



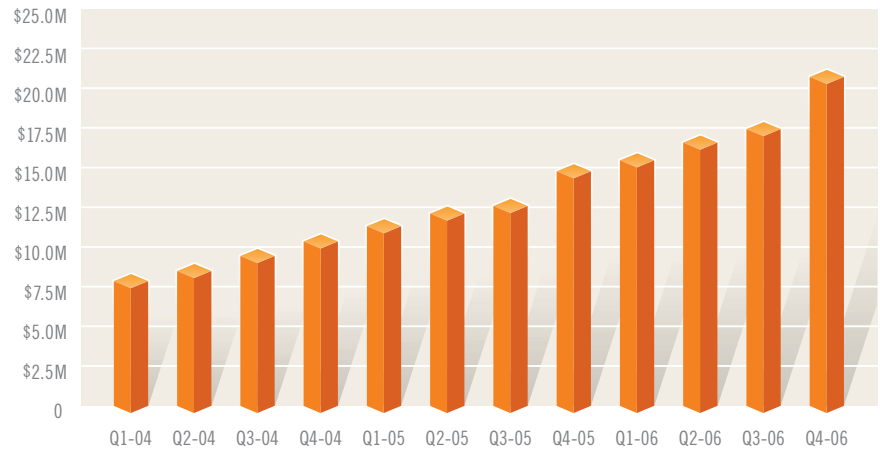
THE SINGLE SOURCE FOR eCOMMERCE PAYMENT

CyberSource®

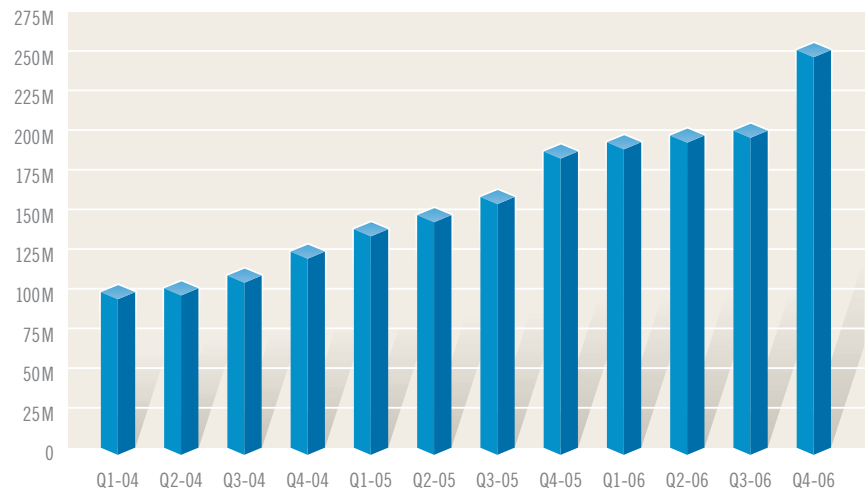
ANNUAL REPORT 2006

CYBERSOURCE THREE YEARS IN REVIEW

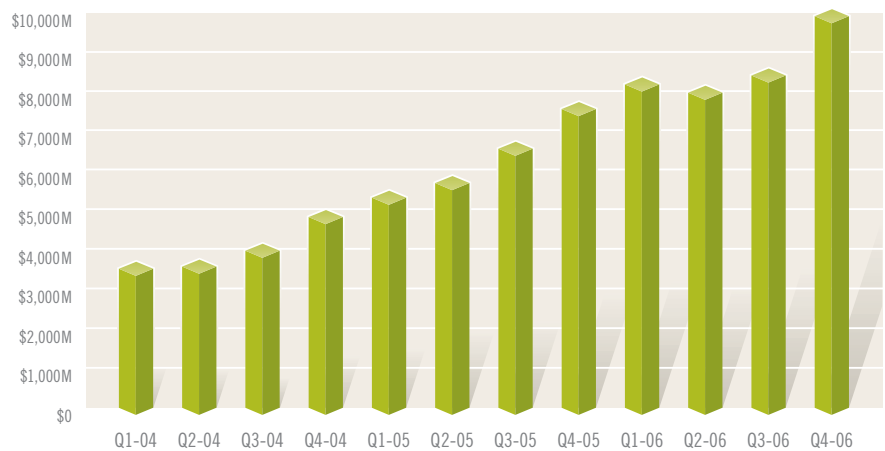
Revenue



Transaction Volume



Authorization Dollars Processed



LETTER FROM THE CHAIRMAN

Dear stockholders:

2006 was another record year for CyberSource Corporation. Once again, our business grew rapidly in virtually every operating and financial metric. CyberSource transaction volume grew 34%, our customer count grew 35%, and revenue grew 39%. With eCommerce in the U.S. growing about 20-25% per year, these results indicate that CyberSource not only achieved strong growth in 2006, but gained market share. Some of the key operating and financial metrics include:

	2006 RESULTS	GROWTH 2006 VS. 2005
Transaction volume	854.2 million	+34%
Customer count	18,200 at year end	+35%
Value of transactions processed	\$34.5 billion	+36%
Revenue	\$70.3 million	+39%
Earnings per share	\$0.39	+50%
Net income	\$14.4 million	+56%
Stock price at 12/31/2006	\$11.02	+67%

We continue to attract outstanding global brands as customers. In 2006, we were proud to welcome Condé Nast Publications, Hearst Communications, OfficeMax, Phillip Morris, Rand McNally, Seagate, and Shell Oil Global Communications, among thousands of others to CyberSource. They join a customer base that includes British Airways, Eastman Kodak, Home Depot, Nike, Starbucks, Toshiba and Yahoo!.

Contributing to our strong performance this year are our leading-edge technology and solid infrastructure, combined with unparalleled customer support. CyberSource uptime was 99.992% for 2006. And, CyberSource was again recognized, by an independent company, for excellence in customer satisfaction and support – our fifth consecutive year of winning such an award. That commitment to excellence directly

contributed to our strong customer growth. In the last three years, our installed base of customers increased six fold, from approximately 3,000 customers to more than 18,000 by the end of 2006.

Another important development during the year was our acquisition of auction payment service BidPay from First Data Corporation. In just three short months, the BidPay team completely re-architected and re-launched this service. Although BidPay represents a small portion of our business, by the end of 2006 we had over 250,000 registered BidPay users, over 32,000 sellers, and over 500,000 active listings, demonstrating strong demand for alternatives in the auction payment space.

As strong as our growth has been, we see tremendous opportunity going forward. CyberSource has created a unique position in the market as the world's first payment management company. Customers no longer view payment, risk management, and reconciliation as autonomous, independent tasks. Rather, all of these are critically intertwined components of the overall business flow. CyberSource enables customers to optimize business processes by providing seamless integration of these payment components. In so doing, we help customers increase sales conversion, minimize payment costs, and

comply with today's strict payment security requirements. By adding more value to every order, we deepen our relationships with customers, improve their businesses, and improve our own economics.

Some key elements of our growth strategy are:

Global payment acceptance: We continue to expand our global footprint, enabling our customers to sell more by supporting more regional payment types and currencies. While eCommerce in North America continues to grow at a robust rate, many markets in Europe, Asia, and Latin America are growing even faster. Over the last year we continued to expand in Europe and formed new partnerships in Latin America and India.

Risk and security management: Our 8th Annual Online Fraud Report showed that while fraud rates, as a percentage of online revenue, have remained static year over year, the overall increase in eCommerce translates into an increase in fraud losses. It is no longer enough to simply contain fraud rates. CyberSource remains at the forefront of risk management, empowering customers with industry-leading tools and services to protect good orders while controlling the overall cost of fraud. And, because data security remains a top concern for our customers, we launched the CyberSource Payment Data Management™ service, which enables customers to minimize the risks associated with storing sensitive data.

Fully-managed services: As the complexity of payment and risk management grows, CyberSource is providing more managed services that shield our customers from that complexity. We are seeing a growing appetite in the market for fully-managed services as

customers seek to focus resources on their core businesses and leverage partners, like CyberSource, to provide expertise in non-core, complex areas.

Channel & alliance partners: CyberSource has built strategic partnerships with leading financial institutions and eCommerce technology platform providers. Through these alliances, CyberSource enhances the partners' offerings by providing payment management expertise to accelerate their eCommerce businesses. These partnerships amplify our marketing message and they are especially crucial in helping us to penetrate the small business segment.

Back in 1997, we created a "BHAG," or Big Hairy Audacious Goal, for CyberSource. Our BHAG was to process one billion billable transactions in the year 2007. In 1997, that was a nearly impossible goal. At that time, we were processing a few thousand transactions per day – few people had ever bought anything online. As we enter 2007, we appear to be on track to accomplish what was once a seemingly unattainable goal. We are at the heart of an exciting industry, and the next ten years promise to be even more exhilarating and rewarding than the last ten.

*"As we enter 2007,
we appear to be
on track to
accomplish what was
once a seemingly
unattainable goal."*



William S. McKiernan
Chairman and Chief Executive Officer



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2006

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

For the transition period from _____ to _____

Commission File Number 000-26477
CYBERSOURCE CORPORATION
(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction
of Incorporation or Organization)

77-0472961
(I.R.S. Employer
Identification Number)

1295 Charleston Road
Mountain View, California 94043
(650) 965-6000
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Securities Registered Pursuant to Section 12(b) of the Act:

None

Securities Registered Pursuant to Section 12(g) of the Act:

Common Stock, \$.001 Par Value per Share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933, as amended.

☐ Yes ☒ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Act of 1934, as amended. ☐ 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 and 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 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 the 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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

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

☐ Yes ☒ No

The aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2006 was approximately \$359.4 million (based on a closing sale price of \$11.70 per share as reported for the NASDAQ Global Market on such date). Shares of Common Stock held by officers and directors have been excluded from this calculation because such persons may be deemed to be affiliates.

The number of shares of the registrant's Common Stock, \$.001 par value per share, outstanding as of March 1, 2007 was 35,068,279.

Documents incorporated by reference: Portions of Part II and Part III of this Form 10-K incorporates information by reference from the registrant's Proxy Statement for its 2007 Annual Meeting of Stockholders.

CAUTIONARY STATEMENTS

The statements contained in this Report on Form 10-K that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding the Company's expectations, objectives, anticipations, plans, hopes, beliefs, intentions or strategies regarding the future. Forward-looking statements include, without limitation, statements regarding (a) estimates regarding U.S. eCommerce revenues for 2006 and the potential growth of online sales, (b) Europe's pace of growth, (c) our statement that eCommerce sales are growing by more than 20% per year, far faster than the 2.1% growth rate of traditional in-store credit card purchases, (d) the trend among some of our large U.S. customers seeking greater and more ready access to international markets (e) data suggesting that the overall cost of fraud, which includes the cost of fraud management and the rejection of good orders, continues to rise, (f) online merchants' increasing focus on meeting regulatory requirements in areas such as collection of sales taxes, (g) our goal of providing a single source solution that simplifies and optimizes online payment and (h) our belief that the overall cost of eCommerce fraud will increase under "Item 1, Business—Market Characteristics"; the statement regarding our belief that enterprises will demand a payment service capable of supporting multiple, independent sales channels and enterprises see significant benefit in being able to manage and control a single transaction payment platform under the heading "Item 1, Business—Technology"; statements regarding (a) our belief that our well-defined software development methodology enables us to deliver software services that satisfy real business needs for the global market while meeting commercial quality expectations, (b) our belief that a strong emphasis placed on analysis and design early in the project lifecycle reduces the number and costs of defects that may be found in later stages and (c) our belief that as the number of services in our market increase and functionalities overlap, companies such as ours may become increasingly subject to infringement claims under the heading "Item 1, Business—Product Development"; the statement regarding our belief that our success depends upon our proprietary technology and licensed technology under the heading "Item 1, Business—Intellectual Property"; the statement regarding our technology, processes, and people enabling us to deliver the highest level of services and performance to our customers under the heading "Item 1, Business—Operations"; the statement regarding our solutions alliances and strategic alliances resulting in cooperative development efforts, streamlining of integration capabilities and leveraged marketing efforts under the heading "Item 1, Business—Sales and Marketing"; the statement regarding our beliefs with respect to our systems and processes enabling us to comply with the Fair Credit Reporting Act if we were deemed a consumer reporting agency under the heading of "Item 1, Business—Regulations"; statements regarding (a) our expectation that the competition in our market is to intensify in the future and that it is subject to rapid technological change, (b) our expectation that other companies, including financial services and credit companies may enter the market and provide competing services, (c) our belief that current and potential competitors may develop and market new technologies that render our existing or future products and services obsolete, unmarketable or less competitive, (d) our belief that current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with other solution providers, thereby increasing their ability to address the needs of our existing or prospective customers, and (e) our belief that the market for our solutions is rapidly evolving and we may not be able to compete successfully against current and future competitors under the heading of "Item 1, Business—Competition"; statements that (a) we may pursue strategic acquisitions of complementary businesses or technologies that would provide additional product or service offerings, additional industry expertise, a broader client base or an expanded geographic presence, (b) any future acquisition could result in the use of significant amounts of cash, dilutive issuances of equity securities, or the incurrence of debt or amortization expenses related to goodwill and other intangible assets, any of which would materially adversely affect our business, operating results and financial condition, (c) we may be required to expend significant capital and other resources to protect against security breaches and to address any problems they may cause, (d) as BidPay.com's revenue increases, our potential liability for such chargebacks increases, (e) our future growth will depend in part on the success of our relationships with existing and future sales alliances that market our products and services to their merchant accounts, (f) to the extent that new regulations make it more difficult or expensive to grant stock options to employees, we may incur increased compensation costs, change our equity compensation strategy or find it difficult to attract, retain and motivate employees, each of

which could materially and adversely affect our business, and (g) our future success will depend upon our ability to retain our key management personnel under the heading of “Item 1A, Risk Factors”; statements regarding (a) our belief that the potential adverse effects of the lawsuit would be borne by our insurers and (b) statements regarding our belief that litigation outcomes of class action lawsuits and other claims would not have a material effect on our consolidated financial condition, results of operations or cash flows under the heading of “Item 3, Legal Proceedings” and under “Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies”; statements regarding our belief that we do not anticipate paying any cash dividends in the foreseeable future under the heading “Item 5, Market for Registrant’s Common Equity and Related Stockholder Matters”; statements regarding (a) our intention to maintain the remaining valuation allowance until sufficient further positive evidence exists to support further reversals of the valuation allowance, (b) our expectation that we will recognize stock-based compensation expense ratably over the requisite service period of the award, (c) our expectation that our overall gross margins will continue to decrease as our global acquiring services revenues increase in the future, (d) our expectation that product development expenses will increase in absolute dollars during 2007, (e) our expectation that product development expenses will moderately decrease as a percentage of revenue during 2007 as compared to 2006 due primarily to expected revenue growth, (f) our expectation that sales and marketing expenses will increase in absolute dollars during 2007 as we continue to develop our sales and marketing infrastructure to support our anticipated revenue growth, (g) our expectation that sales and marketing expenses in 2007 will moderately decrease as a percentage of revenues as compared to 2006 due primarily to expected revenue growth, (h) our expectation that general and administrative expenses will increase in absolute dollars in 2007 due primarily to higher personnel-related expenses and higher third-party professional fees, (i) our expectation that general and administrative expenses in 2007 will modestly decrease as a percentage of revenues as compared to 2006 due primarily to expected revenue growth and (j) our expectation that interest income will increase in 2007 due to anticipated higher cash, cash equivalents and short-term investment balances under the heading “Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations”; the statement regarding our belief that our cash and short-term investment balances will be sufficient to meet our working capital requirements for at least the next twelve months under the heading “Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources”; the statement regarding our belief that the adoption of SAB 108 is not currently expected to have a significant impact on our consolidated financial statements under the heading “Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations—Recent Pronouncements”; the statement regarding our anticipation that our operating expenses are relatively fixed in the short term under the heading “Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations—Risk Factors”; statements regarding (a) our belief that any direct financial impact of the proposed settlement is expected to be borne by our insurers, (b) the lawsuit with ReD will not have a material effect on our financial condition, results of operations, or cash flows and (c) our belief that there are no claims or actions pending or threatened against us, the ultimate disposition of which would have a material impact on our financial position or results of operations, under the heading “Item 8, Financial Statements and Supplementary Data—Notes to Consolidated Financial Statements—Note 12—Litigation and Contingencies”; and statements regarding (a) our goal of monitoring our internal controls for financial reporting and making modifications as necessary and (b) our intent that the internal controls for financial reporting be maintained as dynamic systems that change (including improvements and corrections) as conditions warrant under the heading “Item 9A, Controls and Procedures—Internal Control Over Financial Accounting.”

All forward-looking statements included in this document are based on information available to the Company on the date hereof, and the Company assumes no obligation to update any such forward-looking statements. It is important to note that the Company's actual results could differ materially from those included in such forward looking statements. Factors that could cause actual results to differ materially from the forward looking statements include risks and uncertainties detailed throughout this Annual Report, and in particular in the “Risk Factors” section at the end of “Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Such factors include but are not limited to the following cautions: (1) We are subject to the risks encountered by early stage companies, such as risks of intense competition and rapid technological change in our industry, risks that we may not be able to fully utilize relationships with our strategic partners and indirect sales channels, risks that any fluctuations in our quarterly operating results will be significant relative to our revenues and risks that we may not be able to adequately integrate acquired businesses; (2) We may incur future losses and there is no assurance that we will realize sufficient revenues to achieve ongoing profitability; (3) Our competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements; (4) Potential system failures, compromised security measures or lack of capacity issues could negatively affect demand for our services; (5) Growth in the significance of the Internet as a commercial marketplace may occur more slowly than anticipated; (6) We may not be successful in attracting and/or retaining key employees in the future, (7) Third parties may claim that the technology employed in providing our current or future products and services infringes upon their rights and (8) Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. These cautionary statements should be considered in the context of such factors, as well as those disclosed from time to time in the Company's Reports on Forms 10-Q and 8-K.

PART I

ITEM 1: BUSINESS

Company Overview

CyberSource Corporation ("CyberSource" or the "Company") provides secure electronic payment and risk management solutions to organizations that process orders for goods and services over the Internet. CyberSource's payment solutions allow eCommerce merchants to accept a wide range of online payment options, from credit cards and electronic checks, to global payment options and emerging payment types. Our risk and compliance management tools address complexities common to online merchants such as credit card fraud, online tax requirements, and export controls. Our reporting and management tools facilitate the automation of the flow of complex eCommerce processes, such as recurring billing and payment reconciliation. We partner with and connect to a large network of payment processors and other payment service providers to offer merchants a single source solution.

Traditionally, our target customer base has been medium and large enterprises, but during the last five years we have also targeted development and marketing efforts on the small business segment.

In 2006, we processed approximately 854 million transactions, a 34% increase over 2005. The dollar value of all credit card authorization requests we processed in 2006 exceeded \$34 billion, an average of nearly \$4 million per hour.

On March 7, 2006, CyberSource acquired auction payment service BidPay.com, Inc. from First Data Corporation. CyberSource purchased proprietary technology, databases, and certain intellectual property rights, including exclusive rights to the BidPay.com brand. On June 14, 2006, the service was re-launched. As of December 31, 2006, BidPay.com had approximately 250,000 registered users and was listed on approximately 500,000 auctions. BidPay.com operates as a wholly owned subsidiary of CyberSource.

CyberSource Corporation was founded in 1994 and initially launched software.net, an online software store and built the payment processing capability to support software.net. In 1996, CyberSource Corporation created a second business focused on payment processing and ran two separate business units, an online software store and the payment processing business. On December 31, 1997, two business units were split into two separate corporations through the spin-off of the payment processing business into a separate corporation initially named, Internet Commerce Services Corporation. After the online software store changed its name to software.net Corporation (and later to Beyond.com Corporation), Internet Commerce Services Corporation changed its name to CyberSource Corporation and continues to operate today under that name. Our headquarters is located at 1295 Charleston Road, Mountain View, California 94043, and our telephone number is (650) 965-6000. We maintain a website at www.cybersource.com. The reference to this website address does not constitute incorporation by reference of the information contained therein.

The Company is subject to the informational requirements of the Securities Exchange Act of 1934 (the "Exchange Act"). Accordingly, the Company files periodic reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC"). Such reports, proxy statements and other information may be obtained by visiting the Public Reference Room of the SEC at 450 Fifth Street, NW, Washington, D.C. 20549 or by calling the SEC at 1-800-SEC-0330. Our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports, and the Proxy Statement for our Annual Meeting of Stockholders are made available, free of charge, on our website, www.cybersource.com, as soon as reasonably practicable after the reports have been filed with or furnished to the SEC.

Market Characteristics

In 1997, Forrester Research estimated the total U.S. online market to be \$2.4 billion. Their total estimate of U.S. online sales for 2006 is \$211.4 billion, a nine year compounded annual growth rate of 64%. Online sales in Europe are growing at an even faster pace according to Forrester Research. In 2006, the U.S. Census Bureau reported that online sales by U.S. retailers grew by 23.4% as compared to a total retail sales growth of 6.1%. At the end of 2006, the U.S. Census Bureau estimated that online sales of these retailers comprised 3.0% of their total U.S. sales, up from 2.5% at the end of 2005.

As the online commerce market has grown, business requirements and attitudes about electronic commerce have evolved. What began as an online sales experiment for many organizations has become a strategic component of their business plan. Although credit cards have long been the dominant payment method available to online purchasers, alternative consumer preferences and cultural preferences have impacted the global payment environment. A wide spectrum of payment options, such as debit cards, electronic checks, stored value certificates, and online payment innovations such as Bill Me Later are emerging worldwide. Since 2002, we have experienced a noticeable trend among some of our large U.S. customers to seek greater access to

international markets, especially Europe. Conducting online commerce internationally involves supporting more payment types, currency conversions, new payment processors and mitigating higher fraud risk.

The growth of eCommerce has also resulted in more complexity with internal business processes. Online fraud has evolved into an organized and systemic threat to online merchants. The latest “CyberSource Fraud Survey,” sponsored by CyberSource and conducted by Mindwave Research in October 2006 concluded that online sellers expected fraudulent transactions to cost on average 1.4% of revenues in 2006. Though that is statistically equivalent to the direct fraud cost projected by the prior year’s survey, the data suggests that the overall cost of fraud, which includes the cost of fraud management and the rejection of good orders, continues to rise. The cost of fraud management is incurred, for example, when merchants require manual intervention, a step that slows order processing and increases costs. Among other things, we are focused on improving our automated management tools to speed the appropriate disposition of orders.

Online merchants are also giving increased focus to meeting regulatory requirements in areas such as collection of sales taxes. U.S. merchants are gradually moving toward adding sales tax to their online orders as state and local governments focus on this revenue source. European Union regulations require that all online sellers of digital goods collect the applicable value-added tax for sales in the European Union. In June 2005, in the U.S., Visa and MasterCard began requiring compliance with a comprehensive security requirement called the Payment Card Industry Data Security Standard (PCI) to limit the threat of cardholder information theft.

The combination of these market trends is making the management of electronic payment transactions more complex. Online merchants are finding the need to maintain technical and financial connections with a number of different payment processors and service providers, integrate those disparate connections with a number of internal business systems, allocate manual resources to keep pace with the growth of online sales, and comply with statutory and card association requirements. CyberSource focuses on enabling our customers to meet these market requirements simply and cost effectively. Our goal is to provide a single source solution that simplifies and optimizes online payment.

Platform Options

CyberSource solutions are made available to customers through hosted services, enterprise software, or a combination of the two. Merchants that elect to outsource processing to CyberSource use our hosted services. Merchants that prefer to maintain processing internally and establish connections directly to processors use our enterprise software, called CyberSource Payment Manager. Both platforms are augmented by CyberSource Professional Services, which provides consulting, design, integration, and optimization services.

Over 18,000 customers use our hosted transaction processing services. Key attributes of our hosted services include redundancy of networks and data centers, strict security, and high capacity.

In December 2005, the Payment Card Industry Data Security Standard (PCI) was introduced, superseding prior data security standards, including the Visa AIS, Visa CISP, and MasterCard SDP programs. CyberSource is evaluated once annually, and has been certified as compliant for 2006-2007.

CyberSource packaged software offerings consist of CyberSource Payment Manager and Decision Manager Custom Edition. CyberSource Payment Manager connects the merchant’s business systems with a variety of payment processors. CyberSource Decision Manager Custom Edition is our enterprise software product for risk management. Decision Manager Custom Edition provides a central software platform for order process management, enabling merchants to automatically determine whether to accept, review, or reject incoming orders.

CyberSource Customers

Our customers range in size from small sole proprietorships to some of the world’s largest corporations and institutions. To properly serve this diverse set of needs, CyberSource divides its potential market into two segments, both of which require different solutions. Merchants and institutions that have high sales volume generally demand the greatest range of payment options and the most sophisticated risk and management tools. These customers often sell in multiple countries and require support for local currencies and local payment options. High volume customers also frequently need to integrate payment processing with one or more internal business systems. Smaller merchants generally seek simplicity and ease of use. CyberSource addresses these needs with bundled services and integrations into popular online shopping cart software, while bringing to the small business market some of the advantages of CyberSource’s enterprise-level services, including important new payment options such as electronic checks, PayPal, and subscription payment, as well as reliability and high-quality customer support.

CyberSource Products and Services

CyberSource Payment Solutions

CyberSource Advanced

For the enterprise customer, CyberSource offers a comprehensive set of payment products and services. Requirements of these larger merchants typically include acceptance of all major credit cards, the ability to bill customers at regular monthly intervals, support for international payment options, sophisticated fraud prevention, and tools to automate internal processes to reduce the administrative costs and burdens of accepting online orders.

CyberSource Advanced enables merchants to accept payments made by all major credit or charge cards including American Express, Discover, Diners Club, JCB, MasterCard, and Visa cards. CyberSource customers can also accept payment by corporate procurement cards, electronic checks, and the Bill Me Later service. Merchants that have business models based on subscriptions can take advantage of the CyberSource recurring billing service. For merchants selling internationally, CyberSource supports direct debit, and bank transfers, as well as regional card brands such as Switch, Solo, Visa Electron, Laser, Carte Bleue, Carta Si, and Dankort.

CyberSource Essentials

CyberSource Essentials gives businesses the ability to accept major credit cards via their websites as well as process telephone, facsimile, and mail order payments using a web-based virtual terminal. CyberSource Essentials includes support for payment options such as eChecks, PayPal, and subscription payment along with our reliability and high quality customer support.

CyberSource Global Acquiring (Merchant Account Services)

CyberSource provides the underwriting services required for merchants to accept card payments within the United States, as well as accept and process regional payment types worldwide. CyberSource interfaces with the banking system on behalf of the merchant to authorize the payment presented by a merchant's customer, collect funds from their customer's bank, and deposit the funds into the merchant's designated checking account. These services are available as a bundled offering with all CyberSource payment solution packages and software.

CyberSource Payment Manager

CyberSource Payment Manager is an enterprise software processing platform that operates behind the scenes to authorize and settle payments originating from one or more sales channels. Once installed on the merchant's servers, CyberSource Payment Manager receives transaction requests from the merchant's commerce platform, contact center application, point-of-sale or enterprise resource planning system. CyberSource Payment Manager routes those requests to the payment network for authorization, either through our connections or packaged software gateways, and returns the results to dependent business systems.

CyberSource Risk Management Solutions

The CyberSource suite of modular, scalable services, ranging from fully managed services to individual tools, is designed to help merchants address the growing challenge of online fraud. CyberSource solutions can be implemented as a single component or as fully-integrated systems, and can be managed in-house, outsourced, or constructed as a blend of both.

Managed Risk Service

This service provides the professional analysis, design, modeling and monitoring services required to optimize transaction conversion, while minimizing manual review and fraud risk associated with card-not-present transactions. We collaborate with customers to set business metrics, review performance, and provide business tools.

Rule & Decisioning Systems: CyberSource Decision Manager

We offer a range of decision management systems ranging from hosted solutions that include custom rule and case management capabilities to locally managed software that can be customized to the merchant's installation. Hosted risk services are marketed as CyberSource Decision Manager Standard Edition and CyberSource Decision Manager Advanced Edition. Software installed and managed locally by merchants is marketed as CyberSource Decision Manager Custom Edition. These systems include interfaces to our risk scoring service as well as other external services and the merchant's own data.

Fraud Detection/Verification Tools

CyberSource Advanced Fraud Screen enhanced by Visa (AFS), the only risk scoring service endorsed and enhanced by Visa U.S.A. Inc., provides a real-time fraud risk assessment. AFS relies on a patented process blending multiple risk models, assessing over 150 attributes of the transaction and transaction histories, to determine the fraud risk associated with a card-not-present order. The results from AFS include a numerical risk score as well as risk profile codes indicating the types of risk detected by the system.

Payer Authentication Services

Through a single connection to CyberSource, CyberSource customers can use card association authentication systems such as Verified by Visa and MasterCard Secure Code.

Delivery Address Verification

We offer Delivery Address Verification (DAV) services to verify the validity of addresses worldwide and comply with the U.S. Postal Service's requirements, such as bar code and carrier route identification. If an address is in error and is found to be correctable, DAV will return a corrected address and identify address elements in error.

Tax Calculation and Export Compliance

Online organizations often require tools to facilitate tax payment and export regulatory compliance. The CyberSource Tax Service calculates sales and use taxes for over 60,000 taxing jurisdictions in the United States and Canada and supports value added tax calculation in 28 countries. The CyberSource Export Compliance service helps online merchants comply with U.S. Government export regulations by comparing orders against a changing list of denied countries or persons.

Professional Services

Building upon our experience in eCommerce, we employ a team of experts that can help merchants operate effective online businesses. The CyberSource Professional Services group provides business and technical consulting services including technology selection, analysis of impacts of the online business on internal processes, devising merchant-specific risk management strategies, systems installation, integration of CyberSource products and services with the merchants' existing internal systems, building custom reporting tools, disaster recovery planning, and security consulting. In April 2005, we introduced the CyberSource PCI Compliance Service, a comprehensive assessment and readiness program for eCommerce merchants seeking full compliance with the Payment Card Industry Data Security Standard (PCI). PCI is a unified data security standard developed jointly by Visa and MasterCard aimed at limiting the threat of cardholder information theft. As of December 31, 2006, we employed 13 persons in our Professional Services group.

BidPay

On March 7, 2006, we acquired auction payment service BidPay.com, Inc. from First Data Corporation. CyberSource purchased proprietary technology, databases, and certain intellectual property rights, including exclusive rights to the BidPay.com brand. On June 14, 2006, the service was re-launched. As of December 31, 2006, BidPay.com had approximately 250,000 registered users and was listed on approximately 500,000 auctions. During the fourth quarter of 2006, BidPay.com revenue was approximately \$173,000 and generated a loss. BidPay.com operates as a wholly owned subsidiary of CyberSource.

Technology

Transaction Services

Our transaction processing system employs a modular architecture designed for scalability, reliability, extensibility and performance. This system is composed of multiple groups of servers and routers that appear as a single point of contact to our customers' systems. This system also utilizes the latest industry standards to maximize compatibility with our customers' commerce systems. In addition, we have implemented a global network of telecommunications access points that are designed to optimize transaction processing response times and to mitigate the effects of system failures. The primary software components of our system are the transaction databases, the commerce processing engine, the commerce services applications, the CyberSource Order Processing API, the Simple Commerce Messaging Protocol (SCMP) and respective client software.

Transaction Database Architecture

Two primary sets of databases form the core of our transaction processing system: the transaction processing databases, which maintain information necessary to process each individual transaction, and the post-transaction database, which generates and provides detailed information about customers' transactions, with advanced reporting capabilities available in XML and other formats.

Commerce Engine

Our commerce engine manages workflow functions and the required communications between our servers, our database, and our processors, including Barclays Bank, First Data Corporation, Chase Paymentech, Streamline (provided by the Royal Bank of Scotland Group), Vital Processing Services and others. Our commerce engine is designed to meet the transaction processing demands of our customers in a secure, fast, efficient, reliable, scalable and interoperable manner and was designed to scale rapidly to balance and handle peak transaction processing loads. Additional commerce engine servers can be readily added to accommodate increased customer demand.

Commerce Services Applications

We have developed and licensed a set of software applications that perform the hosted services. These services include credit card processing, electronic check processing, order decision management, gift and promotional certificates, Bill Me Later payment service, payer authentication, PayPal, CyberSource Advanced Fraud Screen enhanced by Visa, tax services, delivery address verification, and export compliance. These applications contain the rules and logic necessary to provide our hosted services to customers. In many cases, execution of the applications are distributed among the commerce engine and database systems, enabling us to minimize interruptions during scheduled maintenance when enhancing or adding additional services to meet our customers' needs.

Order Processing API using Web Services

In 2003, we introduced the CyberSource Order Processing API to allow the secure and reliable communication of order data from our customers' systems to CyberSource systems. The Order Processing API provides our customers with a way to send invoice data to CyberSource for processing by any of the CyberSource commerce services applications. Using industry standard web services technologies, including SOAP, XML, and WS Security, the Order Processing API provides customers with an industry recognized implementation path allowing the Order Processing API to be built into customer order management applications. The Order Processing API uses the Data Encryption Standard, RSA/public key cryptography and digital certificates to ensure secure signed communication of transaction data.

Simple Commerce Messaging Protocol

We developed SCMP to enable efficient and secure connections between our commerce engine systems and our customers' systems. In order to ensure secure messaging, SCMP utilizes industry standards for secure communications including the Data Encryption Standard, RSA/public key cryptography and digital certificates. SCMP has been designed so that it can be integrated into virtually any commerce server platform.

Client Software

Our commerce services are invoked by a common programming interface residing on our customers' commerce servers. Client software is provided for SCMP and Order Processing API interfaces and can be easily installed by customers using pre-built developer kits and application plug-ins. These developer kits are available for most popular Internet programming environments, including ASP/COM, .NET, Java and others, and for most operating systems, including Windows NT/2000, Linux, and UNIX (Solaris, HP/UX, IBM/AIX and others). Developer kits also come with samples that customers can use to quickly deploy CyberSource services within their enterprises.

Data Centers and Network Access

Our data centers are located at facilities in Santa Clara and San Jose California, Denver, Colorado London, England and Tokyo, Japan. These secure data center facilities contain our servers, network firewalls, routers and other technology necessary to provide high availability transaction services and connectivity to the Internet, our customers and processing partners. The data centers provide high-speed and redundant network connectivity, uninterruptible power systems, fire detection and suppression systems, physical security and surveillance on a 24 hours a day, 7 days a week, 365 days a year basis. In addition, we have access to numerous network points of presence located on five continents from third party providers enhancing our ability to serve

customers globally. These points of presence, through controlled route announcements to providers such as AT&T, UU-NET, Sprint, GLBX, Cable & Wireless, Verio, AboveNet, Telia and Level 3 Communications, enable us to provide direct, rapid and reliable access to our suite of services.

Industry Standards

The implementation of our architecture for hosted services is based on and complies with widely accepted industry standards. For example, the commerce engine utilizes components from industry leaders such as Cisco, Hewlett Packard, IBM, Microsoft, Red Hat, RSA Data Security, Sun Microsystems and Sybase. Adherence to industry standards provides compatibility with existing applications, ease of modification, and reduces the need for software modules to be rewritten over time, thus protecting our customers' investments.

Enterprise Software

CyberSource Payment Manager

The CyberSource Payment Manager product is based on modular systems architecture that allows this server to be installed into large customer infrastructures where a dedicated payment gateway interface will be used. The CyberSource Payment Manager is designed as a three-layer software architecture well suited for enterprise deployment. These layers include the multiple sales channel interface, core server, and database. The CyberSource Payment Manager core server supports a common programming interface that can be adapted to multiple sales channel enterprise systems. These sales systems could be used in conjunction with a call center in order to accept orders through an interactive voice response unit, from a Web server using hypertext transfer protocol, from a point-of-sale terminal, or from a wireless application protocol device. This architecture supports our belief that enterprises will demand a payment server capable of supporting multiple, independent sales channels, and that the enterprise sees significant benefit in being able to manage and control a single transaction payment platform.

The database layer is based on a standard structured query language (SQL) interface, offering a choice of implementations with any of the standard relational database management systems (RDBMS) on the market. Database platforms currently used by our customers include Microsoft SQL Server, Oracle, and Sybase.

CyberSource Decision Manager Custom Edition

CyberSource Decision Manager Custom Edition is powerful and flexible order decision/fraud management software that enables customers to customize fraud rules based on their specific product, industry, and environment variables. It intelligently and efficiently routes transactions for processing or customer service action and provides customers with the ability to adapt quickly to emerging fraud trends.

The decision engine itself is built on standard Java 2 Enterprise Edition (J2EE) technology and is currently deployable on the BEA WebLogic Platform, IBM WebSphere Application Server or JBOSS Application Server. Back-end database connectivity is provided through the Java Database Connectivity (JDBC) application programming interface, an integral part of the J2EE standard. Currently supported databases are IBM DB2, Microsoft SQL Server and Oracle RDBMS.

The architecture is extensible through a standards-based XML developer API, allowing our professional services organization or the customer to build custom plug-ins that can communicate with other external data sources. These data sources can provide additional information about the customer's order, allowing more flexibility in determining associated risk. Standard plug-ins available from CyberSource connect Decision Manager Custom Edition to all of our hosted services, to CyberSource Payment Manager, as well as to third-party services.

Product Development

Our product development team is responsible for the design, development, and release of our software and core infrastructure for services. We emphasize quality assurance throughout our development lifecycle. We believe that a strong emphasis placed on analysis and design early in the project lifecycle reduces the number and costs of defects that may be found in later stages.

When appropriate, we utilize third parties to expand the capacity and technical expertise of our internal product development organization. On occasion, we have licensed third-party technology that we feel provides the strongest technical alternative. We believe this approach shortens time-to-market without compromising our competitive position or product quality. As of December 31, 2006, we employed 52 persons in our product development department.

Intellectual Property

Our success depends upon our proprietary technology and licensed technology. We rely on a combination of patent, copyright, trademark, trade secret laws, confidentiality procedures and licensing arrangements to establish and protect our proprietary rights.

We have been issued four patents and have eleven patent applications pending. The first issued patent, for a method and system for controlling distribution of software in a multi-tiered distribution chain, expires in April 2016. The second issued patent, for a method and system for detecting fraud in a credit card transaction over the Internet, expires in July 2017. The third issued patent, for a non-extensible thin server that generates user interfaces via browser, expires in April 2018. The fourth issued patent, for a method and system for delivering digital products electronically, expires in November 2017. We have pending patent applications covering cryptography, digital delivery, stored value, electronic gift certificate processing, electronic check processing, and enhancements to our fraud screening and digital delivery systems. We investigate, define and prepare applications for new patents as a part of the standard product development cycle. Our engineering management team meets on a regular basis to harvest new inventions from the engineering department. We cannot assure that any patent application that we file will issue as a patent, and we cannot assure that any patent issued to us will not be held invalid or unenforceable based on prior art or for any other reason.

We believe that numerous patent applications relating to the Internet commerce field have been filed or have issued as patents. From time to time, in the ordinary course of business, we become aware of one or more patents of third parties that we choose to evaluate for a variety of purposes. These purposes may include determining the general contents of patents, reviewing the technological developments of their assignees and determining whether our technology may overlap. We have not conducted searches to determine whether any of our services or technology could be alleged to infringe upon any patent rights of any third party. We cannot assure that none of our products, services, and technology infringes any patent of any third party.

As part of our confidentiality procedures, we generally enter into non-disclosure agreements with our employees, contractors, vendors, potential customers and alliances, and our license agreements with our customers, with respect to our software, services, documentation and other proprietary information, contain confidentiality obligations. Despite these precautions, third parties could reverse engineer, copy or otherwise obtain our technology without authorization, or develop similar technology independently. While we police the use of our services and technology through online monitoring and functions designed into SCMP and our commerce engine, an unauthorized third-party may nevertheless gain unauthorized access to our services or pirate our software. We are unable to determine the extent to which piracy of our intellectual property or software exists. Software piracy is a prevalent problem in our industry. Effective protection of intellectual property rights may be unavailable or limited in foreign countries. We cannot assure that the protection of our proprietary rights will be adequate or that our competitors will not independently develop similar technology, duplicate our services, or design around any intellectual property rights we hold. See the discussion under Item 3 “Litigation” for further information regarding infringement of our 154 Patent.

From time to time we may receive notice of claims of infringement of other parties’ intellectual property rights. As the number of services in our market increases and functionalities overlap, companies such as ours may become increasingly subject to infringement claims. Any infringement claims, with or without merit, could be time-consuming, result in costly litigation, diversion of technical and management personnel, or require us to develop non-infringing technology or enter into licensing agreements. Such licensing agreements, if required, may not be available on acceptable terms, if at all. In the event of a successful claim of infringement and our failure or inability to develop non-infringing technology or license the proprietary rights on a timely basis, our business, operating results and financial condition could be materially adversely affected.

Operations

Our operations department is responsible for the 24 hours a day, 7 days a week, 365 days a year management and support of our global data centers and technology infrastructure. We support and manage the transaction services business with enterprise-class technologies and tools. These technologies and tools are deployed and managed by strict adherence to proven operational principles, processes, and procedures. We believe this technology, the processes, and our employees enable us to deliver the highest level of services and performance to our customers.

As of December 31, 2006, we employed 29 persons in our operations department.

Customer Support

One of CyberSource’s key areas of focus is customer satisfaction. We provide a range of customer implementation and sustaining support services to ensure a high level of performance, reliability, and customer satisfaction for our customers. These

services ensure our customers get solutions implemented quickly, as well as provide the support necessary to identify and effectively resolve operational issues. Our offerings range from basic phone support, online ticketing, and self-help to priority response from dedicated technical account managers.

The Company's performance during 2006 was measured by CustomerSat, Inc. through surveys to customers using CyberSource's hosted suite of payment and risk management services. CyberSource received CustomerSat's Achievement in Customer Excellence award in November of 2006.

As of December 31, 2006 we employed 56 persons in our customer support department.

Sales and Marketing

We target prospective customers worldwide through a direct sales force as well as reseller and referral programs. Our indirect sales channel is divided into "resellers," "managed commerce providers," and "referral partners." We have contractual relationships with these companies that range from referral relationships to reselling our software and services.

Resellers: Our resellers provide our software and services as part of their larger offering portfolio and facilitate the sale and billing of our services. Resellers are authorized to sell our hosted services and support services. Our resellers include banks, small business resellers, and payment service providers such as Bank of America, First Data Merchant Services, MIVA, a division of FindWhat.com, Chase Paymentech, as well as a number of smaller partners.

Managed Commerce Providers (MCPs): Managed commerce providers typically host customized and turnkey storefronts for online businesses. MCPs manage the entire customer relationship including operations, support, and billing. MCPs include internet service providers, application service providers, and specialized systems integrators. Our MCP partners include AuctionAnything, Accretive Commerce, The Acquity Group, Channel Advisor, Capitol Advantage, ChannelWave, Comergent, Crimson Bow, Escalate, Graphtek, MarketWorks, Radquest, and UniteU.

Referral Partners: These are companies with which we have referral agreements, structured with or without monetary incentives. These allies include companies from the payment industry, independent software vendors, integrators and consulting firms.

In addition to channel and referral relationships, we pursue both solutions alliances and strategic alliances. These result in cooperative product development efforts, streamlining of integration capabilities and leveraged marketing efforts.

Solutions Alliances: These alliances integrate CyberSource technology into some of their products, making it easier for their customers to access CyberSource products and services. These alliances include commerce server vendors, interactive voice response vendors, and enterprise software vendors. Current solutions alliance relationships include: Aspect, ATG, BEA, BroadVision, IBM, Microsoft, PeopleSoft, and Siebel.

Strategic Alliances: Our strategic alliances include our relationships with AmeriNet, CheckFree, FDC/Telecheck, I4 Commerce, PayPal, and Visa U.S.A. We work with strategic alliances to enhance our existing solutions portfolio, develop new services and drive the adoption of industry standards.

As of December 31, 2006, we employed a total of 63 employees in sales and marketing and an additional 13 professional service consultants.

Competition

The market for our products and services is intensely competitive and subject to rapid technological change. We expect competition to intensify in the future. Our primary source of competition comes from businesses that develop their own internal, custom-made systems. Such businesses typically make large initial investments to develop custom-made systems and therefore, may be less likely to adopt outside services or vendor-developed online commerce transaction processing software.

We face competition from merchant acquirers, independent sales organizations, and payment processors such as iPayment Inc., First Data Corporation, Chase Paymentech, and Royal Bank of Scotland. We also face competition from transaction service providers such as Lightbridge, PayPal and Retail Decisions as well as e-commerce providers such as Bertelsmann Financial Services, Digital River, and GSI Commerce Inc. Further, other companies, including financial services and credit companies may enter the market and provide competing services.

Many of our competitors have longer operating histories, substantially greater financial, technical, marketing or other resources, or greater name recognition than we do. Our competitors may be able to respond more quickly than we can to new or

emerging technologies and changes in customer requirements. Competition could seriously impede our ability to sell additional products and services on terms favorable to us. Our current and potential competitors may develop and market new technologies that render our existing or future products and services obsolete, unmarketable or less competitive. Our current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with other solution providers, thereby increasing their ability to address the needs of our existing or prospective customers. Our current and potential competitors may establish or strengthen cooperative relationships with our current or future channel partners, thereby limiting our ability to sell products and services through these channels. We expect that competitive pressures may result in the reduction of our prices or our market share or both, which could materially and adversely affect our business, results of operations or financial condition.

We compete on the basis of certain factors, including:

- system and product reliability;
- product performance;
- domain expertise;
- sales channels, operating environments and applications supported;
- ease of implementation and integration;
- time to market;
- customer support; and,
- price.

Presently, we believe that we compete favorably with respect to each of these factors. However, the market for our solutions is rapidly evolving and we may not be able to compete successfully against current and future competitors.

Employees

As of December 31, 2006, we had a total of 247 full-time employees, including 76 employees in professional services, sales, and marketing, 52 employees in product development, 85 employees in operations and customer support, and 34 employees in general and administrative services. None of our employees are represented by a labor union and we consider employee relations to be good.

International Sales

Products and services provided to merchants outside the United States accounted for 10.0%, 9.6% and 9.4% of our revenues in 2006, 2005 and 2004, respectively.

Regulations

The following regulations may adversely affect our business now or in the future:

- *Fair Credit Reporting Act.* Because our fraud screening system assesses the probability of fraud in a card-not-present credit card transaction, we may be deemed a consumer reporting agency under the Fair Credit Reporting Act. As a precaution, we have implemented processes that we believe will enable us to comply with the Act if we were deemed a consumer reporting agency. Complying with the Act requires us to provide information about personal data stored by us. Failure to comply with the Act could result in claims being made against us by individual consumers and the Federal Trade Commission.
- *Export Control Regulations.* Current export control regulations prohibit the export of strong encryption technology without a license unless exempt from license requirements, thereby preventing us from using stronger encryption technology to protect the security of data being transmitted to and from Internet merchants outside of the United States. We have obtained a license to use 1024-bit encryption technology with our international merchants. Furthermore, we believe that our products and services fall under certain licensing exemptions as financial products.

ITEM 1A: RISK FACTORS.

Set forth below and elsewhere in this Annual Report on Form 10-K, including in Item 7, Management's Discussion and Analysis, and in other documents we file with the Securities and Exchange Commission are risks and uncertainties that could cause actual results to differ materially from those described herein:

The Expected Fluctuations of Our Quarterly Results Could Cause Our Stock Price to Fluctuate or Decline

We expect that our quarterly operating results will fluctuate significantly in the future based upon a number of factors, many of which are not within our control. We base our operating expenses on anticipated market growth and our operating expenses are relatively fixed in the short term. As a result, if our revenues are lower than we expect, our quarterly operating results may not meet the expectations of public market analysts or investors, which could cause the market price of our common stock to decline.

Our quarterly results may fluctuate in the future as a result of many factors, including the following:

- changes in the size and number of transactions processed on behalf of customers as a result of seasonality, success of each customer's business, general economic conditions or regulatory requirements restricting our customers;
- our ability to attract new customers and to retain our existing customers;
- customer acceptance of new products and services we may offer, including our global acquiring business and the BidPay.com business that we re-launched, and if such businesses are not operated profitably, the write down of intangible assets related to such businesses;
- customer acceptance of our pricing model;
- customer acceptance of our software and our professional services offerings;
- the success of our sales and marketing programs;
- an interruption with one or more of our processors, other financial institutions and technology service providers;
- seasonality of the retail sector;
- changes in accounting rules and regulations;
- war or other international conflicts; and
- weakness in the general U.S. economy and the lack of available capital for our customers and potential future customers.

Other factors that may affect our quarterly results are set forth elsewhere in this section. As a result of these factors, our revenues are not predictable with any significant degree of certainty.

Due to the uncertainty surrounding our revenues and expenses, we believe that quarter-to-quarter comparisons of our historical operating results should not be relied upon as an indicator of our future performance.

Our Stock Price May Fluctuate Substantially Due to Factors Outside Our Control

The market price for our common stock may be affected by a number of factors outside our control, including the following:

- the announcement of new products, services or enhancements by our competitors;
- quarterly variations in our competitors' results of operations;
- changes in earnings estimates or recommendations by securities analysts;
- developments in our industry; and
- general market conditions and other factors, including factors unrelated to our operating performance or the operating performance of our competitors.

These factors and fluctuations, as well as general economic, political and market conditions may materially and adversely affect the market price of our common stock.

The Intense Competition in Our Industry Could Reduce or Eliminate the Demand for Our Products and Services

The market for our products and services is intensely competitive and subject to rapid technological change. We expect competition to intensify in the future. We face competition from merchant acquirers, independent sales organizations, and payment processors such as Chase Paymentech Solutions, First Data Corporation, LLC., iPayment Inc., and Royal Bank of Scotland. We also face competition from transaction service providers such as Lightbridge, PayPal, and Retail Decisions as well

as e-commerce providers such as Bertelsmann Financial Services, Digital River, and GSI Commerce Inc. Further, other companies, including financial services and credit companies may enter the market and provide competing services.

Many of our competitors have longer operating histories, substantially greater financial, technical, marketing or other resources, or greater name recognition than we do. Our competitors may be able to respond more quickly than we can to new or emerging technologies and changes in customer requirements. Competition could seriously impede our ability to sell additional products and services on terms favorable to us. Our current and potential competitors may develop and market new technologies that render our existing or future products and services obsolete, unmarketable or less competitive. Our current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with other solution providers, thereby increasing their ability to address the needs of our existing or prospective customers. Our current and potential competitors may establish or strengthen cooperative relationships with our current or future channel partners, thereby limiting our ability to sell products and services through these channels. We expect that competitive pressures may result in the reduction of our prices or our market share or both, which could materially and adversely affect our business, results of operations or financial condition.

We May Pursue Strategic Acquisitions and Our Business Could be Materially and Adversely Affected if We Fail to Adequately Integrate Acquired Businesses

As part of our future business strategy, we may pursue strategic acquisitions of complementary businesses or technologies that would provide additional product or service offerings, additional industry expertise, a broader client base or an expanded geographic presence. For example, during the first quarter of 2006, we acquired BidPay.com with the view of participating in the payment market for online auctions, an area in which we do not have any experience. If we do not successfully integrate a strategic acquisition, or if the benefits of the transaction do not meet the expectations of financial or industry analysts, the market price of our common stock may decline. Any future acquisition could result in the use of significant amounts of cash, dilutive issuances of equity securities, or the incurrence of debt or amortization expenses related to goodwill and other intangible assets, any of which could materially adversely affect our business, operating results and financial condition. In addition, acquisitions involve numerous risks, including:

- difficulties in assimilating the operations, technologies, products and personnel of an acquired company;
- risks of entering markets in which we have either no or limited prior experiences, such as the payment market for online auctions;
- the diversion of management's attention from other business concerns; and
- the potential loss of key employees of an acquired company.

Potential System Failures and Lack of Capacity Issues Could Negatively Affect Demand for Our Services

Our ability to deliver services to our merchants depends on the uninterrupted operation of our commerce transaction processing systems. Our systems and operations are vulnerable to damage or interruption from:

- "denial of service" attacks;
- computer viruses;
- war, earthquake, fire, flood and other manmade or natural disasters; and
- power loss, telecommunications or data network failure, operator negligence, improper operation by employees, physical and electronic break-ins and similar events.

Despite the fact that we have implemented redundant servers in third-party hosting centers located in Santa Clara, California, and Denver, Colorado, we may still experience service interruptions for the reasons listed above and a variety of other reasons. If our redundant servers are not available, we may not have sufficient business interruption insurance to compensate us for resulting losses. We have experienced periodic interruptions, affecting all or a portion of our systems, which we believe will continue to occur from time to time. For example, on November 12, 1999, our services were unavailable for approximately ten hours due to an internal system problem. We have also subsequently experienced service interruptions and performance issues. Any interruption in our systems that impairs our ability to efficiently and timely provide services could damage our reputation and reduce demand for our services.

Our success also depends on our ability to grow, or scale, our commerce transaction systems to accommodate increases in the volume of traffic on our systems, especially during peak periods of demand. We may not be able to anticipate increases in the use of our systems or successfully expand the capacity of our network infrastructure. Our inability to expand our systems to

handle increased traffic could result in system disruptions, slower response times and other difficulties in providing services to our merchant customers, which could materially harm our business.

A Breach of Our eCommerce Security Measures Could Reduce Demand for Our Services

A requirement of the continued growth of e-Commerce is the secure transmission of confidential information over public networks. We rely on public key cryptography, an encryption method that utilizes two keys, a public and a private key, for encoding and decoding data, and digital certificate technology, or identity verification, to provide the security and authentication necessary for secure transmission of confidential information. Regulatory and export restrictions may prohibit us from using the most secure cryptographic protection available and thereby expose us to an increased risk of data interception. A party who is able to circumvent security measures could misappropriate proprietary information or interrupt our operations. Any compromise or elimination of security could reduce demand for our services.

We may be required to expend significant capital and other resources to protect against security breaches and to address any problems they may cause. Concerns over the security of the Internet and other online transactions and the privacy of users may also inhibit the growth of the Internet and other online services generally, and the Web in particular, especially as a means of conducting commercial transactions. Because our activities involve the storage and transmission of proprietary information, such as credit card numbers, security breaches could damage our reputation and expose us to a risk of loss or litigation and possible liability. Our security measures may not prevent security breaches, and failure to prevent security breaches may disrupt our operations.

BidPay.com May Incur Losses Resulting From User Fraud or Disputes Between Users of Our Service and There Can Be No Assurance That We Will Be Successful in This Business

BidPay.com has incurred losses, and is subject to future significant risk of losses resulting from fraud and disputes between users of our service including:

- the initiation of a chargeback for both legitimate reasons and in cases of consumer fraud;
- non-delivery of goods or services due to merchant fraud or disputes regarding the quality of goods or services provided;
- identify theft or the unauthorized use of a credit card resulting from consumer or merchant fraud; and
- potential breaches of system security.

Failure to identify fraudulent transactions or resolve disputes between users would increase BidPay.com's losses. We have established systems and procedures designed to detect and reduce the impact of consumer and merchant fraud, but we cannot assure that these measures are or will be effective. During the fourth quarter of 2006, BidPay.com revenue was approximately \$173,000 and generated losses. If BidPay.com's revenue increases, our potential liability for such chargebacks also would increase.

There can be no assurance that we will be successful in this business. As of December 31, 2006, we had recorded intangible assets related to our acquisition of BidPay.com in March 2006, with a carrying value of approximately \$3.0 million. If we are not successful, we will incur substantial charges as a result of exiting this business.

We Could Incur Chargeback or Merchant Fraud Losses

We have potential liability for certain transactions processed through our global acquiring services if the payments associated with such transactions are rejected, refused, or returned for reasons such as consumer fraud or billing disputes. For instance, if a billing dispute between a merchant and payer is not ultimately resolved in favor of the merchant, the disputed transaction may be charged back to the merchant's bank and credited to the payer's account. If the charged back amount cannot be recovered from the merchant's account, or if the merchant refuses or is financially unable to reimburse its bank for the charged back amount, we may bear the loss for the amount of the refund paid to the payer's bank. We could also incur fraud losses as a result of merchant fraud. Merchant fraud occurs when a merchant, rather than a customer, intentionally uses a stolen or counterfeit card, card number, or other bank account number to process a false sales transaction, or knowingly fails to deliver merchandise or services in an otherwise valid transaction. We may be responsible for any losses for certain transactions if we are unable to collect from the merchant.

We have established systems and procedures designed to detect and reduce the impact of consumer fraud and merchant fraud, but we cannot assure you that these measures are or will be effective. To date, we have not incurred any significant losses relating to charged back transactions. During 2006, our global acquiring revenue represented approximately 36.9% of our

transaction and support revenue. Our global acquiring revenue may also include fees generated for gateway services as it is becoming more common to charge the customer a bundled price for transaction services provided. To the extent our global acquiring revenue grows, our potential liability for such chargebacks or merchant fraud increases.

If We Are Not Able to Fully Utilize Relationships With Our Sales Alliances, We May Experience Lower Revenue Growth and Higher Operating Costs

Our future growth will depend in part on the success of our relationships with existing and future sales alliances that market our products and services to their merchant accounts. If these relationships are not successful or do not develop as quickly as we anticipate, our revenue growth may be adversely affected. Accordingly, we may have to increase our sales and marketing expenses in an attempt to secure additional merchant accounts.

Our Market is Subject to Rapid Technological Change and to Compete We Must Continually Enhance Our Systems to Comply with Evolving Standards

To remain competitive, we must continue to enhance and improve the responsiveness, functionality and features of our products and services and the underlying network infrastructure. The Internet and the e-Commerce industries are characterized by rapid technological change, changes in user requirements and preferences, frequent new product and service introductions embodying new technologies, and the emergence of new industry standards and practices that could render our technology and systems obsolete. Our success will depend, in part, on our ability to both internally develop and license leading technologies to enhance our existing products and services and develop new products and services. We must continue to address the increasingly sophisticated and varied needs of our merchants, and respond to technological advances and emerging industry standards and practices on a cost-effective and timely basis. The development of proprietary technology involves significant technical and business risks. We may fail to develop new technologies effectively or to adapt our proprietary technology and systems to merchant requirements or emerging industry standards. If we are unable to adapt to changing market conditions, merchant requirements or emerging industry standards, our business would be materially harmed.

The Demand for Our Products and Services Could Be Negatively Affected by a Reduced Growth of e-Commerce or Delays in the Development of the Internet Infrastructure

Sales of goods and services over the Internet do not currently represent a significant portion of overall sales of goods and services. We depend on the growing use and acceptance of the Internet as an effective medium of commerce by merchants and customers in the United States and internationally. The sale of goods and services over the Internet has gained acceptance more slowly outside of the United States. We cannot be certain that acceptance and use of the Internet will continue to develop or that a sufficiently broad base of merchants and consumers will adopt, and continue to use, the Internet as a medium of commerce.

The increase in the significance of the Internet as a commercial marketplace may occur more slowly than anticipated for a number of reasons, including potentially inadequate development of the necessary network infrastructure or delayed development of enabling technologies and performance improvements. If the number of Internet users, or the use of Internet resources by existing users, continues to grow, it may overwhelm the existing Internet infrastructure. Delays in the development or adoption of new standards and protocols required to handle increased levels of Internet activity could also have a detrimental effect. These factors could result in slower response times or adversely affect usage of the Internet, resulting in lower numbers of commerce transactions and lower demand for our products and services.

Our International Business Exposes Us to Additional Foreign Risks

Products and services provided to merchants outside the United States accounted for 10.0%, 9.6% and 9.4% of our revenues in 2006, 2005 and 2004, respectively. In March 2000, we entered into a joint venture agreement with Japanese partners Marubeni Corporation and Trans-Cosmos, Inc. and established CyberSource K.K. to provide commerce transaction services to the Japanese market. Conducting business outside of the United States is subject to additional risks that may affect our ability to sell our products and services and result in reduced revenues, including:

- changes in regulatory requirements;
- reduced protection of intellectual property rights;
- evolving privacy laws in Europe;
- the burden of complying with a variety of foreign laws; and
- war, political or economic instability or constraints on international trade.

In addition, some software contains encryption technology that renders it subject to export restrictions and we may become liable to the extent we violate these restrictions. We might not successfully market, sell and distribute our products and services in local markets and we cannot be certain that one or more of these factors will not materially adversely affect our future international operations, and consequently, our business, financial condition and operating results.

Also, sales of our products and services conducted through our subsidiary in the United Kingdom are denominated in Pounds Sterling. We may experience fluctuations in revenues or operating expenses due to fluctuations in the value of the Pound Sterling relative to the U.S. Dollar. We do not currently enter into transactions with the specific purpose to hedge against currency exchange fluctuations.

Changes in Accounting Standards Regarding Stock Option Plans Will Reduce Our Profitability and Could Limit the Desirability of Granting Stock Options, Which Could Harm Our Ability to Attract and Retain Employees

FASB issued its final standard that requires us to record an expense related to employee stock option grants and stock purchases. As a result, we have included employee stock-based compensation costs in our results of operations for the year ended December 31, 2006, as discussed in Note 1 in the Notes to Condensed Consolidated Financial Statements. The full impact is dependent upon, among other things, the outcome of the Company's current assessment of different long-term incentive strategies involving stock awards in order to continue to attract and retain employees, the total number of stock awards granted and the tax benefit that the Company may or may not receive from stock-based expenses. In addition, new regulations implemented by The NASDAQ Stock Market requiring shareholder approval for all stock option plans could make it more difficult for us to grant options to employees in the future. To the extent that new regulations make it more difficult or expensive to grant stock options to employees, we may incur increased compensation costs, change our equity compensation strategy or find it difficult to attract, retain and motivate employees, each of which could materially and adversely affect our business.

If We Lose Key Personnel, We May Not be Able to Successfully Manage Our Business and Achieve Our Objectives

We believe our future success will depend upon our ability to retain our key management personnel, including William S. McKiernan, our Chief Executive Officer, and other key members of management because of their experience and knowledge regarding the development, special opportunities and challenges of our business. None of our current key employees are subject to an employment contract which enables us to retain them for a specific period of time. We may not be successful in attracting and retaining key employees in the future.

We May Not Be Able to Adequately Protect Our Proprietary Technology and May Be Infringing Upon Third-Party Intellectual Property Rights

Our success depends upon our proprietary technology. We rely on a combination of patent, copyright, trademark and trade secret rights, confidentiality procedures and licensing arrangements to establish and protect our proprietary rights.

As part of our confidentiality procedures, we enter into non-disclosure agreements with our employees, contractors, vendors and potential customers and alliances. Despite these precautions, third parties could copy or otherwise obtain and use our technology without authorization, or develop similar technology independently. Effective protection of intellectual property rights may be unavailable or limited in foreign countries. We cannot assure you that the protection of our proprietary rights will be adequate or that our competitors will not independently develop similar technology, duplicate our products and services or design around any patents or other intellectual property rights we hold.

We also cannot assure you that third parties will not claim that the technology employed in providing our current or future products and services infringe upon their rights. We have not conducted any search to determine whether any of our products and services or technologies may be infringing upon patent rights of third parties. As the number of products and services in our market increases and functionalities increasingly overlap, companies such as ours may become increasingly subject to infringement claims. In addition, these claims also might require us to enter into royalty or license agreements. Any infringement claims, with or without merit, could absorb significant management time and lead to costly litigation. If required to do so, we may not be able to obtain royalty or license agreements, or obtain them on terms acceptable to us.

We May Become Subject to Government Regulation and Legal Uncertainties That Would Adversely Affect Our Financial Results

We are not currently subject to direct regulation by any domestic or foreign governmental agency, other than regulations applicable to businesses generally, export control laws and laws or regulations directly applicable to e-Commerce. However, due to the increasing usage of the Internet, it is possible that a number of laws and regulations may be applicable or may be adopted in the future with respect to conducting business over the Internet covering issues such as:

- taxes;
- user privacy;
- pricing;
- content;
- right to access personal data;
- copyrights;
- distribution; and
- characteristics and quality of products and services.

For example, we believe that our fraud screen service may require us to comply with the Fair Credit Reporting Act (the “Act”). As a precaution, we have implemented processes that we believe will enable us to comply with the Act if we were deemed a consumer reporting agency. Complying with the Act requires us to provide information about personal data stored by us. Failure to comply with the Act could result in claims being made against us by individual consumers and the Federal Trade Commission.

Furthermore, the growth and development of the market for e-Commerce may prompt more stringent consumer protection laws that may impose additional burdens on those companies conducting business online. The adoption of additional laws or regulations may decrease the growth of the Internet or other online services, which could, in turn, decrease the demand for our products and services and increase our cost of doing business.

The applicability of existing laws governing issues such as property ownership, copyrights, encryption and other intellectual property issues, taxation, libel, export or import matters and personal privacy to the Internet is uncertain. The vast majority of laws were adopted prior to the broad commercial use of the Internet and related technologies. As a result, they do not contemplate or address the unique issues of the Internet and related technologies. Changes to these laws intended to address these issues, including some recently proposed changes in the United States regarding taxation and encryption and in the European Union regarding contract formation and privacy, could create uncertainty in the Internet marketplace and impose additional costs and other burdens. These uncertainties, costs and burdens could reduce demand for our products and services or increase the cost of doing business due to increased litigation costs or increased service delivery costs.

The Anti-Takeover Provisions in Our Certificate of Incorporation Could Adversely Affect the Rights of the Holders of Our Common Stock

Anti-takeover provisions of Delaware law and our Certificate of Incorporation may make a change in control more difficult to finalize, even if a change in control would be beneficial to the stockholders. These provisions may allow our Board of Directors to prevent changes in our management and controlling interests. Under Delaware law, our Board of Directors may adopt additional anti-takeover measures in the future.

One anti-takeover provision that we have is the ability of our Board of Directors to determine the terms of preferred stock and issue preferred stock without the approval of the holders of the common stock. Our Certificate of Incorporation allows the issuance of up to 5,610,969 shares of preferred stock. As of December 31, 2006, there are no shares of preferred stock outstanding. However, because the rights and preferences of any series of preferred stock may be set by our Board of Directors in its sole discretion without approval of the holders of the common stock, the rights and preferences of this preferred stock may be superior to those of the common stock. Accordingly, the rights of the holders of common stock may be adversely affected.

Our Fraud Detection Services and Marketing Agreement With Visa U.S.A. Can Be Terminated

In July 2001, we entered into an agreement with Visa U.S.A. to jointly develop and promote the CyberSource Advanced Fraud Screen Service Enhanced by Visa for use in the United States. Under the terms of the agreement, Visa agreed to promote and market the new product to its member financial institutions and Internet merchants. The agreement expires in July 2007, but can be terminated by either party with ninety days prior written notice. Thereafter, the agreement renews automatically for additional periods of one year, unless terminated by either party.

Failure to Maintain Effective Internal Controls in Accordance with Section 404 of the Sarbanes-Oxley Act Could Have a Material Adverse Effect on Our Business and Stock Price

Section 404 of the Sarbanes-Oxley Act of 2002 requires annual management assessments of the effectiveness of our internal controls over financial reporting and a report by our Independent Registered Public Accounting Firm addressing these

assessments. The threshold for what constitutes a significant deficiency in internal control under Section 404 of the Sarbanes-Oxley Act has been set quite low and, during the course of our annual testing, we may find one or more material weaknesses or significant deficiencies. Furthermore, there is no guarantee that we will be able to remedy any deficiencies we may find in a cost effective manner and in time to meet the deadline imposed by the Sarbanes-Oxley Act for compliance with the requirements of Section 404. In addition, if we fail to maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act. Failure to maintain an effective internal control environment could have a material adverse effect on our business and our stock price.

ITEM 1B: UNRESOLVED STAFF COMMENTS.

Not applicable.

ITEM 2: PROPERTIES

Facilities

Our primary offices are located in approximately 72,000 square feet of space in Mountain View, California, under a lease expiring in December 2011. During December 2001, we consolidated the under-utilized space in our Mountain View facility and used approximately 43,000 square feet from January 2002 through December 2004. During December 2004, we reviewed our future facility needs and determined that our forecasted growth for 2005 and beyond would require the utilization of certain unoccupied space. As a result, we extended the lease on our Mountain View facility through 2011. In addition, we occupy leased office space in various cities throughout the United States. We also maintain sales and support offices in leased space in Reading, United Kingdom.

ITEM 3: LEGAL PROCEEDINGS

In July and August 2001, various class action lawsuits were filed in the United States District Court, Southern District of New York, against us, our Chairman and CEO, a former officer, and four brokerage firms that served as underwriters in our initial public offering. The actions were filed on behalf of persons who purchased our stock issued pursuant to or traceable to the initial public offering during the period from June 23, 1999 through December 6, 2000. The action alleges that our underwriters charged secret excessive commissions to certain of their customers in return for allocations of our stock in the offering. The two individual defendants are alleged to be liable because of their involvement in preparing and signing the registration statement for the offering, which allegedly failed to disclose the supposedly excessive commissions. On December 7, 2001, an amended complaint was filed in one of the actions to expand the purported class to persons who purchased our stock issued pursuant to or traceable to the follow-on public offering during the period from November 4, 1999 through December 6, 2000. The lawsuit filed against us is one of several hundred lawsuits filed against other companies based on substantially similar claims. On April 19, 2002, a consolidated amended complaint was filed to consolidate all of the complaints and claims into one case. The consolidated amended complaint alleges claims that are virtually identical to the amended complaint filed on December 7, 2001 and the original complaints. In October 2002, our officer and a former officer that were named in the amended complaint were dismissed without prejudice. In July 2002, we, along with other issuer defendants in the case, filed a motion to dismiss the consolidated amended complaint with prejudice. On February 19, 2003, the court issued a written decision denying the motion to dismiss with respect to CyberSource and the individual defendants. On July 2, 2003, a committee of our Board of Directors conditionally approved a proposed partial settlement with the plaintiffs in this matter. The settlement would provide, among other things, a release of us and of the individual defendants for the conduct alleged in the action to be wrongful in the Amended Complaint. We would agree to undertake other responsibilities under the partial settlement, including agreeing to assign away, not assert, or release certain potential claims we may have against our underwriters. The committee agreed to approve the settlement subject to a number of conditions, including the participation of a substantial number of other Issuer Defendants in the proposed settlement, the consent of our insurers to the settlement, and the completion of acceptable final settlement documentation. On August 31, 2005, the court issued a formal preliminary approval for the settlement. On April 24, 2006, a hearing was held for the court to consider the motion for final approval of the settlement. On December 5, 2006, the United States Court of Appeals for the Second Circuit (the "Second Circuit") issued an opinion vacating the District Court's certification of a litigation class in that portion of the case between the Plaintiffs and the underwriter defendants. Because the Second Circuit's opinion was directed to the class certified by the District Court for the Plaintiffs' litigation against the underwriter defendants, the opinion's effect on the class certified by the District Court for our settlement is unclear. On January 5, 2007, Plaintiffs filed a petition for rehearing to the full panel of the Second Circuit. The proposed settlement is pending final approval by the District Court. There can be no assurance that the settlement will be approved and, because of the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of the case if it is not. However, any direct financial impact of the proposed settlement is expected to be borne by our insurers.

On August 11, 2004, we filed suit in the Northern District of California against Retail Decisions, Inc. (“ReD US”) and Retail Decisions Plc (“ReD UK”) (collectively, “ReD”), Case No. 3:04-CIV-03268, alleging that ReD infringes our U.S. Patent No. 6,029,154 (the “’154 Patent”). We served ReD US with the complaint on August 12, 2004, and we served ReD UK with the complaint on August 13, 2004. On September 30, 2004, ReD responded to our complaint. ReD filed a motion to stay the case for 90 days pending a determination by the U.S. Patent and Trademark Office (“PTO”) as to whether it will grant ReD’s request that the PTO re-examine the ’154 Patent. ReD also filed a motion for a more definite statement by us with respect to our allegation that ReD is willfully infringing the ’154 Patent. In addition, ReD UK filed a motion to dismiss the action against it on the ground that it is not subject to personal jurisdiction in the Northern District of California. On October 27, 2004, ReD filed a request for re-examination with the PTO, based on prior art ReD discovered that allegedly invalidates the patent. On October 28, 2004, we filed an opposition to ReD’s motion to stay the case for 90 days and an opposition to ReD’s motion for a more definite statement with respect to willful infringement. Based on ReD UK’s representation that ReD US is the sole entity that develops, operates, and distributes the eBitGuard service, we agreed to dismiss ReD UK while reserving the right to reinstitute action against ReD UK in the event we later discover that ReD UK is subject to the court’s personal jurisdiction. In return, ReD UK agreed that if we later establish that personal jurisdiction existed, we could re-file against ReD UK in this action without prejudice to our damages claim. We also filed an amended complaint, removing ReD UK as a named defendant and restating the willful infringement claim. On November 16, 2004, the court granted ReD’s motion to stay the proceedings pending the PTO’s decision as to whether it will grant ReD’s request for re-examination. On December 30, 2004, the PTO granted ReD’s request for a re-examination. On January 19, 2005, ReD filed a motion to dismiss the case without prejudice or to extend the stay until completion of the re-examination process. On January 24, 2005, the court extended the stay pending the re-examination process, vacated ReD’s motion to dismiss, and ordered quarterly updates as to the status of the re-examination process. On April 25, 2005, the parties filed a joint status report that was approved by the court. On June 20, 2005, the PTO issued a preliminary office action rejecting all of the claims of the ’154 patent based on one of the prior art references cited by ReD. On July 14, 2005, we met with the PTO examiner handling the re-examination to distinguish the prior art from the claims of the ’154 patent. On August 9, 2006, the PTO issued a final office action rejecting all of the claims of the ’154 patent. On September 7, 2006, we filed a response to the office action requesting certain amendments to the claims. On October 10, 2006, the PTO filed a response rejecting the amendments and extending our deadline to file a notice of appeal. On October 30, 2006, we filed a notice of appeal. While there can be no assurances as to the outcome of the lawsuit, we do not presently believe that the lawsuit would have a material effect on our financial condition, results of operations, or cash flows.

We are currently party to various legal proceedings and claims which arise in the ordinary course of business. While the outcome of these matters cannot be predicted with certainty, we do not believe that the outcome of any of these claims or any of the above mentioned legal matters will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

ITEM 4: SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5: MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Since our initial public offering on June 23, 1999, our common stock has traded on the NASDAQ Global Market under the symbol “CYBS.” The following table sets forth the range of high and low closing sales prices of our common stock for the periods indicated:

<u>Year ended December 31, 2005</u>	<u>High</u>	<u>Low</u>
First Quarter	\$ 6.84	\$ 5.06
Second Quarter.....	\$ 7.76	\$ 4.96
Third Quarter	\$ 7.52	\$ 6.50
Fourth Quarter.....	\$ 7.53	\$ 5.97
 <u>Year ended December 31, 2006</u>	 <u>High</u>	 <u>Low</u>
First Quarter	\$ 11.16	\$ 6.48
Second Quarter.....	\$ 11.70	\$ 8.47
Third Quarter	\$ 12.30	\$ 9.70
Fourth Quarter.....	\$ 11.30	\$ 9.61

We had approximately 320 shareholders of record as of March 1, 2007. We have not declared or paid any cash dividends on our common stock and presently intend to retain our future earnings to fund the development and growth of our business and, therefore, do not anticipate paying any cash dividends in the foreseeable future.

In January 2007, our Board of Directors authorized the use of up to \$10.0 million for the repurchase of shares of our common stock. The purchases may be made in the open market from time to time over the next twelve months as market and business conditions warrant. In addition, all purchases are subject to the availability of shares and, accordingly, there is no guarantee as to the timing or number of shares to be repurchased.

In the fourth quarter of 2006, we repurchased 136,205 shares at an average price of \$9.82 per share, including repurchase costs. All of the repurchased shares were cancelled and returned to the status of authorized, unissued shares.

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Program	Maximum Dollar Value of Shares Yet to Be Purchased Under the Program at the End of the Period (000's)
October 1, 2006 to October 31, 2006	-	-	-	-
November 1, 2006 to November 30, 2006	136,205	\$ 9.82	136,205	\$ 7,539
December 1, 2006 to December 31, 2006	-	-	-	-
Total	136,205	\$ 9.82	136,205	\$ 7,539

Securities Authorized for Issuance Under Equity Compensation Plans and Stock Performance Graph

Information regarding securities authorized for issuance under equity compensation plans and the stock performance graph is incorporated by reference to the "Equity Compensation Plan Information" and the "Stock Performance Graph" sections of CyberSource's Proxy Statement for the 2007 Annual Meeting of Stockholders.

ITEM 6: SELECTED FINANCIAL DATA

The following selected financial data should be read in conjunction with the Consolidated Financial Statements and Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this Form 10-K. The historical results are not necessarily indicative of future results.

SELECTED CONSOLIDATED FINANCIAL DATA

	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands, except per share data)				
Consolidated Statements of Operations Data:					
Revenues	\$ 70,250	\$ 50,511	\$ 36,709	\$ 27,503	\$ 28,024
Cost of revenues	<u>34,627</u>	<u>20,492</u>	<u>12,023</u>	<u>9,293</u>	<u>11,984</u>
Gross profit.....	35,623	30,019	24,686	18,210	16,040
Operating expenses:					
Product development	9,283	8,000	6,772	7,529	8,078
Sales and marketing.....	14,443	11,140	10,065	11,164	13,143
General and administrative.....	9,861	6,031	5,551	4,942	5,856
Restructuring and other non-recurring charges (recoveries).....	<u>—</u>	<u>—</u>	<u>(1,493)</u>	<u>467</u>	<u>2,473</u>
Total operating expenses	<u>33,587</u>	<u>25,171</u>	<u>20,895</u>	<u>24,102</u>	<u>29,550</u>
Income (loss) from operations.....	2,036	4,848	3,791	(5,892)	(13,510)
Interest income, net	2,344	1,324	695	625	1,158
Other income (loss)	341	—	—	(175)	(162)
Income tax provision (benefit)	<u>(9,690)</u>	<u>(3,074)</u>	<u>25</u>	<u>—</u>	<u>—</u>
Net income (loss)	<u>\$ 14,411</u>	<u>\$ 9,246</u>	<u>\$ 4,461</u>	<u>\$ (5,442)</u>	<u>\$ (12,514)</u>
Basic net income (loss) per share	<u>\$ 0.42</u>	<u>\$ 0.28</u>	<u>\$ 0.13</u>	<u>\$ (0.17)</u>	<u>\$ (0.38)</u>
Diluted net income (loss) per share.....	<u>\$ 0.39</u>	<u>\$ 0.26</u>	<u>\$ 0.12</u>	<u>\$ (0.17)</u>	<u>\$ (0.38)</u>
Weighted average number of shares used in computing basic net income (loss) per share.....	<u>34,623</u>	<u>33,464</u>	<u>33,448</u>	<u>32,860</u>	<u>32,900</u>
Weighted average number of shares used in computing diluted net income (loss) per share.....	<u>36,593</u>	<u>35,811</u>	<u>35,884</u>	<u>32,860</u>	<u>32,900</u>

	<u>December 31,</u>				
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
	(In thousands)				
Consolidated Balance Sheet Data:					
Cash, cash equivalents and short-term investments	\$54,944	\$47,001	\$44,703	\$44,361	\$49,275
Working capital.....	60,286	53,234	45,468	41,629	42,852
Total assets.....	87,043	65,327	55,280	54,807	61,807
Total stockholders' equity.....	78,628	56,933	47,499	44,195	49,368

ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this document.

This Report on Form 10-K contains forward-looking statements within the “safe harbor” provisions of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements regarding our expectations, hopes, intentions, beliefs or strategies regarding the future. Actual results could differ materially from those projected in any forward-looking statements for the reasons noted under the sub-heading “Risk Factors” and in other sections of this Report on Form 10-K. All forward-looking statements included in this Form 10-K are based on information available to us on the date of this Report on Form 10-K, and we assume no obligation to update the forward-looking statements, or to update the reasons why actual results could differ from those projected in the forward-looking statements. See “Risk Factors” below, as well as such other risks and uncertainties as are detailed in our Securities and Exchange Commission reports and filings for a discussion of the factors that could cause actual results to differ materially from the forward-looking statements.

Overview

CyberSource Corporation provides secure electronic payment and risk management solutions to organizations that process orders for goods and services over the Internet. CyberSource's payment solutions allow eCommerce merchants to accept a wide range of online payment options, from credit cards and electronic checks, to global payment options and emerging payment types. Our risk and compliance management tools address complexities common to online merchants such as credit card fraud, online tax requirements and export controls. Our reporting and management tools facilitate the automation of the flow of complex eCommerce processes, such as recurring billing and payment reconciliation. We partner with and connect to a large network of payment processors and other payment service providers to offer merchants a single source solution.

We derive our revenues from monthly commerce transaction processing fees and global acquiring fees, support service fees, professional services and the sale of enterprise software licenses and related maintenance. Transaction and global acquiring revenues are recognized in the period in which the transactions occur. Professional services revenue and support service fees are recognized as the related services are provided and costs are incurred. Enterprise software license revenue is recognized when the contract is signed, the software is delivered and the fee is fixed or determinable, and collectibility is reasonably assured. Enterprise software maintenance revenue is recognized ratably over the term of the maintenance period. For each of the years ended December 31, 2006, 2005 and 2004, no customer accounted for more than 10% of revenues.

Critical Accounting Policies

Our financial statements are based on the selection and application of significant accounting policies, which require management to make significant estimates and assumptions. We believe that the following are the more critical judgment areas in the application of our accounting policies that currently affect our financial condition and results of operations.

Revenue Recognition

We recognize revenue in accordance with SEC Staff Accounting Bulletin No. 104, Revenue Recognition (“SAB 104”) and Statement of Position 97-2, Software Revenue Recognition, (“SOP 97-2”), as amended. SAB 104 and SOP 97-2 require that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the fee is fixed or determinable; and (4) collectibility is reasonably assured. Determination of criteria (4) is based on management's judgments regarding the collectibility of fees. Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenue recognized for any reporting period could be adversely affected.

We derive a significant portion of our transaction processing revenues from global acquiring fees charged to merchants for payment processing services. Our fees, which are primarily a percentage of the dollar amount of each transaction processed, are based upon the merchant's monthly charge volume and risk profile. In addition, we record revenues for miscellaneous services

related to global acquiring, such as fees for processing credit card chargebacks. In accordance with Emerging Issues Task Force 99-19, Reporting Revenue Gross as a Principal Versus Net as an Agent ("EITF 99-19"), we recognize these fees on a gross basis as we are the primary agent in the transaction in the period the merchants' transactions are processed. Related interchange fees paid to card issuing banks and assessments paid to credit card associations are recognized in cost of revenues at that time.

We use the residual method of accounting as permitted by Statement of Position 98-9 ("SOP 98-9") to recognize revenue when a software license includes one or more elements to be delivered at a future date and vendor specific objective evidence ("VSOE") exists for all undelivered elements. We allocate revenue to each element based on its fair value as determined by VSOE. We defer revenue for any undelivered elements and recognize the deferred revenue when the product is delivered or over the period in which the service is performed.

We derive our professional services revenue from time and material contracts and fixed-price contracts, which require the accurate estimation of the cost, scope and duration of each engagement. Revenue and the related costs for these projects are generally recognized as those services are delivered. Estimates are made regarding time to complete the projects and revisions to estimates are reflected in the period in which changes become known. If we do not accurately estimate the resources required or the scope of work to be performed, or do not manage our projects properly within the planned periods of time or satisfy obligations under the contracts, then future professional service margins may be significantly and negatively affected or losses on existing contracts may need to be recognized.

Accounts Receivable

We maintain allowances for doubtful accounts for estimated losses resulting from the potential inability of our customers to make required payments as well as for potential sales returns. If the financial condition of our customers was to deteriorate, resulting in their inability to make payments, additional allowances may be required. These estimates are based on historical bad debt experience and other known factors. If the historical data we used to determine these estimates does not properly reflect future losses, additional allowances may be required.

Reserve for Merchant Losses

We have potential liability for certain transactions processed through our global acquiring services if the payments associated with such transactions are rejected, refused, or returned for reasons such as consumer fraud or billing disputes. For instance, if a billing dispute between a merchant and payer is not ultimately resolved in favor of the merchant, the disputed transaction may be charged back to the merchant's bank and credited to the payer's account. If the charged back amount cannot be recovered from the merchant's account, or if the merchant refuses or is financially unable to reimburse its bank for the charged back amount, we may bear the loss for the amount of the refund paid to the payer's bank. We could also incur fraud losses as a result of merchant fraud. Merchant fraud occurs when a merchant, rather than a customer, intentionally uses a stolen or counterfeit card, card number, or other bank account number to process a false sales transaction, or knowingly fails to deliver merchandise or services in an otherwise valid transaction. We may be responsible for any losses for certain transactions if we are unable to collect from the merchant. We evaluate the merchant's risk for potential losses based on historical experience and other relevant factors and record a loss reserve accordingly. If the data we use to determine potential losses does not properly reflect future losses, additional reserves may be required.

Legal Contingencies

We are currently involved in certain legal proceedings and are required to assess the likelihood of any adverse judgments or outcomes of these proceedings as well as potential ranges of probable losses. A determination of the amount of accruals required, if any, for these contingencies is made after careful analysis. As discussed in Note 12 of our consolidated financial statements, as of December 31, 2006, we do not believe our current proceedings will have a material impact on our consolidated financial condition, results of operations or cash flows. It is possible, however, that future results of operations for any particular quarter or annual period could be materially affected by changes in our assumptions or as a result of the effectiveness of our strategies related to these proceedings.

Accounting for Income Taxes

We account for income taxes using the liability method, which requires the recognition of deferred tax assets or liabilities for the tax-effected temporary differences between the financial reporting and tax bases of our assets and liabilities, and for net operating loss and tax credit carryforwards. Prior to the fourth quarter of 2005, we recorded a full valuation allowance to reserve for the benefit of our deferred tax assets due to the uncertainty surrounding our ability to realize these assets.

During the fourth quarter of 2005, we recorded an income tax benefit of \$3.1 million. This benefit included a \$3.2 million reduction in the valuation allowance related to a portion of our deferred tax assets that will more likely than not be realized. This determination was primarily based on projected taxable income. During the fourth quarter of 2006, we recorded an income tax

benefit of \$11.0 million. This benefit included a \$9.9 million reduction in the valuation allowance related to a portion of our deferred tax assets that will more likely than not be realized, based on future projected taxable income. In evaluating our ability to realize our deferred tax assets we consider all available positive and negative evidence including our past operating results and our forecast of future taxable income. In determining future taxable income, we make assumptions to forecast federal, state, and international operating income, the reversal of temporary differences, and the implementation of any feasible and prudent tax planning strategies. These assumptions require significant judgment regarding the forecasts of future taxable income, and are consistent with the forecasts used to manage our business. We intend to maintain the remaining valuation allowance until sufficient further positive evidence exists to support further reversals of the valuation allowance. Our income tax expense recorded in the future will be reduced to the extent of offsetting decreases in our valuation allowance.

Stock-based Compensation

Prior to the January 1, 2006 adoption of the Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment" ("SFAS 123R"), we accounted for stock-based compensation using Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure" ("SFAS 148"). SFAS 148 required disclosure of the effects of an entity's accounting policy with respect to stock-based employee compensation on reported net income and earnings per share in annual and interim financial statements. As permitted under SFAS 148, we adopted the disclosure only provisions and continued to follow the intrinsic value method of accounting for employee stock options in accordance with Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB 25").

Effective January 1, 2006, the beginning of our first fiscal quarter of 2006, we adopted the fair value recognition provisions of SFAS 123R, using the modified-prospective transition method. Under this transition method, stock-based compensation expense was recognized in the consolidated financial statements. Compensation expense recognized included the estimated expense for stock options granted on and subsequent to January 1, 2006, based on the fair value at grant date estimated in accordance with the provisions of SFAS 123R, and the estimated expense for the portion vesting during 2006 for options granted prior to, but not vested as of January 1, 2006, based on the fair value at grant date estimated in accordance with the original provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). Results for prior periods have not been restated, as provided for under the modified-prospective method.

As a result of adopting SFAS 123R, our income before income taxes and net income, reduced by the expense for stock option awards, for 2006 were both \$4.7 million lower than if we had continued to account for stock-based compensation under APB 25. Basic and diluted earnings per share for the year ended December 31, 2006, would have been \$0.14 and \$0.13 higher, respectively, if we had not adopted SFAS 123R. As of December 31, 2006, total unrecognized stock-based compensation expense related to non-vested stock options was approximately \$11.8 million, which is expected to be recognized over a weighted average period of approximately 2.9 years.

Under the fair value recognition provisions of SFAS 123R, we used the Black-Scholes option valuation model to estimate stock-based compensation expense at the grant date based on the fair value of the award and we will recognize the expense ratably over the requisite service period of the award. Determining the appropriate fair value model and assumptions used in calculating the fair value of stock-based awards requires judgment, including estimating stock price volatility, forfeiture rates and expected life.

Long-Lived Assets

Statement of Financial Accounting Standard No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144") requires that we perform tests for impairment of our intangible assets, other than goodwill, annually and more frequently whenever events or circumstances suggest that our intangible assets may be impaired. As of December 31, 2006, we had recorded intangible assets related to our acquisition of BidPay.com ("BidPay") in March 2006, with a carrying value of approximately \$3.0 million. To evaluate potential impairment, SFAS 144 requires us to assess whether the future cash flows related to these assets will be greater than their carrying value at the time of the test. Accordingly, while our cash flow assumptions are consistent with the plans and estimates we are using to manage the underlying businesses, there is significant judgment in determining the cash flows attributable to our intangible assets over their respective estimated useful lives.

We are required to periodically evaluate our intangible asset balances for impairment. If we incur impairments to our intangible assets, it would have an adverse impact on our future earnings.

Results of Operations

The following table sets forth certain items in our consolidated statements of operations expressed as a percentage of revenue for the periods indicated:

	Year Ended December 31,		
	2006	2005	2004
Revenues	100.0%	100.0%	100.0%
Cost of revenues	<u>49.3%</u>	<u>40.6%</u>	<u>32.8%</u>
Gross profit	50.7%	59.4%	67.2%
Operating expenses:			
Product development	13.2%	15.8%	18.4%
Sales and marketing	20.6%	22.1%	27.4%
General and administrative	14.0%	11.9%	15.1%
Restructuring charges	—	—	(4.1%)
Total operating expenses	<u>47.8%</u>	<u>49.8%</u>	<u>56.8%</u>
Income from operations	2.9%	9.6%	10.4%
Other income	0.5%	—	—
Interest income	<u>3.3%</u>	<u>2.6%</u>	<u>1.9%</u>
Income before income taxes	6.7%	12.2%	12.3%
Income tax provision (benefit)	<u>(13.8%)</u>	<u>(6.1%)</u>	<u>0.1%</u>
Net income	<u>20.5%</u>	<u>18.3%</u>	<u>12.2%</u>

Years Ended December 31, 2006 and 2005

Revenues. Revenues increased to \$70.3 million in 2006, an increase of approximately \$19.7 million or 39.1% as compared to \$50.5 million in 2005. Transaction and support revenues increased to \$63.3 million in 2006, an increase of approximately 46.6% as compared to \$43.2 million in 2005. Approximately 80% of the increase in transaction and support revenues was from existing customers, primarily resulting from an increase in global acquiring services revenue as well as an increase in transaction volumes processed. The remaining increase in transaction and support revenues was from new customers that entered into contracts during the twelve months ended December 31, 2006. We processed approximately 854.2 million transactions in 2006 as compared to approximately 637.1 million transactions in 2005, an increase of approximately 34%. Global acquiring revenues represented approximately 36.9% of our transaction and support revenues for the year ended December 31, 2006, as compared to 25.6% for the year ended December 31, 2005. Enterprise software license and maintenance revenues decreased to \$3.0 million in 2006, a decrease of approximately 17.7% as compared to \$3.7 million in 2005. The decrease is due primarily to one license agreement which generated approximately \$0.5 million in software license and maintenance revenues during the year ended December 31, 2005. No software transactions of this magnitude were recorded in 2006. Professional services revenues increased to \$3.9 million in 2006, an increase of approximately 7.5% as compared to \$3.6 million in 2005, due primarily to a general increase in demand for professional services projects that occurred during the year ended December 31, 2006.

Cost of Revenues. Transaction and support cost of revenues consist primarily of costs incurred in the delivery of e-commerce transaction services, including personnel costs in our operations and customer support functions, processing and interchange fees paid relating to our global acquiring services, other third-party fees, depreciation of capital equipment used in our network infrastructure and costs related to the hosting of our servers at third-party hosting centers in the United States and the United Kingdom. Transaction and support cost of revenues increased to \$32.3 million or 51.1% of transaction and support revenues in 2006 from \$17.7 million or 41.0% of transaction and support revenues in 2005. The increase in absolute dollars is primarily due to higher processing fees paid to third parties such as the credit card issuing banks, payment processors and card associations related to our global acquiring services, which are variable costs that will increase in absolute dollars as the related revenue increases and will decrease as the related revenue decreases. As the gross margins from our global acquiring services business are significantly lower than our historical transaction and support gross margins, we expect our overall gross margins to continue to decrease as our global acquiring services revenues increase in the future. Enterprise software cost of revenues is composed of customer support personnel costs, third-party fees and fulfillment costs. Enterprise software cost of revenues decreased to \$0.3 million or 8.9% of enterprise software revenues in 2006 from \$0.8 million or 22.8% of enterprise software revenues for 2005. The decrease in absolute dollars and as a percentage of enterprise software revenues is primarily due to a decrease in third-party fees as there were fewer transactions during 2006 in which we resold third-party software in conjunction with sales of our software. Professional services cost of revenues consist principally of personnel-related costs and expenses and a portion of allocated overhead costs related to providing professional services. Professional services cost of revenues of \$2.0 million or 51.5% of professional services revenues for 2006 was relatively consistent with the \$2.0 million or 54.0% of professional services revenues for 2005.

Product Development. Product development expenses consist primarily of compensation and related costs of employees engaged in the research, design and development of new services, and to a lesser extent, facility costs and related overhead. Product development expenses increased to \$9.3 million in 2006 from \$8.0 million in 2005, an increase of 16.0%. The increase in absolute dollars is primarily due to an increase in headcount and related compensation expense of approximately \$1.2 million, including stock-based compensation of approximately \$0.8 million. As a percentage of revenue, product development expenses decreased to 13.2% in 2006 as compared to 15.8% in 2005. The decrease is primarily due to the increase in revenue from existing and new customers, offset to a certain extent by the increase in product development expenses during 2006. We expect product development expenses will increase in absolute dollars during 2007 as we continue to increase headcount to support the development of newly offered services and other related internal systems. As a percentage of revenue, we expect product development expenses in 2007 to moderately decrease as compared to 2006 due primarily to expected revenue growth.

Sales and Marketing. Sales and marketing expenses consist primarily of compensation of sales and marketing personnel, market research and advertising costs, and, to a lesser extent, facility costs and related overhead. Sales and marketing expenses increased to \$14.4 million in 2006 from \$11.1 million in 2005, an increase of 29.7%. The increase in absolute dollars is primarily due to an increase in headcount and related compensation expense of approximately \$2.9 million, including stock-based compensation of approximately \$1.0 million. As a percentage of revenue, sales and marketing expenses decreased to 20.6% in 2006 as compared to 22.1% in 2005. The decrease is primarily due to the increase in revenue from existing and new customers during 2006, offset to a certain extent by the increase in sales and marketing expenses during 2006. We expect that sales and marketing expenses will increase in absolute dollars during 2007 as we continue to develop our sales and marketing infrastructure to support our anticipated revenue growth. As a percentage of revenue, we expect sales and marketing expenses in 2007 to moderately decrease as compared to 2006 due primarily to expected revenue growth.

General and Administrative. General and administrative expenses consist primarily of compensation for administrative personnel, fees for outside professional services and, to a lesser extent, facility costs and related overhead. General and administrative expenses increased to \$9.9 million in 2006 from \$6.0 million in 2005, an increase of 63.5%. The increase is primarily due to an increase in headcount and related compensation expense of approximately \$3.5 million, including stock-based compensation expense of approximately \$2.2 million and, to a lesser extent, an increase in third party professional fees of approximately \$0.2 million. As a percentage of revenue, general and administrative expenses increased to 14.0% in 2006 as compared to 11.9% in 2005. The increase is primarily due to the increases in compensation expense and third party professional fees, offset to a certain extent, by the increase in revenue from existing and new customers during 2006. We expect general and administrative expenses will increase in absolute dollars in 2007 due primarily to higher personnel-related expenses and higher third-party professional fees. As a percentage of revenue, we expect general and administrative expenses in 2007 to modestly decrease as compared to 2006 due primarily to expected revenue growth.

Other Income. Other income for 2006 consists primarily of settlement proceeds of \$0.4 million received resulting from a lawsuit we filed against CardSystems Solutions, Inc. ("CardSystems") and individual members of CardSystems' board of directors, alleging breach of contract, promissory estoppel, fraud and unjust enrichment. Also included in other income are exchange rate losses of approximately \$0.1 million and joint venture income of approximately \$41,000.

Interest Income. Interest income which consists of interest earnings on cash, cash equivalents and short-term investments increased to \$2.3 million in 2006 from \$1.3 million in 2005, an increase of 77.0%. This increase is primarily due to an increase in average balances of cash, cash equivalents and short-term investments during 2006 as compared to 2005 as a result of our income from operations in 2006 and slightly higher investment yields. We expect interest income to increase in 2007 due to anticipated higher cash, cash equivalents and short-term investment balances.

Income Tax Provision (Benefit). We recorded an income tax benefit of \$9.7 million in 2006 as compared to \$3.1 million in 2005, an increase of 215.2%. Included in the \$9.7 million income tax benefit was a \$9.9 million reversal of the valuation allowance related to a portion of our deferred tax assets, which was recorded in the fourth quarter of 2006, offset by amounts accrued for our estimated 2006 federal, state and foreign income tax liabilities. Included in the \$3.1 million income tax benefit was a \$3.2 million reversal of the valuation allowance related to a portion our deferred tax assets, which was recorded in the fourth quarter of 2005, offset by amounts accrued for our estimated 2005 federal, state and foreign income tax liabilities. Prior to the fourth quarter of 2005, we recorded a full valuation allowance to reserve for the benefit of our deferred tax assets due to the uncertainty surrounding our ability to realize these assets. The \$9.9 million reversal of the valuation allowance was based on projected taxable income.

As of December 31, 2006, we had federal and state net operating loss carryforwards of approximately \$157.6 million and \$46.1 million, respectively. If we are not able to use them, the federal and state net operating loss carryforwards will expire in 2012 through 2024. The Tax Reform Act of 1986 imposes substantial restrictions on the utilization of net operating losses and tax credits in the event of a corporation's ownership change, as defined in the Internal Revenue Code. Our ability to utilize net operating loss carryforwards may be limited if such an ownership change occurs.

Years Ended December 31, 2005 and 2004

Revenues. Revenues increased to \$50.5 million in 2005, an increase of approximately \$13.8 million or 37.6% as compared to \$36.7 million in 2004. Transaction and support revenues increased to \$43.2 million in 2005, an increase of approximately 50.3% as compared to \$28.7 million in 2004. Approximately 80% of the increase in transaction and support revenues was from existing customers, primarily resulting from an increase in global acquiring services revenue as well as an increase in transaction volumes processed. The remaining increase in transaction and support revenues was from new customers that entered into contracts during the twelve months ended December 31, 2005. We processed approximately 637.1 million transactions in 2005 as compared to approximately 436.3 million transactions in 2004, an increase of approximately 46%. Transaction and support revenues increased at a lower rate relative to the increase in total transactions processed due primarily to the increase in transaction volumes of our higher-volume customers that receive greater discounts as their transaction volumes increase. Global acquiring revenues represented approximately 25.6% of our transaction and support revenues for the year ended December 31, 2005, as compared to 8.5% for the year ended December 31, 2004. Enterprise software license and maintenance revenues increased to \$3.7 million in 2005, an increase of approximately 7.3% as compared to \$3.4 million in 2004. The increase is due primarily to one license agreement which generated approximately \$0.5 million in software license and maintenance revenues during the year ended December 31, 2005. Professional services revenues decreased to \$3.6 million in 2005, a decrease of approximately 19.8% as compared to \$4.5 million in 2004, due primarily to a general decrease in demand for professional services, resulting in a decrease in billable hours as well as a decrease in the average contract price of projects that occurred during the year ended December 31, 2005.

Cost of Revenues. Transaction and support cost of revenues increased to \$17.7 million or 41.0% of transaction and support revenues in 2005 from \$9.4 million or 32.7% of transaction and support revenues in 2004. The increase in absolute dollars is primarily due to higher processing fees paid to third parties related to our global acquiring services which is a variable cost that will increase in absolute dollars as the related revenue increases and will decrease as the related revenue decreases. The increase as a percentage of transaction and support revenues is primarily due to an increase in our global acquiring revenues which have lower gross margins relative to our historical transaction service revenues. Enterprise software cost of revenues increased to \$0.8 million or 22.8% of enterprise software revenues in 2005 from \$0.5 million or 14.8% of enterprise software revenues for 2004. The increase in absolute dollars and as a percentage of enterprise software revenues is primarily due to an increase in third party license fees. Professional services cost of revenues decreased to \$2.0 million or 54.0% of professional services revenues for 2005 as compared to \$2.1 million or 46.9% of professional services revenues for 2004. The decrease in absolute dollars is due to lower personnel-related costs resulting from a decrease in personnel necessary to support our professional services projects. The increase in professional services cost of revenues as a percentage of professional services revenues is primarily due to an increase in lower-margin projects during 2005. During the year ended December 31, 2005, we reversed \$0.2 million in accrued liabilities that had previously been recorded as cost of revenues in prior years.

Product Development. Product development expenses increased to \$8.0 million in 2005 from \$6.8 million in 2004, an increase of 18.1%. The increase is primarily due to an increase in headcount and related compensation expense which increased by approximately \$1.2 million. As a percentage of revenue, product development expenses decreased to 15.8% in 2005 as compared to 18.4% in 2004. The decrease is primarily due to the increase in revenue from existing and new customers, offset in part by the increase in product development expenses during 2005. During the year ended December 31, 2005, we reversed \$0.1 million in accrued liabilities that had previously been recorded as product development expenses in prior years.

Sales and Marketing. Sales and marketing expenses increased to \$11.1 million in 2005 from \$10.1 million in 2004, an increase of 10.7%. The increase is primarily due to a decrease in utilization of professional services personnel as compared to the same period last year. To the extent professional services personnel are not utilized on professional services projects, they are redeployed in support of sales efforts and the related compensation expense is classified as sales and marketing expense accordingly. As a percentage of revenue, sales and marketing expenses decreased to 22.1% in 2005 as compared to 27.4% in 2004. The decrease is primarily due to the increase in revenue from existing and new customers during 2005, offset to a certain extent by the increase in sales and marketing expenses resulting in part from the decrease in utilization of professional services personnel on professional services projects. During the year ended December 31, 2005, we reversed \$0.2 million in accrued liabilities that had previously been recorded as sales and marketing expenses in prior years.

General and Administrative. General and administrative expenses increased to \$6.0 million in 2005 from \$5.6 million in 2004, an increase of 8.6%. The increase is primarily due to an increase in headcount and related compensation expense which increased by approximately \$0.3 million. As a percentage of revenue, general and administrative expenses decreased to 11.9% in 2005 as compared to 15.1% in 2004. The decrease is primarily due to the increase in revenue from existing and new customers during 2005. During the year ended December 31, 2005, we reversed \$0.2 million in accrued liabilities that had previously been recorded as general and administrative expenses in prior years.

Restructuring Charges (Recoveries). During 2001, we exited certain under-utilized space in our Mountain View, California facility. During the fourth quarter of 2004, we re-evaluated our future facility needs and determined that our forecasted growth would require the utilization of the unoccupied space in our Mountain View, California facility beginning in 2005. As a result,

we decided to no longer market the available space at this facility, and extended the lease on this facility through December 2011. As a result, we reversed the remaining \$1.5 million balance of previously recorded restructuring charges related to this facility.

Interest Income. Interest income, which consists of interest earnings on cash, cash equivalents and short-term investments increased to \$1.3 million in 2005 from \$0.7 million in 2004, an increase of 90.5%. This increase is primarily due to an increase in average balances of cash, cash equivalents and short-term investments during 2005 as compared to 2004 as a result of our income from operations in 2005 and slightly higher investment yields.

Income Tax Provision (Benefit). We recorded an income tax benefit of \$3.1 million in 2005 as compared to a provision for income tax expense of \$25,000 in 2004.

Related Parties

For the years ended December 31, 2006, 2005 and 2004, legal fees of approximately \$0.4 million, \$0.5 million and \$0.5 million, respectively, were paid to Morrison & Foerster LLP, a law firm in which one of our directors is a partner. As of December 31, 2006 and 2005, we had immaterial amounts of accounts payable due to Morrison & Foerster LLP.

The terms of our contracts with the above related parties are consistent with our contracts with other independent parties.

Liquidity and Capital Resources

Our cash, cash equivalents and short-term investments were \$54.9 million as of December 31, 2006 compared to \$47.0 million as of December 31, 2005. An overview of the significant cash flow activities for the years ended December 31, 2006 and 2005 are as follows (in thousands):

	<u>Year Ended December 31,</u>	
	<u>2006</u>	<u>2005</u>
Cash provided by operating activities	\$ 9,841	\$ 3,949
Proceeds from issuance of common stock.....	4,672	2,966
Acquisition of BidPay	(1,990)	—
Purchases of equipment.....	(2,506)	(1,571)
Repurchases of common stock.....	(2,461)	(2,405)

Cash, cash equivalents and short-term investments increased \$7.9 million from December 31, 2005 to December 31, 2006. This increase is primarily due to the following:

- improved cash flows from operating activities of \$9.8 million, primarily due to increased revenue in 2006; and
- proceeds from the exercise of employee stock options and the issuance of common stock under the employee stock purchase plan of \$4.7 million.

These increases are offset by decreases in cash, cash equivalents and short-term investments due to the following:

- the acquisition of BidPay for approximately \$2.0 million;
- purchases of computer hardware and software of approximately \$2.5 million; and
- repurchases of common stock under the company's repurchase program of approximately \$2.5 million.

We believe that our cash and short-term investment balances as of December 31, 2006 will be sufficient to meet our working capital and capital requirements for at least the next twelve months. Our future capital requirements will depend on many factors including the level of investment we make in new businesses, new products or new technologies. We currently have no agreements or understandings with respect to any future investments or acquisitions. To the extent that our existing cash resources and future earnings are insufficient to fund our future activities, we may need to obtain additional equity or debt financing. Additional funds may not be available or, if available, we may not be able to obtain them on favorable terms.

The following is a table summarizing our significant commitments as of December 31, 2006, consisting of future minimum lease payments under all non-cancelable and operating leases (in thousands):

	<u>Total</u>	<u>Less than 1 year</u>	<u>1 – 3 years</u>	<u>3 – 5 years</u>	<u>More than 5 years</u>
Operating leases	\$ 6,937	\$ 1,160	\$ 2,827	\$ 2,697	\$ 253
Total commitments.....	\$ 6,937	\$ 1,160	\$ 2,827	\$ 2,697	\$ 253

Recent Pronouncements

In July 2006, the FASB issued FASB Interpretation Number 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), an interpretation of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109. FIN 48 is effective for fiscal years beginning after December 15, 2006 and as a result is effective for us in the first quarter of 2007. We are currently evaluating the impact the adoption of FIN 48 could have on our consolidated financial position, results of operations and cash flows.

In September 2006, the FASB issued SFAS 157, "Fair Value Measurements" ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted. We must adopt these new requirements no later than the first quarter of 2008. We have not yet determined the effect on our consolidated financial statements, if any, upon adoption of SFAS 157, or if we will adopt the requirements prior to the first fiscal quarter of 2008.

In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). The intent of SAB 108 is to reduce diversity in practice for the method companies use to quantify financial statement misstatements, including the effect of prior year uncorrected errors. SAB 108 establishes an approach that requires quantification of financial statement errors using both an income statement and a cumulative balance sheet approach. SAB 108 is effective for annual financial statements for fiscal years ending after November 15, 2006. The adoption of SAB 108 is not currently expected to have a significant impact on our consolidated financial statements.

ITEM 7A: QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

We provide our services to customers primarily in the United States and, to a lesser extent, in Europe and elsewhere throughout the world. As a result, our financial results could be affected by factors, such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. All sales are currently denominated in U.S. Dollars or Pound Sterling. A strengthening of the U.S. Dollar or the Pound Sterling could make our products less competitive in foreign markets. Our interest income is sensitive to changes in the general level of U.S. interest rates. Due to the nature of our cash equivalents and short-term investments, which are primarily money market funds, government bonds and commercial paper, we have concluded that there is no material market risk exposure.

ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CYBERSOURCE CORPORATION
CONSOLIDATED FINANCIAL STATEMENTS
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of
CyberSource Corporation

We have audited the accompanying consolidated balance sheets of CyberSource Corporation as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedule listed in the Index at 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 CyberSource Corporation at December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, 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 therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of CyberSource Corporation's internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 12, 2007 expressed an unqualified opinion thereon.

As discussed in Note 1 to the financial statements, the Company changed its method of accounting for share-based payments in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment."

/s/ ERNST & YOUNG LLP

San Jose, California
March 12, 2007

CYBERSOURCE CORPORATION
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 21,701	\$ 14,383
Short-term investments	33,243	32,618
Trade accounts receivable, net of allowances of \$493 and \$650 at December 31, 2006 and 2005	9,614	8,592
Prepaid expenses and other current assets	1,823	2,843
Deferred income taxes	<u>2,320</u>	<u>3,192</u>
Total current assets	68,701	61,628
Property and equipment, net	3,618	2,542
Intangible assets, net	2,845	—
Non-current deferred income taxes, net	9,629	—
Other noncurrent assets	<u>2,250</u>	<u>1,157</u>
Total assets	<u>\$ 87,043</u>	<u>\$ 65,327</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 409	\$ 519
Other accrued liabilities	6,056	5,944
Deferred revenue	<u>1,950</u>	<u>1,931</u>
Total current liabilities	<u>8,415</u>	<u>8,394</u>
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.001 par value:		
Authorized shares—50,000,000		
Issued and outstanding shares—34,908,894 in 2006 and 33,940,021 in 2005	35	34
Additional paid-in capital	368,606	361,710
Accumulated other comprehensive loss	(52)	(439)
Accumulated deficit	<u>(289,961)</u>	<u>(304,372)</u>
Total stockholders' equity	<u>78,628</u>	<u>56,933</u>
Total liabilities and stockholders' equity	<u>\$ 87,043</u>	<u>\$ 65,327</u>

See accompanying notes.

CYBERSOURCE CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)

	Year Ended December 31,		
	2006	2005	2004
Revenues:			
Transaction and support	\$ 63,304	\$ 43,184	\$ 28,737
Enterprise software	3,041	3,693	3,443
Professional services	<u>3,905</u>	<u>3,634</u>	<u>4,529</u>
Total revenues	70,250	50,511	36,709
Cost of revenues:			
Transaction and support	32,343	17,689	9,389
Enterprise software	272	842	509
Professional services	<u>2,012</u>	<u>1,961</u>	<u>2,125</u>
Total cost of revenues	<u>34,627</u>	<u>20,492</u>	<u>12,023</u>
Gross profit	35,623	30,019	24,686
Operating expenses:			
Product development	9,283	8,000	6,772
Sales and marketing	14,443	11,140	10,065
General and administrative	9,861	6,031	5,551
Restructuring charges (recoveries)	<u>—</u>	<u>—</u>	<u>(1,493)</u>
Total operating expenses	<u>33,587</u>	<u>25,171</u>	<u>20,895</u>
Income from operations	2,036	4,848	3,791
Other income	341	—	—
Interest income	<u>2,344</u>	<u>1,324</u>	<u>695</u>
Income before taxes	4,721	6,172	4,486
Income tax provision (benefit)	<u>(9,690)</u>	<u>(3,074)</u>	<u>25</u>
Net income	<u>\$ 14,411</u>	<u>\$ 9,246</u>	<u>\$ 4,461</u>
Basic net income per share	<u>\$ 0.42</u>	<u>\$ 0.28</u>	<u>\$ 0.13</u>
Diluted net income per share	<u>\$ 0.39</u>	<u>\$ 0.26</u>	<u>\$ 0.12</u>
Weighted average number of shares used in computing basic net income per share	<u>34,623</u>	<u>33,464</u>	<u>33,448</u>
Weighted average number of shares used in computing diluted net income per share .	<u>36,593</u>	<u>35,811</u>	<u>35,884</u>

See accompanying notes.

CYBERSOURCE CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands, except share amounts)

	<u>Common Stock</u>		<u>Additional Paid in Capital</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Accumulated Deficit</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>				
Balance at December 31, 2003.....	33,169,123	\$ 33	\$ 362,257	\$ (16)	\$ (318,079)	\$ 44,195
Issuance of common stock under stock option plans.....	1,120,676	1	2,866	—	—	2,867
Issuance of common stock under employee stock purchase plan.....	71,691	—	221	—	—	221
Repurchase of common stock, net	(930,200)	(1)	(4,287)	—	—	(4,288)
Unrealized loss on short-term investments	—	—	—	(57)	—	(57)
Foreign currency translation adjustment.....	—	—	—	100	—	100
Net income.....	—	—	—	—	4,461	4,461
Comprehensive income	—	—	—	—	—	4,504
Balance at December 31, 2004.....	33,431,290	33	361,057	27	(313,618)	47,499
Issuance of common stock under stock option plans.....	869,342	1	2,586	—	—	2,587
Issuance of common stock under employee stock purchase plan.....	82,389	—	379	—	—	379
Repurchase of common stock, net	(443,000)	—	(2,405)	—	—	(2,405)
Tax benefit from employee stock options.....	—	—	93	—	—	93
Unrealized gain on short-term investments.....	—	—	—	24	—	24
Foreign currency translation adjustment.....	—	—	—	(490)	—	(490)
Net income.....	—	—	—	—	9,246	9,246
Comprehensive income	—	—	—	—	—	8,780
Balance at December 31, 2005.....	33,940,021	34	361,710	(439)	(304,372)	56,933
Issuance of common stock under stock option plans.....	1,221,765	1	4,539	—	—	4,540
Issuance of common stock under employee stock purchase plan.....	15,113	—	132	—	—	132
Repurchase of common stock, net	(268,005)	—	(2,461)	—	—	(2,461)
Stock-based compensation	—	—	4,686	—	—	4,686
Unrealized gain on short-term investments.....	—	—	—	21	—	21
Foreign currency translation adjustment.....	—	—	—	366	—	366
Net income.....	—	—	—	—	14,411	14,411
Comprehensive income	—	—	—	—	—	14,798
Balance at December 31, 2006.....	<u>34,908,894</u>	<u>\$ 35</u>	<u>\$ 368,606</u>	<u>\$ (52)</u>	<u>\$ (289,961)</u>	<u>\$ 78,628</u>

See accompanying notes.

CYBERSOURCE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2006	2005	2004
Operating activities:			
Net income.....	\$ 14,411	\$ 9,246	\$ 4,461
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,542	775	1,126
Stock-based compensation.....	4,686	—	—
Income on investment in joint venture.....	(41)	—	—
Deferred income taxes	(9,724)	(3,192)	—
Tax benefit from employee stock options.....	—	93	—
Changes in assets and liabilities:			
Increase in accounts receivable.....	(1,022)	(1,992)	(1,772)
(Increase) decrease in prepaid expenses and other current assets	1,020	(722)	461
(Increase) decrease in other noncurrent assets	(1,052)	(872)	86
Increase (decrease) in accounts payable	(110)	127	(108)
(Increase) decrease in other accrued liabilities	112	395	(2,730)
Increase in deferred revenue	<u>19</u>	<u>91</u>	<u>7</u>
Net cash provided by operating activities.....	9,841	3,949	1,531
Investing activities:			
Purchases of property and equipment	(2,506)	(1,571)	(677)
Acquisition of BidPay.com.....	(1,990)	—	—
Proceeds from payment of promissory note under loan agreement	—	—	645
Purchases of short-term investments.....	(58,842)	(67,515)	(69,855)
Maturities of short-term investments	<u>58,238</u>	<u>66,572</u>	<u>67,258</u>
Net cash used in investing activities.....	(5,100)	(2,514)	(2,629)
Financing activities:			
Issuance of notes receivable.....	—	(175)	—
Proceeds from exercise of stock options and issuance of common stock under the employee stock purchase plan.....	4,672	2,966	3,088
Repurchase of common stock, net	<u>(2,461)</u>	<u>(2,405)</u>	<u>(4,288)</u>
Net cash provided by (used in) financing activities.....	<u>2,211</u>	<u>386</u>	<u>(1,200)</u>
Effect of foreign exchange rate changes on cash.....	<u>366</u>	<u>(490)</u>	<u>100</u>
Net increase (decrease) in cash and cash equivalents.....	7,318	1,331	(2,198)
Cash and cash equivalents at beginning of period.....	<u>14,383</u>	<u>13,052</u>	<u>15,250</u>
Cash and cash equivalents at end of period	<u>\$ 21,701</u>	<u>\$ 14,383</u>	<u>\$ 13,052</u>
Supplemental disclosure of cash flow information:			
Taxes paid	\$ 80	\$ 7	\$ —

See accompanying notes.

CYBERSOURCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

The Company

CyberSource Corporation (“CyberSource” or the “Company”) provides secure electronic payment and risk management solutions to organizations that process orders for goods and services over the Internet. CyberSource’s payment solutions allow eCommerce merchants to accept a wide range of online payment options, from credit cards and electronic checks, to global payment options and emerging payment types. The Company’s risk and compliance management tools address complexities common to online merchants such as credit card fraud, online tax requirements and export controls. The Company’s reporting and management tools facilitate the automation of the flow of complex eCommerce processes, such as recurring billing and payment reconciliation. The Company partners with and connects to a large network of payment processors and other payment service providers to offer merchants a single source solution.

Basis of Presentation

The accompanying consolidated financial statements reflect the financial position and results of operations of the Company and its wholly owned subsidiaries. All intercompany transactions and balances have been eliminated.

Foreign Currency Translation

The financial statements of the Company’s non-U.S. subsidiaries are translated into U.S. dollars in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 52, “Foreign Currency Translation.” Assets and liabilities of the Company’s subsidiaries are translated at the rates of exchange at the end of the period. Revenues and expenses are translated using the average exchange rates in effect during the period. Foreign currency translation adjustments are recorded in other comprehensive income (loss). Gains and losses realized from foreign currency transactions denominated in currencies other than the subsidiary’s functional currency were not material through December 31, 2005 and were approximately \$0.1 million in losses for the year ended December 31, 2006.

Use of Estimates

The preparation of financial statements in conformity with 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 as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

The Company derives its revenues from monthly commerce transaction processing fees, support service fees, professional services and the sale of enterprise software licenses and related maintenance. The Company recognizes revenue in accordance with SEC Staff Accounting Bulletin No. 104, Revenue Recognition (“SAB 104”) and Statement of Position 97-2, “Software Revenue Recognition” (“SOP 97-2”), as amended. SAB 104 and SOP 97-2 require that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services rendered; (3) the fee is fixed or determinable; and (4) collectibility is reasonably assured. Determination of criteria (4) is based on management’s judgments regarding the collectibility of those fees.

Transaction revenues are recognized in the period in which the transactions occur. The Company derives a significant portion of its transaction processing revenues from global acquiring fees charged to merchants for payment processing services. The Company’s fees, which are primarily a percentage of the dollar amount of each transaction processed, are based upon the merchant’s monthly charge volume and risk profile. In addition, the Company records revenues for miscellaneous services related to global acquiring, such as fees for processing credit card chargebacks. In accordance with Emerging Issues Task Force 99-19, Reporting Revenue Gross as a Principal Versus Net as an Agent (“EITF 99-19”), the Company recognizes these fees on a gross basis as it is the primary agent in the transaction in the period the merchants’ transactions are processed. Related interchange fees paid to card issuing banks and assessments paid to credit card associations are recognized in cost of revenues at that time.

Professional services revenue and support service fees are recognized as the related services are provided and costs are incurred. The Company recognizes software license revenue in the period in which the contract is signed, the software is delivered and the fee is collectible. The Company uses the residual method of accounting as permitted by Statement of Position 98-9 (“SOP 98-9”) to recognize revenue when a software license includes one or more elements to be delivered at a future date and vendor specific objective evidence (“VSOE”) exists for all undelivered elements. The Company allocates revenue to each element based upon its fair value as determined by VSOE. The Company defers revenue for any undelivered elements and recognizes the deferred revenue when the product is delivered or over the period in which the service is performed.

CYBERSOURCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The Company derives its professional services revenue from time and material contracts and fixed-price contracts, which require the accurate estimation of the cost, scope and duration of each engagement. Revenue and the related costs for these projects are generally recognized as those services are delivered. Estimates are made regarding percent complete based on original hours budgeted and projected hours to complete the projects and revisions to estimates are reflected in the period in which changes become known. The Company has not had significant losses on professional services engagements to date.

Provisions are provided for sales returns and are based on historical experience and other known factors. For the years ended December 31, 2006, 2005 and 2004, no customer accounted for more than 10% of total revenues.

Cash, Cash Equivalents and Short-Term Investments

The Company considers all highly liquid investments with an original maturity from the date of purchase of three months or less to be cash equivalents. As of December 31, 2006 and 2005, cash equivalents consist primarily of investments in money market funds.

Short-term investments are classified as available-for-sale and are carried at fair market value. Short-term investments are primarily composed of government and corporate bonds with an original maturity greater than three months and less than one year. Also included in short-term investments are approximately \$6.1 million in auction rate securities with final maturities ranging from 28 to 40 years. Although some maturities may extend beyond one year, these securities are available to be used for current operations and therefore, are classified as short-term investments as all of the Company's auction rate securities have auction dates within one year of the prior auction date. Cash, cash equivalents and short-term investments consist of the following as of December 31, 2006 and 2005 (in thousands):

	<u>Carrying Value at December 31, 2006</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Market Value at December 31, 2006</u>
Cash and cash equivalents:				
Cash	\$ 5,606	\$ —	\$ —	\$ 5,606
Commercial paper	1,051	—	—	1,051
Money market funds	<u>15,044</u>	<u>—</u>	<u>—</u>	<u>15,044</u>
Total cash and cash equivalents	<u>21,701</u>	<u>—</u>	<u>—</u>	<u>21,701</u>
Short-term investments:				
Municipal bonds	6,061	—	—	6,061
Corporate bonds	2,011	1	—	2,012
U.S. Government and agency securities	2,033	—	(1)	2,032
Commercial paper	<u>23,164</u>	<u>—</u>	<u>(26)</u>	<u>23,138</u>
Total short-term investments	<u>33,269</u>	<u>1</u>	<u>(27)</u>	<u>33,243</u>
Total cash, cash equivalents and short-term investments	<u>\$ 54,970</u>	<u>\$ 1</u>	<u>\$ (27)</u>	<u>\$ 54,944</u>
	<u>Carrying Value at December 31, 2005</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Market Value at December 31, 2005</u>
Cash and cash equivalents:				
Cash	\$ 2,309	\$ —	\$ —	\$ 2,309
Money market funds	<u>12,074</u>	<u>—</u>	<u>—</u>	<u>12,074</u>
Total cash and cash equivalents	<u>14,383</u>	<u>—</u>	<u>—</u>	<u>14,383</u>
Short-term investments:				
Municipal bonds	16,242	—	—	16,242
Corporate bonds	6,622	—	(18)	6,604
U.S. Government and agency securities	<u>9,802</u>	<u>—</u>	<u>(30)</u>	<u>9,772</u>
Total short-term investments	<u>32,666</u>	<u>—</u>	<u>(48)</u>	<u>32,618</u>
Total cash, cash equivalents and short-term investments	<u>\$ 47,049</u>	<u>\$ —</u>	<u>\$ (48)</u>	<u>\$ 47,001</u>

CYBERSOURCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Net unrealized losses on short-term investments, which represent the difference between the fair market value and the amortized cost, were \$27,000 as of December 31, 2006 and \$48,000 as of December 31, 2005. There were no realized gains or losses from the sale of short-term investments during fiscal 2006, 2005 or 2004.

Concentration of Credit Risk

Financial instruments that potentially subject the Company and its subsidiaries to concentrations of credit risk consist principally of cash, cash equivalents, short-term investments and accounts receivable.

Cash, cash equivalents and short-term investments are invested in major financial institutions in the United States. Such deposits may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Company's investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments.

The accounts receivable of the Company and its subsidiaries are derived from sales to customers located primarily in the United States and Europe. The Company performs ongoing credit evaluations of its customers. The Company generally does not require collateral.

An allowance for doubtful accounts is determined with respect to those amounts that the Company has determined to be doubtful of collection. At December 31, 2006 and 2005, no customer accounted for 10% or more of the Company's accounts receivable balance. At December 31, 2006 and 2005, the percentage of accounts receivable due from foreign customers was 15% and 12%, respectively.

The Company has no off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other hedging arrangements.

Property and Equipment

Property and equipment are stated at cost and are depreciated on a straight-line basis over estimated useful lives of three years. Leasehold improvements are amortized on a straight-line basis over the shorter of the lease terms or the estimated useful lives. Depreciation expense was \$1.4 million, \$0.8 million and \$1.1 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Property and equipment consist of the following (in thousands):

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
Computer equipment and software	\$ 24,930	\$ 22,853
Furniture and fixtures	2,027	1,731
Office equipment	1,000	1,375
Leasehold improvements	<u>2,793</u>	<u>2,793</u>
	30,750	28,752
Less accumulated depreciation and amortization	<u>27,132</u>	<u>26,210</u>
	<u>\$ 3,618</u>	<u>\$ 2,542</u>

Product Development

Product development expenditures are charged to operations as incurred. SFAS No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed," requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based on the Company's product development process, technological feasibility is established upon the completion of a working model. To date, costs incurred by the Company between the completion of the working model and the point at which the product is ready for general release have been insignificant. Accordingly, the Company has charged all such costs to product development expense in the period incurred.

Advertising Expense

The cost of advertising is recorded as an expense when incurred. Advertising costs were approximately \$54,000, \$10,000 and \$0.1 million during the years ended December 31, 2006, 2005 and 2004, respectively.

CYBERSOURCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Accounting for Stock-Based Compensation

Prior to the January 1, 2006 adoption of the Financial Accounting Standards Board (“FASB”) Statement of Financial Accounting Standards No. 123(R), “Share-Based Payment” (“SFAS 123R”), the Company accounted for stock-based compensation using Statement of Financial Accounting Standards No. 148, “Accounting for Stock-Based Compensation — Transition and Disclosure” (“SFAS 148”). SFAS 148 required disclosure of the effects of an entity’s accounting policy with respect to stock-based employee compensation on reported net income and earnings per share in annual and interim financial statements. As permitted under SFAS 148, the Company adopted the disclosure only provisions and continued to follow the intrinsic value method of accounting for employee stock options in accordance with Accounting Principles Board Opinion No. 25 “Accounting for Stock Issued to Employees” (“APB 25”).

Effective January 1, 2006, the beginning of the Company’s first fiscal quarter of 2006, the Company adopted the fair value recognition provisions of SFAS 123R, using the modified-prospective transition method. Under this transition method, stock-based compensation expense was recognized in the consolidated financial statements. Compensation expense recognized included the estimated expense for stock options granted on and subsequent to January 1, 2006, based on the fair value at grant date estimated in accordance with the provisions of SFAS 123R, and the estimated expense for the portion vesting during 2006, for options granted prior to, but not vested as of January 1, 2006, based on the fair value at grant date estimated in accordance with the original provisions of Statement of Financial Accounting Standards No. 123, “Accounting for Stock-Based Compensation” (“SFAS 123”). Results for prior periods have not been restated, as provided for under the modified-prospective method. Total stock-based compensation expense recognized in the consolidated statement of operations for the year ended December 31, 2006 was \$4.7 million before income taxes.

As a result of adopting SFAS 123R, the Company’s income before income taxes and net income, reduced by the expense for stock option awards, for the year ended December 31, 2006, were both \$4.7 million lower than if it had continued to account for stock-based compensation under APB 25. Basic and diluted earnings per share for the year ended December 31, 2006 would have been \$0.14 and \$0.13 higher, respectively, if the Company had not adopted SFAS No. 123R.

The following table shows the effect on net earnings and earnings per share for the years ended December 31, 2005 and 2004 had compensation cost been recognized based upon the estimated fair value on the grant date of stock options, and employee stock purchase plan (“ESPP”) shares, in accordance with SFAS 123, as amended by SFAS 148 (in thousands, except per share amounts):

	<u>Year Ended December 31,</u>	
	<u>2005</u>	<u>2004</u>
Net income, as reported	\$ 9,246	\$ 4,461
Total stock-based employee compensation expense determined under the fair value method for all awards, net of related tax effects.....	<u>(3,009)</u>	<u>(3,392)</u>
Pro forma net income.....	<u>\$ 6,237</u>	<u>\$ 1,069</u>
Basic net income per share, as reported.....	<u>\$ 0.28</u>	<u>\$ 0.13</u>
Pro forma basic net income per share	<u>\$ 0.19</u>	<u>\$ 0.03</u>
Diluted net income per share, as reported.....	<u>\$ 0.26</u>	<u>\$ 0.12</u>
Pro forma diluted net income per share	<u>\$ 0.17</u>	<u>\$ 0.03</u>

Stock Options

In March 1998, the Company adopted its 1998 Stock Option Plan (the “1998 Option Plan”). There are 1,900,000 shares of common stock authorized for issuance under the 1998 Option Plan. The 1998 Option Plan provides for the issuance of common stock and the granting of options to employees, officers, directors, consultants, independent contractors, and advisors of the Company. The exercise price of a nonqualifying stock option and an incentive stock option shall not be less than 85% and 100%, respectively, of the fair value of the underlying shares on the date of grant. Options granted under the 1998 Option Plan generally become exercisable over four years at the rate of 25% per year from the grant date.

In January 1999, the Company adopted its 1999 Stock Option Plan (the “1999 Option Plan”). The Company has reserved a total of 11,000,000 shares of common stock for issuance under the 1999 Option Plan. The provisions of the 1999 Option Plan are similar to those of the 1998 Option Plan. In May 2004, the Company reserved 2,000,000 additional shares of common stock under the 1999 Option Plan. In May 2006, the Company reserved 2,000,000 additional shares of common stock under the 1999 Option Plan.

CYBERSOURCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

In October 1999, the Company adopted the 1999 Nonqualified Stock Option Plan (the “1999 Nonqualified Option Plan”). The Company has reserved a total of 1,737,500 shares of common stock for issuance under the 1999 Nonqualified Option Plan. The 1999 Nonqualified Option Plan provides for the granting of non-qualified stock options to employees, consultants and directors. The other provisions of the 1999 Nonqualified Option Plan are similar to those of the 1999 and 1998 Stock Option Plans.

In September 2000, the Company assumed the PaylinX Stock Option Plan as a result of its acquisition of PaylinX Corporation in September 2000. During 2004, the Company retired the unissued shares available for grant. Options previously granted under this plan that have not yet expired or otherwise become unexercisable continue to be administered under such plan, and any portions that expire or become unexercisable for any reason shall be canceled and be unavailable for future issuance.

Stock options to purchase the Company’s common stock are granted at prices equal to the fair market value on the date of grant. Options generally vest monthly over a four year period beginning from the date of grant and generally expire six to ten years from the date of grant. Options granted to non-employee directors generally become vested nine months from the date of grant. Nearly all outstanding stock options are non-qualified stock options. As of December 31, 2006, 16.6 million shares are authorized for issuance under the Company’s stock option plans.

A summary of the Company’s stock option activity is presented in the following table:

	<u>Shares</u>	<u>Weighted average exercise price per share</u>	<u>Weighted average remaining contractual life</u>	<u>Aggregate intrinsic value</u>
Outstanding as of December 31, 2003.....	5,941,051	\$ 5.45		
Granted	2,046,500	5.24		
Exercised	(1,120,676)	2.56		
Forfeited.....	<u>(684,043)</u>	7.27		
Outstanding as of December 31, 2004.....	6,182,832	5.70		
Granted	1,509,675	5.69		
Exercised	(869,342)	2.97		
Forfeited.....	<u>(465,029)</u>	9.03		
Outstanding as of December 31, 2005.....	6,358,136	5.83		
Granted	2,711,600	9.44		
Exercised	(1,221,765)	3.72		
Forfeited.....	<u>(347,055)</u>	8.24		
Outstanding as of December 31, 2006.....	<u>7,500,916</u>	\$ 7.37	5.76	\$ 33,530,090
Vested and expected to vest as of December 31, 2006.....	7,098,809	\$ 7.27	5.76	\$ 32,774,903
Exercisable as of December 31, 2006.....	4,079,790	\$ 6.59	5.54	\$ 24,165,551

The following table summarizes information about options outstanding at December 31, 2006:

<u>Exercise Price</u>	<u>Number of Options Outstanding</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Life (Years)</u>	<u>Number of Options Exercisable</u>	<u>Weighted Average Exercise Price</u>
\$ 0.05–\$ 3.62	1,532,511	\$ 1.94	5.40	1,492,496	\$ 1.93
\$ 3.70–\$ 5.43	1,677,317	\$ 5.13	7.62	897,679	\$ 5.07
\$ 5.46–\$ 8.36	2,214,988	\$ 7.32	5.67	1,143,266	\$ 6.79
\$ 8.47–\$10.53	1,645,000	\$ 10.09	4.82	219,749	\$ 9.09
\$10.60–\$64.63	<u>431,100</u>	\$ 25.18	3.84	<u>326,600</u>	\$ 29.71
	<u>7,500,916</u>	\$ 7.37		<u>4,079,790</u>	\$ 6.59

At December 31, 2005 and 2004, 4,020,129 and 3,504,689 options were exercisable at a weighted average exercise price of \$6.30 and \$7.09, respectively.

CYBERSOURCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

For stock options granted during 2006, 2005 and 2004, and ESPP shares purchased during 2005 and 2004, the Company determined the fair value at the date of grant or purchase using the Black-Scholes option valuation model and the following weighted average assumptions:

	Year Ended December 31,		
	2006	2005	2004
Stock options:			
Risk-free interest rate.....	4.64% - 4.75%	4.37%	3.43%
Dividend yield	—	—	—
Volatility.....	0.58 - 0.64	0.60	0.75
Expected life (years).....	2.96	3.97	4
Employee stock purchase plan shares:			
Risk-free interest rate.....	—	3.50%	1.61%
Dividend yield	—	—	—
Volatility.....	—	0.44	0.75
Expected life (months).....	—	6	6

The expected life of the options represents the estimated period of time until exercise and is based on historical experience of similar awards, giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. Expected stock price volatility is based on historical volatility of the Company's stock over the expected life of the options. The risk-free interest rate is based on the yield available on U.S. Treasury zero-coupon issues with an equivalent remaining expected life. The Company has not paid dividends in the past and does not plan to pay any dividends in the near future.

The weighted average fair value of options granted was \$4.80, \$2.81 and \$2.86 per share for options granted during 2006, 2005 and 2004, respectively. The weighted average fair value for shares purchased under the Company's ESPP was \$0.33 and \$1.44 per share during 2005 and 2004, respectively. In July 2005, the Company amended the ESPP, permitting eligible employees to authorize payroll deductions of up to 10% of their base compensation to purchase shares of the Company's common stock at 95% of the fair market value of the common stock on the purchase date. As a result of this amendment and the provisions of SFAS 123R, shares granted under the ESPP are non-compensatory. As of December 31, 2006, 700,000 shares are authorized for issuance under the ESPP.

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes option valuation model. The assumptions used to calculate the fair value of options granted are evaluated and revised, as necessary, to reflect market conditions and the Company's experience. Options granted are valued using the single option valuation approach, and the resulting expense is recognized on a straight-line basis over the vesting period of the option. Compensation expense is recognized only for those options expected to vest, with forfeitures estimated at the date of grant based on the Company's historical experience and future expectations. Prior to the adoption of SFAS 123R, the effect of forfeitures on the pro forma expense amounts was recognized as the forfeitures occurred.

As of December 31, 2006, total unrecognized stock-based compensation expense related to non-vested stock options was approximately \$11.8 million, which is expected to be recognized over a weighted average period of approximately 2.9 years. During 2006, 2005 and 2004, the total intrinsic value of stock options exercised was approximately \$6.9 million, \$3.5 million and \$5.0 million, respectively. During 2006, the total cash received from the exercise of stock options was approximately \$4.7 million.

During 2006, the Company granted 100,000 restricted shares at a weighted average grant date fair value of \$10.46. No shares have vested as of December 31, 2006.

Employee Stock Purchase Plan

In June 1999, the Company's Board of Directors and stockholders adopted the 1999 Employee Stock Purchase Plan ("ESPP") and reserved 500,000 shares of common stock for issuance under this plan. In accordance with Section 423 of the Internal Revenue Code, this plan permitted eligible employees to authorize payroll deductions of up to 10% of their base compensation to purchase shares of the Company's common stock at the lower of 85% of the fair market value of the common stock on the first day of the offering period or the purchase date. In July 2005, the Company amended the ESPP, permitting eligible employees to authorize payroll deductions of up to 10% of their base compensation to purchase shares of the Company's

CYBERSOURCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

common stock at 95% of the fair market value of the common stock on the purchase date. In May 2004, the Company reserved an additional 200,000 shares of common stock for issuance under the 1999 Employee Stock Purchase Plan. During the year ended December 31, 2006, the Company issued 15,113 shares of common stock to employees under the terms of the plan. As of December 31, 2006, 146,416 shares remain available for purchase under the plan.

In November 2005, the FASB issued FASB Staff Position No. 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards* (“FSP 123R-3”). The Company has elected to adopt the alternative transition method for calculating the tax effects of share-based compensation pursuant to FAS 123R-3. The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool related to the effects of employee share-based compensation.

Long-Lived Assets

Statement of Financial Accounting Standard No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets” (“SFAS 144”) requires that the Company perform tests for impairment of its intangible assets other than goodwill annually and more frequently whenever events or circumstances suggest that its intangible assets may be impaired. As of December 31, 2006, the Company had recorded intangible assets related to our acquisition of BidPay.com (“BidPay”) in March 2006, with a carrying value of approximately \$3.0 million. To evaluate potential impairment, SFAS 144 requires the Company to assess whether the future cash flows related to these assets will be greater than their carrying value at the time of the test. Accordingly, while the Company’s cash flow assumptions are consistent with the plans and estimates it is using to manage the underlying businesses, there is significant judgment in determining the cash flows attributable to its intangible assets over their respective estimated useful lives.

Net Income Per Share

In accordance with Statement of Financial Accounting Standards No. 128, “Earnings Per Share,” basic and diluted net income per share has been computed using the weighted average number of shares of common stock outstanding during the period.

Income Taxes

Income taxes are calculated under the provisions of Statement of Financial Accounting Standards No. 109, “Accounting for Income Taxes” (“SFAS 109”). Under SFAS 109, the liability method is used in accounting for income taxes, which includes the effects of temporary differences between financial and taxable amounts of assets and liabilities as well as the effects of net operating loss and credit carryforwards to determine deferred tax assets and liabilities. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to more likely than not be realized. Prior to the fourth quarter of 2005, the Company recorded a full valuation allowance to reserve for the benefit of its deferred tax assets due to the uncertainty surrounding its ability to realize these assets.

During the fourth quarter of 2005, the Company recorded an income tax benefit of approximately \$3.1 million which included a \$3.2 million reduction in the Company’s valuation allowance against its deferred tax assets. During the fourth quarter of 2006, the Company recorded an income tax benefit of approximately \$11.0 million which included a \$9.9 million reduction in the Company’s valuation allowance against its deferred tax assets. These determinations were based on projected taxable income.

Accumulated Other Comprehensive Loss

The Company’s comprehensive income (loss) consists of its net income and other comprehensive income (loss), including unrealized gains or losses on available for sale securities and foreign currency translation gains or losses.

New Accounting Pronouncements

In July 2006, the FASB issued FASB Interpretation Number 48, “Accounting for Uncertainty in Income Taxes” (“FIN 48”), an interpretation of SFAS 109. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with SFAS 109. FIN 48 is effective for fiscal years beginning after December 15, 2006 and as a result is effective for the Company in the first quarter of 2007. The Company is currently evaluating the impact the adoption of FIN 48 could have on its consolidated financial position, results of operations and cash flows.

CYBERSOURCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

In September 2006, the FASB issued SFAS 157, “Fair Value Measurements” (“SFAS 157”), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted. The Company must adopt these new requirements no later than the first quarter of 2008. The Company has not yet determined the effect on the Company’s consolidated financial statements, if any, upon adoption of SFAS 157, or if it will adopt the requirements prior to the first fiscal quarter of 2008.

In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements” (“SAB 108”). The intent of SAB 108 is to reduce diversity in practice for the method companies use to quantify financial statement misstatements, including the effect of prior year uncorrected errors. SAB 108 establishes an approach that requires quantification of financial statement errors using both an income statement and a cumulative balance sheet approach. SAB 108 is effective for annual financial statements for fiscal years ending after November 15, 2006. The adoption of SAB 108 is not currently expected to have a significant impact on the Company’s consolidated financial statements.

2. BidPay.com Acquisition

In March 2006, the Company acquired BidPay.com, Inc. (“BidPay”), a payment service provider for online auctions. The Company’s primary reason for the acquisition of BidPay is to expand its services into the payment market for online auctions. The aggregate purchase price of approximately \$3.0 million consisted of cash consideration of approximately \$2.0 million, including \$0.2 million of acquisition costs, and \$1.0 million in deferred taxes related to the difference between the financial and tax basis of the assets acquired, in exchange for BidPay’s proprietary technology, its databases, and certain intellectual property rights, including exclusive rights to the BidPay brand.

In accordance with Emerging Issues Task Force 98-3, “Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business,” the Company determined that it had acquired productive assets as opposed to a business. As a result, no amount of the purchase price was allocated to goodwill. The total purchase price of \$3.0 million was allocated based on the fair values presented below (in thousands):

	<u>Fair Market Value</u>	<u>Straight-line Amortization</u>
Technology platform	\$ 269	3
Customer list.....	269	6
Trade name	2,419	—
Total.....	<u>\$ 2,957</u>	

The Company recorded approximately \$0.1 million of amortization expense related to intangible assets in the year ended December 31, 2006, respectively.

Estimated amortization expense for the intangible assets on the Company’s December 31, 2006 balance sheet for the fiscal years ended December 31, is as follows (in thousands):

2007	\$ 134
2008	134
2009	60
2010	45
2011	45
Thereafter	8
Total.....	<u>\$ 426</u>

The pro forma results of operations have not been presented for the acquisition of BidPay because the effect of this acquisition was not considered material.

3. Balance Sheet Detail

Prepaid expenses and other current assets consist of the following (in thousands):

CYBERSOURCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	December 31,	
	2006	2005
Prepaid expenses	\$ 1,253	\$ 1,505
Value added taxes receivable.....	119	956
Acquiring receivable.....	441	185
Notes receivable	—	175
Other current assets	<u>10</u>	<u>22</u>
Total prepaid expenses and other current assets	<u>\$ 1,823</u>	<u>\$ 2,843</u>

Other non-current assets consist of the following (in thousands):

	December 31,	
	2006	2005
Prepaid rent.....	\$ 1,968	\$ 824
Deposits	225	265
Other non-current assets	<u>57</u>	<u>68</u>
Total other noncurrent assets	<u>\$ 2,250</u>	<u>\$ 1,157</u>

Prepaid rent represents the difference between the Company's rent expense on a straight-line basis and its rent payments to date. Prepaid rent will increase if rent payments are higher than the rent expense on a straight-line basis and decrease if rent payments are lower than the rent expense on a straight-line basis.

Other accrued liabilities consist of the following (in thousands):

	December 31,	
	2006	2005
Employee benefits and related expenses	\$ 3,167	\$ 2,415
Accrued cost of revenues.....	1,617	920
Other liabilities	<u>1,272</u>	<u>2,609</u>
Total other accrued liabilities.....	<u>\$ 6,056</u>	<u>\$ 5,944</u>

4. Segment Information

Operating segments are identified as components of an enterprise about which separate discrete financial information is available that is evaluated by the chief operating decision maker or decision-making group to make decisions about how to allocate resources and assess performance. The Company's chief operating decision maker is the Chief Executive Officer. The Company views its operations as principally three segments, Commerce transaction services and support, enterprise software and professional services and manages the business based on the revenues and cost of revenues of these segments. Additionally, revenues from outside the United States were 10.0%, 9.6% and 9.4% of total revenues for the years ended December 31, 2006, 2005 and 2004, respectively. For the years ended December 31, 2006, 2005 and 2004, no customer accounted for more than 10% of revenues.

The following tables present revenues and cost of revenues by the Company's three reportable segments for the years ended December 31, 2006, 2005 and 2004. There were no inter-business unit sales or transfers. The Company does not report operating expenses, depreciation and amortization, interest income (expense), income taxes, capital expenditures, or identifiable assets by its segments to the Chief Executive Officer. The Company's Chief Executive Officer reviews the revenues and cost of revenues from each of the Company's reportable segments, and all of the Company's expenses are managed by and reported to the Chief Executive Officer on a consolidated basis. Revenues and cost of revenues are as follows (in thousands):

	December 31,		
	2006	2005	2004
Revenues:			
Commerce transaction services and support	\$ 63,304	\$ 43,184	\$ 28,737
Enterprise software.....	3,041	3,693	3,443
Professional services	<u>3,905</u>	<u>3,634</u>	<u>4,529</u>
Total revenues	<u>\$ 70,250</u>	<u>\$ 50,511</u>	<u>\$ 36,709</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	<u>December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Cost of revenues:			
Commerce transaction services and support	\$ 32,343	\$ 17,689	\$ 9,389
Enterprise software	272	842	509
Professional services	<u>2,012</u>	<u>1,961</u>	<u>2,125</u>
Total cost of revenues	<u>\$ 34,627</u>	<u>\$ 20,492</u>	<u>\$ 12,023</u>

5. Restructuring Charges (Recoveries)

During 2001, the Company exited certain under-utilized space in its Mountain View, California facility. During the fourth quarter of 2004, the Company re-evaluated its future facility needs and determined that its forecasted growth would require the utilization of the unoccupied space in its Mountain View, California facility beginning in 2005. As a result, the Company decided to no longer market the available space at its Mountain View, California facility, and extended its lease on this facility through December 2011. As a result, the Company reversed the remaining \$1.5 million balance of previously recorded restructuring charges related to this facility.

6. Investment in Joint Venture

On March 1, 2000, the Company entered into a joint venture agreement with Japanese partners Marubeni Corporation and Trans-Cosmos, Inc. to establish CyberSource K.K. to provide commerce transaction services to the Japanese market. The Company will maintain a majority controlling interest in CyberSource K.K., subject to certain veto rights granted to the partners, which will expire when CyberSource K.K. achieves at least \$2.0 million in quarterly revenue. The joint venture is being accounted for under the equity method of accounting until the veto rights granted to the partners as described above expire. After such date, in accordance with the joint venture agreement, the Company will consolidate the financial position and results of operations of CyberSource K.K. As of December 31, 2005, the Company had recognized losses to the extent of its historical investment. In 2006, the Company recognized joint venture income of approximately \$41,000.

7. Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss are as follows (in thousands):

	<u>Year Ended</u> <u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
Cumulative foreign currency translation adjustment	\$ (25)	\$ (391)
Unrealized loss on short-term investments	<u>(27)</u>	<u>(48)</u>
Accumulated other comprehensive loss.....	<u>\$ (52)</u>	<u>\$ (439)</u>

8. Commitments

The Company leases its primary facility and certain equipment under noncancelable operating leases. The lease agreement for the Company's primary facility expires in December 2011. Rental expense was approximately \$1.9 million, \$1.8 million and \$1.7 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Future minimum lease payments under noncancelable operating leases at December 31, 2006 are as follows (in thousands):

<u>Year ending December 31,</u>	<u>Operating</u> <u>Leases</u>
2007	\$ 1,160
2008	1,385
2009	1,442
2010	1,350
2011	1,347
2012	<u>253</u>
Total minimum payments	<u>\$ 6,937</u>

CYBERSOURCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

9. Stockholders' Equity

Preferred Shares

The Company is authorized to issue 5,610,969 shares of preferred stock. The Company's Board of Directors has the ability to determine the rights and preferences of the preferred stock and can issue the preferred stock without the approval of the holders of the common stock. As of December 31, 2006, there are no shares of preferred stock outstanding.

Common Shares

The Company is authorized to issue 50,000,000 shares of common stock. The holders of common stock are entitled to one vote per share on all matters to be voted upon by the stockholders of the Company. Subject to the preferences that may be applicable to any outstanding shares of preferred stock, the holders of common stock are entitled to receive ratably such dividends, if any, as may be declared by the Board of Directors.

The Company has reserved shares of common stock for future issuance at December 31, 2006 as follows:

1998 and 1999 Stock Option Plans:

Options outstanding	7,500,916
Options available for future grants	2,320,691
1999 Employee Stock Purchase Plan—shares available for future purchase	<u>146,416</u>
	<u>9,968,023</u>

10. Common Stock Repurchase Program

On January 22, 2004, the Board of Directors authorized management to use up to \$10.0 million over a twelve-month period beginning at January 22, 2004 to repurchase shares of the Company's common stock. During the twelve months ending January 21, 2005, the Company repurchased 930,200 shares at an average price of \$4.61 per share, net of repurchase costs. All of the repurchased shares were cancelled and returned to the status of authorized, unissued shares.

On January 26, 2005, the Board of Directors authorized management to use up to \$10.0 million over a twelve-month period beginning at February 1, 2005 to repurchase additional shares of the Company's common stock. During the twelve months ending January 31, 2006, the Company repurchased 443,000 shares at an average price of \$5.43 per share, net of repurchase costs. All of the repurchased shares were cancelled and returned to the status of authorized, unissued shares.

On February 7, 2006, the Board of Directors authorized management to use up to \$10.0 million over a twelve-month period beginning at February 10, 2006 to repurchase additional shares of the Company's common stock. During the period beginning February 10, 2006 and ending December 31, 2006, the Company repurchased 268,005 shares at an average price of \$9.18 per share, net of repurchase costs. All of the repurchased shares were cancelled and returned to the status of authorized, unissued shares.

11. Related Party Transactions

For the years ended December 31, 2006, 2005 and 2004, legal fees of approximately \$0.4 million, \$0.5 million and \$0.5 million, respectively, were paid to Morrison & Foerster LLP, a law firm in which a director of the Company is a partner. As of December 31, 2006 and 2005, the Company had immaterial amounts of accounts payable due to Morrison & Foerster LLP.

The terms of the Company's contracts with the above-related parties are consistent with its contracts with other independent parties.

12. Litigation and Contingencies

In July and August 2001, various class action lawsuits were filed in the United States District Court, Southern District of New York, against the Company, its Chairman and CEO, a former officer, and four brokerage firms that served as underwriters in its initial public offering. The actions were filed on behalf of persons who purchased the Company's stock issued pursuant to or traceable to the initial public offering during the period from June 23, 1999 through December 6, 2000. The action alleges that the Company's underwriters charged secret excessive commissions to certain of their customers in return for allocations of the Company's stock in the offering. The two individual defendants are alleged to be liable because of their involvement in preparing and signing the registration statement for the offering, which allegedly failed to disclose the supposedly excessive commissions.

CYBERSOURCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

On December 7, 2001, an amended complaint was filed in one of the actions to expand the purported class to persons who purchased the Company's stock issued pursuant to or traceable to the follow-on public offering during the period from November 4, 1999 through December 6, 2000. The lawsuit filed against the Company is one of several hundred lawsuits filed against other companies based on substantially similar claims. On April 19, 2002, a consolidated amended complaint was filed to consolidate all of the complaints and claims into one case. The consolidated amended complaint alleges claims that are virtually identical to the amended complaint filed on December 7, 2001 and the original complaints. In October 2002, the Company's officer and a former officer that were named in the amended complaint were dismissed without prejudice. In July 2002, the Company, along with other issuer defendants in the case, filed a motion to dismiss the consolidated amended complaint with prejudice. On February 19, 2003, the court issued a written decision denying the motion to dismiss with respect to CyberSource and the individual defendants. On July 2, 2003, a committee of the Company's Board of Directors conditionally approved a proposed partial settlement with the plaintiffs in this matter. The settlement would provide, among other things, a release of the Company and of the individual defendants for the conduct alleged in the action to be wrongful in the Amended Complaint. The Company would agree to undertake other responsibilities under the partial settlement, including agreeing to assign away, not assert, or release certain potential claims it may have against its underwriters. The committee agreed to approve the settlement subject to a number of conditions, including the participation of a substantial number of other Issuer Defendants in the proposed settlement, the consent of the Company's insurers to the settlement, and the completion of acceptable final settlement documentation. On August 31, 2005, the court issued a formal preliminary approval for the settlement. On April 24, 2006, a hearing was held for the court to consider the motion for final approval of the settlement. On December 5, 2006, the United States Court of Appeals for the Second Circuit (the "Second Circuit") issued an opinion vacating the District Court's certification of a litigation class in that portion of the case between the Plaintiffs and the underwriter defendants. Because the Second Circuit's opinion was directed to the class certified by the District Court for the Plaintiffs' litigation against the underwriter defendants, the opinion's effect on the class certified by the District Court for the Company's settlement is unclear. On January 5, 2007, Plaintiffs filed a petition for rehearing to the full panel of the Second Circuit. The proposed settlement is pending final approval by the District Court. There can be no assurance that the settlement will be approved and, because of the inherent uncertainties of litigation, the Company cannot accurately predict the ultimate outcome of the case if it is not. However, any direct financial impact of the proposed settlement is expected to be borne by the Company's insurers.

On August 11, 2004, the Company filed suit in the Northern District of California against Retail Decisions, Inc. ("ReD US") and Retail Decisions Plc ("ReD UK") (collectively, "ReD"), Case No. 3:04-CIV-03268, alleging that ReD infringes the Company's U.S. Patent No. 6,029,154 (the "'154 Patent"). The Company served ReD US with the complaint on August 12, 2004, and the Company served ReD UK with the complaint on August 13, 2004. On September 30, 2004, ReD responded to the Company's complaint. ReD filed a motion to stay the case for 90 days pending a determination by the U.S. Patent and Trademark Office ("PTO") as to whether it will grant ReD's request that the PTO re-examine the '154 Patent. ReD also filed a motion for a more definite statement by the Company with respect to its allegation that ReD is willfully infringing the '154 Patent. In addition, ReD UK filed a motion to dismiss the action against it on the ground that it is not subject to personal jurisdiction in the Northern District of California. On October 27, 2004, ReD filed a request for re-examination with the PTO, based on prior art ReD discovered that allegedly invalidates the patent. On October 28, 2004, the Company filed an opposition to ReD's motion to stay the case for 90 days and an opposition to ReD's motion for a more definite statement with respect to willful infringement. Based on ReD UK's representation that ReD US is the sole entity that develops, operates, and distributes the eBitGuard service, the Company agreed to dismiss ReD UK while reserving the right to reinstitute action against ReD UK in the event the Company later discovers that ReD UK is subject to the court's personal jurisdiction. In return, ReD UK agreed that if the Company later establishes that personal jurisdiction existed, the Company could re-file against ReD UK in this action without prejudice to its damages claim. The Company also filed an amended complaint, removing ReD UK as a named defendant and restating the willful infringement claim. On November 16, 2004, the court granted ReD's motion to stay the proceedings pending the PTO's decision as to whether it will grant ReD's request for re-examination. On December 30, 2004, the PTO granted ReD's request for a re-examination. On January 19, 2005, ReD filed a motion to dismiss the case without prejudice or to extend the stay until completion of the re-examination process. On January 24, 2005, the court extended the stay pending the re-examination process, vacated ReD's motion to dismiss, and ordered quarterly updates as to the status of the re-examination process. On April 25, 2005, the parties filed a joint status report that was approved by the court. On June 20, 2005, the PTO issued a preliminary office action rejecting all of the claims of the '154 patent based on one of the prior art references cited by ReD. On July 14, 2005, the Company met with the PTO examiner handling the re-examination to distinguish the prior art from the claims of the '154 patent. On August 9, 2006, the PTO issued a final office action rejecting all of the claims of the '154 patent. On September 7, 2006, the Company filed a response to the office action requesting certain amendments to the claims. On October 10, 2006, the PTO filed a response rejecting the amendments and extending the Company's deadline to file a notice of appeal. On October 30, 2006, the Company filed a notice of appeal. While there can be no assurances as to the outcome of the lawsuit, the Company does not presently believe that the lawsuit would have a material effect on its financial condition, results of operations, or cash flows.

CYBERSOURCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The Company is currently party to various legal proceedings and claims which arise in the ordinary course of business. While the outcome of these matters cannot be predicted with certainty, the Company does not believe that the outcome of any of these claims or any of the above mentioned legal matters will have a material adverse effect on its consolidated financial position, results of operations or cash flows.

13. Income Taxes

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

	December 31,		
	2006	2005	2004
Domestic	\$ 3,421	\$ 4,952	\$ 3,358
Foreign	<u>1,300</u>	<u>1,220</u>	<u>1,128</u>
Income before taxes	<u>\$ 4,721</u>	<u>\$ 6,172</u>	<u>\$ 4,486</u>

The Company's provision (benefit) for income taxes consists of the following (in thousands):

	December 31,		
	2006	2005	2004
Current income taxes:			
Federal	\$ 22	\$ 80	\$ 15
State	<u>12</u>	<u>38</u>	<u>10</u>
Total current income tax expense	<u>34</u>	<u>118</u>	<u>25</u>
Deferred income taxes:			
Federal	(7,458)	(2,285)	—
State	(1,770)	(403)	—
Foreign	<u>(496)</u>	<u>(504)</u>	<u>—</u>
Total deferred income tax benefit	<u>(9,724)</u>	<u>(3,192)</u>	<u>—</u>
Total provision (benefit) for income taxes	<u>\$ (9,690)</u>	<u>\$ (3,074)</u>	<u>\$ 25</u>

A reconciliation between the tax provision computed at the statutory income tax rate of 34% and the Company's actual effective income tax provision is as follows (in thousands):

	December 31,		
	2006	2005	2004
Tax provision at statutory rate of 34%	\$ 1,605	\$ 2,098	\$ 1,570
State income taxes	(1,160)	(241)	269
Other	87	25	15
Foreign net operating losses utilized	(886)	(870)	(338)
Decreased valuation allowance	<u>(9,336)</u>	<u>(4,086)</u>	<u>(1,491)</u>
Provision for income taxes	<u>\$ (9,690)</u>	<u>\$ (3,074)</u>	<u>\$ 25</u>

During 2006, the Company recorded an income tax benefit of approximately \$9.7 million. This benefit included a \$9.9 million reduction in the Company's valuation allowance against its deferred tax assets. During 2005, the Company recorded an income tax benefit of approximately \$3.1 million. This benefit included a \$3.2 million reduction in the Company's valuation allowance against its deferred tax assets. These determinations were based on projected taxable income.

As of December 31, 2006, the Company has approximately \$157.6 million federal and \$46.1 million state net operating loss carryforwards to reduce future taxable income. Of these amounts, \$5.4 million and \$0.9 million represent federal and state tax deductions, respectively, from stock option compensation. The tax benefit from these deductions will be recorded as an adjustment to additional paid-in capital in the year in which the benefit is realized.

As of December 31, 2006, the Company also has research and development tax credit carryforwards of approximately \$1.1 million and \$0.7 million for federal and state income tax purposes, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The net operating loss and credit carryforwards will expire at various dates beginning in 2012 through 2024, if not utilized. The utilization of the net operating losses and credits may be subject to a substantial annual limitation due to the “change in ownership” provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses and credits before utilization.

The components of the net deferred tax assets are as follows (in thousands):

	December 31,	
	2006	2005
Deferred tax assets:		
Net operating loss carryforwards.....	\$ 51,388	\$ 58,145
Research credit carryforwards.....	1,816	1,806
Other, net.....	1,992	2,526
Depreciation differences.....	581	—
Non-deductible stock compensation charges	1,833	—
Deferred tax assets	<u>\$ 57,610</u>	<u>\$ 62,477</u>
Deferred tax liabilities:		
Acquired intangibles	(1,151)	—
Net deferred tax assets.....	\$ 56,459	\$ 62,477
Valuation allowance	(44,510)	(59,285)
Net deferred tax assets.....	<u>\$ 11,949</u>	<u>\$ 3,192</u>

Under SFAS 109, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Due to the uncertainty surrounding the realization of the tax attributes in tax returns, the Company has recorded a valuation allowance against certain deferred tax assets. \$6.3 million of the valuation allowance is attributable to the tax benefits of stock option compensation, the benefit of which will be credited to additional paid-in capital in the year in which the benefit is realized. The valuation allowance decreased approximately \$14.8 million from December 31, 2005 to December 31, 2006.

14. Employee Savings and Retirement Plan

The Company maintains a defined contribution plan under Internal Revenue Service Code 401(k) (the “401(k) Plan”). The 401(k) Plan provides for tax deferred salary deductions. Employees can elect to contribute to the 401(k) Plan up to 20% of their salary, subject to current statutory limits. The Company is not required to contribute to the 401(k) Plan and has made no contributions since the inception of the 401(k) Plan.

15. Net Income Per Share Computation

The following table reconciles the numerators and denominators of the net income per share calculation for the years ended December 31, 2006, 2005 and 2004 (in thousands, except per share data):

	December 31,		
	2006	2005	2004
Basic net income per share computation:			
Net income	<u>\$ 14,411</u>	<u>\$ 9,246</u>	<u>\$ 4,461</u>
Net income attributable to common stockholders	<u>\$ 14,411</u>	<u>\$ 9,246</u>	<u>\$ 4,461</u>
Weighted-average common shares outstanding	<u>34,623</u>	<u>33,464</u>	<u>33,448</u>
Basic net income per share attributable to common stockholders.....	<u>\$ 0.42</u>	<u>\$ 0.28</u>	<u>\$ 0.13</u>
Diluted net income per share computation:			
Net income	<u>\$ 14,411</u>	<u>\$ 9,246</u>	<u>\$ 4,461</u>
Net income attributable to common stockholders	<u>\$ 14,411</u>	<u>\$ 9,246</u>	<u>\$ 4,461</u>
Weighted-average common shares outstanding	34,623	33,464	33,448

CYBERSOURCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Incremental shares attributable to the assumed purchase of shares through the employee stock purchase plan.....	—	—	10
Incremental shares attributable to the assumed exercise of outstanding options	<u>1,970</u>	<u>2,347</u>	<u>2,426</u>
Total diluted weighted average common shares	<u>36,593</u>	<u>35,811</u>	<u>35,884</u>
Diluted net income per share attributable to common stockholders.....	<u>\$ 0.39</u>	<u>\$ 0.26</u>	<u>\$ 0.12</u>

Options to purchase 361,000, 1,230,000, and 708,000 shares of common stock were outstanding during 2006, 2005, and 2004, respectively, but were not included in the computation of diluted earnings per share because the effect was antidilutive.

16. Guarantees

The Company from time to time enters into certain types of contracts that contingently require the Company to indemnify parties against third-party claims. These contracts primarily relate to: (i) certain real estate leases, under which the Company may be required to indemnify property owners for environmental and other liabilities, and other claims arising from the Company's use of the applicable premises; and (ii) certain agreements with the Company's officers, directors and employees, under which the Company may be required to indemnify such persons for liabilities arising out of their employment relationship.

The terms of such obligations vary. Generally, a maximum obligation is not explicitly stated. Because the obligated amounts of these types of agreements often are not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, the Company has not been obligated to make significant payments for these obligations, and no liabilities have been recorded for these obligations on its balance sheet as of December 31, 2006 or 2005.

17. Quarterly Financial Information (Unaudited)

Summarized quarterly financial information for fiscal 2006 and 2005 is as follows (in thousands, except per share data):

	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>	<u>Fiscal Year</u>
<u>Fiscal 2006</u>					
Revenues	\$ 15,584	\$ 16,398	\$ 17,359	\$ 20,909	\$ 70,250
Gross profit	8,439	8,694	8,586	9,904	35,623
Net income	875	790	286	12,460	14,411
Basic net income per share.....	\$ 0.03	\$ 0.02	\$ 0.01	\$ 0.36	\$ 0.42
Diluted net income per share	\$ 0.02	\$ 0.02	\$ 0.01	\$ 0.34	\$ 0.39
<u>Fiscal 2005</u>					
Revenues	\$ 11,160	\$ 11,912	\$ 12,529	\$ 14,910	\$ 50,511
Gross profit	7,118	7,002	7,243	8,656	30,019
Net income	1,018	1,403	1,628	5,197	9,246
Basic net income per share.....	\$ 0.03	\$ 0.04	\$ 0.05	\$ 0.15	\$ 0.28
Diluted net income per share	\$ 0.03	\$ 0.04	\$ 0.05	\$ 0.14	\$ 0.26

The fourth quarter fiscal 2006 and 2005 net income includes a reduction in the Company's deferred tax asset valuation allowance of \$9.9 million and \$3.2 million, respectively.

18. Subsequent Events (unaudited)

On January 24, 2007, the Board of Directors authorized management to use up to \$10.0 million over a twelve-month period beginning at January 30, 2007 to repurchase additional shares of the Company's common stock. During the period beginning January 30, 2007 and ended March 1, 2007, the Company did not repurchase any shares.

ITEM 9: CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not Applicable

ITEM 9A: CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that its disclosure controls and procedures are effective in timely alerting them to material information required to be included in this report. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

Internal Control Over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d -15(f)) for the Company. Management designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. The internal controls procedures were designed with the objective of providing reasonable assurance that the Company's transactions are properly authorized, its assets are safeguarded against unauthorized acquisition, use or disposition and its transactions are properly recorded and reported, all to permit the preparation of the Company's financial statements in conformity with U.S. generally accepted accounting principles.

As of the end of the period covered by this report, the Company's management carried out an evaluation, under the supervision and with the participation of its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's internal controls over financial reporting. In making this assessment, the Company's management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control-Integrated Framework. In the course of this evaluation, the Company sought to identify data errors, controls problems or acts of fraud. Our internal controls over financial reporting are evaluated on an ongoing basis by our finance department. The overall goal of these various evaluation activities is to monitor our internal controls over financial reporting and to make modifications as necessary; our intent in this regard is that the internal controls over financial reporting will be maintained as dynamic systems that change (including improvements and corrections) as conditions warrant.

Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that its internal controls over financial reporting are effective. It should be noted that internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company's independent registered public accounting firm, Ernst & Young LLP, audited management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2006. Ernst & Young LLP has issued an attestation report which is included in this Form 10-K.

Changes in Internal Control Over Financial Reporting

There have been no significant changes in the Company's internal controls or in other factors which could significantly affect internal controls subsequent to the date the Company carried out this evaluation.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of
CyberSource Corporation

We have audited management's assessment, included in the accompanying Management Assessment of Internal Control, that CyberSource Corporation maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). CyberSource Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that CyberSource Corporation maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, CyberSource Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of CyberSource Corporation as of December 31, 2006 and 2005 and the related consolidated statements of operations, stockholder's equity and cash flows for each of the three years in the period ended December 31, 2006 of CyberSource Corporation and our report dated March 12, 2007 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Jose, California
March 12, 2007

ITEM 9B: OTHER INFORMATION

None.

PART III

ITEM 10: DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item is incorporated by reference to the Company's Proxy Statement for the 2007 Annual Meeting of Stockholders.

ITEM 11: EXECUTIVE COMPENSATION

The information required by this item is incorporated by reference to the Company's Proxy Statement for the 2007 Annual Meeting of Stockholders.

ITEM 12: SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item is incorporated by reference to the Company's Proxy Statement for the 2007 Annual Meeting of Stockholders.

ITEM 13: CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information required by this item is incorporated by reference to the Company's Proxy Statement for the 2007 Annual Meeting of Stockholders.

ITEM 14: PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is incorporated by reference to the Company's Proxy Statement for the 2007 Annual Meeting of Stockholders.

ITEM 15: EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) 1. Financial Statements

The following documents are filed as part of this Report:

	<u>Page</u>
Report of Independent Registered Public Accounting Firm	29
Consolidated Balance Sheets	30
Consolidated Statements of Operations	31
Consolidated Statements of Stockholders' Equity	32
Consolidated Statements of Cash Flows	33
Notes to Consolidated Financial Statements	34

2. Financial Statement Schedule

Schedule II—Valuation and Qualifying Accounts is listed on page 53 of this Annual Report on Form 10-K. All other schedules are omitted because they are not applicable or the required information is shown in the Financial Statements or the notes thereto.

3. Index to Exhibits

See Index to Exhibits on page 54.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, in Mountain View, California on the 13th day of March, 2007.

CYBERSOURCE CORPORATION

By: /s/ WILLIAM S. MCKIERNAN
William S. McKiernan
Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints William S. McKiernan and Steven D. Pellizzer, and each of them, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities and Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Signature	Title	Date
<u>/s/ WILLIAM S. MCKIERNAN</u> William S. McKiernan	Chief Executive Officer and Chairman of the Board (Principal Executive Officer)	March 13, 2007
<u>/s/ STEVEN D. PELLIZZER</u> Steven D. Pellizzer	Chief Financial Officer and Vice President of Finance (Principal Financial Officer)	March 13, 2007
<u>/s/ SCOTT R. CRUICKSHANK</u> Scott R. Cruickshank	President, Chief Operating Officer and Director	March 13, 2007
<u>/s/ JOHN J. McDONNELL, JR.</u> John J. McDonnell, Jr.	Director	March 13, 2007
<u>/s/ STEVEN P. NOVAK</u> Steven P. Novak	Director	March 13, 2007
<u>/s/ RICHARD SCUDELLARI</u> Richard Scudellari	Director	March 13, 2007
<u>/s/ KENNETH R. THORNTON</u> Kenneth R. Thornton	Director	March 13, 2007

CYBERSOURCE CORPORATION

SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS

December 31, 2004, 2005 and 2006

(In thousands)

	<u>Balance at Beginning of Year</u>	<u>Amounts Charged to Revenue, Costs, or Expenses</u>	<u>Write- offs and Recoveries</u>	<u>Balance at End of Year</u>
2004				
Allowance for Doubtful Accounts.....	\$ 558	\$ 170	\$ 255	\$ 473
2005				
Allowance for Doubtful Accounts.....	\$ 473	\$ 445	\$ 268	\$ 650
2006				
Allowance for Doubtful Accounts.....	\$ 650	\$ 793	\$ 950	\$ 493

EXHIBIT INDEX

<u>Exhibit Number</u>	<u>Document</u>
3.1(1)	Certificate of Incorporation of the Registrant, as amended.
3.2(1)	Bylaws of the Registrant, as amended.
3.3(2)	Amendment to the Bylaws.
3.4(3)	Amendment to the Bylaws.
3.5(4)	Amendment to the Bylaws
3.6(5)	Amendment to the Bylaws
4.1	Reference is made to Exhibits 3.1, 3.2, 3.3 and 3.4.
10.1(1)+	Form of Indemnification Agreement between the Registrant and each of its directors and officers.
10.2(1)+	1998 Stock Option Plan.
10.3(6)+	1999 Stock Option Plan, as amended
10.4(7)x	Conveyance Agreement dated December 31, 1997 by and between CyberSource Corporation and Internet Commerce Service Corporation.
10.5(8)x	Amended and Restated Inter-Company Cross License Agreement dated May 19, 1998 by and between Internet Commerce Services Corporation and software.net Corporation.
10.6(9)x	Internet Commerce Services Agreement dated April 23, 1998 by and between Internet Commerce Services Corporation and software.net Corporation.
10.7(10)	Amended and Restated Investors' Rights Agreement dated October 21, 1998.
10.8(11)+	1999 Employee Stock Purchase Plan, as amended.
10.9(12)x	CyberSource Internet Commerce Services Agreement dated May 1, 1999 by and between CyberSource Corporation and Beyond.com Corporation.
10.10(13)+	1999 Nonqualified Stock Option Plan, as amended.
10.11(14)x	Software License Agreement dated June 30, 1999 by and between CyberSource Corporation and Beyond.com Corporation.
10.12(15)	Lease Agreement dated November 3, 1999 by and between Shoreline Investments V and CyberSource Corporation.
10.13(16)	Second Amendment, dated December 30, 2004, to Lease, dated November 3, 1999 by and between Shoreline Investments V and CyberSource Corporation.
10.14(17)	Oral Employment Agreements with Directors and Named Executive Officers
10.15(18)	Executive Employment Agreement dated March 31, 2006, by and between CyberSource Corporation and Scott Cruickshank
23.1	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
24.1	Power of Attorney. Reference is made to Page 52.
31.1	Certification of William S. McKiernan, Chief Executive Officer of the Registrant dated March 13, 2007, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Steven D. Pellizzer, Chief Financial Officer of the Registrant dated March 13, 2007, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of William S. McKiernan, Chief Executive Officer of the Registrant dated March 13, 2007, in accordance with 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Steven D. Pellizzer, Chief Financial Officer of the Registrant dated March 13, 2007, in accordance with 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) Previously filed as an exhibit, bearing the same number, to the Registrant's registration statement on Form S-1 (No. 333-77565).

(2) Previously filed as exhibit, bearing the same number, to the Registrant's registration statement on Form S-1/A (No. 333-77565) filed on June 17, 1999.

- (3) Previously filed as exhibit 99.2 to the Registrant's Form 8-K filed on August 18, 2005.
 - (4) Previously filed as exhibit 3.5 to the Registrant's Current Report on Form 8-K filed on April 5, 2006.
 - (5) Previously filed as exhibit 3.6 to the Registrant's Current Report on Form 8-K filed on April 19, 2006.
 - (6) Previously filed as exhibit 10.3 to the Registrant's Form 10-Q for the quarter ended June 30, 2006.
 - (7) Previously filed as exhibit 10.9 to the Registrant's registration statement on Form S-1 (No. 333-77545).
 - (8) Previously filed as exhibit 10.10 to the Registrant's registration statement on Form S-1 (No. 333-77545).
 - (9) Previously filed as exhibit 10.11 to the Registrant's registration statement on Form S-1 (No. 333-77545).
 - (10) Previously filed as exhibit 10.12 to the Registrant's registration statement on Form S-1 (No. 333-77545).
 - (11) Previously filed as exhibit 10.8 to the Registrant's Form 10-Q for the quarter ended June 30, 2006.
 - (12) Previously filed as exhibit 10.16 to the Registrant's registration statement on Form S-1 (No. 333-89337).
 - (13) Previously filed as exhibit 10.17 to the Registrant's registration statement on Form S-1 (No. 333-89337).
 - (14) Previously filed as exhibit 10.18 to the Registrant's registration statement on Form S-1 (No. 333-89337).
 - (15) Previously filed as exhibit 10.19 to the Registrant's Form 10-K for the year 1999 (No. 000-26477).
 - (16) Previously filed as an exhibit, bearing the same number, to the Registrant's Form 10-K for the year 2004 (No. 000-26477).
 - (17) Previously filed in the Registrant's Form 8-K filed March 10, 2005.
 - (18) Previously filed as exhibit 10.15 to the Registrant's Form 10-Q for the quarter ended March 31, 2006.
- x Confidential treatment granted as to portions of this exhibit.
- + Management contract or compensation plan, contract or arrangement.

CONSENT OF ERNST & YOUNG LLP, INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements (Form S-8 No. 333-54938, No. 333-43090, No. 333-90725, No. 333-54936, No. 333-117507, No. 333-135598) pertaining to the 1998 Stock Option Plan, 1999 Stock Option Plan, 1999 Non-Qualified Stock Option Plan, PaylinX Corporation 2000 Stock Option Plan, and 1999 Employee Stock Purchase Plan of CyberSource Corporation, of our reports dated March 12, 2007, with respect to the consolidated financial statements and schedule of CyberSource Corporation, CyberSource Corporation management's assessment of the effectiveness of internal control over financial reporting, and the effectiveness of internal control over financial reporting of CyberSource Corporation, included in this Annual Report (Form 10-K) for the year ended December 31, 2006.

/s/ ERNST & YOUNG LLP

San Jose, California
March 12, 2007

CYBERSOURCE CORPORATION

CERTIFICATION

I, William S. McKiernan, certify that:

1. I have reviewed this report on Form 10-K of CyberSource Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2007

By: /s/ William S. McKiernan
William S. McKiernan
Chief Executive Officer

CYBERSOURCE CORPORATION

CERTIFICATION

I, Steven D. Pellizzer, certify that:

1. I have reviewed this report on Form 10-K of CyberSource Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2007

By: /s/ Steven D. Pellizzer
Steven D. Pellizzer
Chief Financial Officer

CYBERSOURCE CORPORATION

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of CyberSource Corporation (the "Company") on Form 10-K for the period ending December 31, 2006 as filed with the Securities and Exchange Commission on the date therein specified (the "Report"), I, William S. McKiernan, Chief Executive Officer of the Company, certify as of the date hereof, solely for purposes of 18 U.S.C. Section 1350, that to the best of my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company at the dates and for the periods indicated.

This Certification has not been, and shall not be deemed, "filed" with the Securities and Exchange Commission.

Date: March 13, 2007

/s/ William S. McKiernan
 William S. McKiernan
 Chief Executive Officer

CYBERSOURCE CORPORATION

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of CyberSource Corporation (the "Company") on Form 10-K for the period ending December 31, 2006 as filed with the Securities and Exchange Commission on the date therein specified (the "Report"), I, Steven D. Pellizzer, Chief Financial Officer of the Company, certify as of the date hereof, solely for purposes of 18 U.S.C. Section 1350, that to the best of my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company at the dates and for the periods indicated.

This Certification has not been, and shall not be deemed, "filed" with the Securities and Exchange Commission.

Date: March 13, 2007

/s/ Steven D. Pellizzer
 Steven D. Pellizzer
 Chief Financial Officer

CAUTIONARY STATEMENT

The Company believes that presentation of both GAAP and non-GAAP financial results may provide investors with additional meaningful and relevant information. The non-GAAP financial measures are provided as a complement to GAAP financial measures. Management believes the non-GAAP measures help indicate trends in the company's business and management uses the non-GAAP measures to plan and forecast future periods. Non-GAAP information is not determined using GAAP and should not be considered superior to or as a substitute for GAAP measures or data prepared in accordance with GAAP. Furthermore, non-GAAP information may not be comparable across companies, as other companies may use different non-GAAP adjustments.

The statements contained in the Chairman's Letter to Stockholders that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding the Company's expectations, objectives, anticipations, plans, hopes, beliefs, intentions or strategies regarding the future. Forward-looking statements in the Chairman's Letter to Stockholders include, without limitation, statements regarding: (a) financial results indicating that the Company is gaining market share; (b) the Company attracting outstanding global brands as customers; (c) the strength of the Company's performance; (d) the Company's technology being leading-edge and the Company's infrastructure being solid, and the contribution of these factors to the Company's performance; (e) strength of the Company's customer growth; (f) the Company's commitment to excellence contributing to the Company's customer growth; (f) the importance of the Company's acquisition of BidPay; (g) the BidPay results demonstrating a strong demand for alternatives in the auction payment space; (h) opportunities going forward; (i) the Company having created a unique position in the market; (j) the Company being the world's first payment management company; (k) the Company enabling customers to increase sales conversion, minimize payments costs, and comply with payment security requirements; (l) the Company expanding its global reach; (m) growth in e-commerce; (n) the rates of growth in e-commerce in Europe, Asia, and Latin America outpacing the rate of growth in North America; (o) the Company being at the forefront of risk management and the tools and services being industry-leading; (p) the Company empowering customers to protect good orders while controlling the overall cost of fraud; (q) the CyberSource Payment Data Management service enabling customers to minimize the risks associated with storing sensitive data; (r) the Company's services shielding customers from the complexities of payment and risk management; (s) the Company seeing a growing appetite in the market for fully-managed services; (t) the relationships established by the Company with financial institutions and technology platform providers being strategic; (u) the Company enhancing the offerings of financial institutions and technology platform providers; (v) the relationships with financial institutions and technology platform providers amplifying the Company's marketing message to a larger audience and the importance of the relationships in helping the Company penetrate the small business segment; (w) the Company appearing to be on track to process a billion billable transactions in 2007; (x) the Company being at the heart of an exciting industry; and, (y) the next ten years promising to be even more exhilarating and rewarding than the last ten years. All forward-looking statements included in this document are based on information available to the Company on the date hereof, and the Company assumes no obligation to update any such forward-looking statements. It is important to note that the Company's actual results could differ materially from those included in such forward-looking statements. These cautionary statements should be considered in the context of the factors set forth in the enclosed Annual Report on Form 10-K on pages 10-17, as well as those disclosed from time to time in the Company's Reports on Forms 10-Q, 10-K, and 8-K.

C O R P O R A T E I N F O R M A T I O N

BOARD OF DIRECTORS

William S. McKiernan
Chairman and Chief Executive Officer
CyberSource Corporation

Scott R. Cruickshank
President and Chief Operating Officer
CyberSource Corporation

John J. McDonnell, Jr.
Former Chairman and Chief Executive Officer
TNS, Inc.

Steven P. Novak
President and Chief Executive Officer
Palladio Capital Management, LLC

Richard Scudellari
Partner
Morrison & Foerster LLP

Kenneth R. Thornton
Retired General Manager
Global Public Sector
International Business Machines

OFFICERS & KEY EMPLOYEES

William S. McKiernan
Chairman and Chief Executive Officer

George H. Barby
Vice President, Worldwide Operations

Carolyn A. Brackett
Vice President, Channels & Alliances

Scott R. Cruickshank
President and Chief Operating Officer

Perry S. Dembner
Vice President, Marketing

Robert J. Ford
Executive Vice President, Product Development
and Chief Technology Officer

Kirsten Fry-Sanchez
Vice President, Product Management

David A. Glaser
Vice President, Professional Services

David L. Hansen
President, BidPay.com, Inc.,
a CyberSource company

David J. Kim
Vice President and General Counsel

Jay Martin
Vice President, Engineering

Patricia A. Martin
Vice President, Customer Support

Steven D. Pellizzer
Vice President, Finance and Chief Financial Officer

Michael A. Walsh
Senior Vice President, Worldwide Sales

INVESTOR RELATIONS

Additional copies of this annual report and the company's Form 10-K as filed with the Securities and Exchange Commission can be obtained without charge by contacting the Investor Relations Department of CyberSource at:

Investor Relations
CyberSource Corporation
1295 Charleston Road
Mountain View, California 94043-1307
Tel: 650.965.6000
Fax: 650.625.9145
Email: ir@cybersource.com
Website: www.cybersource.com

The common stock of CyberSource is traded on the NASDAQ Market under the trading symbol "CYBS."

TRANSFER AGENT

American Stock Transfer and Trust Company
59 Maiden Lane
New York, NY 10038
Tel: 212.936.5100

LEGAL COUNSEL

Morrison & Foerster LLP
Palo Alto, California

INDEPENDENT AUDITORS

Ernst & Young, LLP
San Jose, California

ANNUAL MEETING

The annual meeting of stockholders will be held at our corporate headquarters located at 1295 Charleston Road, Mountain View, California on Thursday, May 17, 2007 at 10:00 a.m., Pacific Daylight Time.





NORTH AMERICA

CyberSource Corporation
1295 Charleston Road
Mountain View, CA 94043
T: 650.965.6000
F: 650.625.9145
Email: info@cybersource.com

EUROPE

CyberSource Ltd.
The Waterfront
300 Thames Valley Park Drive
Thames Valley Park
Reading RG6 1PT
United Kingdom
T: +44 (0) 118.929.4840
F: +44 (0) 870.460.1931
Email: uk@cybersource.com

JAPAN

CyberSource KK
3-11-11 Shibuya, Shibuya-ku
Tokyo, 150-0002 Japan
T: +81.3.5774.7733
F: +81.3.5774.7732
Email: mail@cybersource.co.jp

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