As filed with the Securities and Exchange Commission on February 18, 2004

Registration Number 333-111096

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

AMENDMENT NO. 1 TO
FORM SB-2
REGISTRATION STATEMENT
Under
THE SECURITIES ACT OF 1933

Marchex, Inc.
(Name of small business issuer in its charter)

Delaware	7389	35-2194038
(State or other jurisdiction of incorporation or organization)	(Primary standard industrial classification code number)	(I.R.S. employer identification number)

	Russell C. Horowitz
	Chairman and Chief Executive Officer
Marchex, Inc.	**Marchex, Inc.**
2101 Fourth Avenue	**2101 Fourth Avenue**
Suite 1980	**Suite 1980**
Seattle, Washington 98121	**Seattle, Washington 98121**
(206) 774-5000	**(206) 774-5000**
(Address and telephone number of principal executive offices and principal place of business)	(Name, address and telephone number of agent for service)

Copies to:

Francis J. Feeney, Jr., Esq.	**Michael Jay Brown, Esq.**
Nixon Peabody LLP	**Dorsey & Whitney LLP**
101 Federal Street	**1420 Fifth Avenue**
Boston, MA 02110	**Suite 3400**
(617) 345-1000	**Seattle, WA 98101**
	(206) 903-8800

Approximate date of commencement of proposed sale to the public:
As soon as practicable after the effective date hereof.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: ☐

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration number of the earlier effective registration statement for the same offering: ☐

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: ☐

If delivery of the prospectus is expected to be made pursuant to Rule 434 under the Securities Act, please check the following box: ☐

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with section 8(a) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said section 8(a), may determine.

Table of Contents

PROSPECTUS (Subject to Completion)
Dated February 18, 2004

4,000,000 shares

MARCHEX

Marchex, Inc.
Class B Common Stock

This is our initial public offering of shares of our Class B common stock. No public market currently exists for any shares of our capital stock. We anticipate the initial public offering price of our Class B common stock will be from $6.00 to $7.00 per share. This price may not reflect the market price of our Class B common stock after our offering.

We have two classes of authorized common stock: Class A common stock and Class B common stock. All of our outstanding Class A common stock is beneficially owned by our founding officers. Holders of our Class B common stock are entitled to one vote per share, while holders of our Class A common stock are entitled to twenty-five votes per share, on all matters submitted to a vote of our stockholders.

We have applied to list our Class B common stock on the NASDAQ National Market and have reserved the trading symbol "MCHX."

This offering involves a high degree of risk. Before buying any shares you should read the discussion of material risks of investing in our Class B common stock in " Risk Factors" beginning on page 7.

	Per Share	Total
Public offering price	$	$
Underwriting discounts and commissions	$	$
Proceeds, before expenses, to us	$	$

As additional compensation to the underwriters, we have granted the representative of the underwriters a warrant, exercisable over a period commencing one year after the offering date and ending five years from the offering date, to purchase 120,000 shares of our Class B common stock at an exercise price equal to 130% of the initial public offering price.

We granted the underwriters a 30-day option to purchase up to 600,000 shares of Class B common stock at the initial public offering price, less the underwriting discounts and commissions, to cover over-allotments, if any. If the underwriters exercise the option in full, the total underwriting discounts and commissions will be $ and our total proceeds, before expenses, will be $.

The underwriters are offering the Class B common stock on a firm commitment basis, such that the underwriters will purchase all offered shares if any of such shares are not purchased. National Securities, on behalf of the underwriters, expects to deliver the shares on or about , 2004.

Our directors, officers and employees will purchase up to 600,000 shares at the initial public offering price. At our request, the underwriters have reserved shares at the initial public offering price for this purpose. Any reserved shares which are not purchased will be offered by the underwriters to the general public on the same basis as the other shares offered by this prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

National Securities Corporation

The date of this prospectus is February , 2004.

[INSIDE FRONT COVER]

Table of Contents

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide information different from that contained in this prospectus. We are offering to sell, and seeking offers to buy, shares of Class B common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of our Class B common stock.

TABLE OF CONTENTS

Until   , 2004, 25 days after the date of this offering, all dealers that effect transactions in our Class B common stock, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers’ obligation to deliver a prospectus while acting as underwriters and with respect to their unsold allotments or subscriptions.

PROSPECTUS SUMMARY

This summary highlights selected information contained elsewhere in this prospectus. This summary may not contain all of the information that you should consider before investing in our Class B common stock. You should carefully read the entire prospectus, including "Risk Factors" and the financial statements, before making an investment decision. Unless otherwise specified or the context otherwise requires, references in this prospectus to "we," "our" and "us" refer to Marchex, Inc. and its wholly-owned subsidiaries, including Enhance Interactive, Inc. (f/k/a ah-ha.com, Inc.), and TrafficLeader, Inc. (f/k/a Sitewise Marketing, Inc.), on a consolidated basis.

Our Company

We provide technology-based services to merchants engaged in online transactions. Our objective is to be a leader in terms of growth, profitability, technological innovation, and business model innovation. We anticipate achieving our objectives through a combination of consolidation opportunities, growing those businesses we acquire, internal development initiatives and strategic relationships.

We believe there is a significant, long-term opportunity to capture market share of online transactions, and services that support online transactions, by building a profitable, diversified global company that provides a wide range of technology-based services to merchants, including: Web site infrastructure and development services; online payment and commerce infrastructure; promotional tools to market and sell products and services; and automated tools to manage and track online transactions. We intend to leverage the experience of our senior management to capture this opportunity, as they have substantial operational and strategic experience, including experience in building and managing public companies, executing acquisitions and forming strategic relationships.

Our current operating businesses are in the performance-based advertising and search marketing industries, primarily focused on helping merchants market and sell their products and services via the Internet. We currently provide our merchant customers with the following technology-based services:

- ***Performance-Based Advertising*** primarily includes pay-per-click and paid inclusion services.
    - *Pay-Per-Click Services*. With pay-per-click services, merchant advertisers purchase keywords based on an amount they choose for a targeted placement, usually within search engine results.
    - *Paid Inclusion Services*. With paid inclusion services, merchant advertisers pay for their Web pages and product databases to be crawled, or searched, and indexed and included primarily within search engine and shopping engine results. Generally, the paid inclusion results are presented separately from the pay-per-click results.
- ***Search Marketing*** is designed for merchant advertisers who are focused on acquiring customers through search-based marketing methods, such as pay-per-click management ("advertising campaign management"), enhancing the performance of their campaigns through tracking and analyzing historical results ("conversion tracking and analysis"), and refining their Web sites for increased relevance in algorithmic search engine indexes ("search engine optimization").

In support of our partners and merchants, we devote resources to developing and building proprietary technology-based products and services that we believe are innovative and provide a high degree of utility. Additionally, we continually evaluate opportunities to evolve existing technologies and business models, and we regularly consider possible acquisitions and strategic relationships.

Our Industry

Internet-based transactions between consumers and merchants have grown rapidly in recent years. This growth is the result of decreasing price points of Internet access devices coupled with corresponding performance gains of such devices; a large installed base of personal computers in the workplace and home; penetration of broadband technologies and increased Internet usage; and the emergence of compelling commerce opportunities and a growing awareness among consumers of the convenience and other benefits of online shopping. We believe that today's consumers are becoming increasingly confident that they can find comprehensive product information and securely transact online. Additionally, we believe merchants' abilities to more efficiently and effectively acquire and monetize customers have also led to a steady increase in merchants coming online and therefore in the number of online transactions.

We believe there is a significant, long-term opportunity to capture market share of online transactions and services that support online transactions, by building a profitable, diversified global company that provides a wide range of technology-based services to merchants, including: Web site infrastructure and development services; online payment and commerce infrastructure; promotional tools to market and sell products and services; and automated tools to manage and track online transactions. On an ongoing basis, we intend to evaluate points in the merchant transactions value chain that will provide the greatest opportunity for us to build and acquire offerings with the following characteristics: growth, scalability, profitability and defensibility.

Our Strategy

We intend to leverage our senior management's experience, our financial and human resources, and our existing operating businesses to provide technology-based services for merchants engaged in online transactions. Key elements of our strategy include the following initiatives:

- provide quality services in support of merchants and distribution partners;
- increase the number of merchants served;
- continue to innovate and develop proprietary technologies and intellectual property;
- pursue selective acquisition and consolidation opportunities;
- drive increased profitability through revenue growth and operating leverage; and
- develop new markets.

Our Relationship with Our Founding Officers

In connection with our formation in January 2003, Russell C. Horowitz, Ethan A. Caldwell, Peter Christothoulou, John Keister and Victor Oquendo, our founding officers, provided our initial capital investment. As of December 31, 2003, these founding officers beneficially owned 71% of our capital stock, which represented 98% of the combined voting power of all of our outstanding stock. Upon completion of this offering, these founding officers will own 59% of all of our outstanding common stock, excluding any amounts that may be purchased by them in this offering, which will represent 97% of the combined voting power of all of our outstanding stock.

Company Information

We were incorporated in Delaware on January 17, 2003. On February 28, 2003, we acquired eFamily.com, Inc., together with its direct wholly-owned subsidiary Enhance Interactive. eFamily was incorporated in Utah on November 29, 1999, under the name FocusFilter.com, Inc. On October 24, 2003, we acquired TrafficLeader, which was incorporated in Oregon on January 24, 2000, under the name Sitewise Marketing, Inc.

[Table of Contents](#)

From January 17, 2003 (inception) through February 28, 2003, we were involved in business and product development, as well as financing and acquisition initiatives. During this period we had no revenues.

Our principal executive offices are located at 2101 Fourth Avenue, Suite 1980, Seattle, Washington 98121, and our telephone number is (206) 774-5000. Our corporate Web site address is *www.marchex.com*. Our subsidiaries have Web sites located at *www.enhance.com* and *www.trafficleader.com*. The information on our Web sites is not incorporated by reference into and does not form a part of this prospectus.

The Offering

Class B common stock offered	4,000,000 shares
Common stock to be outstanding after the offering:	
Class A common stock (twenty-five votes per share)	11,987,500 shares
Class B common stock (one vote per share)	12,291,563 shares
Total	24,279,063 shares
Proposed NASDAQ National Market symbol *	MCHX
Use of proceeds	We expect to use the net proceeds of the offering for: • product and business development; • acquisitions and strategic relationships; • capital expenditures; • personnel; • facilities; • our earn-out payment obligations (related to our acquisitions); and • working capital and other general corporate purposes. Pending such use, we plan to invest the net proceeds in short-term, investment grade, interest-bearing securities. See “Use of Proceeds.”

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* We have applied to list our Class B common stock on the NASDAQ National Market and have reserved the trading symbol “MCHX.”

Unless we indicate otherwise, in preparing this prospectus:

- we have given effect to the conversion of all outstanding shares of our preferred stock into 6,724,063 shares of our Class B common stock upon the closing of this offering;
- we have *not* given effect to the exercise by the underwriters of the over-allotment option granted to them to purchase an additional 600,000 shares of Class B common stock in the offering;
- we have *not* given effect to the exercise by the representative of the warrant to be issued as compensation under the underwriting agreement; and

- we have assumed the filing of a certificate of amendment to our certificate of incorporation concurrently with the completion of this offering.

The number of shares of common stock to be outstanding after this offering is based on 20,279,063 shares outstanding as of February 16, 2004. This number of shares:

- includes 6,724,063 shares of Class B common stock issuable upon the automatic conversion of all outstanding shares of our Series A convertible preferred stock upon the completion of this offering;
- excludes 5,013,953 shares of Class B common stock that we have reserved for issuance under our 2003 stock incentive plan and 300,000 shares of Class B common stock that we have reserved for issuance under our 2004 employee stock purchase plan. As of February 16, 2004, 3,196,600 shares were subject to outstanding options, of which 2,421,500 options have a weighted average exercise price of $1.67 per share and 775,100 options will have an exercise price equal to the initial public offering price; and
- excludes 262,500 shares of Class A common stock that are held in treasury.

The numbers of shares beneficially owned by our officers and directors and included in this prospectus do not include any shares of Class B common stock that any officer or director may purchase in the offering. In cases where we have calculated ownership percentages following the offering, these calculations assume that no additional shares of Class B common stock were purchased by the officers and directors in the offering. Our officers and directors may individually decide to purchase shares of the Class B common stock in the offering.

You should rely only on the information contained in this prospectus. This prospectus is not an offer to sell or a solicitation of an offer to buy shares in any jurisdiction where such offer or any sales of shares would be unlawful. The information in this prospectus is complete and accurate only as of the date on the front cover regardless of the time of delivery of this prospectus or of any sale of shares.

See “Risk Factors” and other information included in this prospectus for a discussion of factors you should consider before investing in shares of our Class B common stock.

Table of Contents

Summary Consolidated Financial Data

The following tables summarize historical consolidated financial data regarding our business and should be read together with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and the related notes included elsewhere in this prospectus. The summary information as of December 31, 2003 and for the year ended December 31, 2002, the period from January 1, 2003 to February 28, 2003 and the period from January 17, 2003 (inception) to December 31, 2003 has been derived from our audited consolidated financial statements included elsewhere in this prospectus. The results of operations for Enhance Interactive have been presented as the "Predecessor" for the year ended December 31, 2002 and for the period from January 1, 2003 to February 28, 2003. See subsection "Presentation of Financial Reporting Periods" on page 29 for a further description of the basis of presentation of the 2003 period and of other financial reporting periods.

	Predecessor Periods		Successor Period
	Year ended December 31, 2002	Period from January 1 to February 28, 2003	Period from January 17 (inception) to December 31, 2003
Consolidated Statement of Operations Data:			
Revenue	$ 10,070,507	3,071,055	19,892,158
Income (loss) from operations	(238,150)	555,072	(3,327,723)
Net income (loss)	(89,783)	332,519	(2,169,352)
Accretion to redemption value of redeemable convertible preferred stock	—	—	1,318,885
Net income (loss) applicable to common stockholders	$ (89,783)	332,519	(3,488,237)
Consolidated Statement of Cash Flows Data:			
Cash flows from operating activities	$ 1,539,808	353,053	2,907,053
Other Financial Data:			
Operating income before amortization (OIBA) (1)	$ 126,543	594,053	1,820,795

	December 31, 2003		
	Actual	Pro forma (2)	Pro forma as Adjusted (2)
Consolidated Balance Sheet Data:			
Cash and cash equivalents	$ 6,019,119	6,019,119	29,648,996
Total current assets	8,343,151	8,343,151	31,973,028
Total assets	33,702,612	33,702,612	56,956,139
Total current liabilities	8,501,674	8,501,674	8,155,201
Series A redeemable convertible preferred stock	21,440,402	—	—
Total stockholders' equity	$ 1,834,332	23,274,734	46,874,734

(1) We report operating income before amortization (OIBA) that is a supplemental measure to GAAP. OIBA represents income (loss) from operations before (1) stock-based compensation expense and (2) amortization of intangible assets. This measure, among other things, is one of the primary metrics by which we evaluate the performance of our business. Additionally, management uses adjusted OIBA which excludes acquisition-related retention consideration as we view this as part of the earn-out consideration from the transaction. Adjusted OIBA is the basis on which our internal budgets are based and by which management is currently evaluated. Management believes that investors should have access to, and we are obligated to provide, the same set of tools that we use in analyzing our results. This non-GAAP measure should be considered in addition to results prepared in accordance with GAAP, and should not be considered in

isolation, as a substitute for or superior to GAAP results. We believe this measure is useful to investors because it represents our consolidated operating results, taking into account depreciation, which we believe is an ongoing cost of doing business, but excluding the effects of certain other non-cash expenses. OIBA has certain limitations in that it does not take into account the impact to our statement of operations of certain expenses, including non-cash stock-based compensation associated with our employees and acquisition-related accounting. We endeavor to compensate for the limitations of the non-GAAP measure presented by providing the comparable GAAP measure with equal or greater prominence, GAAP financial statements and detailed descriptions of the reconciling items and adjustments, including quantifying such items, to derive the non-GAAP measure. The following is a reconciliation of Income (loss) from operations and Net income (loss) applicable to common stockholders to the non-GAAP measure of Operating income before amortization:

	Predecessor Periods		Successor Period
	Year ended December 31, 2002	Period from January 1 to February 28, 2003	Period from January 17 (inception to December 31, 2003
Operating income before amortization (OIBA)	$ 126,543	594,053	1,820,795
Stock-based compensation	(364,693)	(38,981)	(2,125,110)
Amortization of intangible assets	—	—	(3,023,408)
Income (loss) from operations	(238,150)	555,072	(3,327,723)
Other income:			
Interest income	5,491	1,529	45,874
Adjustment to fair value of redemption obligation	—	—	25,500
Other	—	—	2,685
Total other income	5,491	1,529	74,059
Income (loss) before provision for income taxes	(232,659)	556,601	(3,253,664)
Income tax expense (benefit)	(142,876)	224,082	(1,084,312)
Net income (loss)	(89,783)	332,519	2,169,352)
Accretion to redemption value of redeemable convertible preferred stock	—	—	1,318,885
Net income (loss) applicable to common stockholders	$ (89,783)	332,519	(3,488,237)

(2) Pro forma amounts give effect to the automatic conversion of all outstanding shares of our Series A redeemable convertible preferred stock into Class B common stock upon the closing of this offering. Pro forma as adjusted amounts also give effect to the issuance and sale of shares of our Class B common stock at an assumed initial public offering price of $6.50 per share, which represents the middle of the filing range as of the date of this prospectus (after deducting the underwriting discounts and commissions and estimated expenses of the offering).

RISK FACTORS

Any investment in our Class B common stock involves a high degree of risk. You should carefully consider the following information about these risks, together with the other information contained in this prospectus, before you decide whether to purchase our Class B common stock. Additional risks and uncertainties not currently known to us or that we currently do not deem material may also become important factors that may harm our business. If any of the following risks occur, our business, financial condition and results of operations could be materially adversely affected. In such case, the trading price of our Class B common stock could decline, and you may lose all or part of your investment.

Risks Relating to Our Company

Our limited operating history makes evaluation of our business difficult. Our failure to adequately address the risks and difficulties of an early-stage company could seriously harm our business, financial condition and operating results.

We were formally incorporated in January 2003. We acquired Enhance Interactive in February 2003 and TrafficLeader in October 2003. As a result, we have limited historical financial data upon which to base planned operating expenses or forecast accurately our future operating results. Further, our limited operating history will make it difficult for investors and securities analysts to evaluate our business and prospects. You must consider our prospects in light of the risks, expenses and difficulties we face as an early stage company with a limited operating history. Our failure to address these risks and difficulties successfully could seriously harm our business, financial condition and operating results.

We may need additional funding to support our operations and capital expenditures, which may not be available to us and which lack of availability could adversely affect our financial condition.

We have no committed sources of additional capital. For the foreseeable future, we intend to fund our operations and capital expenditures from limited cash flow from operations, our cash on hand and the net proceeds of the offering. If our capital resources are insufficient, we will have to raise additional funds. We may need additional funds to continue our operations, pursue business opportunities (such as expansion, acquisitions of complementary businesses or the development of new products or services), to react to unforeseen difficulties or to respond to competitive pressures. There can be no assurance that any financing arrangements will be available in amounts or on terms acceptable to us, if at all. Furthermore, the sale of additional equity or convertible debt securities may result in additional dilution to existing stockholders. If adequate additional funds are not available, we may be required to delay, reduce the scope of or eliminate material parts of the implementation of our business strategy, including the possibility of additional acquisitions or internally developed businesses.

In addition, we are obligated to make earnings-based performance payments to the original shareholders and certain employees of eFamily which we acquired in February 2003, together with its direct wholly-owned subsidiary, Enhance Interactive. These payment obligations are calculated based on a percentage of Enhance Interactive's earnings before taxes excluding stock-based compensation and amortization of intangibles relating to the acquisition for the calendar years 2003 and 2004, according to the terms of the merger agreement, with a maximum aggregate obligation of $13.5 million. For the 2003 calendar year, the total Enhance Interactive earnings-based payment obligation was approximately $3.5 million. We may also be obligated to make revenue-based performance payments to the original shareholders of TrafficLeader, which we acquired in October 2003. If TrafficLeader has revenues in excess of $15 million for 2004, we will be obligated to pay an amount equal to 10% of each dollar in revenue above the $15 million threshold, with a maximum obligation of $1 million. If we are unable to raise sufficient funds in this offering or any subsequent offerings, we may not be able to meet our payment obligations under our acquisition agreements for Enhance Interactive and TrafficLeader, which could have a material adverse effect upon our financial condition.

Further, in the event that we have not completed a firm commitment initial public offering with gross proceeds of at least $20 million prior to October 24, 2005, the original shareholders of TrafficLeader can require us to redeem 425,000 shares of our Class B common stock for $8 per share (for an aggregate redemption amount of $3.4 million) upon the affirmative vote of the holders of 75% of such shares. Our failure to meet this potential payment obligation could have a material adverse effect upon our financial condition.

We have incurred losses since our inception, and we expect our losses to continue for the foreseeable future, which will adversely affect our ability to achieve profitability.

To date, we have incurred net losses and had an accumulated deficit of $3.5 million for the period from January 17, 2003 (inception) through December 31, 2003 and as of December 31, 2003.

Our net losses are likely to continue for the foreseeable future. Also, our net losses may increase to the extent we increase our sales and marketing activities and acquire additional businesses. These efforts may prove to be more expensive than we currently anticipate, which could further increase our net losses. We cannot predict when, or if, we will become profitable in the future. Even if we achieve profitability, we may not be able to sustain it.

We may make acquisitions, which could divert management's attention, cause ownership dilution to our stockholders, be difficult to integrate and adversely affect our financial results.

Our business strategy depends heavily upon our ability to identify, structure and integrate acquisitions. Acquisitions, strategic relationships and investments in the technology and Internet sectors involve a high degree of risk. We may also be unable to find a sufficient number of attractive opportunities, if any, to meet our objectives. Although many technology and Internet companies have grown in terms of revenue, few companies are profitable or have competitive market share. Our potential strategic acquisition, strategic relationship or investment targets and partners may have histories of net losses and may expect net losses for the foreseeable future.

Acquisition transactions are accompanied by a number of risks that could harm us and our business, operating results and financial condition:

- we could experience a substantial strain on our resources, including time and money, and we may not be successful;
- our management's attention may be diverted from our ongoing business concerns;
- while integrating new companies, we may lose key executives or other employees of these companies;
- we could experience customer dissatisfaction or performance problems with an acquired company or technology;
- we may become subject to unknown or underestimated liabilities of an acquired entity or incur unexpected expenses or losses from such acquisitions; and
- we may incur possible impairment charges related to goodwill or other intangible assets or other unanticipated events or circumstances, any of which could harm our business.

Consequently, we might not be successful in integrating any acquired businesses, products or technologies, and might not achieve anticipated revenue and cost benefits.

The loss of our senior management, including our founding officers, could harm our current and future operations and prospects.

We are heavily dependent upon the continued services of Russell C. Horowitz and John Keister and the other members of our senior management team. We do not have long-term employment agreements with any of the members of our senior management team. Each of these individuals may voluntarily terminate his employment with Marchex at any time upon short notice. Following any termination of employment, each of these employees would only be subject to a twelve-month period of non-competition under our standard confidentiality agreement.

Further, as of December 31, 2003, our founding officers together controlled ninety-eight percent (98%) of the combined voting power of our issued and outstanding capital stock and after the offering will control ninety-seven percent (97%) of such combined voting power. Their collective voting control is not tied to their continued employment with Marchex. The loss of the services of any member of our senior management, including our founding officers, for any reason, or any conflict among our founding officers, could harm our Company and its business, financial condition and operating results.

We may have difficulty attracting and retaining qualified, experienced, highly skilled personnel, which could adversely affect our business, financial condition and operating results.

In order to fully implement our business plan, we will need to attract and retain additional qualified personnel. Thus, our success will in significant part depend upon the efforts of personnel not yet identified and upon our ability to attract and retain highly skilled managerial, engineering, sales and marketing personnel. We are also dependent on managerial and technical personnel to the extent they may have knowledge or information about our businesses and technical systems that may not be known by other personnel in our Company. There can be no assurance that we will be able to attract and retain necessary personnel. The failure to hire and retain such personnel could materially and adversely affect our business, financial condition and operating results.

Our use of variable plan accounting for some stock options will result in stock-based compensation charges and reduce our reported net income.

We use variable plan accounting to account for certain non-qualified stock options (for the purchase of an aggregate of 125,000 shares) issued under our 2003 stock incentive plan and, accordingly, we may be required to record a compensation charge on a quarterly basis, which will lower our earnings. These options were issued in connection with the acquisition of Enhance Interactive and are conditioned upon employment. These options are potentially subject to forfeiture if certain indemnification obligations under the acquisition agreement are not met. Under variable plan accounting, compensation expense is measured quarterly as the amount by which the fair value of the shares of our Class B common stock exceeds the exercise price for these options and is recognized over the vesting period of the options. Increases or decreases in the fair value of our Class B common stock between the date of grant and the date of the exercise of these options could result in a corresponding increase or decrease in the measure of compensation expense and thus could cause fluctuations in our earnings from period to period.

New rules, including those contained in and issued under the Sarbanes-Oxley Act of 2002, may make it difficult for us to retain or attract qualified officers and directors, which could adversely affect our business and our ability to obtain or retain listing of our Class B common stock on NASDAQ.

We may be unable to attract and retain qualified officers, directors and members of board committees required to provide for our effective management as a result of the recent and currently proposed changes in the rules and regulations which govern publicly-held companies, including, but not limited to, certifications from executive officers and requirements for financial experts on the board of directors. The perceived increased personal risk associated with these recent changes may deter qualified individuals from accepting these roles. The enactment of the Sarbanes-Oxley Act of 2002 has resulted in the issuance of a series of new rules and regulations and the strengthening of existing rules and regulations by the Securities and Exchange Commission, as well as the adoption of new and more stringent rules by the NASDAQ National Market.

Further, certain of these recent and proposed changes heighten the requirements for board or committee membership, particularly with respect to an individual’s independence from the corporation and level of experience in finance and accounting matters. We may have difficulty attracting and retaining directors with the requisite qualifications. If we are unable to attract and retain qualified officers and directors, our business and our ability to maintain the NASDAQ National Market System listing of our shares of Class B Common Stock (assuming we are successful in obtaining such listing) could be adversely affected.

If we are unable to obtain adequate insurance, our financial condition could be adversely affected in the event of uninsured or inadequately insured loss or damage. Our ability to effectively recruit and retain qualified officers and directors could also be adversely affected if we experience difficulty in obtaining adequate directors' and officers' liability insurance.

We may not be able to obtain insurance policies on terms affordable to us that would adequately insure our business and property against damage, loss or claims by third parties. To the extent our business or property suffers any damages, losses or claims by third parties, which are not covered or adequately covered by insurance, the financial condition of our Company may be materially adversely affected.

We currently have directors' and officers' liability insurance, but we may be unable to maintain sufficient insurance as a public company to cover liability claims made against our officers and directors. If we are unable to adequately insure our officers and directors, we may not be able to retain or recruit qualified officers and directors to manage our Company, which could have a material adverse effect on the operations of our Company.

Risks Relating to Our Business

We are dependent on our distribution partners for a significant portion of our total revenue. A loss of distribution partners or decrease in revenue from distribution partners could adversely affect our business, financial condition and operating results.

We rely primarily on distribution partners to provide us with access to users and consumers. This sector has experienced, and will likely continue to experience, consolidation among the larger distribution partners. This consolidation has reduced the number of partners that control the online advertising outlets with the most user traffic. For example, Yahoo! owns or controls multiple distribution networks and destinations. According to *U.S. Bancorp Piper Jaffray* in a March 2003 report, Yahoo! Search accounts for twenty-one percent (21%) of the online searches in the United States and Google accounts for thirty-four percent (34%). Certain Yahoo! subsidiaries are among our current distribution partners, and we purchase advertising on Google.

As a result, the larger distribution partners have greater control over determining the market terms of distribution, including placement of merchant advertisements and cost of placement. Our agreements with large distribution partners contain short-term termination clauses in their favor. We cannot be assured that we will maintain our current agreements with any of these distribution partners. In addition, we cannot be assured that any of these distribution partners will continue to generate current levels of revenue for us. A loss of any of these distribution partners or a decrease in revenue from any one of these distribution partners could have an adverse effect on our revenue and profitability, and the loss of any one large distribution partner could have a material adverse effect on our business, financial condition and results of operations.

If we do not maintain and grow a critical mass of merchant advertisers and distribution partners, our business, financial condition and operating results could be adversely affected.

Our success depends, in part, on the maintenance and growth of a critical mass of merchant advertisers and distribution partners and a continued interest in our performance-based advertising and search marketing services. If our business is unable to achieve a growing base of merchant advertisers, our current distribution partners may be discouraged from continuing to work with us, and this may create obstacles for us to enter into agreements with new distribution partners. Similarly, if our distribution network does not grow and improve over time, current and prospective merchant advertisers may reduce or terminate their business with us. Therefore, any decline in the number of merchant advertisers and distribution partners could adversely affect the value of our services generally and could seriously harm our business, financial condition and operating results.

Our ability to increase the volume of transactions on our services is dependent upon building and maintaining a substantial base of merchant advertisers. We may not successfully develop or market technologies, products or services that are competitive or accepted by merchant advertisers. Merchant advertiser attrition or a reduction in merchant advertiser spending with us could have a material adverse effect on our business. Failure to achieve and maintain a large and active base of merchant advertisers could have a material adverse effect on our business, financial condition and operating results.

We are dependent upon our distribution partners to continue to provide us traffic that our merchant advertisers deem to be of value, and if they do not, it could have a material adverse effect on our business, financial condition and operating results.

We are dependent upon our distribution partners to provide us traffic that our merchant advertisers deem to be of value. We monitor the traffic of our distribution partners in an attempt to optimize the quality of traffic we deliver to our merchant advertisers, which may include terminating certain distribution partners. We review factors such as non-human processes, including robots, spiders, scripts (or other software), mechanical automation of clicking and other sources and causes of low-quality traffic, including, but not limited to, other non-human clicking agents. Even with such monitoring in place, there is a risk that a certain amount of low-quality traffic will be provided to our merchant advertisers, which, if not contained, may be detrimental to those relationships. Low-quality traffic (or traffic that is deemed to be less valuable by our merchant advertisers) that is provided by our distribution partners may prevent us from growing our base of merchant advertisers and cause us to lose relationships with existing merchant advertisers, thereby materially adversely affecting our business, financial condition and operating results.

We may be subject to intellectual property claims, which could adversely affect our business, divert our resources and management attention from our business operations and create uncertainty about ownership of technology essential to our business, financial condition and operating results.

Our success depends, in part, on our ability to protect our intellectual property and to operate without infringing on the intellectual property rights of others in the process. There can be no guarantee that any of our intellectual property will be adequately safeguarded, or that it will not be challenged by third parties. We may be subject to patent infringement claims or other intellectual property infringement claims that would be costly to defend and could limit our ability to use certain critical technologies.

For example, Overture Services, a subsidiary of Yahoo!, which operates in certain competitive areas with us, owns a patent (U.S. Patent No. 6,269,361), which purports to give Overture rights to certain bid-for-placement products and pay-per-performance search technologies. Overture is currently involved in litigation with two companies relating to this patent (FindWhat and Google). These companies are vigorously contesting Overture’s patent. If we were to acquire or develop a related product or business model that Overture construes as infringing upon the above-referenced patent, then we could be asked to license, re-engineer our product(s) or revise our business model according to terms that may be extremely expensive and/or unreasonable. Additionally, if Overture construes any of our current products or business models as infringing upon the above-referenced patent, then we could be asked to license, re-engineer our product(s) or revise our business model according to terms that could be extremely expensive and/or unreasonable.

Any patent litigation could negatively impact our business by diverting resources and management attention from other aspects of the business and adding uncertainty as to the ownership of technology and services that we view as proprietary and essential to our business. In addition, a successful claim of patent infringement against us and our failure or inability to license the infringed or similar technology on reasonable terms, or at all, could have a material adverse effect on our business, financial condition and operating results.

We currently have a reliance on certain distribution partners, including Yahoo! and its subsidiaries, to distribute our services. The termination of any of these distribution relationships could have a material adverse effect on our business, financial condition and operating results.

We currently have certain distribution partners that deliver a significant percentage of traffic to our merchant listings, in terms of click-throughs. However, for the period of January 17, 2003 (inception) through December 31, 2003, none of these partners represented more than 10% of our total revenue. Given the consolidation trend in distribution and ownership of traffic, we anticipate that one or more distribution partners could individually represent more than 10% of our total revenue in future periods. For example, Yahoo!, through its subsidiaries, such as Inktomi and Overture, is an important distribution partner of our paid inclusion services, and they represent less than 10% of our total revenue for the period from January 17, 2003 (inception) to December 31, 2003. Existing agreements with certain Yahoo! subsidiaries contain mutual termination clauses and are primarily structured on a variable-payment basis, under which we make payments based on a specified percentage of revenue or based on the number of paid click-throughs. We intend to continue devoting resources in support of our Yahoo! relationship, although there are no guarantees that this relationship will remain in place over the short- or long-term.

Currently, many participants in the performance-based advertising and search marketing industries own significant portions of the traffic that they deliver to advertisers. We do not believe, for example, that Yahoo! and Google are as reliant as we are on a distribution network to deliver their services. This gives these companies a significant advantage in delivering their services, and with a lesser degree of risk. If the existing relationships with our distribution partners were terminated, our business, financial condition and operating results would suffer.

We have grown quickly and if we fail to manage our growth, our business, financial condition and operating results could suffer.

We have rapidly expanded our operations and anticipate that further significant expansion, including the possible acquisition of third-party assets, technologies or businesses, will be required to address potential growth in our customer base and market opportunities. This expansion has placed, and is expected to continue to place, a significant strain on our management, operational and financial resources. If we are unable to manage our growth effectively or if we are unable to successfully integrate any assets, technologies or businesses that we may acquire, our business, financial condition and operating results could be affected adversely.

Risks Relating to Our Industry

If we are unable to compete in the highly competitive performance-based advertising and search marketing industries, we may experience reduced demand for our products and services and our business, financial condition and operating results could be adversely affected.

We operate in a highly competitive environment. We principally compete with other companies in five main areas:

- sales to merchant advertisers of performance-based advertising;
- sales to merchant advertisers of paid inclusion services;
- aggregation or optimization of advertising inventory for distribution through search engines, product shopping engines, directories, Web sites or other outlets;
- delivery of products and services to end users or customers of merchants at destination Web sites or other distribution outlets; and
- services that allow merchants to manage their advertising campaigns across multiple networks and track the success of these campaigns.

Although we currently pursue a strategy that allows us to potentially partner with all relevant companies in the industry, there are certain companies in the industry that may not wish to partner with us. Despite the fact that we currently work with several of our potential competitors, there are no guarantees that these companies will continue to work with us in the future.

We currently or potentially compete with a variety of companies, including Decide Interactive, DoubleClick, FindWhat, Google, LookSmart, Microsoft, ValueClick and Yahoo!. We currently have some form of relationship with a majority of these companies. Going forward, however, these relationships could be terminated by either party. Furthermore, our competitors may be able to secure agreements with more favorable terms, which could reduce the usage of our services, increase the amount payable to our distribution partners, reduce total revenue and thereby have a material adverse effect on our business, operating results and financial condition. Increased competition is likely to result in a loss of market share, which could seriously harm our business, financial condition and operating results.

We expect competition to intensify in the future because current and new competitors can enter our market with little difficulty. The barriers to entering our market are relatively low. In fact, many current Internet and media companies presently have the technical capabilities and advertiser bases to enter the search marketing services industry. Further, if the consolidation trend continues among the larger media and search engine companies with greater brand recognition, the share of the market remaining for us and other smaller search marketing services providers could decrease, even through the number of smaller providers could continue to increase. These factors could adversely affect our competitive position in the search marketing services industry.

Some of our competitors, as well as potential entrants into our market, may be better positioned to succeed in this market. They may have:

- longer operating histories;
- more management experience;
- an employee base with more extensive experience;
- a better ability to service customers in multiple cities in the United States and internationally by virtue of the location of sales offices;
- larger customer bases;
- greater brand recognition; and
- significantly greater financial, marketing and other resources.

In addition, many current and potential competitors can devote substantially greater resources than we can to promotion, Web site development and systems development. Furthermore, currently and in the future to the extent the use of the Internet and other online services increases, there will likely be larger, more well-established and well-financed entities that acquire companies and/or invest in or form joint ventures in categories or countries of interest to us, all of which could adversely impact our business. Any of these trends could increase competition, reduce the demand for any of our services and could have a material adverse effect on our business, operating results and financial condition.

If we are not able to respond to the rapid technological change characteristic of our industry, our products and services may not be competitive and our business may suffer.

The market for our products and services is characterized by rapid change in business models and technological infrastructure, and we will need to constantly adapt to changing markets and technologies to provide competitive products and services. We believe that our future success will depend, in part, upon our ability to develop our products and services for both our target market and for applications in new markets. We may not, however, be able to successfully do so, and our competitors may develop innovations that render our products and services obsolete or uncompetitive.

Our technical systems are vulnerable to interruption and damage that may be costly and time-consuming to resolve and may harm our business and reputation.

A disaster could interrupt our services for an indeterminate length of time and severely damage our business, prospects, financial condition and results of operations. Our systems and operations are vulnerable to damage or interruption from:

- fire;
- floods;

- network failure;
- hardware failure;
- software failure;
- power loss;
- telecommunications failures;
- break-ins;
- terrorism, war or sabotage;
- computer viruses;
- denial of service attacks;
- penetration of our network by unauthorized computer users and “hackers” and other similar events;
- natural disaster; and
- other unanticipated problems.

We may not have developed or implemented adequate protections or safeguards to overcome any of these events. We also may not have anticipated or addressed many of the potential events that could threaten or undermine our technology network. Any of these occurrences could cause material interruptions or delays in our business, result in the loss of data or render us unable to provide services to our customers. In addition, if a person is able to circumvent our security measures, he or she could destroy or misappropriate valuable information or disrupt our operations. We have deployed firewall hardware intended to thwart hacker attacks. Although we maintain property insurance and business interruption insurance, our insurance may not be adequate to compensate us for all losses that may occur as a result of a catastrophic system failure or other loss, and our insurers may not be able or may decline to do so for a variety of reasons.

If we fail to address these issues in a timely manner, we may lose the confidence of our merchant advertisers and distribution partners, our revenue may decline and our business could suffer. In addition, as we expand our service offerings and enter into new business areas, we may be required to significantly modify and expand our software and technology platform. If we fail to accomplish these tasks in a timely manner, our business will likely suffer.

We rely on third party technology, server and hardware providers, and a failure of service by these providers could adversely affect our business, financial condition and operating results.

We rely upon third party colocation providers to host our main servers. In the event that these providers experience any interruption in operations or cease operations for any reason or if we are unable to agree on satisfactory terms for continued hosting relationships, we would be forced to enter into a relationship with other service providers or assume hosting responsibilities ourselves. If we are forced to switch hosting facilities, we may not be successful in finding an alternative service provider on acceptable terms or in hosting the computer servers ourselves. We may also be limited in our remedies against these providers in the event of a failure of service. In the past, we have experienced short term outages in the service maintained by one of our current colocation providers. We also rely on third party providers for components of our technology platform, such as hardware and software providers, credit card processors and domain name registrars. A failure or limitation of service or available capacity by any of these third party providers could adversely affect our business, prospects, financial condition and operating results.

We may not be able to protect our intellectual property rights, which could result in our competitors marketing competing products and services utilizing our intellectual property and could adversely affect our business, financial condition and operating results.

Our success and ability to compete effectively are substantially dependent upon our internally developed and acquired technology and data resources, which we protect through a combination of copyright, trade secret, patent and trademark law. To date, we have filed two provisional patent applications with the United States Patent and Trademark Office and may in the future file additional patents with respect to internally developed or acquired technologies. Our industry is highly competitive and many individuals and companies have sought to patent processes in the industry. In addition, the patent process takes several years and involves considerable expense. Further, patent applications and patent positions in our industry are highly uncertain and involve complex legal and factual questions due in part to the number of competing technologies. As a result, we may not be able to successfully prosecute these patents, in whole or in part, or any additional patent filings that we may make in the future. We also depend on our trade name and domain names. We may not be able to adequately protect our technology and data resources. In addition, intellectual property laws vary from country to country, and it may be more difficult to protect our intellectual property in some foreign jurisdictions we may enter. If we fail to obtain and maintain patent or other intellectual property protection for our technology, our competitors could market competing products and services utilizing our technology. Any such failure could have a material adverse effect on our business, financial condition and operating results.

Despite our efforts to protect our proprietary rights, unauthorized parties domestically and internationally may attempt to copy or otherwise obtain and use our services, technology and other intellectual property. We cannot be certain that the steps we have taken will prevent any misappropriation or confusion among consumers and merchant advertisers.

We may be involved in lawsuits to protect or enforce our patents, which could be expensive and time consuming.

We may initiate patent litigation against third parties to protect or enforce our patent rights, and we may be similarly sued by others. We may also become subject to interference proceedings conducted in the patent and trademark offices of various countries to determine the priority of inventions. The defense and prosecution, if necessary, of intellectual property suits, interference proceedings and related legal and administrative proceedings is costly and may divert our technical and management personnel from their normal responsibilities. We may not prevail in any of these suits. An adverse determination of any litigation or defense proceedings could put our patents at risk of being invalidated or interpreted narrowly and could put our patent applications at risk of not being issued.

Furthermore, because of the substantial amount of discovery required in connection with intellectual property litigation, there is a risk that some of our confidential information could be compromised by disclosure during this type of litigation. In addition, during the course of this kind of litigation, there could be public announcements of the results of hearings, motions or other interim proceedings or developments in the litigation. If securities analysts or investors perceive these results to be negative, it could have an adverse effect on the trading price of our Class B common stock.

Our quarterly results of operations might fluctuate due to seasonality, which could adversely affect our growth rate and in turn the market price of our Class B common stock.

Our quarterly results have fluctuated in the past and may fluctuate in the future due to seasonal fluctuations in the level of Internet usage. As is typical in our industry, the second and third quarters of the calendar year generally experience relatively lower usage than the first and fourth quarters. It is generally understood that during the spring and summer months of the year, Internet usage is lower than during other times of the year, especially in comparison to the fourth quarter of the calendar year. The extent to which usage may decrease during these off-peak periods is difficult to predict. Prolonged or severe decreases in usage during these periods may adversely affect our growth rate and our business, financial condition and operating results and in turn the market price of our Class B common stock.

We are susceptible to general economic conditions, and a downturn in advertising and marketing spending by merchants could adversely affect our business, financial condition and operating results.

Our business, financial condition and operating results will be subject to fluctuations based on general economic conditions, in particular those conditions that impact merchant-consumer transactions. If there were to be a general economic downturn that affected consumer activity in particular, however slight, then we would expect that business entities, including our merchant advertisers and potential merchant advertisers, could substantially and immediately reduce their advertising and marketing budgets. We believe that during periods of lower consumer activity, merchant spending on advertising and marketing is more likely to be reduced, and more quickly, than many other types of business expenses. These factors could cause a material adverse effect on our business, financial condition and operating results.

We depend on the growth of the Internet and Internet infrastructure for our future growth and any decrease or less than anticipated growth in Internet usage could adversely affect our business, financial condition and operating results.

Our future revenue and profits, if any, depend upon the continued widespread use of the Internet as an effective commercial and business medium. Factors which could reduce the widespread use of the Internet include:

- possible disruptions or other damage to the Internet or telecommunications infrastructure;
- failure of the individual networking infrastructures of our merchant advertisers and distribution partners to alleviate potential overloading and delayed response times;
- a decision by merchant advertisers to spend more of their marketing dollars in offline areas;
- increased governmental regulation and taxation; and
- actual or perceived lack of security or privacy protection.

In particular, concerns over the security of transactions conducted on the Internet and the privacy of users may inhibit the growth of the Internet and other online services, especially online commerce. In order for the online commerce market to develop successfully, we and other market participants must be able to transmit confidential information, including credit card information, securely over public networks. Any decrease or less than anticipated growth in Internet usage could have a material adverse effect on our business, financial condition and operating results.

We are exposed to risks associated with credit card fraud and credit payment, and we may continue to suffer losses as a result of fraudulent data or payment failure by merchant advertisers.

We have suffered losses and may continue to suffer losses as a result of payments made with fraudulent credit card data. Our failure to control fraudulent credit card transactions adequately could reduce any gross profit margin. In addition, under limited circumstances, we extend credit to merchant advertisers who may default on their accounts payable to us. If a significant merchant advertiser to whom we extend credit is unable to pay our service fees, our business, financial condition and operating results could be adversely affected.

Government regulation of the Internet may adversely affect our business, financial condition and operating results.

Companies engaging in online search, commerce and related businesses face uncertainty related to future government regulation of the Internet. Due to the rapid growth and widespread use of the Internet, legislatures at the federal and state levels are enacting and considering various laws and regulations relating to the Internet. Furthermore, the application of existing laws and regulations to Internet companies remains somewhat unclear. Our business, financial condition and operating results may be negatively affected by new laws, and such existing or new regulations may expose us to substantial compliance costs and liabilities and may impede the growth in use of the Internet.

The application of these statutes and others to the Internet search industry is not entirely settled. Further, several existing and proposed federal laws could have an impact on our business, financial condition and operating results:

- The Digital Millennium Copyright Act and its related safe harbors, are intended to reduce the liability of online service providers for listing or linking to third-party Web sites that include materials that infringe copyrights or other rights of others.
- The Children's Online Protection Act and the Children's Online Privacy Protection Act are intended to restrict the distribution of certain materials deemed harmful to children, and they impose additional restrictions on the ability of online services to collect user information from minors.
- The Protection of Children from Sexual Predators Act of 1998 requires online service providers to report evidence of violations of federal child pornography laws under certain circumstances.
- The CAN-SPAM Act of 2003 and certain state laws are intended to regulate interstate commerce by imposing limitations and penalties on the transmission of unsolicited commercial electronic mail via the Internet.

With respect to the subject matter of each of these laws, courts may apply these laws in unintended and unexpected ways. As a company that provides services over the Internet, we may be subject to an action brought under any of these or future laws governing online services. Many of the services of the Internet are automated and companies, such as ours, may be unknowing conduits for illegal or prohibited materials. It is not known how courts will rule in many circumstances; for example, it is possible that some courts could find strict liability or impose "know your customer" standards of conduct in certain circumstances.

We may also be subject to costs and liabilities with respect to privacy issues. Several Internet companies have incurred costs and paid penalties for violating their privacy policies. Further, it is anticipated that new legislation will be adopted by federal and state governments with respect to user privacy. Such legislation could negatively affect our business.

Additionally, foreign governments may pass laws which could negatively impact our business and/or may prosecute us for our products and services based upon existing laws. Any such prosecution or costs incurred in addressing foreign laws could negatively affect our business.

The restrictions imposed by, and costs of complying with, current and possible future laws and regulations related to our business could harm our business, financial condition and operating results.

Future regulation of search engines may adversely affect the commercial utility of our search marketing services.

The Federal Trade Commission, or FTC, has recently reviewed the way in which search engines disclose paid placements or paid inclusion practices to Internet users. In 2002, the FTC issued guidance recommending that all search engine companies ensure that all paid search results are clearly distinguished from non-paid results, that the use of paid inclusion is clearly and conspicuously explained and disclosed and that other disclosures are made to avoid misleading users about the possible effects of paid placement or paid inclusion listings on search results. Such disclosures if ultimately mandated by the FTC or voluntarily made by us may reduce the desirability of our paid placement and paid inclusion services. We believe that some users may conclude that paid search results are not subject to the same relevancy requirements as non-paid search results, and will view paid search results less favorably. If such FTC disclosure reduces the desirability of our paid placement and paid inclusion services, and "click-throughs" of our paid search results decrease, our business, financial condition and operating results could be adversely affected.

State and local governments may in the future be permitted to levy additional taxes on Internet access and electronic commerce transactions, which could adversely affect our business, financial condition and operating results.

In 1998, the federal government imposed a three-year moratorium on state and local governments' imposition of new taxes on Internet access or electronic commerce transactions. This moratorium was extended until November 1, 2003, and has now expired. It is expected that Congress will enter into a several month extension of the moratorium, but such an extension may not be enacted. Unless the moratorium is extended, state and local governments may levy additional taxes on Internet access and electronic commerce transactions. An increase in applicable taxes may make electronic commerce transactions less attractive for merchants and businesses, which could result in a decrease in the level of usage of our services and reduce our revenue.

We may incur liabilities for the activities of users of our service, which could adversely affect our business, financial condition and operating results.

The law relating to the liability of providers of online services for activities of their users and for the content of their merchant advertiser listings is currently unsettled and could damage our business, financial condition and operating results. Our insurance policies may not provide coverage for liability arising out of activities of our users or merchant advertisers for the content of our listings. Furthermore, we may not be able to obtain or maintain adequate insurance coverage to reduce or limit the liabilities associated with our businesses. We may not successfully avoid civil or criminal liability for unlawful activities carried out by consumers of our services or for the content of our listings. Our potential liability for unlawful activities of users of our services or for the content of our listings could require us to implement measures to reduce our exposure to such liability, which may require us, among other things, to spend substantial resources or to discontinue certain service offerings. Any costs incurred as a result of such liability or asserted liability could have a material adverse effect on our business, financial condition and operating results.

Risks Relating To This Offering

The market price of our Class B common stock is likely to be highly volatile, which could adversely impact the market price of our Class B common stock and cause investment losses for our stockholders and could result in shareholder litigation with substantial costs, economic loss and diversion of our resources.

The trading price of our Class B common stock is likely to be highly volatile and could be subject to wide fluctuations in price in response to various factors, many of which are beyond our control, including:

- developments concerning proprietary rights, including patents, by us or a competitor;
- announcements by us or our competitors of significant contracts, acquisitions, commercial relationships, joint ventures or capital commitments;
- actual or anticipated fluctuations in our operating results;
- developments concerning our various strategic collaborations;
- lawsuits initiated against us or lawsuits initiated by us;
- changes in the market valuations of similar companies; and
- changes in our industry and the overall economic environment.

In addition, the stock market in general, and the NASDAQ National Market and the market for online commerce companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of the listed companies. These broad market and industry factors may seriously harm the market price of our Class B common stock, regardless of our operating performance. In the past, following periods of volatility in the market, securities class action litigation has often been instituted against these companies. Litigation against us, whether or not a judgment is entered against us, could result in substantial costs and potentially economic loss, and a diversion of our management's attention and resources, any of which could seriously harm our financial condition.

There may not be an active, liquid trading market for our Class B common stock, and the initial public offering price may not be indicative of prices that will prevail in the market.

Prior to this offering, there has been no public market for our Class B common stock. An active trading market for our Class B common stock may not develop or be sustained following this offering. The initial public offering price will be determined by negotiations between us and representatives of the underwriters based upon a number of factors. The initial public offering price may not be indicative of prices that will prevail in the trading market.

Our founding officers will control the outcome of stockholder voting, and there may be an adverse effect on the price of our Class B common stock due to the disparate voting rights of our Class A common stock and our Class B common stock.

Upon the completion of this offering, our founding officers will beneficially own all of our outstanding shares of Class A common stock, representing 96% of the voting power of all issued and outstanding shares of our capital stock. With respect to their entire holdings, the founding officers will hold 97% of the combined voting power of all of our outstanding capital stock. The holders of our Class A common stock and Class B common stock have identical rights except that the holders of our Class B common stock are entitled to one vote per share, while holders of our Class A common stock are entitled to twenty-five votes per share on all matters to be voted on by stockholders. This concentration of control could be disadvantageous to our other stockholders with interests different from those of our founding officers. This difference in the voting rights of our Class A common stock and Class B common stock could adversely affect the price of our Class B common stock to the extent that investors or any potential future purchaser of our shares of Class B common stock give greater value to the superior voting rights of our Class A common stock.

Further, as long as our founding officers have a controlling interest, they will continue to be able to elect our entire board of directors and generally be able to determine the outcome of all corporate actions requiring stockholder approval. As a result, our founding officers will be in a position to continue to control all fundamental matters affecting the Company, including any merger involving, sale of substantially all of the assets of, or change in control of, the Company.

Our founding officers' ability to control the Company may result in our Class B common stock trading at a price lower than the price at which it would trade if our founding officers did not have a controlling interest in us. This control may deter or prevent a third party from acquiring us which could adversely affect the market price of our Class B common stock.

Anti-takeover provisions may limit the ability of another party to acquire us, which could cause our stock price to decline.

Our certificate of incorporation, as amended, our by-laws and Delaware law contain provisions that could discourage, delay or prevent a third party from acquiring us, even if doing so may be beneficial to our stockholders. In addition, these provisions could limit the price investors would be willing to pay in the future for shares of our Class B common stock. The following are examples of such provisions in our certificate of incorporation, as amended or our by-laws:

- the authorized number of our directors can be changed only by a resolution of our board of directors;
- advance notice is required for proposals that can be acted upon at stockholder meetings;
- there are limitations on who may call stockholder meetings; and
- our board of directors is authorized, without prior stockholder approval, to create and issue "blank check" preferred stock.

We are also subject to Section 203 of the Delaware General Corporation Law, which provides, subject to enumerated exceptions, that if a person acquires 15% or more of our voting stock, the person is an "interested stockholder" and may not engage in "business combinations" with us for a period of three years from the time the person acquired 15% or more of our voting stock.

We anticipate that we will retain our future earnings, and as a result you are not likely to receive dividends as a holder of Class B common stock.

We anticipate that we will retain all of our future earnings, if any, for use in the operation and expansion of our business. Therefore, you are not likely to receive dividends in the foreseeable future. In addition, dividends, if and when paid, may be subject to income tax withholding.

You will incur immediate and substantial dilution in the book value of the common stock you purchase, which could adversely affect the market price of our Class B common stock.

The initial public offering price is substantially higher than the price paid for our common stock in the past. This is referred to as dilution. The offering, therefore, will result in an immediate increase in net tangible book value of $0.98 per share to existing stockholders and an immediate dilution in net tangible book value of $5.57 per share to new investors purchasing shares of our common stock in this offering (based on the middle of the filing range as of the date of this prospectus). The exercise of outstanding options or warrants may result in further dilution. See “Dilution.”

Senior management will have broad discretion over the use of proceeds from this offering, which may be used for purposes that are not successful in increasing our operating results or market value.

The “Use of Proceeds” section reflects our current best estimate of the allocation of the net proceeds of this offering. The amounts actually expended by us for each purpose may vary significantly depending on a number of factors, such as the amount of cash used or generated by our operations and management’s assessment of our specific needs. Our senior management team will have considerable discretion in the application of the net proceeds, and you will not have the opportunity, as part of your investment decision, to assess whether the proceeds are being used appropriately. The net proceeds may be used for purposes that do not increase our operating results or market value. Until the net proceeds are used, they may be placed in investments that either do not produce income or lose value. See “Use of Proceeds.”

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus includes forward-looking statements. All statements other than statements of historical facts contained in this prospectus, including statements regarding our future financial position, business strategy and plans and objectives of management for future operations, are forward-looking statements. The words "believe," "may," "estimate," "continue," "anticipate," "intend," "expect" and similar expressions, as they relate to us, are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. These forward-looking statements are subject to a number of risks, uncertainties and assumptions described in "Risk Factors" and elsewhere in this prospectus, including, among other things:

- the anticipated benefits and risks associated with our business strategy;
- our future operating results and the future value of our Class B common stock;
- the anticipated sizes or trends of the markets in which we compete and the anticipated competition and consolidation in those markets;
- our ability to attract and maintain merchant advertisers and distribution partners in a cost-efficient manner and on beneficial commercial terms;
- potential intellectual property litigation;
- potential government regulation;
- our future capital requirements and our ability to satisfy our capital needs;
- the anticipated use of the proceeds realized from this offering;
- the potential for additional issuances of our securities; and
- the possibility of future acquisitions of businesses and technologies.

Market data and forecasts used in this prospectus, including for example, estimates of the size and growth rates of the performance-based advertising and search marketing industries and the Internet advertising and transaction markets generally, have been obtained from independent industry sources. Forecasts and other forward-looking information obtained from these sources are subject to the same qualifications and the additional uncertainties accompanying any estimates of future market size.

These risks are not exhaustive. Other sections of this prospectus include additional factors which could adversely impact our business and financial performance. Moreover, we operate in a very competitive and rapidly changing environment. New risk factors emerge from time to time and it is not possible for our management to predict all risk factors, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

You should not rely upon forward-looking statements as predictions of future events. We cannot assure you that the events and circumstances reflected in the forward-looking statements will be achieved or occur and actual results could differ materially from those projected in the forward-looking statements.

Table of Contents

USE OF PROCEEDS

We estimate that the net proceeds from the sale of the shares of our Class B common stock in this offering will be approximately $23.6 million, assuming an initial public offering price of $6.50, which represents the middle of the filing range as of the date of this prospectus, and after deducting the estimated underwriting discounts and commissions and estimated offering expenses. If the underwriters exercise the over-allotment option in full, we estimate that the net proceeds will be approximately $27.3 million.

The principal purposes of this offering are to:

- increase our working capital, capitalization and financial flexibility; and
- establish a public market for the Class B common stock, which will facilitate future access to public equity and debt markets, provide additional means to acquire potential businesses and technologies, and enhance our ability to use the Class B common stock as a means of attracting and retaining employees.

We expect to use the net proceeds from this offering approximately as follows:

	Approximate Dollar Amount	Approximate Percentage of Net Proceeds
Product and business development	$ 1.0 million	4%
Acquisitions and strategic relationships	12.0 million	51
Capital expenditures	1.0 million	4
Personnel (recruiting, hiring, training and other associated costs)	1.0 million	4
Facilities (rent, capital improvements, moving expenses and deposits)	1.0 million	4
Earn-out payment obligations (related to our acquisitions)	3.5 million	15
Working capital and other general corporate purposes	4.1 million	18
	$23.6 million	100%

The foregoing represents our current best estimate of the allocation of the net proceeds of this offering, based on the expected use of funds necessary to finance our existing activities in accordance with management's current objectives and market conditions. The amounts actually expended by us for each purpose may vary significantly depending on a number of factors, such as the amount of cash used or generated by our operations and management's assessment of our specific needs. The amounts of the allocations, which are not fixed obligations, may be proportionately reduced in the event the actual net proceeds are less than the estimated amount above.

Although we have no current agreements or commitments with respect to any acquisition, we may, if the opportunity arises, use a greater portion of the net proceeds to acquire or invest in products, technologies or companies. Any such acquisition could result in a reallocation of the estimated amounts set forth in the table above (which reallocation could be substantial).

In addition, we may be required to make additional payments for earn-out obligations relating to our acquisitions of Enhance Interactive and TrafficLeader.

Overall, we will retain broad discretion over the use of our net proceeds from the sale of the Class B common stock in this offering. Allocation of the net proceeds will be subject to economic conditions, our financial condition, changes in our business plan and strategy and our response to competitive pressures. Our management may spend the proceeds from this offering in ways the stockholders may not deem desirable. The timing and amount of our actual expenditures will be based on many factors, including cash flows from operations and the growth of our business.

Until we use the net proceeds of this offering for the above purposes, we intend to invest the funds in short-term, investment grade, interest-bearing securities. We cannot predict whether the proceeds will yield a favorable return.

DETERMINATION OF OFFERING PRICE

Prior to this offering, there has been no public market for the shares of our Class B common stock. The initial public offering price for the shares of our Class B common stock will be determined by negotiation between the representative of the underwriters and us. Among the factors considered in determining the proposed filing range of our initial public offering price were our record of operations, our financial position and prospects, the experience of our management, our revenue and other operating information, and the market prices of securities and financial and operating information of companies engaged in businesses similar to ours.

Table of Contents

CAPITALIZATION

The following table sets forth our capitalization as of December 31, 2003 on:

- an actual basis;
- a pro forma basis to give effect to the conversion of all outstanding shares of Series A redeemable convertible preferred stock into 6,724,063 shares of Class B common stock; and
- a pro forma as adjusted basis to also give effect to the sale of 4,000,000 shares of Class B common stock in this offering at an assumed initial public offering price of $6.50 per share, which represents the middle of the filing range as of the date of this prospectus, less estimated underwriting discounts and commissions and estimated offering expenses.

You should read this table in conjunction with our consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations," included elsewhere in this prospectus.

	As of December 31, 2003		
	Actual	**Pro Forma**	**Pro Forma as Adjusted**
Cash and cash equivalents	$ 6,019,119	6,019,119	29,648,996
Series A redeemable preferred stock, $0.01 par value: 8,500,000 shares authorized; 6,724,063 shares issued and outstanding actual; 8,500,000 shares authorized, none issued and outstanding pro forma; and 1,000,000 shares authorized, none issued and outstanding pro forma as adjusted	$ 21,440,402	—	—
Stockholders' equity:			
Common stock, $0.01 par value: 46,500,000 shares authorized;			
Class A: 12,500,000 shares authorized; 12,250,000 shares issued and 11,987,500 shares outstanding actual, pro forma and pro forma as adjusted	122,500	122,500	122,500
Class B: 34,000,000 shares authorized; 1,567,500 shares issued and outstanding actual, including 137,500 shares of restricted stock; 8,291,563 shares issued and outstanding pro forma; 12,291,563 shares issued and outstanding pro forma as adjusted	15,675	82,916	122,916
Treasury stock: 262,500 shares of Class A common stock actual, pro forma and pro forma as adjusted	—	—	—
Additional paid-in capital	6,716,734	28,089,895	51,649,895
Deferred stock-based compensation	(1,532,340)	(1,532,340)	(1,532,340)
Accumulated deficit	(3,488,237)	(3,488,237)	(3,488,237)
Total stockholders' equity	1,834,332	23,274,734	46,874,734
Total capitalization	$ 23,274,734	23,274,734	46,874,734

The above discussion and table exclude:

- 4,000,000 shares of Class B common stock reserved for issuance under our stock incentive plan as of December 31, 2003, as well as an additional 1,013,953 shares reserved for issuance under the "evergreen provision" of the plan as of January 1, 2004.
- 600,000 shares of Class B common stock issuable upon the exercise of the over-allotment option by the underwriters.

- 120,000 shares of Class B common stock issuable upon the exercise of the representative's warrant.

As of December 31, 2003, 3,089,600 shares were subject to outstanding options under the stock incentive plan, of which 2,421,500 options are at a weighted average exercise price of $1.67 per share and 668,100 options will have an exercise price equal to the initial public offering price. As of December 31, 2003, 325,000 options were exercisable with a weighted average exercise price of $0.98 per share.

DILUTION

Purchasers of our Class B common stock in this offering will experience immediate and substantial dilution in the pro forma net tangible book value of the common stock from the initial public offering price. In our calculations, we have assumed an initial public offering price of $6.50 per share of Class B common stock, which represents the middle of the filing range as of the date of this prospectus.

Pro forma net tangible book value per common share is determined by dividing pro forma net tangible book value (total tangible assets less total liabilities) by the pro forma number of shares of common stock outstanding as of December 31, 2003. These pro forma amounts also assume the conversion of all outstanding shares of Series A convertible preferred stock into 6,724,063 shares of Class B common stock.

As of December 31, 2003, our pro forma net tangible book value of our common stock was approximately $(1.1) million, or approximately $(0.05) per share of our common stock.

As of December 31, 2003, after giving effect to the sale of 4,000,000 shares of Class B common stock offered by this prospectus (after deduction of the underwriting discounts and estimated offering expenses), our adjusted net tangible book value would have been approximately $22.5 million, or $0.93 per share of common stock.

The offering, therefore, will result in an immediate increase in net tangible book value of $0.98 per share to existing stockholders and an immediate dilution in net tangible book value of $5.57 per share to new investors purchasing shares of our Class B common stock in this offering.

The following table illustrates the per share dilution to the new investors:

Public offering price per share		$6.50
Pro forma net tangible book value per share as of December 31, 2003	$(0.05)	
Increase in net tangible book value per share attributable to this offering	$ 0.98	
As adjusted pro forma net tangible book value per share after offering		$0.93
Dilution per share to new investors in this offering		$5.57

The following table summarizes, on a pro forma basis as of December 31, 2003, after giving effect to this offering, the differences between existing holders of common stock and the new investors with respect to the number of shares of common stock purchased from us, the total cash consideration paid and the average price per share paid by existing holders and investors in this offering, in each case before deducting underwriting discounts and commissions and estimated offering expenses.

	Shares Purchased		Total Cash Consideration		Average Price Per Share
	Number	Percent	Amount	Percent	
Existing stockholders	19,979,063	83.3%	$ 20,304,701	43.9%	$ 1.02
New investors	4,000,000	16.7	26,000,000	56.1	6.50
Total	23,979,063	100.0%	$ 46,304,701	100.0%	$ 1.93

The above discussion and table are based on pro forma shares outstanding as of December 31, 2003 and exclude:

- 4,000,000 shares of Class B common stock reserved for issuance under our stock incentive plan as of December 31, 2003, as well as an additional 1,013,953 shares reserved for issuance under the "evergreen provision" of the plan as of January 1, 2004, and an additional 300,000 shares of Class B common stock reserved for issuance under our employee stock purchase plan as of February 16, 2004;
- 600,000 shares of Class B common stock issuable upon the exercise of the over-allotment option by the underwriters;
- 120,000 shares of Class B common stock issuable upon the exercise of the representative's warrant; and
- the issuance of 425,000 shares of Class B common stock issued in connection with the acquisition of TrafficLeader valued at $6.75 per share, subject to a redemption right, and the issuance of 137,500 shares of restricted Class B common stock to employees valued at $6.75 per share. The 137,500 shares of restricted Class B common stock vest over a period of three years.

To the extent that any of these shares of Class B common stock are issued, your investment may be further diluted. As of December 31, 2003, 3,089,600 shares were subject to outstanding options under the stock incentive plan of which 2,421,500 options are at a weighted average exercise price of $1.67 per share and 668,100 options will have an exercise price equal to the initial public offering price. As of December 31, 2003, 325,000 options were exercisable at a weighted average exercise price of $0.98 per share. We may also grant more options or warrants in the future.

DIVIDEND POLICY

We have never declared or paid any cash dividends on shares of our Class B common stock. We currently intend to retain our earnings for future growth and do not anticipate paying any cash dividends in the foreseeable future. Any future determination to pay dividends will be at the discretion of our board of directors and will depend on a number of factors, such as our results of operations, capital requirements, financial conditions, future prospects and other factors that the board of directors deems relevant.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis of our financial condition and results of operations together with our financial statements and related notes appearing elsewhere in this prospectus. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including, but not limited to, those set forth under "Risk Factors" and elsewhere in this prospectus.

Overview

We are an early stage company focused on providing technology-based services to merchants engaged in online transactions. Our current operating businesses are in the performance-based advertising and search marketing industries, primarily focused on helping merchants market and sell their products and services via the Internet.

We currently provide our merchant advertisers with the following technology-based services through our wholly-owned operating subsidiaries Enhance Interactive and TrafficLeader:

- ***Performance-Based Advertising*** primarily includes pay-per-click and paid inclusion services.
  - *Pay-Per-Click Services.* With pay-per-click services, merchant advertisers purchase keywords based on an amount they choose for a targeted placement, usually within search engine results.
  - *Paid Inclusion Services*. With paid inclusion services, merchant advertisers pay for their Web pages and product databases to be crawled, or searched, and indexed and included primarily within search engine and shopping engine results.
- ***Search Marketing*** is designed for merchant advertisers who are focused on advertising campaign management, conversion tracking and analysis, and search engine optimization.

Enhance Interactive provides performance-based advertising services to merchant advertisers, including pay-per-click listings. Through Enhance Interactive, merchant advertisers market their products and services to millions of consumers and businesses through targeted pay-per-click listings that are primarily found in search engine or directory results when users search for information, products or services.

TrafficLeader provides performance-based advertising and search marketing services to merchant advertisers, including paid inclusion, advertising campaign management, conversion tracking and analysis, and search engine optimization. Through TrafficLeader's primary service, paid inclusion, TrafficLeader manages advertising campaigns and services for merchant advertisers that have hundreds or even thousands of products or content pages. TrafficLeader's paid inclusion service helps merchant advertisers reach prospective advertisers by placing their products or information, as well as associated detail and pricing, into many of the Internet's most-visited search engines, product shopping engines, and directories.

We were incorporated in Delaware on January 17, 2003. On February 28, 2003, we acquired eFamily, together with its direct wholly-owned subsidiary Enhance Interactive. eFamily was incorporated in Utah on November 29, 1999, under the name FocusFilter.com, Inc. On October 24, 2003, we acquired TrafficLeader, which was incorporated in Oregon on January 24, 2000, under the name Sitewise Marketing, Inc.

From January 17, 2003 (inception) through February 28, 2003, we were involved in business and product development, as well as financing and acquisition initiatives. During this period we had no revenues.

We currently have offices in Seattle, Washington; Provo, Utah; and Eugene, Oregon.

Acquisitions

Enhance Interactive. In February 2003, we acquired eFamily together with its wholly-owned subsidiary Enhance Interactive, a Provo, Utah-based company, for the following consideration:

- $13.3 million in net cash and acquisition costs; plus
- additional consideration in the form of a contingent earnings-based cash payment of up to $13.5 million payable over two years.

The additional consideration consists of two components: (i) a contingent earnings-based payment to the original stockholders (“earn-out consideration”) and (ii) a contingent earnings-based payment to certain employees (“retention consideration”). These amounts are payable by us with respect to the years 2003 and 2004. We shall have no obligation with respect to a calendar year in the event that Enhance Interactive’s earnings before taxes, excluding stock-based compensation and amortization of intangibles relating to the acquisition (“earnings before taxes”) do not exceed $3.5 million for that calendar year. The threshold determination is calculated separately for each of the calendar years 2003 and 2004. For the 2003 calendar year, the total Enhance Interactive earnings-based payment obligation was approximately $3.5 million.

The contingent payment of earn-out consideration, payable to the original stockholders of Enhance Interactive, is calculated based on the formula of 69.44% of earnings before taxes for each of the calendar years 2003 and 2004, up to a maximum payout cap of $12.5 million in aggregate. This payment obligation for each calendar year is conditioned on Enhance Interactive meeting the earnings threshold described above. To the extent we make any payments under this obligation, we have and will account for such amounts as additional goodwill. For the 2003 calendar year, the earn-out consideration was approximately $3.2 million.

The contingent payment of retention consideration, payable to certain employees of Enhance Interactive, is calculated based on the formula of 5.56% of Enhance Interactive’s earnings before taxes for each of the calendar years 2003 and 2004, up to a maximum payout cap of $1 million in aggregate. This payment obligation for each calendar year is also conditioned on Enhance Interactive meeting the earnings threshold described above. To the extent we make any payments under this obligation, we have and will account for such amounts as compensation. For the 2003 calendar year, the retention consideration was approximately $283,000.

In connection with this acquisition, we also issued nonqualified stock options to certain employees of Enhance Interactive, subject to their continued employment, to purchase up to an aggregate of 1,250,000 shares of our Class B common stock with an exercise price per share of $0.75.

The Enhance Interactive operations were consolidated in our results from the acquisition date of February 28, 2003 and have had a substantial impact on our results.

TrafficLeader. In October 2003, we acquired TrafficLeader, a Eugene, Oregon-based company, for the following consideration:

- $3.2 million in net cash and acquisition costs; plus
- 425,000 shares of Class B common stock with a redemption right that requires us to buy back the 425,000 shares for $8 per share, but only at the election of the holders of 75% of such shares in the event we have not completed a firm commitment initial public offering with gross proceeds of at least $20 million prior to October 24, 2005; plus
- 137,500 shares of restricted Class B common stock which will vest over a three-year period in installments of 16.67% after each six month period during that term; plus
- additional consideration in the form of a contingent revenue-based cash incentive payment of up to $1 million.

With respect to the second and third components of the acquisition consideration, the fair value of the shares and the redemption right were recorded at $3.9 million.

Of the 137,500 restricted shares, 108,432 were issued to employees of TrafficLeader and valued at $732,000, which amount will be recorded as compensation expense over the associated employment period during which these shares vest.

The contingent, revenue-based payment is conditioned on TrafficLeader having revenue in excess of $15 million for calendar 2004. To the extent we make any payment under this obligation, we will account for such amount as additional goodwill. In the event that TrafficLeader meets the minimum revenue threshold, we will be obligated to pay an amount equal to 10% of each dollar in revenue above the $15 million revenue threshold, up to a maximum payout of $1 million.

In the event on or prior to December 31, 2004, there is a change of control of TrafficLeader or of us, or both TrafficLeader's CEO and CTO either resign for good reason or are terminated without cause, or we take any action prior to the end of December 31, 2004, which makes it impractical to calculate or reconstruct the earn-out obligation, we will be obligated to pay the full amount of the $1 million contingent payment obligation.

Consolidated Statements of Operations

Our consolidated statements of operations, stockholders' equity, and cash flows have been presented for the period of January 17, 2003 (inception) through December 31, 2003. Business planning and other activities related to our business began in late 2002. We were organized and incorporated in Delaware in January 2003. Included in the results of operations subsequent to our incorporation in January 2003 are reimbursements to certain founding officers for approximately $86,000 in general and administrative pre-incorporation costs. Included in property and equipment are purchases from certain of our founding officers of approximately $62,000 for the carrying value of the assets.

The assets, liabilities and operations of Enhance Interactive and TrafficLeader are included in our consolidated financial statements since the date of their respective acquisitions in February and October 2003. All significant inter-company transactions and balances have been eliminated in consolidation. Our purchase accounting resulted in all assets and liabilities from our acquisitions of Enhance Interactive and TrafficLeader being recorded at their estimated fair values. For the period of February 28 through December 31, 2003 and October 24, 2003 through December 31, 2003, all goodwill, intangible assets and liabilities resulting from the respective Enhance Interactive and TrafficLeader acquisitions have been recorded in our financial statements. Accordingly, our consolidated financial results for periods subsequent to the acquisitions of Enhance Interactive and TrafficLeader are not comparable to the financial statements of Enhance Interactive and TrafficLeader presented for prior periods. The consolidated statements of operations, stockholders' equity, and cash flows reflecting Enhance Interactive's historical results have been presented for the year ended December 31, 2002 and the period from January 1, 2003 through February 28, 2003.

eFamily and its wholly-owned subsidiary Enhance Interactive are described as Enhance Interactive in the accompanying Management's Discussion and Analysis of Financial Condition and Results of Operations. In the accompanying consolidated financial statements, the statements of operations, stockholders' equity, and cash flows reflecting Enhance Interactive results have been presented as the "Predecessor" for the year ended December 31, 2002 and the period of January 1, 2003 to February 28, 2003.

Presentation of Financial Reporting Periods

For purposes of our discussion, we have included the results of operations of the Predecessor, Enhance Interactive. The results of operations of TrafficLeader have been included as of the acquisition date of October 24, 2003. The comparative periods presented are the results of Enhance Interactive for the year ended

December 31, 2002 (2002 period), compared to the combined results for the period of January 17, 2003 (inception) to December 31, 2003 and the results of Enhance Interactive for the period of January 1, 2003 to February 28, 2003 (2003 period). In the 2003 period, we have included the overlapping operating activities of Enhance Interactive and our operating activities for the period of January 17, 2003 (inception) through February 28, 2003. From January 17, 2003 (inception) through February 28, 2003, we were involved in business and product development, as well as financing and acquisition initiatives. During this period we had no revenues. Accordingly, our activities were different from the operating activities of Enhance Interactive.

Revenue

We currently generate revenue through our operating businesses. The primary sources of revenue are the performance-based advertising services, which include pay-per-click listings and paid inclusion. The secondary sources of revenue are the search marketing services, which include advertising campaign management, conversion tracking and analysis and search engine optimization. We recognize revenue upon the completion of our performance obligation, provided that: (i) evidence of an arrangement exists, (ii) the arrangement fee is fixed and determinable, and (iii) collection is reasonably assured. We have no barter transactions.

In providing pay-per-click advertising services primarily through Enhance Interactive, we generate revenue upon our delivery of qualified click-throughs to our merchant advertisers. These merchant advertisers pay us a designated transaction fee for each click-through, which occurs when an online user clicks on any of their advertisement listings after it has been placed by us or by our distribution partners. Each click-through on an advertisement listing represents a completed transaction. The advertisement listings are displayed within our distribution network, which includes search engines, directories, destination sites and other targeted Web-based content. We provide priority of placement within our displayed advertisement listings based on the merchant advertiser's price commitment for each click-through.

In our paid inclusion services delivered primarily through TrafficLeader, merchant advertisers pay for their Web pages and product databases to be crawled, or searched, and included in search engine and product shopping engine results within our distribution network. Generally, the paid inclusion results are presented separately on a Web page from the pay-per-click listings. For this service, revenue is generated when an online user clicks on a paid inclusion listing from search engine or product shopping engine results. Each click-through on an advertisement listing represents a completed transaction for which the merchant advertiser pays for on a per-click basis. The placement of a paid inclusion result within search engine results is largely determined by its relevancy, as determined by the search engine partner.

Merchant advertisers also pay us for our search marketing services, which are primarily delivered by TrafficLeader. Merchant advertisers pay us additional fees for such services as advertising campaign management, conversion tracking and analysis, and search engine optimization. Merchant advertisers generally pay us on a click-through basis, although in certain cases we receive a fixed fee for delivery of these services. In some cases we also deliver banner campaigns for select merchant advertisers, primarily through Enhance Interactive. We may also charge initial set-up or inclusion fees as part of our services. Total revenue from these services accounted for less than 9% of total revenue in all periods presented.

Banner advertising revenue (generated by Enhance Interactive) is primarily based on a fixed fee per click and is generated and recognized on click-through activity. In limited cases, banner payment terms are volume-based with revenue generated and recognized when impressions are delivered.

Non-refundable account set-up fees are paid by merchant advertisers and are recognized ratably over the longer of the term of the contract or the average expected merchant advertiser relationship period, which generally ranges from twelve months to more than two years.

Other inclusion fees are generally associated with monthly or annual subscription-based services where a merchant advertiser pays a fixed amount to be included in our index of listings or our distribution partners' indexes of listings. These subscription arrangements are recognized ratably over the service period.

We enter into agreements with various distribution partners to provide distribution for the URL strings and advertisement listings of our merchant advertisers. We generally pay distribution partners based on a percentage of revenue or a fixed amount per click-through on these listings. The level of click-throughs contributed by our distribution partners has varied, and we expect it will continue to vary, from quarter to quarter and year to year, sometimes significantly. Our growth will be impacted by our ability to increase our distribution, which impacts the number of Internet users who have access to our merchant advertisers' listings and the rate at which our merchant advertisers are able to convert clicks from these Internet users into completed transactions, such as a purchase or sign up. Our growth also depends on our ability to continue to increase the number of merchant advertisers who use our services and the amount these merchant advertisers spend on our services.

We anticipate that these variables will fluctuate in the future, affecting our growth rate and our financial results. In particular it is difficult to project the number of click-throughs we will deliver to our merchant advertisers and how much merchant advertisers will spend with us, and it is even more difficult to anticipate the average revenue per click-through.

In addition, we believe we will experience seasonality. Our quarterly results have fluctuated in the past and may fluctuate in the future due to seasonal fluctuations in levels of Internet usage. It is generally understood that during the spring and summer months, Internet usage is lower than during other times of the year, especially in comparison to the fourth quarter of the calendar year. The extent to which usage may decrease during these off-peak periods is difficult to predict. Prolonged or severe decreases in usage during these periods may adversely affect our growth rate and results.

Service Costs

Service costs include network operations and customer service costs that consist primarily of costs associated with serving our search results, maintaining our Web sites, credit card processing fees, network fees, fees paid to outside service providers, and customer service. Customer service and other costs associated with providing our performance-based advertising and search marketing services and maintaining our Web site include depreciation of Web site and network equipment, colocation service charges of our Web site equipment, bandwidth, and software license fees, salaries of related personnel, stock-based compensation and amortization of intangible assets.

Service costs also include user acquisition costs that relate primarily to payments to our distribution partners for access to their user traffic. We enter into agreements of varying durations with distribution partners that integrate our services into their sites and indexes. The primary economic structure of our distribution partner agreements is a variable payment based on a specified percentage of revenue. These variable payments are often subject to minimum payment amounts per click-through. Other economic structures that to a lesser degree exist include:

- fixed payments, based on a guaranteed minimum amount of usage delivered;
- variable payments based on a specified metric, such as number of paid click-throughs; and
- a combination arrangement with both fixed and variable amounts.

We expense user acquisition costs under two methods: agreements with fixed payments are generally expensed at the greater of pro-rata over the term the fixed payment covers; or usage delivered to date divided by the guaranteed minimum amount of usage delivered.

Agreements with variable payment based on a percentage of revenue, number of paid click-throughs or other metrics are generally expensed based on the volume of the underlying activity or revenue multiplied by the agreed-upon price or rate.

Sales and Marketing

Sales and marketing expenses consist primarily of payroll and related expenses for personnel engaged in marketing and sales functions; advertising and promotional expenditures; and cost of systems used to sell to and serve merchant advertisers.

Product Development

Product development costs consist primarily of expenses incurred in the research and development, creation and enhancement of our Internet site and services. Research and development expenses include compensation and related expenses, costs of computer hardware and software, and costs incurred in developing features and functionality of the services we offer. For the periods presented, substantially all of the product development expenses are research and development.

Product development costs are expensed as incurred or capitalized into property and equipment in accordance with the American Institute of Certified Public Accountants' Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." This statement requires that costs incurred in the preliminary project and post-implementation stages of an internal use software project be expensed as incurred and that certain costs incurred in the application development stage of a project be capitalized.

General and Administrative

General and administrative expenses consist primarily of payroll and related expenses for executive and administrative personnel, bad debt provision, facilities, professional services (including legal and insurance), and other general corporate expenses.

Acquisition-Related Retention Consideration

Acquisition-related retention consideration results from our contingent, earnings-based payment obligation to certain employees of Enhance Interactive for each of the calendar years 2003 and 2004, pursuant to the terms of the merger agreement. See subsection "Acquisitions" above. We shall have no obligation with respect to a year in the event that Enhance Interactive's earnings before taxes do not exceed $3.5 million for that calendar year. The threshold determination is calculated separately for each of calendar years 2003 and 2004.

The contingent payment obligation is calculated based on the formula of 5.56% of Enhance Interactive's earnings before taxes for each of the calendar years 2003 and 2004, up to a maximum payout cap of $1 million in the aggregate. See subsection "Acquisitions" above. To the extent we make any payments under this obligation, we will account for such amounts as compensation. For the 2003 calendar year, the retention consideration was approximately $283,000.

Stock-Based Compensation

Stock-based compensation consists of the following components:

- the intrinsic value of employee option and restricted stock issuances in cases where the fair value of the underlying stock was greater than the exercise price on the date of the grant;
- the fair value of non-employee option issuances; and

- the amount by which the fair value of our Class B common stock exceeds the exercise price at the end of the period for certain options. We use variable accounting for the options to purchase 125,000 shares of our Class B common stock that were issued under our stock incentive plan. These options are being held in escrow as security for the indemnification obligations under the Enhance Interactive merger agreement, and are subject to forfeiture. We will continue to account for them as variable awards until the expiration of the agreed-upon escrow period on February 28, 2004.

Amortization of Identifiable Intangibles

Amortization of identifiable intangible assets relates to intangible assets identified in connection with the purchase of Enhance Interactive and, TrafficLeader. Intangible assets identified in connection with the purchase of Enhance Interactive were valued at $8.4 million at the acquisition date of February 28, 2003. Intangible assets identified in connection with the purchase of TrafficLeader were valued at $1.3 million at the acquisition date of October 24, 2003. The intangible assets have been identified as non-competition agreements, trade and domain names, distributor relationships, and merchant advertising customer base relationships and acquired technology. These assets are amortized over useful lives ranging from 12 to 42 months.

Provision for Income Taxes

For income tax purposes, we utilize the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in results of operations in the period that includes the enactment date. A valuation allowance is recorded for deferred tax assets when it is more likely than not that such deferred tax assets will not be realized.

As of December 31, 2003, we had net operating loss carryforwards of $1.8 million, which will begin to expire in 2019. The Tax Reform Act of 1986 limits the use of net operating loss (NOL) and tax credit carryforwards in certain situations where changes occur in the stock ownership of a company. We believe that such a change has occurred, and that the utilization of the approximately $1.8 million of carryforwards is limited such that substantially all of these NOL carryforwards will never be utilized.

Accretion to Redemption Value of Redeemable Convertible Preferred Stock

Holders of Series A redeemable convertible preferred stock are entitled to receive annual cumulative dividends at the per annum rate of 8% of the original purchase price per share when and if declared by the board of directors. Upon conversion of the Series A redeemable convertible preferred stock either by optional conversion or by mandatory conversion upon a firm commitment initial public offering with gross proceeds of at least $20 million, all accumulated and unpaid dividends on the Series A redeemable convertible preferred stock, whether or not declared, since the date of issue up to and including the conversion date, shall be forgiven.

No holders of common stock will receive any dividends or distributions until the holders of the Series A redeemable preferred stock receive a dividend or distribution equal to all accrued but unpaid dividends on such preferred stock plus the per-share amount declared for the common stock on an as-converted basis.

We account for the difference between the carrying amount of the redeemable preferred stock and the redemption amount by increasing the carrying amount for periodic accretion using the interest method, so that the carrying amount will equal the redemption amount at the earliest redemption date.

Results of Operations

Comparison of the year ended December 31, 2002 (2002 period), to the combined periods of January 17 (inception) to December 31, 2003, and of January 1 to February 28, 2003 (2003 period).

Revenue. Revenue increased 128% from $10.1 million in the 2002 period to $23 million in the 2003 period. This increase was due primarily to an increase in the number of distribution partners, merchant advertisers, overall traffic volume and the acquisition of TrafficLeader. Our distribution partners increased from approximately 290 in the 2002 period to approximately 410 in the 2003 period and the number of merchant advertisers increased from more than 7,700 to more than 10,600. We believe the increase in revenue is primarily a result of the growth of our existing distribution partners, the increased number of searches and the resulting click-throughs performed by users of our service, as well as the addition of new distribution partners and merchant advertisers. We believe the above factors, combined with our sales efforts and improved operational controls, have contributed to an increase in the number of merchant advertisers. The increase in revenue in the 2003 period is also attributable to the acquisition of TrafficLeader in October 2003, which added 11 unique distribution partners and more than 280 merchant advertisers. TrafficLeader's operating results were included in the 2003 period as of the acquisition date of October 24, 2003.

Our growth rate will depend, in part, on our ability to increase the number of click-throughs performed by users of our service, primarily through our distribution partners. If we do not renew our distribution partner agreements or replace traffic lost from terminated distribution agreements with other sources or if our distribution partners' search businesses do not grow or are adversely affected, our revenue and results of operations may be materially and adversely affected. Our growth rate will also depend in part on our ability to increase the number and volume of transactions with merchant advertisers. We believe this is dependent in part on delivering high quality traffic that ultimately results in purchases or conversions for our merchant advertisers.

Expenses

Service Costs. Service costs increased 106% from $6.3 million in the 2002 period to $13 million in the 2003 period. The net increase in costs was mainly attributable to an increase in payments to distribution partners of $6.2 million, an increase in credit card processing fees of $333,000, an increase in personnel costs of $171,000, a decrease in technology licensing costs of $104,000, and an increase in facility and other costs of $91,000. This net increase related to a greater number of searches, an increase in database and hardware capacity requirements as a result of an increase in our distribution partner base and corresponding number of searches, an increase in the number of personnel required to support our services and increased fees paid to outside service providers. Service costs represented 63% of revenue in the 2002 period and 57% of revenue in the 2003 period. As a percentage of revenue, the decrease in service costs for the 2003 period compared to the 2002 period was primarily a result of network operation expenses containing fixed costs and also not increasing at a higher rate than revenue. The decrease in the 2003 period was partially offset by the impact on service cost as a percentage of revenue resulting from the acquisition of TrafficLeader in October 2003. Since TrafficLeader's user acquisition costs are higher as a percentage of revenue than Enhance Interactive, to the extent that TrafficLeader's operations make up a larger percentage of future operations, we expect that service costs will increase as a percentage of revenue. We also expect that service costs will continue to increase in absolute dollars, since we anticipate expanding our operations.

Sales and Marketing. Sales and marketing expense increased 55% from $1.8 million in the 2002 period to $2.8 million in the 2003 period. As a percentage of revenue, sales and marketing expenses were 18% in the 2002 period and 12% in the 2003 period. The increase in dollars was primarily related to an increase in personnel costs of $614,000, primarily due to an increase in the number of employees and the acquisition of TrafficLeader in October 2003. The remaining increase is related to increases in outside marketing activities, rent, travel and other operating costs arising from operations in multiple jurisdictions. We expect that sales and marketing expenses will increase in absolute dollars in connection with any revenue increases, to the extent we expand our sales force, and to the extent we increase our marketing activities.

Product Development. Product development expenses increased 77% from $812,000 in the 2002 period to $1.4 million in the 2003 period. As a percentage of revenue, product development expenses were 8% in the 2002 period and 6% in the 2003 period. As a percentage of revenue, the decrease in product development expenses in the 2003 period compared to the 2002 period was primarily a result of the allocation of product development expenses over a larger revenue base. The increase in dollars was primarily due to an increase in personnel costs of $461,000, primarily due to an increase in the number of employees and the acquisition of TrafficLeader in October 2003, and rent and other operating expenses of $163,000 arising from operations in multiple jurisdictions. We expect that product development expenses will increase in absolute dollars as we expect to increase the number of personnel and consultants to enhance our service offerings.

General and Administrative. General and administrative expenses increased 205% from $977,000 in the 2002 period to $3.0 million in the 2003 period. As of percentage of revenue, general and administrative expenses were 10% in the 2002 period and 13% in the 2003 period. The increase in the dollars was due to an increase in personnel costs of $640,000, an increase in professional fees of $617,000, an increase in travel of $288,000, an increase in insurance of $74,000, an increase in bad debt expense of $126,000, and an increase in facility and other operating expenses of $257,000. Many of these costs and increases in costs as a percentage of revenue in the 2003 period result from operating in multiple jurisdictions commencing in 2003 and increased operating activity, including the acquisition of TrafficLeader in October 2003. We expect that our general and administrative expenses will increase in absolute dollars to the extent that we expand our operations and incur additional costs in connection with becoming a public company, such as professional fees and insurance.

Acquisition-Related Retention Consideration. Acquisition-related retention consideration increased from zero in the 2002 period to $283,000 in the 2003 period. During the 2003 period, the components of acquisition-related retention consideration were service costs of $34,000, sales and marketing of $96,000, product development of $104,000 and general and administrative of $49,000. The acquisition-related retention consideration was calculated as part of the contingent, earnings-based payment obligation to certain employees of Enhance Interactive and is equal to 5.56% of Enhance Interactive's earnings before taxes in excess of $3.5 million for the 2003 period of which $283,000, including $23,000 of employer-related payroll taxes, has been recorded in 2003. We accounted for this payment amount as compensation.

In addition, with respect to calendar year 2004, we will be obligated to pay additional acquisition-related retention consideration to certain employees of Enhance Interactive if Enhance Interactive has earnings before taxes in excess of $3.5 million. This acquisition-related retention consideration will be equal to 5.56% of Enhance Interactive's earnings before taxes for the 2004 period. The acquisition-related retention consideration for the calendar years 2003 and 2004 is subject to an aggregate maximum of $1 million. We will account for any payment amount as compensation.

Stock-Based Compensation. The amortization of stock-based compensation increased 493% from $365,000 in the 2002 period to $2.2 million in the 2003 period. During the 2002 period, the components of stock-based compensation were service costs of $3,000, sales and marketing of $149,000, product development of $57,000 and general and administrative of $156,000. The 2002 period amount related primarily to the January 2002 sale of 2,031,666 shares to employees for cash consideration totaling $10,000; $357,000 in stock-based compensation was recorded in connection with the share issuance based on the difference between the cash consideration and the estimated fair value. During the 2003 period, the components of stock-based compensation were service costs of $10,000, sales and marketing of $423,000, product development of $279,000 and general and administrative of $1.5 million. Amounts in the 2003 period related primarily to the vesting of stock options granted to employees in which the exercise price was less than the fair value of the shares at the date of grant, and $112,000 related to restricted stock issued to employees for future services in connection with the acquisition of TrafficLeader. The 2003 period also includes $781,000 of stock-based compensation for options to purchase 125,000 shares of Class B common stock, which are being held in escrow as security for the indemnification obligations under the Enhance Interactive merger agreement. These options are subject to forfeiture, until the expiration of the escrow period on February 28, 2004. Accordingly, we have accounted for these options as variable awards. Under variable plan accounting, compensation expense is measured quarterly as the amount by which the fair value of the shares of our Class B common stock covered by the option grant exceeds the exercise price and is recognized over the option's vesting period. Increases or decreases in the fair value of our Class B common stock between the date of grant and the date of exercise result in a corresponding increase or decrease in the measure of compensation expense.

Amortization of Identifiable Intangibles. Intangible amortization expense increased from zero in the 2002 period to $3 million in the 2003 period as a result of amortizing identifiable intangibles associated with the purchase of Enhance Interactive and TrafficLeader. During the 2003 period, the components of amortization of intangibles were service costs of $2.2 million, sales and marketing of $348,000, and general and administrative of $458,000. Our purchase accounting resulted in all assets and liabilities from our acquisition of Enhance Interactive and TrafficLeader being recorded at their estimated fair values on the acquisition dates of February 28, 2003 and October 24, 2003, respectively. For the period of February 28, 2003, through December 31, 2003, all goodwill, identifiable intangible assets and liabilities resulting from the Enhance Interactive and TrafficLeader acquisitions have been recorded in our financial statements. The identified intangibles amounted to $9.7 million and are being amortized over a range of useful lives of 12 to 42 months. Our consolidated financial results for periods subsequent to the acquisition of Enhance Interactive are not comparable to the financial statements of Enhance Interactive presented for prior periods. Our future growth depends upon our ability to identify, structure and integrate acquisitions. We may acquire identifiable intangible assets as part of future acquisitions and if so, we expect that our intangible amortization will increase in absolute dollars.

Other Income. Other income increased from $5,000 in the 2002 period to $76,000 in the 2003 period. Interest income and the adjustment to the fair value of the TrafficLeader redemption obligation account for primarily all of the increase. Interest income includes interest on cash balances. Interest income increased from $5,000 in the 2002 period to $47,000 in the 2003 period due to an increase in the average cash balance for the period resulting from the Series A redeemable convertible preferred stock financing.

The adjustment to fair value of the redemption obligation went from zero in the 2002 period to $26,000 in the 2003 period. As of the date of acquisition of TrafficLeader, a redemption obligation was recorded at fair value in the amount of $81,000. The $26,000 adjustment reflects the decrease in the fair value of the obligation to $55,000 as of December 31, 2003.

Income Taxes. The income tax benefit increased from $143,000 in the 2002 period to $860,000 in the 2003 period. The 2002 period effective tax rate benefit of 61% differed from the expected effective rate of 34% primarily due to reversing $208,000 of the valuation allowance on deferred tax assets and due to the effective rate impact of the $133,000 of non-deductible stock-based compensation during the 2002 period. During the 2002 period, Enhance Interactive determined that it was more likely than not, based on improved operating performance, that it would realize all of the available net deferred tax assets. The income tax effective rate was 32% in the 2003 period. This differed from the expected rate of 34% primarily due to state income taxes offset by non-deductible stock compensation amounts. The 2003 period was also impacted by the following factors:

- On February 28, 2003, and October 24, 2003 in connection with the purchase accounting for the respective acquisitions of Enhance Interactive and TrafficLeader, we recorded net deferred tax liabilities in the amount of approximately $3.5 million relating to the difference in the book basis and tax basis of its assets and liabilities.
- Approximately $3.6 million of these deferred tax liabilities related to the book basis versus tax basis of the identifiable intangible assets in the acquisitions totaling approximately $9.7 million.

During the period of January 1 through February 28, 2003, as a result of a tax deduction from stock option exercises, Enhance Interactive recognized a tax-effected benefit of approximately $231,000, which was recorded as a credit to additional paid in capital.

Accretion to Redemption Value of Redeemable Convertible Preferred Stock. The accretion to redemption value of preferred stock was $1,319,000 in the 2003 period. The accretion to the redemption value recorded during the period is based upon 6,724,063 shares of Series A preferred stock outstanding as of December 31, 2003 with a dividend rate of 8% per annum.

Net Income (Loss) Applicable to Common Stockholders. Net loss applicable to common stockholders increased from $90,000 in the 2002 period to $3.2 million in the 2003 period. The increase was primary attributable to an increase in operating income offset by an increase of $3.0 million in amortization of intangible assets and an increase of $1.8 million in stock-based compensation.

Operating Income Before Amortization. Our management believes that certain non-GAAP measures are helpful, when presented in conjunction with the comparable GAAP measures. The non-GAAP measures are not meant to replace or supercede the GAAP measures, but rather to supplement the information to present to the readers of the financial statements the same information as management considers in assessing the results of operations and performance.

When presenting non-GAAP measures we will present a reconciliation of the most directly comparable GAAP measure. These non-GAAP measures are consistent with how management views the results of operations in assessing performance.

We report Operating Income Before Amortization (“OIBA”) that is a supplemental measure to GAAP. This measure, among other things, is one of the primary metrics by which the company evaluates the performance of our business. Additionally, management uses adjusted OIBA which excludes acquisition-related retention consideration as we view this as part of the earn-out consideration from the transaction. Adjusted OIBA is the basis on which our internal budgets are based and by which management is currently evaluated. Management believes that investors should have access to, and we are obligated to provide, the same set of information that we use in analyzing our results. This non-GAAP measure should be considered in addition to results prepared in accordance with GAAP, but should not be considered in isolation, as a substitute for, or superior to, GAAP results. OIBA is defined as income (loss) from operations before (1) stock-based compensation expense and (2) amortization of intangible assets. This measure includes acquisition-related retention consideration resulting from the 2003 earn-out payment obligation from the Enhance Interactive acquisition. We provide and encourage investors to examine the reconciling adjustments between the GAAP and non-GAAP measures, which we discuss below.

We believe this measure is useful to investors because it represents our consolidated operating results, taking into account depreciation, which we believe is an ongoing cost of doing business, but excluding the effects of certain other non-cash expenses. OIBA has certain limitations in that it does not take into account the impact to our statement of operations of certain expenses including non-cash stock-based compensation associated with our employees and acquisition related accounting. We endeavor to compensate for the limitations of the non-GAAP measure presented by providing the comparable GAAP measure with equal or greater prominence, GAAP financial statements and detailed descriptions of the reconciling items and adjustments, including quantifying such items, to derive the non-GAAP measure.

The following are the non-cash expenses that are excluded from our non-GAAP measures:

- stock-based compensation consists of restricted stock and options expense, which relates mostly to restricted stock and options issued in connection with acquisitions. We view this expense as part of transaction costs which are not paid in cash. Stock-based compensation also includes the expense associated with certain employee stock options where on the date of grant the fair value of the underlying stock exceeded the exercise price.
- amortization of intangible assets is a non-cash expense relating primarily to acquisitions. At the time of an acquisition, the intangible assets of the acquired company, such as distribution partner relationships and merchant advertiser customer relationships are valued and amortized over their estimated lives.

While it is likely that we will have significant intangible amortization expense as we continue to acquire companies, we believe that since intangibles represent costs incurred by the acquired company to build value prior to the acquisition, they were part of transaction costs and will not be replaced with cash costs when the intangibles are fully amortized.

The following is a reconciliation of income (loss) from operations and net income (loss) applicable to common stockholders to the non-GAAP measure of operating income before amortization for the year ended December 31, 2002, the period of January 1, 2003 to February 28, 2003 and the period of January 17, 2003 (inception) to December 31, 2003.

	Predecessor Periods		Successor Period
	Year ended December 31, 2002	Period from January 1 to February 28, 2003	Period from January 17 (inception) to December 31, 2003
Operating income before amortization (OIBA)	$ 126,543	594,053	1,820,795
Stock-based compensation	(364,693)	(38,981)	(2,125,110)
Amortization of intangible assets	—	—	(3,023,408)
Income (loss) from operations	(238,150)	555,072	(3,327,723)
Other income:			
Interest income	5,491	1,529	45,874
Adjustments to fair value of redemption obligation	—	—	25,500
Other	—	—	2,685
Total other income	5,491	1,529	74,059
Income (loss) before provision for income taxes	(232,659)	556,601	(3,253,664)
Income tax expense (benefit)	(142,876)	224,082	(1,084,312)
Net income (loss)	(89,783)	332,519	(2,169,352)
Accretion to redemption value of redeemable convertible preferred stock	—	—	1,318,885
Net income (loss) applicable to common stockholders	$ (89,783)	332,519	(3,488,237)

Operating income before amortization (“OIBA”) increased from $127,000 in the 2002 period to $2.4 million in the 2003 period. The increase was primarily attributable to increased operating activity that resulted in an increase in revenue of $12.9 million offset by an increase in operating expenses of $10.6 million, excluding stock-based compensation expense and amortization of intangible assets.

Quarterly Results of Operations

The following tables set forth our unaudited quarterly results of operations data for the eight most recent quarters and periods ended December 31, 2003, as well as such data expressed as a percentage of our revenues for the periods presented. The information in the tables below should be read in conjunction with our consolidated financial statements and the notes thereto included elsewhere in this prospectus. We have prepared this information on the same basis as the consolidated financial statements and the information includes all adjustments, consisting only of normal recurring adjustments, that we consider necessary for a fair statement of our financial position and operating results for the quarters/periods presented. Our quarterly operating results have varied substantially in the past and may vary substantially in the future. You should not draw any conclusions about our future results from the results of operations for any particular quarter or period presented.

	Predecessor Periods					Successor Periods			
	Quarter ended March 31, 2002	Quarter ended June 30, 2002	Quarter ended Sept 30, 2002	Quarter ended Dec 31, 2002	Period from Jan 1 to Feb 28, 2003	Period from Jan 17 (inception) to March 31, 2003	Quarter ended June 30, 2003	Quarter ended Sept 30, 2003	Quarter ended Dec 31, 2003
Revenue	$ 1,725,659	2,070,213	2,631,707	3,642,928	3,071,055	1,715,933	5,356,286	5,359,274	7,460,665
Expenses:									
Service costs (1)	1,098,184	1,310,469	1,755,041	2,170,479	1,732,813	883,280	2,955,535	2,967,206	4,486,049
Sales and marketing (1)	327,406	372,028	436,950	684,853	365,043	214,615	654,182	723,753	868,133
Product development (1)	128,969	157,811	202,350	322,543	144,479	104,947	354,927	384,248	447,300
General and administrative (1)	220,564	165,314	233,166	357,837	234,667	426,919	729,856	659,177	927,967
Acquisition-related retention consideration (2)	—	—	—	—	—	—	—	—	283,269
Stock-based compensation (3)	358,141	1,910	2,221	2,421	38,981	710,991	550,078	326,407	537,634
Amortization of intangible assets (4)	—	—	—	—	—	290,087	869,588	869,588	994,145
Total operating expenses	2,133,264	2,007,532	2,629,728	3,538,133	2,515,983	2,630,839	6,114,166	5,930,379	8,544,497
Income (loss) from operations	(407,605)	62,681	1,979	104,795	555,072	(914,906)	(757,880)	(571,105)	(1,083,832)
Other income:									
Interest income	106	686	1,732	2,967	1,529	3,092	13,479	16,931	12,372
Adjustment to fair value of redemption obligation	—	—	—	—	—	—	—	—	25,500
Other	—	—	—	—	—	—	—	—	2,685
Total other income	106	686	1,732	2,967	1,529	3,092	13,479	16,931	40,557
Income (loss) before provision for income taxes	(407,499)	63,367	3,711	107,762	556,601	(911,814)	(744,401)	(554,174)	(1,043,275)
Income tax expense (benefit)	—	—	(190,717)	47,841	224,082	(323,092)	(263,771)	(196,368)	(301,081)
Net income (loss)	(407,499)	63,367	194,428	59,921	332,519	(588,722)	(480,630)	(357,806)	(742,194)
Accretion to redemption value of redeemable convertible preferred stock	—	—	—	—	—	119,081	385,274	407,265	407,265
Net income (loss) applicable to common stockholders	$ (407,499)	63,367	194,428	59,921	332,519	(707,803)	(865,904)	(765,071)	(1,149,459)

(1) Excludes acquisition-related retention consideration, stock-based compensation and amortization of intangible assets									
(2) Components of acquisition-related retention consideration:									
Service costs	$ —	—	—	—	—	—	—	—	33,723
Sales and marketing	—	—	—	—	—	—	—	—	96,262
Product development	—	—	—	—	—	—	—	—	104,233
General and administrative	—	—	—	—	—	—	—	—	49,051
(3) Components of stock-based compensation:									
Service costs	$ 2,350	241	285	285	190	—	—	—	9,776
Sales and marketing	145,602	920	1,074	1,073	715	128,993	99,861	87,720	105,297
Product development	56,238	210	315	315	37,710	69,769	95,108	38,348	37,855
General and administrative	153,951	539	547	748	366	512,229	355,109	200,339	384,706
(4) Components of amortization of intangible assets:									
Service costs	$ —	—	—	—	—	215,087	644,588	644,588	712,694
Sales and marketing	—	—	—	—	—	29,167	87,500	87,500	143,951
Product development	—	—	—	—	—	—	—	—	—
General and administrative	—	—	—	—	—	45,833	137,500	137,500	137,500

Table of Contents

	As A Percentage of Net Revenue								
	Predecessor Periods					Successor Periods			
	Quarter ended March 31, 2002	Quarter ended June 30, 2002	Quarter ended Sept 30, 2002	Quarter ended Dec 31, 2002	Period from Jan 1 to Feb 28, 2003	Period from Jan 17 (inception) to March 31, 2003	Quarter ended June 30, 2003	Quarter ended Sept 30, 2003	Quarter ended Dec 31, 2003
Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Expenses:									
Service costs (1)	63.6	63.3	66.7	59.6	56.4	51.5	55.2	55.4	60.1
Sales and marketing (1)	19.0	18.0	16.6	18.8	11.9	12.5	12.2	13.5	11.6
Product development (1)	7.5	7.6	7.7	8.9	4.7	6.1	6.6	7.2	6.0
General and administrative (1)	12.8	8.0	8.9	9.8	7.6	24.9	13.6	12.3	12.4
Acquisition-related retention consideration (2)	—	—	—	—	—	—	—	—	3.8
Stock-based compensation (3)	20.8	0.1	0.1	0.1	1.3	41.4	10.3	6.1	7.2
Amortization of intangible assets (4)	—	—	—	—	—	16.9	16.2	16.2	13.3
Total operating expenses	123.6	97.0	99.9	97.1	81.9	153.3	114.1	110.7	114.5
Income (loss) from operations	(23.6)	3.0	0.1	2.9	18.1	(53.3)	(14.1)	(10.7)	(14.5)
Other income:									
Interest income	—	—	0.1	0.1	—	0.2	0.3	0.3	0.2
Adjustment to fair value of redemption obligation	—	—	—	—	—	—	—	—	0.3
Other	—	—	—	—	—	—	—	—	—
Total other income	—	—	0.1	0.1	—	0.2	0.3	0.3	0.5
Income (loss) before provision for income taxes	(23.6)	3.1	0.1	3.0	18.1	(53.1)	(13.9)	(10.3)	(14.0)
Income tax expense (benefit)	0.0	0.0	(7.2)	1.3	7.3	(18.8)	(4.9)	(3.7)	(4.0)
Net income (loss)	(23.6)	3.1	7.4	1.6	10.8	(34.3)	(9.0)	(6.7)	(9.9)
Accretion to redemption value of redeemable convertible preferred stock	—	—	—	—	—	6.9	7.2	7.6	5.5
Net income (loss) applicable to common stockholders	(23.6)%	3.1%	7.4%	1.6%	10.8%	(41.2)%	(16.2)%	(14.3)%	(15.4)%

For purposes of discussion, we have included the results of operations of the Predecessor, Enhance Interactive. The results of operations of TrafficLeader have been included since the acquisition date of October 24, 2003. The results of operations for the quarter ended March 31, 2003 as discussed below is based on the combined periods including our results from January 17, 2003 (inception) to March 31, 2003 and Enhance Interactive's results from January 1, 2003 to February 28, 2003 (quarter ended March 31, 2003). From January 17, 2003 (inception) through February 28, 2003, we were involved in business and product development, as well as financing and acquisition initiatives and accordingly, our activities were different from the operating activities of Enhance Interactive. For further discussion of the presentation of Financial Reporting Periods, see page 30.

Revenue progressively increased in the quarters presented due primarily to an increase in the number of and growth of distribution partners, an increase in the number of merchant advertisers, and an overall increase in the number of searches and resulting click-throughs performed by users of our service. Revenue in the quarter ended December 31, 2003 also increased as a result of the acquisition of TrafficLeader.

Service costs increased in each quarter presented mainly as a result of increases each quarter in payments to distribution partners, costs of processing larger numbers of transactions, such as related credit card processing fees, and personnel and facility costs. Service costs generally decreased as a percentage of revenue in the 2003 quarters as compared to the 2002 quarters. The decrease in the percentage of revenue during this period is attributable to fixed network costs not increasing as revenue has grown, as well as economies of scale in our support and network infrastructure being realized, and certain variable costs having increased at a lower rate than revenue. Service costs increased as a percentage of revenue in the quarter ended December 31, 2003 primarily due to the acquisition of TrafficLeader in this period. TrafficLeader's operations have a higher ratio of service costs to revenue than the operations of Enhance Interactive since user acquisition costs account for a higher ratio of its revenue.

Sales and marketing expense, product development expense, and general and administrative expense generally increased over the quarters presented, largely as a result of increases in personnel associated with selling, developing, and supporting our services. The increases in the 2003 quarters relative to the 2002 quarters are also related to increases in rent and other operating expenses arising from maintaining operations in multiple jurisdictions. The quarter ended December 31, 2003 was also impacted by the inclusion of TrafficLeader personnel in that period.

Stock-based compensation for the quarter ended March 31, 2002 was primarily related to the sale of shares to employees for cash consideration for amounts less than the estimated fair value. The stock-based compensation in the 2003 quarters related primarily to (i) employee stock options, for which the exercise price was less than the fair value on the date of grant, and (ii) the options to purchase 125,000 shares of Class B common stock held in escrow as security for the indemnification obligations under the Enhance Interactive merger agreement. The options held in escrow are accounted for as variable awards. Stock-based compensation increased in the quarter ended December 31, 2003 primarily due to amounts recognized for restricted shares issued to employees in connection with the acquisition of TrafficLeader.

Amortization of intangible assets expense in the initial three quarters of 2003 resulted from amortizing identifiable intangibles associated with the purchase of Enhance Interactive. Amortization of intangible assets expense increased in the quarter ended December 31, 2003 as a result of the additional amortization of identifiable intangibles associated with the purchase of TrafficLeader.

Table of Contents

	Predecessor Periods					Successor Periods			
	Quarter ended March 31, 2002	Quarter ended June 30, 2002	Quarter ended Sept 30, 2002	Quarter ended Dec 31, 2002	Period from Jan 1 to Feb 28, 2003	Period from Jan 17 (inception) to March 31, 2003	Quarter ended June 30, 2003	Quarter ended Sept 30, 2003	Quarter ended Dec 31, 2003
Operating income before amortization (OIBA) (1)	$ (49,464)	64,591	4,200	107,216	594,053	86,172	661,786	624,890	447,947
Stock-based compensation	(358,141)	(1,910)	(2,221)	(2,421)	(38,981)	(710,991)	(550,078)	(326,407)	(537,634)
Amortization of intangible assets	—	—	—	—	—	(290,087)	(869,588)	(869,588)	(994,145)
Income (loss) from operations	(407,605)	62,681	1,979	104,795	555,072	(914,906)	(757,880)	(571,105)	(1,083,832)
Other income:									
Interest income	106	686	1,732	2,967	1,529	3,092	13,479	16,931	12,372
Adjustment to fair value of redemption obligation	—	—	—	—	—	—	—	—	25,500
Other	—	—	—	—	—	—	—	—	2,685
Total other income	106	686	1,732	2,967	1,529	3,092	13,479	16,931	40,557
Income (loss) before provision for income taxes	(407,499)	63,367	3,711	107,762	556,601	(911,814)	(744,401)	(554,174)	(1,043,275)
Income tax expense (benefit)	—	—	(190,717)	47,841	224,082	(323,092)	(263,771)	(196,368)	(301,081)
Net income (loss)	(407,499)	63,367	194,428	59,921	332,519	(588,722)	(480,630)	(357,806)	(742,194)
Accretion to redemption value of redeemable convertible preferred stock	—	—	—	—	—	119,081	385,274	407,265	407,265
Net income (loss) applicable to common stockholders	$ (407,499)	63,367	194,428	59,921	332,519	(707,803)	(865,904)	(765,071)	(1,149,459)

(1) We report operating income before amortization ("OIBA") that is a supplemental measure to GAAP. OIBA represents income (loss) from operations plus (1) stock-based compensation expense and (2) amortization of intangible assets. This measure, among other things, is one of the primary metrics by which we evaluate the performance of our business. Additionally, management uses adjusted OIBA which excludes acquisition-related retention consideration as we view this as part of the earn-out consideration from the transaction. Adjusted OIBA is the basis on which our internal budgets are based and by which management is currently evaluated. Management believes that investors should have access to, and we are obligated to provide, the same set of tools that we use in analyzing our results. This non-GAAP measure should be considered in addition to results prepared in accordance with GAAP, but should not be considered in isolation, as a substitute for, or superior to GAAP results. We believe this measure is useful to investors because it represents our consolidated operating results, taking into account depreciation, which we believe is an ongoing cost of doing business, but excluding the effects of certain other non-cash expenses.

OIBA has certain limitations in that it does not take into account the impact to our statement of operations of certain expenses including non-cash stock-based compensation associated with our employees and acquisition-related accounting. We endeavor to compensate for the limitations of the non-GAAP measure presented by providing the comparable GAAP measure with equal or greater prominence, GAAP financial statements and detailed descriptions of the reconciling items and adjustments, including quantifying such items, to derive the non-GAAP measure. This table provides a reconciliation of income (loss) from operations and net income (loss) applicable to common stockholders to the non-GAAP measure of operating income before amortization for the eight most recent quarters and/or periods ended December 31, 2003.

Liquidity and Capital Resources

We have financed our Company through the private sales of securities in January through May of 2003, which totaled approximately $20.3 million. Primarily from such proceeds, we have funded our business operations and the acquisitions of Enhance Interactive and TrafficLeader. The acquisition of Enhance Interactive resulted in $13.3 million in net cash consideration and the acquisition of TrafficLeader amounted to $3.2 million in net cash consideration. As of December 31, 2003, we had cash and cash equivalents of $6.0 million. As of December 31, 2003, we had contractual obligations of $836,000 of which $694,000 is for rent under our facility leases. In February 2004, we entered into a $2.3 million commitment for additional office space in Seattle, Washington, and this commitment extends through 2009. As of December 31, 2003, we had $21.4 million outstanding of Series A redeemable convertible preferred stock which are not included as components of stockholders' equity because they are redeemable in certain events at the option of the holders, but are a part of our overall capital structure. If the offering is consummated under the terms presently anticipated, each of the outstanding shares of our Series A redeemable convertible preferred stock will automatically convert into one share of Class B common stock upon closing, and any accumulated dividends will be forgiven.

Net cash flow provided by operating activities was $1.5 million for the 2002 period and $3.3 million for the 2003 period. Cash was provided primarily from net income (losses) offset by non-cash amounts including depreciation and amortization of identifiable intangibles and stock-based compensation. The TrafficLeader acquisition, which occurred near the end of the 2003 period, contributed limited net cash flow to operations in the 2003 period. Accordingly, the operating cash flows were principally derived from Enhance Interactive's operating activity.

Enhance Interactive working capital cash flows contribute to cash provided by operations, in large part as a result of the advance payment structure in place for most merchant advertisers. With respect to most of these merchant advertisers, we receive payment for pay-per-click advertising services prior to our delivery of the click-throughs. Our corresponding payments to the distribution partners who provide placement for the listings are generally made only after our delivery of a click-through. In most cases, the amount payable to the distribution partner will be calculated at the end of a calendar month, with a payment period following the delivery of the click-throughs. This payment structure results in a lag period between the receipt of the cash from the merchant advertisers and the payment to the distribution partners. These services constituted the majority of revenue in the 2003 period.

Nearly all of the TrafficLeader merchant advertisers are billed on a monthly basis following the month of our click-through delivery. This payment structure results in our advancement of monies to the distribution partners who have provided the corresponding placements of the listings. Merchant advertisers' payments are generally received one to two weeks following payment to distribution partners. We expect that in future periods, if the paid inclusion service provided by TrafficLeader accounts for a greater percentage of our operating activity, working capital requirements will increase as a result.

Net cash flow used in investing activities was $334,000 for the 2002 period and $17.2 million for the 2003 period. Cash flow used in investing activities include capital expenditures for property and equipment and the acquisition of Enhance Interactive for $13.3 million in February 2003 and the acquisition of TrafficLeader for $3.2 million in October 2003. As a result of the Enhance Interactive and TrafficLeader acquisitions, we increased our property and equipment purchases for items such as network equipment and software, furniture, software and equipment for our personnel, and systems used to sell to and serve merchant advertisers. Purchases of property, plant and equipment for the period following the Enhance Interactive acquisition date of February 28, 2003 through December 31, 2003 totaled $466,000. As our operations increase, we expect property and equipment purchases will increase as we continue to invest in equipment and software for our systems and personnel.

Net cash flow provided by financing activities was $24,000 for the 2002 period and $20.3 million for the 2003 period. Cash flows from financing activities for the 2002 period relate to eFamily's issuance of stock. Cash flows from financing activities for the 2003 period relate to proceeds from employees exercising stock options and proceeds from the sale of Class A and Class B common stock and Series A redeemable convertible preferred stock in the aggregate amount of $20.3 million.

For the 2003 period, the total aggregate Enhance Interactive contingent, earnings-based payment obligation is approximately $3.5 million. This payment obligation includes the earn-out consideration of approximately $3.2 million and the retention consideration of approximately $283,000, for the 2003 period. These amounts are payable on the earlier of (i) April 1, 2004 or (ii) three days after we have received gross proceeds of at least $20 million from an initial public offering.

For purposes of the calculations of the contingent earnings and revenue-based payment obligations for Enhance Interactive and TrafficLeader, we have allocated revenue based on the source of revenue. We attribute revenue from products and services originating with Enhance Interactive to Enhance Interactive, and likewise we attribute revenue from products and services originating with TrafficLeader to TrafficLeader. Consistent with that approach, we allocate revenues based on origination of merchant advertiser and distribution partner relationships and agreements.

Future contingent earnings- and revenue-based payment obligations related to the Enhance Interactive and TrafficLeader acquisitions, which will be determined in early 2005 for the 2004 calendar year, could significantly impact our cash flows and could significantly reduce our available cash and cash equivalents balances. These payment obligations are still subject to the aggregate maximums of $13.5 million, of which $3.5 million has been recorded in 2003, for Enhance Interactive and $1 million for TrafficLeader.

The following table summarizes our contractual obligations as of December 31, 2003, as well as an amount relating to a lease commitment entered into in February 2004 and the effect these obligations are expected to have on our liquidity and cash flows in future periods:

	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Contractual Obligations:					
Operating leases (A)	$ 3,009,905	615,375	1,028,330	910,800	455,400
Other contractual obligations	142,000	142,000	—	—	
Series A redeemable convertible preferred stock (B)	34,800,000	—	—	—	34,800,000
Earn-out obligation associated with acquisition of Enhance Interactive (C)	Up to 13,500,000	3,502,369	Up to 9,997,631	—	—
Class B common stock subject to put redemption right (D)	3,400,000	—	3,400,000	—	—
Earn-out obligation associated with acquisition of TrafficLeader (E)	Up to 1,000,000	Up to 1,000,000	Up to 1,000,000	—	—
Total Contractual Obligations	Up to $55,851,905	Up to 5,259,744	Up to 15,425,961	910,800	35,255,400

(A) Included in operating leases in the table above is a $2.3 million commitment for additional office space in Seattle, Washington that extends through 2009. We anticipate relocating from our current Seattle offices in the first half of 2004. We expect to record a charge in the first half of 2004 relating to the relocation of up to $350,000.

(B) The Series A redeemable convertible preferred stock has redemption rights that will be eliminated upon the automatic conversion of the Series A redeemable convertible preferred stock into Class B common stock upon completion of the offering. Holders of Series A redeemable convertible preferred stock are entitled to receive cumulative dividends at the per annum rate of 8% of the original issue price per share when and if declared by the board of directors. The cumulative amount of preferred dividends in arrears is $1,317,000 or $0.20 per share at December 31, 2003. The board of directors has not declared any dividends as of December 31, 2003. Upon conversion of the Series A redeemable convertible preferred stock, either by optional conversion or by mandatory conversion upon an initial public offering, all accumulated and unpaid dividends on the Series A redeemable convertible preferred stock, whether or not declared, since the date of issue up to and including the conversion date, shall be forgiven. If dividends or other distributions are paid on the Class B common stock, the holders of Series A redeemable convertible preferred stock are entitled to the preferential dividends above and are entitled to per share dividends equal to those declared or paid to holders of Class B common stock. At the election of the holders of at least a majority of the outstanding shares of Series A redeemable convertible preferred stock on each of the First Redemption Date (March 31, 2011), Second Redemption Date (March 31, 2012), Third Redemption Date (March 31, 2013) and Final Redemption Date (March 31, 2014), we shall redeem one-third of the number of shares of Series A redeemable convertible preferred stock held by such holders on each of the first three redemption dates and the remainder of any shares not already redeemed shall be redeemed on the final redemption date. The aggregate redemption amount is $21,489,000 at December 31, 2003.

(C) A contingent, earnings-based payment obligation may be owed to the former shareholders of Enhance Interactive. The payment obligation has two components, which consist of earn-out consideration and retention consideration.

The earn-out consideration is calculated based on the formula of 69.44% of Enhance Interactive's earnings before taxes for each of the calendar years 2003 and 2004, up to an aggregate maximum payout cap of $12.5 million. In the event earnings before taxes do not exceed $3.5 million for 2003 or 2004, then no amount shall be payable for the related period. Any amounts payable will be accounted for as additional goodwill.

The retention consideration is calculated based on the formula of 5.56% of Enhance Interactive's earnings before taxes for each of the calendar years 2003 and 2004, up to an aggregate maximum payout cap of $1 million. In the event earnings before taxes do not exceed $3.5 million for 2003 or 2004, then no amount shall be payable for the related period. Any amounts payable will be accounted for as compensation.

Based on the calculation for calendar year 2003, we have recorded a $3.5 million payment liability for the total 2003 earnings-based payment obligations, which will reduce the maximum aggregate obligation by the same amount.

(D) In the event we have not completed a firm commitment initial public offering with gross proceeds of at least $20 million prior to October 24, 2005, the former shareholders of TrafficLeader have the right to require us to redeem 425,000 shares of Class B common stock for $8 per share (for an aggregate redemption of $3.4 million), but only upon the affirmative vote of the holders of 75% of such shares. These shares were valued at $6.75 per share and the associated redemption right has a value of $55,000 at December 31, 2003, and will be reflected as a liability, until such time as a qualifying initial public offering occurs. Based upon the terms of the redemption right, we will mark the redemption right to fair value at each reporting period until such time as the redemption right expires or the shares are redeemed.

(E) A contingent, revenue-based payment obligation may be owed under the TrafficLeader acquisition agreement. The contingent revenue-based payment is conditioned on TrafficLeader having revenue in excess of $15 million for calendar year 2004. In the event that TrafficLeader meets the minimum revenue threshold, we will be obligated to pay an amount equal to 10% of each dollar in revenue above the $15 million threshold, up to a maximum payout cap of $1 million. Any amount payable will be accounted for as additional goodwill.

In the event on or prior to December 31, 2004, there is a change of control of TrafficLeader or of us, or both TrafficLeader's CEO and CTO either resign for good reason or are terminated without cause, or we take any action prior to the end of December 31, 2004, which makes it impractical to calculate or reconstruct the earn out obligation, we will be obligated to pay the full amount of the $1 million contingent payment obligation.

We anticipate that we will need to invest working capital towards the development and expansion of our overall operations. We may make further acquisitions, which, in addition to the issuance of equity securities, could result in the reduction of our cash balances or the incurrence of debt. We have allocated approximately $12 million of the net proceeds from this offering to fund acquisitions. See "Use of Proceeds." Furthermore, we expect that future capital expenditures may be higher than amounts recorded in the 2003 period if our operating activity continues to increase. In addition, TrafficLeader expenditures were only included in the 2003 period as of the acquisition date of October 24, 2003. Future reporting periods will include all of TrafficLeader's operating results for such periods. TrafficLeader's operations have a higher ratio of service costs to revenue than the operations of Enhance Interactive.

Based on our operating plans, we believe that the proceeds from this offering, together with our existing resources and cash flows provided by operations, will be sufficient to fund our planned operations for at least twelve months from the date of this prospectus. However, additional equity and debt financing may be needed to support our Company needs. If additional financing is necessary, it may not be available; and if it is available, it may not be possible for us to obtain financing on satisfactory terms. Failure to generate sufficient revenue or raise additional capital could have a material adverse effect on our ability to continue as a going concern and to achieve our intended business objectives.

Critical Accounting Policies

The policies below are critical to our business operations and the understanding of our results of operations. In the ordinary course of business, we make a number of estimates and assumptions relating to the reporting of our results.

Our consolidated financial statements have been prepared with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses and the related disclosures of contingent assets and liabilities. We base our estimates on historical experience and on various assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Our critical accounting policies relate to the following matters and are described below:

- Revenue;
- Goodwill and intangible assets;
- Stock-based compensation; and
- Allowance for doubtful accounts and merchant advertiser credits.

Revenue

We currently generate revenue through our operating businesses by delivering performance-based and search marketing services to merchant advertisers. The primary revenue driver has been performance-based advertising, which includes pay-per-click listings, delivered primarily through Enhance Interactive; and beginning in October 2003, paid inclusion, delivered primarily through TrafficLeader. For these particular services, revenue is recognized upon a user's click-through of a merchant advertiser listing within our distribution network. Each click-through represents a completed transaction.

We have entered into agreements with various distribution partners in order to expand our distribution network, which includes search engines, directories, product shopping engines and other Web sites through which we distribute our merchant advertisers' listings. We generally pay distribution partners based on a specified percentage of revenue or a fixed amount per click-through on these listings. We act as the primary obligor in these transactions, and we are responsible for providing customer and administrative services to the merchant advertiser. In accordance with EITF Issue No. 99-19, "Reporting Revenue Gross as a Principal Versus Net as an Agent," the revenue derived from merchant advertisers who receive paid introductions through us as supplied by distribution partners is reported gross based upon the amounts received from the merchant advertiser.

Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of identifiable assets acquired and liabilities assumed in business combinations accounted for under the purchase method.

We apply the provisions of the Financial Accounting Standards Board's (FASB) Statements of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," (SFAS 142). Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS 142. SFAS 142 also requires that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," (SFAS 144).

Goodwill not subject to amortization is tested annually for impairment, and is tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. To date, no impairment charge has been taken for the goodwill related to our acquisitions of Enhance Interactive or TrafficLeader. If the fair value is lower than the carrying value, a material impairment charge may be reported in our financial results.

We review our long-lived assets for impairment in accordance with SFAS 144 whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment is to be recognized by the amount by which the carrying amount of the assets exceeds fair value. Assets to be disposed of are separately presented on the balance sheet and reported at the lower of their carrying amount or fair value less costs to sell, and are no longer depreciated.

No impairment of our intangible assets has been indicated to date. To the extent such evaluation indicates that the useful lives of intangible assets are different than originally estimated, the amortization period is reduced or extended and, accordingly, the quarterly amortization expense is increased or decreased.

As a result of the significance of the goodwill and intangible asset carrying values, any impairment charges or changes to the estimated amortization periods could have a material adverse effect on our financial results.

Stock-Based Compensation

Our stock-based compensation plan is described more fully in Note 8 to the consolidated financial statements. We account for the plan under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations including FASB Interpretation No. 44, "Accounting for Certain Transactions involving Stock Compensation," an interpretation of APB Opinion No. 25 issued in March 2000, to account for our employee stock options. Under this method, employee compensation expense is recorded on the date of grant only if the fair value of the underlying stock exceeded the exercise price. SFAS No. 123, "Accounting for Stock-Based Compensation," established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans.

As allowed by SFAS No. 123, we have elected to continue to apply the intrinsic value-based method of accounting described above for options granted to employees, and have adopted the disclosure requirements of SFAS No. 123. We recognize compensation expense over the vesting period utilizing the accelerated methodology described in Financial Accounting Standards Board Interpretation No. 28, "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans." We account for non-employee stock-based compensation in accordance with SFAS No. 123 and EITF No. 96-18.

We use variable plan accounting to account for options to purchase 125,000 shares of our Class B common stock issued under our stock incentive plan that are held in escrow as security for the indemnification obligations under the Enhance Interactive merger agreement. These options are subject to forfeiture, until the expiration of the escrow period on February 28, 2004. Accordingly, we may be required to record a compensation charge on a quarterly basis, which will lower our earnings. Under variable plan accounting, compensation expense is measured quarterly as the amount by which the fair value of the shares of our Class B common stock covered by the option grant exceeds the exercise price and is recognized over the option's vesting period. Increases or decreases in the fair value of our Class B common stock between the date of grant and the date of exercise result in a corresponding increase or decrease in the measure of compensation expense.

The amount of stock-based compensation to be recognized is derived based on our determination of the fair value of our Class B common stock. We determine the fair value of our Class B common stock based on several factors, including our operating performance, issuances of our convertible preferred stock, liquidation preferences of our preferred stock, and valuations of other publicly-traded companies.

The amount of compensation expense actually recognized in future periods could be lower than currently anticipated if unvested stock options for which deferred compensation has been recorded are forfeited. In addition, if we used different assumptions to determine the deemed fair value of our Class B common stock, we could have reported materially different amounts of stock-based compensation. We currently are not required to record stock-based compensation charges if the employee stock option exercise price or restricted stock purchase price equals or exceeds the deemed fair value of our common stock at the date of grant. Several companies have recently elected to change their accounting policies and begun to record the fair value of options as an expense. In addition, we understand that discussions of potential changes to applicable accounting standards are ongoing. If we had estimated the fair value of options on the date of grant using a Black-Scholes pricing model, and then amortized this estimated fair value over the vesting period of the options, our net income (loss) would have been adversely affected. See Note 1(m) to our consolidated financial statements for a discussion of how our net income (loss) would have been adversely affected.

Allowance for Doubtful Accounts and Merchant Advertiser Credits

Accounts receivable balances are presented net of allowance for doubtful accounts and merchant advertiser credits. The allowance for doubtful accounts is our best estimate of the amount of probable credit losses in our accounts receivable. We determine our allowance based on analysis of historical bad debts, advertiser concentrations, advertiser creditworthiness and current economic trends. We review the allowance for collectibility on a quarterly basis. Account balances are written off against the allowance after all reasonable means of collection have been exhausted and the potential recovery is considered remote. If the financial condition of our advertisers were to deteriorate, resulting in an impairment of their ability to make payments, or if we underestimated the allowances required, additional allowances may be required which would result in increased general and administrative expenses in the period such determination was made.

We determine our allowance for merchant advertiser credits and adjustments based upon our analysis of historical credits. Material differences may result in the amount and timing of our revenue for any period if our management made different judgments and estimates.

Related Party Transactions

For a description of our related party transactions see "Certain Relationships and Related Transactions."

Recent Accounting Pronouncements

In November 2002, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 00-21 (EITF 00-21), "Revenue Arrangements with Multiple Deliverables." EITF 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which the vendor will perform multiple revenue generating activities. EITF 00-21 became effective for fiscal periods beginning after June 15, 2003. The adoption of EITF 00-21 has not had a material impact on our financial position and results of operations.

In May 2003, the FASB issued SFAS 150, “Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity.” The Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). It is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of this Statement did not have a material impact on our financial statements.

In December 2003, the SEC issued Staff Accounting Bulletin No. 104, “Revenue Recognition” (SAB No. 104), which revises or rescinds certain sections of SAB No. 101, “Revenue Recognition in Financial Statements” in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB No. 104 did not have a material effect on our financial position and results of operations.

BUSINESS

Company Overview

We provide technology-based services to merchants engaged in online transactions. Our objective is to be a leader in terms of growth, profitability, technological innovation, and business model innovation. We anticipate achieving our objectives through a combination of consolidation opportunities, growing those businesses we acquire, internal development initiatives and strategic relationships.

We believe there is a significant, long-term opportunity to capture market share of online transactions, and services that support online transactions, by building a profitable, diversified global company that provides a wide range of technology-based services to merchants, including: Web site infrastructure and development services; online payment and commerce infrastructure; promotional tools to market and sell products and services; and automated tools to manage and track online transaction. We intend to leverage the experience of our senior management to capture this opportunity, as they have substantial operational and strategic experience, including experience in building and managing public companies, executing acquisitions and forming strategic relationships.

Our current operating businesses are in the performance-based advertising and search marketing industries, primarily focused on helping merchants market and sell their products and services via the Internet. We currently provide our merchant customers with the following technology-based services: (1) performance-based advertising, including pay-per-click services, primarily through Enhance Interactive; and paid inclusion services, primarily through TrafficLeader; and (2) search marketing services, including advertising campaign management, conversion tracking and analysis, and search engine optimization, through TrafficLeader.

Enhance Interactive. Enhance Interactive provides performance-based advertising services to merchant advertisers, including pay-per-click services. Through Enhance Interactive's pay-per-click service, merchant advertisers create keyword listings that describe their product or service, which are marketed to millions of consumers and businesses primarily through search engine or directory results.

TrafficLeader. TrafficLeader provides performance-based advertising and search marketing services to merchant advertisers, including paid inclusion, advertising campaign management, conversion tracking and analysis, and search engine optimization. Through TrafficLeader's primary service, paid inclusion, TrafficLeader manages search-based advertising campaigns and services for merchant advertisers. TrafficLeader's paid inclusion service helps merchant advertisers, who have hundreds or even thousands of products, reach prospective customers by first indexing their product databases and creating highly relevant product listings and then placing these listings in front of potential customers, primarily through search engines. Merchant advertiser's product listings map directly to user search queries, which link to specific product or information pages when clicked. On behalf of merchant advertisers, TrafficLeader indexes these highly relevant listings into many of the Internet's most-visited search engines, product shopping engines, and directories.

Collectively, our operating businesses distribute advertisements and paid listings through hundreds of partners, including search engines, directories, product shopping engines and other Web sites.

In support of our partners and merchants, we devote resources to developing and building proprietary technology-based products and services that we believe are innovative and provide a high degree of utility. Additionally, we continually evaluate opportunities to evolve existing technologies and business models, and we regularly consider possible acquisitions and strategic relationships.

We were incorporated in Delaware on January 17, 2003. On February 28, 2003, we acquired eFamily together with its direct wholly-owned subsidiary Enhance Interactive. eFamily was incorporated in Utah on November 29, 1999, under the name FocusFilter.com, Inc. On October 24, 2003, we acquired TrafficLeader, which was incorporated in Oregon on January 24, 2000, under the name Sitewise Marketing, Inc.

From January 17, 2003 (inception) through February 28, 2003, we were involved in business and product development, as well as financing and acquisition initiatives. During this period we had no revenues.

Industry Overview

Internet-based transactions between consumers and merchants have grown rapidly in recent years. This growth is the result of decreasing price points of Internet access devices coupled with corresponding performance gains of such devices; a large installed base of personal computers in the workplace and homes; penetration of broadband technologies and increased Internet usage; and the emergence of compelling commerce opportunities and a growing awareness among consumers of the convenience and other benefits of online shopping.

Today's consumers are becoming increasingly confident that they can find comprehensive product information and securely transact online. This, combined with merchants' ability to more efficiently and effectively acquire and monetize customers, has led to a steady increase in online merchant transactions. We believe that the combination of these and other factors have significantly enhanced the effectiveness of the Internet as a mass commerce medium. We further believe that these characterizations are supported by the following industry estimates:

- **Growing Internet Population and Internet Penetration Levels**. *Morgan Stanley* estimates that global Internet users will grow at a compounded annual growth rate of 17% to 976 million by 2005 (representing 15% global population penetration), up from 609 million users at the end of 2002 (representing 10% global population penetration). *Morgan Stanley* also estimates that Internet users in North America will grow at a compounded annual growth rate of 11% to 242 million by 2005, up from 176 million users at the end of 2002.
- **Large Number of Small Businesses Operating Online**. According to *International Data Corporation (IDC)*, by the end of 2007, 77% of the 8.5 million small businesses in the United States (defined as firms with under 100 employees that are not based at home) will have Web sites, compared to 62% of the 8 million small businesses in 2003.
- **Growth of Electronic Commerce**. *Forrester Research* believes that electronic commerce activity in the United States, fueled by a steady stream of new online shoppers and new product category sales, will grow at a compounded annual growth rate of 19% over the next five years to nearly $230 billion in 2008 (representing 10% of total retail sales in the United States).
- **Growth of Online Advertising**. *U.S. Bancorp Piper Jaffray* estimates that online advertising in the United States will grow at a compounded annual growth rate of 19% from $6.7 billion in 2003 to more than $15 billion in 2008 (representing approximately 6% of total advertising spending, compared to approximately 2% of total advertising spending in 2003).
- **Growth of Performance-Based Advertising and Search Marketing**. *U.S. Bancorp Piper Jaffray* estimates that the global market for performance-based advertising and search marketing, such as pay-per-click listings and paid inclusion, will grow at a compounded annual growth rate of 38% from approximately $1.4 billion in 2002 to approximately $7 billion in 2007.
- **Growth in Certain Businesses that Support Online Merchants**. According to *IDC*, the Web hosting market in the United States will grow at a compounded annual growth rate of 15% from more than $5.1 billion in 2002 to $10.4 billion in 2007.

Given the preceding global Internet user and online commerce trends, we believe there is a significant, long-term opportunity to capture market share of online transactions, and services that support online transactions, through building a profitable, diversified global company that provides a wide range of technology-based services to merchants, including: online payment infrastructure; automated tools and services to facilitate transactions; promotional tools to market goods and services; and automated tools to manage and track all aspects of online transactions. On an ongoing basis, we intend to evaluate points in the merchant transactions value chain that will provide the greatest opportunity for us to build and acquire offerings with the following characteristics: growth, scalability, profitability and defensibility.

Strategy

We intend to leverage our senior management's experience, our financial and human resources, and our existing operating businesses to provide technology-based services for merchants engaged in online transactions. Key elements of our strategy include the following initiatives:

- ***Provide Quality Services in Support of Merchants and Partners***. We believe that providing high quality services makes us more attractive to merchants and partners. In addition to selected strategic acquisitions, we intend to expand our offerings through internal development initiatives to provide merchants and partners additional, value-added services. Specifically, we intend to expand our services by providing systems and information that help merchant advertisers maximize the performance of online marketing budgets; and to partners by working with them to develop and market new products. For example, we currently offer services that optimize and enhance a merchant advertiser's listing with a service that allows us to extract relevant product information from merchant advertisers' sites to create separate listings, an analytics service that calculates the effectiveness of an advertising campaign, and optimization services to improve performance within algorithmic search engines. We have developed these services to meet the needs of our merchant advertisers, and we expect to continue to develop technologies as their needs and those of the market continue to evolve.
- ***Increase the Number of Merchants Served.*** By providing merchants a consistently high level of service, support and ability to achieve their targeted return-on-investment thresholds, we strive to build merchant loyalty and deliver long-term value. We intend to increase our merchants served through:
  - direct sales force efforts for each of our operating companies, including strategic sales and telesales initiatives;
  - referral arrangements with entities that can promote our services to potential merchants;
  - trade show, seminar and conference attendance and sponsorships; and
  - the acquisition of complementary operating businesses and services.
- ***Continue to Innovate and Develop Proprietary Technologies and Intellectual Property.*** In support of our partners and merchants, we are building additional, proprietary products and services that we believe are innovative and provide a high degree of utility. We intend to invest our resources in identifying potential offerings that create or evolve new products, technologies and/or business models. We intend to continue to file patents as appropriate to protect such proprietary products and business models. We are building and intend to continue to build new technologies that are in line with these objectives.
- ***Pursue Selective Acquisition and Consolidation Opportunities*****.** We plan to selectively pursue strategic acquisition candidates. We apply rigorous evaluation criteria to acquisition candidates that are intended to help achieve our return-on-invested capital requirements, which we believe will translate into increased shareholder value. We do this through focusing on acquisition opportunities that represent a combination of the following characteristics:
  - underleveraged and/or under-commercialized assets;
  - opportunities for business model, product or service innovation and evolution;
  - critical mass of transactions volume, merchants, revenue and/or profits;

  - revenue growth and expanding margins and operating profitability (or the characteristics to achieve significant scale and profitability); and
  - an opportunity to enhance efficiencies and provide incremental growth opportunities for our operating businesses.

- ***Drive Increased Profitability through Revenue Growth and Operating Leverage***. We are focused on achieving consistent growth in a manner that promotes profitability. Our operating structure, internal operating initiatives and strategic acquisition initiatives are concentrated on building businesses with profit margins that increase as our revenue increases. As such, we invest our resources in new initiatives only after planning and analysis that outline targeted return-on-invested-capital parameters.
- ***Develop New Markets***. We will analyze opportunities and may seek to expand our technology-based services into new categories or new countries where our services can be replicated on a cost effective basis, or where the creation or evolution of a service may be appropriate. We anticipate utilizing various strategies to enter new markets, including: strategic relationships; acquiring products that address a new category or opportunity; acquiring country-specific properties; and creating joint venture relationships and internal initiatives where existing services can be extended internationally.

Operating Businesses

We currently deliver technology-based services through our operating companies, Enhance Interactive and TrafficLeader. Our current operating businesses are focused on supporting and building the businesses of our partners: our merchant advertisers focused on acquiring transactions and customers; and our distribution partners focused on building the number of advertisers and revenue opportunities within their networks. Specifically, our operating businesses deliver products and services in the performance-based advertising and search marketing industries, primarily focused on helping merchants market and sell their products and services via the Internet through the following technology-based services: (1) performance-based advertising, including pay-per-click services, primarily through Enhance Interactive; and paid inclusion, primarily through TrafficLeader; and (2) search marketing services, including advertising campaign management, conversion tracking and analysis, and search engine optimization, through TrafficLeader.

- ***Performance-Based Advertising***, primarily including pay-per-click and paid inclusion services. Each of these services enables merchants to reach their target audience through search and directory results. The key difference between the common implementation of these services is whether payment by a merchant advertiser influences the rank of its listing within the applicable search or directory results.
  - *Pay-Per-Click Services.* With pay-per-click services, merchant advertisers purchase keywords based on an amount they choose for a targeted placement, usually within search engine results. In this model, the advertiser drives pricing.
  - *Paid Inclusion Services.* With paid inclusion services, merchant advertisers pay for their Web pages and product databases to be crawled, or searched, and indexed and included primarily within search engine and shopping engine results. Generally, the paid inclusion results are presented separately from the pay-per-click results. In this model, pricing is generally driven by the distribution partner, and does not affect placement in search results; rather, listings are generally ranked based on relevancy as determined by the partner search engine.

    We believe that paid inclusion is an important complement to the algorithmic search technologies that determine the ranking of results within many of the major search engines (such as AltaVista, Ask Jeeves, Google and Inktomi), since merchant advertisers typically provide paid inclusion technology companies direct access to their internal product databases. Often, only once a paid inclusion company has crawled, replicated and optimized hundreds or thousands of individual product and informational Web pages for a merchant advertiser do links to these pages appear within search engine results. The indexing and subsequent listing of these Web pages made possible by paid inclusion companies enhances the overall relevancy of the search engines with which the company partners.

- ***Search Marketing***, designed for merchant advertisers who are focused on acquiring customers through search-based marketing methods, optimizing the performance of their campaigns through tracking and analyzing historical results, and refining their Web sites for increased relevance in algorithmic search engine indexes. These services include advertising campaign management, conversion tracking and analysis, and search engine optimization. We believe that businesses may benefit from the search marketing services we provide to enhance the performance of their advertising campaigns.

Enhance Interactive

Enhance Interactive provides performance-based advertising services, including pay-per-click listings, to merchant advertisers. Through Enhance Interactive, merchant advertisers market their products and services to millions of consumers and businesses through targeted pay-per-click listings that are primarily found in the form of search engine or directory results when a user searches for information, products or services. For the quarter ended December 31, 2003, Enhance Interactive processed more than 4 billion search queries. Enhance Interactive also delivers other advertising services such as banner advertising, branded advertisements that include a merchant advertiser logo associated with its advertisements (LogoLinks™ program), and paid inclusion services.

Merchant Advertising on Enhance Interactive. The pay-per-click results sold and distributed by the Enhance Interactive service are prioritized for users by the amount the merchant advertiser is willing to pay each time a user clicks on the merchant's advertisement. Merchant advertisers pay Enhance Interactive when a click-through occurs on their advertisement.

Enhance Interactive provides services to thousands of merchant advertisers who want to drive consumers and customer leads to their Web sites. Potential merchant advertisers find Enhance Interactive directly, through contact by our telesales force, through direct sales efforts, through third-party referral programs, and through a variety of marketing activities that include trade shows, targeted mailings, e-mails and other promotional material sent directly to merchant advertisers, advertising agencies and search engine marketers.

When Enhance Interactive merchant advertisers submit advertisement listings to the Enhance Interactive service, Enhance Interactive reviews them for relevance and for conformity with our editorial guidelines. Merchant advertisers participate only in markets that are relevant to their Web site and product or service offerings. Enhance Interactive may also assist merchant advertisers in optimizing their advertisement campaigns by recommending relevant keywords available to them based on their Web sites and product or service offerings.

Distribution on Enhance Interactive. Enhance Interactive distributes merchant advertisements through hundreds of partners, including search engines, directories and other Web sites. The economic arrangements with Enhance Interactive's distribution partners vary and may include:

- payment by Enhance Interactive based on a specified percentage of revenue generated;
- payment by Enhance Interactive based on a fixed click-through price; and
- combinations of the foregoing.

As of February 16, 2004, Enhance Interactive had arrangements for inclusion of its pay-per-click results and advertisements on four of the top 25 most visited Internet properties according to the December 2003 report of *comScore MediaMetrix*.

TrafficLeader

TrafficLeader provides performance-based advertising and search marketing services to merchant advertisers, including paid inclusion, advertising campaign management, conversion tracking and analysis, and search engine optimization.

- *Paid Inclusion*. TrafficLeader's paid inclusion program delivers targeted advertiser listings into some of the Internet's most-visited search engines. Paid inclusion leverages proprietary technology to crawl and extract relevant product data and content from a merchant advertiser database and Web site, and create highly relevant, optimized Uniform Resource Locator (URL) strings and advertisement listings.

Increased listing relevancy frequently translates into a better search experience for users, allowing them to find targeted results in response to their search queries; and better return-on-investment for merchant advertisers, as higher relevance typically leads to increased click-through rates and customer acquisition rates.

Once TrafficLeader's technology has crawled, extracted, optimized and refined the merchant advertiser URL strings and advertisement listings, such strings and listings are automatically tagged and placed into partner search and directory indexes. These URL strings and listings map directly to user search queries, which link back to specific product pages when clicked. We believe that this process typically leads to high advertiser conversion rates or customer acquisitions. As TrafficLeader's merchant advertisers typically have dynamically-updating product databases, TrafficLeader frequently refreshes merchant advertisers' listings to ensure that the most up-to-date product information and/or content is available to TrafficLeader's partners. Merchant advertiser URL strings and advertisement listings are typically ordered based on relevance to the user search query. Merchant advertisers pay TrafficLeader a fixed price for each click received on their URL string and advertisement listing.

Additionally, through leveraging proprietary technology, TrafficLeader analyzes an advertiser's database as well as thousands to millions of actual, relevant user search queries to create additional, unique merchant advertiser listings that drive targeted traffic resulting in highly competitive conversion, or customer acquisition, rates. These additional, unique listings are generally included as part of TrafficLeader's basic paid inclusion service.

- *Search Engine Data Feed Creation.* TrafficLeader also promotes a self-managed paid inclusion service, FeedWorks. FeedWorks is a technology-based service that extracts all relevant data from a merchant advertiser's database and Web site, autonomously generates properly structured data feeds, and then provides the merchant advertiser with those feeds, which the merchant advertiser may then submit into search engine indexes.
- *Conversion Tracking and Analysis.* TrafficLeader's Web analytics service, Real Performance Measurement (RPM), allows merchant advertisers to calculate the effectiveness of paid inclusion and performance-based advertising campaigns. Through RPM, merchant advertisers examine which URL strings and advertisement listings are converting to sales and which are not; and identify future opportunities based on this data.
- *Advertising Campaign Management.* TrafficLeader's Preferred Placement program is an advertising campaign management service that continuously tracks, monitors and optimizes the placement of performance-based search advertising campaigns for merchant advertisers across a number of performance-based search advertising engines.
- *Search Engine Optimization.* TrafficLeader also offers search engine optimization services, Site Centric Services. Site Centric Services help merchant advertisers better organize and design their Web sites so their listings are optimized on the algorithmic search engines, such as AltaVista, Ask Jeeves (Teoma), Google, LookSmart (WiseNut), and Yahoo! (Inktomi).

Merchant Advertising on TrafficLeader. TrafficLeader primarily attracts merchant advertisers that have product databases, want to increase their online sales, and want to achieve target return-on-investment metrics. Potential merchant advertisers find TrafficLeader directly, through a variety of means, including contact by our direct sales staff, through marketing efforts such as trade shows or advertising, and through third-party referral programs.

Distribution on TrafficLeader. TrafficLeader distributes merchant advertiser URL strings and advertisement listings through distribution partners, including search engines and product shopping engines. The economic arrangements with TrafficLeader's partners vary and may include:

- payment by TrafficLeader based on a specified percentage of revenue;
- payment by TrafficLeader based on a fixed click-through price; and
- combinations of the foregoing.

For example, current agreements with certain Yahoo! subsidiaries contain mutual termination clauses and are primarily structured on a variable-payment basis, under which we make payments based on a specified percentage of revenue or based on the number of paid click-throughs.

As of February 16, 2004, TrafficLeader's results appeared on a majority of the top 10 most visited Internet properties according to the December 2003 report of *comScore MediaMetrix*.

Sales, Business Development, Marketing, Advertising and Promotion

As of February 16, 2004, we had 39 full-time employee equivalents in our sales departments, including 32 at Enhance Interactive, and seven at TrafficLeader; 12 full-time employee equivalents in our business development departments, including seven at Enhance Interactive and four at TrafficLeader; and five full-time employee equivalents in our marketing departments, including four at Enhance Interactive. Our sales departments currently focus on adding new merchant advertisers to our operating businesses, while our business development departments are currently directed to service existing distribution partnerships and selectively add new distribution partners. Our marketing departments focus on promoting our operating businesses through affiliate relationships, press coverage, industry exposure, and trade shows. Our advertising and promotion of our services is broken into four main categories: direct sales, agency sales, online promotion, and referral agreements.

- Direct Sales: Our sales staff targets new merchant advertiser relationships through telesales efforts, direct marketing, and attendance and sponsorship at various trade shows and conferences.
- Agency Sales: Our agency program includes a group within the sales team that targets interactive agencies and other entities that service merchant advertisers. This sales group focuses on in-person and remote presentations of our services to agencies, and is also periodically engaged in various marketing initiatives at industry trade shows and conferences. Our agency agreements may include a combination of revenue sharing, performance-based fees and other costs.
- Online Promotion: We engage in certain advertising and direct marketing focused on acquiring new merchant advertisers and new distribution partners.
- Referral Agreements: We seek to build referral arrangements with entities that can promote our services to large numbers of potential advertisers. Our referral partner agreements are based on a combination of revenue sharing and performance-based fees.

We intend to continue our strategy of growing our merchant advertiser base through sales and marketing programs while being as efficient as possible in terms of our marketing and advertising costs. We continually evaluate our marketing and advertising strategies to maximize the effectiveness of our programs and their return on investment.

Information Technology and Systems

We have a proprietary technology platform for the purposes of managing and delivering advertisements to our partners. We also combine third party licenses and hardware to create an operating environment that focuses on quality products and services, with such features as automated online customer purchasing, real-time customer support and interactive reporting for customers and partners. We employ commercially available technologies and products distributed by various companies, including Cisco, Dell, Intel, Microsoft, Sun Microsystems and Veritas. We also utilize public domain software such as Apache, Linux, MySQL, Sun Microsystems Java, and Tomcat.

Our technology platform must be compatible with the systems used by our distribution partners, enabling us to deliver advertisement listings in rapid response to user queries made through such partners. We continue to build and innovate additional functionality to attempt to meet the quickly evolving demands of the marketplace. We devote significant financial and human resources to improving our merchant and partner experiences by continuing to develop our technology infrastructure. The cost of developing our technology solutions is included in the overall cost structure of our services and is not separately funded by any individual merchants or partners.

In order to maintain a professional level of service and availability, we primarily rely upon third parties to provide hosting services, including hardware support and service, and network monitoring. Our servers are configured for high availability and large volumes of Internet traffic and are located in leased third-party facilities. Back-end databases make use of redundant servers and data storage arrays. We also have standby servers that provide for additional capacity as necessary. The facilities housing our servers provide redundant HVAC, power and Internet connectivity.

We continuously review ways to improve major aspects of our technology support and maintenance, including improving, upgrading and implementing business continuity plans, data retention initiatives, and backup and recovery processes.

Competition

Many of our potential competitors, as well as potential entrants into our target markets, have longer operating histories, larger customer or user bases, greater brand recognition and greater financial, marketing and other resources than we have. Many current and potential competitors can devote substantially greater resources than we can to promotion, Web site and systems development. In addition, currently and in the future as the use of the Internet and other online services increases, there will likely be larger, more well-established and well-financed entities that acquire companies relevant to our business strategy; and invest in or form joint ventures in categories or countries relevant to our business strategy; all of which could adversely impact our business. Any of these trends could increase competition, reduce the demand for any of our services and could have a material adverse effect on our business, operating results and financial condition.

We, as well as our operating companies, pursue a strategy that we believe allows us to work with all relevant companies in the industry, even those companies that some people or entities may perceive as our competitors. We intend to continue with a strategy that allows us to consider and pursue business arrangements with all companies in our industry.

We provide our services to: (i) merchant advertisers who acquire advertisement inventory through Enhance Interactive or TrafficLeader; (ii) partners who provide said inventory; and (iii) other intermediaries who may provide purchase and/or sales opportunities, including advertising agencies, search engine marketing companies and search engine optimization companies. Our operating businesses depend on maintaining and continually expanding their network of partners and merchants to generate transactions. As a result, we may compete with those who:

- sell performance-based advertising or search marketing services to merchants;
- aggregate or optimize advertising inventory for distribution through search engines, product shopping engines, directories, Web sites or other outlets; or
- provide destination Web sites or other distribution outlets that reach end users or customers of the merchants.

The industry defined by the sale of online advertising and marketing services is highly competitive. Although overall Internet advertising expenditures have increased in the last few years, the advertising industry has suffered in certain respects as many online businesses have ceased operations and many traditional businesses have scaled back their advertising budgets. In addition, we believe that today’s typical Internet advertiser is becoming more sophisticated regarding the different forms of Internet advertising, how to purchase Internet advertising in a cost-effective manner, and return-on-investment measurement. The competition for this pool of advertising dollars has also put downward pressure on pricing points, and online advertisers have demanded more effective means of reaching customers. We believe that these factors have contributed to the growth in performance-based advertising relative to certain other forms of online advertising and marketing, and as a result this sector has attracted many competitors.

Due to the long-term growth trends in online advertising, these competitors, real and potential, range in size and focus. Our competitors may include such diverse participants as small referral companies, established advertising agencies, inventory resellers, search engines, and destination Web sites. To some extent, we may compete with our business partners, as we do with all other types of advertising sales companies and agencies. Furthermore, to a more limited extent, we may also compete with traditional offline media such as television, radio and print and direct marketing companies, for a share of merchant advertisers' total advertising budgets. Although we pursue a strategy that enables us to work with most, if not all, of our competitors, there are no guarantees that all companies will view us as a potential partner.

We are also affected by the competition among destination Web sites that reach users or customers of search services. Several large media and search engine companies dominate this end of the transaction channel, although thousands of other smaller outlets are available to customers as well. User traffic among the media and search engine companies is concentrated among such larger participants as AOL, Google, Microsoft through MSN Search, and Yahoo! through FAST, Inktomi, Overture and Yahoo! Search. The online search industry continues to experience consolidation of major Web sites and search engines, which has the effect of increasing the negotiating power of these parties in relation to smaller providers. The major destination Web sites and distribution providers may have leverage to demand more favorable contract terms, such as pricing, renewal and termination provisions.

We expect competition to intensify in the future as new competitors can enter our market with little difficulty. The barriers to entering our market are relatively low. In fact, many current Internet and media companies presently have the technical capabilities and advertiser bases to enter the search marketing services industry. Further, if the consolidation trend continues among the larger media and search engine companies with greater brand recognition, the share of the market remaining for us and other smaller search marketing services providers could decrease, even though the number of smaller providers could continue to increase. These factors could adversely affect our competitive position and relatively small market share in the search marketing services industry.

Intellectual Property and Proprietary Rights

We seek to protect our intellectual property through existing laws and regulations and by contractual restrictions. We rely upon trademark, patent and copyright law, trade secret protection and confidentiality or license agreements with our employees, customers, partners and others to help us protect our intellectual property.

Our technologies involve a combination of proprietary rights, owned and developed by us, commercially available software and hardware elements that are licensed or purchased by us from various providers, including Cisco, Dell, Intel, Microsoft, Sun Microsystems and Veritas, and public domain software, such as Apache, Linux, MySQL, Sun Microsystems Java and Tomcat. We continue to develop additional technologies to update, supplement and replace existing components of the platform. We intend to protect these additional intellectual property rights through patent applications and trade secret enforcement.

Our policy is to apply for patents or for other appropriate statutory protection when we develop valuable new or improved technology. We currently do not have any registered patents. We have filed two patent applications with the U.S. Patent and Trademark Office for various aspects of our transaction technologies and services, with the following titles, numbers and descriptions:

- US Provisional Patent Application Serial Number 60/504,963, of Horowitz et al., entitled "Performance-Based Online Advertising System and Method," was filed on September 23, 2003 and is currently pending. This patent application describes a system, method, and computer program product for implementing an online, performance-based service for advertisers that provides the ability for advertisers to purchase various advertising products.
- US Provisional Patent Application Serial Number 60/523,688, of Horowitz et al., entitled "Online Advertising System and Method," was filed on November 21, 2003 and is currently pending. This patent application describes an online advertising system, method, and computer program product configured to present an advertiser with keyword-driven pricing for advertisements.

The status of any patent involves complex legal and factual questions. The scope of allowable claims is often uncertain. As a result, we cannot be sure that any patent application filed by us will result in a patent being issued, nor that any patents issued in the future will afford adequate protection against competitors with similar technology; nor can we provide assurance that patents issued to us will not be infringed upon or designed around by others. Furthermore, the performance-based search advertising industry has been the subject of numerous patents and patent applications, which in turn has resulted in litigation. The outcome of this ongoing litigation or any future claims in this sector may adversely affect our business or financial prospects.

We have been issued registered trademarks in the United States covering certain goods and services for “TrafficLeader,” “Sitewise” and “Direct Search Inclusion.” We have applied for registered trademark status for “Marchex” and “Enhance Interactive.” We do not know whether we will be able to successfully defend our proprietary rights since the validity, enforceability and scope of protection of proprietary rights in Internet-related industries are uncertain and still evolving.

Government Regulation

We are subject to governmental regulation much like many other companies. There are still relatively few laws or regulations specifically addressed to the Internet. As a result, the manner in which existing laws and regulations should be applied to the Internet in general, and how they relate to our businesses in particular, is unclear in many cases. Such uncertainty arises under existing laws regulating matters, including user privacy, defamation, pricing, advertising, taxation, gambling, sweepstakes, promotions, content regulation, quality of products and services, and intellectual property ownership and infringement.

To resolve some of the current legal uncertainty, we expect new laws and regulations to be adopted that will be directly applicable to our activities. Any existing or new legislation applicable to us could expose us to substantial liability, including significant expenses necessary to comply with such laws and regulations, and could dampen the growth in use of the Internet in general.

Several new federal laws that could have an impact on our business have already been adopted. The Digital Millennium Copyright Act is intended to reduce the liability of online service providers for listing or linking to third party Web sites that include materials that infringe copyrights or rights of others. The Children’s Online Protection Act and the Children’s Online Privacy Protection Act are intended to restrict the distribution of certain materials deemed harmful to children and impose additional restrictions on the ability of online services to collect user information from minors. In addition, the Protection of Children from Sexual Predators Act requires online services providers to report evidence of violations of federal child pornography laws under certain circumstances.

The foregoing legislation may impose significant additional costs on our business or subject us to additional liabilities, if we were not to comply fully with their terms, whether intentionally or not. If we did not meet the safe harbor requirements of the Digital Millennium Copyright Act, we could be exposed to copyright actions, which could be costly and time-consuming. The Children’s Online Protection Act and the Children’s Online Privacy Protection Act impose fines and penalties to persons and operators that are not fully compliant with their requirements. The federal government could impose penalties on those parties that do not meet the full compliance practices of the Protection of Children from Sexual Predators Act. We intend to fully comply with the laws and regulations that govern our industry, and we employ internal resources and incur outside professional fees to establish, review and maintain policies and procedures to reduce the risk of noncompliance.

We post our privacy policy and practices concerning the use and disclosure of any user data on our Web sites. Any failure by us to comply with posted privacy policies, Federal Trade Commission requirements or other domestic or international privacy-related laws and regulations could result in proceedings by governmental or regulatory bodies that could potentially harm our businesses, results of operations and financial condition. In this regard, there are a large number of legislative proposals before the U.S. Congress and various state legislative bodies regarding privacy issues related to our businesses. It is not possible to predict whether or when such legislation may be adopted, and certain proposals, if adopted, could harm our business through a decrease in user registrations and revenue. These decreases could be caused by, among other possible provisions, the required use of disclaimers or other requirements before users can utilize our services.

Table of Contents

Employees

As of February 16, 2004, we employed a total of 170 full-time employee equivalents. We have never had a work stoppage, and none of our employees are represented by a labor union. We consider our employee relationships to be positive. If we were unable to retain our key employees or we were unable to maintain adequate staffing of qualified employees, particularly during peak sales seasons, our business would be adversely affected.

Properties

We do not own property. Our corporate offices are located at 2101 Fourth Avenue, Suite 1980, Seattle, Washington, and are comprised of approximately 8,453 square feet leased under sublease and lease agreements expiring in June 2006 and April 2004 respectively, at a combined monthly rental of $15,123. Our Enhance Interactive offices are located at 360 West 4800 North, Provo, Utah, and are comprised of approximately 13,050 square feet under a sublease agreement expiring in May 2005, at a monthly rental of $16,802. Additionally, our TrafficLeader offices are located at 2986 Crescent Avenue, Eugene, Oregon, and are comprised of approximately 6,725 square feet leased under sublease and lease agreements expiring in July 2004 and October 2004 respectively, at a combined monthly rental of approximately $9,572 per month.

In February 2004, we entered into a $2.3 million commitment for additional office space in Seattle, Washington, and this commitment extends through 2009. Beginning in March 2004, the commitment provides for the leasing of 11,400 square feet of office space at $16,150 per month, increasing to 26,788 square feet at $37,950 per month, over the term of the commitment ending in 2009.

Our information technology systems are hosted and maintained in third-party facilities under colocation services agreements. See “Information Technology and Systems.”

Legal Proceedings

We are not currently a party to any material legal proceeding and, to the best of our knowledge, none is threatened. From time to time, however, we may be subject to legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of intellectual property rights, and a variety of claims arising in connection with our services.

Table of Contents

MANAGEMENT

Executive Officers and Directors

Our executive officers and directors, their ages and their positions are as follows.

Name	Age	Position(s)
Russell C. Horowitz	37	Chairman of the Board of Directors, Chief Executive Officer and Treasurer
Michael A. Arends	33	Chief Financial Officer
Ethan A. Caldwell	35	Chief Administrative Officer, General Counsel and Secretary
Peter Christothoulou	32	Chief Strategy Officer
John Keister	37	President, Chief Operating Officer and Director
Walter Korman	30	Senior Vice President of Engineering
Victor Oquendo	31	Senior Vice President of Technology Operations
Dennis Cline (1) (2)	43	Director
Jonathan Fram (1) (2)	47	Director
Rick Thompson (1) (2)	44	Director

(1) Member of the Audit Committee.
(2) Member of the Nominating and Governance Committee.

Russell C. Horowitz. Mr. Horowitz is a founding officer and has served as the Chairman of our board of directors, Chief Executive Officer and Treasurer since our inception in January 2003. From January 2001 to December 2002, Mr. Horowitz and our founding officers jointly reviewed new business opportunities in the retail, media, finance and technology industries. Mr. Horowitz was previously a founder of Go2Net, a provider of online services to merchants and consumers, including online payment authorization technology, Web search and directory services and merchant web hosting, and served as its Chairman and Chief Executive Officer from its inception in February 1996 until its merger into InfoSpace, a provider of online services focused on Web search, online payment solutions for merchants, mobile infrastructure applications and content for wireless carriers, in October 2000, at which time Mr. Horowitz served as the Vice Chairman and President of the combined company through the merger integration process until January 2001. Additionally, Mr. Horowitz served as the Chief Financial Officer of Go2Net from its inception until May 2000. Prior to Go2Net, Mr. Horowitz served as the Chief Executive Officer and a director of Xanthus Management, LLC, the general partner of Xanthus Capital, a merchant bank focused on investments in early-stage companies, and was a founder and Chief Financial Officer of Active Apparel Group, now Everlast Worldwide. Mr. Horowitz received a B.A. in Economics from Columbia College of Columbia University.

Michael A. Arends. Mr. Arends has served as our Chief Financial Officer since May 2003. Prior to joining Marchex, Mr. Arends held various positions at KPMG since 1995, most recently as a Partner in KPMG’s Pacific Northwest Information, Communications and Entertainment assurance practice. Mr. Arends is a Certified Public Accountant and a Chartered Accountant and received a Bachelor of Commerce from the University of Alberta.

Ethan A. Caldwell. Mr. Caldwell is a founding officer and has served as our Chief Administrative Officer, General Counsel and Secretary since our inception in January 2003. From January 2001 to December 2002, Mr. Caldwell reviewed, together with the other founding officers, new business opportunities in the retail, media, finance and technology industries. Mr. Caldwell was previously Senior Vice President, General Counsel and Corporate Secretary of Go2Net, from November 1996, until its merger with InfoSpace in October 2000. Mr. Caldwell assisted in the integration of Go2Net with InfoSpace through December 2000. Mr. Caldwell received his J.D. from the University of Maryland and his B.A. in Political Science from Occidental College.

Peter Christothoulou. Mr. Christothoulou is a founding officer and has served as our Chief Strategy Officer since our inception in January 2003. From January 2001 to December 2002, Mr. Christothoulou reviewed, together with the other founding officers, new business opportunities in the retail, media, finance and technology industries. Mr. Christothoulou was previously the Senior Vice President of Strategic Initiatives for Go2Net, focused on strategic acquisitions and investments, from January 2000 until its merger with InfoSpace in October 2000, at which time he served as the Senior Vice President of Corporate Strategy and Development of the combined company through the merger integration process until January 2001. Prior to Go2Net, Mr. Christothoulou was a Vice President in the Investment Banking Group of U.S. Bancorp Piper Jaffray, focused primarily on merger and acquisition advisory services for technology companies, and was with the investment banking firm from 1996 until January 2000. Mr. Christothoulou received a B.A. in Economics from the University of Washington.

John Keister. Mr. Keister is a founding officer and has served as our Chief Operating Officer and as a member of our board of directors since our inception in January 2003, and as our President since December 2003. From February 2001 to December 2002, Mr. Keister reviewed, together with the other founding officers, new business opportunities in the retail, media, finance and technology industries. Mr. Keister was previously a founder of Go2Net and served as its President from 1999 until its merger into InfoSpace in October 2000, at which time he served as Executive Vice President of the Consumer Division through the merger integration process until January 2001. He also served as a member of the board of directors of Go2Net and as its Chief Operating Officer from 1996 to 1999. Mr. Keister received B.A. degrees in Philosophy and in Diplomacy & World Affairs from Occidental College.

Walter Korman. Mr. Korman has been an executive in our technology organization since March 2003, and currently serves as Senior Vice President of Engineering. Mr. Korman was previously Director of Technology Mergers and Acquisitions at Go2Net from 1999 until its merger with InfoSpace in October 2000, after which he served as the combined company’s Senior Director of Operations Integration until June 2001. From 2001 to February 2003, he was a Software Engineer with Three Rings Design, an Internet games development company. Mr. Korman received a B.A. and M.S. in Computer Science from the University of California, San Diego.

Victor Oquendo. Mr. Oquendo is a founding officer and has been a leader of our technology organization since our inception in January 2003, and currently serves as Senior Vice President of Technology Operations. From January 2001 to January 2003, Mr. Oquendo reviewed, together with the other founding officers, new business opportunities in the retail, media, finance and technology industries. Mr. Oquendo was previously the Senior Vice President of Technology for Go2Net from 1998 until its merger with InfoSpace in October 2000, at which time he served as the combined company’s Senior Vice President of Technology Operations through the merger integration process until January 2001. Mr. Oquendo received a B.S. in Computer Science from the Rose-Hulman Institute of Technology.

Dennis Cline. Mr. Cline has served as a member of our board of directors since May 2003. Mr. Cline is currently the managing partner of DMC Investments, a firm he founded in 2000, which provides capital and consulting services to technology companies. From 1998 to 2000, Mr. Cline was the Chief Executive Officer of DirectWeb, a provider of a bundled solution of computer hardware and Internet access for consumers. Prior to DirectWeb Mr. Cline was a senior executive at Network Associates, a provider of computer security solutions. Mr. Cline received his J.D. from Rutgers School of Law and his B.A. from Rutgers University.

Jonathan Fram. Mr. Fram has served as a member of our board of directors since May 2003. Mr. Fram currently serves as a consultant to companies that provide media and voice services over the Internet. From May 2002 through December 2003, Mr. Fram was the CEO for Envivio, a privately-held company, where he remains a member of the board of directors, a provider of MPEG-4 broadcast and streaming solutions. From October 2001 to May 2002, Mr. Fram was the Acting CEO of Envivio while he was a consultant to France Telecom, Envivio’s majority shareholder at that time. From August 2000 to July 2001, Mr. Fram was the President and CEO of eVoice, an online voicemail and unified messaging provider, until its sale to America Online in July 2001. Prior to eVoice from July 1999 to August 2000, Mr. Fram was the President of Net2Phone, a provider of voice services over IP networks, until AT&T acquired a controlling interest in the company. Prior to Net2Phone, from 1991 to 1999, Mr. Fram was a General Manager at Bloomberg, responsible for the Television, Internet and Radio divisions. Mr. Fram received a B.S. degree in Electrical Engineering and Computer Science from Princeton University.

Rick Thompson. Mr. Thompson has served as a member of our board of directors since May 2003. Mr. Thompson has been the Vice President for the Extended Windows Platform Group at Microsoft since December 2002. From February 2001 to November 2002, Mr. Thompson was a business consultant to retail automotive, packaged goods and health and fitness companies. From May 2000 through January 2001, Mr. Thompson was the CFO and EVP for Product Development for Go2Net. Prior to Go2Net, from 1987 through 2000, Mr. Thompson was the Vice President of Hardware for Microsoft. Mr. Thompson received B.A. degrees in Economics and in French from Bates College.

Election of Directors and Officers

Our board of directors currently consists of the following five members: (i) Russell C. Horowitz (Chairman), (ii) John Keister, (iii) Dennis Cline, (iv) Jonathan Fram and (v) Rick Thompson. Messrs. Horowitz and Keister are the only management members of our board of directors and were selected as directors pursuant to a voting provision in the stockholders' agreement that will automatically terminate upon the closing of this offering. Messrs. Cline, Fram and Thompson are independent directors as defined by the applicable rules of the National Association of Securities Dealers, Inc. listing standards. We refer to these directors as our "independent directors." There are no family relationships among any of our directors and executive officers.

The directors are elected at each annual meeting of stockholders to serve until their successors have been duly elected and qualified, or until their earlier resignation or removal, if any. Executive officers are appointed by, and serve at the discretion of, the board of directors.

Board Committees

Audit Committee

The audit committee of our board of directors is comprised of Messrs. Cline, Fram and Thompson, each of whom is an independent director. The audit committee shall act pursuant to a formal charter adopted by the board, which will be available on our Web site. The audit committee reviews, with our independent auditors, the scope and timing of the auditors' services, the auditors' report on our consolidated financial statements following completion of the audit, and our internal accounting and financial control policies and procedures. In addition, the audit committee makes annual recommendations to the board of directors for the appointment of independent auditors for the ensuing year. The board has determined that each of the members of the audit committee qualifies as an "audit committee financial expert" as that term is defined in accordance with the Securities and Exchange Act of 1934 and the Sarbanes-Oxley Act of 2002 and that each also satisfies related NASDAQ finance or accounting experience requirements. Mr. Thompson currently serves as the chairman of the audit committee.

Compensation Committee

Prior to the consummation of the offering, our board of directors shall establish a compensation committee comprised of at least two persons among Messrs. Cline, Fram and Thompson, each of whom is an independent director. The compensation committee will act pursuant to a formal charter to be adopted by the board, which will be available on our Web site. At such time, the compensation committee shall review and evaluate the compensation and benefits of all of our officers, including the compensation of our CEO, review general policy matters relating to compensation and employee benefits, and make recommendations concerning these matters to our board of directors. The compensation committee shall also administer our stock incentive plan and our employee stock purchase plan. For a more detailed description of our stock incentive plan, please see "Benefit Plans."

Nominating and Governance Committee

The nominating and governance committee is comprised of Messrs. Cline, Fram and Thompson, each of whom is an independent director. The nominating and governance committee shall act pursuant to a formal charter adopted by the board, which will be available on our Web site. The nominating and governance committee identifies individuals qualified to become board members, recommend to the board those persons to be nominated by the board of directors as directors at the annual meeting of stockholders, develop and recommend to the board a set of corporate governance principles applicable to our company and oversee the evaluation of the board and management. Mr. Fram currently serves as the chairman of the nominating and governance committee.

Our board of directors may establish other committees it deems necessary or appropriate from time to time.

Code of Conduct and Code of Ethics

We have adopted a code of conduct applicable to each of our officers, directors and employees, and a code of ethics applicable to our Chief Executive Officer and our senior financial officers, as contemplated by Section 406 of the Sarbanes-Oxley Act of 2002 and will include both codes on our Web site at *www.marchex.com*. We will disclose any amendments to, or waivers from, any provisions of either our code of conduct or our code of ethics on a Form 8-KSB filed with the Securities and Exchange Commission and on our Web site by posting such information within five days after such amendment or waiver.

Corporate Governance Guidelines

Prior to the consummation of the offering, our board of directors will adopt corporate governance guidelines to ensure effective corporate governance. These guidelines will also provide that our independent directors shall meet regularly (not less than two times per year) in executive session at which only our independent directors shall be present.

Compensation of Directors

Our directors currently do not receive cash compensation for their services as members of the board of directors. Directors are, however, reimbursed for the expenses they incur in attending meetings of the board of directors or board of director committees. We have granted a non-qualified stock option pursuant to our stock incentive plan to purchase 40,000 shares of our Class B common stock, at an exercise price of $3 per share and with vesting in equal annual increments on the first, second, third and fourth anniversaries of their respective dates of board service, to each of Messrs. Cline, Fram and Thompson.

Compensation Committee Interlocks and Insider Participation

No interlocking relationship exists between any proposed member of our compensation committee and any member of any other company's board of directors or compensation committee. Members of the compensation committee will not receive additional compensation other than the compensation noted above that they received pursuant to becoming members of the board of directors. See "Security Ownership of Certain Beneficial Owners and Management" and "Certain Relationships and Related Transactions" for a summary of the holdings, rights and transactions of these members with respect to our shares of our Class B common stock.

EXECUTIVE COMPENSATION

The following table sets forth the compensation earned by our Chief Executive Officer and our Chief Financial Officer for services rendered in all capacities during the period from our inception, January 17, 2003, to December 31, 2003. No other executive officer's total annual salary and bonus for 2003 exceeds $100,000. We refer to these executives as our "named executive officers" elsewhere in this prospectus.

Summary Compensation Table

	2003 Compensation			Long-term Compensation
Name and Principal Position	Salary	Bonus	All other compensation	Securities Underlying Options
Russell C. Horowitz (Chief Executive Officer)(1)	$ 39,712	0	*	0
Michael A. Arends (Chief Financial Officer)(2)	$ 104,000	0	*	450,000

(1) Mr. Horowitz was not paid a salary for the period from January 17, 2003 (inception) through March 16, 2003, and his salary compensation commenced as of March 17, 2003.

(2) Mr. Arends joined Marchex as of May 1, 2003, and his salary compensation commenced as of that date.

* No other compensation in excess of the lesser of either $50,000 or 10% of total annual salary and bonus.

The following table sets forth information with respect to stock options granted to our named executive officers during the period from our inception, January 17, 2003, to December 31, 2003.

Option Grants

Name	Number of Securities underlying options granted	Percentage of Total Options Granted to Employees	Exercise Price Per Share	Expiration Date
Russell C. Horowitz	0	0%	N/A	N/A
Michael A. Arends	350,000	11.3%	$3.00	5/1/2013
	100,000	3.3%	IPO price	5/1/2013
	450,000	14.6%		

The following table sets forth information regarding unexercised options held as of December 31, 2003, by our named executive officers. There was no public trading market for our Class B common stock as of December 31, 2003. Accordingly, these values have been calculated on the basis of an assumed initial public offering price of $6.50, which represents the middle of the filing range as of the date of this prospectus, less the applicable exercise price per share, multiplied by the number of shares issued or issuable, as the case may be, on the exercise of the option.

Aggregate Option Exercises/Option Values

	Number of Shares Acquired on Exercise		Number of Securities Underlying Unexercised Options At December 31, 2003		Value of Unexercised In-the-Money Options At December 31, 2003	
Name	Exercised	Value Realized	Exercisable	Unexercisable	Exercisable	Unexercisable
Russell C. Horowitz	N/A	N/A	N/A	N/A	N/A	N/A
Michael A. Arends	N/A	N/A	33,333	416,667	116,667	1,108,335

Employment Contract with Named Executive Officers

Russell C. Horowitz

We have entered into an Executive Employment Agreement with Russell C. Horowitz, our Chief Executive Officer, effective as of January 17, 2003. The agreement with Mr. Horowitz provides for an at-will employment term and an annual base salary of $50,000. Mr. Horowitz has signed our standard confidentiality agreement, which provides, among other things, that Mr. Horowitz will not compete with us for twelve months following termination of his employment.

Michael A. Arends

We have also entered into an Executive Employment Agreement with Michael A. Arends, our Chief Financial Officer, effective as of May 1, 2003. The agreement with Mr. Arends provides for an at-will employment term and an initial annual base salary of $156,000, which will be adjusted to $135,000 upon the closing of a qualified initial public offering with gross proceeds to us in excess of $20 million.

Under the agreement, Mr. Arends was granted a stock option to purchase 350,000 shares of Class B common stock at an exercise price of $3.00, subject to a four-year vesting schedule, 166,665 shares of which are designated as an incentive stock option and the remainder of which are designated as a non-qualified stock option. In addition, Mr. Arends was granted a non-qualified stock option to purchase 100,000 shares of Class B common stock at an exercise price equal to either the fair value one year from the date of the agreement or, if earlier, the initial public offering price, subject to a vesting schedule through October 31, 2007.

In the event that either (i) Russell C. Horowitz ceases to be a Marchex employee for any reason or (ii) a change in control occurs while Mr. Arends is employed by Marchex, all options or other equity awards held by Mr. Arends with respect to our Class B common stock shall become fully vested. For purposes of this provision, a change in control occurs if one person or entity acquires control of 50% or more of our common stock entitled to vote for directors, but does not occur as a result of an acquisition by Marchex or any corporation controlled by Marchex.

Mr. Arends has the right to a severance payment in the event of termination meeting certain conditions as set forth in the employment agreement, up to a maximum payment of one year’s salary.

Mr. Arends has signed our standard confidentiality agreement, which provides, among other things, that Mr. Arends will not compete with us for twelve months following termination of his employment.

Benefit Plans

Stock Incentive Plan. On January 17, 2003, we adopted our 2003 stock incentive plan. The plan provides for the granting of shares of Class B common stock to employees, directors, and consultants of Marchex, its affiliates and strategic partners and provides for the following types of option grants:

- incentive stock options within the meaning of Section 422 of the Internal Revenue Code (sometimes known as ISOs);
- non-statutory stock options, which are options not intended to qualify as ISOs (sometimes known as non-qualified options); and
- right to purchase shares pursuant to restricted stock purchase agreements.

Marchex has reserved 5,013,953 shares of Class B common stock for issuance under the plan. The plan also provides for annual increases in the number of shares available for issuance under the plan, on the first day of our fiscal year, equal to 5% of the outstanding shares of Class B common stock (including any shares of common stock issuable upon conversion of any outstanding capital stock) on such date. The total number of shares of

Class B common stock for which options designated as ISO's may be granted shall not exceed 8,000,000. As of December 31, 2003, options to purchase 3,089,600 shares of Class B common stock were outstanding. As of December 31, 2003, no options had been exercised under the plan.

At the discretion of the board, the plan administrator shall be either the full board of directors or a special committee of the board consisting of at least two members of the board. A majority of the members of the committee constitutes a quorum and any action may be taken by a majority of those present and voting at the meeting. The entire board of directors or the special committee administering the plan selects the participants who will receive awards and determines the terms and conditions of such awards. Grants of stock under the plan will be subject to the terms of an option agreement or stock grant agreement, each in a form approved by the plan administrator.

Pursuant to the plan, ISOs may only be granted to employees. No option designated as an ISO may be granted to any participant who owns stock totaling more than 10% of the voting power of all classes of our outstanding capital stock, unless the exercise price of such stock equals at least 110% of the fair value on the grant date and the term of the option does not exceed five years.

The plan will terminate automatically ten years from the date of adoption by the stockholders, on January 17, 2013, unless terminated sooner by the vote of the plan administrator or the requisite stockholder vote.

Employee Stock Purchase Plan. Our 2004 employee stock purchase plan, which will become effective on the first date that our Class B common stock is publicly traded as a result of this offering assuming we receive gross proceeds in excess of $20 million, was adopted by our board of directors and approved by our stockholders on February 15, 2004. This plan will be intended to qualify under Section 423 of the Internal Revenue Code and will permit eligible employees to purchase our Class B common stock for amounts up to 15% of their compensation in offering periods under the plan. Under the purchase plan, no employee will be permitted to purchase stock worth more than $25,000 in any calendar year, valued as of the first day of each offering period. We have authorized an aggregate of 300,000 shares of our Class B common stock for issuance under the purchase plan to participating employees.

The purchase plan will provide for offering periods which shall be determined by the board of directors. Eligible participants may purchase Class B common stock under the purchase plan at a price equal to the lesser of 85% of the fair value on the first day of an offering period and 85% of the fair value on the last day of an offering period.

401(k) Plan (Enhance Interactive). Our subsidiary, Enhance Interactive, sponsors a 401(k) plan covering its employees. The 401(k) plan is intended to qualify under Section 401(a) of the Internal Revenue Code of 1986, as amended, so that contributions to the 401(k) plan by employees or by Enhance Interactive and the investment earnings thereon, are not taxable to employees until withdrawn from the 401(k) plan, and so that contributions by Enhance Interactive, if any, will be deductible by Enhance Interactive when made. Under the 401(k) plan, employees may elect to reduce their current compensation by up to the plan's prescribed annual limit and to have the amount of such reduction contributed to the 401(k) plan. The 401(k) plan permits, but does not require, additional matching and profit sharing contributions to the 401(k) plan by Enhance Interactive on behalf of all eligible participants in the 401(k) plan. To date, no matching or profit sharing contributions have been made by Enhance Interactive to the 401(k) plan.

401(k) Plan (TrafficLeader). Our subsidiary, TrafficLeader, sponsors a 401(k) plan covering its employees. The 401(k) plan is intended to qualify under Section 401(a) of the Internal Revenue Code of 1986, as amended, so that contributions to the 401(k) plan by employees or by TrafficLeader and the investment earnings thereon, are not taxable to employees until withdrawn from the 401(k) plan, and so that contributions by TrafficLeader, if any, will be deductible by TrafficLeader when made. Under the 401(k) plan, employees may elect to reduce their current compensation by up to the statutorily prescribed annual limit and to have the amount of such reduction contributed to the 401(k) plan. The 401(k) plan permits, but does not require, additional matching and non-elective contributions to the 401(k) plan by TrafficLeader on behalf of all eligible participants in the 401(k) plan. To date, no matching or non-elective contributions have been made by TrafficLeader to the 401(k) plan.

Limitations on Directors' Liability and Indemnification Matters

As permitted by Delaware General Corporation Law, we have included in our certificate of incorporation a provision to eliminate the personal liability of our directors for monetary damages for breach or alleged breach of their fiduciary duties as directors, other than breaches of their duty of loyalty, actions not in good faith or which involve intentional misconduct, or transactions from which they derive improper personal benefit. In addition, our by-laws provide that we are required to indemnify our officers and directors under certain circumstances, including those circumstances in which indemnification would otherwise be discretionary, and we are required to advance expenses to our officers and directors as incurred in connection with proceedings against them for which they may be indemnified.

The limitations summarized above, however, do not affect our ability or the ability of our stockholders to seek non-monetary-based remedies, such as an injunction or rescission, against a director for breach of his fiduciary duty nor would such limitations limit liability under the federal securities laws. Our by-laws provide that we shall, to the extent permitted by Delaware law, indemnify and advance expenses to our currently acting and former directors, officers, employees and agents or director, officers, employees and agents of other corporations, partnerships, joint ventures, trusts or other enterprises if serving at our request arising in connection with their acting in such capacities.

At present, we are not aware of any pending or threatened litigation or proceeding involving our directors, officers, employees or agents in which indemnification would be required or permitted. We believe that our certificate of incorporation and by-law provisions are necessary to attract and retain qualified persons as directors and officers.

We have also entered into indemnification agreements with each of our directors and executive officers.

Table of Contents

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth information regarding the beneficial ownership of our common stock as of February 16, 2004 and as adjusted to reflect the sale of the Class B common stock offered hereby by:

- each person (or group of affiliated persons) who is known by us to own beneficially more than 5% of the outstanding shares of our common stock;
- each of our directors who own our common stock;
- each of our executive officers listed in the "Summary Compensation Table" who owns our common stock; and
- all directors and executive officers as a group.

Percentage of beneficial ownership is based on 20,279,063 shares of common stock outstanding as of February 16, 2004 (assuming the conversion of the outstanding convertible preferred stock), and 24,279,063 shares of common stock outstanding after completion of the offering. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, shares of common stock subject to options held by that person that are currently exercisable or exercisable within 60 days of February 16, 2004, are deemed outstanding. These shares are not, however, deemed outstanding for the purposes of computing the percentage ownership of any other person. Except as otherwise noted below, the address for each beneficial owner listed below is c/o Marchex, Inc., 2101 Fourth Avenue, Suite 1980, Seattle, Washington 98121.

Name and Address of Beneficial Owner	Number of Shares Owned	Percentage of Shares Outstanding: Before Offering	Percentage of Shares Outstanding: After Offering
Russell C. Horowitz (1)	9,525,040	47.0%	39.2%
Michael A. Arends (2)	48,333	*	*
John Keister (3)	2,695,160	13.3%	11.1%
Rainwater River Authority, LLC (4)	70,000	3.8%	3.2%
Twin Oaks Plateau, LLC (5)	500,000	2.5%	2.1%
Dennis Cline (6)	100,000	*	*
Jonathan Fram	0	0%	0%
Rick Thompson (7)	1,158,333	5.7%	4.8%
All directors and executive officers as a group (10 persons) (8)	15,762,492	77.5%	64.8%

Except as indicated in the footnotes below and except as subject to community property laws where applicable, the persons named in the table above have sole voting and investment power with respect to all shares of common stock shown as beneficially owned by them.

The table above does not include any shares that may be purchased in the offering.

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* Less than one percent of the outstanding shares of common stock.

(1) Includes: (i) 8,026,707 shares of our Class A common stock held by MARRCH Investments, LLC; (ii) 1,400,000 shares of our Class B common stock held by MARRCH Investments, LLC; and (ii) 83,333 shares of our Class B common stock held by Pemrose, LLC. Mr. Horowitz is the managing member of these entities and, as such, may be deemed to exercise voting and investment power over the shares held by all of these entities. It also includes 5,000 shares of our Class B common stock held in an Individual Retirement Account for the benefit of Mr. Horowitz and 10,000 shares of our Class B common stock.

(2) Includes: (i) 33,333 shares of our Class B common stock issuable upon exercise of options; (ii) 4,500 shares of our Class B common stock; and (iii) 10,500 shares of our Class B common stock held by the Nicole

Marie Arends 2003 Trust for the benefit of Nicole Marie Arends, the daughter of Mr. Arends, for which shares Mr. Arends disclaims beneficial ownership.

(3) Includes: (i) 2,000,167 shares of our Class A common stock; (ii) 6,160 shares of our Class B common stock held in an Individual Retirement Account for the benefit of Mr. Keister; (iii) 65,000 shares of our Class B common stock held in a Grantor Retained Annuity Trust, of which Mr. Keister is the grantor; and (iv) 623,833 shares of our Class B common stock.

(4) The David Horowitz Trust II is the sole member of Rainwater River Authority, LLC. The beneficiary of such trust is Mr. David M. Horowitz. The address for Rainwater River Authority, LLC is: 10900 NE 8th Street, Suite 900, Bellevue, Washington 98004.

(5) The David Horowitz Trust is the sole member of Twin Oaks Plateau, LLC. The beneficiary of such trust is Mr. David M. Horowitz. The address for Twin Oaks Plateau, LLC is: 10900 NE 8th Street, Suite 900, Bellevue, Washington 98004.

(6) Consists of 100,000 shares held by DMC Investments, LLC, a limited liability company of which Mr. Cline is the managing member.

(7) Consists of 1,158,333 shares of our Class B common stock.

(8) Includes an aggregate of: (i) 11,987,500 shares of our Class A common stock; (ii) 3,716,659 shares of our Class B common stock (including 10,500 shares for which beneficial ownership has been disclaimed); and (iii) 58,333 shares of our Class B common stock issuable upon exercise of options, of which options for the purchase of 33,333 shares of Class B common stock are exercisable at this time.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Transactions with Our Founding Officers

Russell C. Horowitz, Ethan A. Caldwell, Peter Christothoulou, John Keister and Victor Oquendo, our founding officers, were involved in our initial funding. Following our inception, in January 2003, we issued an aggregate of 12,250,000 shares of our Class A common stock to these founding officers at a purchase price of $0.01 per share for a total purchase price of $122,500 and 1,000,000 shares of our Class B common stock for the benefit of Russell C. Horowitz individually or a Russell C. Horowitz–designated affiliated entity, at a purchase price of $0.01 per share for a total purchase price of $10,000. In connection with, and as part of, our preferred stock financing in February and May 2003, we issued an aggregate of 2,442,326 shares of our Series A redeemable convertible preferred stock to these founding officers at a purchase price of $3 per share for an aggregate purchase price of $7,326,980.

Private Placement Financing

In February and May 2003, we sold an aggregate of 6,724,063 shares of our Series A redeemable convertible preferred stock in a private placement at a purchase price of $3 per share for a total purchase price of $20,172,201 (this amount includes all investments, including investments of the executive officers and directors). Upon closing of this offering, all outstanding shares of preferred stock will automatically convert into Class B common stock and all share and per share amounts have been adjusted to reflect this conversion. The following table summarizes purchases, valued in excess of $60,000, of shares of our Series A redeemable convertible preferred stock by certain of our executive officers, directors, five-percent stockholders and certain of their family members or permitted transferees:

Investor	Number of Shares Purchased	Aggregate Consideration	
Ethan A. Caldwell	50,000	$	150,000
DMC Investments, LLC (1)	100,000	$	300,000
Rainwater River Authority, LLC (2)	720,000	$	2,160,000
Donald J. Horowitz (3)	171,200	$	513,600
Entities affiliated with Russell C. Horowitz (4)	1,488,333	$	4,465,000
John Keister (5)	706,993	$	2,120,980
Marcia McGreevy Lewis (6)	33,333	$	100,000
Sylvia Mathews (7)	150,000	$	450,000
Victor Oquendo	200,000	$	600,000
Rick Thompson	833,333	$	2,500,000

(1) Dennis Cline, one of our directors, is the managing member of DMC Investments, LLC.

(2) The David Horowitz Trust II is the sole member of Rainwater River Authority, LLC. The beneficiary of such trust, Mr. David M. Horowitz, is the brother of Mr. Russell C. Horowitz.

(3) Mr. Donald J. Horowitz is Mr. Russell C. Horowitz's father. These shares are held jointly with rights of survivorship with Lynda Horowitz.

(4) The record holders of these securities consist of: (i) MARRCH Investments, LLC and (ii) Pemrose, LLC. See footnote (1) in "Security Ownership of Certain Beneficial Ownership and Management" for a description of Mr. Horowitz's relationship to these entities. It also includes 5,000 shares issued to an Individual Retirement Account for the benefit of Mr. Horowitz.

(5) Includes 6,160 shares issued to an Individual Retirement Account for the benefit of Mr. Keister and 65,000 shares issued to a Grantor Retained Annuity Trust, of which Mr. Keister is the grantor.

(6) Ms. McGreevy Lewis is Mr. Keister's mother.

(7) Ms. Mathews is Mr. Russell C. Horowitz's mother. Includes 58,000 shares issued to an Individual Retirement Account for the benefit of Ms. Mathews.

In connection with the sale of the preferred stock, the investors were granted piggy-back registration rights, and we may therefore become obligated if requested after completing this offering to effect a registration under the Securities Act of 1933 of the shares of Class B common stock held by these investors upon the conversion of the preferred stock. See “Description of Capital Stock” for a more complete description of these registration rights.

We believe that we have executed all of the transactions set forth above on terms no less favorable to us than we could have obtained from unaffiliated third parties. It is our intention to ensure that all future transactions between us and our officers, directors and principal stockholders and their affiliates, are approved by a majority of the board of directors, including a majority of the independent and disinterested members of our board of directors, and are on terms no less favorable to us than those that we could obtain from unaffiliated third parties.

DESCRIPTION OF CAPITAL STOCK

General

The following summary description of our capital stock is not intended to be complete and is subject, and qualified in its entirety by reference, to our certificate of incorporation, as amended, and our bylaws. We have filed copies of each of these documents as exhibits to the registration statement of which this prospectus is a part.

The certificate of amendment to the certificate of incorporation will be adopted prior to the consummation of the offering. The following summary assumes the filing of the certificate of amendment to the certificate of incorporation.

Authorized and Outstanding Capital Stock

Upon the completion of this offering, Marchex will be authorized to issue 12,500,000 shares of Class A common stock, $0.01 par value per share, 125,000,000 shares of Class B common stock, $0.01 par value per share and 1,000,000 shares of undesignated preferred stock, $0.01 par value per share. All currently outstanding shares of Series A redeemable preferred stock will be converted into shares of Class B common stock at a conversion ratio of one-to-one upon the closing of this offering on a firm commitment basis with gross proceeds to Marchex of at least $20 million. The shares of Class A common stock are convertible on a one for one basis into shares of Class B common stock, but only upon the election of the individual holders. In the event that any shares of Class A are converted into shares of Class B, the number of outstanding Class A shares will be reduced on a one for one basis, and the number of Class B shares shall be increased on the same basis.

Prior to Completion of the Offering

As of February 16, 2004, assuming the mandatory conversion of all outstanding shares of the preferred stock, there were 20,279,063 shares of common stock outstanding that were held by 141 stockholders of record. Of these shares:

- 11,987,500 shares were authorized as Class A common stock, and as of this date were held by five stockholders of record, and
- 8,291,563 shares were authorized as Class B common stock, and as of this date were held by 136 stockholders of record.

As of February 16, 2004, we had options outstanding for the purchase an aggregate of 3,196,600 shares of Class B common stock of which 2,421,500 options are at a weighted average exercise price of $1.67 per share and 775,100 options will have an exercise price equal to the initial public offering price. These options were issued under our stock incentive plan, which is discussed in more detail below.

Upon Completion of the Offering

Our authorized capital stock, following the completion of this offering, will consist of shares of common stock and preferred stock:

- with 12,500,000 shares authorized as our Class A common stock, $0.01 par value per share, of which 11,987,500 will be outstanding and 262,500 will be held in treasury;
- with 125,000,000 shares authorized as our Class B common stock, $0.01 par value per share, of which 12,291,563 will be outstanding (12,891,563 shares if the underwriters' over-allotment option is exercised in full). The representative of the underwriters may also exercise a warrant for the purchase of up to 120,000 shares of Class B common stock over a period commencing one year after the initial public offering date and ending five years from the initial public offering date for an exercise price of 130% of the initial public offering price; and
- with 1,000,000 shares as undesignated preferred stock, $0.01 par value per share, none of which will be outstanding.

Common Stock

We have two classes of authorized common stock: Class A common stock and Class B common stock. Except with respect to voting rights, the Class A and Class B shares have identical rights. Holders of our Class A common stock are entitled to twenty-five votes for each share held and holders of our Class B common stock are entitled to one vote for each share held on all matters submitted to a vote of the stockholders, including the election of directors. Except as otherwise required by the laws of the State of Delaware, the holders of outstanding shares of Class A common stock and the holders of outstanding shares of Class B common stock vote as one class with respect to the election of directors and with respect to all other matters to be voted on by the stockholders of the Company.

Each share of Class A common stock is convertible, at the holder's option, into one share of Class B common stock. Our Class B common stock is not convertible into our Class A common stock. Subject to the prior rights of any of our outstanding preferred stock to receive dividends and distributions, holders of our common stock are entitled to receive ratably any dividends that may be declared by the board of directors out of funds legally available and are entitled to receive, pro rata, all of our assets available for distribution to such holders upon liquidation, dissolution or winding up of the Company. The outstanding shares of Class A common stock and Class B common stock are, and the shares of Class B common stock to be issued upon completion of this offering will be, fully paid and non-assessable.

Preferred Stock

Upon the closing of this offering, all outstanding shares of Series A redeemable convertible preferred stock will be converted into 6,724,063 shares of Class B common stock based on the then-effective conversion ratio of one-to-one and the Series A redeemable preferred stock will automatically be retired. Thereafter, our board of directors will have the authority, without further action by the stockholders, to issue up to 1,000,000 shares of preferred stock, $0.01 par value, in one or more series. Our board of directors will also have the authority to designate the rights, preferences, privileges and restrictions of each such series, including dividend rights, dividend rates, conversion rights, voting rights, terms of redemption, redemption prices, liquidation preferences and the number of shares constituting any series. The issuance of preferred stock may have the effect of delaying, deferring or preventing a change in control of Marchex without further action by the stockholders. The issuance of preferred stock with voting and conversion rights may also adversely affect the voting power of the holders of Class B common stock. In certain circumstances, an issuance of preferred stock could have the effect of decreasing the market price of the Class B common stock. Upon the closing of this offering, no shares of preferred stock will be outstanding. Marchex currently has no plans to issue any shares of preferred stock.

Representative's Warrant

At the closing of this offering, we will sell a warrant to purchase shares of our Class B common stock to the representative for nominal consideration.

The representative of the underwriters, or its designees, may exercise a warrant for the purchase of up to 120,000 shares of Class B common stock over a period commencing one year after the initial public offering date and ending five years from the initial public offering date for an exercise price of 130% of the initial public offering price. We have reserved an equivalent number of shares of Class B common stock for issuance upon exercise of the warrant. The holder of the warrant will not possess any rights as a stockholder unless the warrant is exercised. The representative's warrant grants to the holder thereof certain rights of registration for the shares of Class B common stock issuable upon exercise thereof.

Stock Consideration in the Traffic Leader Acquisition

As partial consideration in the acquisition of TrafficLeader, Marchex issued an aggregate of 562,500 shares of Class B common stock to the former stockholders of TrafficLeader, 425,000 of which are fully vested on the date of grant and 137,500 of which are subject to vesting over time. Marchex is subject to continuing obligations under the agreement and plan of merger dated as of October 1, 2003, entered into by Marchex and TrafficLeader and its stockholders. We also refer to this agreement as the acquisition agreement. The shares issued in connection with the acquisition are subject to a stock transfer and restriction agreement dated as of October 24, 2003, between the former stockholders of TrafficLeader and Marchex.

The acquisition agreement and the stock transfer and restriction agreement provide that 137,500 shares of the total stock consideration are classified as “restricted equity consideration.” The restricted equity consideration is subject to a three year vesting schedule, with the first 16.67% vesting on the six month anniversary of the closing date and an additional 16.67% shall vest on the last day of each successive six month period over the next two and one half years. These shares of restricted equity consideration shall become fully vested in the event of an acceleration event as defined in the acquisition agreement with respect to Gerald Wiant and Bruce Fabbri, the former principal stockholders of TrafficLeader, and upon a “change of control” of Marchex with respect to all of the other stockholders who are identified in the stock transfer and restriction agreement. The restricted equity consideration granted to each of Gerald Wiant and Bruce Fabbri shall be subject to forfeiture in the event that their employment relationship with us terminates for any reason.

Pursuant to the acquisition agreement, Marchex is obligated to redeem 425,000 shares of Class B common stock at a price of $8 per share, in the event that Marchex has not effected the sale of shares of common stock in firm commitment underwritten public offering pursuant to an effective registration statement with at least $20 million of gross proceeds by October 24, 2005, upon the election of the holders of at least 75% of such shares.

With respect to the vested shares, the holders shall also have certain registration and drag along rights pursuant to the stock transfer and restriction agreement, as set forth in more detail below.

Registration Rights

After the completion of this offering, the holders of approximately 20,279,063 shares of our Class A and Class B common stock, or their permitted transferees, will be entitled to certain “piggy-back” rights with respect to registration of their shares, or “registrable securities,” under the Securities Act. These registration rights were granted pursuant to two separate agreements, the stockholders’ agreement entered into with investors as of January 23, 2003, and the stock transfer and restriction agreement entered into with the holders of those shares of Class B common stock which were issued in connection with the acquisition of TrafficLeader as of October 24, 2003. Of the total number of shares subject to registration rights, 19,716,563 shares of Class A and Class B common stock have rights under the January 2003 agreement, and 562,500 shares of Class B common stock have rights under the October 2003 agreement.

Under the terms of these agreements, if we determine to register any of our securities under the Securities Act in connection with a public offering for cash following this offering, either for our own account or for the account of other security holders exercising registration rights, the holders of these shares are entitled to notice of the registration and to include their shares of common stock in the registration upon request at our expense.

These “piggy-back” registration rights are not triggered in the case of certain excluded offerings such as registrations relating solely to employee benefit plans, Rule 145 transactions, common stock issuable upon the conversion of debt securities or any form that does not require substantially the same information that would be required to register these shares.

These “piggy-back” registration rights are subject to the right of the managing underwriter of an offering to limit the number of shares included in such registration and underwriting. Each of the holders shall also be required to enter into the underwriting agreement for any offering including their shares. These agreements also provide that the holders of these registration rights if requested by the Company and the managing underwriter shall not sell, transfer or otherwise dispose of their shares for 180 days following the closing of this offering.

If our stockholders with registration rights cause a large number of securities to be registered and sold in the public market, those sales could cause the market price of our common stock to fall. If we were to initiate a registration and include registrable securities because of the exercise of registration rights, the inclusion of registrable securities could adversely affect our ability to raise capital.

We have agreed to certain "piggy-back" registration rights for the securities underlying the representative's warrant, which shall continue with respect to the shares for a period of five years from the first closing date of this offering.

Drag Along Rights

After the completion of this offering, the holders of approximately 13,555,000 shares of our Class A and Class B common stock, or their permitted transferees, will be entitled to drag along rights with respect to the sale of their shares. Of the total number of shares subject to these drag along rights, 12,992,500 shares of Class A and Class B common stock have rights under the January 2003 agreement, and 562,500 shares of Class B common stock have rights under the October 2003 agreement.

Under each of these agreements, the stockholders have drag along rights in the event that a majority of the voting power of a defined group of stockholders proposes to either:

- make a bona fide sale or exchange (in a business combination or otherwise) of all of the shares they hold to a third party who is not an affiliate or associate; or
- enter into a transaction pursuant to which we agree to merge with or into another entity or agree to sell all or substantially all of our assets.

For the holders who are party to the January 2003 agreement, those stockholders who hold a majority of the voting power of the outstanding securities subject to such agreement may effectuate the drag along right. For the holders who are party to the October 2003 agreement, those stockholders who hold a majority of the voting power of all of our outstanding securities may effectuate the drag along right.

Under each of these agreements, these majority stockholders have the right, exercisable upon 30 days' notice to the other stockholders, subject thereto to require the other stockholders to sell or vote all of their shares of our common stock in favor of the subject transaction.

2003 Stock Incentive Plan

See "Executive Compensation—Benefit Plans" for a complete explanation of the plan.

2004 Employee Stock Purchase Plan

See "Executive Compensation—Benefit Plans" for a complete explanation of the plan.

Anti-Takeover Provisions Affecting Stockholders

Following this offering, our founding officers will control ninety-seven percent (97%) of the combined voting power of our outstanding common stock, which could be deemed to have an anti-takeover effect.

Our certificate of incorporation, as amended, provides that no director shall be personally liable to us or our stockholders for monetary damages for breach of fiduciary duty as a director notwithstanding any provision of law imposing such liability, provided that, to the extent provided by applicable law, the certificate of incorporation shall not eliminate the liability of a director for:

- any breach of the director's duty of loyalty to us or our stockholders;
- acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law;

- acts or omissions in respect of certain unlawful dividend payments or stock redemptions or repurchases; or
- any transaction from which such director derives improper personal benefit.

Our by-laws provide that we shall, to the extent permitted by Delaware law, indemnify and advance expenses to our currently acting and former directors, officers, employees and agents or director, officers, employees and agents of other corporations, partnerships, joint ventures, trusts or other enterprises if serving at our request arising in connection with their acting in such capacities. We have entered into indemnification agreements with each of our directors and executive officers.

We are subject to Section 203 of the Delaware General Corporation Law. Subject to specific exceptions, Section 203 prohibits a publicly held Delaware corporation from engaging in a "business combination" with an "interested stockholder" for a period of three years after the time the person became an interested stockholder, unless:

- the business combination, or the transaction in which the stockholder became an interested stockholder, is approved by our board of directors prior to the time the interested stockholder attained that status;
- upon consummation of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding those shares owned by persons who are directors and also officers and by employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer; or
- at or after the time a person became an interested stockholder, the business combination is approved by our board of directors and authorized at an annual or special meeting of stockholders by the affirmative vote of at least two-thirds of the outstanding voting stock that is not owned by the interested stockholder.

"Business combinations" include mergers, asset sales and other transactions resulting in a financial benefit to the interested stockholder. Subject to various exceptions, in general an "interested stockholder" is a person who, together with his or her affiliates and associates, owns, or within three years did own, 15% or more of the shares of the corporation's outstanding voting stock. These restrictions could prohibit or delay the accomplishment of mergers or other takeover or change in control attempts with respect to us and, therefore, may discourage attempts to acquire us.

In addition, our certificate of incorporation, as amended, authorizes the board of directors to issue up to 1,000,000 shares of undesignated preferred stock, $0.01 par value per share. The preferred stock may be issued in one or more series, the terms of which may be determined at the time of issuance by our board of directors without further action by the stockholders. These terms may include voting rights, including the right to vote as a series on particular matters, preferences as to dividends and liquidation, conversion rights and redemption rights.

The provisions described above could have the effect of discouraging open market purchases of our Class B common stock because they may be considered disadvantageous by a stockholder who desires to undertake a business combination with us.

NASDAQ National Market Listing

We have applied to list our Class B common stock on the NASDAQ National Market and have reserved the trading symbol "MCHX."

Transfer Agent and Registrar

The transfer agent and registrar for our Class B common stock is   .

MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

General

Market Information

Prior to this offering, there has been no public market for our Class B common stock.

Upon completion of this offering, we will have 12,291,563 shares of Class B common stock outstanding, assuming no exercise of the underwriters' over-allotment option, and 12,891,563 shares of Class B common stock outstanding if the underwriters exercise their over-allotment option. Of these shares:

- the 4,000,000 shares of Class B common stock included in this offering, plus any shares issued upon exercise of the over-allotment option by the underwriters, will be freely tradable without restriction under the Securities Act, unless purchased by our "affiliates" as that term is defined in Rule 144 under the Securities Act; and
- the remaining 8,291,563 shares of Class B common stock that will be outstanding after this offering, and all of the shares of Class A common stock are "restricted securities" within the meaning of Rule 144.

Approximately 180 days after the date of this prospectus, we intend to file one or more registration statements on Form S-8 under the Securities Act to register the shares of Class B common stock to be issued under our stock incentive plan and our employee stock purchase plan and, as a result, all shares of Class B common stock acquired upon exercise of stock options and other equity-based awards granted under these plans will thereafter be freely tradable under the Securities Act unless purchased by our affiliates. These registration statements are expected to become effective upon filing.

Restricted securities generally may be sold only if they are registered under the Securities Act or are sold under an exemption from registration, including the exemptions provided by Rules 144 and 701 under the Securities Act, which are summarized below. Subject to the lock-up agreements described below, shares held by our affiliates that are not restricted securities may be sold subject to compliance with Rule 144 of the Securities Act without regard to the prescribed holding period under Rule 144.

The representative has requested pursuant to the underwriting agreement the lock-up of shares held prior to this offering by officers, directors and holders of at least 1% of the outstanding shares for a period of 180 days after the consummation of this offering. In addition, for shares reserved for purchase in this offering by our officers, directors and employees, they will agree to such restrictions for a period of 180 days after the consummation of this offering. The representative, may, in its sole discretion, permit early release of shares subject to the lock-up agreements. In considering any request to release shares subject to this lock-up agreement, the representative will consider the possible impact of the release of the shares on the trading price of the stock sold in the offering. The representative does not have any present intention or any understandings, implicit or explicit, to release any of the shares subject to the lock-up agreements prior to the expiration of the lock-up period.

Securities Authorized for Issuance under Equity Compensation Plans

Equity Compensation Plan Information as of December 31, 2003:*

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance
Equity compensation plans approved by security holders**	2,421,500 668,100	$1.67 per share initial public offering price	910,400
Equity compensation plans not approved by security holders	Not applicable	Not applicable	Not applicable
Total	3,089,600	$1.67 to IPO price	910,400

* This table omits our 2004 employee stock purchase plan as such plan was not adopted by our board of directors until February 15, 2004 and was not approved by our stockholders until February 15, 2004. This plan will become effective on the date that the Class B common stock is publicly traded as a result of an initial public offering with gross proceeds in excess of $20 million pursuant to an effective registration statement.

** We have reserved 5,013,953 shares of Class B common stock for issuance under our 2003 stock incentive plan, of which an increase of 1,013,953 to the authorized number of shares available under the plan occurred on January 1, 2004 as a result of the “evergreen provision” under the plan. The “evergreen provision” provides for annual increases in the number of shares available for issuance under the plan, on the first day of our fiscal year, equal to 5% of the outstanding shares of Class B common stock (including any shares of common stock issuable upon conversion of any outstanding capital stock) on such date.

Holders

As of February 16, 2004, assuming the mandatory conversion of all outstanding shares of the preferred stock, there were 20,279,063 shares of common stock outstanding that were held by 141 stockholders of record. Of these shares:

- 11,987,500 shares were authorized as Class A common stock, and as of this date were held by five stockholders of record; and
- 8,291,563 shares were authorized as Class B common stock, and as of this date were held by 136 stockholders of record.

Rule 144

In general, under Rule 144 as currently in effect, a person who has beneficially owned shares for at least one year is entitled to sell in “brokers’ transactions” or to market makers, within any three-month period commencing 90 days after the date of this prospectus, a number of shares that does not exceed the greater of:

- one percent of the number of shares of Class B common stock then outstanding, approximately 242,791 shares immediately after the completion of this offering (248,791 shares if the underwriters’ over-allotment option is exercised in full); or
- the average weekly trading volume in our Class B common stock during the four calendar weeks preceding the required filing of a Form 144 with respect to such sale.

Sales under Rule 144 are generally subject to the availability of current public information about us. In addition, a person who is not deemed to have been an affiliate at any time during the 90 days preceding a sale and who has beneficially owned the shares proposed to be sold for at least two years would be entitled to sell those shares under Rule 144(k) without regard to the requirements described above.

Rule 701

Rule 701 permits our directors, officers, employees or consultants who purchase shares pursuant to a written compensatory plan or contract to resell such shares in reliance upon Rule 144, but without compliance with certain restrictions. Rule 701 provides that affiliates may sell their Rule 701 shares under Rule 144 90 days after effectiveness of the registration statement of which this prospectus forms a part without complying with the holding period requirement and that non-affiliates may sell such shares in reliance on Rule 144 90 days after the effectiveness of such registration statement without complying with the holding period, public information, volume limitation or notice requirements of Rule 144. Those shares issuable upon the exercise of vested options will be saleable 180 days after the effectiveness of the registration statement, subject to the provisions of Rule 144.

Registration of Shares

We have entered into a stockholders' agreement with certain of our investors and a stock transfer and restriction agreement with the former stockholders of TrafficLeader, each of which provide our stockholders with "piggy-back" registration rights. See "Description of Capital Stock—Registration Rights."

We have agreed to certain "piggy-back" registration rights for the securities underlying the representative's warrant. See "Underwriting."

UNDERWRITING

Under the terms and subject to the conditions contained in an underwriting agreement dated the date of this prospectus, the underwriters named below, for whom National Securities Corporation is acting as representative, have severally agreed to purchase, and we have agreed to sell to them, severally, the number of shares indicated below:

Name	Number of Shares
National Securities Corporation	
Total	

The underwriting agreement provides that the obligations of the several underwriters to pay for and accept delivery of the shares of Class B common stock offered hereby are subject to a number of conditions, including the receipt by National Securities of the legal opinions of its counsel and our counsel, officer's certificates and a letter from our independent auditors, and to certain other conditions, including the conditions that no stop order suspending the effectiveness of the registration statement be in effect and no proceedings for such purpose are threatened by the Securities and Exchange Commission. The underwriters are obligated to take and pay for all of the shares of Class B common stock offered hereby (other than those covered by the over-allotment option described below) if any are purchased.

Over-Allotment Option

We have granted to the underwriters an option, exercisable for 30 days from the date of this prospectus, to purchase up to an aggregate of 600,000 additional shares of our Class B common stock at the public offering price listed on the cover page of this prospectus, less underwriting discounts and commissions. The underwriters may exercise this option solely for the purpose of covering over-allotments, if any, made in connection with the offering of the shares of our Class B common stock offered by this prospectus. To the extent this option is exercised, all purchases shall be made by representative for representative's account unless representative elects to purchase less than all of additional shares, in which case the remaining additional shares not purchased by representative shall be purchased for the account of each underwriter (other than representative) in the same proportion as the number of shares of firm stock set forth opposite such underwriter's name in the above table bears to the total number of shares of firm stock purchased by all underwriters (other than representative).

Directed Share Program

At our request, the underwriters have reserved for sale, at the initial public offering price, up to 600,000 shares for our officers, directors, employees, consultants and others having a relationship with us. The number of shares of our Class B common stock available for sale to the general public will be reduced to the extent these reserved shares are purchased. Any reserved shares that are not purchased by these persons will be offered by the underwriters to the general public on the same basis as the other shares in this offering.

Commissions and Discounts

The following table shows the per-share and total underwriting discounts and commissions to be paid to the underwriters by us in connection with this offering. The underwriting discounts and commissions have been determined through negotiations between the underwriters and us, and have been calculated as a percentage of the offering price. These amounts are shown assuming both no exercise and full exercise of the over-allotment option.

	Per Share	No Exercise	Full Exercise
Public Offering Price	$	$	$
Underwriting Discounts & Commissions	$	$	$
Proceeds, before expenses, to us	$	$	$

The underwriters propose to offer the shares of Class B common stock directly to the public at the initial public offering price per share set forth on the cover page of this prospectus and to selected dealers at such price less a concession not in excess of $[   ] per share. The underwriters may allow, and these dealers may re-allow, a concession not in excess of $[   ] per share to certain other dealers. After this offering, the public offering price, concession and re-allowance may be changed by the representative.

We have agreed to pay to the representative the maximum amount of $50,000 to account for the representative's direct expenses in connection with this offering on a non-accountable basis, of which $25,000 has been paid by us and the balance shall be paid upon the first closing date. Subject to our written pre-approval, additional direct expenses of Representative shall be paid up to a maximum of $50,000.

Representative's Warrant

In connection with this offering, we have agreed to sell a warrant to the representative for $100.00. The representative's warrant is for the account of the representative or the representative's designees, which will be limited to the representative's officers, directors and employees, to purchase 120,000 shares of our Class B common stock. The shares issuable upon exercise of the representative's warrant will be in all respects identical to the shares offered to you. No holder of the representative's warrant will possess any rights as a shareholder unless the warrant is exercised. The representative's warrant contains a cashless exercise provision and provides for adjustment in the number of shares issuable upon exercise thereof as a result of certain subdivisions and combinations of the common stock. The representative's warrant will be limited to a term of five years from the first closing date and will become exercisable only commencing 12 months after the first closing date at a per share exercise price equal to 130% of the initial public offering price per share set forth on the cover page of this prospectus. The one-year restriction on the exercise of the representative's warrant is pursuant to Rule 2710(c)(7)(A) of the NASD Conduct Rules. The representative's warrant may not be sold, assigned, transferred, pledged or hypothecated except to the representative's designee for a period of one year from the completion of the offering.

The representative's warrant is not redeemable by us. In addition, we have agreed to certain "piggy-back" registration rights for the securities underlying the representative's warrant which shall continue with respect to the shares for a period of five years from the first closing date.

Any profit realized by the representative on the sale of the securities issuable upon exercise of the representative's warrant may be deemed to be additional underwriting compensation. During the term of the representative's warrant, the holders thereof are given the opportunity to profit from a rise in the market price of our Class B common stock. We may find it more difficult to raise additional equity capital while the representative's warrant is outstanding. At any time at which the representative's warrant is likely to be exercised, we may be able to obtain additional equity capital on more favorable terms.

Lock-up Agreements

The representative has requested pursuant to the underwriting agreement the lock-up of shares held prior to this offering by officers, directors and holders of at least 1% of the outstanding shares for a period of 180 days after the consummation of this offering. In addition, for shares reserved for purchase in this offering by our officers, directors and employees, they will agree to such restrictions for a period of 180 days after the consummation of this offering. The representative, may, in its sole discretion, permit early release of shares subject to the lock-up agreements.

Indemnification

We and the underwriters have agreed to indemnify each other against certain liabilities, including liabilities under the Securities Act of 1933, as amended, and to contribute to payments which the indemnified party may be required to make in respect thereof. We and the underwriters are each aware that, in the opinion of the Securities and Exchange Commission, such indemnification is against public policy as expressed in the Securities Act of 1933, as amended, and is, therefore, unenforceable.

Stabilizing Transactions, Short Positions and Penalty Bids

In order to facilitate the offering of the Class B common stock, the underwriters may engage in transactions that stabilize, maintain or otherwise affect the price of our Class B common stock in accordance with Regulation M under the Securities Exchange Act of 1934.

- Stabilizing transactions permit bids to purchase the underlying security so long as the stabilizing bids do not exceed a specified maximum.
- Over-allotment involves sales by the underwriters of shares in excess of the number of shares the underwriters are obligated to purchase, which creates a syndicate short position. The short position may be either a covered short position or a naked short position. In a covered short position, the number of shares over-allotted by the underwriters is not greater than the number of shares which they may purchase in the over-allotment option. In a naked short position, the number of shares involved is greater than the number of shares in the over-allotment option. The underwriters may close out any short position by either exercising their over-allotment option and/or purchasing shares in the open market.
- Syndicate covering transactions involve purchases of the Class B common stock in the open market after the distribution has been completed in order to cover syndicate short positions. In determining the source of shares to close out the short position, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the over-allotment option. If the underwriters sell more shares than could be covered by the over-allotment option—a naked short position—that position can only be closed out by buying shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of the shares in the open market after pricing that could adversely affect investors who purchase in the offering.
- Penalty bids permit the representative to reclaim a selling concession from a syndicate member when the common stock originally sold by the syndicate member is purchased in a stabilizing or syndicate covering transaction to cover syndicate short positions.
- In passive market making, market makers in the Class B common stock who are underwriters or prospective underwriters may, subject to limitations, make bids for or purchases of the Class B common stock until the time, if any, at which a stabilizing bid is made.

These stabilizing transactions, syndicate covering transactions and penalty bids may have the effect of raising or maintaining the market price of the Class B common stock or preventing or retarding a decline in the market price of the Class B common stock. As a result, the price of the Class B common stock may be higher than the price that might otherwise exist in the open market. These transactions may be effected on the Nasdaq National Market or otherwise and, if commenced, may be discontinued at any time.

Determination of Offering Price

Prior to this offering, there has been no public market for our Class B common stock. Consequently, the public offering price of our Class B common stock will be determined by negotiation between the representative of the underwriters and us.

The underwriters have advised us that this prospectus will be delivered by mail only.

LEGAL MATTERS

The validity of the shares of Class B common stock offered hereby will be passed upon for us by Nixon Peabody LLP. A partner with the law firm of Nixon Peabody LLP beneficially owns 30,000 shares of Class B common stock.

EXPERTS

The consolidated financial statements of the Predecessor to Marchex, Inc. as of December 31, 2002 and February 28, 2003 and of Marchex, Inc. and subsidiaries as of December 31, 2003, and for the year ended December 31, 2002, the period from January 1, 2003 through February 28, 2003, and the period from January 17, 2003 (inception) through December 31, 2003 and the financial statements of Sitewise Marketing, Inc. as of December 31, 2002 and September 30, 2003, and for the year ended December 31, 2002 and the nine month period ended September 30, 2003 have been included herein in reliance upon the reports of KPMG LLP, independent auditors, appearing elsewhere herein, and upon the authority of said firm as experts in accounting and auditing.

DISCLOSURE OF COMMISSION POSITION OF INDEMNIFICATION FOR SECURITIES ACT LIABILITIES

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the small business issuer pursuant to the foregoing provisions, or otherwise, the small business issuer has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy and, is therefore, unenforceable.

WHERE YOU CAN FIND MORE INFORMATION

We have filed a registration statement on Form SB-2 with the Securities and Exchange Commission, or SEC, for the Class B common stock we are offering by this prospectus. This prospectus does not contain all of the information set forth in the registration statement or in the exhibits and schedules thereto. For further information with respect to Marchex and our Class B common stock, we make reference to the registration statement and to the exhibits and schedules filed therewith. Statements contained in this prospectus, relating to the contents of any contract or any other document referred to are not necessarily complete, and in each instance, reference is made to the copy of such contract or other document filed as an exhibit to the registration statement, each such statement being qualified in all respects by such reference.

A copy of the registration statement may be inspected by anyone without charge at the SEC's principal office in Washington, D.C., and copies of all or any part of the registration statement may be obtained from the Public Reference Section of the SEC, 450 Fifth Street, N.W., Washington, D.C. 20549, upon payment of certain fees prescribed by the SEC. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference rooms. The SEC maintains a web site that contains reports, proxy and information statements and other information regarding registrants that file electronically with the SEC. The address of the Web site is www.sec.gov.

Upon completion of the offering, we will be subject to the information reporting requirements of the Securities Exchange Act of 1934, as amended and, in accordance therewith, will file reports, proxy statements and other information with the SEC.

We intend to furnish our stockholders with annual reports containing financial statements audited by our independent public accountants and to make available to our stockholders quarterly reports for the first three fiscal quarters of each fiscal year containing unaudited interim financial information.

[Table of Contents](#)

	Page
Marchex, Inc.	
Independent Auditors' Report	F-2
Consolidated Balance Sheets of the Predecessor to Marchex, Inc. as of December 31, 2002, and February 28, 2003, and of Marchex, Inc. and subsidiaries as of December 31, 2003	F-3
Consolidated Statements of Operations for the year ended December 31, 2002, period from January 1, 2003 to February 28, 2003 (Predecessor periods), and the period from January 17, 2003 (inception) to December 31, 2003 (Successor period)	F-4
Consolidated Statements of Stockholders' Equity for the year ended December 31, 2002, period from January 1, 2003 to February 28, 2003 (Predecessor periods), and the period from January 17, 2003 (inception) to December 31, 2003 (Successor period)	F-5
Consolidated Statements of Cash Flows for the year ended December 31, 2002, period from January 1, 2003 to February 28, 2003, (Predecessor periods), and the period from January 17, 2003 (inception) to December 31, 2003 (Successor period)	F-6
Notes to Consolidated Financial Statements	F-7
Sitewise Marketing, Inc. (d.b.a. TrafficLeader)	
Independent Auditors' Report	F-33
Balance Sheets as of December 31, 2002 and September 30, 2003	F-34
Statements of Operations for the year ended December 31, 2002 and nine month period ended September 30, 2003	F-35
Statements of Stockholders' Equity for the year ended December 31, 2002 and nine month period ended September 30, 2003	F-36
Statements of Cash Flows for the year ended December 31, 2002 and nine month period ended September 30, 2003	F-37
Notes to Financial Statements	F-38
Unaudited Pro Forma Condensed Consolidated Financial Statements	F-47
Unaudited Pro Forma Condensed Consolidated Statements of Operations for the year ended December 31, 2003	F-49
Notes to Unaudited Pro Forma Condensed Consolidated Financial Statements	F-50

Independent Auditors' Report

The Board of Directors and Stockholders
Marchex, Inc.:

We have audited the accompanying consolidated balance sheets of the Predecessor to Marchex, Inc. as of December 31, 2002 and February 28, 2003 and of Marchex, Inc. and subsidiaries as of December 31, 2003 and the related consolidated statements of operations, stockholders' equity and cash flows for the years ended December 31, 2002, the period from January 1, 2003 through February 28, 2003 (Predecessor periods), and the period from January 17, 2003 (inception) through December 31, 2003 (Successor period). These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Predecessor to Marchex, Inc. and Marchex, Inc. and its subsidiaries, as of December 31, 2002, February 28, 2003 and December 31, 2003 and the results of their operations and their cash flows for the Predecessor periods and Successor period in conformity with accounting principles generally accepted in the United States of America.

/s/ KPMG LLP

Seattle, Washington
February 16, 2004

MARCHEX, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

	Predecessor Periods		Successor Period	
	December 31, 2002	February 28, 2003	December 31, 2003	December 31, 2003 Pro Forma
				(unaudited)
Assets				
Current assets:				
Cash and cash equivalents	$ 1,494,300	1,820,763	6,019,119	
Accounts receivable, net	489,664	538,213	1,627,730	
Other receivables	—	1,137	384	
Prepaid expenses	30,014	49,615	117,596	
Income tax receivable	—	—	290,939	
Deferred tax assets	89,920	117,645	263,193	
Other current assets	39,211	46,159	24,190	
Total current assets	2,143,109	2,573,532	8,343,151	
Property and equipment, net	473,793	494,087	994,793	
Deferred tax assets	52,956	32,187	—	
Other assets	9,435	9,435	409,878	
Goodwill	—	—	17,252,999	
Identifiable intangible assets, net	—	—	6,701,791	
Total assets	$ 2,679,293	3,109,241	33,702,612	
Liabilities and Stockholders' Equity				
Current liabilities:				
Accounts payable	$ 1,294,877	891,124	2,842,229	
Accrued payroll and benefits	128,301	257,000	252,642	
Accrued expenses and other current liabilities	118,581	107,015	1,031,850	
Deferred revenue	736,594	812,385	848,958	
Earn-out liability payable	—	—	3,525,995	
Total current liabilities	2,278,353	2,067,524	8,501,674	
Deferred tax liabilities	—	—	1,829,687	
Deferred revenue	27,682	27,541	38,993	
Other non-current liabilities	2,993	4,085	2,274	
Fair value of redemption obligation	—	—	55,250	
Total liabilities	2,309,028	2,099,150	10,427,878	
Series A redeemable convertible preferred stock, $0.01 par value. Authorized 8,500,000; ($21,489,395 aggregate liquidation preference and redemption value at December 31, 2003) issued and outstanding 6,724,063 shares at December 31, 2003; (no shares issued and outstanding on pro forma basis)	—	—	21,440,402	—
Commitments, contingencies, and subsequent events				
Stockholders' equity:				
Predecessor Periods:				
Common stock, no par value. Authorized 35,000,000 shares;				
Class A: 30,496,112 authorized through February 28, 2003; 23,355,421 and 24,894,319 issued and outstanding at December 31, 2002 and February 28, 2003, respectively	398,774	696,815	—	—
Class B: 4,503,888 authorized through February 28, 2003 4,503,888 issued and outstanding at December 31, 2002 and February 28, 2003	1,419,986	1,419,986	—	—
Successor Period:				
Common stock, $.01 par value. Authorized 46,500,000 shares;				
Class A: 12,500,000 authorized; 12,250,000 issued and 11,987,500 outstanding at December 31, 2003	—	—	122,500	122,500
Class B: 34,000,000 authorized; issued and outstanding 1,567,500 at December 31, 2003, including 137,500 of restricted stock; (8,291,563 issued and outstanding on pro forma basis)	—	—	15,675	82,916
Additional paid-in capital	—	—	6,716,734	28,089,895
Deferred stock-based compensation	(9,266)	—	(1,532,340)	(1,532,340)
Accumulated deficit	(1,439,229)	(1,106,710)	(3,488,237)	(3,488,237)
Total stockholders' equity	370,265	1,010,091	1,834,332	23,274,734
Total liabilities and stockholders' equity	$ 2,679,293	3,109,241	33,702,612	33,702,612

See accompanying notes to consolidated financial statements.

Table of Contents

MARCHEX, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

	Predecessor Periods		Successor Period
	Year ended December 31, 2002	Period from January 1 to February 28, 2003	Period from January 17 (inception) to December 31, 2003
Revenue	$ 10,070,507	3,071,055	19,892,158
Expenses:			
Service costs (1)	6,334,173	1,732,813	11,292,070
Sales and marketing (1)	1,821,237	365,043	2,460,683
Product development (1)	811,673	144,479	1,291,422
General and administrative (1)	976,881	234,667	2,743,919
Acquisition-related retention consideration (2)	—	—	283,269
Stock-based compensation (3)	364,693	38,981	2,125,110
Amortization of intangible assets (4)	—	—	3,023,408
Total operating expenses	10,308,657	2,515,983	23,219,881
Income (loss) from operations	(238,150)	555,072	(3,327,723)
Other income:			
Interest income	5,491	1,529	45,874
Adjustment to fair value of redemption obligation	—	—	25,500
Other	—	—	2,685
Total other income	5,491	1,529	74,059
Income (loss) before provision for income taxes	(232,659)	556,601	(3,253,664)
Income tax expense (benefit)	(142,876)	224,082	(1,084,312)
Net income (loss)	(89,783)	332,519	(2,169,352)
Accretion to redemption value of redeemable convertible preferred stock	—	—	1,318,885
Net income (loss) applicable to common stockholders	$ (89,783)	332,519	(3,488,237)
Basic and diluted net loss per share applicable to common stockholders			$ (0.26)
Shares used to calculate basic and diluted net loss per share			13,259,747
Pro forma basic and diluted net loss per share applicable to common stockholders (unaudited)			$ (0.18)
Shares used to calculate pro forma basic and diluted net loss per share (unaudited)			19,011,093

(1) Excludes acquisition-related retention consideration, stock-based-compensation and amortization of intangible-assets

(2) Components of acquisition-related retention consideration:			
Service costs	$ —	—	33,723
Sales and marketing	—	—	96,262
Product development	—	—	104,233
General and administrative	—	—	49,051
(3) Components of stock-based-compensation:			
Service costs	$ 3,161	190	9,776
Sales and marketing	148,669	715	421,871
Product development	57,078	37,710	241,080
General and administrative	155,785	366	1,452,383
(4) Components of amortization of intangible assets:			
Service costs	$ —	—	2,216,957
Sales and marketing	—	—	348,118
Product development	—	—	—
General and administrative	—	—	458,333

See accompanying notes to consolidated financial statements.

Table of Contents

MARCHEX, INC. AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity

	Class A common stock		Class B common stock		Deferred stock-based compensation	Accumulated deficit	Total stockholders' equity
	Shares	Amount	Shares	Amount			
PREDECESSOR PERIODS:							
Balances at December 31, 2001	18,564,400	$ 10,315	4,503,888	$ 1,419,986	(9,455)	(1,349,446)	71,400
Exercise of stock options	2,759,355	13,797	—	—	—	—	13,797
Sale of stock to employees at less than fair market value	2,031,666	367,210	—	—	—	—	367,210
Stock compensation from options	—	7,452	—	—	189	—	7,641
Net loss	—	—	—	—	—	(89,783)	(89,783)
Balances at December 31, 2002	23,355,421	$ 398,774	4,503,888	$ 1,419,986	(9,266)	(1,439,229)	370,265
Exercise of stock options	1,306,603	37,288	—	—	—	—	37,288
Issuance of additional shares to employee shareholder	73,529	37,500	—	—	—	—	37,500
Issuance of additional shares to existing shareholders	158,766	—	—	—	—	—	—
Stock compensation from options	—	—	—	—	1,481	—	1,481
Cancellations of unvested options	—	(7,785)	—	—	7,785	—	—
Income tax benefit of option exercises	—	231,038	—	—	—	—	231,038
Net income	—	—	—	—	—	332,519	332,519
Balances at February 28, 2003	24,894,319	$ 696,815	4,503,888	$ 1,419,986	—	(1,106,710)	1,010,091

	Class A common stock		Class B common stock		Additional paid-in capital	Deferred stock-based compensation	Accumulated deficit	Total stockholders' equity
	Shares	Amount	Shares	Amount				
SUCCESSOR PERIOD:								
Balances at January 17, 2003 (inception)	—	$ —	—	$ —	—	—	—	—
Sale of common stock	12,250,000	122,500	1,000,000	10,000	—	—	—	132,500
Issuance of stock for services	—	—	5,000	50	3,700	—	—	3,750
Issuance of stock in connection with acquisition	—	—	454,068	4,541	3,060,418	—	—	3,064,959
Issuance of stock for services as part of acquisition	—	—	108,432	1,084	730,832	(731,916)	—	—
Share forfeiture	(262,500)	—	—	—	—	—	—	—
Stock compensation from options	—	—	—	—	2,921,784	(800,424)	—	2,121,360
Net loss	—	—	—	—	—	—	(3,488,237)	(3,488,237)
Balances at December 31, 2003	11,987,500	$ 122,500	1,567,500	$ 15,675	6,716,734	(1,532,340)	(3,488,237)	1,834,332

See accompanying notes to consolidated financial statements.

MARCHEX, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	Predecessor Periods		Successor Period
	Year ended December 31, 2002	Period from January 1 to February 28, 2003	Period from January 17 (inception) to December 31, 2003
Cash flows from operating activities:			
Net income (loss)	$ (89,783)	332,519	(2,169,352)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Amortization and depreciation	214,562	43,584	3,337,108
Adjustment to fair value of redemption obligation	—	—	(25,500)
Allowance for doubtful accounts and merchant advertiser credits	256,817	86,908	469,782
Stock-based compensation	364,693	38,981	2,125,110
Deferred income taxes	(142,876)	(6,956)	(1,878,373)
Income tax benefit related to stock options	—	231,038	—
Change in certain assets and liabilities, net of acquisition:			
Accounts receivable, net	(463,243)	(135,457)	(761,427)
Other receivables	7,223	(1,137)	753
Income tax receivable	—	—	(290,939)
Prepaid expenses and other current assets	(43,392)	(26,549)	(37,442)
Accounts payable	916,188	(403,753)	1,334,024
Accrued expenses, payroll, benefits and other current liabilities	73,136	117,133	393,917
Deferred revenue	443,490	75,650	127,934
Acquisition-related retention consideration in earn-out liability	—	—	283,269
Other non-current liabilities	2,993	1,092	(1,811)
Net cash provided by (used in) operating activities	1,539,808	353,053	2,907,053
Cash flows from investing activities:			
Purchases of property and equipment	(349,856)	(63,878)	(543,245)
Cash paid for acquisition, net of cash acquired	—	—	(16,523,613)
Decrease (increase) in other non-current assets	15,565	—	(45,216)
Net cash used in investing activities	(334,291)	(63,878)	(17,112,074)
Cash flows from financing activities:			
Deferred offering costs paid	—	—	(29,877)
Proceeds from exercises of stock options	13,797	37,288	—
Proceeds from sale of stock	10,158	—	132,500
Proceeds from sale of redeemable convertible preferred stock	—	—	20,121,517
Net cash provided by financing activities	23,955	37,288	20,224,140
Net increase in cash and cash equivalents	1,229,472	326,463	6,019,119
Cash and cash equivalents at beginning of period	264,828	1,494,300	—
Cash and cash equivalents at end of period	$ 1,494,300	1,820,763	6,019,119
Supplemental disclosure of cash flow information—cash paid during the period for income taxes	$ —	—	1,085,000
Supplemental disclosure of non-cash investing and financing activities:			
Issuance of stock and redemption right in connection with acquisition	$ —	—	3,415,709
Accretion to redemption value of redeemable convertible preferred stock	$ —	—	1,318,885
Deferred offering costs recorded in accrued expenses	$ —	—	346,473
Additional acquisition earn-out consideration included in earn-out liability	$ —	—	3,242,726

See accompanying notes to consolidated financial statements.

MARCHEX, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(1) Description of Business and Summary of Significant Accounting Policies and Practices

(a) Description of Business and Basis of Presentation

Marchex, Inc. (the “Company”), formed in January 2003, provides technology-based services to merchants engaged in online transactions over the Internet.

Prior to February 28, 2003, the Company was involved in business and product development activities, as well as financing and acquisition initiatives. Revenue commenced with the acquisition of eFamily.com, Inc. and its wholly-owned operating subsidiary ah-ha.com, Inc.

On February 28, 2003, the Company acquired 100% of the outstanding stock of eFamily.com, Inc. and its wholly-owned operating subsidiary, based in Provo, Utah. ah-ha.com, Inc. was renamed Enhance Interactive, Inc. in December 2003. The aggregate cash consideration, including acquisition costs to acquire Enhance Interactive was approximately $15,117,000. The purchase price excludes performance-based contingent payments that depend on Enhance Interactive’s achievement of a minimum threshold of income before income taxes, excluding stock-based compensation and amortization of intangible assets relating to the purchase (“earnings before taxes”), in calendar years 2003 and 2004. Additional details regarding this acquisition are in note 11 to these consolidated financial statements.

Enhance Interactive provides performance-based advertising services to merchant advertisers, including pay-per-click listings. Through Enhance Interactive’s pay-per-click service, merchant advertisers create keyword listings that describe their products or services, which are marketed to consumers and businesses primarily through search engine or directory results when users search for information, products or services using the Internet.

The Company’s consolidated statements of operations, stockholders’ equity and cash flows have been presented for the period from January 17, 2003 (inception) through December 31, 2003. The assets, liabilities and operations of Enhance Interactive are included in the Company’s consolidated financial statements since the February 28, 2003 date of acquisition. All significant inter-company transactions and balances have been eliminated in consolidation. The Company’s purchase accounting resulted in all assets and liabilities being recorded at their estimated fair values on the acquisition date. Accordingly, the Company’s consolidated financial results for periods subsequent to the acquisition are not comparable to the financial statements of Enhance Interactive presented for prior periods. The consolidated statements of operations, stockholders’ equity and cash flows representing Enhance Interactive’s results prior to February 28, 2003 have been presented as the “Predecessor” for the year ended December 31, 2002 and the period from January 1 to February 28, 2003. The Company, including the results of Enhance Interactive since the date of its acquisition, is referred to as the “Successor” in the accompanying consolidated financial statements.

The consolidated financial statements of the Predecessor include the financial statements of eFamily.com, Inc. and its wholly-owned subsidiary, Enhance Interactive (formerly known as ah-ha.com, Inc.). All significant inter-company transactions and balances have been eliminated in consolidation.

On October 24, 2003, the Company acquired 100% of the outstanding stock of Sitewise Marketing, Inc. (d.b.a TrafficLeader) ("TrafficLeader"). In November, 2003, Sitewise Marketing, Inc., based in Eugene, Oregon, was renamed TrafficLeader, Inc. The purchase consisted of:

- Cash and acquisition costs of approximately $3,570,000;
- 425,000 shares of Class B common stock, which are subject to a redemption right;
- 137,500 shares of restricted Class B common stock that vest over a period of 3 years.

The purchase price excludes performance-based contingent payments that depend on TrafficLeader's achievement of revenue thresholds. The assets, liabilities and operations of TrafficLeader are included in the Company's consolidated financial statements since the October 24, 2003 date of acquisition. Additional details of this acquisition are in note 12.

TrafficLeader provides performance-based advertising and search marketing services to merchant advertisers, including paid inclusion, advertising campaign management, conversion tracking and analysis, and search engine optimization. Through its primary service, paid inclusion, TrafficLeader manages search-based advertising campaigns and services for merchant advertisers. TrafficLeader's paid inclusion service helps merchant advertisers reach prospective customers by first creating relevant product listings and then placing these listings in front of potential customers, primarily through search engines. Merchant advertiser's product listings map directly to user search queries, which link to specific product or information pages when clicked. On behalf of merchant advertisers, TrafficLeader indexes these relevant listings through its distribution partners, including search engines, product shopping engines and directories.

(b) Cash and Cash Equivalents

The Company and the Predecessor consider all highly liquid investments with an original maturity of three months or less at the date of purchase and proceeds in-transit from credit and debit card transactions with settlement terms of less than five days to be cash equivalents. Cash equivalents totaled approximately $722,000, $1,226,000 and $4,590,000 at December 31, 2002, February 28, 2003 and December 31, 2003, respectively. Cash equivalents as of the periods presented consist primarily of money market funds and include credit and debit card in-transit amounts of approximately $99,000, $137,000 and $161,000 at December 31, 2002, February 28, 2003 and December 31, 2003, respectively.

(c) Fair Value of Financial Instruments

The Company and the Predecessor had the following financial instruments as of the periods presented: cash and cash equivalents, accounts receivable, other receivables, accounts payable and accrued liabilities, fair value of redemption obligation and Series A redeemable convertible preferred stock. The carrying value of cash and cash equivalents, accounts receivable, other receivables, accounts payable and accrued liabilities approximates their fair value based on the liquidity of these financial instruments or based on their short-term nature. The fair value of the redemption obligation is recorded in the consolidated balance sheet at its estimated fair value. Factors affecting the fair value determination include, among others, interest rates, the difference between the redemption amount and the fair market value of our Class B common stock, the proximity in time to the redemption date and the probability of the redemption right being exercised. The carrying value of the Series A redeemable

Table of Contents

convertible preferred stock is recorded at its accreted redemption value. The fair value is estimated to be approximately $47,070,000 at December 31, 2003.

(d) Accounts Receivable

Accounts receivable are recorded at the invoiced amount and do not bear interest. Accounts receivable balances are presented net of allowance for doubtful accounts and allowance for merchant advertiser credits.

Allowance for Doubtful Accounts

The allowance for doubtful accounts is the Company's and the Predecessor's best estimate of the amount of probable credit losses in existing accounts receivable. The Company and Predecessor determine the allowance based on analysis of historical bad debts, advertiser concentrations, advertiser credit-worthiness and current economic trends. Past due balances over 90 days and specific other balances are reviewed individually for collectibility. The Company and Predecessor review the allowance for collectibility quarterly. Account balances are written off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

The allowance for doubtful account activity for the periods indicated is as follows:

	Balance at beginning of period	February 28, 2003 Enhance Interactive acquisition date	October 24, 2003 TrafficLeader acquisition date	Charged to costs and expenses	Write-offs	Balance at end of period
Allowance for doubtful accounts:						
Predecessor Periods:						
December 31, 2002	$ 159,259	—	—	75,798	226,112	8,945
February 28, 2003	8,945	—	—	35,540	8,842	35,643
Successor Period:						
December 31, 2003	$ —	35,643	48,654	162,990	156,007	91,280

There were no merchant advertisers who represented 10% or greater of revenue for the periods presented. Merchant advertisers who had an account receivable balance of 10% or greater of accounts receivable were as follows: one merchant advertiser represented 22% of outstanding balances at December 31, 2002 and three merchant advertisers represented 44% at February 28, 2003, respectively. There were no merchant advertisers representing 10% or greater at December 31, 2003.

Allowance for Merchant Advertiser Credits

The allowance for merchant advertiser credits is the Company's and Predecessor's best estimate of the amount of expected future reductions in a merchant advertiser's payment obligations related to delivered services. The Company and the Predecessor determine the allowance for merchant advertiser credits and adjustments based on analysis of historical credits.

MARCHEX, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements—(Continued)

The allowance for merchant advertiser credits activity for the periods indicated is as follows:

	Balance at beginning of period	February 28, 2003 Enhance Interactive acquisition date	October 24, 2003 TrafficLeader acquisition date	Additions charged against revenue	Credits processed	Balance at end of period
Allowance for merchant advertiser credits:						
Predecessor Periods:						
December 31, 2002	$ 22,823	—	—	181,019	163,852	39,990
February 28, 2003	39,990	—	—	51,368	36,653	54,705
Successor Period:						
December 31, 2003	$ —	54,705	6,000	306,792	299,651	67,846

(e) Property and Equipment

Property and equipment are stated at cost. Depreciation on computers and other related equipment, purchased and internally developed software, and furniture and fixtures is calculated on the straight-line method over the estimated useful lives of the assets, generally averaging three years. Leasehold improvements are amortized straight-line over the shorter of the lease term or estimated useful lives of the assets ranging from three to five years.

(f) Goodwill

Goodwill represents the excess of the purchase price over the fair value of identifiable assets acquired and liabilities assumed in business combinations accounted for under the purchase method.

The Company applies the provisions of the Financial Accounting Standards Board's (FASB) Statements of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS 142. SFAS 142 also requires that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144).

Goodwill not subject to amortization is tested annually for impairment, and is tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value.

(g) Impairment or Disposal of Long-Lived Assets

The Company reviews its long-lived assets for impairment in accordance with SFAS 144 whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds fair value. Assets to be disposed of would be separately presented on the balance sheet and reported at the lower of their carrying amount or fair value less costs to sell, and are no longer depreciated.

(h) Revenue Recognition

Revenue is generated primarily through performance-based advertising and search marketing services, which include pay-per-click listings and paid inclusion. Revenue from pay-per-click listings and paid inclusion listings is generated when a user clicks on a merchant advertiser's listings after it has been placed by the Company, the Predecessor, or by our distribution partners into a search engine, directory, or other Web site.

The secondary sources of revenue include other search marketing services, including advertising campaign management, conversion tracking and analysis and search engine optimization, as well as banner advertising, account set-up fees and other inclusion fees. These secondary sources of revenue together constituted less than 9%, 6% and 6% of revenue for the year ended December 31, 2002, the period from January 1 to February 28, 2003, and the period from January 17, 2003 (inception) to December 31, 2003, respectively. The Company and the Predecessor have no barter transactions.

The Company and the Predecessor follow Staff Accounting Bulletin 101, *Revenue Recognition in Financial Statements* (SAB No. 101) as amended by SAB No. 104, *Revenue Recognition* that revises and rescinds certain sections of SAB No. 101. These bulletins summarize certain of the Security and Exchange Commission (SEC) staff's views on the application of accounting principles generally accepted in the United States of America to revenue recognition. We generally recognize revenue upon completion of our performance obligation, provided evidence of an arrangement exits, the arrangement fee is fixed and determinable and collection is reasonably assured.

Merchant advertisers generally pay for the supplementary search marketing services based on usage that is billed on a fixed amount per click-through or a fixed monthly amount. Revenue is recognized on a click-through basis or in the month the service is provided.

Banner advertising revenue is primarily based on a fixed fee per click-through and recognized on click-through activity. In limited cases, banner payment terms are volume-based with revenue recognized when impressions are delivered.

Non-refundable account set-up fees paid by merchant advertisers are recognized ratably over the longer term of the contract or the average expected merchant advertiser relationship period, which generally ranges between one and two years.

Other inclusion fees are generally associated with monthly or annual subscription-based services where a merchant advertiser pays a fixed amount to be included in the Predecessor's, Company's or distribution partners' index of listings. Other inclusion fees are recognized ratably over the service period, which is typically one year.

The Company and the Predecessor enter into agreements with various distribution partners to provide merchant advertisers' listings. The Company and the Predecessor generally pay distribution partners based on a percentage of revenue or a fixed amount per click-through on these listings. The Company and the Predecessor act as the primary obligor with the merchant advertiser for revenue click-through transactions and are responsible for the fulfillment of services. In accordance with Emerging Issues Task Force (EITF) Issue No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent*, the revenue derived from advertisers are reported gross based upon the amounts received from the merchant advertiser.

(i) Service Costs

Service costs include network operations and customer service costs that consist primarily of costs associated with providing performance-based advertising and search marketing services, maintaining the Company's and the Predecessor's Web site, credit card processing fees and network and fees paid to outside service providers that provide the Company's and the Predecessor's paid listings and customer services. Customer service and other costs associated with serving the Company's and the Predecessor's search results and maintaining the Company's and the Predecessor's Web site include depreciation of Web site and network equipment, colocation charges of the Company's and the Predecessor's Web site equipment, bandwidth, software license fees, salaries of related personnel, stock-based compensation and amortization of intangible assets.

Service costs also include user acquisition costs that relate primarily to payments made to distribution partners who provide an opportunity for the Company's merchant advertisers to market and sell their products. The Company and the Predecessor enter into agreements of varying durations with distribution partners that integrate the Company's and the Predecessor's services into their Web sites and indexes. The primary economic structure of the distribution partner agreements is a variable payment based on a specified percentage of revenue. These variable payments are often subject to minimum payment amounts per click-through. Other economic structures that to a lesser degree exist include: 1) fixed payments, based on a guaranteed minimum amount of usage delivered, 2) variable payments based on a specified metric, such as number of paid click-throughs, and 3) a combination arrangement with both fixed and variable amounts.

The Company and the Predecessor expense user acquisition costs under two methods; agreements with fixed payments are expensed as the greater of the following:

- pro-rata over the term the fixed payment covers, or
- usage delivered to date divided by the guaranteed minimum amount of usage.

Agreements with variable payment based on a percentage of revenue, number of paid click-throughs or other metrics are expensed as incurred based on the volume of the underlying activity or revenue multiplied by the agreed-upon price or rate.

(j) Advertising Expenses

Advertising costs are expensed as incurred and include Internet-based direct advertising and trade shows. Such costs are included in sales and marketing. The amounts for all periods presented were approximately $84,000, $11,000 and $133,000 for the years ended December 31, 2002, the period from January 1 to February 28, 2003 and the period from January 17 (inception) to December 31, 2003, respectively.

(k) Product Development

Product development costs consist primarily of expenses incurred by the Company or the Predecessor in the research and development, creation, and enhancement of the Company's or the Predecessor's Web site and services. Research and development expenses are expensed as incurred and include compensation and related expenses, costs of computer hardware and software, and costs incurred in developing features and functionality of the services. For the periods presented, substantially all of the product development expenses are research and development.

Product development costs are expensed as incurred or capitalized into property and equipment in accordance with the American Institute of Certified Public Accountants' (AICPA) Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (SOP 98-1). SOP 98-1 requires that cost incurred in the preliminary project and post-implementation stages of an internal use software project be expensed as incurred and that certain costs incurred in the application development stage of a project be capitalized.

(l) Income Taxes

The Company and the Predecessor utilize the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in results of operations in the period that includes the enactment date. A valuation allowance is recorded for deferred tax assets when it is more likely than not that such deferred tax assets will not be realized.

In connection with the purchase accounting for the acquisition of the Predecessor and TrafficLeader, the Company recorded net deferred tax liabilities in the amount of approximately $3.0 million and $456,000, respectively, relating to the difference in the book basis and tax basis of its assets and liabilities.

(m) Stock Option Plan

The Company and the Predecessor apply the intrinsic value-based method of accounting prescribed by Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations including FASB Interpretation No. 44, *Accounting for Certain Transactions involving Stock Compensation an interpretation of APB Opinion No. 25* issued in March 2000, to account for its employee stock options and restricted stock grants. Under this method, employee compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. SFAS No. 123, *Accounting for Stock-Based Compensation*, established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Company and the Predecessor have elected to apply the intrinsic value-based method of accounting described above for options granted to employees, and have adopted the disclosure requirements of SFAS No. 123.

MARCHEX, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements—(Continued)

The Company and the Predecessor recognize compensation expense over the vesting period utilizing the accelerated methodology described in FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*.

The following table illustrates the effect on net loss if the fair-value-based method had been applied to all outstanding awards in each period.

	Predecessor Periods		Successor Period
	Year Ended December 31, 2002	Period from January 1 to February 28, 2003	Period from January 17 (inception) to December 31, 2003
Net income (loss) applicable to common stockholders:			
As reported	$ (89,783)	322,519	(3,488,237)
Add: stock-based employee expense included in reported net income (loss), net of related tax effect	361,843	38,428	1,436,147
Deduct: stock-based employee compensation expense determined under fair-value-based method for all awards, net of related tax effect (1)	(380,907)	(42,375)	(2,267,730)
Pro forma	$ (108,847)	318,572	(4,319,820)
Net loss per share applicable to common stockholders:			
As reported (basic and diluted)			$ (0.26)
Pro forma (basic and diluted)			$ (0.33)

(1) See note 6(b) and 7(c) for details of the assumptions used to arrive at the fair value of each option grant.

The Company and the Predecessor account for non-employee stock-based compensation in accordance with SFAS No. 123 and FASB Emerging Issues Task Force (EITF) Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*.

(n) Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. The Company and the Predecessor have used estimates in determining certain provisions, including allowance for doubtful accounts, allowance for merchant advertiser credits, useful lives for property and equipment, intangibles, the fair value of a redemption right obligation, the fair-value of the Company's and the Predecessor's common stock and stock option awards, the fair value of the Series A redeemable convertible preferred stock and a valuation allowance for deferred tax assets. Actual results could differ from those estimates.

(o) Concentrations

The Company and the Predecessor maintain substantially all of their cash and cash equivalents with two financial institutions.

Primarily all of the Company's and the Predecessor's revenue earned from merchant advertisers is generated through arrangements with distribution partners. The Company may not be successful in

MARCHEX, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements—(Continued)

renewing any of these agreements, or if they are renewed, they may not be on terms as favorable as current agreements. The Company may not be successful in entering into agreements with new distribution partners on commercially acceptable terms. In addition, several of these distribution partners may be considered potential competitors.

The percentage of revenue earned from merchant advertisers supplied by distribution partners representing more than 10% of consolidated revenue is as follows:

	Predecessor Periods		Successor Period
	Year Ended December 31, 2002	Period from January 1 to February 28, 2003	Period from January 17 (inception) to December 31, 2003
Distribution partner A	11%	12%	7%

(p) ***Segment Reporting and Geographic Information***

Operating segments are revenue-producing components of the enterprise for which separate financial information is produced internally for the Company's or the Predecessor's management. For all periods presented the Company and the Predecessor operated as a single segment. The Company and the Predecessor operate in a single business segment principally in domestic markets providing Internet merchant transaction services to enterprises.

Revenues from merchant advertisers by geographical areas are tracked on the basis of the location of the merchant advertiser. The vast majority of the Company's and its Predecessor's revenue and accounts receivable are derived from domestic sales to advertisers engaged in various activities involving the Internet.

Revenues by geographic region are as follows (in percentages):

	Predecessor Periods		Successor Period
	Year Ended December 31, 2002	Period from January 1 to February 28, 2003	Period from January 17 (inception) to December 31, 2003
United States	92%	90%	91%
Canada	5%	5%	4%
Other countries	3%	5%	5%
	100%	100%	100%

(q) ***Net Income (Loss) Per Share***

The Company's basic and diluted net loss per share is presented for the period from January 17, 2003 (inception) to December 31, 2003. Basic net loss per share is computed by dividing net loss applicable to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net loss per share is computed by dividing net loss applicable to common stockholders by the weighted average number of common and dilutive common equivalent shares outstanding during the period. Net loss applicable to common stockholders consists of net loss as adjusted for the impact of accretion of redeemable convertible preferred stock to its redemption value. As the Company had a net loss during the period from January 17, 2003 (inception) to December 31, 2003 basic and diluted net loss per share are the same.

The following table reconciles the Company's reported net loss to net loss applicable to common stockholders used to compute basic and diluted net loss per share for the period from January 17, 2003 (inception) to December 31, 2003:

	Successor Period
	Period from January 17 (inception) to December 31, 2003
Net loss	$ (2,169,352)
Accretion to redemption value of Series A redeemable convertible preferred stock	1,318,885
Net loss applicable to common stockholders	$ (3,488,237)
Basic and diluted net loss per share applicable to common stockholders	$ (0.26)
Weighted average number of shares outstanding used to calculate basic and diluted net loss per share	13,259,747

The computation of diluted net loss per share excludes the following because their effect would be anti-dilutive:

- 6,724,063 shares issuable upon conversion of the Series A redeemable convertible preferred stock;
- outstanding options at December 31, 2003 to acquire 2,421,500 shares of Class B common stock with a weighted average exercise price of $1.67 per share and 668,100 options to acquire shares of Class B common stock with an exercise price that will equal the initial public offering price. In the event that twelve months from the option grant date the Company has not completed a firm commitment initial public offering with gross proceeds of at least $20 million, these options will have an exercise price equal to the then determined fair market value.
- 108,432 shares of restricted Class B common stock issued in connection with the October 2003 acquisition of TrafficLeader. These shares are for future services that vest over 3 years. Additionally, these shares were excluded from the computation of basic net loss per share.

(r) Guarantees

The Predecessor adopted FASB Interpretation (FIN) No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, during the year ended December 31, 2002. FIN No. 45 provides expanded accounting guidance surrounding liability recognition and disclosure requirements related to guarantees, as defined by the interpretation. The Company adopted FIN No. 45 upon inception. In the ordinary course of business, neither the Company nor the Predecessor is subject to potential obligations under guarantees that fall within the scope of FIN No. 45 except for standard indemnification provisions that are contained within many of our advertiser and distribution partner agreements, and give rise only to the disclosure requirements prescribed by FIN No. 45.

Indemnification provisions contained within the Company's and the Predecessor's advertiser and distribution partner agreements are generally consistent with those prevalent in the Company's industry. The Company and its Predecessor have not incurred significant obligations under advertiser and distribution partner indemnification provisions historically and do not expect to incur significant obligations in the future. Accordingly, the Company and the Predecessor do not maintain accruals for potential advertiser and distribution partner indemnification obligations.

(s) Initial Public Offering (IPO), Pro Forma Net Loss Per Share and Pro Forma Balance Sheet

In December 2003, the Board of Directors authorized the filing of a registration statement with the SEC that would permit the Company to sell shares of the Company's Class B common stock in connection with a proposed IPO.

If the offering is consummated under the terms presently anticipated, each of the 6,724,063 outstanding shares of the Company's Series A redeemable convertible preferred stock will automatically convert into one share of Class B common stock upon closing of the proposed IPO and the Series A redeemable convertible preferred stock will automatically be retired. Thereafter, the authorized number of shares of preferred stock will be 1,000,000 and authorized number of shares of Class B common stock will be 125,000,000. The Board of Directors will have the authority to issue up to 1,000,000 shares of preferred stock, $.01 par value in one or more series and have the authority to designate rights, preferences, privileges and restrictions of each such series, including dividend rights, dividend rates, conversion rights, voting rights, terms of redemption, redemption prices, liquidation preferences and the number of shares constituting any series. The foregoing automatic conversion has been reflected in the accompanying unaudited pro forma balance sheet as if it had occurred as of December 31, 2003.

The pro forma net loss per share is calculated as if the Series A redeemable convertible preferred stock had converted into shares of common stock at the original issuance date.

(t) Recently Issued Accounting Standards

In November 2002, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 00-21 ("EITF 00-21"), *Revenue Arrangements with Multiple Deliverables.* EITF 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which the vendor will perform multiple revenue generating activities. EITF 00-21 became effective for fiscal periods beginning after June 15, 2003. The adoption of EITF 00-21 has not had a material impact on the Company's financial position and results of operations.

In May 2003, the FASB issued SFAS 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity.* The Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). It is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of this Statement did not have a material impact on our financial statements.

MARCHEX, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements—(Continued)

In December 2003, the SEC issued Staff Accounting Bulletin No. 104, *Revenue Recognition* (SAB No. 104) which revises or rescinds certain sections of SAB No. 101, *Revenue Recognition in Financial Statements* in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB No. 104 did not have a material effect on the Company's financial position and results of operations.

(2) Related Party Transactions

From January 1, 2002 to February 28, 2003, MyFamily.com, Inc. ("MyFamily") owned all 4,503,888 shares of the Predecessor's Class B common stock representing an approximate 20% interest. On February 28, 2003, the Company acquired 100% of the outstanding stock of the Predecessor, including MyFamily's stockholder interest. Amounts earned from advertising services provided to MyFamily are disclosed below. The Company and the Predecessor also purchased certain miscellaneous supplies and leased space from MyFamily or entities affiliated with MyFamily. The amounts in relation to these transactions follow:

	Predecessor Periods		Successor Period
	Year Ended December 31, 2002	Period from January 1 to February 28, 2003	Period from January 17 (inception) to December 31, 2003
Revenue earned from MyFamily	$ 18,606	2,559	7,849
General and administrative expenses paid to MyFamily:			
Rental expense	158,105	36,717	179,668
Supplies and other purchases	5,101	600	3,000

Amounts due from MyFamily included in accounts receivable are as follows:

	Predecessor Periods		Successor Period
	December 31, 2002	February 28, 2003	December 31, 2003
Due from MyFamily	$ 24,580	17,855	—

TrafficLeader subleases office space to Wiant Design, an entity owned by an employee of TrafficLeader. In connection with the sublease, $554 was received subsequent to the TrafficLeader acquisition from Wiant Design and included in the period from January 17 (inception) to December 31, 2003. The amount has been recorded as a reduction to rent expense.

MARCHEX, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements—(Continued)

(3) Property and Equipment

Property and equipment consisted of the following:

	Predecessor Periods		Successor Period
	December 31, 2002	February 28, 2003	December 31, 2003
Computer and other related equipment	$ 653,652	703,113	878,583
Purchased and internally developed software	214,852	229,269	368,247
Furniture and fixtures	4,000	4,000	41,225
Leasehold improvements	—	—	19,137
	872,504	936,382	1,307,192
Less accumulated depreciation and amortization	(398,711)	(442,295)	(312,399)
Property and equipment, net	$ 473,793	494,087	994,793

Depreciation and amortization expense incurred by the Company and the Predecessor was approximately $215,000, $44,000, and $313,700 for the year ended December 31, 2002, the period from January 1 to February 28, 2003 and the period from January 17, 2003 (inception) to December 31, 2003, respectively.

(4) Commitments

The Company has commitments for future payments related to office facilities leases and other contractual obligations. The Company leases its office facilities under operating lease agreements expiring through 2006. The Company also has other contractual obligations expiring over varying time periods through 2004. Future minimum payments are as follows:

	Office leases	Other contractual obligations	Total
2004	$ 427,474	142,000	569,474
2005	203,415	—	203,415
2006	62,639	—	62,639
2007 and thereafter	—	—	—
Total minimum payments	$ 693,528	142,000	835,528

Other contractual obligations primarily relate to minimum contractual payments due to distribution partners and other service providers. Rent expense incurred by the Company and the Predecessor was approximately $158,100, $36,700, $361,000 for the year ended December 31, 2002, the period from January 1 to February 28, 2003, and the period from January 17, 2003 (inception) to December 31, 2003, respectively.

Table of Contents

(5) Income Taxes

The provision for income taxes for the Company and the Predecessor periods consists of the following:

	Predecessor Periods		Successor Period
	Year Ended December 31, 2002	Period from January 1 to February 28, 2003	Period from January 17 (inception) to December 31, 2003
Current provision			
Federal	$ —	—	701,689
State	—	—	92,372
Deferred provision			
Federal	(130,236)	(25,417)	(1,735,078)
State	(12,640)	(2,467)	(237,104)
Utilization of net operating loss carryforwards	—	115,940	93,809
Tax expense of equity adjustment for stock option exercise	—	136,026	—
Total income tax provision (benefit):	$ (142,876)	224,082	(1,084,312)

Income tax expense (benefit) differed from the amounts computed by applying the U.S. federal income tax rate of 34% to loss before income taxes as a result of the following:

	Predecessor Periods		Successor Period
	Year Ended December 31, 2002	Period from January 1 to February 28, 2003	Period from January 17 (inception) to December 31, 2003
Income tax expense (benefit) at U.S. statutory rate of 34%	$ (79,104)	189,244	(1,106,246)
State taxes, net of federal benefit	(7,678)	18,368	(95,523)
Non-deductible stock compensation	133,180	13,988	93,660
Other non-deductible expenses	18,942	2,482	23,797
Change in valuation allowance	(208,216)	—	—
Total income tax provision (benefit):	$ (142,876)	224,082	(1,084,312)

MARCHEX, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements—(Continued)

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are presented below:

	Predecessor Periods		Successor Period
	December 31, 2002	February 28, 2003	December 31, 2003
Deferred tax assets:			
Net operating loss carryforwards	$ 115,840	95,012	—
Accrued liabilities not currently deductible	51,768	78,572	258,278
Stock compensation	3,171	—	687,585
Deferred revenue	39,268	40,596	40,459
Start-up costs not currently deductible	—	—	48,719
Total deferred tax assets	210,047	214,180	1,035,041
Valuation allowance	—	—	—
	210,047	214,180	1,035,041
Deferred tax liabilities:			
Intangible assets-amortization not deductible for tax	—	—	2,459,921
Excess of tax over financial statement depreciation	67,271	64,348	141,614
	67,271	64,348	2,601,535
Net deferred tax assets (liabilities)	$ 142,776	149,832	(1,566,494)

At December 31, 2003, the Company had net operating loss carryforwards of approximately $1,782,000 which begin to expire in 2019. The Tax Reform Act of 1986 limits the use of net operating loss (NOL) and tax credit carryforwards in certain situations where changes occur in the stock ownership of a company. The Company believes that such a change has occurred, and that the utilization of the approximately $1,782,000 in carryforwards is limited such that substantially all of these NOL carryforwards will never be utilized.

As of January 1, 2002, due to the Predecessor's history of net operating losses, and the restrictions on the ability to utilize its NOL carryforwards due to ownership changes, the Predecessor had previously established a valuation allowance equal to its net deferred tax assets. During 2002, the Predecessor reversed the valuation allowance on its net deferred tax assets, as the Predecessor believed it was more likely than not, based on improved operating performance that these assets would be realized. In determining that it was more likely than not that the Predecessor would realize all of the available net deferred tax assets, the following factors were considered: historical trends relating to merchant advertiser usage rates and click-throughs, projected revenues and expenses, and the amount of existing net operating loss carryforwards.

The valuation allowance decreased approximately $208,000 during the year ended December 31, 2002. The valuation allowance did not change during the period from January 1 to February 28, 2003 or the period from January 17 (inception) to December 31, 2003.

On February 28, 2003 and October 24, 2003, in connection with the purchase accounting for the respective acquisitions of the Predecessor and TrafficLeader, the Company recorded a net deferred tax liability in the amount of approximately $3.0 million and $456,000, respectively, relating to the difference in the book basis and tax basis of its assets and liabilities. Approximately $3.1 million and $479,000, respectively, of this net deferred tax liability related to the book basis versus tax basis of the identifiable intangible assets in the acquisition totaling approximately $8.4 million and $1.3 million, respectively.

The Company has recorded a deferred tax asset for stock-based compensation recorded on unexercised non-qualified stock options. The ultimate realization of this asset is dependent upon the fair value of the Company's stock when the options are exercised.

MARCHEX, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements—(Continued)

During the period from January 1 through February 28, 2003, as a result of a tax deduction from stock option exercises, the Predecessor recognized a tax-effected benefit of approximately $231,000 which was recorded as a credit to additional paid in capital.

(6) Stockholders' Equity – Predecessor Periods

(a) Common Stock and Authorized Capital

The Predecessor's articles of incorporation provided for 35,000,000 shares of common stock authorized and issued, no par value. A total of 30,496,112 shares were designated as Class A common stock and 4,503,888 shares as Class B common stock. MyFamily held the Class B common stock representing approximately 20% of the interest in the Predecessor. Each share of Class A and B common stock has the right to one vote per share.

The Class B holders had the right to elect one of the Predecessor's four members of the Board of Directors, as long as Class B common stock made up greater than 5% of the common stock. Any amendments to the articles of incorporation, bylaws, increase in the authorized number of shares of common stock issuable under of the Predecessor's stock option plans or issuance of additional shares of common stock outside of the Predecessor's stock option plan required approval of greater than 50% of the Class B holders.

Each share of Class B common stock could be converted into Class A common stock at the option of the holder at any time based upon a conversion ratio, subject to adjustment for dilution. The initial conversion ratio was determined by dividing the original issue price of $0.01 by the conversion price in effect at the time the shares are converted. The conversion price was the original issue price adjusted for subsequent equity adjustments. Each share would automatically convert into Class A common stock upon the closing of a public offering of common stock with gross proceeds of at least $40,000,000.

(b) Stock Option Plans

2001 Plan

In June 2001, the Predecessor adopted the 2001 Stock Incentive Plan (the 2001 Plan). The 2001 Plan was maintained for officers, employees, directors and consultants under which approximately 8,000,000 shares of Class A common stock were reserved for issuance. Generally, stock options were granted with 10 year terms and vested monthly over 2 years.

During 2002, the Predecessor granted options to acquire Class A common stock with exercise prices less than the then current fair market value. As a result, the Predecessor recorded total deferred compensation expense of approximately $18,000.

Approximately $8,000 and $1,000 was recognized as stock compensation expense related to these options during the year ended December 31, 2002 and the period from January 1 to February 28, 2003, respectively.

Prior to February, 2003, all outstanding vested options, totaling 1,306,603 were exercised and all unvested options were cancelled.

MARCHEX, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements—(Continued)

The fair value for each option grant is estimated at the date of grant using a Black-Scholes option pricing model based on the following assumptions for the year ended December 31, 2002, and the period from January 1 to February 28, 2003: risk-free interest rates of 6%; no dividends; volatility factor of the expected market price of the Company's common stock of 174%; and a weighted-average expected life of 3 years.

The following table summarizes stock option activity:

	Options available for grant	Number of options outstanding	Weighted average exercise price of options outstanding	Weighted average fair value of options granted
Balance at December 31, 2001	3,672,952	4,327,048	$ 0.005	$ —
Granted below fair value	(177,500)	177,500	0.230	0.242
Granted equal or above fair value	(172,000)	172,000	0.230	0.202
Exercised	—	(2,759,355)	0.005	
Expired and cancelled	72,125	(72,125)	0.092	
Balance at December 31, 2002	3,395,577	1,845,068	0.044	
Exercised	—	(1,306,603)	0.029	
Expired or cancelled	538,465	(538,465)	0.082	
Balance at February 28, 2003	3,934,042	—	$ —	

In January 2002, the Predecessor sold 2,031,666 shares of Class A common stock to employees for cash consideration totaling approximately $10,000. In connection with the sale, the Predecessor recorded approximately $357,000 in compensation expense related to the difference between the cash consideration and the estimated fair market value of the shares sold.

In February 2003, the Predecessor issued 232,295 shares of Class A common stock to several existing investors whose investments had been diluted subsequent to their initial contribution. One of the investors, who was issued 73,529 common shares, was an employee and, accordingly, the Predecessor recorded compensation expense of $37,500 representing the estimated fair value of the shares issued.

(7) Stockholders' Deficit – Successor Period

(a) Authorized Capital and Common Stock

The Company's articles of incorporation have 46,500,000 shares of common stock authorized, $0.01 par value, of which 12,500,000 shares have been authorized as Class A common stock and 34,000,000 shares have been authorized as Class B common stock, and 8,500,000 shares of preferred stock authorized, of which all such shares were designated Series A redeemable convertible preferred stock, $0.01 par value per share.

The initial capitalization of the Company included the issuance of 12,250,000 shares of Class A common stock and 1,000,000 shares of Class B common stock. Except with respect to voting rights, the Class A and Class B common stock have identical rights.

In October 2003, in connection with a voluntary change in job responsibilities, a member of senior management voluntarily forfeited 262,500 Class A common shares and returned them to the Company.

Each share of Class A common stock has the right to twenty-five votes per share and each share of Class B common stock has the right to one vote per share.

Each share of Class A common stock is convertible at the holder's option into one share of Class B common stock.

In accordance with the stockholders' agreement signed by Class A and the founding Class B common stockholders, the following provisions exist:

The Company holds a repurchase right in the event of a proposed sale of Class A common stock. In the event the Company does not exercise the repurchase right, the other Class A stockholders have the right to purchase the shares based on their proportionate interests. In the event Class A shares are transferred to parties other than the Company or other Class A stockholders, they automatically convert to Class B shares.

So long as an individual stockholder subject to the stockholders agreement has a beneficial ownership interest of 5% or more of any class of stock in the Company, the stockholder shall have a right to participate on a pro-rata basis in any new issuance of securities, other than shares issued in an IPO.

At each annual meeting to elect board of director members, stockholders subject to the agreement agree to vote in favor of two Directors as designated by an entity controlled by the Company's CEO.

(b) Series A Redeemable Convertible Preferred Stock

In February and May 2003, the Company issued a total of 6,724,063 shares, $0.01 par value per share, of Series A redeemable convertible preferred stock (Series A Preferred Stock), at $3.00 per share for net proceeds totaling $20,121,517, net of issuance costs of $50,684.

A summary of the significant terms of the Series A Preferred Stock is as follows:

Conversion

Each share of Series A Preferred Stock can be converted at the option of the holder at any time after issuance according to a conversion ratio, subject to adjustment for dilution. The initial conversion ratio is determined by dividing the original issue price of $3.00 by the conversion price in effect at the time the shares are converted. The conversion price is the original issue price adjusted for subsequent equity adjustments of which there have been none through December 31, 2003. Each share shall automatically convert into Class B common stock upon the closing of a public offering of common stock with gross proceeds of at least $20,000,000.

Redemption

At the election of the holders of at least a majority of the outstanding shares of Series A Preferred Stock on each of the First Redemption Date (March 31, 2011), Second Redemption Date (March 31, 2012), Third Redemption Date (March 31, 2013) and the final redemption date (March 31, 2014) the Company shall redeem one-third of the number of shares of Series A Preferred Stock held by such holder on each of the first three redemption dates and the remainder of any shares not already redeemed shall be redeemed on the final redemption date, in each case for $3.00 per share plus all accrued and unpaid dividends thereon whether or not declared.

The Company accounts for the difference between the carrying amount of redeemable preferred stock and the redemption amount by increasing the carrying amount for periodic accretion using the interest method, so that the carrying amount will equal the redemption amount at the redemption date. The aggregate redemption amount is approximately $21,489,000 at December 31, 2003.

Voting

Each share of Series A Preferred Stock has voting rights equal to the Class B common stock into which it is convertible.

Dividends

Holders of Series A Preferred Stock are entitled to receive cumulative dividends at the per annum rate of 8% of the original issue price per share when and if declared by the board of directors. The cumulative amount of preferred dividends in arrears is approximately $1,317,000 or $0.20 per share at December 31, 2003. The board of directors has not declared any dividends as of December 31, 2003. Upon conversion of the Series A Preferred Stock, either by optional conversion or by mandatory conversion upon an initial public offering, all accumulated and unpaid dividends on the Series A Preferred Stock, whether or not declared, since the date of issue up to and including the conversion date, shall be forgiven. If dividends or other distributions are paid on the common stock, the holders of Series A Preferred Stock are entitled to the preferential dividends above and are entitled to per share dividends equal to those declared or paid to holders of common stock.

Liquidation

In the event of liquidation, dissolution or winding up of the Company, holders of Series A Preferred Stock are entitled to receive, prior to the distribution of any Company assets, an amount of $3.00 per share in addition to any accumulated and unpaid dividends, whether or not declared.

After the original liquidation distribution has been paid to the holders of Series A Preferred Stock, the remaining assets of the corporation shall be distributed pro-rata among the holders of the common stock and Series A Preferred Stock on an as-converted basis.

(c) Stock Option Plan

In January 2003, the Company adopted a stock incentive plan (the “Plan”) pursuant to which the Plan’s Administrative Committee, appointed by the Company’s Board of Directors, may grant both stock options and restricted stock awards to employees, officers, non-employee directors, and consultants and may be designated as incentive or non-qualified stock options at the discretion of the Administrative Committee. The Plan authorizes grants of options to purchase up to 4,000,000 shares of authorized but unissued Class B common stock and provides for the total number of shares of Class B common stock for which options designated as incentive stock options may be granted shall not exceed 8,000,000 shares. Annual increases are to be added on the first day of each fiscal year beginning on January 1, 2004 equal to 5% of the outstanding common stock (including for this purpose any shares of common stock issuable upon conversion of any outstanding capital stock of the Company). As a result of this provision, the authorized number of shares available under this Plan was increased by 1,013,953 to 5,013,953 on January 1, 2004. Generally, stock options have 10-year terms and vest 25% at the end of each year over a 4 year period.

MARCHEX, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements—(Continued)

In connection with the purchase of Enhance Interactive, the Company agreed to grant 1,250,000 options to purchase Class B common stock at an exercise price of $0.75 per share to employees of Enhance Interactive. The options were not accounted for as purchase consideration as they were contingent upon the employees signing employment agreements with the Company. A total of 416,667 of these options were vested upon issuance. The remaining 833,333 shares vest in one-third increments at the end of each year over a 3 year period.

The purchase agreement requires 125,000 of the 416,667 vested options be held in escrow as security for the indemnification obligations under the merger agreement. While in escrow, these options are not exercisable and are subject to forfeiture. These options are accounted for as variable awards because they are subject to forfeiture, until the expiration of the escrow period on February 28, 2004. In accounting for variable awards, compensation cost is measured each period as the amount by which the then fair market value of the stock exceeds the exercise price. Changes, either increases or decreases, in the fair value of those awards between the date of grant and the measurement date result in a change in the measure of compensation for the award. Compensation costs recognized for the period from January 17, 2003 (inception) to December 31, 2003 for these 125,000 options were approximately $781,000.

During the period from January 17, 2003 (inception) to December 31, 2003, the Company granted certain options including those discussed above with exercise prices less than the then current fair market value. As a result, the Company recorded total deferred compensation expense of approximately $2,104,000, excluding the variable awards noted above. The Company recognized compensation expense over the vesting period utilizing the accelerated methodology described in FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans* (FIN 28).

In accordance with the accelerated methodology under FIN 28, approximately $1,192,000 was recognized as stock-based compensation expense during the period January 17, 2003 (inception) to December 31, 2003 and approximately $913,000 remained as deferred compensation December 31, 2003, which will continue to be amortized over the vesting period of the options.

In May 2003, in consideration for consulting services, the Company issued options under the Plan enabling a consultant to purchase 12,500 shares of its Class B common stock, at an exercise price of $3.00 per share. The options were fully vested at the grant date. Based on the fair value of the options, the Company recognized total compensation expense of approximately of $36,000 during the period from January 17, 2003 (inception) to December 31, 2003. The $2.89 fair value of each option was determined on the date of grant using the Black-Scholes option pricing model with the following assumptions: expected dividend yield of 0%, risk free interest rate of 5.5%, volatility of 111%, and an expected life equal to the option term of ten years.

The per share fair value of stock options granted during the period from January 17, 2003 (inception) to December 31, 2003 was determined on the date of grant using the Black Scholes option-pricing model with the following weighted-average assumptions: expected dividend yield 0%, risk-free interest rate of 5.5%, volatility ranging from 102% to 111%, for employee and director grants, an expected life of 4 years for employees, and for consultants, an expected life of 10 years. At December 31, 2003, there were 910,400 additional shares available for grant under the Plan.

MARCHEX, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements—(Continued)

Stock option activity during the period indicated is as follows:

	Options available for grant	Number of options outstanding	Weighted average exercise price of options outstanding	Weighted average fair value of options granted
Plan adoption (January 17, 2003)	4,000,000	—	$ —	$ —
Granted below fair value	(1,714,500)	1,714,500	1.28	2.22
Granted equal or above fair value	(707,000)	707,000	2.60	1.52
Granted equal or above fair value	(668,100)	668,100	IPO price	4.33
Balance at December 31, 2003	910,400	3,089,600	$ 1.67 – IPO price	2.52

The Company granted 668,100 options with an exercise price that will be equal to Company's initial public offering price.

The following table summarizes information concerning currently outstanding and exercisable options at December 31, 2003:

Options Outstanding			Options Exercisable	
Weighted average exercise price	Number outstanding	Weighted average remaining contractual Life	Number exercisable	Weighted average exercise price of exercisable options
$0.75	1,434,000	9.16	291,667	$0.75
$3.00	987,500	9.32	33,333	$3.00
IPO price	668,100	9.53	—	—
$1.67 – IPO price	3,089,600	9.29	325,000	$0.98

A total of 450,350 of the outstanding options were vested at December 31, 2003 of which 125,000 were held in escrow as security for the indemnification obligations under the eFamily.com, Inc. merger agreement and were not exercisable.

An additional 107,000 options with exercise prices that will equal the initial public offering price were granted subsequent to December 31, 2003 through February 11, 2004.

(d) Issuance of Class B Common Stock

In February 2003, in consideration for consulting services, the Company issued 5,000 shares of Class B common stock and recognized approximately $4,000 of compensation expense representing the estimated fair value of the shares issued during the period from January 17, 2003 (inception) to December 31, 2003.

In October 2003, in connection with the acquisition of TrafficLeader, the Company issued 108,432 shares of restricted Class B common stock that were valued at $6.75 per share. The shares are forfeitable and were issued to employees for future services, and vest over a period of three years, with the first 16.67% vesting after six months and each additional 16.67% vesting each successive 6-month period over the next thirty months. The 108,432 shares were valued at approximately $732,000 and are being recorded as compensation expense over the associated employment period in which these shares vest. In accordance with the accelerated methodology under FIN 28, approximately $112,000 was recognized as stock-based compensation during the period January 17, 2003 (inception) to December 31, 2003 and approximately $620,000 remained as deferred compensation at December 31, 2003.

MARCHEX, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements—(Continued)

(8) Contingencies

The Company is involved in legal and administrative proceedings and claims of various types from time to time. While any litigation contains an element of uncertainty, management presently believes that the outcome of each such proceeding or claim which is pending or known to be threatened, or all of them combined, will not have a material adverse effect on the Company.

(9) 401(k) Savings Plan

The Company has a Retirement/Savings Plan ("401(k) Plan") under Section 401(k) of the Internal Revenue Code which covers those employees that meet eligibility requirements. Eligible employees may contribute up to 15% of their compensation subject to Internal Revenue Code provisions. Under the 401(k) Plan, management may, but is not obligated to, match a portion of the employee contributions up to a defined maximum. No matching contributions have been made to date.

(10) Pre-Incorporation Costs

Business planning and other activities related to the Company's business began in late 2002. On January 17, 2003, the Company was incorporated as a separate legal entity. Included in the results of operations subsequent to January 17, 2003 are Company reimbursements to certain founders for approximately $86,000 in general and administrative pre-incorporation costs. Included in property and equipment are purchases from its founders of approximately $62,000 which equated to the carrying value of the assets.

(11) Acquisition of Predecessor

On February 28, 2003, the Company acquired 100% of the outstanding shares of the Predecessor. The results of the Predecessor's operations have been included in the Company's consolidated financial statements since that date. The Predecessor provides online advertising services to advertisers, including pay-for-performance advertising. The Predecessor's merchant advertisers can market to consumers and businesses through advertisements that are primarily found in the form of results on search engines, directories and other Web sites.

The aggregate cash consideration including acquisition costs was approximately $15,117,000. The purchase price excludes earnings-based contingent payments that depend on the achievement of minimum income before taxes, excluding stock-based compensation and amortization of intangibles related to the acquisition ("earnings before taxes") thresholds in calendar year 2003 and 2004 of the business acquired from the Predecessor. The payment of the earnings-based contingent amounts is based on the formula of 69.44% of the acquired businesses' 2003 and 2004 earnings before taxes up to an aggregate maximum payout cap of $12,500,000 ("earn-out consideration"). In the event earnings before taxes do not exceed $3,500,000 for 2003 or 2004, then no amount shall be payable for the related period. The contingent earn-out consideration payments are being accounted for as additional goodwill. For 2003, additional goodwill of $3,243,000 was recorded for the earn-out consideration.

In addition, if the minimum $3,500,000 thresholds above are achieved, a payment of 5.56% of the acquired business' earnings before taxes for calendar years 2003 and 2004, up to an aggregate maximum of $1,000,000 will be paid to certain current employees of the acquired business ("acquisition-related retention consideration"). These amounts will be accounted for as compensation expense. The threshold determination is calculated separately for each of calendar years 2003 and 2004. For 2003, $283,000 was recorded for the acquisition-related retention consideration including employer payroll-related taxes.

The 2003 earn-out and acquisition-related retention consideration amounts are payable on the earlier of (i) April 1, 2004 or (ii) three days after receipt of gross proceeds of $20 million from an IPO.

MARCHEX, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements—(Continued)

As part of the purchase agreement and conditioned upon continued employment, the Company agreed to issue 1,250,000 options to purchase Class B common shares at an exercise price of $0.75 per share to employees of the Predecessor. Of these options, 416,667 were vested upon issuance. The remaining 833,333 shares vest in one-third increments at the end of each year over a 3 year period.

A total of $1,500,000 and 125,000 of the 416,667 vested options were placed in escrow to secure indemnification obligations of the former shareholders of the Predecessor. The amounts can be released after 12 months. The cash escrow is included as part of the purchase price consideration and will ultimately be released to the former Predecessor shareholders in the event no indemnification obligations are identified.

The Company's purchase price has been recorded in the accompanying consolidated financial statements from the date of acquisition. As a result, the consolidated financial statements after the acquisition reflect a different basis of accounting than the historical financial statements prepared for the Predecessor Periods prior to February 28, 2003.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition:

Current assets, including acquired cash of $1,820,763	$ 2,532,050
Property and equipment	494,087
Other non-current assets	9,435
Identifiable intangible assets	8,400,000
Goodwill	8,736,783
Total assets acquired	20,172,355
Current liabilities	1,986,229
Non-current deferred tax liabilities	3,065,347
Other non-current liabilities	4,085
Total liabilities assumed	5,055,661
Net assets acquired	$ 15,116,694

The total goodwill related to the acquisition at December 31, 2003 was $11,980,000 which includes $3,243,000 of goodwill recorded for the 2003 earnings-based earn-out obligation.

The $8,400,000 of acquired intangible assets have a weighted average useful life of approximately 2.5 years. The identifiable intangible assets are comprised of a merchant advertising customer base valued at approximately $700,000 (2-year weighted-average useful life), distribution partner base valued at approximately $900,000 (2.5-year weighted-average useful life), non-compete agreements valued at approximately $1,100,000 (2-year weighted-average useful life), trademarks/domain names valued at approximately $400,000 (3-year weighted average useful life), acquired technology valued at 5,300,000 (2.6-year weighted-average useful life). The $11,980,000 of goodwill, including the $3,243,000 goodwill amount for the 2003 earnings-based earn-out obligation, and the acquired intangible assets not deductible for tax purposes.

The results of Predecessor's operations are included in the pro forma information presented in note 14.

(12) Acquisition of TrafficLeader, Inc.

On October 24, 2003, the Company acquired 100% of the outstanding stock of Sitewise Marketing, Inc. (d.b.a. TrafficLeader) ("TrafficLeader"). Sitewise Marketing, Inc. was renamed TrafficLeader, Inc. in November, 2003. TrafficLeader provides search marketing services. As a result of the acquisition, the Company obtained a broader base of service offerings and distribution partners. The purchase price consideration consisted of:

- Cash and acquisition costs of approximately $3,570,000; and
- 425,000 shares of class B common stock. In the event the Company has not completed an IPO with gross proceeds of $20 million prior to October 24, 2005, the purchase agreement provides the selling shareholders with a right to cause the 425,000 shares of Class B common stock to be redeemed for $8 per share (aggregate redemption amount of $3,400,000) upon the affirmative vote of holders of 75% of such shares. These shares were valued at $6.75 per share and the associated redemption right was recorded at an estimated fair value of $80,750. Based on the terms of the redemption right, the obligation is subject to variable accounting and the Company will mark the redemption right to fair value at each reporting period until such time as the redemption right expires or the shares are redeemed. The estimated fair value of the redemption right, which has been recorded as a liability, was $55,250 at December 31, 2003.

In addition, the Company issued 137,500 shares of restricted Class B common stock, valued at $6.75 per share. The shares were issued to employees and vest over a period of three years, with the first 16.67% vesting after six months and each additional 16.67% vesting each successive 6-month period over the next thirty months. Of these restricted shares, 29,068 shares valued at approximately $196,000 are non-forfeitable and included as part of the purchase consideration. As part of employment agreements signed with certain employees of TrafficLeader, a deferred stock compensation charge of approximately $732,000 was recorded in association with 108,432 of these shares. The Company expects to recognize compensation costs for the value of the shares over the associated three-year employment periods over which those shares vest. Stock-based compensation cost of approximately $112,000 was recognized from the acquisition date through December 31, 2003.

The purchase price excludes revenue-based contingent payments that depend on the TrafficLeader's achievement of revenue thresholds. For each dollar of TrafficLeader revenue in calendar 2004 in excess of $15 million, the Company, at the end of 2004, will pay 10% in the form of a revenue-based payment to the former TrafficLeader shareholders up to a maximum $1.0 million. Any amounts paid will be accounted for as additional goodwill.

In the event there is a change in control of the Company or of TrafficLeader, or the termination without cause or resignation for good reason of both of TrafficLeader's CEO and CTO on or prior to December 31, 2004, the Company will be obligated to pay the full amount of the $1 million performance-based contingent payment; if awarded, the payment would be recorded as compensation.

In connection with the acquisition, $175,000 of cash consideration and 100,000 shares of the 425,000 shares of Class B common stock were placed in escrow to secure indemnification obligations of the former shareholders of TrafficLeader. The cash can be released after nine months and the shares can be released after one year. The escrowed amounts are included as part of the purchase price consideration and will ultimately be released to the former TrafficLeader shareholders in the event no indemnification obligations are identified.

MARCHEX, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements—(Continued)

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition.

Current assets, including acquired cash of $342,451	$ 1,175,439
Property and equipment	271,161
Other non-current assets	4,077
Intangible assets	1,300,000
Goodwill	5,273,490
Total assets acquired	8,024,167
Current liabilities	826,095
Non-current deferred tax liabilities	482,229
Total liabilities assumed	1,308,324
Net assets acquired	$ 6,715,843

The $1,300,000 of acquired intangible assets have a weighted average useful life of approximately 2.4 years. The identifiable intangible assets are comprised of a merchant advertising customer base of approximately $300,000 (12-month weighted-average useful life), distribution partner base of approximately $600,000 (3-year weighted-average useful life), trademarks/domain names of approximately $100,000 (3-year weighted-average useful life), and acquired technology of $300,000 (2.5-year weighted-average useful life). The $5,273,490 of goodwill and the acquired intangible assets are not deductible for tax purposes. The estimated fair values of assets acquired and liabilities assumed are based upon preliminary estimates and may vary from the final allocation of the purchase price consideration.

(13) Acquired Identifiable Intangible Assets

Indentifiable intangible assets at December 31, 2003 consist of the following:

Merchant advertiser customer	$ 1,000,000
Distribution partner base	1,500,000
Non-compete agreements	1,100,000
Trademarks/domains	525,199
Acquired technology	5,600,000
	9,725,199
Less accumulated amortization	(3,023,408)
Total	$ 6,701,791

Aggregate amortization expense for the period from January 17, 2003 (inception) to December 31, 2003 was approximately $3,023,000. Estimated amortization expense for the next three years is approximately: $4,082,000 in 2004, $2,304,000 in 2005 and $316,000 in 2006.

Marchex, Inc.

Notes to Consolidated Financial Statements—(Continued)

(14) Pro Forma Results of Operations – Predecessor and TrafficLeader (Unaudited)

The following table presents pro forma results of operations as if the acquisition of the Predecessor and TrafficLeader had occurred as of the beginning of each of the periods presented. The following pro forma results of operations are based on the historical results of operations of the Predecessor and TrafficLeader for the year ended December 31, 2002, and in 2003 the historical results of operations of the Company for the period from January 17, 2003 (inception) to December 31, 2003, the Predecessor for the two months ended February 28, 2003, and TrafficLeader for the period ended October 23, 2003.

	Year ended December 31, 2002	January 2003 to December 31, 2003
Revenue	$ 14,075,109	27,351,966
Net loss	$ (3,879,332)	(2,880,362)
Net loss applicable to common stockholders	$ (3,879,332)	(4,199,247)
Net loss per share applicable to common stockholders		
Basic and diluted loss per share		$ (0.31)

The pro forma information is not necessarily indicative of the combined results that would have occurred had the acquisitions taken place at the beginning of 2002 or at the beginning of 2003, nor is it necessarily indicative of results that may occur in the future.

(15) Subsequent Events

(a) In February 2004, the Company entered into an agreement to commit for additional office facilities in Seattle, Washington. Future minimum payments related to these facilities are as follows: $188,000 in 2004, $340,000 in 2005, $422,000 in 2006, and $455,000 in each of 2007, 2008 and 2009. The remaining lease obligation at December 31, 2003 for office facilities in Seattle, Washington, from which the Company expects to relocate, totalled $313,000.

(b) On February 15, 2004, the Company's board of directors and shareholders approved the 2004 Employee Stock Purchase Plan, which will become effective on the first date that our Class B common stock is publicly traded as a result of an offering with gross proceeds in excess of $20 million. The plan provides employees the opportunity to purchase the Company's Class B common stock at 85% of the lower of the fair value at the beginning or end of a three-month offering period. A total of 300,000 shares have been initially reserved under the plan.

Independent Auditors' Report

The Board of Directors and Stockholders
Marchex, Inc.:

We have audited the accompanying balance sheets of Sitewise Marketing, Inc. as of December 31, 2002, and September 30, 2003 and the related statements of operations, stockholders' equity, and cash flows for the year ended December 31, 2002 and nine month period ended September 30, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 financial position of Sitewise Marketing, Inc. as of December 31, 2002 and September 30, 2003, and the results of its operations and their cash flows for the year ended December 31, 2002 and nine month period ended September 30, 2003 in conformity with accounting principles generally accepted in the United States of America.

/s/ KPMG LLP

Seattle, Washington
December 1, 2003

SITEWISE MARKETING, INC.
(D.B.A. TRAFFICLEADER)

Balance Sheets

	December 31, 2002	September 30, 2003
Assets		
Current assets:		
Cash and cash equivalents	$ 132,652	473,210
Accounts receivable, net of allowance for doubtful accounts and merchant advertiser credits of $16,037 and $40,643 at December 31, 2002 and September 30, 2003, respectively	775,384	639,289
Prepaid expenses	4,577	8,646
Total current assets	912,613	1,121,145
Property and equipment, net	152,341	279,291
Other assets	—	4,077
Total assets	$ 1,064,954	1,404,513
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 404,237	503,935
Accrued payroll and benefits	140,953	163,938
Accrued expenses and other current liabilities	602	97,677
Line of credit	27,000	—
Deferred revenue	16,794	39,601
Total current liabilities	589,586	805,151
Other non-current liabilities	1,585	—
Total liabilities	591,171	805,151
Stockholders' equity:		
Common stock, no par value, 20,000,000 authorized; issued and outstanding 10,007,500 at December 31, 2002 and 10,008,500 at September 30, 2003	692,819	689,547
Deferred stock-based compensation	(21,101)	(8,490)
Accumulated deficit	(197,935)	(81,695)
Total stockholders' equity	473,783	599,362
Total liabilities and stockholders' equity	$ 1,064,954	1,404,513

See accompanying notes to financial statements.

SITEWISE MARKETING, INC.
(D.B.A. TRAFFICLEADER)

Statements of Operations

	Year ended December 31, 2002	Nine month period ended September 30, 2003
Revenue	$ 4,004,602	3,986,156
Expenses:		
Service costs (*)	2,986,685	3,045,991
Sales and marketing (*)	322,106	339,150
Product development (*)	102,358	125,292
General and administrative (*)	380,408	311,443
Stock-based compensation (**)	24,474	9,139
Total expenses	3,816,031	3,831,015
Income from operations	188,571	155,141
Other income (expense):		
Interest income	—	416
Other income (expense), net	(1,785)	(793)
Net income	$ 186,786	154,764

(*) Amounts exclude stock-based compensation

(**) Components of stock-based compensation

Service costs	$ 12,412	2,954
Sales and marketing	4,209	2,891
Product development	6,823	2,901
General and administrative	1,030	393

See accompanying notes to financial statements.

Table of Contents

SITEWISE MARKETING, INC.
(D.B.A. TRAFFICLEADER)

Statements of Stockholders' Equity

	Common stock		Deferred stock-based compensation	Accumulated deficit	Total stockholders' equity
	Shares	Amount			
Balances at December 31, 2001	10,000,000	$ 697,196	(51,452)	(384,721)	261,023
Exercise of employee stock options	7,500	1,500	—	—	1,500
Stock-based compensation on options granted at less than fair market value	—	9,481	(9,481)	—	—
Amortization of stock based compensation	—	—	24,474	—	24,474
Cancellation of unvested options	—	(15,358)	15,358		—
Net income	—	—	—	186,786	186,786
Balances at December 31, 2002	10,007,500	692,819	(21,101)	(197,935)	473,783
Exercise of employee stock options	1,000	200	—	—	200
Dividend distribution to stockholders	—	—	—	(38,524)	(38,524)
Amortization of stock based compensation	—	—	9,139	—	9,139
Cancellation of unvested options	—	(3,472)	3,472	—	—
Net income	—	—	—	154,764	154,764
Balances at September 30, 2003	10,008,500	$ 689,547	(8,490)	(81,695)	599,362

See accompanying notes to financial statements.

SITEWISE MARKETING, INC.
(D.B.A. TRAFFICLEADER)

Statements of Cash Flows

	Year ended December 31, 2002	Nine month period ended September 30, 2003
Cash flows from operating activities:		
Net income	$ 186,786	154,764
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization and depreciation	61,895	80,564
Allowance for doubtful accounts	98,196	74,318
Stock-based compensation	24,474	9,139
Gain on sale of fixed asset	27	—
Change in certain assets and liabilities:		
Accounts receivable, net	(332,502)	61,777
Prepaid expenses	(4,578)	(4,068)
Accounts payable	81,874	99,698
Accrued expenses and other	36,363	120,059
Deferred revenue	1,402	22,807
Non-current liabilities	1,271	(1,585)
Net cash provided by operating activities	155,208	617,473
Cash flows from investing activities:		
Purchases of property and equipment	(116,869)	(207,514)
Proceeds from sale of property and equipment	393	—
Decrease (increase) in other non-current assets	—	(4,077)
Net cash used in investing activities	(116,476)	(211,591)
Cash flows from financing activities:		
Proceeds from exercises of stock options	1,500	200
Repayment of bank line of credit	(8,000)	(27,000)
Dividends paid to shareholders	—	(38,524)
Net cash used in financing activities	(6,500)	(65,324)
Net increase in cash and cash equivalents	32,232	340,558
Cash and cash equivalents at beginning of period	100,420	132,652
Cash and cash equivalents at end of period	$ 132,652	473,210
Supplemental disclosure of cash flow information—cash paid during the period for interest	$ 1,812	793

See accompanying notes to financial statements.

Table of Contents

SITEWISE MARKETING, INC.
(D.B.A. TRAFFICLEADER)

Notes to Financial Statements
Year ended December 31, 2002 and nine month period ended September 30, 2003

(1) Description of Business and Summary of Significant Accounting Policies and Practices

(a) Description of Business and Basis of Presentation

Sitewise Marketing, Inc. d.b.a. TrafficLeader ("the Company"), based in Eugene, Oregon, was formed in January, 2000. TrafficLeader provides performance-based advertising and search marketing services to merchant advertisers, including paid inclusion, advertising campaign management, conversion tracking and analysis, and search engine optimization. Through TrafficLeader's primary service, paid inclusion, TrafficLeader manages search-based advertising campaigns and services for merchant advertisers. TrafficLeader's paid inclusion service helps merchant advertisers reach prospective customers by first creating highly relevant product listings and then placing them in front of potential customers, primarily through search engines. The merchant advertiser's product listings map directly to user search queries, which link to specific product or information pages when clicked. On behalf of merchant advertisers, TrafficLeader indexes these highly relevant listings into many of the Internet's most visited search engines, product shopping engines, directories and other Web sites.

(b) Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity at date of purchase of three months or less to be cash equivalents. At December 31, 2002 and September 30, 2003 all accounts were held in bank deposit accounts.

(c) Fair Value of Financial Instruments

At December 31, 2002 and September 30, 2003, the Company had the following financial instruments: cash and cash equivalents, accounts receivables, accounts payable and accrued liabilities. The carrying value of cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities and the line of credit approximates their fair value based on the liquidity of these financial instruments or based on their short-term nature.

(d) Accounts Receivable

Accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company determines the allowance based on analysis of historical bad debts, merchant advertiser concentrations, merchant advertiser credit-worthiness and current economic trends. The Company reviews its allowance for collectibility quarterly. Past due balances over 90 days and specified other balances are reviewed individually for collectibility. All other balances are reviewed on an aggregate basis. Account balances are written off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

The Company does not have any off-balance sheet credit exposure related to its merchant advertisers.

The allowance for doubtful account activity for the periods indicated is as follows:

	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Write-offs	Balance at End of Period
Allowance for doubtful accounts:				
December 31, 2002	$ 67,097	98,196	158,709	$ 6,584
September 30, 2003	6,584	74,318	41,260	39,642

SITEWISE MARKETING, INC.
(D.B.A. TRAFFICLEADER)

Notes to Financial Statements—(Continued)
Year ended December 31, 2002 and nine month period ended September 30, 2003

At December 31, 2002 and September 30, 2003, one merchant advertiser represented 15% and 11%, respectively, of total accounts receivable.

For the year ended December 31, 2002 and the nine month period ended September 30, 2003, one merchant advertiser represented approximately 19% and 24%, respectively, of total revenue.

(e) Property and Equipment

Property and equipment are stated at cost. Depreciation on computers and other related equipment, purchased and internally developed software and furniture and fixtures is calculated on the straight-line method over the estimated useful lives of the assets generally averaging three years. Leasehold improvements are amortized on the straight line method over the shorter of the lease term or estimated useful lives of the assets ranging from three to five years.

(f) Impairment or Disposal of Long-Lived Assets

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their estimated fair value. Assets to be disposed of would be separately presented on the balance sheet and reported at the lower of their carrying amount or fair value less costs to sell, and are no longer depreciated.

(g) Advertising Expenses

Advertising costs are expensed as incurred and include Internet-based direct advertising and trade shows. Such costs are included in sales and marketing. The amounts for the periods presented were not significant.

(h) Product Development

Product development costs consist primarily of expenses incurred by the Company in the research and development, creation and enhancement of its Internet site and services. Research and development expenses include compensation and related expenses, costs of computer hardware and software, and costs incurred in developing features and functionality of the services. For all periods presented, substantially all product development expenses are research and development.

Product development costs are expensed as incurred or capitalized into property and equipment in accordance with Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (SOP 98-1). SOP 98-1 requires that costs incurred in the preliminary project and post-implementation stages of an internal use software project be expensed as incurred and that certain costs incurred in the application development stage of a project be capitalized.

SITEWISE MARKETING, INC.
(D.B.A. TRAFFICLEADER)

Notes to Financial Statements—(Continued)
Year ended December 31, 2002 and nine month period ended September 30, 2003

(i) Stock Option Plan

The Company applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations including Financial Accounting Standards Board ("FASB") Interpretation No. 44, "Accounting for Certain Transactions involving Stock Compensation an interpretation of APB Opinion No. 25" issued in March 2000, to account for its employee stock options. Under this method, employee compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. SFAS No. 123, *Accounting for Stock-Based Compensation*, established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Company has elected to continue to apply the intrinsic value-based method of accounting described above for options granted to employees, and has adopted the disclosure requirements of SFAS No. 123.

The Company recognizes compensation expense over the vesting period utilizing the accelerated methodology described in FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*.

The following table illustrates the effect on net income if the fair-value-based method had been applied to all outstanding and unvested awards in each period:

	Year ended December 31, 2002	Nine month period ended September 30, 2003
Net income:		
As reported	$ 186,786	154,764
Add: stock-based employee expense included in reported net income	24,474	9,139
Deduct: stock-based employee compensation expense determined under fair-value-based method for all awards (1)	(38,515)	(14,614)
Pro forma	$ 172,745	149,289

(1) See Note 4 for details of the assumptions used to arrive at the fair value of each.

The Company accounts for non-employee stock-based compensation in accordance with SFAS No. 123 and FASB's Emerging Issues Task Force ("EITF") Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods and Services.*

(j) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. The Company has used estimates in determining certain provisions, including uncollectible accounts receivable, useful lives for property and equipment and the fair-value of the Company's common stock. Actual results could differ from those estimates.

SITEWISE MARKETING, INC.
(D.B.A. TRAFFICLEADER)

Notes to Financial Statements—(Continued)
Year ended December 31, 2002 and nine month period ended September 30, 2003

(k) Concentrations

The Company maintains substantially all of its cash and cash equivalents with one financial institution.

Primarily all of the Company's revenue earned from merchant advertisers is supplied through distribution partners under short-term agreements. The Company may not be successful in renewing any of these agreements, or if they are renewed, they may not be on terms as favorable as current agreements. The Company may not be successful in entering into agreements with new distribution partners on commercially acceptable terms. In addition, several of these distribution partners may be considered potential competitors.

The percentage of revenue earned from merchant advertisers supplied by distribution partners representing more than 10% of revenue is as follows:

	Year ended December 31, 2002	Nine month period ended September 30, 2003
Affiliate A	42%	40%
Affiliate B	12%	12%

(l) Segment Reporting and Geographic Information

Operating segments are revenue-producing components of the enterprise for which separate financial information is produced internally for the Company's management. For all periods presented, the Company operated as a single segment. The Company operates in a single business segment principally in domestic markets providing Internet merchant transaction services to enterprises.

The Company attributes revenue from merchant advertisers in different geographical areas on the basis of the location of the customer. Substantially all of the Company's revenue and accounts receivable are derived from domestic sales to merchant advertisers engaged in various activities involving the Internet.

(m) Revenue Recognition

Revenue is generated primarily through paid inclusion services, that is, revenue is generated when a user clicks on a merchant advertiser's listings after it has been included by our distribution partners in their index of search listings. In paid inclusion services, merchant advertisers pay for their Web pages and product databases to be crawled, or searched, and included within search engine results. Generally, the paid inclusion results are delivered in a different section of the results than the pay-per-click listing results where the merchant advertiser drives placement through the price they choose to pay per click. For this inclusion service, revenue is not a result of placement in search results; rather the arrangement provides for inclusion in particular search engines, which may determine ranking based on individual algorithms such as relevancy determinations for a particular query.

Merchant advertisers also pay for supplementary search marketing services including advertising campaign management, conversion tracking and analysis, and search engine optimization. Merchants generally pay on a per click-through basis for these fees, although in limited cases a flat service fee is received for delivery of these services. These supplementary services allow merchant advertisers to track, monitor and optimize the placement of their advertising listings; to calculate conversion of listings that result in sales and those that do not; and optimize and organize their sites and listings for enhanced performance within algorithmic search engines. Revenue also consists of initial set-up fees.

SITEWISE MARKETING, INC.
(D.B.A. TRAFFICLEADER)

Notes to Financial Statements—(Continued)
Year ended December 31, 2002 and nine month period ended September 30, 2003

Revenue from these collective services accounted for less than 2% of total revenue in all periods presented. The Company has no barter transactions.

The supplementary services are generally based on usage that is billed on a fixed amount per click-through or a fixed monthly amount. Revenue is recognized on a click-through basis or in the month the service is provided.

The Company follows Staff Accounting Bulletin 101, *Revenue Recognition in Financial Statements* (SAB No. 101). This pronouncement summarizes certain of the Security and Exchange Commissions (SEC) staff's view on the application of accounting principles generally accepted in the United States of America to revenue recognition. Revenue associated with paid inclusion fees and supplementary search marketing services is recognized once persuasive evidence of an arrangement is obtained, services are performed, provided the fee is fixed and determinable and collection is reasonably assured.

Non-refundable initial account set-up fees paid by a merchant advertiser are recognized ratably over the longer of the contract or the average expected merchant advertiser campaign period which is currently estimated to be one year.

The Company has entered into agreements with various distribution partners to provide merchant advertisers' listings. The Company generally pays distribution partners based on a specified percentage of revenue or a fixed amount per click-through on these listings. The Company acts as principal to revenue transactions and bears the risk of loss. In accordance with EITF No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent*, the revenue derived from merchant advertisers who receive paid introductions through the Company as supplied by distribution partners is reported gross of the payment to distribution partners.

(n) Service Costs

Service costs represent those costs specifically applicable to our revenue. Service costs include network operations and customer service costs that consist primarily of costs associated with serving our search results, maintaining our Web site, credit card processing fees and network and fees paid to outside service providers that provide our paid listings and customer services. Customer service and other costs associated with providing our performance-based advertising and search marketing services, and maintaining our Web site include depreciation of Web site and network equipment, colocation charges of our Web site equipment, bandwidth, software license fees and salaries of related personnel.

Service costs also include user acquisition costs that relate primarily to payments made to distribution partners who provide an opportunity for the Company's merchant advertisers to market and sell their products through such distribution partners. The Company enters into agreements of varying durations with distribution partners that integrate the Company's services into their sites and indexes. The primary economic structure of the distribution partner agreements is a variable payment based on a specified percentage of revenue. These variable payments are often subject to minimum payment amounts per click-through. Other economic structures that to a lesser degree exist include: 1) fixed payments, based on a guaranteed minimum amount of traffic delivered, 2) variable payments based on a specified metric, such as number of paid click-throughs, and 3) a combination arrangement with both fixed and variable amounts.

The Company expenses user acquisition costs under two methods; agreements with fixed payments are expensed as the greater of the following:

- pro-rata over the term the fixed payment covers, or
- usage delivered to date divided by the guaranteed minimum amount of usage

SITEWISE MARKETING, INC.
(D.B.A. TRAFFICLEADER)

Notes to Financial Statements—(Continued)
Year ended December 31, 2002 and nine month period ended September 30, 2003

Agreements with variable payment based on a percentage of revenue, number of paid click-throughs or other metric are expensed as incurred based on the volume of the underlying activity or revenue multiplied by the agreed-upon price or rate.

(o) Income Taxes

The stockholders of the Company elected to utilize the provisions of subchapter S of the Internal Revenue Code. In lieu of corporate income taxes, the stockholders of a subchapter S corporation are taxed on their portion of the Company's taxable income. Therefore, no provision or liability for Federal income taxes was recorded in the financial statements.

(p) Guarantees

The Company adopted FASB Interpretation (FIN) No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, during the year ended December 31, 2002. FIN No. 45 provides expanded accounting guidance surrounding liability recognition and disclosure requirements related to guarantees, as defined by the interpretation. In ordinary course of business, the Company is not subject to potential obligations under guarantees that fall within the scope of FIN No. 45, except for standard indemnification provisions that are contained within many of it's merchant advertiser and distribution partner agreements, and give rise only to the disclosure requirements prescribed by FIN No. 45.

Indemnification provisions contained within the Company's merchant advertiser and distribution partner agreements are generally consistent with those prevalent in industry. The Company has not incurred significant obligations under merchant advertiser and distribution partner indemnification provisions historically and does not expect to incur significant obligations in the future. Accordingly, the Company does not maintain accruals for potential merchant advertiser and distribution partner indemnification obligations.

(q) Recently Issued Accounting Standards

In November 2002, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 00-21 ("EITF 00-21"), *Revenue Arrangements with Multiple Deliverables*. EITF 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which the vendor will perform multiple revenue generating activities. EITF 00-21 became effective for fiscal periods beginning after June 15, 2003. The adoption of EITF 00-21 has not had a material impact on the Company's financial position and results of operations.

In May 2003, the FASB issued SFAS 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. The Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). It is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of this Statement did not have a material impact on our financial statements.

(r) Related Party Transactions

The Company subleases office space to Wiant Design, an entity owned by the Company's CEO. Amounts received from Wiant Design for the year ended December 31, 2002 and the nine months ended September 30, 2003 are $2,940 and $2,205, respectively, and have been recorded as a reduction to rent expense.

SITEWISE MARKETING, INC.
(D.B.A. TRAFFICLEADER)

Notes to Financial Statements—(Continued)
Year ended December 31, 2002 and nine month period ended September 30, 2003

(2) Property and Equipment

Property and equipment consisted of the following at:

	December 31, 2002	September 30, 2003
Computer and other related equipment	$ 123,787	299,111
Purchased and internally developed software	127,801	150,580
Furniture and fixtures	7,547	14,258
Leasehold improvements	3,483	6,183
Less accumulated depreciation and amortization	(110,277)	(190,841)
Property and equipment, net	$ 152,341	279,291

Depreciation and amortization expense incurred by the Company was approximately $61,895 and $80,564 for the year ended December 31, 2002 and the nine-month period ended September 30, 2003, respectively.

(3) Commitments

The Company has commitments for future payments related to office facility leases and other contractual obligations. The Company leases its office facilities under operating lease agreements expiring through 2004. The Company also has other contractual obligations expiring over varying time periods through 2004. Future minimum payments are as follows:

	Office Leases	Contractual Obligations	Total
Through end of 2003	$ 28,556	4,571	33,127
2004	83,491	7,500	90,991
Total minimum payments	$ 112,047	12,071	124,118

Other contractual obligations primarily relate to minimum contractual payments due to content and other service providers. Rent expense was $61,000 and $66,000 for the year ended December 31, 2002 and the nine-month period ended September 30, 2003, respectively.

(4) Stockholders' Equity

2000 Stock Incentive Plan

In November 2000, the Company adopted the 2000 Stock Incentive Plan (the 2000 Plan). The 2000 Plan was maintained for officers, employees, directors and consultants under which 1,000,000 shares of Common stock were reserved for issuance. Generally, stock options were granted with 10 year terms and vest 12.5% after the first six months and then 6.25% every three months for the next 3.5 years.

The Company granted certain options with exercise prices less than the then current fair market value. As a result, the Company recorded total deferred stock-based compensation of approximately $185,000. The Company recognized compensation expense over the vesting period utilizing the accelerated methodology described in FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*.

SITEWISE MARKETING, INC.
(D.B.A. TRAFFICLEADER)

Notes to Financial Statements—(Continued)
Year ended December 31, 2002 and nine month period ended September 30, 2003

In accordance with this methodology approximately $24,000 and $9,000 was recognized as stock compensation expense for the year ended December 31, 2002 and nine-month period ended September 30, 2003 respectively.

The fair value for each option grant is estimated at the date of grant using a Black-Scholes option pricing model based on the following assumptions for the year ended December 31, 2002 and the nine-month period ended September 30, 2003: risk-free interest rates of 6%; no dividends; volatility factor of the expected market price of the Company's common stock of 111%; and a weighted-average expected life of approximately 3 years.

The following table summarizes stock option activity:

	Options available for grant	Number of options outstanding	Weighted average exercise price of options outstanding	Weighted average fair value of options granted
Balance at December 31, 2001	310,500	689,500	$ 0.20	
Granted below fair value	(30,000)	30,000	$ 0.25	$ 0.48
Exercised	—	(7,500)	$ 0.20	
Expired or cancelled	98,500	(98,500)	$ 0.20	
Balance at December 31, 2002	379,000	613,500	$ 0.20	
Exercised	—	(1,000)	$ 0.20	
Expired or cancelled	30,000	(30,000)	$ 0.20	
Balance at September 30, 2003	409,000	582,500	$ 0.20	

The following table summarizes information concerning outstanding and exercisable options at September 30, 2003:

	Options outstanding			Options exercisable	
Exercise prices	Number outstanding	Weighted-average remaining contractual life (years)	Weighted-average exercise price	Number exercisable	Weighted-average exercise price
$ 0.20	562,500	7.69	$ 0.20	463,438	$ 0.20
0.28	20,000	8.72	0.28	5,625	0.28
$ 0.20 – 0.28	582,500	7.72	$ 0.20	469,063	$ 0.20

(5) Contingencies

The Company is involved in legal and administrative proceedings and claims of various types from time to time. While any litigation contains an element of uncertainty, management presently believes that the outcome of each such proceeding or claim which is pending or known to be threatened, or all of them combined, will not have a material adverse effect on the Company.

SITEWISE MARKETING, INC.
(D.B.A. TRAFFICLEADER)

Notes to Financial Statements—(Continued)
Year ended December 31, 2002 and nine month period ended September 30, 2003

(6) Line of Credit

At December 31, 2002, the Company had available a $200,000 bank line of credit, secured by substantially all of the Company's assets, bearing interest at the prime rate plus 1% (approximately 6% at December 31, 2002). Borrowings under this line of credit were $27,000 at December 31, 2002. The line of credit was repaid in full and terminated in August 2003.

(7) 401(k) Savings Plan

The Company's Retirement/Savings Plan ("401 (k) Plan") adopted May 1, 2003 under Section 401 (k) of the Internal Revenue Code covers those employees that meet eligibility requirements. Eligible employees may contribute up to 25% of their compensation subject to Internal Revenue Code provisions. Under the 401 (k) Plan, management may, but is not obligated to, match a portion of the employee contributions up to a defined maximum. No matching contributions have been made to date.

(8) Subsequent Events

On October 24, 2003, Marchex, Inc. acquired 100% of the outstanding stock of the Company. The consideration consisted of:

- cash and acquisition costs of approximately $3,570,000;
- 425,000 shares of class B common stock. In the event that Marchex has not completed an IPO with gross proceeds of $20 million prior to October 24, 2005, the 425,000 shares of Class B common stock can be redeemed for $8 per share upon the affirmative vote of the holders of 75% of such shares.

In addition, Marchex, Inc. issued 137,500 shares of restricted class B common stock, of which 29,068 shares are non-forfeitable and 108,432 shares are based on continued employment agreements. The restricted shares vest over a period of 3 years, one-third at the end of each year, valued at $6.75 per share.

The purchase price excludes performance-based contingent payments that depend on the TrafficLeader's achievement of revenues thresholds. For each dollar of TrafficLeader revenue in calendar 2004 in excess of $15 million, Marchex, at the end of 2004, will pay 10% in the form of a performance-based payment to the former TrafficLeader shareholders up to a maximum $1 million. Any amounts will be accounted for as additional goodwill.

UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Enhance Interactive Acquisition

On February 28, 2003, Marchex, Inc. ("Company") acquired 100% of the outstanding stock of eFamily.com, Inc. and its wholly-owned subsidiary, ah-ha.com, Inc. ah-ha.com, Inc., based in Provo, Utah was renamed Enhance Interactive, Inc. in December 2003. The aggregate net cash consideration including acquisition costs to acquire Enhance Interactive was approximately $13.3 million. The $13.3 million purchase price excludes earnings-based contingent payments that depend on, Enhance Interactive's achievement of pre-tax minimum income before tax thresholds in calendar years 2003 and 2004. The payment of the earnings-based amounts is based on the formula of 69.44% of Enhance Interactive's 2003 and 2004 income before taxes up to an aggregate maximum payout cap of $12.5 million ("earn-out consideration"). In the event income before taxes, excluding stock-based compensation and amortization of intangible assets related to the acquisition ("earnings before taxes"), does not exceed $3.5 million for 2003 and 2004, then no amount shall be payable for the related period. These contingent payments, if made, will be accounted for as additional goodwill. For 2003, additional goodwill of approximately $3,423,000 was recorded for the earn-out consideration.

Additionally, if the minimum $3.5 million thresholds above are achieved, a payment of 5.56% of Enhance Interactive's income before taxes for calendar years 2003 and 2004, up to an aggregate maximum of $1 million will be paid to certain then current employees of Enhance Interactive ("acquisition-related retention consideration"). These amounts will be accounted for as compensation expense. The threshold determination is calculated separately for each of the calendar years 2003 and 2004. For 2003, approximately $283,000 was recorded for the acquisition-related retention consideration including employer payroll-related taxes. The amount of the total consideration to be paid to the former shareholders of Enhance Interactive was determined by an arms-length negotiation between the parties. As part of the purchase price and conditioned upon their employment subsequent to the acquisition, the Company agreed to issue 1,250,000 options to purchase Class B common shares at an exercise price of $0.75 per share to employees of Enhance Interactive. Of these options, 416,667 shares were vested upon issuance. The remaining 833,333 shares vest in one-third increments at the end of each year over a three year period. The contingent payments will be recorded as an expense in the period during which they would be earned.

The Company's purchase method of accounting for its acquisition of Enhance Interactive resulted in all assets and liabilities being recorded at their estimated fair values on the acquisition date. For the period from February 28, 2003 through December 31, 2003, all goodwill, identifiable intangible assets and liabilities resulting, exclusive of any 2004 contingent consideration, from the Enhance Interactive acquisition have been recorded in the consolidated financial statements of the Company. The statement of operations reflecting Enhance Interactive's results have been labeled as the "Predecessor" for the period from January 1 through February 28, 2003. The Company, including the results of Enhance Interactive since the date of acquisition, is labeled as the "Successor" in the accompanying unaudited Pro Forma condensed financial statements.

TrafficLeader Acquisition

On October 24, 2003, the Company acquired 100% of the outstanding stock of TrafficLeader, a Eugene, Oregon based company, for approximately $3.2 million in cash and acquisition costs, net of cash acquired.

Additionally, the Company issued 425,000 shares of Class B common stock subject to a separate redemption right. In the event the Company has not completed a firm commitment initial public offering with gross proceeds of at least $20 million prior to October 24, 2005, the former shareholders of TrafficLeader can redeem 425,000 shares of our Class B common stock for $8 per share (an aggregate redemption amount of $3.4 million) upon the affirmative vote of the holders of 75% of such shares. The shares were valued at $6.75 per share and the associated redemption right will be recorded as a liability, until such time as the redemption right expires or the shares are redeemed. Based on the terms of the redemption right, the redemption right will be marked to market at each reporting period until such time as the redemption right expires or the shares are redeemed.

The Company also issued 137,500 shares of restricted class B common stock that are valued at $6.75 per share. The shares were issued to employees that vest over a period of three years, with the first 16.67% vesting after six months and each additional 16.67% vest each successive 6-month period over the next two and a half years. Of those restricted shares, 29,068 non-forfeitable shares valued at approximately $196,000 are included as part of the purchase consideration. The remaining 108,432 shares were issued to employees of TrafficLeader for future services. The 108,432 shares were valued at approximately $732,000 and will be recorded as compensation expense over the associated employment period in which the shares vest. The purchase price excludes revenue-based contingent payments that depend on TrafficLeader's achievement of revenue thresholds. For each dollar of TrafficLeader revenue in calendar 2004 in excess of $15 million, the Company will pay 10% in the form of a revenue-based payment to the former shareholders up to a maximum $1 million. These contingent payments, if made, will be accounted for as additional goodwill. For the period from October 24, 2003 through December 31, 2003, all goodwill, identifiable intangible assets and resulting liabilities, exclusive of contingent consideration, from the TrafficLeader acquisition have been recorded in the consolidated financial statements of the Company. The estimated fair values of assets acquired and liabilities assumed are based upon preliminary estimates and may not be indicative of the final allocation of purchase price consideration.

Pro Forma Financial Information

The following unaudited pro forma condensed consolidated statements of operations for the year-ended December 31, 2003 give effect to the Company's acquisition of the Predecessor, and the acquisition of TrafficLeader as if they had occurred on January 1, 2003.

The unaudited pro forma condensed consolidated statements of operations for the period ended December 31, 2003 are based upon the historical results of operations of the Company for the period from January 17, 2003 (inception) through December 31, 2003, the Predecessor for the period from January 1 through February 28, 2003 and TrafficLeader for the period ended October 23, 2003. The unaudited pro forma condensed consolidated statements of operations and the accompanying notes should be read in conjunction with the historical financial statements and notes thereto of the Company, the Predecessor and TrafficLeader.

The unaudited pro forma condensed consolidated financial information is intended for illustrative purposes only and is not necessarily indicative of the combined results that would have occurred had the acquisitions taken place on January 1, 2003, nor is it necessarily indicative of results that may occur in the future.

Table of Contents

MARCHEX, INC.

UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
For the year ended December 31, 2003

	Predecessor	Successor	TrafficLeader		
	Period from January 1 to February 28, 2003	Period from January 17, 2003 (inception) to December 31, 2003	Period from January 1 to October 23, 2003	Pro Forma Adjustments	Pro Forma Combined
Revenue	$ 3,071,055	19,892,158	4,388,753	—	27,351,966
Expenses:					
Service Costs (1)	1,732,813	11,292,070	3,372,050		16,396,933
Sales and marketing (1)	365,043	2,460,683	374,293		3,200,019
Product development (1)	144,479	1,291,422	140,647		1,576,548
General and administrative (1)	234,667	2,743,919	343,369		3,321,955
Acquisition-related retention consideration (2)	—	283,269	—		283,269
Stock-based compensation (3)	38,981	2,125,110	9,968	362,999 (e) 122,222 (g)	2,659,280
Amortization of intangible assets (4)	—	3,023,408	—	579,500 (a) 530,400 (c)	4,133,308
Total operating expenses	2,515,983	23,219,881	4,240,327	1,595,121	31,571,312
Income (loss) from operations	555,072	(3,327,723)	148,426	(1,595,121)	(4,219,346)
Other income (expense)					
Interest income	1,529	45,874	663	—	48,066
Adjustment to fair value of redemption obligation	—	25,500	—	—	25,500
Other income (expense)	—	2,685	(793)	—	1,892
Total other income (expense)	1,529	74,059	(130)	—	75,458
Income (loss) before provision for income taxes	556,601	(3,253,664)	148,296	(1,595,121)	(4,143,888)
Income tax expense (benefit)	224,082	(1,084,312)	—	(216,200) (b) (203,408) (d) 61,323 (f) (45,011) (k)	(1,263,526)
Net income (loss)	332,519	(2,169,352)	148,296	(1,191,825)	(2,880,362)
Accretion of redemption value of redeemable convertible preferred stock	—	1,318,885	—	—	1,318,885
Net Income (loss) applicable to common stockholders	$ 332,519	(3,488,237)	148,296	(1,191,825)	(4,199,247)
Basic and diluted net loss per share applicable to common stockholders	$	(0.26)			(0.31)
Shares used to calculate basic and diluted net loss per share		13,259,747		374,384 (i)	13,634,131
Adjusted pro forma basic and diluted net loss per share applicable to common stockholders	$	(0.18)			(0.22)
Shares used to calculate adjusted pro forma basic and diluted net loss per share		19,011,093		374,384 (l)	19,385,477
(1) Excludes acquisition-related retention consideration, stock-based compensation and amortization of intangible assets					
(2) Components of acquisition-related retention consideration:					
Service costs	$ —	33,723	—	—	33,723
Sales and marketing	—	96,262	—	—	96,262
Product development	—	104,233	—	—	104,233
General and administrative	—	49,051	—	—	49,051
(3) Components of stock-based compensation:					
Service costs	$ 190	9,776	3,219	3,300	16,485
Sales and marketing	715	421,871	3,156	21,755	447,497
Product development	37,710	241,080	3,166	8,187	290,145
General and administrative	366	1,452,383	427	451,977	1,905,153
(4) Components of amortization of intangible assets:					
Service costs	$ —	2,216,958	—	716,352	2,933,310
Sales and marketing	—	348,117	—	301,882	649,999
Product development	—	—	—	—	—
General and administrative	—	458,333	—	91,666	549,999

See notes to unaudited pro forma condensed consolidated Statements of Operations.

MARCHEX, INC.

Notes To Unaudited Pro Forma Condensed Consolidated Statements of Operations

Pro Forma Adjustments.

The following adjustments were applied to the historical statements of operations of the Company, the Predecessor and TrafficLeader to arrive at the unaudited pro forma condensed consolidated statements of operations:

(a) Represents the amortization of identifiable intangible assets associated with the Company's acquisition of the Predecessor, which are amortized over their useful lives ranging from 24 to 42 months, amortization of $3.5 million in the first twelve months, following the acquisition. The Company, for the period from January 17, 2003 (inception) to December 31, 2003, recorded approximately $2.9 million of amortization related to the above-noted identifiable intangible assets.

(b) Represents the deferred income tax benefit associated with the amortization of intangibles in connection with the Company's acquisition of the Predecessor.

(c) Represents the amortization of identifiable intangible assets associated with the acquisition of TrafficLeader, which are amortized over their useful lives ranging from 12 to 36 months, amortization of $653,000 in the first twelve months following the acquisition. The Company, for the period of January 17, 2003 (inception) to December 31, 2003, recorded approximately $123,000 of amortization related to the above-noted identifiable intangible assets.

(d) Represents the deferred income tax benefit associated with the amortization of intangibles in connection with the acquisition of TrafficLeader.

(e) Represents stock-based compensation charges associated with shares of restricted Class B common stock issued to employees of TrafficLeader valued at approximately $732,000 at the transaction date. The Company is recognizing stock-based compensation expense for the value of these shares over the associated employment period in which these shares vest, which results in $476,000 in amortization in the first twelve months following the acquisition. The Company, for the period from January 17, 2003 (inception) to December 31, 2003, recorded approximately $112,000 relating to the above-noted restricted shares.

(f) Represents pro-forma income tax expense as though TrafficLeader was taxed as a C Corporation for the periods presented. Prior to the Company's acquisition, TrafficLeader was an S-Corp, in which case shareholders were taxed on their portion of TrafficLeader's taxable income.

(g) Represents stock-based compensation charges associated with options issued to employees of Enhance Interactive. As part of the Enhance Interactive purchase agreement, the Company agreed to issue 1,250,000 options to purchase Class B common shares at an exercise price of $0.75 per share to employees of Enhance Interactive. 416,667 of these options were vested upon issuance. The remaining 833,333 shares vest in one-third increments at the end of each year over a three year period. The intrinsic value associated with the initial grant of the 1,250,000 options totaled $1,800,000. Compensation totaling $600,000 was recognized for the 416,667 options that vested upon issuance. For the 833,333 remaining options, the Company is recognizing stock-based compensation expense over the associated employment period in which these shares vest which results in $733,333 in amortization for the first twelve months following the acquisition. The Company, for the period from January 17 (inception) to December 31, 2003, recorded approximately $1,211,000 relating to the above-noted options, excluding the variable accounting charges noted below.

125,000 of the 416,667 vested options are held in escrow as security for the indemnification obligations under the merger agreement and are subject to forfeiture. These options are accounted for by the Company as variable awards because they are subject to forfeiture, until the expiration of the escrow period which is

MARCHEX, INC.

Notes To Unaudited Pro Forma Condensed Consolidated Statements of Operations—(Continued)

February 28, 2004. In accounting for variable awards, compensation cost is measured each period as the amount by which the then fair market value of the stock exceeds the exercise price. Changes, either increases or decreases in the fair value of those awards between the date of grant and the measurement date, result in a change in the measure of compensation for the award. Compensation costs recognized by the Company for the period from January 17, 2003 (inception) to December 31, 2003 for these 125,000 options were approximately $781,000. Of the $781,000, a total of $180,000 is included as part of the $600,000 compensation amount noted above that was recognized at the time of issuance. In periods prior to the acquisition of the Enhance Interactive, the Company and the Predecessor have not given effect in the pro forma statement of operations to the potential impact of the variable plan accounting because the effect is non-recurring.

The option grants were for post acquisition services and were not accounted for as part of the merger consideration.

(h) Represents the deferred income tax expense (benefit) associated with the recognition of stock-based compensation adjustments for options issued to employees of Enhance Interactive.

(i) The following is a reconciliation of shares used to compute historical basic and diluted net loss per share to historical pro forma basic and diluted net loss per share and to shares used to compute adjusted pro forma basic and diluted net loss per share for the combined twelve month period ended December 31, 2003. Potentially dilutive securities were not included in the computations because their effects would be anti-dilutive.

	Pro Forma basic and diluted	Adjusted Pro Forma basic and diluted
Shares used to calculate net loss per share	13,259,747	13,259,747
Pro forma shares issued in TrafficLeader acquisition subject to redemption right	341,954	341,954
Pro forma restricted shares issued in TrafficLeader acquisition	23,394	23,394
Weighted average restricted shares issued in TrafficLeader acquisition for services expected to vest during the period	9,036	9,036
Weighted average shares assuming conversion of Series A redeemable convertible Preferred stock at the original issuance date	—	5,751,346
Shares used to calculate pro forma and adjusted pro forma basic and diluted net loss per share	13,634,131	19,385,477

If the proposed initial public offering (IPO) is consummated under the terms presently anticipated, each of the 6,724,063 outstanding shares of the Company’s Series A redeemable convertible preferred stock will automatically convert into 1 share of Class B common stock upon closing of the proposed IPO.

The adjusted pro forma basic and diluted shares used to calculate net loss per share are calculated above as if the Series A redeemable convertible preferred stock had converted into shares of common stock at the original issuance date.

(j) Based upon the terms of the redemption right of $8 per share on the 425,000 shares issued in the TrafficLeader acquisition, the obligation will be reflected as a liability and is subject to variable plan

MARCHEX, INC.

Notes To Unaudited Pro Forma Condensed Consolidated Statements of Operations—(Continued)

accounting. The obligation will be marked to market at each reporting date until such time as the redemption right expires or the shares are redeemed. No adjustment for possible changes in the value of the redemption right has been reflected in the accompanying pro forma statements.

(k) Other information.

The purchase price for Enhance Interactive ("Predecessor") excludes earnings-based contingent payments that depend on Enhance Interactive's achievement of minimum income before taxes excluding stock-based compensation and amortization of intangible assets related to the acquisition ("earnings before taxes") thresholds in calendar year 2003 and 2004. The payment of the earn-out amounts is based on the formula of 69.44% of the Enhance Interactive's 2003 and 2004 earnings before taxes up to an aggregate maximum payout cap of $12.5 million. In the event earnings before taxes does not exceed $3.5 million for 2003 or 2004, then no amount shall be payable for the related period. Any amounts will be accounted for as additional goodwill. For 2003, additional goodwill of $3,243,000 was recorded for the earn-out consideration.

In addition, if the individual $3.5 million thresholds above are achieved, a payment of 5.56% of Enhance Interactive's earnings before taxes for calendar years 2003 and 2004, up to an aggregate maximum of $1 million will be paid to certain current employees of Enhance Interactive (acquisition retention consideration). These amounts will be accounted for as compensation. The threshold determination is calculated separately for each of calendar years 2003 and 2004. For 2003, $283,000 was recorded for the acquisition-related retention consideration.

Estimated amortization relating to intangible assets acquired as part of the acquisition of Enhance Interactive for the next five years is: $3.5 million in 2004, $1.9 million in 2005 and $83,000 in 2006.

The purchase price for TrafficLeader excludes revenue-based contingent earn-out payments that depend on TrafficLeader's achievement of revenue thresholds. For each dollar of TrafficLeader revenue in calendar 2004 in excess of $15 million, the Company, at the end of 2004, will pay 10% in the form of an earn-out based payment to the former TrafficLeader shareholders up to a maximum $1 million. Any amounts paid under this provision will be accounted for as additional goodwill.

In the event there is a change in control of the Company or of TrafficLeader, or the termination without cause or resignation for good reason of both of TrafficLeader's CEO and CTO on or prior to December 31, 2004, the Company will be obligated to pay the full amount of the $1 million performance-based contingent payment; if awarded, the payment would be recorded as compensation.

Estimated amortization relating to intangible assets acquired as part of the acquisition of TrafficLeader for the next five years is: $597,000 in 2004, $353,000 in 2005 and $227,000 in 2006.

[Table of Contents](#)

4,000,000 Shares

Marchex, Inc.

Class B Common Stock

Dealer Prospectus Delivery Obligation

Until , 2004, 25 days after the date of this offering, all dealers that effect transactions in these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers' obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

PART II
INFORMATION NOT REQUIRED IN PROSPECTUS

Item 24. ***Indemnification of Directors and Officers***

The certificate of incorporation and the by-laws of the registrant provide that the registrant shall indemnify its officers, directors and certain others to the maximum extent permitted by the General Corporation Law of the State of Delaware.

Section 145 of the General Corporation Law of the State of Delaware provides in relevant part as follows:

> (a) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative) other than an action by or in the right of the corporation) by reason of the fact that the person is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by the person in connection with such action, suit or proceeding if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding had no reasonable cause to believe the person's conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that the person's conduct was unlawful.

> (b) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that the person is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses (including attorneys' fees) actually and reasonably incurred by the person in connection with the defense or settlement of such action or suit if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interest of the corporation and except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation unless and only to the extent that the Court of Chancery or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery or such other court shall deem proper.

The General Corporation Law does not allow for the elimination or limitation of liability of a director: (i) for any breach of a director's duty of loyalty to the corporation or its stockholders; (ii) acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) arising under Section 174 thereof; or (iv) for any transaction from which the director derived an improper personal benefit. The General Corporation Law provides further that the indemnification permitted thereunder shall not be deemed exclusive of any rights to which the directors and officers may be entitled under the corporation's bylaws, any agreement, a vote of stockholders or otherwise.

In addition, pursuant to our certificate of incorporation and by-laws, we shall indemnify our directors and officers against expenses (including judgments or amounts paid in settlement) incurred in any action, civil or criminal, to which any such person is a party by reason of any alleged act or failure to act in his capacity as such, except as to a matter as to which such director or officer shall have been finally adjudged not to have acted in good faith in the reasonable belief that his action was in the best interest of the corporation.

The underwriting agreement between us and the underwriters of this offering provides that the underwriters are obligated, under certain circumstances, to indemnify our directors, officers and controlling persons against certain liabilities, including liabilities under the Securities Act. Reference is made to the form of Underwriting Agreement filed at Exhibit 1.1 hereto.

We maintain directors and officers liability insurance for the benefit of our directors and certain of our officers. We have entered into indemnification agreements with each of our directors and our executive officers.

Item 25. ***Other Expenses of Issuance and Distribution***

The following table sets forth the expenses (other than the underwriting discounts and commissions) payable in connection with the sale of the Class B common stock offered hereby, all of which will be paid by Marchex, Inc. Certain of these expenses are based on the best estimate of Marchex, Inc., as indicated below.

	Amount to be Paid
SEC registration fee	$ 2,832*
NASD filing fee	3,720*
NASDAQ National Market listing fee	100,000*
Printing and engraving expenses	125,000*
Legal fees and expenses	355,000*
Accounting fees and expenses	435,000*
Blue sky fees and expenses	35,000*
Transfer agent and registrar fees and expenses	25,000*
Miscellaneous fees and expenses	18,448*
Total	$1,100,000

* Estimated amount of expense as of the filing date of this Amendment No. 1 to Registration Statement.

Item 26. ***Recent Sales of Unregistered Securities***

Since our inception on January 17, 2003, we have issued the following securities, none of which have been registered under the Securities Act of 1933, as amended (the “Act”):

1. In January 2003, we issued and sold an aggregate of 12,250,000 shares of our Class A common stock to our five founding officers for aggregate cash consideration of $122,500.

2. In January 2003, we issued and sold 1,000,000 shares of our Class B common stock to a limited liability company controlled and managed by one of our founding officers for cash consideration of $10,000.

3. In February 2003, we also issued 5,000 shares of Class B common stock for services pursuant to a stock grant agreement.

4. In February and May 2003, we issued and sold 6,724,063 shares of our Series A redeemable convertible preferred stock to ninety-four (94) investors, each of whom we reasonably believe is an “accredited investor” within the meaning of Rule 501 of Regulation D of the Act, for an aggregate cash consideration of approximately $20,172,201.

5. In October 2003, we issued 562,500 shares of our Class B common stock as partial consideration in connection with our acquisition of TrafficLeader, with an allocated value of $3,796,875.

6. Since our inception, under the stock incentive plan, we have granted options to a number of our employees, directors and consultants to purchase an aggregate of: (i) 2,421,500 shares of our Class B common stock with a weighted average exercise price of $1.67 per share; and (ii) 775,100 shares of our Class B common stock with an exercise price equal to the initial public offering price per share.

No underwriters were involved in any of the foregoing transactions. Such sales and issuances of stock and issuance of options were made in reliance upon an exemption from the registration provisions of the Act set forth in Section 4(2) and Rule 506 of Regulation D thereof relative to the sale by an issuer not involving a public offering or the rules and regulations thereunder, or in the case of certain options to purchase shares of Class B common stock, Rule 701 of the Act. All of the foregoing securities are deemed restricted securities for purposes of the Act.

Item 27. ***Exhibits and Financial Statement Schedules***

(a) Exhibits

Number	Description
*1.1	Form of Underwriting Agreement.
**2.1	Agreement and Plan of Merger, dated as of February 19, 2003, by and among Registrant, Marchex Acquisition Corporation, eFamily.com, Inc., the Shareholders of eFamily.com, Inc., ah-ha.com, Inc. and Paul J. Brockbank, as Stockholder Representative.
**2.2	Agreement and Plan of Merger, dated as of October 1, 2003, by and among Registrant, Sitewise Acquisition Corporation, TrafficLeader, Inc., the Shareholders of TrafficLeader, Inc. and Gerald Wiant, as Shareholder Representative.
**3.1	Certificate of Incorporation of the Registrant.
**3.2	Certificate of Designation, Preferences and Rights of the Series A Convertible Preferred Stock.
***3.3	Certificate of Amendment to the Certificate of Incorporation of the Registrant.
**3.4	By-laws of the Registrant, as currently in effect.
***4.1	Specimen stock certificate representing shares of Class B common stock of the Registrant.
**4.2	Stockholders’ Agreement, dated as of January 23, 2003, by and among the Registrant and the investors named therein.
**4.3	Stock Transfer and Restriction Agreement, dated as of October 24, 2003, by and among the Registrant and those holders of Class B common stock named therein.
**4.4	Series A Preferred Stock Subscription and Stock Purchase Agreement.
*4.5	Form of Representative’s Warrant Agreement.
*5.1	Form of Opinion of Nixon Peabody LLP.
***10.1	Amended and Restated 2003 Stock Incentive Plan.
**10.2	Sublease Assignment and Assumption Agreement, dated as of January 18, 2003, by and between Marrch Holdings, LLC, the Registrant and Ecology and Environment, Inc.
**10.3	Office Lease, dated as of September 5, 2003, by and between the Registrant and Selig Real Estate Holdings Five.
**10.4	Sublease, dated as of March 13, 2000, by and between MyFamily.com, Inc. and ah-ha.com, Inc.
**10.5	Indenture of Lease, dated as of August 31, 2001, by and between A&A Properties, N.W., L.L.C. and Sitewise Marketing, Inc.

Table of Contents

Number	Description
**10.6	Sublease, dated as of June 1, 2003, by and between Radiant Marketing Solutions, Inc., as sublessor, and Sitewise Marketing, Inc., as sublessee, and Jerry Wiant and Bruce Fabbri, as guarantors.
**10.7	Executive Employment Agreement, dated as of January 17, 2003, by and between Russell C. Horowitz and the Registrant.
*10.8	Executive Employment Agreement, dated as of May 1, 2003, by and between Michael A. Arends and the Registrant.
*10.9	Form of Director and Executive Officer Indemnification Agreement.
*10.10	2004 Employee Stock Purchase Plan.
*10.11	Letter of Intent, dated as of February 11, 2004, by and between Seattle's Best Coffee, LLC and the Registrant.
***10.12	Sublease, dated as of February , 2004, by and between Seattle's Best Coffee, LLC and the Registrant.
**21.1	Subsidiaries of the Registrant.
*23.1	Independent Auditors' Consent.
*23.2	Consent of Counsel (included in Exhibit 5.1).
24.1	Power of Attorney (see Page II-5).

* Filed herewith.
** Previously filed.
*** To be filed by amendment.

(b) Financial Statement Schedules

Schedules not listed above have been omitted because the information required to be set forth therein is not applicable or is shown in the financial statements or notes thereto.

Item 28. ***Undertakings***

Undertaking Required by Regulation S-B, Item 512 (d):

The undersigned Registrant hereby undertakes to provide to the underwriters at the closing of this offering specified in the underwriting agreement certificates in such denomination and registered in such names as required by the underwriters to permit proper delivery to each purchaser.

Undertaking Required by Regulation S-B, Item 512 (e):

Insofar as indemnification for liabilities arising under the Securities Act of 1933, as amended (the "Act"), may be permitted to directors, officers and controlling persons of the Registrant pursuant to any arrangement, provision or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable.

In the event that a claim for indemnification against such liabilities (other than payment by the Registrant of expenses incurred or paid by a director, officer or controlling person of the Registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

Undertaking Required by Regulation S-B, Item 512 (f):

The undersigned registrant hereby undertakes to:

(1) for determining any liability under the Securities Act of 1933, as amended (the “Securities Act”), treat the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the Registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act as part of this registration statement as of the time it was declared effective; and

(2) for determining any liability under the Securities Act, treat each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

Table of Contents

SIGNATURES

In accordance with the requirements of the Securities Act of 1933, the registrant certifies that it has reasonable grounds to believe that it meets all of the requirements of filing on Form SB-2 and authorizes this Amendment No. 1 to Registration Statement to be signed on its behalf by the undersigned, in the City of Seattle, State of Washington on February 18, 2004.

MARCHEX, INC.

By: /s/ RUSSELL C. HOROWITZ

Russell C. Horowitz
Chairman and Chief Executive Officer

POWER OF ATTORNEY

We, the undersigned officers and directors of Marchex, Inc., hereby severally constitute and appoint Russell C. Horowitz and Michael A. Arends, and each of them singly, our true and lawful attorneys, with full power to them and each of them to sign for us in our names in the capacities indicated below, all pre-effective and post-effective amendments to this registration statement and any related subsequent registration statement pursuant to Rule 462(b) of the Securities Act of 1933, as amended, and generally to do all things in our names and on our behalf in such capacities to enable Marchex, Inc. to comply with the provisions of the Securities Act of 1933, as amended, and all requirements of the Securities and Exchange Commission.

In accordance with the requirements of the Securities Act of 1933, this Amendment No. 1 to Registration Statement was signed by the following persons in the capacities and on the dates indicated:

Signature	Date
/s/ RUSSELL C. HOROWITZ **Russell C. Horowitz** **Chairman and Chief Executive Officer** **(Principal Executive Officer)**	February 18, 2004
/s/ MICHAEL A. ARENDS **Michael A. Arends** **Chief Financial Officer** **(Principal Financial and Accounting Officer)**	February 18, 2004
/s/ JOHN KEISTER **John Keister** **President, Chief Operating Officer and Director**	February 18, 2004
/s/ DENNIS CLINE **Dennis Cline** **Director**	February 18, 2004
/s/ JONATHAN FRAM **Jonathan Fram** **Director**	February 18, 2004
/s/ RICK THOMPSON **Rick Thompson** **Director**	February 18, 2004

Table of Contents

EXHIBIT INDEX

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**2.2	Agreement and Plan of Merger, dated as of October 1, 2003, by and among Registrant, Sitewise Acquisition Corporation, TrafficLeader, Inc., the Shareholders of TrafficLeader, Inc. and Gerald Wiant, as Shareholder Representative.
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**3.2	Certificate of Designation, Preferences and Rights of the Series A Convertible Preferred Stock.
***3.3	Certificate of Amendment to the Certificate of Incorporation of the Registrant.
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***4.1	Specimen stock certificate representing shares of Class B common stock of the Registrant.
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**21.1	Subsidiaries of the Registrant.
*23.1	Independent Auditors' Consent.
*23.2	Consent of Counsel (included in Exhibit 5.1).
24.1	Power of Attorney (see Page II-5).

* Filed herewith.
** Previously filed.
*** To be filed by amendment.

EXHIBIT 1.1

4,000,000 Shares

Marchex, Inc.

Class B Common Stock ($.01 Par Value)

FORM OF UNDERWRITING AGREEMENT

__________, 2004

NATIONAL SECURITIES CORPORATION
As Representative of the several Underwriters
named in Schedule A hereto
c/o National Securities Corporation
1001 Fourth Avenue
Suite 2200
Seattle, Washington 98154-1100

Dear Ladies and Gentlemen:

1. INTRODUCTORY. Marchex, Inc., a Delaware corporation (the "Company"), proposes to issue and sell through you, pursuant to the terms of this Agreement, to the several underwriters named in Schedule A hereto (the "Underwriters," or, each, an "Underwriter"), an aggregate of 4,000,000 shares of Class B Common Stock, $.01 par value per share (the "Common Stock"), of the Company. The aggregate of 4,000,000 shares so proposed to be sold is hereinafter referred to as the "Firm Stock". The Company also grants to the Underwriters an option, upon the terms and conditions set forth in Section 3 hereof, to purchase up to an additional 600,000 shares of Common Stock (the "Additional Shares"). The Firm Stock and the Additional Shares are hereinafter collectively referred to as the "Shares." National Securities Corporation ("National") is acting as a representative of the several Underwriters and in such capacity is hereinafter referred to as the "Representative".

In connection with the proposed offering of the Shares, National has agreed to administer a directed share program (the "Directed Share Program") pursuant to which up to 600,000 Firm Shares, or fifteen percent (15%) of the Firm Shares, to be purchased by it (the "Reserved Shares") shall be reserved for sale at the initial public offering price to the Company's officers, directors, employees and consultants and others having a relationship with the Company (the "Directed Share Participants") as part of the distribution of the Shares by the Underwriters, subject to the terms of this Agreement, the applicable rules, regulations and interpretations of the National Association of Securities Dealers, Inc. ("NASD") and all other applicable laws, rules and regulations. The number of Shares available for sale to the general public will be reduced to the extent that the Directed Share Participants purchase the Reserved Shares. Reserved Shares not confirmed for purchase by the Directed Share Participants by the end of the business day on which this Agreement is executed will be offered to the general public by the Underwriters on the same basis as the other Shares being issued and sold hereunder. The Company has supplied National with the names, addresses and telephone numbers of the individuals or other entities which the Company has designated to be participants in the Directed Share Program. It is understood that any number of those designated to participate in the Directed Share Program may decline to do so.

The Company also proposes, pursuant to Section 3 hereof, upon the successful closing of the offering of the Shares and the fulfillment of the terms of the Underwriting Agreement by Representative, to issue and sell to the Representative, for its own account or for the account of the Representative's Designee (as hereinafter defined) for an aggregate price of One Hundred Dollars ($100.00), a warrant to purchase up to an aggregate of 120,000 shares of Common Stock (the "Representative's Warrant") at a per share price equal to 130% of the per share initial offering price of the Shares set forth in the "Registration Statement" and "Prospectus" (as hereinafter defined) which such Representative's Warrant shall only be exercisable during the period commencing one (1) year from the First Closing Date (as hereinafter defined) and ending five (5) years from such First Closing Date, in accordance with the terms and conditions of the form of Representative's warrant agreement substantially in the form of Exhibit 4.5 to the Registration Statement (the "Representative's Warrant Agreement").

2. REPRESENTATIONS AND WARRANTIES OF THE COMPANY. The Company represents and warrants to, and agrees with, the several Underwriters that:

(a) A registration statement on Form SB-2 in the form in which it became or becomes effective and also in such form as it may be when any post-effective amendment thereto shall become effective with respect to the Shares, including any pre-effective prospectus included as part of the registration statement as originally filed or as part of any amendment or supplement thereto, or filed pursuant to Rule 424 under the Securities Act of 1933, as amended (the "Securities Act"), and the rules and regulations (the "Rules and Regulations") of the Securities and Exchange Commission (the "Commission") thereunder, copies of which have heretofore been delivered to you, has been carefully prepared by the Company in conformity with the requirements of the Securities Act and has been filed with the Commission under the Securities Act; one or more amendments to such registration statement, including in each case an amended pre-effective prospectus, copies of which amendments have heretofore been delivered to you, have been so prepared and filed. Such registration statement (SEC File No. 333-111096), including all exhibits and financial statements, is referred to hereinafter as the "Registration Statement." Each prospectus was endorsed with the legend required by Item 501(a)(7) of Regulation S-B. If it is contemplated, at the time this Agreement is executed, that a post-effective amendment to the Registration Statement will be filed and must be declared effective before the offering of the Shares may commence, the term "Registration Statement" as used in this Agreement means the Registration Statement as amended by said post-effective amendment. The term "Registration Statement" as used in this Agreement shall also include any registration statement relating to the Shares that is filed and declared effective pursuant to Rule 462(b) under the Securities Act. The term "Prospectus" as used in this Agreement means the prospectus in the form included in the Registration Statement, or, (A) if the prospectus included in the Registration Statement omits information in reliance on Rule 430A under the Securities Act and such information is included in a prospectus filed with the Commission pursuant to Rule 424(b) under the Securities Act, the term "Prospectus" as used in this Agreement means the prospectus in the form included in the Registration Statement as supplemented by the addition of the Rule 430A information contained in the prospectus filed with the Commission pursuant to Rule 424(b) and (B) if any prospectus that meet the requirements of Section 10(a) of the Securities Act are delivered pursuant to Rule 434 under the Securities Act, then (i) the term "Prospectus" as used in this Agreement means the "prospectus subject to completion" (as such term is defined in Rule 434(g) under the Securities Act) as supplemented by (a) the addition of Rule 430A information or other information contained in the form of prospectus delivered pursuant to Rule 434(b)(2) under the Securities Act or (b) the information contained in the term sheets described in Rule 434(b)(3) under the Securities Act, and (ii) the date of any such prospectus shall be deemed to be the date of the term sheets. The term "Pre-Effective Prospectus" as used in this Agreement means the prospectus subject to completion in the form included in the Registration Statement at the time of the initial filing of the Registration Statement with the Commission, and as such prospectus shall have been amended from time to time prior to the date of the Prospectus.

(b) The Commission has not issued or threatened to issue any order preventing or suspending the use of any Pre-Effective Prospectus, and, at its date of issue, each Pre-Effective Prospectus conformed in all material respects with the requirements of the Securities Act and the Rules and Regulations and did not include any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading. When the Registration Statement becomes effective and by the Closing Date (as hereafter defined), the Registration Statement and Prospectus and any amendment or supplement thereto will contain all material statements and information required to be included therein by the Securities Act and the Rules and Regulations and conformed and will conform in all material respects to the requirements of the Securities Act and the Rules and Regulations and neither the Registration Statement nor the Prospectus, nor any amendment or supplement thereto, included or will include any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading; provided, however, that the foregoing representations, warranties and agreements shall not apply to information contained in or omitted from any Pre-Effective Prospectus or the Registration Statement or the Prospectus or any such amendment or supplement thereto in reliance upon, and in conformity with, written information furnished to the Company by or on behalf of any Underwriter through National specifically for use in the preparation thereof.

(c) Subsequent to the respective dates as of which information is given in the Registration Statement and Prospectus, and except as set forth or contemplated or otherwise identified as a risk factor in the Prospectus, (i) the Company has not incurred any material liabilities or obligations, direct or contingent, purchased any of its outstanding capital stock or paid or declared any dividends or other distributions on its capital stock or entered into any material transactions, whether or not incurred in the ordinary course of business, nor entered into any transactions not in the ordinary course of business, and (ii) there has not been any material adverse change in the condition (financial or otherwise), properties, business, management, net worth or results of operations of the Company and its subsidiaries considered as a whole, or any material change in the capital stock, short-term or long-term debt of the Company.

(d) The financial statements, together with the related notes and schedules, set forth in the Prospectus and elsewhere in the Registration Statement fairly present, the financial position, the results of operations and changes in financial position, shareholders' equity and cash flows of the Company at the respective dates or for the respective periods therein specified.

Such statements and related notes and schedules have been prepared in accordance with generally accepted accounting principles applied on a consistent basis except as may be set forth in the Prospectus. The summary and selected financial and statistical data included in the Prospectus and the Registration Statement present fairly the information shown therein and such data have been prepared on a basis consistent with the financial statements contained therein.

(e) KPMG LLP, who have expressed their opinions on the audited financial statements and related schedules included in the Registration Statement and the Prospectus, are independent public accountants as required by the Securities Act and the Rules and Regulations.

(f) The Company and each of its subsidiaries (each of which is set forth on Schedule C, a “Subsidiary” or the “Subsidiaries”), have been duly incorporated, are and at the Closing Date will be validly existing as corporations in good standing under the laws of the jurisdiction of each of their incorporation, have the corporate power and authority to own or lease their property and to conduct their business as described in the Registration Statement and Prospectus and are duly qualified to transact business and are in good standing in each jurisdiction in which the conduct of their business or their ownership or leasing of property requires such qualification, except to the extent that the failure to be so qualified or be in good standing would not have a material adverse effect on the Company or its Subsidiaries.

(g) The Company’s authorized and outstanding capital stock is on the date hereof, and will be on the First Closing Date (as hereinafter defined), as set forth under the heading “Capitalization” in the Prospectus; the securities of the Company conform to the descriptions thereof in the Prospectus and have been duly authorized and validly issued and are fully paid and nonassessable and have been issued in compliance with all federal and state securities laws and were not issued in violation of or subject to any preemptive rights or similar rights to subscribe for or purchase securities and conform to the description thereof contained in the Prospectus. Except as disclosed in or contemplated by the Prospectus and the financial statements of the Company and related notes thereto included in the Prospectus, the Company does not have outstanding any options or warrants to purchase, or any preemptive rights or other rights to subscribe for or to purchase, any securities or obligations convertible into, or any contracts or commitments to issue or sell, shares of its capital stock or any such options, rights, convertible securities or obligations. The description of the Company’s stock option and other stock plans or arrangements, and the options or other rights granted or exercised thereunder, as set forth in the Prospectus, fairly presents the information required to be shown with respect to such plans, arrangements, options and rights.

(h) The Shares to be issued and sold by the Company to the Underwriters hereunder (including the Additional Shares) have been duly and validly authorized and, when issued and delivered against payment therefor as provided herein, will be duly and validly issued, fully paid and nonassessable and free of any preemptive or similar rights and will conform to the description thereof in the Prospectus. The form of certificate for the Shares conforms to the requirements of the Delaware General Corporation Law. The shares to be issued and sold by the Company pursuant to the Representative’s Warrant Agreement have been duly and validly authorized and, when issued and delivered against payment therefor as provided herein and in the Representative’s Warrant Agreement, will be duly and validly issued, fully paid and nonassessable and free of any preemptive or similar rights and will conform to the description thereof in the Prospectus. The Company has reserved a sufficient number of shares of Common Stock from its authorized but unissued Common Stock for issuance upon exercise of the Representative's Warrant in accordance with the provisions of the Representative's Warrant Agreement. No further approval or authority of the stockholders or the Board of Directors of the Company will be required for the issuance and sale of the Shares or shares issuable upon exercise of the Representative's Warrant as contemplated herein.

(i) Except as set forth in the Prospectus, there are no legal or governmental proceedings pending to which the Company or any Subsidiary is a party or of which any property of the Company or any Subsidiary is subject, which, if determined adversely to the Company might individually or in the aggregate (i) prevent or adversely affect the transactions contemplated by this Agreement, (ii) suspend the effectiveness of the Registration Statement, (iii) prevent or suspend the use of the Pre-Effective Prospectus in any jurisdiction; (iv) is required to be disclosed in the Registration Statement, which is not so disclosed; or (v) result in a material adverse change in the condition (financial or otherwise), properties, business, management, net worth or results of operations of the Company considered as a whole; and to the Company's knowledge no such proceedings are threatened or contemplated against the Company by governmental authorities or others. Neither the Company nor any Subsidiary is a party or subject to the provisions of any material injunction, judgment, decree or order of any court, regulatory body or other governmental agency or body. The description of the Company's litigation under the heading "Business—Legal Proceedings" in the Prospectus fairly presents the information set forth therein.

(j) The execution, delivery and performance of this Agreement and the Representative's Warrant Agreement and the consummation of the transactions herein and therein, as the case may be, contemplated will not result in a breach or violation of any of the terms or provisions of or constitute a default under any indenture, mortgage, deed of trust, note agreement or other agreement or instrument to which the Company is a party or by which it or any of its properties is or may be bound, the Certificate of Incorporation, By-laws or other organizational documents of the Company or any of its Subsidiaries, or any law, order, rule or regulation of any court or governmental agency or body having jurisdiction over the Company or any of its properties or will result in the creation of a lien.

(k) No consent, approval, authorization or order of any court or governmental agency or body is required for the consummation by the Company of the transactions contemplated by this Agreement, except such as may be required by NASD or under the Securities Act or the securities or "Blue Sky" laws of any jurisdiction in connection with the purchase and distribution of the Shares by the Underwriters.

(l) The Company has the full corporate power and authority to enter into this Agreement and to perform its obligations hereunder (including to issue, sell and deliver the Shares), and this Agreement has been duly and validly authorized, executed and delivered by the Company and is a valid and binding obligation of the Company, enforceable against the Company in accordance with its terms, except to the extent that rights to indemnity and contribution hereunder may be limited by federal or state securities laws or the public policy underlying such laws.

(m) The Company is in all material respects in compliance with, and conducts its business in conformity with, all applicable federal, state, local and foreign laws, rules and regulations or any court or governmental agency or body; to the knowledge of the Company, otherwise than as set forth in the Registration Statement and the Prospectus, no prospective change in any of such federal or state laws, rules or regulations has been adopted which, when made effective, would have a material adverse effect on the operations of the Company.

(n) The Company and its Subsidiaries own or possess all patents, trademarks, trademark registrations, service marks, service mark registrations, tradenames, copyrights, licenses, inventions, trade secrets and rights described in the Prospectus as being owned by them or described in the Prospectus as being necessary for the conduct of their business (collectively, “Company Intellectual Property”), and neither the Company nor any of its Subsidiaries is aware of any claim against the Company or its Subsidiaries to the contrary or any challenge by any other person to the rights of the Company or its Subsidiaries with respect to the foregoing. No claim has been made against the Company or its Subsidiaries alleging the infringement by the Company or its Subsidiaries of any patent, trademark, service mark, tradename, copyright, trade secret, license in or other intellectual property right or franchise right of any person. To the knowledge of the Company, no person is infringing or misappropriating any Company Intellectual Property, which is material to the conduct of its business. To the knowledge of the Company, no current or former employee, officer, director, shareholder, consultant or independent contractor of the Company or any Subsidiary has any valid right, claim or interest in or with respect to any Company Intellectual Property which would materially impair or which could give rise to the material impairment of the use, distribution, license or other exploitation of the Company Intellectual Property by the Company or any such Subsidiary. The Company and each of its Subsidiaries have taken reasonable measures and precautions necessary to protect, preserve and maintain the confidentiality and secrecy of all trade secrets and other confidential information used in the business of the Company and such Subsidiaries and otherwise to maintain and protect the value of all Company Intellectual Property.

(o) The Company and its Subsidiaries have performed all material obligations required to be performed by them under any indenture, mortgage, deed of trust, note agreement or other material agreement or instrument to which any one or more of them is a party or by which any one or more of them or any of their properties is or may be bound, and neither the Company nor any of its Subsidiaries is in default under or in breach of any such material obligation which, if enforced by the other party, would result in a material adverse effect on the operations of the Company or any of its Subsidiaries.

(p) Neither the Company nor any of its Subsidiaries is involved in any material labor dispute nor is any such material dispute threatened. The Company is not aware that any executive, key employee or significant group of employees of the Company or any Subsidiary plans to terminate employment with the Company. The Company does not have nor does it expect to have nor does any Subsidiary have or expect to have any liability for any prohibited transaction or funding deficiency or any complete or partial withdrawal liability with respect to any pension, profit sharing or other plan which is subject to the Employee Retirement Income Security Act of 1974, as amended, including the regulations and published interpretations thereunder (“ERISA”), to which the Company or any Subsidiary makes or ever has made a contribution and in which any employee of the Company or a Subsidiary is or has ever been a participant. With respect to such plans, the Company and each Subsidiary is in compliance in all material respects with all presently applicable provisions of ERISA; no “reportable event” (as defined in ERISA) has occurred with respect to any “pension plan” (as defined in ERISA) for which the Company or any Subsidiary would have any liability; neither the Company nor any Subsidiary has incurred liability under Section 412 or 4971 of the Internal Revenue Code of 1986, as amended, including the regulations and published interpretations thereunder (the “Code”); and each “Pension Plan” for which the Company or any Subsidiary would have liability that is intended to be qualified under Section 401(a) of the Code is so qualified in all material respects.

(q) The Company or a Subsidiary has obtained the written agreement described in Section 8(j) of this Agreement from each of its officers and directors and holders of 1% or more of the outstanding securities of the Company as of the date hereof (as set forth on Schedule B hereto) (subject to earlier release at the discretion of the Underwriters)**.**

(r) The Company, and each of its Subsidiaries, has, and as of the First Closing Date will have, good and marketable title in fee simple to all real property referred to in the Prospectus as being owned by the Company, and each of its Subsidiaries, and good and marketable title to all personal property owned by it or the applicable Subsidiary which is material to the business of the Company or the applicable Subsidiary, in each case free and clear of all liens, encumbrances and defects except such as are described in the Prospectus or such as do not materially affect the value of such property and do not interfere with the use made and proposed to be made of such property by the Company or the applicable Subsidiary; and any real property and buildings described in the Prospectus as being held under lease by the Company or the applicable Subsidiary are, and will be as of the First Closing Date, held by it under valid, subsisting and enforceable leases or subleases with such exceptions as are not material and do not interfere with the use made and proposed to be made of such property and buildings by the Company or the applicable Subsidiary except as described in the Prospectus.

(s) The Company, and each of its Subsidiaries, is insured by insurers of recognized financial responsibility against such losses and risks and in such amounts as are prudent and customary in the business of the Company or the applicable Subsidiary as described in the Prospectus; and neither the Company nor any Subsidiary has reason to believe that it will not be able to renew its existing insurance coverage as and when such coverage expires or to obtain similar coverage from similar insurers as may be necessary to continue its business at a cost that would not materially and adversely affect the condition, financial or otherwise, or the earnings, business or operations of the Company and the applicable Subsidiary, except as described in or contemplated by the Prospectus.

(t) Other than as contemplated by this Agreement, there is no broker, finder or other party that is entitled to receive from the Company any brokerage or finder’s fee or other fee or commission as a result of any of the transactions contemplated by this Agreement.

(u) The Company maintains a system of internal accounting controls sufficient to provide reasonable assurances that (i) transactions are executed in accordance with management’s general or specific authorization; (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles and to maintain accountability for assets; (iii) access to assets is permitted only in accordance with management's general or specific authorization; and (iv) the recorded accountability for assets is compared with existing assets at reasonable intervals and appropriate action is taken with respect to any differences and the Company is otherwise in compliance in all material respects with all applicable effective provisions of the Sarbanes-Oxley Act of 2002 and the rules and regulations issued thereunder by the Commission.

(v) The Company is not, nor after giving effect to the issuance and sale of the Shares will it be, an "investment company" or an entity "controlled" by an "investment company" as such terms are defined in the Investment Company Act of 1940, as amended and the rules and regulations of the Commission promulgated thereunder.

(w) Each certificate signed by any officer of the Company and delivered to the Underwriters or counsel for the Underwriters shall be deemed to be a representation and warranty by the Company as to the matters covered thereby.

(x) All executed agreements or copies of executed agreements filed or incorporated by reference as exhibits to the Registration Statement to which the Company or any Subsidiary is a party or by which any such company is or may be bound or to which its assets, properties or businesses are or may be subject have been duly and validly authorized, executed and delivered by the Company or the applicable Subsidiary and constitute the legal, valid and binding agreements of the Company or the applicable Subsidiary enforceable by and against it in accordance with their respective terms (except as such enforceability may be limited by applicable bankruptcy, insolvency, reorganization or other similar laws relating to enforcement of creditors' rights generally, and general equitable principles relating to the availability of remedies, and except as rights to indemnity or contribution may be limited by federal or state securities laws and the public policy underlying such laws). The descriptions in the Registration Statement of contracts and other documents are accurate and fairly present in all material respects the information required to be shown with respect thereto by the Securities Act and Rules and Regulations, and there are no contracts or other documents that are required by the Securities Act or Rules and Regulations to be described in the Registration Statement or filed as exhibits to the Registration Statement that are not described or filed as required and the exhibits that have been filed are complete and correct copies of the documents of which they purport to be copies. Except as described in the Prospectus, there are no contracts, agreements or understandings between the Company and any person granting such person the right to require the Company to file a registration statement under the Securities Act with respect to any securities of the Company or to require the Company to include such securities with the Shares registered pursuant to the Registration Statement.

(y) The Company and its Subsidiaries are conducting their business in compliance with all applicable laws, ordinances or governmental rules or regulations of the jurisdictions in which they are conducting business, except where the failure to be so in compliance would not materially and adversely affect the business, properties, financial condition or results of operations of the Company and its Subsidiaries. Each approval, consent, order, authorization, designation, declaration or filing by or with any regulatory, administrative or other governmental body necessary in connection with the execution and delivery by the Company of this Agreement and the consummation of the transactions herein contemplated (except such additional steps as may be required by NASD, the Securities Act, the Securities Exchange Act of 1934, as amended (the "Exchange Act"), or to qualify or exempt the Shares for public offering by the Underwriters under state securities or Blue Sky laws) has been obtained or made and is in full force and effect.

(z) Neither the Company nor, to the Company's knowledge, any of its officers, directors or affiliates (within the meaning of the rules and regulations promulgated under the Securities Act) has taken or may take, directly or indirectly, any action designed to cause or result in, or that has constituted or that might reasonably be expected to constitute, the stabilization or manipulation of the price of the shares of Common Stock of the Company, to facilitate the sale or resale of the Shares or otherwise.

(aa) There are no transfer taxes or similar fees or charges under federal law or the laws of any state or foreign jurisdiction, or any political subdivision thereof, required to be paid in connection with the execution and delivery of this Agreement or the issuance and sale by the Company of the Shares.

(bb) No relationship, direct or indirect, exists between or among the Company, on the one hand, and the current or prior directors, officers, shareholders, customers or suppliers of the Company, on the other hand, which is required to be described in the Prospectus that is not so described.

(cc) Neither the Company nor to the Company's knowledge any director, officer, agent, employee or other person associated with or acting on behalf of the Company has used any corporate funds for any unlawful contribution, gift, entertainment or other unlawful expense relating to political activity; made any direct or indirect unlawful payment to any foreign or domestic government official or employee from corporate funds; violated or is in violation of any provisions of the Foreign Corrupt Practices Act of 1972; or made any bribe, rebate, payoff, influence, payment, kickback or other unlawful payment.

(dd) The business, operations and facilities of the Company have been and are being conducted or operated in compliance with all applicable laws, ordinances, rules, regulations, licenses, permits, approvals, plans, authorizations or requirements relating to occupational safety and health, pollution, protection of health or the environment (including, without limitation, those relating to emissions, discharges, release or threatened releases of pollutants, contaminants or hazardous or toxic substances, materials or wastes into ambient air, surface water, groundwater or land, or relating to the manufacture, processing, distribution, use treatment, storage, disposal, transport or handling of chemical substances, pollutants, contaminants or hazardous or toxic substances, materials or wastes, whether solid, gaseous or liquid in nature) or otherwise relating to remediating real property in which the Company has or has had any interest, whether owned or leased, of any governmental department, commission, board, bureau, agency or instrumentality of the United States, any state or political subdivision thereof and all applicable judicial or administrative agency or regulatory decrees, awards, judgments and orders relating thereto, except for such failures to so comply as would not, individually or in the aggregate, have a material adverse effect on the business, properties, financial condition or results of operations of the Company, and the Company has not received any notice from a governmental instrumentality or any third party alleging any violation thereof or liability thereunder (including, without limitation, liability for costs of investigating or remediating sites containing hazardous substances or damage to natural resources).

(ee) Neither the Company nor to the Company's knowledge any officer or employee of the Company is a party to any contract or commitment that restricts in any material respect the ability of the Company to engage in the business of the Company as described in the Registration Statement and the Prospectus.

3. PURCHASE BY, AND SALE AND DELIVERY TO, UNDERWRITERS—CLOSING DATES. The Company agrees to sell to the Underwriters the Firm Stock, and on the basis of the representations, warranties, covenants and agreements herein contained, but subject to the terms and conditions herein set forth, the Underwriters agree, severally and not jointly, to purchase the Firm Stock from the Company, the number of shares of Firm Stock to be purchased by each Underwriter being set opposite its name in Schedule A, subject to adjustment in accordance with Section 12 hereof. The purchase price per share to be paid by the Underwriters to the Company will be $_________ per share [the initial offering price less 5%](the "Purchase Price"). The Company will deliver the Firm Stock to the Representative for the respective accounts of the several Underwriters (in the form of definitive certificates, issued in such names and in such denominations as the Representative may direct by notice in writing to the Company given at or prior to 12:00 noon, New York City time, on the third full business day preceding the First Closing Date (as defined below) or, if no such direction is received, in the names of the respective Underwriters or in such other names as National may designate (solely for the purpose of administrative convenience) and in such denominations as National may determine), against payment of the aggregate Purchase Price therefor in immediately available funds, payable to the order of the Company, all at the offices of Nixon Peabody LLP, 101 Federal Street, Boston, Massachusetts 02110. The time and date of the delivery and closing shall be at 10:00 A.M., New York City time, on ________, 2004, in accordance with Rule 15c6-1 of the Exchange Act. The time and date of such payment and delivery are herein referred to as the "First Closing Date". The First Closing Date and the location of delivery of, and the form of payment for, the Firm Stock may be varied by agreement between the Company and National. The First Closing Date may be postponed pursuant to the provisions of Section 12. The Company shall make the certificates for the Shares available to the Representative for examination on behalf of the Underwriters not later than 10:00 A.M., New York City time, on the business day preceding the First Closing Date at the offices of **[Insert name/address of transfer agent].**

It is understood that National, individually and not as a Representative of the several Underwriters, may (but shall not be obligated to) make payment to the Company on behalf of any Underwriter or Underwriters, for the Shares to be purchased by such Underwriter or Underwriters. Any such payment by National shall not relieve such Underwriter or Underwriters from any of its or their other obligations hereunder.

The several Underwriters agree to make an initial public offering of the Firm Stock at the initial public offering price as soon after the effectiveness of the Registration Statement as practicable. The Representative shall promptly advise the Company of the making of the initial public **offering.**

For the purpose of covering any over-allotments in connection with the distribution and sale of the Firm Stock as contemplated by the Prospectus, the Company hereby grants to the Underwriters an option to purchase, severally and not jointly, the Additional Shares. The price per share to be paid for the Additional Shares shall be the Purchase Price. The option granted hereby for the purpose of covering over-allotments may be exercised as to all or any part of the Additional Shares at any time, and from time to time, not more than thirty (30) days after (i) the date the Registration Statement becomes effective, if the Company has elected not to rely on Rule 430A under the Rules and Regulations, or (ii) the date of this Agreement if the Company has elected to rely upon Rule 430A under the Rules and Regulations. No Additional Shares shall be sold and delivered unless the Firm Stock previously has been, or simultaneously is, sold and delivered. The right to purchase the Additional Shares or any portion thereof may be surrendered and terminated at any time upon notice by the Underwriters to the Company.

The option granted hereby may be exercised by the Underwriters by giving written notice from National to the Company setting forth the number of shares of the Additional Shares to be purchased by them and the date and time for delivery of and payment for the Additional Shares. Each date and time for delivery of and payment for the Additional Shares (which may be the First Closing Date, but not earlier) is herein called the "Option Closing Date" and shall in no event be earlier than two (2) business days nor later than ten (10) business days after written notice is given. (The Option Closing Date and the First Closing Date are herein called the "Closing Dates"). All purchases of Additional Shares from the Company shall be made by National for the account of National unless National elects to purchase less than all of the Additional Shares, in which case the remaining shares of Additional Shares not purchased by National shall be purchased for the account of each Underwriter (other than National) in the same proportion as the number of shares of Firm Stock set forth opposite such Underwriter's name in Schedule A hereto bears to the total number of shares of Firm Stock purchased by all Underwriters (other than National) (subject to adjustment by the Underwriters to eliminate odd lots). Upon exercise of the option by the Underwriters, the Company agrees to sell to the Underwriters the number of shares of Additional Shares set forth in the written notice of exercise and the Underwriters agree, severally and not jointly and subject to the terms and conditions herein set forth, to purchase the number of such shares determined as aforesaid.

The Company will deliver the Additional Shares to the Underwriters (in the form of definitive certificates, issued in such names and in such denominations as the Representative may direct by notice in writing to the Company given at or prior to 12:00 noon, New York City time, on the second full business day preceding the Option Closing Date or, if no such direction is received, in the names of the respective Underwriters or in such other names as National may designate (solely for the purpose of administrative convenience) and in such denominations as National may determine), against payment of the aggregate Purchase Price therefor in immediately available funds, payable to the order of the Company all at the offices of Nixon Peabody LLP, 101 Federal Street, Boston, Massachusetts 02110. The Company shall make the certificates for the Additional Shares available to the Underwriters for examination not later than 10:00 A.M., New York City time, on the business day preceding the Option Closing Date at the offices of **[Insert name/address of transfer agent].** The Option Closing Date and the location of delivery of, and the form of payment for, the Additional Shares may be varied by agreement between the Company and National. The Option Closing Date may be postponed pursuant to the provisions of Section 12.

Upon the successful closing of the offering of the Shares and the fulfillment of the terms of the Underwriting Agreement by Representative, on the First Closing Date, the Company will issue and sell to the Representative or to the officers and directors and employees of Representative (individually, the "Representative's Designee" and collectively, the "Representative's Designees") for an aggregate purchase price of One Hundred Dollars ($100.00) the Representative's Warrant at a per share price equal to 130% of the per share initial public offering price of the Shares set forth in the Registration Statement and Prospectus which such Representative's Warrant shall only be exercisable during the period commencing one (1) year from the Closing Date and ending five (5) years from such Closing Date (in the form of, and in accordance with the provisions of the Representative's Warrant Agreement substantially in the form filed as Exhibit [ ] to the Registration Statement). The Representative's Warrant will be restricted from sale, transfer, assignment or hypothecation for a period of one (1) year from the effective date of the Registration Statement pursuant to NASD Corporate Financing Rule 2710, except to Representative's Designees. Payment for the Representative's Warrant will be made to the Company by check on the First Closing Date against delivery of the certificates representing the Representative's Warrant in accordance with the terms and conditions of the Representative's Warrant Agreement.

The information set forth on the cover page of the Prospectus concerning the Underwriters and under the caption "Plan of Distribution" or otherwise specifically relating to the Underwriters in any Preliminary Prospectus or in the Prospectus relating to the Shares proposed to be filed by the Company (insofar as such information relates to the Underwriters) as heretofore filed and as presently proposed to be amended constitutes the only information furnished by the Underwriters to the Company for inclusion therein, and the Underwriters represent and warrant to the Company that the statements made therein are correct and do not include any untrue statements of material fact or omit to state a material fact required to be state therein, or necessary to make the statements therein, in light of the circumstances under which they are made, not misleading.

4. COVENANTS AND AGREEMENTS OF THE COMPANY. The Company covenants and agrees with the several Underwriters that:

(a) The Company will (i) if the Company and the Representative have determined not to proceed pursuant to Rule 430A, use its commercially reasonable efforts to cause the Registration Statement to become effective, (ii) if the Company and the Representative have determined to proceed pursuant to Rule 430A, use its commercially reasonable efforts to comply with the provisions of and make all requisite filings with the Commission pursuant to Rule 430A and Rule 424 of the Rules and Regulations and (iii) if the Company and the Representative have determined to deliver Prospectuses pursuant to Rule 434 of the Rules and Regulations, to use its commercially reasonable efforts to comply with all the applicable provisions thereof. The Company will advise the Representative promptly as to the time at which the Registration Statement becomes effective, will advise the Representative promptly of the issuance by the Commission of any stop order suspending the effectiveness of the Registration Statement or of the institution of any proceedings for that purpose, and will use its commercially reasonable efforts to prevent the issuance of any such stop order and to obtain as soon as possible the lifting thereof, if issued. The Company will advise the Representative promptly of the receipt of any comments of the Commission or any request by the Commission for any amendment of or supplement to the Registration Statement or the Prospectus or for additional information and will not at any time file any amendment to the Registration Statement or supplement to the Prospectus which shall not previously have been submitted to the Representative a reasonable time prior to the proposed filing thereof or to which the Representative shall reasonably object in writing or which is not in compliance with the Securities Act and the Rules and Regulations.

(b) The Company will prepare and file with the Commission, promptly upon the request of the Representative, any amendments or supplements to the Registration Statement or the Prospectus which in the opinion of the Representative is necessary to enable the several Underwriters to continue the distribution of the Shares and will use its commercially reasonable efforts to cause the same to become effective as promptly as possible.

(c) If at any time after the effective date of the Registration Statement when a prospectus relating to the Shares is required to be delivered under the Securities Act any event relating to or affecting the Company or any of its Subsidiaries occurs as a result of which the Prospectus or any other prospectus as then in effect would include an untrue statement of a material fact, or omit to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, or if it is necessary at any time to amend the Prospectus to comply with the Securities Act, the Company will promptly notify the Representative thereof and will prepare an amended or supplemented prospectus which will correct such statement or omission and file such document with the Commission; and in case any Underwriter is required to deliver a prospectus relating to the Shares nine (9) months or more after the effective date of the Registration Statement, the Company upon the request of the Representative and at the expense of such Underwriter will prepare promptly such prospectus or prospectuses as may be necessary to permit compliance with the requirements of Section 10(a)(3) of the Securities Act.

(d) The Company will deliver to the Representative, at or before the Closing Dates, signed copies of the Registration Statement, as originally filed with the Commission, and all amendments thereto including all financial statements and exhibits thereto and will deliver to the Representative such number of copies of the Registration Statement, including such financial statements but without exhibits, and all amendments thereto, as the Representative may reasonably request. The Company will deliver or mail to or upon the order of the Representative, from time to time until the effective date of the Registration Statement, as many copies of the Pre-Effective Prospectus as the Representative may reasonably request. The Company will deliver or mail to or upon the order of the Representative on the date of the initial public offering, and thereafter from time to time during the period when delivery of a prospectus relating to the Shares is required under the Securities Act, as many copies of the Prospectus, in final form or as thereafter amended or supplemented, as the Representative may reasonably request; provided, however, that the expense of the preparation and delivery of any prospectus required for use nine (9) months or more after the effective date of the Registration Statement shall be borne by the Underwriters required to deliver such prospectus.

(e) The Company will make generally available to its stockholders as soon as practicable, but not later than fifteen (15) months after the effective date of the Registration Statement, an earnings statement which will be in reasonable detail (but which need not be audited) and which will comply with Section 11(a) of the Securities Act, covering a period of at least twelve (12) months beginning after the "effective date" (as defined in Rule 158 under the Securities Act) of the Registration Statement.

(f) The Company will cooperate with the Representative to enable the Shares to be registered or qualified for offering and sale by the Underwriters and by dealers under the securities laws of such jurisdictions as the Representative may designate and at the request of the Representative will make such applications and furnish such consents to service of process or other documents as may be required of it as the issuer of the Shares for that purpose; provided, however, that the Company shall not be required to qualify to do business or to file a general consent (other than that arising out of the offering or sale of the Shares) to service of process in any such jurisdiction where it is not now so subject. The Company will, from time to time, prepare and file such statements and reports as are or may be required of it as the issuer of the Shares to continue such qualifications in effect for so long a period as the Representative may reasonably request for the distribution of the Shares. The Company will advise the Representative promptly after the Company becomes aware of the suspension of the qualifications or registration of (or any such exception relating to) the Common Stock of the Company for offering, sale or trading in any jurisdiction or of any initiation or threat of any proceeding for any such purpose, and, in the event of the issuance of any orders suspending such qualifications, registration or exception, the Company will, with the cooperation of the Representative, use its commercially reasonable efforts to obtain the withdrawal thereof.

(g) The Company will furnish to its stockholders annual reports containing financial statements certified by independent public accountants in accordance with the Rules and Regulations. So long as the Company has active subsidiaries, such financial statements will be on a consolidated basis to the extent the accounts of the Company and its Subsidiaries are consolidated in reports furnished to its stockholders generally, to the extent required by the Rules and Regulations.

(h) The Company will use its commercially reasonable efforts to cause the Common Stock to be listed for quotation on the Nasdaq National Market at or before the time of purchase.

(i) The Company will not, without the prior written consent of National, offer, sell, assign, transfer, encumber, contract to sell, grant an option to purchase or otherwise dispose of any shares of Common Stock or securities convertible into or exercisable or exchangeable for Common Stock during the one hundred and eighty (180) days following the Effective Date, other than the (i) Company's sale of Common Stock hereunder, (ii) the issuance of Common Stock upon the automatic conversion, as a result of the offering and sale of the Shares, of the Company's outstanding convertible preferred stock as described in the Prospectus, (iii) the issuance of Common Stock upon the exercise of stock options which are presently outstanding and described in the Prospectus, (iv) the grant of options to purchase shares of Common Stock under the stock option plan described in the Prospectus, (v) the issuance of Common Stock in connection with the acquisition of any businesses, assets or technologies, and (vi) the Representative's Warrant and the shares issuable upon the exercise of the Representative's Warrant.

(j) The Company will apply the net proceeds from the sale of the Shares as set forth in the description under “Use of Proceeds” in the Prospectus, which description complies in all respects with the requirements of Item 504 of Regulation S-K.

(k) The Company will supply you with copies of all correspondence to and from, and all documents issued to and by, the Commission in connection with the registration of the Shares under the Securities Act.

(l) Upon the successful closing of the offering of the Shares and the fulfillment of the terms of the Underwriting Agreement by Representative, the Company, on the First Closing Date, shall sell to Representative or to Representative’s Designee, as the case may be, the Representative’s Warrant according to the terms specified in Section 3 hereof. The Company has reserved and shall continue to reserve a sufficient number of shares of Common Stock for issuance upon exercise of the Representative’s Warrant.

(m) During a period of three years after the date hereof, the Company will furnish to National, and to each Underwriter who may so request in writing, copies of all periodic and special reports furnished to stockholders of the Company and of all information, documents and reports filed with the Commission.

(n) The Company will maintain a transfer agent and, if necessary under the jurisdiction of incorporation of the Company, a registrar (which may be the same entity as the transfer agent) for its Common Stock.

(o) During the period of three years after the date hereof, the Company will timely file all such reports, forms or other documents as may be required from time to time, under the Securities Act, the Rules and Regulations, the Exchange Act and the rules and regulations promulgated thereunder, and all such reports, forms and documents filed will comply as to form and substance with the applicable requirements under the Securities Act, the Rules and Regulations, the Exchange Act and the rules and regulations promulgated thereunder.

(p) To comply with all applicable securities and other applicable laws, rules and regulations in each jurisdiction in which the Directed Shares are offered in connection with the Directed Share Program.

(q) The Company will endeavor to qualify the shares for offer and sale under the securities or blue sky laws of such jurisdictions as National shall reasonably request.

5. PAYMENT OF EXPENSES. The Company will pay (directly or by reimbursement) all costs, fees and expenses incurred by the Company in connection with the performance of its obligations under this Agreement and incurred by the Company in connection with the transactions contemplated hereby, including but not limited to (i) all expenses and taxes incident to the issuance and delivery of the Firm Stock and Option Stock; (ii) all expenses incident to the registration of the Firm Stock and Option Stock under the Securities Act; (iii) the costs of preparing stock certificates (including printing and engraving costs); (iv) all necessary issue, transfer and other stamp taxes in connection with the issuance and sale of the Firm Stock and Option Stock; (v) fees and expenses of the Company’s counsel and the Company’s independent public accountants; (vi) all costs and expenses incurred in connection with the preparation, printing, filing, shipping and distribution of the Registration Statement, each Pre-Effective Prospectus and the Prospectus (including all exhibits and financial statements) and all amendments and supplements provided for herein; (vii) all filing fees, attorneys' fees and expenses incurred by the Company in connection with exemptions from the qualifying or registering (or obtaining qualification or registration of) all or any part of the Firm Stock and Option Stock for offer and sale and determination of its eligibility for investment under the Blue Sky or other securities laws of such jurisdictions as the Representative may designate; (viii) all fees and expenses of the registrar and transfer agent of the Firm Stock and Option Stock; and (ix) all fees and expenses paid or incurred in connection with filings made with the NASD. Further, upon receipt of a request from Representative, either orally or in writing, Company shall deliver a check to Representative for any amounts paid or payable by Representative pursuant to subparagraph (ix) above.

Representative will pay the following expenses: (a) fees and expenses of Representative's counsel; (b) any advertising, telecommunications, photocopying, printing and other out-of-pocket expenses outside of Company's expenses under (vi) above; and (c) any travel, hotel, meals, car rental and other miscellaneous expenses associated with the carrying out of Representative's responsibilities.

Company agrees to reimburse Representative for the foregoing direct expenses of Representative, on a non-accountable basis, in the maximum amount of $50,000, of which $25,000 was previously paid and the balance shall be paid upon the First Closing Date. Subject to the written pre-approval of the Company, the Company agrees to reimburse Representative for Representative's additional direct expenses in an amount not to exceed an additional $50,000.

6. INDEMNIFICATION AND CONTRIBUTION.

(a) The Company agrees to indemnify and hold harmless each Underwriter and each person, if any, who controls such Underwriter within the meaning of the Securities Act and the respective officers, directors, partners, employees, representatives and agents of each of such Underwriter (collectively, the "Underwriter Indemnified Parties" and, each, an "Underwriter Indemnified Party"), against any losses, claims, damages, liabilities or expenses (including the reasonable cost of investigating and defending against any claims therefor and counsel fees incurred in connection therewith), joint or several, which may be based upon (i) the Securities Act, or any other statute or at common law, on the ground or alleged ground that any Pre-Effective Prospectus, the Registration Statement or the Prospectus (or any Pre-Effective Prospectus, the Registration Statement or the Prospectus as from time to time amended or supplemented) includes or allegedly includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading, unless such statement or omission was made in reliance upon, and in conformity with, written information furnished to the Company by any Underwriter through National specifically for use in the preparation thereof; provided, that with respect to any untrue statement or omission or alleged untrue statement or omission made in any Pre-Effective Prospectus, the indemnity agreement contained in this subsection (a) shall not inure to the benefit of any Underwriter Indemnified Party from whom the person asserting any such losses, claims, damages or liabilities purchased the shares of Shares concerned to the extent that any such loss, claim, damage or liability of such Underwriter Indemnified Party results from the fact that a copy of the Prospectus was not sent or given to such person at or prior to the written confirmation of the sale of such shares of Shares to such person as required by the Securities Act and if the untrue statement or omission concerned has been corrected in the Prospectus, or (ii) the Directed Share Program, provided that the Company shall not be responsible under this clause (ii) for any loss, damage, expense, liability, or claim that resulted from the act(s) or omission(s) of the Underwriters in administering and conducting the Directed Share Program. The Company will be entitled to participate at its own expense in the defense or, if it so elects, to assume the defense of any suit brought to enforce any such liability, but if the Company elects to assume the defense, such defense shall be conducted by counsel chosen by it. In the event the Company elects to assume the defense of any such suit and retain such counsel, any Underwriter Indemnified Parties, defendant or defendants in the suit, may retain additional counsel but shall bear the fees and expenses of such counsel unless (i) the Company shall have specifically authorized the retaining of such counsel or (ii) the parties to such suit include any such Underwriter Indemnified Parties, and the Company and such Underwriter Indemnified Parties at law or in equity have been advised in writing by counsel to the Underwriters that one or more legal defenses may be available to it or them which may not be available to the Company, in which case the Company shall bear the fees and expenses of one counsel to the Underwriter Indemnified Parties. The Company shall not be liable to indemnify any person for any settlement of any such claim effected without the Company's prior written consent. This indemnity agreement is not exclusive and will be in addition to any liability which the Company might otherwise have and shall not limit any rights or remedies which may otherwise be available at law or in equity to each Underwriter Indemnified Party.

(b) Each Underwriter severally and not jointly agrees to indemnify and hold harmless the Company, its directors, its officers who have signed the Registration Statement and each person, if any, who controls the Company or any Subsidiary within the meaning of the Securities Act (collectively, the "Company Indemnified Parties"), against any losses, claims, damages, liabilities or expenses (including, unless the Underwriter or Underwriters elect to assume the defense, the reasonable cost of investigating and defending against any claims therefor and counsel fees incurred in connection therewith), joint or several, which arise out of or are based in whole or in part upon the Securities Act, the Exchange Act or any other federal, state, local or foreign statute or regulation, or at common law, on the ground or alleged ground that any Pre-Effective Prospectus, the Registration Statement or the Prospectus (or any Pre-Effective Prospectus, the Registration Statement or the Prospectus, as from time to time amended and supplemented) includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances in which they were made, not misleading, but only insofar as any such statement or omission was made in reliance upon, and in conformity with, written information furnished to the Company by such Underwriter, directly or through the Representative, specifically for use in the preparation thereof; provided, however, that in no case is such Underwriter to be liable with respect to any claims made against any Company Indemnified Party against whom the action is brought unless such Company Indemnified Party shall have notified such Underwriter in writing within a reasonable time after the summons or other first legal process giving information of the nature of the claim shall have been served upon the Company Indemnified Party, but failure to notify such Underwriter of such claim shall not relieve it from any liability which it may have to any Company Indemnified Party other than on account of its indemnity agreement contained in this paragraph. The Underwriter against whom indemnity may be sought shall not be liable to indemnify any person for any settlement of any such claim effected without such Underwriter's prior written consent. This indemnity agreement is not exclusive and will be in addition to any liability which such Underwriter might otherwise have and shall not limit any rights or remedies which may otherwise be available at law or in equity to any Company Indemnified Party.

(c) If the indemnification provided for in this Section 6 is unavailable or insufficient to hold harmless an indemnified party under subsection (a) or (b) above in respect of any losses, claims, damages, liabilities or expenses (or actions in respect thereof) referred to herein, then each indemnifying party shall contribute to the amount paid or payable by such indemnified party as a result of such losses, claims, damages, liabilities or expenses (or actions in respect thereof) in such proportion as is appropriate to reflect the relative benefits received by the Company on the one hand and the Underwriters on the other from the offering of the Shares. If, however, the allocation provided by the immediately preceding sentence is not permitted by applicable law, then each indemnifying party shall contribute to such amount paid or payable by such indemnified party in such proportion as is appropriate to reflect not only such relative benefits but also the relative fault of the Company on the one hand and the Underwriters on the other in connection with the statements or omissions which resulted in such losses, claims, damages, liabilities or expenses (or actions in respect thereof), as well as any other relevant equitable considerations. The relative benefits received by the Company on the one hand and the Underwriters on the other shall be deemed to be in the same proportion as the total net proceeds from the offering (before deducting expenses) received by the Company bears to the total underwriting discounts and commissions received by the Underwriters, in each case as set forth in the table on the cover page of the Prospectus. The relative fault shall be determined by reference to, among other things, whether the untrue or alleged untrue statement of a material fact or the omission or alleged omission to state a material fact relates to information supplied by the Company or the Underwriters and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such statement or omission. The Company and the Underwriters agree that it would not be just and equitable if contribution were determined by pro rata allocation (even if the Underwriters were treated as one entity for such purpose) or by any other method of allocation which does not take account of the equitable considerations referred to above. The amount paid or payable by an indemnified party as a result of the losses, claims, damages, liabilities or expenses (or actions in respect thereof) referred to above shall be deemed to include any legal or other expenses reasonably incurred by such indemnified party in connection with investigating, defending, settling or compromising any such claim. Notwithstanding the provisions of this subsection (c), no Underwriter shall be required to contribute any amount in excess of the amount by which the total price at which the shares of the Shares underwritten by it and distributed to the public were offered to the public exceeds the amount of any damages which such Underwriter has otherwise been required to pay by reason of such untrue or alleged untrue statement or omission or alleged omission. The Underwriters' obligations to contribute are several in proportion to their respective underwriting obligations and not joint. No person guilty of fraudulent misrepresentations (within the meaning of Section 11(f) of the Securities Act) shall be entitled to contribution from any person who was not guilty of such fraudulent misrepresentations.

7. <u>SURVIVAL OF INDEMNITIES, REPRESENTATIONS, WARRANTIES, ETC</u>. The respective indemnities, covenants, agreements, representations, warranties and other statements of the Company and the several Underwriters, as set forth in this Agreement or made by them respectively, pursuant to this Agreement, shall remain in full force and effect, regardless of any investigation made by or on behalf of any Underwriter, the Company or any of its officers or directors or any controlling person, and shall survive delivery of and payment for the Shares.

8. <u>CONDITIONS OF UNDERWRITERS' OBLIGATIONS</u>. The respective obligations of the several Underwriters hereunder shall be subject to the accuracy, at and (except as otherwise stated herein) as of the date hereof and at and as of the Closing Dates, of the representations and warranties made herein by the Company as to compliance at and as of the Closing Dates by the Company with its covenants and agreements herein contained and other provisions hereof to be satisfied at or prior to the Closing Dates, and to the following additional conditions:

(a) The Registration Statement shall have become effective and no stop order suspending the effectiveness thereof shall have been issued and no proceedings for that purpose shall have been initiated or, to the knowledge of the Company, shall be threatened by the Commission, and any request for additional information on the part of the Commission (to be included in the Registration Statement or the Prospectus or otherwise) shall have been complied with to the reasonable satisfaction of the Representative. Any filings of the Prospectus, or any supplement thereto, required pursuant to Rule 424(b) or Rule 434 of the Rules and Regulations, shall have been made in the manner and within the time period required by Rule 424(b) and Rule 434 of the Rules and Regulations, as the case may be.

(b) The Representative shall have been satisfied that there shall not have occurred any change, on a consolidated basis, prior to the Closing Dates in the condition (financial or otherwise), properties, business, management, net worth or results of operations of the Company, or any change in the capital stock, short-term or long-term debt of the Company, such that the Registration Statement or the Prospectus, or any amendment or supplement thereto, contains an untrue statement of fact which, in the opinion of the Representative, is material, or omits to state a fact which, in the opinion of the Representative, is required to be stated therein or is necessary to make the statements therein not misleading.

(c) The Representative shall be satisfied that no legal or governmental action, suit or proceeding affecting the Company which is material and adverse to the Company or which affects or may affect the Company's ability to perform its obligations under this Agreement shall have been instituted or threatened and there shall have occurred no material adverse development in any existing such action, suit or proceeding.

(d) The Representative shall have received from KPMG LLP, independent certified public accountants, a letter, dated the Closing Date, to the effect set forth in Exhibit I hereto.

(e) The Representative shall have received from Nixon Peabody LLP, counsel for the Company, an opinion, dated the Closing Dates, to the effect set forth in Exhibit II hereto. In rendering such opinion, Nixon Peabody LLP may rely as to all matters governed other than by the laws of the Commonwealth of Massachusetts and the State of Delaware or federal laws on the opinion of local counsel of good standing in such jurisdictions

(f) The Representative shall have received from Dorsey & Whitney LLP, counsel for the Underwriters, their opinion or opinions dated the Closing Dates with respect to the incorporation of the Company, the validity of the Shares, the Registration Statement and the Prospectus and such other related matters as it may reasonably request, and the Company shall have furnished to such counsel such documents as they may request for the purpose of enabling them to pass upon such matters.

(g) The Representative shall have received a certificate, dated the Closing Dates, of the Chief Executive Officer of the Company certifying to the effect that:

(i) No stop order suspending the effectiveness of the Registration Statement has been issued, and, to the best of the knowledge of the signers, no proceedings for that purpose have been instituted or are pending or contemplated under the Securities Act;

(ii) Neither any Pre-Effective Prospectus, as of its date, nor the Registration Statement nor the Prospectus, nor any amendment or supplement thereto, as of the time when the Registration Statement became effective and at all times subsequent thereto up to the delivery of such certificate, included any untrue statement of a material fact or omitted to state any material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading;

(iii) Subsequent to the respective dates as of which information is given in the Registration Statement and the Prospectus, and except as set forth or contemplated in the Prospectus, the Company has not incurred any material liabilities or obligations, direct or contingent, nor entered into any material transactions not in the ordinary course of business and there has not been any material adverse change in the condition (financial or otherwise), properties, business, management, net worth or results of operations of the Company or any change in the capital stock, short-term or long-term debt of the Company; and

(iv) The representations and warranties of the Company in this Agreement are true and correct at and as of the Closing Dates, and the Company has complied with all the agreements and performed or satisfied all the conditions on its part to be performed or satisfied at or prior to the Closing Dates.

(i) The Company shall have furnished to the Representative such additional certificates as the Representative may have reasonably requested as to the accuracy, at and as of the Closing Dates, of the representations and warranties made herein by it and as to compliance at and as of the Closing Dates by it with its covenants and agreements herein contained and other provisions hereof to be satisfied at or prior to the Closing Dates, and as to satisfaction of the other conditions to the obligations of the Underwriters hereunder.

(j) Representative shall have received the written agreements of (i) all officers and directors of the Company and holders of 1% or more of the outstanding securities of the Company as of the date hereof with respect to shares of Common Stock held by such persons prior to the Offering (including securities convertible into or exercisable for Common Stock) (as set forth on Schedule B hereto) and (ii) those holders of shares purchased pursuant to the Directed Share Program, that each will not, without the prior written consent of Representative, offer, sell, assign, transfer, encumber, contract to sell, grant an option to purchase or otherwise dispose of, other than by operation of law, gifts, pledges or dispositions by estate representatives, any of such shares (including, without limitation, Common Stock which may be deemed to be beneficially owned by such officer, director or holder in accordance with the Rules and Regulations) or securities convertible into or exercisable or exchangeable for Common Stock during the one hundred and eighty (180) days following the Effective Date (subject to earlier release at the discretion of the Underwriters).

(k) The Shares shall have been approved for listing for quotation on the Nasdaq National Market, subject only to notice of issuance at or prior to the Closing Date.

9. EFFECTIVE DATE. This Agreement shall become effective (i) if Rule 430A under the Securities Act is not used, when you shall have received notification of the effectiveness of the Registration Statement, or (ii) if Rule 430A under the Securities Act is used, when the parties hereto have executed and delivered this Agreement.

10. TERMINATION.

(a) This Agreement may be terminated by the Company at any time before it becomes effective in accordance with Section 9 by notice to the Representative and may be terminated by the Representative at any time before it becomes effective in accordance with Section 9 by notice to the Company. In the event of any termination of this Agreement under this or any other provision of this Agreement, there shall be no liability of any party to this Agreement to any other party, other than as provided in Section 6 and other than as provided in Section 11 as to the liability of defaulting Underwriters; provided, however, that (i) in the event of such termination, the Company agrees to indemnify and hold harmless the Underwriters from all costs or expenses incident to the performance of the Underwriters' obligations under this Agreement; and (ii) if this Agreement is terminated by the Representative because of any refusal, inability or failure on the part of the Company to perform any agreement herein, to fulfill any of the conditions or covenants herein, or to comply with any provision hereof other than by reason of a default by any of the Underwriters, but specifically excluding any termination pursuant to Section 10(b) hereof, the Company will reimburse the Underwriters severally upon demand for all out-of-pocket expenses (including reasonable fees and disbursements of counsel) that shall have been incurred by them in connection with the transactions contemplated hereby, less any amounts previously paid pursuant to Section 5 hereof.

(b) This Agreement may be terminated after it becomes effective by Representative by notice to the Company (i) if at or prior to the First Closing Date trading in securities on any of the New York Stock Exchange, American Stock Exchange or Nasdaq National Market shall have been suspended or minimum or maximum prices shall have been established on any such exchange or market, or a banking moratorium shall have been declared by New York or United States authorities; (ii) trading of any securities of the Company shall have been suspended on any exchange or in any over-the-counter market; or (iii) if at or prior to the First Closing Date there shall have been (A) an outbreak of major hostilities between the United States and any foreign government excluding hostilities existing as of the date hereof or (B) any material adverse change in financial markets which, in the reasonable judgment of National, makes it impracticable or inadvisable to offer or sell the Firm Stock on the terms contemplated by the Prospectus.

11. SUBSTITUTION OF UNDERWRITERS. If on the First Closing Date or the Option Closing Date, as the case may be, any Underwriter or Underwriters shall default in its or their obligations to purchase Shares hereunder (otherwise than by reason of default on the part of the Company), you, as Representative of the Underwriters, shall use your commercially reasonable efforts to procure within thirty six (36) hours thereafter one or more of the other Underwriters, or any others, to purchase from the Company such amounts as may be agreed upon and upon the terms set forth herein, the Shares which the defaulting Underwriter or Underwriters failed to purchase. If during such thirty six (36) hours you, as such Representative, shall not have procured such other Underwriters, or any others, to purchase the Shares agreed to be purchased by the defaulting Underwriter or Underwriters, then the other Underwriters shall be obligated severally, in proportion to their respective commitments hereunder, to purchase the Shares which such defaulting Underwriter or Underwriters agreed but failed to purchase. If the remaining Underwriters or substituted Underwriters are required hereby or agree to take up all or part of the Shares of a defaulting Underwriter or Underwriters as provided in this Section 11, (i) the Company shall have the right to postpone the Closing Dates for a period of not more than seven (7) full business days in order that the Company may effect whatever changes may thereby be made necessary in the Registration Statement or the Prospectus, or in any other documents or arrangements, and the Company agrees promptly to file any amendments to the Registration Statement or supplements to the Prospectus which may thereby be made necessary, and (ii) the respective numbers of shares to be purchased by the remaining Underwriters or substituted Underwriters shall be taken as the basis of their underwriting obligation for all purposes of this Agreement. Nothing herein contained shall relieve any defaulting Underwriter of its liability to the Company or the other Underwriters for damages occasioned by its default hereunder. The term Underwriter as used in this Agreement shall refer to and include any Underwriter substituted under this Section 11 with like effect as if such substituted Underwriter had originally been named in Schedule A.

12. NOTICES. All communications hereunder shall be in writing and, if sent to the Underwriters, shall be mailed, delivered or telegraphed and confirmed to you, as their Representative c/o National Securities Corporation at 1001 Fourth Avenue, Suite 2200, Seattle, Washington 93154-1100, Attention: [__________], with a copy to Michael Jay Brown, Esq., Dorsey & Whitney LLP, U.S. Bank Centre, 1420 Fifth Avenue, Suite 3400, Seattle, Washington 98101-4010, except that notices given to an Underwriter pursuant to Section 6 hereof shall be sent to such Underwriter at the address furnished by the Representative or, if sent to the Company, shall be mailed, delivered or telegraphed and confirmed c/o Marchex, Inc., 2101 Fourth Avenue, Suite 1980, Seattle Washington 98121, Attention: Chief Executive Officer, with a copy to Francis J. Feeney, Jr., Esq., Nixon Peabody LLP, 101 Federal Street, Boston, Massachusetts 02110.

13. SUCCESSORS. This Agreement shall inure to the benefit of and be binding upon the several Underwriters, the Company and their respective successors and legal representatives. Nothing expressed or mentioned in this Agreement is intended or shall be construed to give any person other than the persons mentioned in the preceding sentence any legal or equitable right, remedy or claim under or in respect of this Agreement, or any provisions herein contained, this Agreement and all conditions and provisions hereof being intended to be and being for the sole and exclusive benefit of such persons and for the benefit of no other person; except that the representations, warranties, covenants, agreements and indemnities of the Company contained in this Agreement shall also be for the benefit of the person or persons, if any, who control any Underwriter or Underwriters within the meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act, and the indemnities of the several Underwriters shall also be for the benefit of each director of the Company, each of its officers who has signed the Registration Statement and the person or persons, if any, who control the Company within the meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act.

14. APPLICABLE LAW. This Agreement shall be governed by and construed in accordance with the internal substantive laws of the State of Washington without giving effect to the choice of law principles thereof.

15. SUBMISSION TO JURISDICTION. Each party hereby consents to the personal jurisdiction of the State of Washington, acknowledges that venue is proper in any state or Federal court in the State of Washington, located in King County, agrees that any action related to this Agreement must be brought in a state or Federal court located in King County in the State of Washington and waives any objection that may exist, now or in the future, with respect to any of the foregoing. Each party (or their respective stockholders and affiliates) waives all right to trial by jury in any action, proceeding or counterclaim (whether based upon contract, tort or otherwise) in any way arising out of or relating to this Agreement.

16. AUTHORITY OF THE REPRESENTATIVES. In connection with this Agreement, you will act for and on behalf of the several Underwriters, and any action taken under this Agreement by National, as Representative, will be binding on all the Underwriters.

17. PARTIAL UNENFORCEABILITY. The invalidity or unenforceability of any Section, paragraph or provision of this Agreement shall not affect the validity or enforceability of any other Section, paragraph or provision hereof. If any Section, paragraph or provision of this Agreement is for any reason determined to be invalid or unenforceable, there shall be deemed to be made such minor changes (and only such minor changes) as are necessary to make it valid and enforceable.

18. GENERAL. This Agreement constitutes the entire agreement of the parties to this Agreement and supersedes all prior written or oral and all contemporaneous oral agreements, understandings and negotiations with respect to the subject matter hereof. In this Agreement, the masculine, feminine and neuter genders and the singular and the plural include one another. The section headings in this Agreement are for the convenience of the parties only and will not affect the construction or interpretation of this Agreement. This Agreement may be amended or modified, and the observance of any term of this Agreement may be waived, only by a writing signed by the Company and the Representative.

19. <u>COUNTERPARTS</u>. This Agreement may be signed in two (2) or more counterparts, each of which shall be an original, with the same effect as if the signatures thereto and hereto were upon the same instrument.

If the foregoing correctly sets forth our understanding, please indicate your acceptance thereof in the space provided below for that purpose, whereupon this letter and your acceptance shall constitute a binding agreement between us.

Very truly yours,

Marchex, Inc.

By: ______________________________

Name: Chief Executive Officer
Title: Russell C. Horowitz

Accepted and agreed to
as of the date first above written.

NATIONAL SECURITIES CORPORATION
Acting on its own behalf and as Representative of the several
Underwriters referred to in the foregoing Agreement.

By: National Securities Corporation.

By: ______________________________

Name:
Title:

SCHEDULE A

Underwriter	Number of shares of Firm Stock
National Securities Corporation	
Total:	

SCHEDULE B

Name of Stockholder

SCHEDULE C

List of Subsidiaries

eFamily.com, Inc.
Enhance Interactive, Inc. (f/k/a ah-ha.com, Inc.)
TrafficLeader, Inc.

EXHIBIT 4.5

MARCHEX, INC.

AND

NATIONAL SECURITIES CORPORATION

FORM OF REPRESENTATIVE'S
WARRANT AGREEMENT

DATED AS OF __________, 2004

REPRESENTATIVE'S WARRANT AGREEMENT dated as of __________, 2004 between MARCHEX, INC., a Delaware corporation (the "Company") and NATIONAL SECURITIES CORPORATION ("National" or the "Representative").

W I T N E S S E T H:

WHEREAS, Representative has agreed pursuant to the underwriting agreement (the "Underwriting Agreement") dated as of the date hereof between the Company and Representative, to act as the underwriter in connection with the Company's proposed public offering (the "Public Offering") of an aggregate of 4,000,000 shares of the Company's Class B common stock, par value $.01 per share (the "Common Stock") at an initial public offering price of [______] per share of Common Stock, plus up to an additional 600,000 shares of Common Stock pursuant to the Representative's over-allotment option; and

WHEREAS, the Company proposes to issue warrants (the "Warrants") to Representative to purchase up to an aggregate of three percent (3%) of the shares of Common Stock offered to the public through the Public Offering, excluding any over-allotments; and

WHEREAS, the Warrants issued pursuant to this Agreement are being issued by the Company to Representative, for its own account or for the account of Representative's designee (limited to officers, directors and employees of Representative, individually, "Representative's Designee" and collectively, "Representative's Designees") on the First Closing Date (as such term is defined in the Underwriting Agreement) in consideration for, and as part of Representative 's compensation in connection with, Representative acting as the representative pursuant to the Underwriting Agreement;

NOW, THEREFORE, in consideration of the foregoing premises, the payment by the Representative to the Company of an aggregate one hundred dollars ($100.00), the agreements herein set forth and other good and valuable consideration, hereby acknowledged, the parties hereto agree as follows:

1. Grant. Upon the successful closing of the Public Offering and the fulfillment of the terms of the Underwriting Agreement by the Representative, the Representative and/or the Representative's Designee (together, the "Holders" and each a "Holder") is hereby granted the right to purchase, at any time from ___________, 2005 (one (1) year from the First Closing Date (as such term is defined in the Underwriting Agreement) (the "Initial Exercise Date") until 5:30 P.M., New York time, on ___________, 2009 (five (5) years from the First Closing Date (as such term is defined in the Underwriting Agreement) of the registration statement and any supplement thereto, on Form SB-2, No. 333-111096) (the "Expiration Date"), up to an aggregate of 120,000 shares of Class B Common Stock at an initial exercise price (subject to adjustment as provided in Section 8 hereof) (the "Shares") of 130% of the Public Offering price per share (the "Initial Exercise Price"). Except as set forth herein, the shares of Class B Common Stock issuable upon exercise of the Warrants are in all respects identical to the shares of Class B Common Stock being purchased by the Underwriters for resale to the public pursuant to the terms and provisions of the Underwriting Agreement.

2. Warrant Certificates. The warrant certificates (the "Warrant Certificates") delivered and to be delivered pursuant to this Agreement shall be in the form set forth in Exhibit A, attached hereto and made a part hereof, with such appropriate insertions, omissions, substitutions, and other variations as required or permitted by this Agreement. This Warrant shall not entitle its Holder to any rights as a stockholder of the Company prior to the exercise of this Warrant.

3. Exercise of Warrant.

3.1 Method of Exercise. The Warrants initially are exercisable commencing on the Initial Exercise Date at the Initial Exercise Price (subject to adjustment as provided in Section 8 hereof) set forth in Section 6 hereof payable by certified or official bank check in New York Clearing House funds, subject to adjustment as provided in Section 8 hereof. Upon surrender of a Warrant Certificate with a Form of Election to Purchase duly executed (substantially in the form of Annex A to the Warrant Certificate), together with payment of the Exercise Price (as hereinafter defined) for the shares of Class B Common Stock purchased at the Company's principal executive offices in Seattle, Washington (presently located at 2101 Fourth Avenue, Suite 1980, Seattle, Washington 98121) the registered holder of a Warrant Certificate shall be entitled to receive a certificate or certificates for the shares of Class B Common Stock so purchased. The purchase rights represented by each Warrant Certificate are exercisable at the option of the Holder thereof, in whole or in part (but not as to fractional shares of the Class B Common Stock). The Warrants may be exercised to purchase all or part of the shares of Class B Common Stock. In the case of the purchase of less than all the shares of Class B Common Stock under any Warrant Certificate, the Company shall cancel said Warrant Certificate upon the surrender thereof and shall execute and deliver a new Warrant Certificate of like tenor for the balance of the shares of Class B Common Stock purchasable thereunder.

3.2 Exercise by Surrender of Warrant. In addition to the method of payment set forth in Section 3.1 and in lieu of any cash payment required thereunder, the Holder(s) shall have the right, at any time and from time to time prior to the Expiration Date, to exercise the Warrants in full or in part by surrendering the Warrant Certificate(s) representing a certain number of additional Warrants as payment of the aggregate Exercise Price for the shares of Common Stock being acquired upon exercise of the Warrants. The Warrants are exercisable pursuant to this Section 3.2 by surrender of the Warrant Certificate(s) with a Form of Election to Purchase duly executed (substantially in the form of Annex B to the Warrant Certificate) and surrender of a certain number of Warrants in addition to those being exercised. The number of additional Warrants to be surrendered in payment of the aggregate Exercise Price for the Warrants being exercised shall be determined by multiplying the number of Warrants to be exercised by the Exercise Price, and then dividing the product thereof by an amount equal to the Market Price (as defined below). Solely for the purposes of this paragraph, Market Price shall be calculated either (i) on the date on which the Form of Election to Purchase attached hereto is deemed to have been sent to the Company pursuant to Section 13 hereof ("Notice Date") or (ii) as the average of the Market Prices for each of the three (3) trading days preceding the Notice Date, whichever of (i) or (ii) is greater.

3.3 Definition of Market Price. As used herein, the phrase "Market Price" at any date shall be deemed to be the last reported sale price, or, in case no such reported sale takes place on such day, the average of the last reported sale prices for the last three (3) trading days, in either case as officially reported by the principal securities exchange on which the Class B Common Stock is listed or admitted to trading or by the Nasdaq National Market ("Nasdaq National Market") or by the National Association of Securities Dealers Automated Quotation System ("Nasdaq"), or, if the Class B Common Stock is not listed or admitted to trading on any national securities exchange or quoted by Nasdaq, the average closing bid price as furnished by the National Association of Securities Dealers, Inc. ("NASD") through Nasdaq or similar organization if Nasdaq is no longer reporting such information, or if the Class B Common Stock is not quoted on Nasdaq, as determined in good faith by resolution of the members of the Board of Directors of the Company, based on the best information available to it.

4. Issuance of Certificates. Upon the exercise of the Warrants, the issuance of certificates for shares of Class B Common Stock shall be made promptly (and in any event within five (5) business days thereafter) without charge to the Holder thereof including, without limitation, any stock transfer or similar tax which may be payable in respect of the issuance thereof, and such certificates shall (subject to the provisions of Sections 5 and 7 hereof) be issued in the name of, or in such names as may be directed by, the Holder thereof; provided, however, that the Company shall not be required to pay any tax which may be payable in respect of any transfer involved in the issuance and delivery of any such certificates in a name other than that of the Holder, and the Company shall not be required to issue or deliver such certificates unless or until the person or persons requesting the issuance thereof shall have paid to the Company the amount of such tax or shall have established to the satisfaction of the Company that such tax has been paid.

The Warrant Certificates and the certificates representing the shares of Class B Common Stock issued upon exercise thereof shall be executed on behalf of the Company by the manual or facsimile signature of the then Chairman of the Board of Directors or President of the Company, attested to by the manual or facsimile signature of the then Secretary of the Company. Warrant Certificates shall be dated the date of execution by the Company upon initial issuance, division, exchange, substitution or transfer. Certificates representing the shares of Class B Common Stock shall be dated as of the Notice Date (regardless of when executed or delivered).

5. Restriction on Transfer of Warrants. The Holder of a Warrant Certificate, by its acceptance thereof, covenants and agrees that the Warrants are being acquired as an investment and not with a view to the distribution thereof, and that the Warrants may not be sold, transferred, assigned, hypothecated or otherwise disposed of, in whole or in part, pursuant to NASD Corporate Financing Rule 2710 (currently a period of one (1) year from the date hereof), except to Representative's Designees (each of which is hereinafter referred to as a "Transferee"), in which case such Transferee shall be entitled to receive a replacement Warrant Certificate in accordance with Section 9 hereof upon presentment of a properly executed Form of Assignment in the form set forth on Annex C to the Warrant Certificate attached hereto and made a part hereof. The Holder of a Warrant Certificate, by its acceptance thereof, further covenants and agrees that this Warrant and the Shares which may be issued upon exercise hereof are being acquired for investment, that the Holder has no present intention to resell or otherwise dispose of all or any part of this Warrant or any Shares, and that the Holder will not offer, sell or otherwise dispose of all or any part of this Warrant or any Shares except under circumstances which will not result in a violation of the Securities Act of 1933, as amended (the "Act"). If the Company conducts any registered offering, the Holder of the Warrant or any Shares shall not, without the prior written consent of the Company and the managing underwriter, if any, in such offering: (i) sell, transfer or otherwise dispose of, or agree to sell, transfer or otherwise dispose of the Warrant or any of the Shares; (ii) sell, transfer or otherwise dispose of, or agree to sell, transfer or otherwise dispose of any right to purchase the Warrant or any of the Shares; or (iii) sell or grant, or agree to sell or grant, options, rights or warrants with respect to the Warrant or any of the Shares. Such restrictions shall be effective for a period of time equal to the period during which the managing underwriter imposes such transfer restrictions on the Company's officers and directors; provided, that in no event shall the restricted period applicable to a Holder of this Warrant or Shares exceed one hundred eighty (180) days after effectiveness of the Company's registration statement filed with the United Stated Securities and Exchange Commission (the "Commission") with respect to such offering.

In connection with the transfer or exercise of Warrants, the Transferee and Holder agree to execute any documents which may be reasonably required by counsel to the Company to comply with the provisions of the Act and applicable state securities laws.

6. Exercise Price.

6.1 Initial and Adjusted Exercise Price. Except as otherwise provided in Section 8 hereof, the initial exercise price of each Warrant shall be the Initial Exercise Price. The adjusted exercise price shall be the price which shall result from time to time from any and all adjustments of the initial exercise price in accordance with the provisions of Section 8 hereof.

6.2 Exercise Price. The term “Exercise Price” herein shall mean the Initial Exercise Price or the adjusted exercise price, depending upon the context or unless otherwise specified.

7. Registration Rights.

7.1 Registration under the Securities Act of 1933. The Warrants and the shares of Class B Common Stock issuable upon exercise of the Warrants (collectively, the “Warrant Securities”) have not been registered under the Act and the certificates representing the Warrant Securities or any other evidence thereof shall bear the following legends:

> The warrant represented by this certificate and the other securities issued upon exercise thereof may not be offered or sold except pursuant to (i) an effective registration statement under the Securities Act of 1933 (the “Act”), (ii) to the extent applicable, Rule 144 under such Act (or any similar rule under such Act relating to the disposition of securities), or (iii) an opinion of counsel, if such opinion shall be reasonably satisfactory to counsel to the issuer, that an exemption from registration under such Act is available.

7.2 Piggyback Registration. If, at any time commencing on the Initial Exercise Date and expiring on the Expiration Date, the Company proposes to register any of its securities under the Act (other than in connection with a merger or pursuant to Form S-4 or Form S-8 or successor form thereto) it will give written notice by registered mail, at least thirty (30) days prior to the filing of each such registration statement, to the Holders of the Warrant Securities of its intention to do so; *provided*, *however*, in accordance with the NASD rules and regulations, in no event shall the right contained in this Section 7.2 continue for more than seven (7) years from the date hereof. If any of the Holders of the Warrant Securities notify the Company within twenty (20) days after mailing of any such notice of its or their desire to include any such securities in such proposed registration statement, the Company shall afford such Holders of the Warrant Securities the opportunity to have any such Warrant Securities registered under such registration statement. In the event that the managing underwriter for said offering advises the Company in writing that in their opinion the number of securities requested to be included in such registration exceeds the number which can be sold in such offering without causing a diminution in the offering price or otherwise adversely affecting the offering, the Company will include in such registration (a) FIRST, the securities the Company proposes to sell, (b) SECOND, any securities held by parties with registration rights granted by the Company prior to the date hereof, (c) THIRD, the Warrant Securities requested to be included in such registration which in the opinion of such underwriter can be sold, PRO RATA among the Holders of Warrant Securities on the basis of the number of Representative’s Warrant Securities requested to be registered by such Holders, and (d) FOURTH, other securities requested to be included in such registration.

Notwithstanding the provisions of this Section 7.2, the Company shall have the right at any time after it shall have given written notice pursuant to this Section 7.2 (irrespective of whether a written request for inclusion of any such securities shall have been made) to elect not to file any such proposed registration statement or to withdraw the same after the filing but prior to the effective date thereof.

7.3 Covenants of the Company with respect to Registration.

In connection with any registration under Section 7.2 hereof, the Company covenants and agrees as follows:

(a) The Company shall pay all costs (excluding fees and expenses of Holder(s)' counsel and any underwriting or selling commissions), fees and expenses in connection with all registration statements filed pursuant to Section 7.2 including, without limitation, the Company's legal and accounting fees, printing expenses, blue sky fees and expenses.

(b) The Company will take all necessary action which may be required in qualifying or registering the Warrant Securities included in a registration statement for offering and sale under the securities or blue sky laws of such states as reasonably are requested by the Holder(s), provided that the Company shall not be obligated to execute or file any general consent to service of process or to qualify as a foreign corporation to do business under the laws of any such jurisdiction.

(c) The Company shall indemnify the Holder(s) of the Warrant Securities to be sold pursuant to any registration statement and each person, if any, who controls such Holders within the meaning of Section 15 of the Act or Section 20(a) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), against all loss, claim, damage, expense or liability (including all expenses reasonably incurred in investigating, preparing or defending against any claim whatsoever) to which any of them may become subject under the Act, the Exchange Act or otherwise, arising from such registration statement but only to the same extent and with the same effect as the provisions pursuant to which the Company has agreed to indemnify each of the Underwriters contained in Section 6 of the Underwriting Agreement and to provide for just and equitable contribution as set forth in Section 6 of the Underwriting Agreement.

(d) The Holder(s) of the Warrant Securities to be sold pursuant to a registration statement, and their successors and assigns, shall severally, and not jointly, indemnify the Company, its officers and directors and each person, if any, who controls the Company within the meaning of Section 15 of the Act or Section 20(a) of the Exchange Act, against all loss, claim, damage, expense or liability (including all expenses reasonably incurred in investigating, preparing or defending against any claim whatsoever) to which they may become subject under the Act, the Exchange Act or otherwise, arising from information furnished by or on behalf of such Holders, or their successors or assigns, for specific inclusion in such registration statement to the same extent and with the same effect as the provisions contained in Section 6 of the Underwriting Agreement pursuant to which the Underwriters have agreed to indemnify the Company and to provide for just and equitable contribution as set forth in the Underwriting Agreement.

(e) Nothing contained in this Agreement shall be construed as requiring the Holder(s) to exercise their Warrants prior to the initial filing of any registration statement or the effectiveness thereof.

(f) The Company shall deliver promptly to each Holder participating in the offering requesting the correspondence and memoranda described below and to the managing underwriters, copies of all correspondence between the Commission and the Company, its counsel or auditors and all memoranda relating to discussions with the Commission or its staff with respect to the registration statement and permit each Holder and underwriter to do such investigation, upon reasonable advance notice, with respect to information contained in or omitted from the registration statement as it deems reasonably necessary to comply with applicable securities laws or rules of the NASD.

7.4 Obligations of Holders. It shall be a condition precedent to the obligations of the Company to take any action pursuant to this Section 7 hereof that each of the selling Holders shall:

(a) Furnish to the Company such information regarding themselves, the Warrant Securities held by them, the intended method of sale or other disposition of such securities, the identity of and compensation to be paid to any underwriters proposed to be employed in connection with such sale or other disposition, and such other information as may reasonably be required to effect the registration of their Warrant Securities.

(b) Notify the Company, at any time when a prospectus relating to the Warrant Securities covered by a registration statement is required to be delivered un the Act, of the happening of any event with respect to such selling Holder as a result of which the prospectus included in such registration statement, as then in effect, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading in the light of the circumstances then existing.

8. Adjustments to Exercise Price and Number of Securities.

8.1 Subdivision and Combination. In case the Company shall at any time subdivide or combine the outstanding shares of Class B Common Stock, the Exercise Price shall forthwith be proportionately decreased in the case of subdivision or increased in the case of combination.

8.2 Stock Dividends and Distributions. In case the Company shall at any time after the date hereof pay a dividend in, or make a distribution of, shares of Class B Common Stock or of the Company’s capital stock convertible into Class B Common Stock, the Exercise Price shall forthwith be proportionately decreased. An adjustment made pursuant to this Section 8.2 shall be made as of the record date for the subject stock dividend or distribution.

8.3 Adjustment in Number of Securities. Upon each adjustment of the Exercise Price pursuant to the provisions of this Section 8, the number of Class B Common Stock issuable upon the exercise at the adjusted exercise price of each Warrant shall be adjusted to the nearest full amount by multiplying a number equal to the Exercise Price in effect immediately prior to such adjustment by the number of Class B Common Stock issuable upon exercise of the Warrants immediately prior to such adjustment and dividing the product so obtained by the adjusted Exercise Price.

8.4 Definition of Class B Common Stock. For the purpose of this Agreement, the term "Class B Common Stock" shall mean (i) the class of stock designated as Class B Common Stock in the Certificate of Incorporation of the Company as amended to date, or (ii) any other class of stock resulting from successive changes or reclassifications of such Class B Common Stock consisting solely of changes in par value, or from par value to no par value, or from no par value to par value.

8.5 Merger or Consolidation. In case after the date hereof of any consolidation of the Company with, or merger of the Company with, or merger of the Company into, another corporation (other than a consolidation or merger which does not result in any reclassification or change of the outstanding Class B Common Stock), the corporation formed by such consolidation or merger shall execute and deliver to the Holder a supplemental warrant agreement providing that the holder of each Warrant then outstanding or to be outstanding shall have the right thereafter (until the expiration of such Warrant) to receive, upon exercise of such Warrant, the kind and amount of shares of stock and other securities and property receivable upon such consolidation or merger, by a holder of the number of securities of the Company for which such Warrant might have been exercised immediately prior to such consolidation, merger, sale or transfer. Such supplemental warrant agreement shall provide for adjustments which shall be identical to the adjustments provided in this Section 8. The above provision of this subsection shall similarly apply to successive consolidations or mergers.

8.6 No Adjustment of Exercise Price in Certain Cases. No adjustment of the Exercise Price shall be made if the amount of said adjustment shall be less than two cents (2) per Warrant Security, provided, however, that in such case any adjustment that would otherwise be required then to be made shall be carried forward and shall be made at the time of and together with the next subsequent adjustment which, together with any adjustment so carried forward, shall amount to at least two cents ($.02) per Warrant Security.

9. Exchange and Replacement of Warrant Certificates.

9.1 Exchange. Each Warrant Certificate is exchangeable without expense, upon the surrender thereof by the registered Holder at the principal executive office of the Company, for a new Warrant Certificate of like tenor and date representing in the aggregate the right to purchase the same number of Warrant Securities in such denominations as shall be designated by the Holder thereof at the time of such surrender.

9.2 Replacement. Upon receipt by the Company of evidence reasonably satisfactory to it of the loss, theft, destruction or mutilation of any Warrant Certificate, and, in case of loss, theft or destruction, of indemnity or security reasonably satisfactory to it, and reimbursement to the Company of all reasonable expenses incidental thereto, and upon surrender and cancellation of the Warrants, if mutilated, the Company will make and deliver a new Warrant Certificate of like tenor, in lieu thereof.

10. Limitation of Fractional Interests. The Company shall not be required to issue certificates representing fractions of shares of Class B Common Stock upon the exercise of the Warrants, nor shall it be required to issue scrip or pay cash in lieu of fractional interests, it being the intent of the parties that all fractional interests shall be eliminated by rounding any fraction up to the nearest whole number of shares of Class B Common Stock or other securities, properties or rights.

11. Reservation and Listing of Securities. The Company shall at all times reserve and keep available out of its authorized shares of Class B Common Stock, solely for the purpose of issuance upon the exercise of the Warrants, such number of shares of Class B Common Stock or other securities, properties or rights as shall be issuable upon the exercise thereof. The Company covenants and agrees that, upon exercise of the Warrants and payment of the Exercise Price therefor, all shares of Class B Common Stock issuable upon such exercise shall be duly and validly issued, fully paid, non-assessable and not subject to the preemptive rights of any stockholder.

12. Notices to Warrant Holders. Nothing contained in this Agreement shall be construed as conferring upon the Holders the right to vote or to consent or to receive notice as a stockholder in respect of any meetings of stockholders for the election of directors or any other matter, or as having any rights whatsoever as a stockholder of the Company. If, however, at any time prior to the expiration of the Warrants and their exercise, any of the following events shall occur:

(a) the Company shall take a record of the holders of its shares of Class B Common Stock for the purpose of entitling them to receive a dividend or distribution payable otherwise than in cash, or a cash dividend or distribution payable otherwise than out of current or retained earnings or capital surplus (in accordance with applicable law), as indicated by the accounting treatment of such dividend or distribution on the books of the Company; or

(b) the Company shall offer to all the holders of its Class B Common Stock any additional shares of capital stock of the Company or securities convertible into or exchangeable for shares of capital stock of the Company, or any option, right or warrant to subscribe therefor; or

(c) a dissolution, liquidation or winding up of the Company (other than in connection with a consolidation or merger) or a sale of all or substantially all of its property, assets and business as an entirety shall be proposed;

then, in any one or more of said events, the Company shall give written notice of such event at least fifteen (15) days prior to the date fixed as a record date or the date of closing the transfer books for the determination of the stockholders entitled to such dividend, distribution, convertible or exchangeable securities or subscription rights, or entitled to vote on such proposed dissolution, liquidation, winding up or sale. Such notice shall specify such record date or the date of closing the transfer books, as the case may be. Failure to give such notice or any defect therein shall not affect the validity of any action taken in connection with the declaration or payment of any such dividend, or the issuance of any convertible or exchangeable securities, or subscription rights, options or warrants, or any proposed dissolution, liquidation, winding up or sale.

13. Notices.

All notices, requests, consents and other communications hereunder shall be in writing and shall be deemed to have been duly made and sent when delivered, or mailed by registered or certified mail, return receipt requested or by Federal Express or other recognized overnight courier:

(a) If to the registered Holder of the Warrants, to the address of such Holder as shown on the books of the Company; or

(b) If to the Company, to the address set forth in Section 3 hereof or to such other address as the Company may designate by notice to the Holders.

14. Supplements and Amendments. The Company and the Representative may from time to time supplement or amend this Agreement without the approval of any Holders of Warrant Certificates (other than the Representative) in order to cure any ambiguity, to correct or supplement any provision contained herein which may be defective or inconsistent with any provisions herein, or to make any other provisions in regard to matters or questions arising hereunder which the Company and the Representative may deem necessary or desirable and which the Company and the Representative deem shall not adversely affect the interests of the Holders of Warrant Certificates.

15. Successors. All the covenants and provisions of this Agreement shall be binding upon and inure to the benefit of the Company, the Holders and their respective successors and assigns hereunder. Neither the Warrants or the Shares may be sold, transferred, assigned or hypothecated for a period of one (1) year from the date of this Warrant Agreement, except to Transferees.

16. Termination. This Agreement shall terminate at 5:30 P.M., New York time, on ______, 2009. Notwithstanding the foregoing, this Agreement will terminate on any earlier date when all Warrants have been exercised.

17. Governing Law; Submission to Jurisdiction. This Agreement and each Warrant Certificate issued hereunder shall be governed by and construed in accordance with the internal substantive laws of the State of Washington without giving effect to the choice of law principles thereof. Each party hereby consents to the personal jurisdiction of the State of Washington, acknowledges that venue is proper in any state or Federal court in the State of Washington, agrees that any action related to this Agreement must be brought in a state or Federal court in the State of Washington and waives any objection that may exist, now or in the future, with respect to any of the foregoing. Each party (or their respective stockholders and affiliates) waives all right to trial by jury in any action, proceeding or counterclaim (whether based upon contract, tort

or otherwise) in any way arising out of or relating to this Agreement. In the event of litigation between the parties arising hereunder, the prevailing party shall be entitled to costs and reasonable attorney's fees.

18. Entire Agreement; Modification. This Agreement (including the Underwriting Agreement to the extent portions thereof are referred to herein) contains the entire understanding between the parties hereto with respect to the subject matter hereof and may not be modified or amended except by a writing duly signed by the party against whom enforcement of the modification or amendment is sought.

19. Severability. If any provision of this Agreement shall be held to be invalid or unenforceable, such invalidity or unenforceability shall not affect any other provision of this Agreement.

20. Captions. The caption headings of the Sections of this Agreement are for convenience of reference only and are not intended, nor should they be construed as, a part of this Agreement and shall be given no substantive effect.

21. Benefits of this Agreement. Nothing in this Agreement shall be construed to give to any person or corporation other than the Company and the Representative and any other registered Holder(s) of the Warrant Securities any legal or equitable right, remedy or claim under this Agreement; and this Agreement shall be for the sole benefit of the Company and the Representative and any other registered Holders of Warrant Securities.

22. No Limitation on Corporate Action. No provisions of the Warrant and no right or option granted or conferred hereunder shall in any way limit, affect, or abridge the exercise by the Company of any of its corporate rights or powers to recapitalize, amend its certificate of incorporation, reorganize or merge with or into another corporation, or to transfer all or any part of its property or assets, or the exercise of any other of its corporate rights and powers, provided such rights or powers as exercised are not inconsistent with any other provision of this Agreement.

23. Counterparts. This Agreement may be executed in any number of counterparts and each of such counterparts shall for all purposes be deemed to be an original, and such counterparts shall together constitute but one and the same instrument.

[Remainder of Page Intentionally Left Blank]

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed as an instrument under seal, as of the day and year first above written.

MARCHEX, INC.

By: ____________________

Name: Russell C. Horowitz
Title: Chief Executive Officer

Attest:

____

Name: Ethan A. Caldwell
Title: Secretary

NATIONAL SECURITIES CORPORATION

By: ____________________

Name:
Title:

EXHIBIT A

FORM OF WARRANT CERTIFICATE

THE WARRANTS REPRESENTED BY THIS CERTIFICATE AND THE OTHER SECURITIES ISSUABLE UPON EXERCISE THEREOF MAY NOT BE OFFERED OR SOLD EXCEPT PURSUANT TO (i) AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933, (ii) TO THE EXTENT APPLICABLE, RULE 144 UNDER SUCH ACT (OR ANY SIMILAR RULE UNDER SUCH ACT RELATING TO THE DISPOSITION OF SECURITIES), OR (iii) AN OPINION OF COUNSEL, IF SUCH OPINION SHALL BE REASONABLY SATISFACTORY TO COUNSEL FOR THE ISSUER, THAT AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT IS AVAILABLE.

THE TRANSFER OR EXCHANGE OF THE WARRANTS REPRESENTED BY THIS CERTIFICATE IS RESTRICTED IN ACCORDANCE WITH THE WARRANT AGREEMENT REFERRED TO HEREIN.

EXERCISABLE ON OR BEFORE
5:30 P.M., NEW YORK TIME, ______, 2009

No. W-______

Warrants to Purchase
[______] shares of Class B
Common Stock

WARRANT CERTIFICATE

This Warrant Certificate certifies that [NATIONAL SECURITIES CORPORATION], or registered assigns, is the registered holder of Warrants to purchase at any time from ______, 2005 until 5:30 p.m. New York time on ______, 2009 (“Expiration Date”), up to [______] fully-paid and non-assessable shares of Class B Common Stock, $0.01 par value (“Class B Common Stock”), of MARCHEX, INC., a Delaware corporation (the “Company”), and [at the initial exercise price, subject to adjustment in certain events (the “Exercise Price”), of $______ per share] of Class B Common Stock upon surrender of this Warrant Certificate and payment of the Exercise Price at an office or agency of the Company, but subject to the conditions set forth herein and in the warrant agreement dated as of ______, 2004 between the Company and NATIONAL SECURITIES CORPORATION (the “Warrant Agreement”). Payment of the Exercise Price shall be made by certified or official bank check in New York Clearing House funds payable to the order of the Company or by surrender of this Warrant Certificate.

No Warrant may be exercised after 5:30 p.m., New York time, on the Expiration Date, at which time all Warrants evidenced hereby, unless exercised prior thereto, hereby shall thereafter be void.

The Warrants evidenced by this Warrant Certificate are part of a duly authorized issue of Warrants issued pursuant to the Warrant Agreement, which Warrant Agreement is hereby incorporated by reference in and made a part of this instrument and is hereby referred to for a description of the rights, limitation of rights, obligations, duties and immunities thereunder of the Company and the holders (the words "holders" or "holder" meaning the registered holders or registered holder) of the Warrants.

The Warrant Agreement provides that upon the occurrence of certain events the Exercise Price and the type and/or number of the Company's securities issuable thereupon may, subject to certain conditions, be adjusted. In such event, the Company will, at the request of the holder, issue a new Warrant Certificate evidencing the adjustment in the Exercise Price and the number and/or type of securities issuable upon the exercise of the Warrants; provided, however, that the failure of the Company to issue such new Warrant Certificates shall not in any way change, alter, or otherwise impair, the rights of the holder as set forth in the Warrant Agreement.

Upon due presentment for registration of transfer of this Warrant Certificate at an office or agency of the Company, a new Warrant Certificate or Warrant Certificates of like tenor and evidencing in the aggregate a like number of Warrants shall be issued to the transferee(s) in exchange for this Warrant Certificate, subject to the limitations provided herein and in the Warrant Agreement, without any charge except for any tax or other governmental charge imposed in connection with such transfer.

Upon the exercise of less than all of the Warrants evidenced by this Certificate, the Company shall forthwith issue to the holder hereof a new Warrant Certificate representing such number of unexercised Warrants.

The Company may deem and treat the registered holder(s) hereof as the absolute owner(s) of this Warrant Certificate (notwithstanding any notation of ownership or other writing hereon made by anyone), for the purpose of any exercise hereof, and of any distribution to the holder(s) hereof, and for all other purposes, and the Company shall not be affected by any notice to the contrary.

Neither the Warrants or the Shares may be sold, transferred, assigned or hypothecated pursuant to NASD Corporate Financing Rule 2710 (currently a period of one year from the date of this Warrant Certificate), except to one or more Designees.

All terms used in this Warrant Certificate which are defined in the Warrant Agreement shall have the meanings assigned to them in the Warrant Agreement.

[Remainder of Page Intentionally Left Blank]

IN WITNESS WHEREOF, the Company has caused this Warrant Certificate to be duly executed under its corporate seal.

Dated as of ______, 2004

MARCHEX, INC.

By: ______________________________

Name: Russell C. Horowitz
Title: Chief Executive Officer

Attest:

____

Name: Ethan A. Caldwell
Title: Secretary

<u>Annex A to Warrant Certificate</u>

FORM OF ELECTION TO PURCHASE PURSUANT TO SECTION 3.1

The undersigned hereby irrevocably elects to exercise the right, represented by this Warrant Certificate, to purchase:

______ shares of Class B Common Stock;

and herewith tenders in payment for such securities a certified or official bank check payable in New York Clearing House Funds to the order of Marchex, Inc. in the amount of $______, all in accordance with the terms of Section 3.1 of the Representative's Warrant Agreement dated as of ______, 2004 between Marchex, Inc. and National Securities Corporation. The undersigned requests that a certificate for such securities be registered in the name of ______ whose address is ______ and that such Certificate be delivered to ______ whose address is ______.

Dated: ______

Signature: ______________________________

(Signature must conform in all respects to name of holder as specified on the face of the Warrant Certificate.)

Annex B to Warrant Certificate

FORM OF ELECTION TO PURCHASE PURSUANT TO SECTION 3.2

The undersigned hereby irrevocably elects to exercise the right, represented by this Warrant Certificate, to purchase:

______ shares of Class B Common Stock;

and herewith tenders in payment for such securities ______ Warrants all in accordance with the terms of Section 3.2 of the Representative's Warrant Agreement dated as of ______, 2004 between Marchex, Inc. and National Securities Corporation. The undersigned requests that a certificate for such securities be registered in the name of ______ whose address is ______ and that such Certificate be delivered to ______ whose address is ______.

Dated: ______

Signature: ______________________________

(Signature must conform in all respects to name of holder as specified on the face of the Warrant Certificate.)

____

(Insert Social Security or Other Identifying Number of Holder)

<u>Annex C to Warrant Certificate</u>

FORM OF ASSIGNMENT

(To be executed by the registered holder if such holder desires to transfer the Warrant Certificate to Representative's Designee.)

FOR VALUE RECEIVED ______ hereby sells, assigns and transfers unto

____

(Please print name and address of transferee)

this Warrant Certificate, together with all right, title and interest therein, and does hereby irrevocably constitute and appoint ______ Attorney, to transfer the within Warrant Certificate on the books of the within-named Company, with full power of substitution.

Dated: ______

Signature: ____

(Signature must conform in all respects to name of holder as specified on the face of the Warrant Certificate.)

____

(Insert Social Security or Other Identifying Number of Holder)

FORM OF OPINION OF NIXON PEABODY LLP

April __, 2004

Marchex, Inc.
2101 Fourth Avenue, Suite 1980
Seattle, WA 98121

Re: Registration Statement on Form SB-2; Registration No. 333-111096

Ladies and Gentlemen:

This opinion is furnished to you in connection with a Registration Statement on Form SB-2 (File No. 333-111096) (the "Registration Statement") filed with the Securities and Exchange Commission (the "Commission") under the Securities Act of 1933, as amended (the "Securities Act"), on December 11, 2003, as amended by Amendment No. 1 filed with the Commission on February 18, 2004, for the registration of 4,600,000 shares of Class B common stock, par value $0.01 per share (the "Shares"), of Marchex, Inc., a Delaware corporation (the "Company"), including 600,000 Shares issuable upon exercise of an underwriters' over-allotment option to be granted by the Company.

The Shares are to be sold by the Company pursuant to an underwriting agreement (the "Underwriting Agreement") to be entered into among the Company and the several underwriters to be named in the Underwriting Agreement for whom National Securities Corporation is acting as a representative. The form of the Underwriting Agreement has been filed as Exhibit 1.1 to the Registration Statement.

In our capacity as special counsel to the Company in connection with such registration, we are familiar with the proceedings taken and proposed to be taken by the Company in connection with the authorization, issuance and sale of the Shares, and for the purposes of this opinion, have assumed such proceedings will be timely completed in the manner presently proposed. We have examined signed copies of the Registration Statement as filed with the Commission. We have also examined and relied upon the Underwriting Agreement, minutes of meetings of the stockholders and the Board of Directors of the Company as provided to us by the Company, the Certificate of Incorporation and By-Laws of the Company, each as restated and/or amended to date, and such other documents as we have deemed necessary for purposes of rendering the opinion hereinafter set forth. In addition, we have examined such matters of fact and questions of law as we have considered appropriate for purposes of this opinion.

In our examination of the foregoing documents, we have assumed the genuineness of all signatures, the authenticity of all documents submitted to us as originals, the conformity to original documents of all documents submitted to us as copies, the authenticity of the originals of such latter documents and the legal competence of all signatories to such documents.

We assume that the appropriate actions will be taken, prior to the offer and sale of the Shares in accordance with the Underwriting Agreement, to register and qualify the Shares for sale under all applicable state securities or "blue sky" laws.

We are opining herein as to the effect on the subject transaction only of the General Corporation Law of the State of Delaware, and we express no opinion with respect to the applicability thereto, or the effect thereon, of any other laws.

Subject to the foregoing, it is our opinion that as of the date hereof, (i) the Shares have been duly authorized by all necessary corporate action of the Company, and (ii) the Shares, upon issuance, delivery and payment therefor in the manner contemplated by the Registration Statement, will be validly issued, fully paid and nonassessable.

Please note that we are opining only as to the matters expressly set forth herein, and no opinion should be inferred as to any other matters. This opinion is based upon currently existing statutes, rules, regulations and judicial decisions, and we disclaim any obligation to advise you of any change in any of these sources of law or subsequent legal or factual developments which might affect any matters or opinions set forth herein.

It is understood that this opinion is to be used only in connection with the offer and sale of the Shares while the Registration Statement is in effect. We consent to your filing this opinion as an exhibit to the Registration Statement and to the reference to our firm contained under the heading “Legal Matters.”

Very truly yours,

/s/ Nixon Peabody LLP

Marchex, Inc.

EXECUTIVE EMPLOYMENT AGREEMENT

AGREEMENT (the “Agreement”), made effective as of the 1st day of May, 2003 by and between Marchex, Inc., a Delaware corporation (“Marchex”) and Michael A. Arends, a resident of Shoreline, Washington (“Executive”).

WHEREAS, the parties desire to enter into this agreement setting forth the terms and conditions of the employment relationship of Executive and Marchex.

NOW, THEREFORE, in consideration of the mutual covenants and promises herein contained, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Marchex and Executive hereby agree as follows:

Section 1. Employment. Marchex hereby employs Executive as the Chief Financial Officer of Marchex, and Executive hereby accepts such employment under and subject to the terms and conditions hereinafter set forth.

Section 2. At-Will Relationship. The term of employment under this Agreement shall begin on the date hereof (the “Effective Date”) and shall continue until either Executive or Marchex elects to terminate the employment relationship. The parties agree and understand this employment relationship is “at-will” and that it may be terminated by either party at any time, with or without cause.

Section 3. Duties. Executive shall serve as the Chief Financial Officer of Marchex, and he shall have such additional duties as Marchex’s Board of Directors (the “Board”) may assign to him from time to time. Executive shall report to the Chairman of the Board and Chief Executive Officer of Marchex (the “Chief Executive Officer”). Executive will undertake and assume the responsibility of performing for and on behalf of Marchex whatever duties are necessary and required in the position of Chief Financial Officer. Executive hereby agrees to devote his full business time and best efforts to the faithful performance of such duties and to the promotion and development of the business and affairs of Marchex while employed by Marchex.

Section 4. Compensation and Related Matters.

Section 4.01 Salary. In consideration of the services rendered by Executive under this Agreement, Marchex shall pay Executive a salary (the “Salary”) at the rate of $156,000 per calendar year, beginning May 1, 2003, or such other Salary as is mutually agreed to by the parties. Such salary shall be adjusted to $135,000 upon the closing of an initial public offering of Marchex’s securities registered under the 1933 exchange act, with gross proceeds in excess of $20 million. The Salary shall be paid in such installments and at such times as Marchex pays its regularly salaried employees. The Salary will be subject to annual adjustment by the Chief Executive Officer, in their sole discretion, based upon the performance by Executive of his duties hereunder and the financial performance of Marchex. Marchex shall deduct or cause to be deducted from Executive's compensation and benefits, as set forth in this Section 4, all taxes and amounts required by law to be withheld.

Section 4.02 Stock Options. Subject to the approval of the Board of Directors or the Marchex 2003 Stock Incentive Plan Administrator, Executive will be granted an option to purchase three hundred fifty thousand (350,000) shares of the common stock of Marchex, subject to the terms and conditions of the Marchex 2003 Stock Incentive Plan, ("Option 1"). Options granted pursuant to Option 1 shall be designated as indicated on Exhibit A-1 as either incentive stock options ("ISO") meeting the requirements of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), or non-qualified options ("NQ") which are not intended to meet the requirements of such Section 422 of the Code. Options granted pursuant to Option 1 shall vest according to the schedule indicated on Exhibit A-1. The exercise price of Option 1 shall be three dollars ($3.00) per share. Subject to the approval of the Board of Directors or the Marchex 2003 Stock Incentive Plan Administrator, Executive will also be granted an option to purchase one hundred thousand (100,000) shares of Marchex's common stock, subject to the terms and conditions of the Marchex 2003 Stock Incentive Plan ("Option 2") and effective upon the earliest of (i) the first anniversary of the Effective Date and (ii) the closing of Marchex's initial public offering. Options granted pursuant to Option 2 shall be designated as NQ and shall vest according to the schedule attached as Exhibit A-2. The exercise price of Option 2 shall be the fair market value of such common stock at the time the option is granted or the price per share equal to the price per share offered and sold to the public pursuant to an effective registration statement prepared in accordance with the Securities Act of 1933, as amended, as determined by the Board. In the event that either (i) Russell C. Horowitz ceases to be a Marchex employee for any reason or (ii) a Change in Control (as defined below) occurs while Executive is employed by Marchex, all options or other equity awards held by Executive with respect to Marchex common stock shall become fully vested. For purposes of this subsection, a "Change in Control" shall be deemed to have occurred upon the acquisition of beneficial ownership of greater than fifty percent (50%) of the combined voting power of the then-outstanding shares of Marchex common stock entitled to vote generally in the election of directors by any individual, entity or group, but excluding for this purpose any such acquisition by Marchex or any corporation controlled by Marchex. With respect to any grants of capital stock, which shall include grants of options to purchase shares of capital stock of Marchex, received by Executive from Marchex, Executive agrees that the investigation of the tax consequences of such a grant of capital stock or options and the implementation of a plan to provide for such consequences are solely the responsibility of Executive. Marchex shall have no responsibility, legal, financial or otherwise, with regards to any tax consequences of any stock or options granted by Marchex to Executive.

Section 4.03. Benefits. During Executive's employment by Marchex, Executive shall be entitled to participate in or receive benefits under any medical or other employee benefit plan or arrangement generally made available by Marchex to its employees, now or in the future, subject to and on a basis consistent with the terms, conditions and overall administration of such plans and arrangements. Nothing in this Section 4 or elsewhere in this Agreement shall be construed to require Marchex to establish any such benefits and/or benefit plans or to prevent Marchex from modifying or terminating any such benefits and/or benefit plans, and no action or failure thereof shall affect this Agreement. In addition to any group and/or executive life insurance benefits made available by Marchex to its employees, Marchex will maintain life insurance which will pay to the Executive's beneficiaries a death benefit equal to one million, five hundred thousand dollars ($1,500,000).

Section 5. Termination of Employment.

Section 5.01 Right to Terminate. Marchex or Executive may terminate Executive's employment hereunder at any time by giving the other party thirty (30) days prior written notice ("Notice of Termination"); provided, that upon Executive's death, Executive's employment hereunder shall terminate automatically. Immediately upon the termination of Executive's employment hereunder for any reason, Executive must return promptly to Marchex any property (including documents) in Executive's possession which is owned by Marchex.

Section 5.02 Benefits upon Termination.

(a) Basic Payments upon Termination. If Executive's employment terminates for any reason, Marchex shall pay Executive's unpaid Salary for the period through the date of termination and Executive's unpaid Salary with respect to any vacation days accrued but not taken as of the date of termination. Executive shall also be entitled to other payments or benefits to the extent provided in Marchex's employee benefit plans or arrangements.

(b) Termination Other than for Cause, or for Death, Disability or Good Reason. If (i) Executive ceases to be a Marchex employee on account of (A) Marchex's termination of Executive's employment other than for Cause, (B) Disability or (C) Executive's death, or (ii) Executive resigns his employment with Marchex after giving Marchex notice of the occurrence of one or more events that constitute Good Reason within a reasonable period (but not more than ninety (90) days after such occurrence) and Marchex fails to correct such occurrence within a reasonable time (but not more than sixty (60) days) and Executive's resignation occurs within ten (10) days after the expiration of that cure period, then in addition to the amounts payable under Section 5.02(a):

(A) The stock options held by Executive shall become fully vested, and

(B) If Executive ceases to be an employee within the first three (3) years of his employment, Marchex shall pay Executive, an amount equal to one fourth (1/4) of the amount that is Executive's Salary. For each additional year after three (3) full years of employment, Executive shall be entitled to an additional amount equal to one twelfth (1/12) of the amount that is Executive's Salary; provided, however, that in no event shall Executive be entitled to an amount equal to more than one (1) year's Salary.

(c) Termination for Cause; Resignation. If Executive ceases to be an employee for any reason other than as set forth in Section 5.02(b), then Marchex shall have no obligation to make any payments to Executive for periods after the date of termination, Executive's unvested stock options shall terminate and Executive's vested options must be exercised, if at all, within the time periods after the date of termination specified in Executive's stock option agreement.

(d) Definitions. For purposes of this paragraph 5, the following definitions shall apply:

(A) Cause. "Cause" shall mean: (i) gross negligence or willful misconduct in the performance of Executive's duties to Marchex that has resulted in or is likely to result in substantial and material damage to Marchex or its subsidiaries, (ii) repeated unexplained or unjustified absence from Marchex, (iii) a material and willful violation of any federal or state law, (iv) commission of any act of fraud with respect to Marchex, or (v) conviction of a felony or a crime involving moral turpitude causing material harm to the standing and reputation of Marchex. Determination of whether Executive's conduct constitutes Cause will be reasonably made by the Board in good faith.

(B) Disability. "Disability" shall mean that (i) Executive has a physical or mental condition that renders Executive incapable, after reasonable accommodation, of performing his duties and (ii) such condition is reasonable determined by the Chief Executive Officer to be of a long-term nature.

(C) Good Reason. "Good Reason" shall mean any material breach of this Agreement by Marchex, the occurrence of which is not remedied by Marchex within five business days following receipt of Executive's Notice of Termination. In the event of a termination for Good Reason, the date of termination shall be the date specified in the Notice of Termination, which shall be not less than twenty (20) business days after the Notice of Termination is delivered.

Section 6. Confidential Information. The CONFIDENTIALITY, ASSIGNMENT OF INVENTIONS AND EMPLOYMENT AT-WILL AGREEMENT FOR CONSULTANTS AND EMPLOYEES attached hereto as Exhibit B (the "Confidentiality Agreement"), and all of the obligations, restrictions, including, but not limited to, the non-compete and non-solicitation provisions, are hereby adopted as part of this Agreement.

Section 7. Severable Provisions. The provisions of this Agreement are severable and the invalidity of any one or more provisions shall not affect the validity of any other provision. In the event that a court of competent jurisdiction shall determine that any provision of this Agreement or the application thereof is unenforceable in whole or in part because of the duration or scope thereof, the parties hereto agree that said court, in making such determination, shall have the power to reduce the duration and scope of such provision to the extent necessary to make it enforceable, and that the Agreement in its reduced form shall be valid and enforceable to the full extent permitted by law.

Section 8. Notices. All notices hereunder shall be in writing and shall be deemed to have been duly given on the date of personal delivery; or on the date of electronic confirmation of receipt, if sent by telecopier; or three (3) days after deposit in the United States mail, if mailed by certified or registered mail, return receipt requested (postage prepaid); or one (1) day after delivery by a reputable overnight courier (delivery charges prepaid), as follows:

If to Marchex:

Marchex, Inc.
2101 Fourth Avenue
Suite 1980
Seattle, WA 98121
Telephone No.: (206) 774-5000
Facsimile No: (206) 774-5049
Attention: General Counsel

If to Executive: Michael A. Arends

or to such other address as a party may notify the other pursuant to a notice given in accordance with this Section 8.

Section 9. Miscellaneous.

Section 9.01. Modification. This Agreement and the Confidentiality Agreement constitute the entire Agreement between the parties hereto with regard to the subject matter hereof, superseding all prior understandings and agreements, whether written or oral. This Agreement may not be amended, revised or waived, except by a writing signed by the parties.

Section 9.02. Assignment and Transfer. This Agreement shall not be terminated by the merger or consolidation of Marchex with any corporate or other entity or by the transfer of all or substantially all of the assets of Marchex to any other person, corporation, firm or entity. The provisions of this Agreement shall be binding on and shall inure to the benefit of any such successor in interest to Marchex. Neither this Agreement nor any of the rights, duties or obligations of Executive shall be assignable by Executive, nor shall any of the payments required or permitted to be made to Executive by this Agreement be encumbered, transferred or in any way anticipated, except as required by applicable laws.

Section 9.03. Headings. The headings in this Agreement are intended solely for convenience of reference and shall be given no effect in the construction or interpretation of this Agreement.

Section 9.04 No Conflicting Agreements. Executive represents and warrants to Marchex that (i) there are no restrictions, agreements, or understandings whatsoever to which Executive is a party which would prevent or make unlawful Executive's execution of this Agreement or Executive's employment hereunder, (ii) the execution of this Agreement and Executive's employment hereunder shall not constitute a breach or violation of any law, contract, agreement or understanding, oral or written, to which Executive is a party or by which Executive is bound, (iii) Executive is free and able to execute this Agreement and to enter into employment with Marchex, (iv) Executive has not violated nor is in violation of any law, regulation, rule, order, stipulation or the like relevant to Marchex's business, and (v) this Agreement is Executive's valid and binding obligation, enforceable in accordance with its terms.

Section 9.05. Governing Law. This Agreement shall be construed under and enforced in accordance with the internal substantive laws of the State of Washington.

Section 9.06 Arbitration. Any dispute, controversy or claim arising out of or in connection with this Agreement shall be exclusively subject to arbitration before the American Arbitration Association in Seattle, Washington, before a single arbitrator in accordance with their then current Commercial Arbitration Rules; provided, however, that disputes with regard to Confidential Information or non-competition provisions shall be excluded from this Section 9.06. Judgment upon any arbitration award may be entered in any court of competent jurisdiction. All parties shall cooperate in the process of arbitration for the purpose of expediting discovery and completing the arbitration proceedings. Nothing contained in this Section 9.06 or elsewhere in this Agreement shall in any way deprive either party of its right to obtain injunctive or other equitable relief in a court of competent jurisdiction.

Section 9.07. Waiver of Breach. The waiver of either party of a breach of any provision of this Agreement, which waiver must be in writing to be effective, shall not operate as or be construed as a waiver of any subsequent breach.

Section 9.08. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original and all of which together shall constitute one instrument.

[Remainder of page intentionally left blank]

IN WITNESS WHEREOF, the parties hereto have duly executed this Agreement as a sealed instrument as of the day and year first above written.

MARCHEX:

MARCHEX, INC.

By: /s/ RUSSELL C. HOROWITZ

Name: Russell C. Horowitz
Title: Chief Executive Officer

EXECUTIVE:

/s/ MICHAEL A. ARENDS

Name: Michael A. Arends

Exhibit A-1

Vesting Schedule and Designations of Option 1

Vest Date	ISO	NQ	Cumulative	Percentage (%)
12/31/03	33,333	0	33,333	9.5
4/30/04	33,333	20,834	87,500	25
10/31/04	0	43,750	131,250	37.5
4/30/05	33,333	10,417	175,000	50
10/31/05	0	43,750	218,750	62.5
4/30/06	33,333	10,417	262,500	75
10/31/06	0	43,750	306,250	87.5
4/30/07	33,333	10,417	350,000	100
TOTALS	166,665	183,335	350,000	100

Exhibit A-2

Vesting Schedule and Designations of Option 2

Vest Date	ISO	NQ	Cumulative	Percentage (%)
10/31/04	0	33,333	33,333	33.3
4/30/05	0	11,111	44,444	44.4
10/31/05	0	11,111	55,555	55.5
4/30/06	0	11,111	66,666	66.6
10/31/06	0	11,111	77,777	77.7
4/30/07	0	11,111	88,888	88.8
10/31/07	0	11,112	100,000	100
TOTALS	0	100,000	100,000	100

Exhibit B

CONFIDENTIALITY, ASSIGNMENT OF INVENTIONS AND
EMPLOYMENT-AT WILL AGREEMENT FOR CONSULTANTS AND FULL-TIME EMPLOYEES

AGREEMENT made as of May 1, 2003, by and between Marchex, Inc., a Delaware corporation, with any of its current or future subsidiaries, affiliates, successors or assigns (collectively, the "Company"), and Michael A. Arends.

NOW, THEREFORE, as a condition of your becoming employed (or your employment being continued) by the Company, or you being retained as a consultant of the Company, and in consideration of your employment or consulting relationship with the Company and your receipt of the compensation now and hereafter paid to you by the Company, you agree to the following:

1. You covenant and agree that all information, whether written, oral or other tangible or intangible forms, which is the property of the Company, including, but not limited to, ideas, concepts, research, industry and product analysis, know-how, techniques, designs, specifications, drawings, blueprints, diagrams, models, samples, flow charts, data, computer programs, computer software, marketing plans, expansion plans, the identity of customers and customer contacts, product development plans, product pricing information, budgets, financial status, results and plans, customer information, customer preferences, personnel information, trade secrets and other technical, financial or business information (collectively, "Confidential Information"), shall be kept secret and confidential at all times during and after the end of the term of your employment or consulting relationship with the Company and shall not be used, or divulged by you, except as is required in the course of your employment or consulting relationship with the Company or as the Company may otherwise expressly authorize in writing.

2. You represent that your performance of all the terms of this Agreement as an employee or consultant of the Company have not breached and will not breach any agreement to keep in confidence proprietary information, knowledge or data acquired by you, in confidence or trust, prior or subsequent to the commencement of your employment or consulting relationship with the Company. You further represent that you will not disclose to the Company, or induce the Company to use, any inventions, confidential or proprietary information, or material belonging to any previous employer or any other third party.

3. You recognize that the Company has received and in the future will receive from third parties their confidential or proprietary information subject to a duty on the Company's part to maintain the confidentiality of such information and to use it only for certain limited purposes. You agree to hold all such confidential or proprietary

information in the strictest confidence and not to disclose it to any person, firm or corporation or to use it except as necessary in carrying out your work for the Company consistent with the Company's agreement with such third party.

4. INVENTIONS.

(a) INVENTIONS RETAINED AND LICENSED. You have attached hereto, as Exhibit A, a list describing with specificity all inventions, original works of authorship, developments, improvements, and trade secrets which were made by you prior to the commencement of your employment (collectively referred to as "Prior Inventions"), which belong solely to you or belong to you jointly with another, which relate in any way to any of the Company's proposed businesses, products or research and development, and which are not assigned to the Company hereunder; or, if no such list is attached, you represent that there are no such Prior Inventions. If, in the course of your employment or consulting relationship with the Company, you incorporate into a Company product, process or machine a Prior Invention owned by you or in which you have an interest, the Company is hereby granted and shall have a non-exclusive, royalty-free, irrevocable, perpetual, worldwide license (with the right to sublicense) to make, have made, copy, modify, make derivative works of, use, sell and otherwise distribute such Prior Invention as part of or in connection with such product, process or machine.

(b) ASSIGNMENT OF INVENTIONS. You agree to promptly make full written disclosure to the Company, to hold in trust for the sole right and benefit of the Company, and hereby assign to the Company, or its designee, all your right, title and interest throughout the world in and to any and all inventions, original works of authorship, developments, concepts, know-how, improvements or trade secrets, whether or not patentable or registrable under copyright or similar laws, which you may solely or jointly conceive or develop or reduce to practice, or cause to be conceived or developed or reduced to practice, during the period of time in which you are employed by or a consultant of the Company (collectively referred to as "Inventions"). "Inventions" shall not include those works created, conceived, developed or reduced to practice by you that are not related to or competitive with the businesses, products and/or services of the Company. You further acknowledge that all inventions, original works of authorship, developments, concepts, know-how, improvements or trade secrets which are made by you (solely or jointly with others) within the scope of and during the period of your employment or consulting relationship with the Company are "works made for hire" (to the greatest extent permitted by applicable law) and are compensated by your salary (if you are an employee) or by such amounts paid to you under any applicable consulting agreement or consulting arrangements (if you are a consultant). In the event that you fail to comply with this Section 4(b), you hereby irrevocably designate and appoint the Company and its duly authorized officers and agents as your agent and attorney in fact, to act for and in your behalf and stead with specific authority to execute, acknowledge, swear to, file, and deliver any and all such instruments that may be necessary or proper to vest such Inventions in the Company.

(c) MAINTENANCE OF RECORDS. You agree to keep and maintain adequate and current written records of all Inventions made by you (solely or jointly with others) during your employment or consulting relationship with the Company. The records may be in the form of notes, sketches, drawings, flow charts, electronic data or recordings, laboratory notebooks, and any other format. The records will be available to and remain the sole property of the Company at all times. You agree not to remove such records from the Company's place of business except as expressly permitted by Company policy which may, from time to time, be revised at the sole election of the Company for the purpose of furthering and protecting the Company's business.

(d) PATENT AND COPYRIGHT RIGHTS. You agree to assist the Company, or its designee, at the Company's expense, in every proper way to secure the Company's rights in the Inventions and any copyrights, patents, trademarks, mask work rights, moral rights, or other intellectual property rights relating thereto in any and all countries, including the disclosure to the Company of all pertinent information and data with respect thereto, the execution of all applications, specifications, oaths, assignments, recordations, and all other instruments which the Company shall deem necessary in order to apply for, obtain, maintain and transfer such rights and in order to assign and convey to the Company, its successors, assigns and nominees the sole and exclusive rights, title and interest in and to such Inventions, and any copyrights, patents, mask work rights or other intellectual property rights relating thereto. You further agree that your obligation to execute or cause to be executed, when it is in your power to do so, any such instrument or papers shall continue after the termination of this Agreement until the expiration of the last such intellectual property right to expire in any country of the world. If the Company is unable because of your mental or physical incapacity or unavailability or for any other reason to secure your signature to apply for or to pursue any application for any United States or foreign patents or copyright registrations covering Inventions or original works of authorship assigned to the Company as above, then you hereby irrevocably designate and appoint the Company and its duly authorized officers and agents as your agent and attorney in fact, to act for and in your behalf and stead to execute and file any such applications and to do all other lawfully permitted acts to further the application for, prosecution, issuance, maintenance or transfer of letter patent or copyright registrations thereon with the same legal force and effect as if originally executed by me. You hereby waive and irrevocably quitclaim to the Company any and all claims, of any nature whatsoever, which you now or hereafter have for infringement of any and all proprietary rights assigned to the Company.

5. You covenant and agree that all data, reports, software, drawings and other records and written material prepared or compiled by you or furnished to you while in the employ of the Company shall be the sole and exclusive property of the Company.

6. You covenant and agree that during the term of your employment or consulting relationship with the Company, you will not directly or indirectly, invest or engage in any business which is a Competitor of the Company, nor will you accept employment or render services to a Competitor as a director, officer, agent, employee or consultant. A

“Competitor” is defined as any person, company or other business entity which is competitive with or engaged in activities similar to the business of the Company. Any exceptions to this policy must be with prior written consent.

7. Since it is anticipated that during the course of your employment with the Company, that you will have extensive access to and become acquainted with Confidential Information, and the disclosure of the foregoing to existing or potential Competitors of the Company would place the Company at a serious competitive disadvantage and do serious damage, financial or otherwise, to the Company’s business, or if you were to work for a competitive business, it would cause the Company irreparable harm, you covenant and agree that for a period of twelve (12) months commencing immediately after the termination of your employment for any reason (the “Non-Compete Period”), you will not, without the express written consent of the company, enter into the employment of, act as a consultant to, or perform any services for any Competitor.

8. In consideration of both your salary as well as the wide access the Company grants you to review and become familiar with the Company’s business, including Confidential Information, you hereby covenant and agree as part of and ancillary to this Agreement, that in the event that your employment or consulting relationship terminates for any reason, for a period of twelve (12) months thereafter (the “Non-Solicitation Period”), you will not, directly or indirectly, either for yourself or through any kind of ownership as a director, agent, employee or consultant, for any other person, firm or corporation, call on, solicit, take away, or cause the loss of clients or customers of the Company on whom you called or with whom you became acquainted during your employment or consulting relationship with the Company.

9. You expressly acknowledge that (i) the covenants set forth in Sections 7 and 8 are reasonable and necessary for the protection of the Company’s Confidential Information and customer and employee relations and (ii) consideration for such covenants has been received by you (in the form of continued employment and salary or amounts paid to you under any applicable consulting agreement or consulting arrangements). You also acknowledge that the enforcement of the covenants contained in Sections 7 and 8 will not deprive you of the ability to earn a livelihood. If any provision of Sections 7 and 8 is held unenforceable by a court of competent jurisdiction, the remaining provisions shall be enforced. In the event a court of competent jurisdiction determines that any covenant contained in Sections 7 and 8 is in any respect overbroad or unreasonable, such provision shall be given effect to the maximum extent possible by narrowing or enforcing in part such provision.

10. While in the employ of the Company and thereafter, you further agree not to, directly or indirectly, solicit, entice, persuade or induce any employee or consultant of the Company to leave the employ of the Company or to become employed by or to enter into contractual relations with a Competitor or any other company; nor shall you assist in the

taking of any such actions by any third party; nor shall you directly or indirectly hire or participate in the hiring of any employee or consultant of the Company.

11. (a) You acknowledge and agree that a breach by you of any provision of this Agreement would cause the Company irreparable injury and damage and therefore, you agree that in the event of a breach by you of any provision of this Agreement, the Company shall be entitled, in addition to any other rights or remedies, to injunctive or other equitable relief, without the posting of any bond or security or proving actual damages, because you acknowledge and agree that money damages would be an inadequate and insufficient remedy.

(b) You agree to pay all costs and expenses, including attorneys' fees, incurred by the Company in enforcing the covenants contained in this Agreement if the Company is successful in so doing. Further, in the event of your violation of any of such covenants, the term of any such covenant shall be automatically extended for a period equal to the period of such violation.

12. Upon termination of your employment or consulting relationship for any reason whatsoever, or whenever requested by the Company, you agree within five (5) days of any such request to return all of the Confidential Information or any other property of the Company in your possession or custody or at your disposal, which you obtained or have been furnished, without retaining any copies thereof.

13. You agree to execute promptly any proper oath or verify any proper document required to carry out the terms of this Agreement upon the Company's written request to do so.

14. This Agreement shall be governed by and construed in accordance with the substantive law of the State of Washington without regard to its conflicts of laws principles. The federal and state courts of the State of Washington shall be the exclusive forum for any legal action brought by the Employee which relates in any way to this Agreement.

15. You agree to inform any new employer, prior to accepting any such new employment, of the existence and terms of this Agreement and to provide such new employer with a copy of this Agreement. You also agree that the Company may notify any person, company or other business entity which the Company believes has hired or may hire you, of the existence and terms of this Agreement; the Company may also furnish a copy of this Agreement to any such person, company or other business entity.

16. Inasmuch as you can terminate your employment or consulting relationship with the Company at any time and for any or no reason, the Company can terminate your employment or consulting relationship at any time and for any or no reason. You understand that the Company subscribes to the policy of "employment at will" and that continued employment with the Company is at the sole and exclusive option of the

Company. No promises or guarantees of permanent or specific term employment will be made to you, by anyone; nor will such purported promises or guarantees, if made, ever be binding on the Company or enforced by you.

17. This Agreement contains the entire understanding between the parties with respect to the subject matter hereof and supersedes all prior agreements and understandings relative to such subject matter. This Agreement may only be amended or modified by an instrument in writing, signed by both of the parties hereto.

18. The provisions of this Agreement shall survive the termination of your employment or consulting relationship with the Company and the assignment of this Agreement by the Company to any successor in interest or other assignment.

19. You acknowledge that, in executing this Agreement, you have had the opportunity to seek the advice of independent legal counsel, and you have read and understood all of the terms and provisions of this Agreement. This Agreement shall not be construed against any party by reason of the drafting or preparation hereof.

[Remainder of Page Intentionally Left Blank]

IN WITNESS WHEREOF, the parties hereto have executed this Agreement on the date first above written.

/s/ MICHAEL A. ARENDS

Name: Michael A. Arends

Marchex, Inc.

By: /s/ ETHAN A. CALDWELL

Name: Ethan A. Caldwell
Title: General Counsel

Exhibit 10.9

FORM OF DIRECTOR AND EXECUTIVE OFFICER INDEMNIFICATION AGREEMENT

This Director and Executive Officer Indemnification Agreement (the "Agreement") is made as of February ____, 2004, by and between Marchex, Inc., a Delaware corporation (the "Company"), and [Indemnitee Name] (the "Indemnitee").

WHEREAS, Indemnitee performs a valuable service for the Company; and

WHEREAS, the Company's Certificate of Incorporation, as amended to date (the "Certificate of Incorporation") provides for the indemnification of officers and directors of the Company to the maximum extent authorized by Section 145 of the Delaware General Corporation Law, as amended ("Law"); and

WHEREAS, the Certificate of Incorporation and the Law, by their nonexclusive nature, permit contracts between the Company and the officers or directors of the Company with respect to indemnification of such officers or directors; and

WHEREAS, in accordance with the authorization as provided by the Law, the Company may purchase and maintain a policy or policies of directors' and officers' liability insurance ("D & O Insurance"), covering certain liabilities which may be incurred by its officers or directors in the performance of their obligations to the Company; and

WHEREAS, increased corporate litigation has subjected directors and officers to litigation risks and expenses, and the limitations on the availability of D & O Insurance may make it increasingly difficult for the Company to attract and retain such persons; and

WHEREAS, the Company desires to provide Indemnitee with specific contractual assurance of Indemnitee's rights to full indemnification against litigation risks and expenses (regardless, among other things, of any amendment to or revocation of the Certificate of Incorporation or By-laws or any change in the ownership of the Company or the composition of its Board of Directors); and

WHEREAS, the Company intends that this Agreement provide Indemnitee with greater protection than that which is provided by the Company's Certificate of Incorporation and By-laws; and

WHEREAS, in order to induce Indemnitee to continue to serve as an officer or director of the Company, the Company has determined and agreed to enter into this contract with Indemnitee.

AGREEMENT

NOW, THEREFORE, in consideration of the mutual promises made in this Agreement, and for other good and valuable consideration, the receipt of which is hereby acknowledged, the Company and Indemnitee hereby agree as follows:

1. Indemnification.

(a) Third Party Proceedings. The Company shall indemnify Indemnitee if Indemnitee is or was a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the Company) by reason of the fact that Indemnitee is or was a director, officer, employee or agent of the Company, or any subsidiary of the Company, by reason of any action or inaction on the part of Indemnitee while an officer or director or by reason of the fact that Indemnitee is or was serving at the request of the Company as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement (if such settlement is approved in advance by the Company, which approval shall not be unreasonably withheld) actually and reasonably incurred by Indemnitee in connection with such action, suit or proceeding if Indemnitee acted in good faith and in a manner Indemnitee reasonably believed to be in or not opposed to the best interests of the Company, and, with respect to any criminal action or proceeding, had no reasonable cause to believe Indemnitee's conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that Indemnitee did not act in good faith and in a manner which Indemnitee reasonably believed to be in or not opposed to the best interests of the Company, or, with respect to any criminal action or proceeding, that Indemnitee had reasonable cause to believe that Indemnitee's conduct was unlawful.

(b) Proceedings by or in the Right of the Company. The Company shall indemnify Indemnitee if Indemnitee was or is a party or is threatened to be made a party to any threatened, pending or completed action or proceeding by or in the right of the Company or any subsidiary of the Company to procure a judgment in its favor by reason of the fact that Indemnitee is or was a director, officer, employee or agent of the Company, or any subsidiary of the Company, by reason of any action or inaction on the part of Indemnitee while an officer or director or by reason of the fact that Indemnitee is or was serving at the request of the Company as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees) and, to the fullest extent permitted by law, amounts paid in settlement (if such settlement is approved in advance by the Company, which approval shall not be unreasonably withheld), in each case to the extent actually and reasonably incurred by Indemnitee in connection with the defense or settlement of such action or suit if Indemnitee acted in good faith and in a manner Indemnitee reasonably believed to be in or not opposed to the best interests of the Company and its stockholders, except that no indemnification shall be made in respect of any claim, issue or matter as to which Indemnitee shall have been finally adjudicated by court order or judgment to be liable to the Company in the performance of Indemnitee's duty to the Company and its stockholders unless and only to the extent that the court in which such action or proceeding is or was pending shall determine upon application that, in view of all the circumstances of the case, Indemnitee is fairly and reasonably entitled to indemnity for such expenses which such court shall deem proper.

(c) Mandatory Payment of Expenses. To the extent that Indemnitee has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in Section 1(a) or Section 1(b) or the defense of any claim, issue or matter therein, Indemnitee shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by Indemnitee in connection therewith.

2. No Employment Rights. Nothing contained in this Agreement is intended to create in Indemnitee any right to continued employment.

3. Expenses, Indemnification Procedure.

(a) Advancement of Expenses. The Company shall advance all expenses incurred by Indemnitee in connection with the investigation, defense, settlement or appeal of any civil or criminal action, suit or proceeding referred to in Section l(a) or Section 1(b) hereof (including amounts actually paid in settlement of any such action, suit or proceeding). Indemnitee hereby undertakes to repay such amounts advanced only if, and to the extent that, it shall ultimately be determined that Indemnitee is not entitled to be indemnified by the Company as authorized hereby.

(b) Notice/Cooperation by Indemnitee. Indemnitee shall, as a condition precedent to his or her right to be indemnified under this Agreement, give the Company notice in writing as soon as practicable of any claim made against Indemnitee for which indemnification will or could be sought under this Agreement. Notice to the Company shall be directed to the Chief Executive Officer of the Company and shall be given in accordance with the provisions of Section 12(d) below. In addition, Indemnitee shall give the Company such information and cooperation as it may reasonably require and as shall be within Indemnitee's power.

(c) Procedure. Any indemnification and advances provided for in Section 1 and this Section 3 shall be made no later than thirty (30) days after receipt of the written request of Indemnitee. If a claim under this Agreement, under any statute, or under any provision of the Company's Certificate of Incorporation or Bylaws providing for indemnification, is not paid in full by the Company within thirty (30) days after a written request for payment thereof has first been received by the Company, Indemnitee may, but need not, at any time thereafter bring an action against the Company to recover the unpaid amount of the claim and, subject to Section 11 of this Agreement, Indemnitee shall also be entitled to be paid for the expenses (including attorneys' fees) of bringing such action. It shall be a defense to any such action (other than an action brought to enforce a claim for expenses incurred in connection with any action, suit or proceeding in advance of its final disposition) that Indemnitee has not met the standards of conduct which make it permissible under applicable law for the Company to indemnify Indemnitee for the amount claimed, but the burden of proving such defense shall be on the Company and Indemnitee shall be entitled to receive interim payments of expenses pursuant to Section 3(a) unless and until such defense may be finally adjudicated by court order or judgment from which no further right of appeal exists. It is the parties' intention that if the Company contests Indemnitee's right to indemnification, the question of Indemnitee's right to indemnification shall be for the court to decide, and neither the failure of the Company (including its Board of Directors, any committee or subgroup of the Board of Directors, independent legal counsel, or its stockholders) to have made a determination that indemnification of Indemnitee is proper in the circumstances because Indemnitee has met the applicable standard of conduct required by applicable law, nor an actual determination by the Company (including its Board of Directors, any committee or subgroup of the Board of Directors, independent legal counsel, or its stockholders) that Indemnitee has not met such applicable standard of conduct, shall create a presumption that Indemnitee has or has not met the applicable standard of conduct.

(d) Notice to Insurers. If, at the time of the receipt of a notice of a claim pursuant to Section 3(b) hereof, the Company has director and officer liability insurance in effect, the Company shall give prompt notice of the commencement of such proceeding to the insurers in accordance with the procedures set forth in the respective policies. The Company shall thereafter take all necessary or desirable action to cause such insurers to pay, on behalf of the Indemnitee, all amounts payable as a result of such proceeding in accordance with the terms of such policies.

(e) Selection of Counsel. In the event the Company shall be obligated under Section 3(a) hereof to pay the expenses of any proceeding against Indemnitee, the Company, if appropriate, shall be entitled to assume the defense of such proceeding, with counsel approved by Indemnitee, upon the delivery to Indemnitee of written notice of its election so to do. After delivery of such notice, approval of such counsel by Indemnitee and the retention of such counsel by the Company, the Company will not be liable to Indemnitee under this Agreement for any fees of counsel subsequently incurred by Indemnitee with respect to the same proceeding, provided that (i) Indemnitee shall have the right to employ counsel in any such proceeding at Indemnitee's expense; and (ii) if (A) the employment of counsel by Indemnitee has been previously authorized by the Company, (B) Indemnitee shall have reasonably concluded that there may be a conflict of interest between the Company and Indemnitee in the conduct of any such defense or (C) the Company shall not, in fact, have employed counsel to assume the defense of such proceeding, then the fees and expenses of Indemnitee's counsel shall be at the expense of the Company.

4. Additional Indemnification Rights; Nonexclusivity.

(a) Scope. Notwithstanding any other provision of this Agreement, the Company hereby agrees to indemnify the Indemnitee to the fullest extent permitted by law, notwithstanding that such indemnification is not specifically authorized by the other provisions of this Agreement, the Company's Certificate of Incorporation, the Company's Bylaws or by statute. In the event of any change, after the date of this Agreement, in any applicable law, statute, or rule which expands the right of a Delaware corporation to indemnify a member of its board of directors or an officer, such changes shall be deemed to be within the purview of Indemnitee's rights and the Company's obligations under this Agreement. In the event of any change in any applicable law, statute or rule which narrows the right of a Delaware corporation to indemnify a member of its board of directors or an officer, such changes, to the extent not otherwise required by such law, statute or rule to be applied to this Agreement shall have no effect on this Agreement or the parties' rights and obligations hereunder.

(b) Nonexclusively. The indemnification provided by this Agreement shall not be deemed exclusive of any rights to which Indemnitee may be entitled under the Company's Certificate of Incorporation, its Bylaws, any agreement, any vote of stockholders or disinterested members of the Company's Board of Directors, the General Corporation Law of the State of Delaware, or otherwise, both as to action in Indemnitee's official capacity and as to action in another capacity while holding such office. The indemnification provided under this Agreement shall continue as to Indemnitee for any action taken or not taken while serving in an indemnified capacity even though he or she may have ceased to serve in any such capacity at the time of any action, suit or other covered proceeding.

5. Partial Indemnification. If Indemnitee is entitled under any provision of this Agreement to indemnification by the Company for some or a portion of the expenses, judgments, fines or penalties actually or reasonably incurred in the investigation, defense, appeal or settlement of any civil or criminal action, suit or proceeding, but not, however, for the total amount thereof, the Company shall nevertheless indemnify Indemnitee for the portion of such expenses, judgments, fines or penalties to which Indemnitee is entitled.

6. Mutual Acknowledgment. Both the Company and Indemnitee acknowledge that in certain instances, Federal law or public policy may override applicable state law and prohibit the Company from indemnifying its directors and officers under this Agreement or otherwise. For example, the Company and Indemnitee acknowledge that the Securities and Exchange Commission (the "SEC") has taken the position that indemnification is not permissible for liabilities arising under certain federal securities laws, and federal legislation prohibits indemnification for certain ERISA violations. Indemnitee understands and acknowledges that the Company has undertaken or may be required in the future to undertake with the SEC to submit the question of indemnification to a court in certain circumstances for a determination of the Company's right under public policy to indemnify Indemnitee.

7. Director and Officer Liability Insurance. The Company shall, from time to time, make the good faith determination whether or not it is practicable for the Company to obtain and maintain a policy or policies of insurance with a reputable insurance company providing the Indemnitee with coverage for losses from wrongful acts, and to ensure the Company's performance of its indemnification obligations under this Agreement. In all policies of director and officer liability insurance, Indemnitee shall be named as an insured in such a manner as to provide Indemnitee the same rights and benefits as are accorded to the most favorably insured of the Company's officers and directors. Notwithstanding the foregoing, the Company shall have no obligation to obtain or maintain such insurance if the Company determines in good faith that such insurance is not reasonably available, if the premium costs for such insurance are disproportionate to the amount of coverage provided, if the coverage provided by such insurance is limited by exclusions so as to provide an insufficient benefit, or if Indemnitee is covered by similar insurance maintained by a parent or subsidiary of the Company. The Company shall not be liable under this Agreement to make any payment of amounts otherwise indemnifiable

hereunder if and to the extent that Indemnitee has otherwise actually received such payment under any insurance policy, contract, agreement or otherwise.

8. Severability. Nothing in this Agreement is intended to require or shall be construed as requiring the Company to do or fail to do any act in violation of applicable law. The Company's inability, pursuant to court order, to perform its obligations under this Agreement shall not constitute a breach of this Agreement. The provisions of this Agreement shall be severable as provided in this Section 8. If this Agreement or any portion hereof shall be invalidated on any ground by any court of competent jurisdiction, then the Company shall nevertheless indemnify Indemnitee to the full extent permitted by any applicable portion of this Agreement that shall not have been invalidated, and the balance of this Agreement not so invalidated shall be enforceable in accordance with its terms.

9. Exceptions. Any other provision herein to the contrary notwithstanding, the Company shall not be obligated pursuant to the terms of this Agreement:

(a) Claims Initiated by Indemnitee. To indemnify or advance expenses to Indemnitee with respect to proceedings or claims initiated or brought voluntarily by Indemnitee and not by way of defense, except with respect to proceedings brought to establish or enforce a right to indemnification under this Agreement or any other statute or law or otherwise as required under Section 145 of the Delaware General Corporation Law, but such indemnification or advancement of expenses may be provided by the Company in specific cases if the Board of Directors finds it to be appropriate;

(b) Lack of Good Faith. To indemnify Indemnitee for any expenses incurred by Indemnitee with respect to any proceeding instituted by Indemnitee to enforce or interpret this Agreement, if a court of competent jurisdiction determines that each of the material assertions made by Indemnitee in such proceeding was not made in good faith or was frivolous;

(c) Insured Claims. To indemnify Indemnitee for expenses or liabilities of any type whatsoever (including, but not limited to, judgments, fines, ERISA excise taxes or penalties, and amounts paid in settlement) to the extent such expenses or liabilities have been paid directly to Indemnitee by an insurance carrier under a policy of officers' and directors' liability insurance maintained by the Company; or

(d) Claims Under Section 16(b). To indemnify Indemnitee for expenses or the payment of profits arising from the purchase and sale by Indemnitee of securities in violation of Section 16(b) of the Securities Exchange Act of 1934, as amended, or any similar successor statute.

10. Construction of Certain Phrases.

(a) For purposes of this Agreement, references to the "Company" shall include, in addition to the resulting corporation, any constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger which, if its separate existence had continued, would have had power and authority to indemnify its directors, officers, and employees or agents, so that if Indemnitee is or was a director, officer, employee or agent of such constituent corporation, or is or was serving at the request of such constituent corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, Indemnitee shall stand in the same position under the provisions of this Agreement with respect to the resulting or surviving corporation as Indemnitee would have with respect to such constituent corporation if its separate existence had continued.

(b) For purposes of this Agreement, references to “other enterprises” shall include employee benefit plans; references to “fines” shall include any excise taxes assessed on Indemnitee with respect to an employee benefit plan; and references to “serving at the request of the Company” shall include any service as a director, officer, employee or agent of the Company which imposes duties on, or involves services by, such director, officer, employee or agent with respect to an employee benefit plan, its participants, or beneficiaries; and if Indemnitee acted in good faith and in a manner Indemnitee reasonably believed to be in the interest of the participants and beneficiaries of an employee benefit plan, Indemnitee shall be deemed to have acted in a manner “not opposed to the best interests of the Company” as referred to in this Agreement.

11. Attorneys’ Fees. In the event that any action is instituted by Indemnitee under this Agreement to enforce or interpret any of the terms hereof, Indemnitee shall be entitled to be paid all court costs and expenses, including reasonable attorneys’ fees, incurred by Indemnitee with respect to such action, unless as a part of such action, the court of competent jurisdiction determines that each of the material assertions made by Indemnitee as a basis for such action were not made in good faith or were frivolous. In the event of an action instituted by or in the name of the Company under this Agreement or to enforce or interpret any of the terms of this Agreement, Indemnitee shall be entitled to be paid all court costs and expenses, including attorneys’ fees, incurred by Indemnitee in defense of such action (including with respect to Indemnitee’s counterclaims and cross-claims made in such action), unless as a part of such action the court determines that each of Indemnitee’s material defenses to such action were made in bad faith or were frivolous.

12. Miscellaneous.

(a) Governing Law. This Agreement shall be construed under and enforced in accordance with the internal substantive laws of the State of Delaware. Any litigation arising out of or incidental to this Agreement shall be initiated only in a court of competent jurisdiction located within the State of Delaware. Each party hereby consents to the personal jurisdiction of the State of Delaware, acknowledges that venue is proper in any state or Federal court in the State of Delaware, agrees that any action related to this Agreement must be brought in a state or Federal court in the State of Delaware and waives any objection that may exist, now or in the future, with respect to any of the foregoing.

(b) Entire Agreement; Enforcement of Rights. This Agreement sets forth the entire agreement and understanding of the parties relating to the subject matter herein and merges all prior discussions between them. No modification of or amendment to this Agreement, nor any waiver of any rights under this Agreement, shall be effective unless in writing signed by the parties to this Agreement. The failure by either party to enforce any rights under this Agreement shall not be construed as a waiver of any rights of such party.

(c) Construction. This Agreement is the result of negotiations between and has been reviewed by each of the parties hereto and their respective counsel, if any; accordingly, this Agreement shall be deemed to be the product of all of the parties hereto, and no ambiguity shall be construed in favor of or against any one of the parties hereto.

(d) Notices. All notices, requests, demands and other communications hereunder shall be in writing and shall be deemed to have been duly given on the date of personal delivery; or on the date of electronic confirmation of receipt, if sent by telecopier; or three (3) days after deposit in the United States mail, if mailed by certified or registered mail, return receipt requested (postage prepaid); or one (1) day after delivery by a reputable overnight courier (delivery charges prepaid), as follows:

(i) If to Indemnitee, to the address set forth below Indemnitee's signature hereto.

(ii) If to the Company, to:

Marchex, Inc.
2101 Fourth Avenue, Suite 1980
Seattle, WA 98121
Tel Number: (206) 774-5000
Fax Number: (206) 774-5049
Attention: Russell C. Horowitz, Chief Executive Officer

with a copy sent at the same time and by the same means to:

Nixon Peabody LLP
101 Federal Street
Boston, MA 02110
Tel Number: (617) 345-6107
Fax Number: (866) 369-4739
Attention: Francis J. Feeney, Esq.

or to such other address as may have been furnished to Indemnitee by the Company or to the Company by Indemnitee, as the case may be.

(e) Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original and all of which together shall constitute one instrument.

(f) Successors and Assigns. This Agreement shall be binding upon the Company and its successors and assigns, and inure to the benefit of Indemnitee and Indemnitee's heirs, legal representatives and assigns.

(g) Modification and Waiver. No supplement, modification, termination or amendment of this Agreement shall be binding unless executed in writing by both of the parties hereto. No waiver of any of the provisions of this Agreement shall be deemed or shall constitute a waiver of any other provisions hereof (whether or not similar) nor shall such waiver constitute a continuing waiver.

(h) Subrogation. In the event of payment under this Agreement, the Company shall be subrogated to the extent of such payment to all of the rights of recovery of Indemnitee, who shall execute all documents required and shall do all acts that may be necessary to secure such rights and to enable the Company to effectively bring suit to enforce such rights.

[Remainder of Page Intentionally Left Blank.]

The parties hereto have executed this Agreement as an instrument under seal as of the day and year set forth on the first page of this Agreement.

COMPANY

Marchex, Inc.

By: ______________________________

Name: Russell C. Horowitz
Title: Chief Executive Officer
Address: 2101 Fourth Avenue, Suite 1980
Seattle, WA 98121

INDEMNITEE

____

Name: [Indemnitee Name]
Address______________________________
____
____

Exhibit 10.10

Marchex, Inc.

2004 EMPLOYEE STOCK PURCHASE PLAN

1. Purpose.

It is the purpose of this Employee Stock Purchase Plan to provide a means whereby eligible employees may purchase Class B common stock of Marchex, Inc. (the “Company”) through after-tax payroll deductions. It is intended to provide a further incentive for employees to promote the best interests of the Company and to encourage stock ownership by employees in order that they may participate in the Company’s economic growth. It is the intention, but not the obligation, of the Company that the Plan qualify as an “employee stock purchase plan” within the meaning of Section 423 of the Internal Revenue Code, and that the provisions of this Plan be construed in a manner consistent with the Code.

2. Definitions.

The following words or terms, when used herein, shall have the following respective meanings:

(a) “Account” means the Employee Stock Purchase Account established for a Participant under Section 7 hereunder.

(b) “Board of Directors” shall mean the Board of Directors of the Company.

(c) “Code” shall mean the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

(d) “Committee” shall mean the committee described in Section 5.

(e) “Common Stock” shall mean shares of the Company’s Class B common stock with a par value of $.01 per share.

(f) “Company” shall mean Marchex, Inc., a Delaware corporation.

(g) “Compensation” means the amount of money reportable on the employee’s Federal Income Tax Withholding Statement, excluding overtime, shift premium, incentive or bonus awards, allowances and reimbursements for expenses such as relocation allowances for travel expenses, income or gains on the exercise of Company stock options or stock appreciation rights, and similar items, whether or not shown on the employee’s Federal Income Tax Withholding Statement. Notwithstanding the foregoing, the Board of Directors or Committee in its sole discretion from time to time may substitute another definition of compensation to be eligible to be taken into account under the Plan, provided that no such determination shall include or exclude any type or amount of Compensation contrary to the requirements of Section 423 of the Code.

(h) “Effective Date” shall mean the first date that the Company’s Common Stock is publicly traded as a result of the Company’s initial underwritten public offering (“IPO”) of shares of its Common Stock, with gross proceeds in excess of $20 million, pursuant to an effective registration statement filed by the Company under the Securities Act of 1933, as amended.

(i) “Eligible Employees” shall mean all persons employed by the Company or a Subsidiary and classified by the Company or the Subsidiary as an employee for federal income tax withholding purposes, but excluding:

(1) Persons who have been employed by the Company or a Subsidiary for less than three months on the first day of the Purchase Period, with the exception of a person previously eligible;

(2) Persons whose customary employment is less than twenty hours per week or five months or less per year; and

(3) Persons who are deemed for purposes of Section 423(b)(3) of the Code to own stock possessing 5% or more of the total combined voting power or value of all classes of stock of the Company or a Subsidiary.

Except as otherwise provided in Section 12, for purposes of the Plan, the employment relationship shall be treated as continuing intact while an individual is on military leave or other leave of absence approved by the Company or a Subsidiary. Where the period of leave exceeds 90 days and the individual’s right to re-employment is not guaranteed either by statute or by contract, the employment relationship shall be deemed to have terminated on the 91st day of such leave.

(j) “Exercise Date” shall mean the last day of a Purchase Period; provided, however, that if such date is not a business day, “Exercise Date” shall mean the immediately preceding business day.

(k) “Participant” shall mean an Eligible Employee who elects to participate in the Plan under Section 6 hereunder.

(l) “Plan” shall mean the Marchex, Inc. 2004 Employee Stock Purchase Plan.

(m) “Purchase Periods” shall mean the four purchase periods within each calendar year, the first commencing on January 1st of each calendar year and continuing through the March 31st of such calendar year, the second commencing on April 1st of each calendar year and continuing through June 30th of such calendar year, the third commencing on July 1st of each calendar year and continuing through the September 30th of such calendar year, and the fourth commencing on October 1st of each calendar year and continuing through December 31st of such calendar year. However, the first Purchase Period shall commence on the first date that the Common Stock is publicly traded as a result of the Company's IPO and shall end on the last day of the quarter in which the IPO occurs.

(n) "Purchase Price" for each share purchased shall be 85% of the closing price of the Common Stock on (i) the first business day of such relevant Purchase Period, or (ii) the relevant Exercise Date, whichever closing price shall be less. Such closing price shall be (a) the closing price on any national securities exchange on which the Common Stock is listed, (b) the closing price of the Common Stock on the Nasdaq National Market, or (c) the average of the closing bid and asked prices in the over-the-counter-market, whichever is applicable, as published in The Wall Street Journal; provided, however, that, with respect to the first Purchase Period, the closing price on the Effective Date shall be the initial public offering price provided for in the underwriting agreement entered into by the Company in connection with the IPO. If no sales of Common Stock were made on such a day, the price of the Common Stock for purposes of clauses (a) and (b) above shall be the reported price for the next preceding day on which sales were made.

(o) "Subsidiary" shall mean any present or future corporation which (i) would be a subsidiary corporation as defined in Section 424(f) of the Code, and (ii) is designated by the Board of Directors as a participating employer for purposes of this Plan.

3. Grant of Option to Purchase Shares.

Each Eligible Employee shall be granted an option ("Option") effective on the first day of each Purchase Period to purchase shares of Common Stock. The term of the Option shall be the length of the Purchase Period. The number of shares subject to each Option shall be the quotient of the aggregate payroll deductions in the Purchase Period authorized by each Participant in accordance with Section 6 divided by the Purchase Price, but in no event shall the number of shares subject to each Option be in excess of 1,000 shares per Purchase Period (subject to adjustment in accordance with Section 4), or such other number of shares as determined from time to time by the Board of Directors or the Committee. Notwithstanding the foregoing, no employee shall be granted an Option which permits his right to purchase shares under the Plan to accrue at a rate which exceeds in any one calendar year $25,000 (or such other amount as may be prescribed from time to time under Section 423 of the Code) of the fair market the value of the Common Stock as of the date the Option to purchase is granted.

4. Shares.

Subject to adjustment upon changes in capitalization of the Company as provided this Section 4, the maximum number of shares of Common Stock which shall be made available for issuance to and purchase by Participants under this Plan shall be 300,000 shares. The shares of Common Stock subject to the Plan shall be either shares of authorized but unissued Common Stock or shares of Common Stock reacquired by the Company and held as treasury shares. Shares of Common Stock not purchased under an Option terminated pursuant to the provisions of the Plan may again be subject to Options granted under the Plan. The aggregate number of shares of Common Stock which may be purchased pursuant to Options granted hereunder, the number of shares of Common Stock covered by each outstanding Option, and the purchase price for each such Option shall be appropriately adjusted for any increase or decrease in the number of outstanding shares of Common Stock resulting from a stock split or other subdivision or consolidation of shares of Common Stock or for other capital adjustments or payments of stock dividends or distributions or other increases or decreases in the outstanding shares of Common Stock effected without receipt of consideration by the Company provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration." Such adjustment shall be made by the Board of Directors whose determination in that respect shall be binding and conclusive.

5. Administration.

The Plan shall be administered by the Board of Directors or a Committee (which may be the same committee as the Company's compensation committee) as may be appointed from time to time by the Board of Directors. Committee members shall be ineligible to participate under the Plan. All members of the Committee shall serve at the discretion of the Board. The Board of Directors or the Committee, if one has been appointed, is vested with full authority to interpret the terms of the Plan, to remedy any ambiguity, inconsistency, or omission, and to make, administer and interpret such equitable rules and regulations regarding the Plan as it may deem advisable. The Board of Directors, or the Committee's, if one has been appointed, determinations as to the interpretation and operation of the Plan shall be final and conclusive. No member of the Board of Directors or the Committee shall be liable for any action or determination made in good faith with respect to the Plan or any Option granted under the Plan.

6. Election to Participate.

An Eligible Employee may elect to become a Participant in the Plan for a Purchase Period by completing a "Stock Purchase Agreement" form prior to the first day of the Purchase Period for which the election is made. Such Stock Purchase Agreement shall be in such form as shall be determined from time to time by the Board of Directors or the Committee. The election to participate shall be effective for the Purchase Period for which it is made. The Stock Purchase Agreement shall remain in effect for successive Purchase Periods unless modified as provided in Section 9 or terminated or suspended as provided in Sections 11 and 12. There is no limit on the number of Purchase Periods for which an Eligible Employee may elect to become a Participant in the Plan. In the Stock Purchase Agreement, the Eligible Employee shall authorize regular payroll deductions of any full percentage of his Compensation, but in no event less than one percent (1%) or more than fifteen percent (15%) of his Compensation. Notwithstanding the foregoing, to the extent necessary to comply with Section 423(b)(8) of the Code and Section 3 herein, a Participant's payroll deductions may be decreased during any Purchase Period scheduled to end during the current calendar year to 0%. Payroll deductions shall re-commence at the rate provided in such Participant's Stock Purchase Agreement at the beginning of the first Purchase Period that is scheduled to end in the following calendar year, unless terminated by the Participant as provided in Section 9. Except as otherwise provided in Section 9, an Eligible Employee may not change his authorization during a Purchase Period to which the election applies. Options granted to Eligible Employees who have failed to execute a Stock Purchase Agreement within the time Periods prescribed by the Plan will automatically lapse.

7. Employee Stock Purchase Account.

An Employee Stock Purchase Account will be established for each Participant in the Plan for bookkeeping purposes, and payroll deductions made under Section 6 will be credited to such Accounts. However, prior to the purchase of shares in accordance with Section 8 or withdrawal from or termination of the Plan in accordance with the provisions hereof, the Company may use for any valid corporate purpose all amounts deducted from a Participant's compensation under the Plan and credited for bookkeeping purposes to his account. The Company shall be under no obligation to pay interest on funds credited to a Participant's account, whether upon purchase of shares in accordance with Section 8 or upon distribution in the event of withdrawal from or termination of the Plan as herein provided.

8. Purchase of Shares.

Each Eligible Employee who is a Participant in the Plan automatically and without any act on his part will be deemed to have exercised his Option on each Exercise Date to the extent that the balance then in his Account under the Plan is sufficient to purchase at the Purchase Price whole shares of the Company's stock subject to his Option and the limitations described in Section 3. Any balance remaining in the Participant's Account shall be carried forward and credited for use in the next Purchase Period. If the Employee chooses not to participate in the next Purchase Period, any balance will be refunded to him in cash.

9. Withdrawal.

A Participant who has elected to authorize payroll deductions for the purchase of shares of Common Stock may cancel his election by written notice of cancellation ("Cancellation") delivered to the office or person designated by the Company to receive Stock Purchase Agreements, but any such Cancellation must be so delivered not later than ten (10) days before the relevant Exercise Date. A Participant will receive in cash, as soon as practicable after delivery of the Cancellation, the amount credited to his Account. Any Participant who so withdraws from the Plan may again become a Participant at the start of the next Purchase Period in accordance with Section 6.

10. Issuance of Stock Certificates.

The shares of Common Stock purchased by a Participant shall, for all purposes, be deemed to have been issued and sold at the close of business on the Exercise Date. Prior to that date none of the rights or privileges of a stockholder of the Company, including the right to vote or receive dividends, shall exist with respect to such shares.

Within a reasonable time after the Exercise Date, the Company shall issue and deliver a certificate for the number of shares of Common Stock purchased by a Participant for the Purchase Period, which certificate shall be registered either in the Participant's name, or jointly in the names of the Participant and his spouse, as the Participant shall designate in his Stock

Purchase Agreement. Such designation may be changed at any time by filing notice thereof with the person designated by the Company to receive such notices.

11. Termination of Employment.

Upon a Participant's termination of employment for any reason, other than death, no payroll deduction may be made from any compensation due him and the entire balance credited to his Account shall be automatically refunded, and his rights under the Plan shall terminate. Upon the death of a Participant, no payroll deduction shall be made from any compensation due him at time of death, and the entire balance in the deceased Participant's Account shall be paid in cash to the Participant's designated beneficiary, if any, under a group insurance plan of the Company covering such employee, or otherwise to his estate, and his rights under the Plan shall terminate.

12. Temporary Layoff and Authorized Leave of Absence; Long Term Disability.

Except as otherwise provided by applicable law, payroll deductions shall cease during a period of absence from work due to a Participant's temporary layoff, authorized leave of absence without pay, disability for which benefits are not payable from the Company. If such Participant shall return to active service prior to the Exercise Date for the current Purchase Period, payroll deductions shall be resumed. He shall not be entitled to make up the deficiency in his Account caused by his absence and, accordingly, the number of shares to be purchased shall be reduced. If the Participant shall not return to active service prior to the Exercise Date for the current Purchase Period, and the Participant was absent for more than fifty percent (50%) of the weeks in the Purchase Period, his Stock Purchase Agreement shall be terminated and the balance in his Account shall be refunded. All other Participants will have an option to cancel their election in accordance with Section 9.

13. Rights Not Transferable; Restrictions on Transfer.

The right to purchase shares of Common Stock under this Plan is exercisable only by the Participant during his lifetime and is not transferable by him. If a Participant attempts to transfer his right to purchase shares under the Plan, he shall be deemed to have requested withdrawal from the Plan and the provisions of Section 9 hereof shall apply with respect to such Participant.

14. No Guarantee of Continued Employment.

Granting of an Option under this Plan shall imply no right of continued employment with the Company for any Eligible Employee.

15. Notice.

Any notice which an Eligible Employee or Participant files pursuant to this Plan shall be in writing and shall be delivered personally or by mail addressed to the Company's General Counsel, c/o Marchex, Inc., 2101 Fourth Avenue, Suite 1980, Seattle, Washington 98121. Any notice to a Participant or an Eligible Employee shall be conspicuously posted in the Company's principal office or shall be mailed addressed to the Participant or Eligible Employee at the address designated in the Stock Purchase Agreement or in a subsequent writing.

16. Merger.

(a) If the Company shall at any time merge or consolidate with another corporation and the holders of the capital stock of the Company immediately prior to such merger or consolidation continue to hold at least 80% by voting power of the capital stock of the surviving corporation ("Continuity of Control"), the holder of each Option then outstanding will thereafter be entitled to receive at the next Exercise Date upon the exercise of such Option for each share as to which such Option shall be exercised the securities or property which a holder of one share of the Common Stock was entitled to upon and at the time of such merger or consolidation, and the Board of Directors or the Committee shall take such steps in connection with such merger or consolidation as the Board of Directors or the Committee shall deem necessary to assure that the provisions of Section 4 shall thereafter be applicable, as nearly as reasonably may be, in relation to the said securities or property as to which such holder of such Option might thereafter be entitled to receive thereunder.

(b) In the event of a merger or consolidation of the Company with or into another corporation which does not involve Continuity of Control, or of a sale of all or substantially all of the assets of the Company while unexercised Options remain outstanding under the Plan, (a) subject to the provisions of clauses (b) and (c), after the effective date of such transaction, each holder of an outstanding Option shall be entitled, upon exercise of such Option, to receive in lieu of shares of Common Stock, shares of such stock or other securities as the holders of shares of Common Stock received pursuant to the terms of such transaction; or (b) all outstanding Options may be cancelled by the Board of Directors or the Committee as of a date prior to the effective date of any such transaction and all payroll deductions shall be paid out to the participating employees; or (c) all outstanding Options may be cancelled by the Board of Directors or the Committee as of the effective date of any such transaction, provided that notice of such cancellation shall be given to each holder of an Option, and each holder of an Option shall have the right to exercise such Option in full based on payroll deductions then credited to his account as of a date determined by the Board of Directors or the Committee, which date shall not be less than ten (10) days preceding the effective date of such transaction.

17. Application of Funds.

All funds deducted from a Participant's compensation in payment for shares purchased or to be purchased under this Plan may be used for any valid corporate purpose provided that the Participant's Account shall be credited with the amount of all payroll deductions as provided in Section 7.

18. Government Approvals or Consents.

This Plan and the Company's obligation to sell and deliver Common Stock under this Plan is subject to listing on a national stock exchange or quotation on the Nasdaq National Market (to the extent the Common Stock is then so listed or quoted) and the approval of all governmental authorities required in connection with the authorization, issuance or sale of such stock. Subject to the provisions of Section 19, the Board of Directors may make such changes in the Plan and include such terms in any offering under this Plan as may be necessary or desirable, in the opinion of counsel, to comply with the rules or regulations of any governmental authority, or to be eligible for tax benefits under the Code or the laws of any state, or in the opinion of the Company's auditors, to eliminate or reduce any unfavorable financial accounting consequences.

19. Amendment of the Plan.

The Board of Directors may, without the consent of the Participants, amend the Plan at any time, provided that, except as otherwise provided in this Plan, no such action shall adversely affect Options theretofore granted hereunder and no such amendment (without approval by the company's stockholders) shall: (i) increase the total number of shares of Common Stock which may be purchased by all Participants or (ii) change the class of Employees eligible to receive Options under the Plan. For purposes of this Section 19, termination of the Plan by the Board of Directors pursuant to Section 20 shall not be deemed to be an action which adversely affects Options theretofore granted hereunder.

20. Term of the Plan.

The Plan shall become effective on the Effective Date. The Plan will terminate on the date which is ten years from the earlier of the date of its adoption and the date of its approval by the stockholders of the Company, provided, however, that the Board of Directors shall have the right to terminate the Plan at any time. In the event of the expiration of the Plan or its termination, all Options then outstanding under the Plan shall automatically be canceled and the entire amount credited to the Account of each Participant hereunder shall be refunded to each such Participant without interest.

21. Notice to Company of Disqualifying Dispositions.

By electing to participate in the Plan, each Participant agrees to notify the Company in writing immediately after the Participant transfers Common Stock acquired under the Plan, if such transfer occurs within two years after the first business day of the Purchase Period in which such Common Stock was acquired. Each Participant further agrees to provide any information about such a transfer as may be requested by the Company or any Subsidiary in order to assist it in complying with any applicable tax laws. The Participant acknowledges that the Company may send a W-2, or substitute therefor, as appropriate, to the Participant with respect to any income recognized by the Participant upon a disqualifying disposition of Common Stock.

22. Withholding of Taxes.

Each Participant must make adequate provision for the Company's federal, state or other tax withholding obligations, if any, which may arise upon the exercise of the Option or the disposition of the Common Stock. At any time, the Company may, but shall not be obligated to, withhold from the Participant's compensation the amount necessary for the Company to meet applicable withholding obligations, including any withholding required to make available to the

Company any tax deductions or benefits attributable to sale or early disposition of Common Stock by the Participant.

23. General.

Whenever the context of this Plan permits, words in any gender shall include any other gender, words in the singular shall include the plural and the plural shall include the singular.

24. Governing Law.

The internal substantive laws of the State of Delaware shall govern all matters relating to this Plan.

Exhibit 10.11

February 11, 2004

SEATTLE'S BEST COFFEE, LLC
c/o Starbucks Coffee Company
2401 Utah Avenue South, Mail Stop S-RE1
Seattle, WA 98134

Attn.: Mr. Michael Malanga

RE: **Letter of Intent: Fifth & Pine – Seattle, WA**

Dear Mr. Malanga:

This letter of intent shall set forth the terms of our proposed sublease agreement, to which terms the parties shall be bound upon the execution and delivery of a definitive sublease agreement and the receipt of consents required under the master lease agreement for the Premises (as defined below). The parties shall work together in good faith to consummate a sublease on the terms set forth herein. For the purposes of this letter of intent, "Sublessor" shall be Seattle's Best Coffee, LLC (sometimes referred to herein as "SBC") and "Sublessee" shall be Marchex, Inc. The term "Master Lease" shall mean that certain lease for the Premises dated June 29, 2001 between Sublessor and Pine Street Development L.L.C. ("Master Landlord").

1. Building

Fifth & Pine
413 Pine Street
Seattle, WA 98101

2. Premises:

Approximately 25,983 square feet of space on floor five and 805 square feet on floor four ("Server Room") for a total of 26,788 rentable square feet. The Premises shall be taken in "must take" segments per the schedule below, inclusive of the Server Room on floor four:

3/31/04 to 6/30/04	11,400 RSF	3 months
7/1/04 to 9/30/04	15,000 RSF	3 months
10/1/04 to 3/31/05	17,500 RSF	6 months
4/1/05 to 9/30/05	20,000 RSF	6 months
10/1/05 to 3/31/06	22,500 RSF	6 months
4/1/06 to 9/30/06	25,000 RSF	6 months
10/1/06 to 12/31/09	26,788 RSF	39 months

Subject to compliance with the applicable terms of the sublease and/or Master Lease, Sublessor may sublease untaken segments to third parties up to the must take dates. The common area fee for Sublessee's access to the lunchroom, the large conference room, and use of the showers/restrooms shall be $100 per month for the first twelve months of the sublease.

3.	***Commencement Date:***	March 31, 2004.
4.	***Term:***	The term is five years and nine months and shall expire December 30, 2009 ("Expiration Date").
5.	***Rental Rate:***	$8.24 NNN base rent equals $17 gross at $8.76 NNN for months 1 – 69.
6.	***Operating Expenses, Taxes & Utilities (NNN):***	Sublessee shall pay all NNN costs, subject to the terms of the Master Lease. NNN to be paid on a pro-rata basis for space occupied per the schedule in Premises, above and the Option to Expand, below. Increases to the controllable NNN expenses shall be capped at five percent (5%) annually, except that the cap shall only apply after Sublessee has started paying rent on 20,000 rentable square feet (i.e., on 4/1/2005). Examples of expenses that the Master Landlord shall have control of to be mutually agreed upon Sublessee's review of the Master Lease. Sublessee shall provide, at its sole cost and expense, janitorial service for the showers/restrooms used by Sublessee if the same is not provided in connection with building maintenance by the Master Landlord.
7.	***Condition of Premises; Tenant Improvements:***	The Premises shall be delivered to Sublessee, broom clean, including FF&E referenced below, with routine maintenance completed by Master Landlord pursuant to Master Landlord's obligations under the Master Lease prior to Commencement of the sublease. In the sublease, Sublessor shall agree upon Sublessee's request and at Sublessee's expense, reasonably to exercise its rights with respect to Master Landlord's obligation to repair, clean and otherwise maintain the Premises pursuant to the Master Lease. Sublessor shall make no representation regarding (nor shall Sublessor be responsible for) compliance with the ADA, OSHA, or any other laws relating to the Premises or Sublessee's improvements therein. Sublessor shall not make any representations or warranties with respect to hazardous substances/toxic contaminants located in, on, or under the building, the property, or the Premises. All costs related to tenant improvements shall be at Sublessee's expense. Any improvements to the Premises shall be subject to Sublessor's and Master Landlord's consent.
8.	***Early Access:***	Sublessee's right to access the Premises shall begin after full execution and delivery of a sublease and receipt of Master Landlord's written consent.
9.	***Moving Allowance:***	All costs related to moving shall be at Sublessee's sole cost and expense. It is understood and agreed that Sublessor is not paying any moving allowance, improvement allowance, or any other amount to Sublessee.
10.	***Space Plans:***	All costs related to space-plans and construction drawings (including without limitation costs of any necessary approvals, permits, and any other expenses related thereto) shall be at Sublessee's sole cost and expense.

11.	***Furniture, Fixtures & Equipment***	Subject to final itemization of all assets, the Premises shall be delivered to Sublessee for occupancy with all of the existing furniture, fixtures and equipment in place. The parties shall mutually develop a list of the furniture, fixtures and equipment, which shall be attached to the sublease. Subject to the acceptance of an asset by Sublesse, Sublessee shall pay for any related equipment maintenance contracts. Sublesse (and its permitted transferees, assigns and sublessees) shall have the right to use all of the accepted assets during the term of the sublease, and, provided the sublease is still in effect on the Expiration Date, Sublessee shall have the right to purchase all of such accepted assets at the end of the term of the sublease for the nominal sum of $1.00.
12.	***Assignment or Subletting:***	<u>To Affiliates</u>: Sublessee requires the right to sublet or assign the Premises to any related entity or affiliate (to be further defined in the sublease) without Sublessor's approval or consent. Sublessee shall have, without it constituting an assignment or subletting requiring Sublessor's consent, the right to issue and/ or to sell shares or to merge with other corporate entities. <u>To Third Parties</u>: Sublessee shall have the right to assign or sublease to non-related entities subject to Sublessor's consent, not to be unreasonably withheld, conditioned, or delayed. In no event shall Sublessee as Sublandlord be released from any liability in connection with an assignment, sublease or other transfer. In addition, if the sublease/assignment rental rate is greater than what Sublessee is paying, then Sublessor (SBC) shall be entitled to 50% of the difference, less Sublandlord's (i.e., Sublessee's) reasonable costs to sublease, to be further defined and agreed. If Sublessor has incurred any monetary impacts from the cap on operating expenses referenced above for the term preceding a sublease/assignment, then Sublessee shall reimburse Sublessor at commencement of the sublease/assignment and the cap shall thereafter be null and void.
13.	***Option for Additional Space:***	Subject to third parties' rights to sublease the must-take space segments, at any time prior to the must-take periods, Sublessee shall have the option to take the next must-take segment by giving Sublessor not less than 15 days prior written notice.
14.	***Signage:***	Sublessor's signage rights shall pass to Sublessee. Sublessee shall pay the cost of removing and installing new signage (including, without limitation, the cost of permits and approvals, design, construction, repairs, and any other costs related thereto). All signage shall be subject to Master Landlord's consent pursuant to and in accordance with the terms of the Master Lease.
15.	***Access:***	Sublessee shall have 24 hours a day, 7 days a week, 52 weeks a year access to the Premises.

16.	***Security Deposit & First Month's Payment:***	First month's base rent and NNN charges shall be paid to Sublessor upon full execution and delivery of a sublease and receipt of Master Landlord's consent. A security deposit of one month's base rent and NNN charges equal to that due for the last month of the first year shall be paid to Sublessor prior to Commencement and held against the performance of Sublessee under the sublease until the end of the first year at which time it shall be refunded to Sublessee (less any costs incurred by Sublessor in the first year due to Sublessee's failure to comply with the terms of the sublease). A security deposit equal to one month's base rent and NNN charges in the last year of the sublease shall be paid to Sublessor prior to Commencement and held against the performance of Sublessee under the sublease until the end of the term at which time it shall be refunded (less any costs incurred by Sublessor due to Sublessee's failure to comply with the terms of the sublease). In each case, the above amounts reflect a single month of base rent and NNN.
17.	***Agency Disclosure:***	At the time of this agreement James Keating of Grubb & Ellis Company represents Sublessee and Sublessor in this transaction as a Dual Agent. This letter serves as written notification of said agency. All parties hereto have acknowledged this disclosure and receipt of the pamphlet entitled *"The Law of Real Estate Agency."*
18.	***Commission:***	Sublessor agrees that the commission to be paid to Grubb & Ellis is the responsibility of Sublessor pursuant to the terms of a separate agreement. The final commission amount will be disclosed to Sublessee prior to execution of a definitive sublease agreement.
19.	***SNDA:***	It is understood and agreed that Sublessor shall have no obligation to obtain an SNDA or other nondisturbance agreement on behalf of Sublessee nor shall the same be a condition to the sublease.
20.	***Miscellaneous:***	It is expressly understood and agreed by Sublessee and Sublessor that this letter of intent is not a binding contract between the parties but it outlines the terms and conditions for discussions regarding a possible sublease of the Premises. Neither party shall have any obligation with respect to the other party (except that, after the mutual execution and delivery hereof, Sublessee shall have the obligation to negotiate in good faith to consummate a sublease including the terms set forth herein) until such time as the parties execute and deliver a definitive sublease agreement and Master Landlord has consented thereto. Sublessee acknowledges and understands that Master Landlord's consent is required to make any sublease fully binding.

Please evidence your acknowledgement and agreement to the foregoing terms by executing and delivering this letter of intent to us. This letter of intent shall be deemed effective as of the date first set forth above.

Sincerely,

MARCHEX, INC.

By:	/s/ Ethan A. Caldwell
Name:	Ethan A. Caldwell
Title:	CAO and General Counsel

ACKNOWLEDGED & AGREED:

SEATTLE'S BEST COFFEE, LLC

By:	/s/ Michael Malanga
Name:	Michael Malanga
Title:	Authorized Agent

Exhibit 23.1

Independent Auditors' Consent

The Board of Directors
Marchex, Inc.:

We consent to the use of our reports included herein and to the reference to our firm under the heading "Experts" in the prospectus.

/s/ KPMG LLP

Seattle, Washington
February 17, 2004