sales effectiveness of those stores.

***Principles of Consolidation and Classification***

The consolidated financial statements include the accounts of Digital River, Inc. and our wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

***Use of Estimates***

The preparation of financial statements in accordance with the United States generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

***Foreign Currency Translation***

Substantially all of our foreign subsidiaries use the local currency of their respective countries as their functional currency. Assets and liabilities are translated at exchange rates prevailing at the balance sheet dates. Revenues, costs and expenses are translated into U.S. dollars at average exchange rates for the period. Gains and losses resulting from translation are recorded as a component of equity. Gains and losses resulting from foreign currency transactions are recognized as other (expense), net.

We are exposed to market risk from changes in foreign currency exchange rates. Our primary risk is the effect of foreign currency exchange rate fluctuations on the U.S. dollar value of foreign currency denominated operating sales and expenses. At December 31, 2008, these exposures were mitigated through the use of foreign exchange forward contracts with maturities of approximately one week. The principal currency exposures being mitigated were the euro, British pound, Australian dollar, Swiss franc, Norwegian krone, Swedish krona and Canadian dollar. We also are exposed to foreign currency exchange risk as a result of changes in intercompany balance sheet accounts and other balance sheet items.

Our foreign currency forward contracts contain credit risk to the extent that our bank counterparties may be unable to meet the terms of the agreements. We minimize such risk by limiting our counterparties to major financial institutions of high credit quality.

***Cash and Cash Equivalents***

We consider all short-term, highly liquid investments, primarily high grade commercial paper and money market accounts, that are readily convertible into known amounts of cash and that have original or remaining maturities of

three months or less at the date of purchase to be cash equivalents. As of December 31, 2008 and 2007, cash balances of \$0.0 million and \$1.5 million, respectively, were held by banks or credit card processors to secure potential future credit card fees, fines and chargebacks or for other payments. In addition, at December 31, 2008 and 2007, \$0.3 million and \$0.4 million were restricted by letter of credit and agreements required by international tax jurisdictions as security for potential tax liabilities.

**Table of Contents****DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)*****Short-Term Investments***

Our short-term investments consist of debt securities that are classified as available-for-sale and are carried on our balance sheet at their market value with cumulative unrealized gains or losses recorded as a component of accumulated other comprehensive income within stockholders' equity. We classify all of our available-for-sale securities as current assets, as these securities represent investments available for current corporate purposes.

***Property and Equipment***

Computer equipment, software and furniture are depreciated under the straight-line method using estimated useful lives of three to seven years and leasehold improvements are amortized over the shorter of the asset life or remaining length of the lease. Property and equipment at December 31 consisted of the following (in thousands):

|  | <b>2008</b> | <b>2007</b> |
|--|-------------|-------------|
| Computer hardware and software                 | \$ 78,660   | \$ 60,977   |
| Furniture, fixtures and leasehold improvements | 15,475      | 13,077      |
| Total property and equipment                   | \$ 94,135   | \$ 74,054   |
| Accumulated depreciation                       | (52,402)    | (42,952)    |
| Net property and equipment                     | \$ 41,733   | \$ 31,102   |

***Purchased Intangible Assets***

Through both domestic and international acquisitions, we have continued to expand our global online businesses. Tangible net assets for our acquisitions were valued at their respective carrying amounts as we believe these amounts approximated their current fair values at the respective acquisition dates. The valuation of identifiable intangible assets acquired reflects management's estimates based on, among other factors, use of established valuation methods. Such assets consist of customer lists and user base, trademarks and trade names, developed technologies and other acquired intangible assets, including contractual agreements. Identifiable intangible assets are amortized using the straight-line method over the estimated useful lives, generally three to ten years. We believe the straight-line method of amortization best represents the distribution of the economic value of the identifiable intangible assets acquired to date. Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in each business combination. The purchase prices of the acquisitions described in Note 4 below exceeded the estimated fair value of the respective related identifiable intangible and tangible assets because we believe these acquisitions will assist with our strategy of establishing and expanding our global online marketplace.

***Long-Lived Assets***

We review all long-lived assets, including intangible assets with definite lives, for impairment in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived

Assets ( SFAS 144 ). Under SFAS 144, impairment losses are recorded whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. For long-lived assets used in operations, impairment losses are only recorded if the asset's carrying amount is not recoverable through its undiscounted, probability-weighted cash flows. We measure the impairment loss based on the difference between the carrying amount and estimated fair value. An impairment loss is recognized when estimated undiscounted cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. As part of our evaluation, we consider certain non-financial data as indicators of impairment such as changes in the operating

**Table of Contents****DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)**

environment and business strategy, competitive information, market trends and operating performance. When an impairment loss is identified, the carrying amount of the asset is reduced to its estimated fair value. There were no significant impairments of long-lived assets, including definite-lived intangible assets, recorded in 2008, 2007 or 2006.

***Other Assets***

The following table summarizes our other assets as of December 31 (in thousands):

|                                  | <b>2008</b> | <b>2007</b> |
|----------------------------------|-------------|-------------|
| Unamortized debt financing costs | \$ 224      | \$ 5,298    |
| Cost of investment               |             | 6,000       |
| Other                            | 562         | 657         |
| Total other assets               | \$ 786      | \$ 11,955   |

Unamortized debt financing costs, in the amount of about \$5.1 million, related to the January 2, 2009 repurchase of our convertible senior notes, were reclassified to current as of December 31, 2008. In 2008, our cost of investment, which are preferred shares in a publicly traded company accounted for under the cost method of accounting, were reclassified to current assets due to their pending liquidation which occurred on January 20, 2009.

***Other Accrued Liabilities***

The following table summarizes our other accrued liabilities as of December 31 (in thousands):

|  | <b>2008</b> | <b>2007</b> |
|--|-------------|-------------|
| Accrued expenses                         | \$ 24,148   | \$ 20,631   |
| Sales, value-added and transaction taxes | 19,788      | 20,598      |
| Current income taxes                     | (2,600)     |             |
| Total other accrued liabilities          | \$ 41,336   | \$ 41,229   |

***Comprehensive Income***

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

In 2008, comprehensive income included \$15.2 million recorded for unrealized foreign exchange losses on the revaluation of investments in foreign subsidiaries; \$0.6 million net of \$0.3 million tax benefit for unrealized investment losses; and \$10.2 million net of \$6.1 million tax benefit for the temporary impairment of auction rate securities. In 2007, comprehensive income included \$18.3 million recorded for unrealized foreign exchange gains on the revaluation of investments in foreign subsidiaries, and \$1.0 million net of \$0.6 million tax expense for unrealized investment gains. In 2006, comprehensive income included \$13.5 million recorded for unrealized foreign exchange gains on the revaluation of investments in foreign subsidiaries, and \$0.6 million net of \$0.2 million tax expense for unrealized investment gains

***Revenue Recognition***

We recognize revenue in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition*, from services rendered once all the following criteria for revenue recognition have been met: (1) persuasive



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**DIGITAL RIVER, INC.**

**Notes to Consolidated Financial Statements (Continued)**

evidence of an agreement exists; (2) the services have been rendered; (3) the fee is fixed and determinable; and (4) collection of the amounts due is reasonably assured.

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

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

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

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

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

***Deferred Revenue***

Deferred revenue is recorded when service payment is received in advance of performing our service obligation. Revenue is recognized over either the estimated usage period when usage information is available, or ratably over the service period when usage information is not available.

***Advertising Costs***

The costs of advertising are charged to sales and marketing expense as incurred. We incurred advertising expense of \$0.7 million, \$0.1 million and \$1.5 million in 2008, 2007 and 2006, respectively.

***Income Taxes***

Deferred income taxes reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. We record deferred tax assets for favorable tax attributes, including tax loss carryforwards. We currently have U.S. tax

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**DIGITAL RIVER, INC.**

**Notes to Consolidated Financial Statements (Continued)**

loss carryforwards, consisting solely of acquired operating tax loss carryforwards, and a lesser amount of acquired foreign operating tax loss carryforwards. A portion of the benefit of the acquired tax loss carryforwards has been reserved by a valuation allowance pursuant to United States generally accepted accounting principles. These valuation allowances of the deferred tax asset will be reversed if and when it is more likely than not that the deferred tax asset will be realized. We evaluate the need for a valuation allowance of the deferred tax asset on a quarterly basis.

***Interest Income***

Our interest income line item is the total of interest income on our cash, cash equivalents, and investments. Interest income was \$18.0 million, \$32.2 million and \$22.8 million in 2008, 2007 and 2006, respectively. The decrease in interest income from 2007 to 2008 was due to the use of \$138 million in cash for our share repurchase program during the first quarter of 2008. Interest income also declined due to lower yields on our portfolio during 2008. The increase from 2006 to 2007 in interest income was primarily due to higher cash balances.

***Other (Expense), Net***

Our other (expense), net line item is the total of interest expense on our debt and foreign currency transaction gains and losses and disposals of asset gains and losses. Interest expense was \$2.5 million in 2008 compared to \$2.4 million in 2007 and 2006 and was related primarily to our Convertible Senior Notes. Our gain from foreign currency remeasurement was \$0.3 million in 2008 compared to a loss of \$0.6 million in 2007 and a gain of 1.5 million in 2006. The loss on disposals of assets was \$1.1 million in 2008. Disposals of assets were immaterial in 2007 and 2006.

***Research and Development and Software Development***

Research and development expenses consist primarily of development personnel and non-employee contractor costs related to the development of new products and services, enhancement of existing products and services, quality assurance, and testing. We follow AICPA Statement of Position No. 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, in accounting for internally developed software. We capitalized \$5.3 million related to software development during 2008, inclusive of amounts outside of Product Research and Development as recorded in our Consolidated Statement of Income. In 2007 and 2006, we capitalized \$0.0 million and \$0.1 million, respectively, of software development costs.

***Stock-Based Compensation Expense***

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

We have adopted SFAS 123(R) using the modified prospective transition method under which prior periods are not revised. Stock-based compensation expense recognized during the period is based on the value of the portion of share-based awards that are ultimately expected to vest during the period. The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option pricing model. The fair value of restricted stock is determined based on the number of shares granted and the closing price of our common stock on the date of grant.

Compensation expense for all share-based payment awards is recognized using the straight-line amortization method over the vesting period. Stock-based compensation expense of \$12.5 million was charged to operating expenses during 2008.

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**DIGITAL RIVER, INC.**

**Notes to Consolidated Financial Statements (Continued)**

As stock-based compensation expense recognized in our Consolidated Statement of Income for 2008 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

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

See Note 5 for further information regarding the impact of our adoption of SFAS 123(R) and the assumptions we use to calculate the fair value of share-based compensation.

***Recent Accounting Pronouncements***

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FAS 133* ( SFAS 161 ). SFAS 161 applies to all derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items accounted for under SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities* ( SFAS 133 ). The provisions of SFAS 161 require entities to provide greater transparency through additional disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, results of operations and cash flows. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008. We are currently evaluating the effects, if any, that SFAS 161 may have on our financial statements.

In December 2007, the FASB issued SFAS No. 160, *Non-controlling Interests in Consolidated Financial Statements* ( SFAS 160 ). SFAS 160 requires entities to report non-controlling (minority) interests in subsidiaries as equity in the consolidated financial statements. SFAS 160 is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the effects, if any, that SFAS 160 may have on our financial statements.

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

**2. Net Income per Share**

Basic income per common share is computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per common share is calculated by dividing net income, adjusted to exclude interest expense and financing cost amortization related to potentially dilutive securities,

by the weighted average number of common shares related to potentially dilutive securities outstanding during the period, plus any additional common shares that would have been outstanding if potentially dilutive common shares had been issued during the period.

**Table of Contents****DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)**

The following table summarizes the computation of basic and diluted earnings per share (in thousands, except per share data):

|  | <b>For the Years Ended December 31,</b> |             |             |
|--|---|-------------|-------------|
|  | <b>2008</b>                             | <b>2007</b> | <b>2006</b> |
| Earnings per share basic   |   |             |             |
| Net income basic   | \$ 63,595                               | \$ 70,814   | \$ 60,810   |
| Weighted average shares outstanding basic  | 37,016                                  | 40,444      | 38,593      |
| Earnings per share basic   | \$ 1.72                                 | \$ 1.75     | \$ 1.58     |
| Earnings per share diluted   |   |             |             |
| Net income basic   | 63,595                                  | \$ 70,814   | \$ 60,810   |
| Exclude: Interest expense and amortized financing cost of convertible senior notes, net of tax benefit | 1,739                                   | 1,739       | 1,739       |
| Net income diluted   | \$ 65,334                               | \$ 72,553   | \$ 62,549   |
| Weighted average shares outstanding basic  | 37,016                                  | 40,444      | 38,593      |
| Dilutive impact of non-vested stock and options outstanding  | 665                                     | 1,045       | 1,624       |
| Dilutive impact of convertible senior notes  | 4,425                                   | 4,425       | 4,425       |
| Weighted average shares outstanding diluted  | 42,106                                  | 45,914      | 44,642      |
| Earnings per share diluted   | \$ 1.55                                 | \$ 1.58     | \$ 1.40     |

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

**3. Investments**

As of December 31, 2008 and 2007, our available-for-sale securities consisted of the following (in thousands):

|             | <b>Unrealized Gain/(Loss)</b>      |                                       |                   | <b>Maturities/Reset Dates</b>      |                                       |
|-------------|------------------------------------|---------------------------------------|-------------------|------------------------------------|---------------------------------------|
|             | <b>Less than<br/>12<br/>Months</b> | <b>Greater<br/>than 12<br/>Months</b> |                   | <b>Less than<br/>12<br/>Months</b> | <b>Greater<br/>than 12<br/>Months</b> |
| <b>Cost</b> |                                    |                                       | <b>Fair Value</b> |                                    |                                       |

**2008**

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|                                     |            |             |    |            |           |           |
|-------------------------------------|------------|-------------|----|------------|-----------|-----------|
| U.S. government sponsored entities  | \$ 9,900   | \$ 100      | \$ | \$ 10,000  | \$ 10,000 | \$        |
| Student loan bonds                  | 109,500    | (16,287)    |    | 93,213     |           | 93,213    |
| Total available-for-sale securities | \$ 119,400 | \$ (16,187) | \$ | \$ 103,213 | \$ 10,000 | \$ 93,213 |

**2007**

|                                     |            |       |        |            |            |           |
|-------------------------------------|------------|-------|--------|------------|------------|-----------|
| U.S. government sponsored entities  | \$ 139,377 | \$ 94 | \$ 859 | \$ 140,330 | \$ 69,070  | \$ 71,260 |
| Student loan bonds                  | 119,750    |       |        | 119,750    | 119,750    |           |
| Other                               | 55,556     |       |        | 55,556     | 55,556     |           |
| Total available-for-sale securities | \$ 314,683 | \$ 94 | \$ 859 | \$ 315,636 | \$ 244,376 | \$ 71,260 |

Realized gains or losses on investments are recorded in our statement of income within other income (expense), net. Realized losses on sales of investments were immaterial in 2008, 2007 and 2006.



**Table of Contents****DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)****4. Business Combinations, Goodwill and Intangible Assets**

The following table summarizes the purchase acquisitions completed during the three years in the period ended December 31, 2008 (in thousands):

| Acquisition                           | Initial<br>Shares<br>Issued | Initial<br>Purchase<br>Consideration | Acquired<br>Assets | Assumed<br>Liabilities | Goodwill  | Other Intangible Assets   |                           |                            |
|---------------------------------------|-----------------------------|--------------------------------------|--------------------|------------------------|-----------|---------------------------|---------------------------|----------------------------|
|                                       |                             |                                      |                    |                        |           | Technology/<br>Trademarks | Customer<br>Relationships | Non-competes<br>Agreements |
| <b>2008</b>                           |                             |                                      |                    |                        |           |                           |                           |                            |
| Think Subscription, Inc.              |                             | \$ 5,100                             | \$ 644             | \$ (1,019)             | \$ 2,007  | \$ 1,209                  | \$ 1,813                  | \$                         |
| CustomCD, Inc.                        |                             | 7,000                                | 764                | (355)                  | 3,136     | 2,059                     | 1,468                     |                            |
| DigitalSwift Corporation              |                             | 9,200                                | 427                | (459)                  | 4,673     | 487                       | 4,325                     |                            |
| Total                                 |                             | \$ 21,300                            | \$ 1,835           | \$ (1,833)             | \$ 9,816  | \$ 3,755                  | \$ 7,606                  | \$                         |
| <b>2007</b>                           |                             |                                      |                    |                        |           |                           |                           |                            |
| Netgiro Systems AB                    |                             | \$ 27,386                            | \$ 8,567           | \$ (7,477)             | \$ 9,742  | \$ 4,424                  | \$ 12,372                 | \$                         |
| Total                                 |                             | \$ 27,386                            | \$ 8,567           | \$ (7,477)             | \$ 9,742  | \$ 4,424                  | \$ 12,372                 | \$                         |
| <b>2006</b>                           |                             |                                      |                    |                        |           |                           |                           |                            |
| Mindvision, Inc.                      |                             | \$ 24,975                            | \$ 2,555           | \$ (8,036)             | \$ 18,859 | \$ 3,170                  | \$ 4,490                  | \$ 40                      |
| Direct Response<br>Technologies, Inc. |                             | 14,876                               | 1,573              | (3,723)                | 11,343    | 2,465                     | 3,620                     |                            |
| Total                                 |                             | \$ 39,851                            | \$ 4,128           | \$ (11,759)            | \$ 30,202 | \$ 5,635                  | \$ 8,110                  | \$ 40                      |

Note: Balances as of acquisition date and do not reflect subsequent earn-outs, adjustments or currency translation.

**Acquisitions completed in 2008**

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

On January 1, 2008, we acquired all of the capital stock of DigitalSwift Corporation (DigitalSwift), a privately-held company based in Madison, Georgia, for approximately \$9.2 million in cash. DigitalSwift is a manufacturer and fulfiller of on-demand, dynamic and build-to-order CDs and DVDs to consumers. The agreement also provides

DigitalSwift shareholders with an earn-out opportunity based on DigitalSwift achieving certain revenue and earnings targets during the first year subsequent to the acquisition. In 2008, we paid earn-outs of \$1.0 million and accrued \$3.0 million for future earn-out payments. Earn-outs were recorded as goodwill in 2008 as they were considered incremental to the purchase price.

On January 1, 2008, we acquired the assets of IA Users Club d.b.a. CustomCD, Inc. (CustomCD), a privately held company based in Portland, Oregon and Krefeld, Germany, for approximately \$7.0 million in cash. This acquisition involved an asset purchase of the US-based business and a stock purchase of the business located in Germany. CustomCD creates, sells and delivers to consumers custom CDs and DVDs containing software, games, and other licensed content. The agreement also provides CustomCD shareholders with an earn-out opportunity based on CustomCD achieving certain revenue and earnings targets during the

**Table of Contents****DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)**

first two years subsequent to the acquisition. In 2008, we paid earn-outs of \$1.3 million. Earn-outs were recorded as goodwill in 2008 as they were considered incremental to the purchase price. Any future earn-out will result in additional goodwill.

***Acquisitions completed in 2007***

On September 1, 2007, we acquired all of the capital stock of NetGiro Systems AB (NetGiro), a privately held company based in Stockholm, Sweden, for approximately \$27.4 million in cash. NetGiro is an online payment service provider.

***Acquisitions completed in 2006***

In June 2006, we acquired all of the capital stock of MindVision, Inc., a privately held e-commerce company based in Lincoln, Nebraska, for approximately \$25.0 million comprised of payments to stockholders of \$21.2 million plus the assumption of certain liabilities totaling approximately \$3.7 million. In November 2006, we recorded \$0.2 million as acquisition cost related to a restructuring plan for employee severance to be paid out over a six month period.

In January 2006, we acquired all of the capital stock of Direct Response Technologies, Inc. (Direct Response), a privately held company based in Pittsburgh, Pennsylvania, for approximately \$15.0 million in cash. Direct Response, a provider of tools for managing affiliate networks, is now named DR Marketing Solutions, Inc. The agreement also provided Direct Response shareholders with an earn-out opportunity based on DR Marketing Solutions, Inc. achieving certain revenue and earnings targets during the first three years subsequent to the acquisition. In 2006, we accrued \$3.5 million for future earn-out payments. In 2007, pursuant to the January 2006 acquisition agreement, certain adjustments were made to the earn-out obligations under this agreement. Under the restructured earn-out agreement a final earn-out of \$3.5 million was accrued and paid in 2007. These earn-outs have been recorded as goodwill in 2006 and 2007 as they were considered incremental to the purchase price.

***Future Earn-outs***

As of December 31, 2008, there were estimated future earn-outs of \$3.0 million in accrued acquisition liabilities. Any of the estimated maximum potential future earn-out beyond the \$3.0 million accrual will result in additional goodwill.

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

The consolidated financial statements include the operating results of each business acquired from the date of acquisition. The following unaudited pro forma condensed results of operations for 2008, 2007 and 2006 have been prepared as if each of the acquisitions in 2008 had occurred on January 1, 2007, and as if each of the 2007 acquisitions had occurred on January 1, 2006 (in thousands except per share data):

|                        | <b>2008</b> | <b>2007</b> | <b>2006</b> |
|------------------------|-------------|-------------|-------------|
| Revenue                | \$ 395,698  | \$ 366,208  | \$ 322,296  |
| Income from operations | 70,373      | 70,590      | 68,260      |

|                          |         |         |         |
|--------------------------|---------|---------|---------|
| Net income               | 62,400  | 67,494  | 61,338  |
| Diluted income per share | \$ 1.52 | \$ 1.51 | \$ 1.41 |

This pro forma financial information does not purport to represent results that would actually have been obtained if the transactions had been in effect on January 1, 2007 or 2006, as applicable, or any future results that may be realized.

**Table of Contents****DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)*****Goodwill***

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

We complete our annual impairment test using a two-step approach based in the fourth quarter of each fiscal year and reassess any intangible assets, including goodwill, recorded in connection with earlier acquisitions. Our assessment has indicated that there is no impairment of goodwill for the years ended December 31, 2008, 2007 and 2006.

The changes in the net carrying amount of goodwill for the years ended December 31, 2008 and 2007 are as follows (in thousands):

|  | <b>Total</b> |
|--|--------------|
| Balance as of December 31, 2006          | \$ 243,799   |
| Goodwill from acquisitions and earn-outs | 13,774       |
| Adjustments(1)                           | 4,312        |
| Balance as of December 31, 2007          | \$ 261,885   |
| Goodwill from acquisitions and earn-outs | 14,955       |
| Adjustments(1)                           | (3,052)      |
| Balance as of December 31, 2008          | \$ 273,788   |

(1) Adjustments to goodwill during the year ended December 31, 2008 and December 31, 2007, resulted primarily from foreign currency translation and tax adjustments relating to goodwill associated with our current and prior period acquisitions.

***Intangible Assets***

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

|                        | <b>As of December 31, 2008</b>       |                                     |                                    |
|------------------------|--------------------------------------|-------------------------------------|------------------------------------|
|                        | <b>Carrying<br/>Amount<br/>Gross</b> | <b>Accumulated<br/>Amortization</b> | <b>Carrying<br/>Amount<br/>Net</b> |
| Customer relationships | \$ 62,265                            | \$ 37,931                           | \$ 24,334                          |
| Non-compete agreements | 5,312                                | 5,301                               | 11                                 |

|                      |           |           |           |
|----------------------|-----------|-----------|-----------|
| Technology/tradename | 30,991    | 23,114    | 7,877     |
| Total                | \$ 98,568 | \$ 66,346 | \$ 32,222 |

|                        | As of December 31, 2007     |                             |                           |
|------------------------|-----------------------------|-----------------------------|---------------------------|
|                        | Carrying<br>Amount<br>Gross | Accumulated<br>Amortization | Carrying<br>Amount<br>Net |
| Customer relationships | \$ 57,327                   | \$ 33,761                   | \$ 23,566                 |
| Non-compete agreements | 5,351                       | 5,328                       | 23                        |
| Technology/tradename   | 29,197                      | 20,404                      | 8,793                     |
| Total                  | \$ 91,875                   | \$ 59,493                   | \$ 32,382                 |

Amortization expense was \$8.4 million, \$7.6 million and \$12.1 million, respectively for the years ended 2008, 2007 and 2006, respectively. The result of the allocation of the purchase price between amortizable costs

**Table of Contents****DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)**

and goodwill could have an impact on our future operating results. The components of intangible assets acquired during the years ended December 31, 2008, 2007 and 2006, are as follows (in thousands). No significant residual value is estimated for these assets.

|                        | 2008      |                             | 2007      |                             | 2006      |                             |
|------------------------|-----------|-----------------------------|-----------|-----------------------------|-----------|-----------------------------|
|                        | Amount    | Weighted<br>Average<br>Life | Amount    | Weighted<br>Average<br>Life | Amount    | Weighted<br>Average<br>Life |
| Customer relationships | \$ 7,606  | 6 years                     | \$ 12,372 | 10 years                    | \$ 8,110  | 8 years                     |
| Non-compete agreements |           |                             |           |                             | 40        | 4 years                     |
| Technology/tradename   | 3,755     | 4 years                     | 4,424     | 8 years                     | 5,635     | 4 years                     |
| Total                  | \$ 11,361 | 5 years                     | \$ 16,796 | 10 years                    | \$ 13,785 | 6 years                     |

Estimated amortization expense for the remaining life of the intangible assets, based on intangible assets as of December 31, 2008, is as follows (in thousands):

| Year       |           |
|------------|-----------|
| 2009       | \$ 7,378  |
| 2010       | 5,868     |
| 2011       | 4,706     |
| 2012       | 4,543     |
| 2013       | 2,617     |
| Thereafter | 7,110     |
| Total      | \$ 32,222 |

Following is an allocation of the net assets acquired from the acquisitions consummated and amounts paid under earn-out arrangements in 2008 and 2007 (in thousands) which includes subsequent year activity for 2007 acquisitions:

|  | 2008     | 2007     |
|--|----------|----------|
| Tangible assets                              | \$ 1,835 | \$ 8,567 |
| Liabilities assumed                          | (1,833)  | (7,477)  |
| Customer relationships                       | 7,606    | 12,372   |
| Technology/tradename                         | 3,755    | 4,424    |
| Goodwill ( year of acquisition)              | 9,816    | 9,742    |
| Goodwill (subsequent to year of acquisition) |          | 5,058    |

|                     |           |           |
|---------------------|-----------|-----------|
| Net assets acquired | \$ 21,179 | \$ 32,686 |
|---------------------|-----------|-----------|

## 5. Stock-Based Compensation

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

Our current plan is described more fully in Note 11.



**Table of Contents****DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)*****Expense Information under SFAS 123(R)***

On January 1, 2006, we adopted SFAS 123(R) which requires measurement and recognition of compensation expense for all stock-based payments made to employees and directors including stock options, restricted stock grants and employee stock purchases made through our Employee Stock Purchase Plan based on estimated fair values. The following table summarizes stock-based compensation expense, net of tax, related to our stock-based compensation plans recognized under SFAS 123(R):

|   | <b>Year Ended December 31,</b> |                       |
|---|--------------------------------|-----------------------|
|   | <b>2008</b>                    | <b>2007</b>           |
|   | <b>(In</b>                     | <b>thousands)</b>     |
|   | <b>thousands)</b>              | <b>(In thousands)</b> |
| Costs and expenses                                      |                                |                       |
| Direct cost of services                                 | \$ 785                         | \$ 807                |
| Network and infrastructure                              | 192                            | 270                   |
| Sales and marketing                                     | 4,562                          | 5,028                 |
| Product research and development                        | 1,258                          | 1,736                 |
| General and administrative                              | 5,751                          | 5,901                 |
| Stock-based compensation included in costs and expenses | 12,548                         | 13,742                |
| Tax benefit   | (2,802)                        | (3,737)               |
| Stock-based compensation expense, net of tax            | \$ 9,746                       | \$ 10,005             |

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

During the twelve months ending ended December 31, 2008, 2007 and 2006 we used the Black-Scholes option pricing model with the following weighted average assumptions:

|  | <b>2008</b> | <b>2007</b> | <b>2006</b> |
|--|-------------|-------------|-------------|
| Risk-free interest rate                        | 2.0%        | 4.5%        | 4.7%        |
| Expected life (years)                          | 3.37        | 3.46        | 4.08        |
| Volatility factor                              | 0.45        | 0.50        | 0.59        |
| Expected dividends                             |             |             |             |
| Weighted average fair value of options granted | \$ 10.74    | \$ 23.11    | \$ 19.00    |

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

equal to the expected term of the options granted. The dividend yield assumption is based on our history and expectation of future dividend payouts.

As stock-based compensation expense recognized in the Consolidated Statement of Income for the twelve months ended December 31, 2008 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience.

At December 31, 2008, there was approximately \$24.4 million of total unrecognized stock-based compensation expense, adjusted for estimated forfeitures, related to unvested share-based awards. Unrecognized stock-based compensation expense is expected to be recognized over the next 2.44 years on a weighted average basis and will be adjusted for any future changes in estimated forfeitures.

Table of Contents**DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)****6. Income Taxes**

The components of pretax income are as follows (in thousands):

|               | <b>Year Ended December 31,</b> |             |             |
|---------------|--------------------------------|-------------|-------------|
|               | <b>2008</b>                    | <b>2007</b> | <b>2006</b> |
| United States | \$ 46,988                      | \$ 74,595   | \$ 65,171   |
| International | 39,283                         | 28,480      | 24,311      |
| Total         | \$ 86,271                      | \$ 103,075  | \$ 89,482   |

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

|   | <b>Year Ended December 31,</b> |             |             |
|---|--------------------------------|-------------|-------------|
|   | <b>2008</b>                    | <b>2007</b> | <b>2006</b> |
| Current tax expense (benefit):                      |                                |             |             |
| United States federal                               | \$ 18,792                      | \$ 29,204   | \$ 34,362   |
| State and local                                     | 1,223                          | 1,842       | 2,160       |
| International                                       | 6,858                          | 5,939       | 2,915       |
| Total current provision for income taxes            | 26,873                         | 36,985      | 39,437      |
| Deferred tax expense (benefit):                     |                                |             |             |
| United States federal                               | (3,926)                        | (3,896)     | (10,136)    |
| State and local                                     | (255)                          | (227)       | (637)       |
| International                                       | (16)                           | (601)       | 8           |
| Total deferred provision (benefit) for income taxes | (4,197)                        | (4,724)     | (10,765)    |
| Provision for income taxes                          | \$ 22,676                      | \$ 32,261   | \$ 28,672   |

The following is a reconciliation of the difference between the actual provision for income taxes and the provision computed by applying the federal statutory rate of 35% to income before income taxes (in thousands):

|                               | <b>Year Ended December 31,</b> |             |             |
|-------------------------------|--------------------------------|-------------|-------------|
|                               | <b>2008</b>                    | <b>2007</b> | <b>2006</b> |
| Tax expense at statutory rate | \$ 30,195                      | \$ 36,076   | \$ 31,319   |

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|                                     |           |           |           |
|-------------------------------------|-----------|-----------|-----------|
| State taxes, net of federal benefit | 968       | 1,615     | 1,469     |
| International rate differential     | (7,860)   | (4,623)   | (3,193)   |
| Tax Credits                         | (955)     | (671)     | (1,909)   |
| Nondeductible expense and other     | 328       | (136)     | 986       |
| Total                               | \$ 22,676 | \$ 32,261 | \$ 28,672 |

**Table of Contents****DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)**

Deferred income taxes reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the bases for income tax purposes. Significant components of deferred income taxes are as follows (in thousands):

|   | <b>2008</b> | <b>2007</b> |
|---|-------------|-------------|
| Deferred tax assets:                        |             |             |
| Net operating loss and credit carryforwards | \$ 8,646    | \$ 12,412   |
| Nondeductible reserves and accruals         | 21,075      | 9,144       |
| Depreciation and amortization               | 4,777       | 3,339       |
| Valuation allowance                         | (2,061)     | (1,390)     |
| Total deferred tax assets                   | 32,437      | 23,505      |
| Deferred tax liabilities:                   |             |             |
| Depreciation                                | (1,191)     |             |
| Other intangibles                           | (11,016)    | (5,054)     |
| Total deferred tax liabilities              | (12,207)    | (5,054)     |
| Net deferred tax assets                     | \$ 20,230   | \$ 18,451   |

As of December 31, 2008, we had U.S. tax loss carryforwards of approximately \$16.5 million and foreign tax loss carryforwards of \$4.3 million. These tax loss carryforwards consist solely of acquired net operating losses. The U.S. tax loss carryforwards expire in the years 2021 through 2025. However, we anticipate most U.S. tax loss carryforwards will be utilized in the next few years.

There is uncertainty of future realization of the deferred tax assets resulting from acquired tax loss carryforwards due to anticipated limitations, including limitations under Section 382 of the Internal Revenue Code. Therefore, a valuation allowance was recorded against the tax effect of such tax loss carryforwards. At December 31, 2008, the Company has a valuation allowance on approximately \$1.4 million of deferred tax assets related to acquired operating losses and other tax attributes as we believe it is more likely than not that these deferred tax assets will not be realized. Any future release of this valuation allowance will reduce expense.

On January 1, 2007, we adopted the provisions of Financial Standards Accounting Board Interpretation No. 48

Accounting for Uncertainty in Income Taxes (FIN 48) an interpretation of FASB Statement No. 109 (SFAS 109). As a result of the implementation of FIN 48, we recognized no material adjustment in the liability for unrecognized income tax benefits. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

|                            |          |
|----------------------------|----------|
| Balance at January 1, 2007 | \$ 3,340 |
|----------------------------|----------|

|  |          |
|--|----------|
| Increases for tax positions taken during current year        | 1,072    |
| Decreases for tax positions taken during prior years         | 1,035    |
| Balance at December 31, 2007                                 | \$ 5,447 |
| Increases for tax positions taken during current year        | 2,957    |
| Increases for tax positions taken during prior years         | 613      |
| Decreases as a result of settlements with taxing authorities | (2,622)  |
| Balance at December 31, 2008                                 | \$ 6,395 |

All of these unrecognized tax benefits would affect our effective tax rate if recognized. We recognize interest and penalties related to uncertain tax positions in income tax expense. We had approximately

**Table of Contents****DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)**

\$0.8 million and \$0.1 million of accrued interest and penalties related to uncertain tax positions at December 31, 2008 and December 31, 2007, respectively.

The Company and its subsidiaries file income tax returns in U.S. federal and various state jurisdictions, and foreign jurisdictions. The tax years 2004-2008 remain open to examination by the major taxing jurisdictions to which we are subject. During 2008, the Internal Revenue Service (IRS) examined the Company's 2004 U.S. income tax return. The examination was substantially completed, resulting in only minor agreed upon adjustments. The Company expects the examination to be finalized in 2009. Several of the Company's international subsidiaries were also under examination during 2008 and the Company expects these examinations to be completed in 2009 as well. Due to the potential resolution of examinations currently being performed by taxing authorities, and the expiration of various statutes of limitation, it is reasonably possible that our gross unrecognized tax benefits balance may change within the next twelve months by a range of zero to \$2.2 million.

No provision has been made for federal income taxes on approximately \$81.3 million of our foreign subsidiaries undistributed earnings as of December 31, 2008 since we plan to indefinitely reinvest all such earnings. If these earnings were distributed to the U.S. in the form of dividends or otherwise, we would be subject to U.S. income taxes on such earnings. The amount of U.S. income taxes would be subject to adjustment for foreign tax credits and for the impact of the step-up in the basis of assets resulting from a Section 338 election made at the time of acquisition. If these earnings were to be distributed, the income tax liability would be approximately \$17.5 million.

**7. Commitments and Contingencies*****Leases***

We currently have 38 facility leases in addition to leasing certain computer equipment under non-cancelable operating leases. Total rent expense, including common area maintenance charges, recognized under all leases was \$7.1 million, \$5.7 million and \$4.3 million for the years ended December 31, 2008, 2007 and 2006, respectively. The minimum annual rents under long-term leases at December 31, 2008, were as follows (in thousands):

| <b>Year ending December 31,</b>  | <b>Lease Obligations</b> |
|----------------------------------|--------------------------|
| 2009                             | 5,048                    |
| 2010                             | 3,735                    |
| 2011                             | 2,312                    |
| 2012                             | 687                      |
| Thereafter                       | 745                      |
| Total future minimum obligations | \$ 12,527                |

***Litigation***

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

Third parties have from time-to-time claimed, and others may claim in the future, that we have infringed their intellectual property rights. We have been notified of several potential patent disputes, and expect that we



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**DIGITAL RIVER, INC.**

**Notes to Consolidated Financial Statements (Continued)**

will increasingly be subject to patent infringement claims as our services expand in scope and complexity. We have in the past been forced to litigate such claims. We may also become more vulnerable to third-party claims as laws, such as the Digital Millennium Copyright Act, the Lanham Act and the Communications Decency Act are interpreted by the courts and as we expand geographically into jurisdictions where the underlying laws with respect to the potential liability of online intermediaries like ourselves are either unclear or less favorable. These claims, whether meritorious or not, could be time consuming and costly to resolve, cause service upgrade delays, require expensive changes in our methods of doing business, or could require us to enter into costly royalty or licensing agreements.

***Indemnification Provisions***

In the ordinary course of business we have included limited indemnification provisions in certain of our agreements with parties with whom we have commercial relations. Under these contracts, we generally indemnify, hold harmless and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party in connection with claims by any third party with respect to our domain names, trademarks, logos and other branding elements to the extent that such marks are applicable to our performance under the subject agreement. In certain agreements, including both agreements under which we have developed technology for certain commercial parties and agreements with our clients, we have provided an indemnity for other types of third-party claims. To date, no significant costs have been incurred, either individually or collectively, in connection with our indemnification provisions.

In addition, we are required by our credit card processors to comply with credit card association operating rules, and we have agreed to indemnify our processors for any fines they are assessed by credit card associations as a result of processing payments for us. The credit card associations and their member banks set and interpret the credit card rules. Visa, MasterCard, American Express, or Discover could adopt new operating rules or re-interpret existing rules that we or our credit card processors might find difficult to follow. We have had payment processing agreements with certain of our payment processors terminated due to violations of their rules. We also could be subject to fines or increased fees from MasterCard and Visa.

**8. Debt**

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

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

payable in our common stock upon the repurchase or conversion of the Notes in connection with the fundamental change.

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**DIGITAL RIVER, INC.**

**Notes to Consolidated Financial Statements (Continued)**

Holders of the Notes have the right to require us to repurchase their Notes prior to maturity on January 1, 2009, 2014 and 2019. We have the right to redeem the Notes at any time on or after January 1, 2009. On January 5, 2009, we announced that holders of 95.5% of the Notes exercised the option to require us to repurchase those Notes on January 2, 2009 at a purchase price of 100.25% of the principal amount of each tendered Note. Notes with an aggregate principal amount of \$8,805,000 remain outstanding. In light of the right of holders to require us to redeem the Notes on January 1, 2009, on January 1, 2008, we reclassified the Notes as short-term debt. As such right has expired and the exercise of the next right to require us to redeem the Notes will not occur until January 1, 2014, we have reclassified the remaining Notes as long-term debt.

We incurred interest expense of \$2.5 million in 2008 and made interest payments of \$2.4 million. We incurred interest expense of \$2.4 million in 2007 and made interest payments of \$2.4 million. We incurred interest expense of \$2.5 million in 2006 and made interest payments of \$2.4 million.

**9. Fair Value Measurements**

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

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

- Level 1 Observable inputs such as quoted prices in active markets;
- Level 2 Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3 Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumption.

As of December 31, 2008, we held certain assets that are required to be measured at fair value on a recurring basis. These included cash equivalents and short and long-term investments.

As of December 31, 2008, Digital River held \$109.5 million of investments at par value, \$93.2 million fair value, in auction-rate securities (ARS), all are AAA/Aaa-rated and 105-115 over collateralized by student loans guaranteed by the U.S. government. All the securities are 100% guaranteed by the Department of Education or the Federal Family Education Loan Program (FFELP) with the exception of two securities which are 82.5% and 99% guaranteed by FFELP. All of these securities continue to fail at auction due to illiquid market conditions.

We did determine a market value discount, due to current illiquid market conditions, of \$16.3 million (14.9% of par value) existed as of December 31, 2008 and recorded a temporary fair value reduction to Other Comprehensive Income on the balance sheet in 2008. We believe the securities will continue to yield the coupon rates.

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

determination of the penalty coupon rate, frequency of reset period associated with each ARS

an average redemption period of seven years

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a contribution of the ARS paying its contractually stated interest rate

determination of the risk adjusted discount rate based on LIBOR rates for these maturities plus market information on student loan credit spreads

In aggregate the ARS portfolio is yielding 2.3% and we continue to receive 100% of the contractually required interest payments. We continue to believe that we will be able to liquidate at par over time. Accordingly, we treated the fair value decline as temporary. We anticipate we have sufficient cash flow from operations to execute our business strategy and fund our operational needs. We believe that capital markets are also available if we need to finance other investing alternatives.

The table below presents our assets measured at fair value on a recurring basis as of December 31, 2008:

|                                     | <b>Fair Value Measurements<br/>As of December 31, 2008</b> |                |                |                |
|-------------------------------------|--|----------------|----------------|----------------|
|                                     | <b>Total</b>   | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> |
| Cash equivalents                    | \$ 490,335   | \$ 490,335     | \$             | \$             |
| Short-term investments              | 10,000   | 10,000         |                |                |
| Long-term investments               | 93,213   |                |                | 93,213         |
| Total assets measured at fair value | \$ 593,548   | \$ 500,335     | \$             | \$ 93,213      |

Based on market conditions, we have classified auction rate securities as Level 3 within FAS 157's hierarchy since our initial adoption of FAS 157 at January 1, 2008. As of December 31, 2008, the difference between fair value and par value of these securities was \$16.3 million, or 2.7% of total assets measured at fair value or 1.5% of total assets reported in our financial statements.

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

|   | <b>Fair Value Measurements Using<br/>Significant Unobservable Inputs<br/>(Level 3)</b> |                                  |              |
|---|--|----------------------------------|--------------|
|   | <b>Short-term<br/>Investments</b>  | <b>Long-term<br/>Investments</b> | <b>Total</b> |
| Balance as of January 1, 2008   | \$ 119,750   | \$                               | \$ 119,750   |
| Total gains or losses (realized/unrealized)<br>Included in other comprehensive income |  | (16,287)                         | (16,287)     |

|                                       |           |           |           |
|---------------------------------------|-----------|-----------|-----------|
| Purchases, issuances, and settlements | (10,250)  |           | (10,250)  |
| Transfers in and/or out of Level 3    | (109,500) | 109,500   |           |
| Balance as of December 31, 2008       | \$        | \$ 93,213 | \$ 93,213 |

***Fair Value of Financial Instruments***

The carrying amount of cash and cash equivalents, accounts receivable, notes payable and accounts payable approximates fair value because of the short maturity of these instruments. As of December 31, 2008 and 2007, the fair value of our \$195 million 1.25% fixed rate convertible senior notes was valued at \$166 million and \$246 million, respectively, based on the quoted fair market value of the debt.

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**DIGITAL RIVER, INC.**

**Notes to Consolidated Financial Statements (Continued)**

**10. Stockholders Equity**

***Share Repurchase Program***

In June 2007 our Board of Directors authorized a new stock buyback program to repurchase up to an aggregate of \$200 million of our common stock. This buyback program superseded the prior buyback program.

During 2008, 4,239,312 shares were repurchased under the 2007 Repurchase Program, including 3,876,612 shares repurchased pursuant to the accelerated share repurchase program. None of the repurchased shares have been retired.

The Accelerated Share Repurchase (ASR) agreement was entered into with Goldman Sachs (GS) on February 7, 2008 and called for GS to repurchase \$127 million of Digital River, Inc. stock between February 7, 2008 and June 20, 2008. Based on the agreement, Digital River received a final share count based on a discount of the Volume Weighted Average Price of Digital River stock from February 21, 2008, through the end of the contract. On June 20, 2008, GS had concluded the ASR program with a final share delivery of 327,767 shares. The aggregate number of shares repurchased pursuant to the ASR program was 3,876,612 shares at an average price of \$32.76 per share. The ASR agreement terminated upon completion of the ASR program on June 20, 2008 in accordance with its terms. With the conclusion of the ASR program, we completed the 2007 Repurchase Program.

During 2007, we repurchased 1,372,185 shares for \$63.0 million. No shares were repurchased during 2006. None of the repurchased shares have been retired.

**11. Employee Benefit Plans**

***Option and Restricted Stock Awards***

*2007 Plan*

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

*1998 Plan*

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

*General Stock Award Information*

As of December 31, 2008, there were 1,976,462 shares available for future awards under our 2007 Plan, respectively. The number of shares available has been reduced by three shares for every two shares granted under the stock award

plan that does not provide for full payment by the participant.

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



**Table of Contents****DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)**

have an exercise price of 110% of the fair market value of a share of common stock on the grant date and will expire no later than five years from the date of grant.

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

|   | <b>Shares Available for Grant</b> | <b>Options Outstanding</b> | <b>Options Price Per Share</b> | <b>Weighted Average Price Per Share</b> |
|---|-----------------------------------|----------------------------|--------------------------------|---|
| Balance, December 31, 2005                            | 1,928,584                         | 4,523,385                  | \$ 2.59 - \$31.13              | \$ 16.69                                |
| Granted   | (395,000)                         | 395,000                    | 29.75 - 57.36                  | 38.64                                   |
| Restricted stock effect on shares available for grant | (134,250)                         | N/A                        | N/A                            | N/A                                     |
| Exercised   |                                   | (1,219,736)                | 2.59 - 45.24                   | 17.31                                   |
| Canceled/expired                                      | 140,866                           | (140,866)                  | 2.59 - 30.69                   | 22.57                                   |
| Balance, December 31, 2006                            | 1,540,200                         | 3,557,783                  | \$ 2.59 - \$57.36              | \$ 18.68                                |
| Granted   | (573,376)                         | 573,376                    | 45.07 - 56.61                  | 54.17                                   |
| Restricted stock effect on shares available for grant | (251,426)                         | N/A                        | N/A                            | N/A                                     |
| Exercised   |                                   | (1,219,519)                | 2.59 - 45.24                   | 11.08                                   |
| Canceled/expired                                      | 133,330                           | (133,330)                  | 4.56 - 56.61                   | 38.01                                   |
| Additional Shares Reserved                            | 2,000,000                         | N/A                        | N/A                            | N/A                                     |
| Balance, December 31, 2007                            | 2,848,728                         | 2,778,310                  | \$ 2.59 - \$57.36              | \$ 28.41                                |
| Granted   | (807,000)                         | 807,000                    | 19.28 - 41.44                  | 31.10                                   |
| Restricted stock effect on shares available for grant | (278,952)                         | N/A                        | N/A                            | N/A                                     |
| Exercised   |                                   | (425,774)                  | 4.56 - 38.17                   | 16.84                                   |
| Canceled/expired                                      | 213,686                           | (213,686)                  | 9.13 - 56.61                   | 38.59                                   |
| Balance, December 31, 2008                            | 1,976,462                         | 2,945,850                  | \$ 2.59 - \$57.36              | \$ 30.08                                |

The following table summarizes significant ranges of outstanding and exercisable options under our 1998 Plan and 2007 Plan as of December 31, 2008:

| <b>Exercise Price</b> | <b>Number Outstanding</b> | <b>Options Outstanding</b> |                               |                                  | <b>Options Exercisable</b> |                               |                                  |
|-----------------------|---------------------------|----------------------------|-------------------------------|----------------------------------|----------------------------|-------------------------------|----------------------------------|
|                       |                           | <b>Weighted Average</b>    | <b>Weighted Average Price</b> | <b>Aggregate Intrinsic Value</b> | <b>Number Exercisable</b>  | <b>Weighted Average Price</b> | <b>Aggregate Intrinsic Value</b> |

**Life  
Remaining**

|                   |           |           |          |              |           |          |              |
|-------------------|-----------|-----------|----------|--------------|-----------|----------|--------------|
| \$ 2.59 - \$ 3.88 | 19,187    | 2.0 years | \$ 2.74  | \$ 423,171   | 19,187    | \$ 2.74  | \$ 423,171   |
| 4.56 - 7.55       | 148,423   | 2.4 years | 5.39     | 2,880,668    | 148,423   | 5.39     | 2,880,668    |
| 9.12 - 13.92      | 344,355   | 3.8 years | 11.74    | 4,497,656    | 296,145   | 11.88    | 3,827,537    |
| 16.72 - 22.98     | 423,446   | 5.1 years | 22.09    | 1,149,141    | 364,695   | 22.55    | 821,460      |
| 23.01 - 30.69     | 621,982   | 6.5 years | 28.02    | 72,897       | 439,592   | 28.41    | 71,772       |
| 33.58 - 57.36     | 1,388,457 | 8.4 years | 41.01    |              | 468,235   | 44.04    |              |
| \$ 2.59 - \$57.36 | 2,945,850 | 6.6 years | \$ 30.08 | \$ 9,023,533 | 1,736,277 | \$ 26.32 | \$ 8,024,608 |

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on options with an exercise price less than the Company's closing stock price of \$24.80 as of December 31, 2008, which would have been received by the option holders had those option holders exercised their options as of that date. The total intrinsic value of options exercised during the twelve months ended December 31, 2008, 2007 and 2006 were \$8.2 million, \$48.9 million and \$38.6 million, respectively, determined as of the date of exercise. The weighted average life remaining on exercisable options is 5.4 years.

**Table of Contents****DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)**

Restricted stock awards are subject to forfeiture if employment terminates prior to the release of the restrictions. During the vesting period, ownership of the shares cannot be transferred. Restricted stock is considered issued and outstanding at the grant date and has the same dividend and voting rights as other common stock. A summary of the changes in restricted stock under our 1998 Plan and 2007 Plan as of December 31, 2008 is as follows:

|                                       | <b>Restricted<br/>Stock</b> | <b>Weighted<br/>Average<br/>Fair Value</b> |
|---------------------------------------|-----------------------------|--|
| Non-Vested Balance, December 31, 2005 |                             | \$   |
| Granted                               | 89,500                      | 39.96                                      |
| Vested                                |                             |  |
| Forfeited                             |                             |  |
| Non-Vested Balance, December 31, 2006 | 89,500                      | \$ 39.96                                   |
| Granted                               | 198,889                     | 53.75                                      |
| Vested                                | (23,713)                    | 39.19                                      |
| Forfeited                             | (31,272)                    | 48.54                                      |
| Non-Vested Balance, December 31, 2007 | 233,404                     | \$ 50.64                                   |
| Granted                               | 498,550                     | 29.04                                      |
| Vested                                | (66,010)                    | 49.42                                      |
| Forfeited                             | (312,582)                   | 33.61                                      |
| Non-Vested Balance, December 31, 2008 | 353,362                     | \$ 35.45                                   |

***Employee Stock Purchase Plan***

We also sponsor an employee stock purchase plan under which 1,200,000 shares have been reserved for purchase by employees. The purchase price of the shares under the plan is the lesser of 85% of the fair market value on the first or last day of the offering period. Offering periods are currently every six months ending on June 30 and December 31. Employees may designate up to ten percent of their compensation for the purchase of shares under the plan. Total shares purchased by employees under the plan were 111,640, 76,436 and 71,183 in the years ended December 31, 2008, 2007 and 2006, respectively. There are 368,777 shares still reserved under the plan as of December 31, 2008.

***Inducement Equity Incentive Plan***

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

***Employee Benefit Plan***

We have a defined contribution 401(k) retirement plan for eligible employees. Employees may contribute up to 15% of their pretax compensation to the plan, with us providing a discretionary match of up to 50% of the total employee contribution. Amounts charged to expense related to our matching contributions were \$2.2 million in 2008, \$2.0 million in 2007 and \$1.4 million in 2006.

**Table of Contents****DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)****12. Segment Information**

We view our operations and manage our business as one reportable segment, providing outsourced e-commerce solutions globally to a variety of companies, primarily in the software and high-tech products markets. Factors used to identify our single operating segment include the financial information available for evaluation by the chief operating decision maker in making decisions about how to allocate resources and assess performance. We market our products and services through our offices in the United States and our wholly-owned branches and subsidiaries operating in the United Kingdom, Germany, Ireland, Luxembourg, Japan, Taiwan and Sweden.

Sales to international customers accounted for 42.8%, 43.2% and 41.2% of revenue for 2008, 2007 and 2006, respectively. Sales are attributed to a geographic region based on the ordering location of the customer. Summarized revenue information by region for fiscal 2008, 2007 and 2006 is as follows (dollars in thousands):

|               | <b>2008</b> | <b>2007</b> | <b>2006</b> |
|---------------|-------------|-------------|-------------|
| United States | \$ 225,385  | \$ 198,388  | \$ 180,905  |
| Europe        | 112,211     | 103,385     | 87,854      |
| Other         | 56,630      | 47,502      | 38,873      |
| Total         | \$ 394,226  | \$ 349,275  | \$ 307,632  |

Revenue derived from sales of product from one software publisher, Symantec Corporation, accounted for approximately 24.3%, 26.2% and 30.2% of our total revenue in 2008, 2007 and 2006, respectively. In addition, revenues derived from proprietary Digital River services sold to Symantec consumers and dealer network sales of Symantec products amounted to approximately 9.4% of total Digital River revenue in 2008, 13.2% in 2007 and 16.6% in 2006.

The following table presents selected asset information by geographic area based on the physical location of the assets (in thousands):

|                              | <b>2008</b>          |               | <b>2007</b>          |               |
|------------------------------|----------------------|---------------|----------------------|---------------|
|                              | <b>United States</b> | <b>Europe</b> | <b>United States</b> | <b>Europe</b> |
| Total property and equipment | \$ 79,781            | \$ 14,354     | \$ 59,359            | \$ 14,695     |
| Accumulated depreciation     | (43,686)             | (8,716)       | (34,185)             | (8,767)       |
| Net property and equipment   | \$ 36,095            | \$ 5,638      | \$ 25,174            | \$ 5,928      |
| Total intangible assets      | \$ 66,951            | \$ 31,617     | \$ 56,302            | \$ 35,573     |
| Accumulated amortization     | (47,487)             | (18,859)      | (41,385)             | (18,108)      |

|                          |            |            |            |            |
|--------------------------|------------|------------|------------|------------|
| Net intangible assets    | \$ 19,464  | \$ 12,758  | \$ 14,917  | \$ 17,465  |
| Total goodwill           | \$ 154,061 | \$ 142,182 | \$ 139,136 | \$ 145,204 |
| Accumulated amortization | (22,455)   |            | (22,455)   |            |
| Net goodwill             | \$ 131,606 | \$ 142,182 | \$ 116,681 | \$ 145,204 |

### 13. Subsequent Events

On January 5, 2009, we announced that holders of 95.5% of our convertible senior notes exercised the option to require us to repurchase those notes on January 2, 2009, at a purchase price of 100.25% of the principal amount of each tendered note for a total of approximately \$187.9 million, which includes accrued interest of \$1.2 million. Notes with an aggregate principal amount of about \$8.8 million remain outstanding. This repurchase will also decrease our dilutive impact of convertible senior on our diluted shares outstanding from about 4.4 million shares to 0.2 million shares in 2009.

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**Schedule II**  
**For Years Ended December 31, 2008, 2007 and 2006**  
(In thousands)

| <b>2008</b>                      | <b>Balance at<br/>Beginning of<br/>Year</b> | <b>Charges<br/>to<br/>Costs and<br/>Expenses</b>    | <b>Deductions</b>  | <b>Balance at<br/>End of<br/>Year</b> |
|----------------------------------|---|---|--|---------------------------------------|
| Allowance for doubtful accounts  | \$ 2,489                                    | \$ 5,214  | \$ (5,246)   | \$ 2,457                              |
| Accrued chargeback reserve       | 1,186                                       | 9,514   | (9,092)  | 1,608                                 |
| <br>                             |   |   |  |                                       |
| <b>2007</b>                      | <b>Balance at<br/>Beginning of<br/>Year</b> | <b>Charges<br/>to<br/>Costs and<br/>Expenses</b>    | <b>Deductions</b>  | <b>Balance at<br/>End of<br/>Year</b> |
| Allowance for doubtful accounts  | \$ 2,339                                    | \$ 581  | \$ (431)   | \$ 2,489                              |
| Accrued chargeback reserve       | 834   | 6,829   | (6,477)  | 1,186                                 |
| <br>                             |   |   |  |                                       |
| <b>2006</b>                      | <b>Balance at<br/>Beginning of<br/>Year</b> | <b>Charges<br/>to<br/>Costs and<br/>Expenses</b>    | <b>Deductions</b>  | <b>Balance at<br/>End of<br/>Year</b> |
| Allowance for doubtful accounts  | \$ 1,023                                    | \$ 1,426  | \$ (110)   | \$ 2,339                              |
| Accrued chargeback reserve       | 1,445                                       | 2,937   | (3,548)  | \$ 834                                |
| <br>                             |   |   |  |                                       |
| <b>Deferred income tax asset</b> | <b>Balance at<br/>Beginning of<br/>Year</b> | <b>Charged /<br/>(Credited)<br/>to<br/>Expenses</b> | <b>Charged /<br/>(Credited)<br/>to<br/>Other<br/>Accounts(1)</b> | <b>Balance at<br/>End of<br/>Year</b> |
| <b>Valuation Allowance</b>       |   |   |  |                                       |
| 2008                             | \$ 1,390                                    | \$  | \$ (19)  | \$ 1,371                              |
| 2007                             | 12,961                                      |   | (11,571)   | 1,390                                 |
| 2006                             | 17,504                                      |   | (4,543)  | 12,961                                |

(1) Amounts not charged (credited) to expenses were charged (credited) to equity or goodwill



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**SIGNATURES**

Pursuant to the requirements of section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Form 10-K/A to be signed on its behalf by the undersigned, thereunto duly authorized on March 9, 2009.

DIGITAL RIVER, INC.

By: /s/ Joel A. Ronning

Joel A. Ronning  
Chief Executive Officer

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**INDEX TO EXHIBITS**

- 23.1++ Consent of Independent Registered Public Accounting Firm.
- 31.1++ Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2++ Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32++ Certification of CEO and CFO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

++ Filed herewith.

- (1) Incorporated by reference from the Company's Current Report on Form 8-K filed on May 4, 2004.
- (2) Incorporated by reference from the Company's Current Report on Form 8-K filed on June 1, 2006.