

Internet Patents Corp
Form 10-Q
May 06, 2013

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

Or

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

For the transition period from to

Commission file number 0-26083

INTERNET PATENTS CORPORATION
(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

94-3220749
(IRS Employer
Identification Number)

10850 Gold Center Drive, Suite 250B Rancho Cordova, CA 95670
(Address of principal executive offices)

(916) 853-1529
(Registrant's telephone number, including area code)

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

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

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Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

The aggregate market value of registrant's voting and non-voting common equity held by non-affiliates of registrant, based upon the closing sale price of the common stock as of the last business day of registrant's most recently completed second fiscal quarter (June 30, 2012), as reported on the Nasdaq Capital Market, was approximately \$16,478,000. Registrant is a smaller reporting company as defined in Regulation S-K. Shares of common stock held by each officer, director and holder of 5% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).

Yes No

The number of outstanding shares of the Registrant's Common Stock, par value \$0.001 per share, on April 30, 2013 were 7,751,952 shares.

FORM 10-Q
INTERNET PATENTS CORPORATION
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PART I: FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INTERNET PATENTS CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)
(unaudited)

| | March 31, 2013 | December 31, 2012 |
|--|-------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 30,527 | \$ 31,068 |
| Short-term investments | 1,493 | 1,497 |
| Restricted cash equivalents and short-term investments | 1,000 | 1,000 |
| Prepaid expenses and other current assets | 148 | 169 |
| Total current assets | 33,168 | 33,734 |
| Property and equipment, net | 27 | 32 |
| Other assets | 27 | 27 |
| Total assets | \$ 33,222 | \$ 33,793 |
| Liabilities and stockholders' equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 149 | \$ 234 |
| Accrued expenses | 312 | 346 |
| Total current liabilities | 461 | 580 |
| Income tax liability | 101 | 101 |
| Total liabilities | 562 | 681 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Common stock | 11 | 11 |
| Paid-in capital | 221,726 | 221,726 |
| Treasury stock | (6,788) | (6,788) |
| Unrealized loss on available-for-sale securities | (1) | - |
| Accumulated deficit | (182,288) | (181,837) |
| Total stockholders' equity | 32,660 | 33,112 |
| Total liabilities and stockholders' equity | \$ 33,222 | \$ 33,793 |

See accompanying notes.

INTERNET PATENTS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)
(unaudited)

| | Three Months Ended March 31, | |
|--|---------------------------------|-----------|
| | 2013 | 2012 |
| Total revenues | \$ - | \$ - |
| Operating expenses: | | |
| General and administrative | 456 | 837 |
| Total operating expenses | 456 | 837 |
| Loss from operations | (456) | (837) |
| Other income | 5 | 100 |
| Net loss | \$ (451) | \$ (737) |
| Net loss per share: | | |
| Basic and diluted | \$ (0.06) | \$ (0.10) |
| Shares used in computing net loss per share: | | |
| Basic and diluted | 7,752 | 7,379 |

See accompanying notes.

INTERNET PATENTS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands)
(unaudited)

| | Three Months Ended March 31, | |
|--|---------------------------------|----------|
| | 2013 | 2012 |
| Net loss | \$ (451) | \$ (737) |
| Other comprehensive loss: | | |
| Unrealized loss on available-for-sale securities | (1) | (1) |
| Other comprehensive loss before tax | (1) | (1) |
| Income tax benefit (expense) related to comprehensive income | - | - |
| Other comprehensive loss, net of tax | (1) | (1) |
| Comprehensive loss | \$ (452) | \$ (738) |

See accompanying notes.

INTERNET PATENTS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)
(unaudited)

| | Three Months Ended March 31, | |
|--|---------------------------------|-----------|
| | 2013 | 2012 |
| Cash flows from operating activities: | | |
| Net loss | \$(451 |) \$(737 |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 5 | 4 |
| Net changes in operating assets and liabilities: | | |
| Prepaid expenses and other current assets | 21 | (39 |
| Other assets | - | 1,000 |
| Accounts payable | (85 |) (2,903 |
| Accrued expenses and other current liabilities | (34 |) (194 |
| Income taxes payable | - | (644 |
| Net cash used in operating activities | (544 |) (3,513 |
| Cash flows from investing activities: | | |
| Purchases of short-term investments | (1,494 |) (736 |
| Redemption of short-term investments | 1,493 | 735 |
| Purchases of restricted cash equivalents and short-term investments | (1,000 |) (1,000 |
| Redemptions of restricted short-term investments | 1,000 | - |
| Purchases of property and equipment | - | (6 |
| Change in interest receivable | 4 | - |
| Net cash provided by (used in) investing activities | 3 | (1,007 |
| Cash flows from financing activities: | | |
| Proceeds from issuance of common stock through stock plans, net of repurchases | - | 5,127 |
| Distribution paid | - | (38,612 |
| Net cash used in financing activities | - | (33,485 |
| Net decrease in cash and cash equivalents | (541 |) (38,005 |
| Cash and cash equivalents, beginning of period | 31,068 | 70,326 |
| Cash and cash equivalents, end of period | \$30,527 | \$32,321 |

See accompanying notes.

INTERNET PATENTS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Business of Internet Patents Corporation

Internet Patents Corporation (“IPC”) was originally incorporated in California in February 1995 and re-incorporated in Delaware in October 1996, and is headquartered outside Sacramento, California. IPC’s headquarters mailing address is 10850 Gold Center Dr., Suite 250, Rancho Cordova, CA 95670, and the telephone number at that location is (916) 853-1529. The principal IPC website is www.internetpatentscorporation.net.

On December 21, 2011 (“Disposition Date”), in connection with the Disposition, the Company changed its name from InsWeb Corporation to Internet Patents Corporation.

Since December 2011, IPC’s business consists solely of plans to license and otherwise enforce its portfolio of six e-commerce patents (“Patent Licensing Business”). From its inception through December 21, 2011, IPC operated an online insurance marketplace that electronically matched consumers and providers of automobile, property, health, term life, and small business insurance. IPC was among the earliest companies operating exclusively online, and we employed a significant staff of software and systems engineers to develop technology leveraging the power of the internet. Although our principal business focus at that time was online insurance lead generation, the problems that our technology experts faced were common to many e-commerce companies. IPC’s innovative solutions to these problems are now covered by patents that we believe apply to many e-commerce activities, including:

- personalized product recommendations to web site visitors;
- retargeting or remarketing to web site visitors;
- online registration and application processes and forms;
- maintaining consistent look and feel of web pages in multiple languages; and
- generating quick or even real time product rate requests.

Under U.S. law, a patent owner is entitled to exclude others from making, selling or using the patented invention for the life of the patent, generally twenty years from its filing date, with some possible term extensions by statute. The patent holder may grant one or more licenses to the patented invention, typically allowing the licensee to make, use and/or sell the patented invention in return for a royalty paid to the patent owner. A patent owner also may sue and recover damages from unlicensed parties for past patent infringement and sometimes future royalties. Although we intend to attempt to negotiate a reasonable royalty for licenses to the patented technologies, we may not be able to reach a negotiated settlement with the accused infringer. In that case we expect to vigorously litigate our infringement claims. To date, none of the Company’s patents have generated direct and specific revenues or been subject to a final adjudication of its validity.

INTERNET PATENTS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

2. Basis of Presentation

The consolidated financial statements include the accounts of IPC and its wholly-owned subsidiaries, Goldrush Insurance Services, Inc. and InsWeb Insurance Services, Inc. All significant inter-company accounts and transactions have been eliminated in the consolidated financial statements.

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not contain all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying unaudited interim condensed consolidated financial statements reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly IPC's financial position as of March 31, 2013 and the results of operations for the three months ended March 31, 2013 and 2012 and of cash flows for the three months ended March 31, 2013 and 2012. The financial data and other information disclosed in these notes to the condensed consolidated financial statements related to these periods are unaudited. The results for the three months ended March 31, 2013 are not necessarily indicative of the results to be expected for any future period.

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in IPC's Annual Report on Form 10-K and other information as filed with the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. The December 31, 2012 condensed consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. The Company believes the disclosures in its notes to the condensed consolidated financial statements are adequate to make the information presented not misleading. IPC has evaluated subsequent events through the time of filing these financial statements. Based upon the evaluation, there was no material impact on the accompanying condensed consolidated financial statements.

Recently Adopted Accounting Pronouncements

In 2013, the Financial Accounting Standards Board ("FASB") issued new accounting guidance clarifying the accounting for the release of cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2013. We do not anticipate that this adoption will have a significant impact on our financial position, results of operations or cash flows.

In 2013, FASB issued new accounting guidance clarifying the accounting for obligations resulting from joint and several liability arrangements for which the total amount under the arrangement is fixed at the reporting date. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2013. We do not anticipate that this adoption will have a significant impact on our financial position, results of operations or cash flows.

3. Fair Value Measurements

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The following table presents the assets measured at fair value on a recurring basis as of March 31, 2013 (in thousands):

| | March 31, 2013 | Level 1 | Level 2 | Level 3 |
|-----------------------------------|-------------------|-----------------|-------------|----------|
| Assets: | | | | |
| Cash equivalents | \$ 46 | \$ 46 | \$ — | — |
| Short-term investments | 1,493 | 1,493 | — | — |
| Restricted cash equivalents | 1,000 | 1,000 | | |
| Total assets at fair value | \$ 2,539 | \$ 2,539 | \$ — | — |

INTERNET PATENTS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

3. Fair Value Measurements (continued)

The following table presents the financial assets measured at fair value on a recurring basis as of December 31, 2012 (in thousands):

| | December 31, 2012 | Level 1 | Level 2 | Level 3 |
|-----------------------------------|-------------------------|-----------------|-------------|----------|
| Assets: | | | | |
| Cash equivalents | \$ 44 | \$ 44 | \$ — | — |
| Short-term investments | 1,497 | 1,497 | | |
| Restricted short-term investments | 1,000 | 1,000 | — | — |
| Total assets at fair value | \$ 2,541 | \$ 2,541 | \$ — | — |

Cash equivalents, short-term investments and restricted cash equivalents and short-term investments include certificates of deposit, money market funds and commercial paper from corporations whose credit ratings are P-1 by Moody's or A-1 by Standard & Poor's. The carrying value of these cash equivalents, short-term investments and restricted cash equivalents and short-term investments approximates fair value. For these securities, IPC uses quoted prices in active markets for identical assets to determine their fair value and are considered to be Level 1 instruments.

4. Restricted Cash Equivalents and Short-Term Investments

As of March 31, 2013 and December 31, 2012, restricted cash equivalents and short-term investments consisted of \$1.0 million each, respectively. The \$1.0 million is used as collateral for a letter of credit of the same amount which secures the Company's obligations under the office space lease for IPC's corporate headquarters.

5. Accrued Expenses and Other Current Liabilities

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

| | March 31, 2013 | December 31, 2012 |
|---------------------------|-------------------|----------------------|
| Deferred rent | \$ 218 | \$ 226 |
| Accrued lease obligations | 70 | 95 |
| Other | 24 | 25 |
| | \$ 312 | \$ 346 |

In 2012, IPC recorded a charge of \$95,000 to record an accrual for lease obligations relating to a formerly occupied facility in San Francisco, California. In evaluating these lease obligations, IPC must make assumptions regarding the estimated future sublease income relative to this facility. These estimates and assumptions are affected by area-specific conditions such as new commercial development, market occupancy rates and future market prices. As a result of the current conditions in the real estate market where this IPC property is located and the inherent risks associated with its sub-lessees, the Company recorded a charge of \$95,000 in 2012, representing the difference

between IPC's lease obligations for this facility and sub-lease income it expects to receive, based on sub-leases entered into, for the duration of the lease. The sub-leases relate to the formerly occupied facility. If this estimate or the related assumptions change in the future, IPC may be required to record a charge to increase its existing accrual.

6. Disposition

In December 2011, we completed the sale of substantially all of the operating assets and liabilities of our insurance lead generation business to Bankrate for an aggregate cash purchase price of \$63.8 million resulting in a gain of \$53.7 million, net of tax. During the quarter ended June 30, 2012, IPC received a supplemental payment from Bankrate of \$67,000 related to the collection of outstanding accounts receivable at the Disposition Date. The \$67,000 was reported as Other Income for the three months ended, June 30, 2012. As a result of this sale, we no longer conduct the lead generation business. Instead, IPC now operates a Patent Licensing Business.

INTERNET PATENTS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

7. Net Loss Per Share

Basic net loss per share is computed using the weighted-average number of shares of common stock outstanding. Diluted net loss per share is a measure of the potential dilution that would occur if stock options had been exercised.

The following table reconciles the numerator and denominator used to calculate basic and diluted net loss per share of common stock:

| (In thousands, except per share amounts) | Three months ended March 31, | |
|--|---------------------------------|----------|
| | 2013 | 2012 |
| Numerator for basic and diluted net loss per share: | | |
| Net loss available to common stockholders | \$(451) | \$(737) |
| Denominator for net loss per share: | | |
| Basic and diluted —weighted average shares of common stock outstanding | 7,752 | 7,379 |
| Net loss per share: | | |
| Basic and diluted | \$(0.06) | \$(0.10) |

Potentially dilutive securities are not included in the diluted net loss calculation, because their inclusion would have been anti-dilutive given the Company's net loss for the three months ended March 31, 2013 and 2012.

For the three months ended March 31, 2013 and 2012; 732 and 13,529 shares issuable upon the assumed exercise of stock options respectively, are not included in the calculation of diluted earnings per share, as their inclusion would have been anti-dilutive.

8. Commitments and Contingencies

Leases

IPC has a non-cancelable 5-year full-service lease for approximately 16,000 square feet of office space in a building that houses IPC's headquarters. The facility is located in Rancho Cordova, California. The lease includes negotiated annual increases in the monthly rental payments. IPC has two consecutive options to extend the term for five years, each at the then prevailing market rent. As noted in Footnote 11 titled "Subsequent Events", on April 16, 2013 IPC subleased this space to an early stage company. Under the terms of the sublease, the sub-lessee will pay IPC a flat monthly rent for the remainder of IPC's leasehold term. The monthly sublease rent is less than IPC's rent obligation to the landlord. IPC plans to move to a smaller location that is more appropriate for a company of its size.

IPC also leases approximately 10,000 square feet of office space in San Francisco, California under a lease expiring in September 2014. This facility is currently fully subleased to two tenants for the remainder of the lease. As of March

31, 2013, IPC is expected to receive \$148,000 from the two sub-lessees for the remainder of IPC's lease.

INTERNET PATENTS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

9. Options and Equity

In January 2012, one of the Company's Board members exercised 42,416 options at exercise prices between \$4.74 and \$5.25 per share. In a cashless exercise, 25,000 shares were tendered to the Company in satisfaction of the exercise price of the options, at a price of \$7.95 per share, based on the closing price of the Company's common stock on the date of exercise. The 25,000 shares tendered have been accounted for by the Company as treasury stock in the accompanying consolidated balance sheets.

As of March 31, 2013, there was no unrecognized compensation cost for all stock options outstanding, as all options became fully vested on December 11, 2011, which was ten days prior to Disposition Date, in accordance with the IPC Stock Option and Executive Plans. During the three months ended March 31, 2013 and 2012 there were common share issuances of 0 and 1,169,985, respectively associated with the exercise of stock options.

10. Litigation Settlement

In February 2012, a one-time payment of \$99,000 was received by IPC following the settlement of commercial litigation with a former employee. The litigation settlement was recorded as other income in the accompanying consolidated statements of operations.

11. Subsequent Event

On April 16, 2013, IPC entered into a sublease with an early stage company for the 16,199 square feet of office space in Rancho Cordova, CA that currently houses its operations. Under the terms of the sublease, the sub-lessee will pay IPC a flat monthly rent for the remainder of IPC's leasehold term. IPC will move to a smaller location that is more appropriate for a company of its size.

The sublease does not terminate IPC's interest in the Rancho Cordova office space, nor does it relieve IPC of the obligation to maintain the premises and pay rent to the landlord. Because the sublease rent that IPC will receive is less than IPC's monthly rent obligation, IPC will evaluate the sublease and market conditions in determining whether to record a charge in the period IPC vacates the premises.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Quarterly Report on Form 10-Q, and in particular Management's Discussion and Analysis of Financial Condition and Results of Operations, contains "forward-looking statements" with respect to IPC's future financial performance. The words or phrases "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," and similar expressions are generally intended to identify forward-looking statements. Such forward-looking statements are subject to various known and unknown risks and uncertainties, and IPC cautions you that any forward-looking information provided by, or on behalf of, IPC is not a guarantee of future performance. Actual results could differ materially from those anticipated in such forward-looking statements due to a number of factors, some of which are beyond IPC's control, including, but not limited to, the unpredictable nature of patent licensing and patent litigation; potential changes in the laws and regulations relating to patents and patent litigation; the risk that we are not currently engaged in the patent licensing business, and our patent portfolio has never generated revenues; future changes we may make in our patent licensing strategy; changes in the taxation of income due to the disallowance or expiration of the Company's net operating losses; and litigation in which IPC is a party. These risks and uncertainties, as well as other risks and uncertainties, which are described in greater detail in IPC's Annual Report on Form 10-K for the year ended December 31, 2012 and other documents filed with the Securities and Exchange Commission, could cause IPC's actual results to differ materially from historical results or those currently anticipated. All forward-looking statements are based on information available to IPC on the date hereof, and IPC assumes no obligation to update such statements.

Overview

IPC's business consists solely of plans to license and otherwise enforce its portfolio of six e-commerce patents ("Patent Licensing Business"). From its original incorporation, IPC was among the earliest companies operating exclusively online, and we employed a significant staff of software and systems engineers to develop technology leveraging the power of the internet. Although our principal business focus at that time was online insurance lead generation, the problems that our technology experts faced were common to many e-commerce companies. IPC's innovative solutions to these problems are now covered by patents that we believe apply to many e-commerce activities, including:

- personalized product recommendations to web site visitors;
- retargeting or remarketing to web site visitors;
- online registration and application processes and forms;
- maintaining consistent look and feel of web pages in multiple languages; and
- generating quick or even real time product rate requests.

Our future revenues are expected to consist of the royalties from licensing the patents and damages for past infringement. We expect significant resistance from entities that we believe infringe one or more of our patents, at least until the validity of the patents can be established. Patent infringement litigation can be expensive and often takes several years to reach the trial stage, and the appeals process could result in further delays in receiving royalties or damage awards. For these reasons, IPC cannot estimate what revenues, if any, it will receive in 2013. In addition to general and administrative expenses, including salaries and benefits, rent and utilities, we will incur expenses associated with patent infringement litigation and being a public company. We cannot predict if we will generate revenues or be profitable in 2013.

During 2012 IPC filed patent infringement lawsuits against six companies. Two of the companies are alleged to infringe the Event Log patent; four companies are alleged to infringe the Dynamic Tabs patent. Each of the lawsuits was filed in the U.S. District Court for the Northern District of California and trial dates for the lawsuits have not been set.

Results of Operations

Operating Expenses

| (in thousands, except percentages) | Three months ended March 31, | | Percentage change from prior period |
|------------------------------------|---------------------------------|--------|---|
| | 2013 | 2012 | |
| General and administrative | \$ 456 | \$ 837 | (46) % |

General and Administrative. General and administrative expenses consist primarily of payroll and related expenses, including employee benefits, facility costs, accounting and legal services and insurance for our general management, administrative and accounting personnel, as well as other general corporate expenses. General and administrative expenses decreased to \$456,000 for the three months ended March 31, 2013 from \$837,000 for the comparable period in 2012. The decrease was primarily due to a reduction in administrative headcount, reduced accounting services, insurance, rent, consulting services, business taxes and public relations. General and administrative expenses are expected to increase for the remainder of 2013, due primarily to an anticipated increase in legal expenses.

Other Income. Other income was \$5,000 for the three months ended March 31, 2013 as compared to \$100,000 for the comparable period in 2012. Other Income for the three months ended March 31, 2013 consists of interest earned on IPC's investment portfolio of cash, cash equivalents and short-term investments. For the three months ended, March 31, 2012, other income also included a one-time payment of \$99,000 received by IPC following the settlement of commercial, non-patent litigation. IPC expects that Other Income will consist entirely of returns received from its investment portfolio in the near future, which will be negligible given the conservative nature of IPC's investment policy and the current economic conditions in the United States.

Income Taxes. Internet Patents Corporation recognized no expense for, and did not receive a benefit from income taxes for the three months ended March 31, 2013 and 2012.

Recently Adopted Accounting Pronouncements

In 2013, the Financial Accounting Standards Board ("FASB") issued new accounting guidance clarifying the accounting for the release of cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2013. We do not anticipate that this adoption will have a significant impact on our financial position, results of operations or cash flows.

In 2013, FASB issued new accounting guidance clarifying the accounting for obligations resulting from joint and several liability arrangements for which the total amount under the arrangement is fixed at the reporting date. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2013. We do not anticipate that this adoption will have a significant impact on our financial position, results of operations or cash flows.

Critical Accounting Policies

IPC's discussion and analysis of its financial condition and results of operations are based on IPC's consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires IPC to make estimates and judgments that affect the reported amounts of assets and liabilities and the 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. IPC bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. IPC believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

Income Taxes.

Under the asset and liability method prescribed under ASC 740, "Income Taxes", IPC recognizes deferred tax assets and liabilities for the future tax consequences attributable to differences between financial statement carrying amounts of assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled.

For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. At March 31, 2013 and March 31, 2012, IPC had unrecognized tax benefits of approximately \$0.3 million and \$0.3 million, respectively (\$0.1 million of which, if recognized, would affect IPC's effective tax rate). IPC does not believe there will be any material changes in its unrecognized tax positions over the next twelve months.

For tax return purposes, IPC had net operating loss carry forwards at March 31, 2013 of approximately \$141.3 million and \$63.2 million for federal income tax and state income tax purposes, respectively. Included in these amounts are unrealized federal and state net operating loss deductions resulting from stock option exercises of approximately \$6.7 million each. The benefit of these unrealized stock option-related deductions has not been included in deferred tax assets and will be recognized as a credit to additional paid-in capital when realized. Federal and state net operating loss carry forwards begin or have begun expiring in 2019 and 2013 respectively.

The carrying value of our deferred tax assets, which was approximately \$48.9 million at March 31, 2013, is dependent upon our ability to generate sufficient future taxable income. We have established a full valuation allowance against our net deferred tax assets to reflect the uncertainty of realizing the deferred tax benefits, given historical losses. A valuation allowance is required when it is more likely than not that all or a portion of a deferred tax asset will not be realized. This assessment requires a review and consideration of all available positive and negative evidence, including our past and future performance, the market environment in which we operate, the utilization of tax attributes in the past, and the length of carryforward periods and evaluation of potential tax planning strategies. We expect to continue to maintain a full valuation allowance until an appropriate level of profitability is sustained or we are able to develop tax strategies that would enable us to conclude that it is more likely than not that a portion of our deferred tax assets would be realizable.

Liquidity and Capital Resources

Summarized cash flow information is as follows (in thousands):

Three months ended

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| | | March 31, | |
|---|------|-----------|------------|
| | 2013 | | 2012 |
| Cash used in operating activities | \$ | (544) | \$ (3,513) |
| Cash provided by (used in) investing activities | | 3 | (1,007) |
| Cash used in financing activities | | - | (33,485) |

At March 31, 2013, IPC's principal source of liquidity was \$30.5 million in cash and cash equivalents and \$1.5 million in short-term investments. IPC adheres to an investment policy with minimal market or settlement risk with its current holdings. There are no restrictions or limitations regarding access to the \$30.5 million in cash and cash equivalents and \$1.5 million in short-term investments. Since inception, IPC has financed its operations primarily through the sale of preferred and common stock and cash flow from operations.

For the three months ended March 31, 2013, net cash used in operating activities was \$0.5 million, primarily consisting of our net loss adjusted for depreciation and amortization of property and equipment of \$0.4 million and cash used of \$0.1 million, primarily due to payment of accounts payable and accrued expenses. This was partially offset by a decrease in prepaid expenses.

For the three months ended March 31, 2012, net cash used in operating activities was \$3.5 million, primarily consisting of our net loss adjusted for depreciation and amortization of property, equipment of \$0.7 million and cash used of \$3.7 million primarily due to payment of accounts payable, income taxes, and accrued expenses and liabilities. This was partially offset by cash provided by deposits and other assets of \$1.0 million.

For the three months ended March 31, 2013, net cash provided by investing activities was \$3,000 representing \$1.5 million relating to the purchases of short-term investments and \$1.0 million relating to purchases of restricted cash equivalents, offset by redemptions of short-term investments of \$1.5 million and redemptions of restricted short-term investments of \$1.0 million.

For the three months ended March 31, 2012, net cash used in investing activities was \$1.0 million representing \$0.7 million relating to the purchases of short term investments and \$1.0 million in purchases of restricted short term investments, offset by the redemptions of short term investments of \$0.7 million.

For the three months ended March 31, 2012, net cash used in financing activities was \$33.5 million, consisting of an aggregate \$38.6 million cash distribution paid to shareholders on March 9, 2012, offset by proceeds from employee stock plans of \$5.1 million.

IPC has a non-cancelable lease through February 14, 2017 for approximately 16,000 square feet of office space in the Sacramento area which houses its corporate headquarters. IPC has two, consecutive options to extend the term for five years each at the prevailing market rent. On April 16, 2013, IPC subleased this space for the remainder of IPC's term. The monthly sublease rent is less than IPC's rent obligation to the landlord.

IPC also leases approximately 10,000 square feet of office space in San Francisco, California under a non-cancelable lease expiring in October 2014. This facility is currently fully subleased to two tenants for the remainder of IPC's lease term.

Future minimum lease commitments as of March 31 31, 2013 are summarized as follows (in thousands):

| Years ending December 31 | Future minimum lease commitments |
|--------------------------|--|
| 2013 | \$ 283 |
| 2014 | 367 |
| 2015 | 342 |
| 2016 | 350 |
| Thereafter | 58 |
| | \$ 1,400 |

IPC currently anticipates that its cash and cash equivalents will be sufficient to meet its anticipated cash needs to fund operations and capital expenditures for at least the next 12 months.

ITEM 4. CONTROLS AND PROCEDURES

- (a) Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.
- (b) During our second fiscal quarter of 2012, our management evaluated and modified our internal controls over financial reporting in light of changes to the Company's business processes necessitated by the discontinuation of the lead generation business and the implementation of a patent licensing business.

PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 1A. RISK FACTORS.

Risks Related to Our Business

Our Patent Licensing Business revenues will be unpredictable.

We received no revenues in 2012 or during the three months ended March 31, 2013, from the Patent Licensing Business. Since we have not historically generated revenues from the Patent Licensing Business, our historical financial and operating information is of limited value in evaluating the Patent Licensing Business and our future prospects. Moreover, our revenues from the Patent Licensing Business, if any, will be unpredictable because of the significant uncertainty associated with patent licensing and patent litigation. We will continue to incur salary, legal and other expenses of operating our business, including the expenses of a public company. Our results of operations and financial condition will be materially adversely affected if we fail to effectively manage our overhead costs associated with the Patent Licensing Business, we become involved in expensive litigation or settlement proceedings which may or may not have successful outcomes, or if the Patent Licensing Business does not perform to our expectations. In addition, the members of our management team do not have significant experience operating a business focused on licensing and otherwise enforcing patented technologies, and therefore may require time to adequately familiarize themselves with the nature of our new Patent Licensing Business.

If any of our patents are declared invalid, our business may be harmed.

The success of our Patent Licensing Business model will depend on our ability to generate royalty fees from licensing our technology or damages from patent infringement lawsuits. However, it is possible that one or more of our patents might be declared invalid if challenged by an entity against whom we seek to enforce our patent rights. Even if our patents are upheld as valid, we may have difficulty identifying entities that will voluntarily enter into a license for our patented technology. In this case, we may be required to litigate to recover damages for infringement, and we will incur significant legal and expert fees and costs, and the litigation may take several years to conclude.

Third parties may choose to alter their business operations rather than pay us an on-going royalty.

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We believe that our patents represent unique technologies that a wide range of third parties have or will find valuable to their operations. In many cases we expect that patent infringement litigation will be required to recover damages for past infringement of our patent rights and to incentivize the defendant to accept a license and pay us royalties for its future use of the technology. Defendants may, however, choose to modify their operations to work around the claims covered by our patents. In that case, they would not pay us royalties for future use and our business may be harmed.

As patent enforcement litigation becomes more prevalent, it may become more difficult for us to voluntarily license our patents to other entities.

We believe that the more prevalent patent enforcement actions become, the more difficult it will be for us to voluntarily license our patents to other entities. As a result, we may need to increase the number of our patent enforcement actions to cause infringing companies to license our patents or pay damages for past infringement. This may result in increased expenses, delay the recovery of damages and harm our business.

New legislation, regulations or rules related to obtaining patents or enforcing patents could significantly increase our operating costs and limit our revenue growth.

If new legislation, regulations or rules are implemented either by Congress, the U.S. Patent and Trademark Office, or the courts that impact the patent application process, the patent enforcement process or the rights of patent holders, these changes could negatively affect our expenses and revenue growth. For example, new rules regarding the burden of proof in patent enforcement actions could significantly increase the cost of litigation for infringement, and new standards or limitations on liability for patent infringement could negatively impact our revenue derived from such actions.

Trial judges and juries often find it difficult to understand complex patent enforcement litigation, and as a result, we may need to appeal adverse decisions by lower courts in order to successfully enforce our patents.

It is difficult to predict the outcome of patent enforcement litigation at the trial level. It is often difficult for juries and trial judges to understand complex, patented technologies, and as a result, there is a higher rate of successful appeals in patent enforcement litigation than more standard business litigation. Such appeals are expensive and time consuming, resulting in increased costs and delayed revenue. Although we may diligently pursue enforcement litigation, we cannot predict with significant reliability the decisions made by juries and trial courts.

Federal courts are becoming more crowded, and as a result, patent enforcement litigation is taking longer.

If we are required to litigate to enforce our patented technologies, our patent enforcement actions will be almost exclusively prosecuted in federal court. Federal trial courts that hear patent enforcement actions also hear criminal cases, which will take priority over our actions. As a result, it is difficult to predict the length of time it will take to complete an enforcement action. Moreover, we believe there is a trend in increasing numbers of civil lawsuits and criminal proceedings before federal judges, and as a result, we believe that the risk of delays in our patent enforcement actions may have an adverse effect on our business in the future unless this trend changes.

Depressed general economic conditions or further adverse changes in general economic conditions could adversely affect our operating results

The severe economic downturn in the United States has resulted in a record level of corporate insolvencies. We are unable to estimate the probability that companies that we assert our patents against have sufficient resources to fully compensate us for their past infringement or future use of our patented technologies. The inability to recover full value from a significant number of entities would harm our future revenues.

Risks Related to Our Common Stock

Our future stock price may fluctuate widely.

The trading price of our common stock has been volatile and may be significantly affected by factors including actual or anticipated operating results, announcements regarding licensing or litigation developments, disputes concerning the validity of one or more of our patents, and our limited trading volume. These fluctuations may harm our stock price. Any negative change in the public's perception of the prospects of the Patent Licensing Business could also depress our stock price regardless of our results.

Our common stock may be delisted from the Nasdaq Capital Market if we fail to satisfy the continued listing standards of that market.

If we are unable to satisfy the continued listing standards of the Nasdaq Capital Market, our common stock may be delisted from that market. In order to continue to be listed on the Nasdaq Capital Market, we must meet all of the following requirements as set forth in Nasdaq Listing Rule 5550(a):

minimum bid price of at least \$1.00 per share for 30 consecutive trading days;

at least 300 total stockholders (including both beneficial holders and holders of record, but excluding any holder who is directly or indirectly an executive officer, director, or the beneficial holder of more than 10% of the total shares outstanding);

at least 500,000 publicly held shares with a market value of at least \$1 million (excluding any shares held directly or indirectly by officers, directors or any person who is the beneficial owner of more than 10% of the total shares outstanding of the Company); and

at least two registered and active market makers, one of which may be a market maker entering a stabilizing bid.

We must also meet at least one of the three standards in Nasdaq Listing Rule 5550(b) as follows:

stockholders' equity of at least \$2.5 million;

market value of listed securities of at least \$35 million; or

net income from continuing operations of \$500,000 in the most recently completed fiscal year or in two of the three most recently completed fiscal years.

If we do not satisfy those standards and we are unsuccessful in taking corrective action to comply with the listing requirements, we may be delisted from the Nasdaq Capital Market. If our common stock were to be delisted from the Nasdaq Capital Market, trading of our common stock most likely would be conducted in the over-the-counter market on an electronic bulletin board established for unlisted securities such as the Pink Sheets or the OTC Bulletin Board. Such trading could substantially reduce the market liquidity of our common stock. As a result, an investor would find it more difficult to dispose of, or obtain accurate quotations for the price of our common stock.

Our success is dependent in part upon the continued services of our senior management with whom we do not have employment agreements.

Our success is dependent in part upon the continued services of the members of our senior management team, and on our ability to attract and retain key management personnel. IPC has no long-term employment agreements with any of its personnel that provide for their continued employment with us. The Company maintains a life insurance policy on two employees that names the Company as the beneficiary, but the loss of the services of any employee could have a material adverse effect on our business, financial condition and results of operations.

Our recent adoption of a shareholder rights plan may reduce the volume of trading in our stock because it limits the ability of persons or entities from acquiring a significant percentage of our outstanding stock.

On November 30, 2012, IPC stockholders approved an amendment to the Company's Certificate of Incorporation creating a stockholder rights plan designed to preserve the value of certain tax assets associated with net operating loss

carryforwards under Section 382 of the Internal Revenue Code of 1986. Stockholders also approved a Section 382 Rights Agreement adopted by our Board of Directors in November 2011. The stockholder rights plan and rights agreement are intended to act as deterrents to any person or group, together with its affiliates and associates, being or becoming the beneficial owner of 4.9% or more of the Company's common stock. The inability of some stockholders to acquire a significant position could substantially reduce the market liquidity of our common stock, making it more difficult for a stockholder to dispose of, or obtain accurate quotations for the price of, our common stock.

Delaware law and our charter documents contain provisions that could discourage or prevent a potential takeover, even if such a transaction would be beneficial to our stockholders.

Provisions of Delaware law and our certificate of incorporation and bylaws could make it more difficult for an entity to acquire us by means of a tender offer, a proxy contest, or otherwise, and the removal of incumbent officers and directors.

ITEM 6. EXHIBITS

| Exhibit Number | Description of Document |
|----------------|---|
| 31.1 | Certification of Chief Executive Officer, pursuant to Exchange Act Rule 13a-14(a). |
| 31.2 | Certification of Chief Financial Officer, pursuant to Exchange Act Rule 13a-14(a). |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer, pursuant to 18 U.S.C. Section 1350. |
| 101.INS* | XBRL Instance |
| 101.SCH* | XBRL Taxonomy Extension Schema |
| 101.CAL* | XBRL Taxonomy Extension Calculation |
| 101.DEF* | XBRL Taxonomy Extension Definition |
| 101.LAB* | XBRL Taxonomy Extension Labels |
| 101.PRE* | XBRL Taxonomy Extension Presentation |

* XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

SIGNATURE

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

Dated: May 6, 2013

INTERNET PATENTS CORPORATION
(Registrant)

/s/ STEVEN J. YASUDA
Steven J. Yasuda
Chief Financial Officer and Chief Accounting
Officer