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

FORM 10-QSB

☒ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended September 30, 2004

☐ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from ______ to ______

Commission File Number: 000-50658

Marchex, Inc.
(Exact name of small business issuer as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**35-2194038** **(IRS Employer Identification No.)**

413 Pine Street, Suite 500
Seattle, Washington 98101
(Address of principal executive offices)

Issuer's telephone number: (206) 331-3300

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date.

Class	Outstanding at November 12, 2004
Class A common stock, par value $.01	**11,987,500**
Class B common stock, par value $.01	**13,496,256**

Transitional Small Business Disclosure Format: Yes ☐ No ☒

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Form 10-QSB
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Part I—Financial Information

Item 1. Financial Statements (unaudited)

MARCHEX, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(unaudited)

	December 31, 2003	September 30, 2004
Assets		
Current assets:		
Cash and cash equivalents	$ 6,019,119	24,772,316
Accounts receivable, net	1,627,730	2,301,249
Other receivables	384	—
Prepaid expenses	117,596	357,871
Income tax receivable	290,939	17,727
Deferred tax assets	263,193	513,404
Other current assets	24,190	46,202
Total current assets	8,343,151	28,008,769
Property and equipment, net	994,793	1,279,962
Other assets	409,878	61,465
Goodwill	17,252,999	26,666,058
Identifiable intangible assets, net	6,701,791	6,487,815
Total assets	$33,702,612	62,504,069
Liabilities and Stockholders’ Equity		
Current liabilities:		
Accounts payable	$ 2,842,229	3,868,745
Accrued payroll and benefits	252,642	278,209
Accrued expenses and other current liabilities	1,031,850	930,283
Accrued facility relocation	—	59,498
Deferred revenue	848,958	1,755,738
Earn-out liability payable	3,525,995	377,547
Total current liabilities	8,501,674	7,270,020
Deferred tax liabilities	1,829,687	658,043
Deferred revenue	38,993	23,617
Accrued facility relocation	—	50,578
Other non-current liabilities	2,274	38,183
Fair value of redemption obligation	55,250	—
Total liabilities	10,427,878	8,040,441
Series A redeemable convertible preferred stock	21,440,402	—
Commitments, contingencies, and subsequent events		
Stockholders’ equity:		
Class A common stock	122,500	122,500
Class B common stock	15,675	134,216
Additional paid-in capital	6,716,734	60,146,934
Deferred stock-based compensation	(1,532,340)	(690,937)
Accumulated deficit	(3,488,237)	(5,249,085)
Total stockholders’ equity	1,834,332	54,463,628
Total liabilities and stockholders’ equity	$33,702,612	62,504,069

See accompanying notes to condensed consolidated financial statements.

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MARCHEX, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations
(unaudited)

	Predecessor Period	Successor Periods			
	Period from January 1 to February 28, 2003	Period from January 17 (inception) to September 30, 2003	Nine months ended September 30, 2004	Quarter ended September 30, 2003	Quarter ended September 30, 2004
Revenue	$ 3,071,055	12,431,493	28,682,924	5,359,274	12,215,835
Expenses:					
Service costs (1)	1,732,813	6,806,021	18,142,886	2,967,206	7,619,496
Sales and marketing (1)	365,043	1,592,722	3,196,996	723,753	1,156,314
Product development (1)	144,479	844,399	1,636,321	384,248	602,478
General and administrative (1)	234,667	1,816,522	2,613,932	659,178	1,072,505
Acquisition-related retention consideration (2)	—	—	374,858	—	119,198
Facility relocation	—	—	199,960	—	(30,499)
Stock-based compensation (3)	38,981	1,587,476	721,403	326,407	125,405
Amortization of intangible assets (4)	—	2,028,244	3,473,976	869,587	1,404,464
Total operating expenses	2,515,983	14,675,384	30,360,332	5,930,379	12,069,361
Income (loss) from operations	555,072	(2,243,891)	(1,677,408)	(571,105)	146,474
Other income (expense):					
Interest income	1,529	33,502	163,808	16,931	82,462
Interest expense	—	—	(3,728)	—	(1,915)
Adjustment to fair value of redemption obligation	—	—	55,250	—	—
Other	—	—	3,644	—	—
Total other income	1,529	33,502	218,974	16,931	80,547
Income (loss) before provision for income taxes	556,601	(2,210,389)	(1,458,434)	(554,174)	227,021
Income tax expense (benefit)	224,082	(783,231)	(118,016)	(196,368)	82,787
Net income (loss)	332,519	(1,427,158)	(1,340,418)	(357,806)	144,234
Accretion to redemption value of redeemable convertible preferred stock	—	911,620	420,430	407,265	—
Net income (loss) applicable to common stockholders	$ 332,519	(2,338,778)	(1,760,848)	(765,071)	144,234
Basic net income(loss) per share applicable to common stockholders		$ (0.18)	$ (0.08)	$ (0.06)	$ 0.01
Diluted net income (loss) per share applicable to common stockholders		$ (0.18)	$ (0.08)	$ (0.06)	$ 0.01
Shares used to calculate basic net income (loss) per share		13,203,398	20,971,993	12,992,500	25,166,363
Shares used to calculate diluted net income (loss) per share		13,203,398	20,971,993	12,992,500	26,968,840

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

(2) Components of acquisition-related retention consideration					
Service costs	—	—	44,608	—	14,185
Sales and marketing	—	—	127,427	—	40,503
Product development	—	—	137,948	—	43,865
General and administrative	—	—	64,875	—	20,645
(3) Components of stock-based compensation					
Service costs	190	39,158	8,550	—	2,250
Sales and marketing	715	316,574	124,161	87,720	7,573
Product development	37,710	164,070	47,230	38,348	12,653
General and administrative	366	1,067,674	541,462	200,339	102,929
(4) Components of amortization of intangible assets					
Service costs	—	1,503,244	2,447,901	644,587	978,389
Sales and marketing	—	204,167	532,527	87,500	207,527
Product development	—	—	—	—	—
General and administrative	—	320,833	493,548	137,500	218,548

See accompanying notes to condensed consolidated financial statements.

MARCHEX, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(unaudited)

	Predecessor Period	Successor Periods	
	Period from January 1 to February 28, 2003	Period from January 17, (inception) to September 30, 2003	Nine months ended September 30, 2004
Cash flows from operating activities:			
Net income (loss)	$ 332,519	(1,427,158)	(1,340,418)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Amortization and depreciation	43,584	2,228,183	3,917,774
Adjustment to fair value of redemption obligation	—	—	(55,250)
Facility relocation	—	—	137,736
Allowance for doubtful accounts and merchant advertiser credits	86,908	282,848	870,325
Stock-based compensation	38,981	1,587,476	721,403
Deferred income taxes	(6,956)	(1,332,902)	(1,436,096)
Income tax benefit related to stock options	231,038	—	179,869
Change in certain assets and liabilities, net of acquisitions:			—
Accounts receivable, net	(135,457)	(512,866)	(1,564,144)
Other receivables	(1,137)	(3,480)	398
Income tax receivable and payable	—	(385,329)	273,212
Prepaid expenses and other current assets	(26,549)	(31,878)	(261,752)
Accounts payable	(403,753)	896,950	570,085
Accrued expenses, payroll, benefits and other current liabilities	117,133	372,392	(82,652)
Deferred revenue	75,650	64,306	313,291
Acquisition-related retention consideration in earn-out liability	—	—	94,278
Other non-current liabilities	1,092	(469)	(2,274)
Net cash provided by operating activities	353,053	1,738,073	2,335,785
Cash flows from investing activities:			
Purchases of property and equipment	(63,878)	(378,385)	(627,148)
Cash paid for acquisitions, net of cash acquired	—	(13,295,931)	(10,519,156)
Proceeds from sale of equipment	—	—	3,710
Decrease in other non-current assets	—	(149,433)	(27,728)
Net cash used in investing activities	(63,878)	(13,823,749)	(11,170,322)
Cash flows from financing activities:			
Capital lease obligation principal paid	—	—	(2,689)
Offering costs paid	—	—	(1,082,809)
Proceeds from IPO, net of offering costs	—	—	28,405,100
Proceeds from exercises of stock options	37,288	—	86,650
Proceeds from employee stock purchase plan	—	—	181,482
Proceeds from sale of stock	—	132,500	—
Proceeds from sale of redeemable convertible preferred stock	—	20,121,517	—
Net cash provided by financing activities	37,288	20,254,017	27,587,734
Net increase in cash and cash equivalents	326,463	8,168,341	18,753,197
Cash and cash equivalents at beginning of period	1,494,300	—	6,019,119
Cash and cash equivalents at end of period	$ 1,820,763	8,168,341	24,772,316

See accompanying notes to condensed consolidated financial statements

Marchex, Inc. and Subsidiaries
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

(1) Description of Business and Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Marchex, Inc. and subsidiaries (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the instructions to the Quarterly Report under the Securities Exchange Act of 1934, as amended, on Form 10-QSB and Item 310(b) of Regulation S-B under the Securities Act of 1933, as amended. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the quarter ended September 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004, or for any other period. The balance sheet at December 31, 2003 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. These financial statements and notes should be read with the financial statements and notes thereto for the year ended December 31, 2003 included in the Company's final prospectus dated March 30, 2004 for its initial public offering filed with the Securities and Exchange Commission.

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 ah-ha.com, Inc., the 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 minimum thresholds in calendar years 2003 and 2004 of income before tax, excluding stock-based compensation and amortization of intangible assets relating to the purchase ("earnings before taxes"). 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 such period. The contingent earn-out consideration payments are being accounted for as additional goodwill, as all former Predecessor shareholders receive the consideration in proportion to their respective share holdings prior to the acquisition date and the amounts reflect the payment of additional purchase price to these shareholders. For the calendar year 2003, additional goodwill of $3,243,000 was recorded for the earn-out consideration.

In addition, if the minimum earnings before taxes thresholds above are achieved, a payment of 5.56% of the acquired businesses' 2003 and 2004 earnings before taxes 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 the calendar years 2003 and 2004. At September 30, 2003, in consideration of the assessed probability of payment, no amounts were accrued for the acquisition-related retention consideration. For the calendar year 2003, $283,000 was recorded for the acquisition-related retention consideration including employer payroll-related taxes. For the quarter ended September 30, 2004, an additional $119,000 in acquisition-related retention consideration was recorded based on the quarterly portion of the annual estimated forecast. For the nine months ended September 30, 2004, total acquisition-related consideration of $375,000 was recorded.

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 product or service, 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 condensed consolidated statements of operations, and cash flows have been presented for the period from January 17, 2003 (inception) through September 30, 2003. The assets, liabilities and operations of Enhance Interactive are included in the Company's condensed consolidated financial statements since the February 28, 2003 acquisition date. 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 condensed consolidated financial results for periods subsequent to the acquisition are not comparable to the condensed financial statements of Enhance Interactive presented for prior periods. The condensed consolidated statements of operations and cash flows representing Enhance Interactive's results prior to February 28, 2003 have been presented as the "Predecessor" for the period from January 1 to February 28, 2003. The Company, including the results of Enhance Interactive since the date of acquisition, is referred to as the "Successor" in the accompanying condensed consolidated financial statements.

The condensed 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 Traffic Leader) ("TrafficLeader"). In November 2003, Sitewise Marketing, Inc., based in Eugene, Oregon, was renamed TrafficLeader, Inc. The costs of acquisition included:

- Cash and acquisition costs of approximately $3,570,000; plus
- 425,000 shares of Class B common stock with a redemption right that required the Company 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 the Company had not completed a firm commitment initial public offering with gross proceeds of at least $20 million prior to October 24, 2005. This redemption right terminated with the closing of the Company's initial public offering on April 5, 2004; plus
- 137,500 shares of restricted Class B common stock that vest over a period of 3 years.

The above summary of the costs of acquisition 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 condensed consolidated financial statements since the October 24, 2003 acquisition date.

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 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.

On July 27, 2004, the Company acquired 100% of the outstanding stock of goClick.com, Inc. ("goClick"), a Norwalk, Connecticut-based company, for the following consideration:

- $7.5 million in net cash and acquisition costs; plus
- 433,541 shares of Class B common stock.

The shares of Class B common stock were valued at $9.55 per share (for accounting purposes) for an aggregate amount of $4.14 million.

goClick is a provider of marketing technology and services for small merchants. The assets, liabilities and operations of goClick are included in the Company's condensed consolidated financial statements since the July 27, 2004 acquisition date.

(2) Initial Public Offering (IPO), Pro Forma Net Loss Per Share and the 2004 Employee Stock Purchase Plan

The Securities and Exchange Commission declared the Company's registration statement on Form SB-2 (Registration No. 333-111096) under the Securities Act of 1933 effective on March 30, 2004. Under this registration statement, in an initial public offering, the Company registered 4,600,000 shares of its Class B common stock, including 600,000 shares subject to the underwriters' over-allotment option, with an aggregate public offering price of $29,900,000.

On April 5, 2004 the Company completed its IPO in which it sold 4,600,000 shares of the Company's Class B common stock that resulted in aggregate gross proceeds of approximately $29,900,000, of which the Company applied approximately $1,500,000 to underwriting discounts and commissions and approximately $1,200,000 to related IPO costs. As a result, the net cash amount of the offering proceeds was approximately $27,200,000. In connection with the IPO, the underwriters were also granted warrants, exercisable for a four-year period commencing one year after the offering date, to purchase 120,000 shares of Class B common stock at an exercise price equal to $8.45 per share. The $579,000 fair value of the warrants is also an IPO related cost and 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 4.75%, volatility of 102%, and an expected life equal to the warrant term of five years.

Upon the completion of the initial public offering on April 5, 2004, 6,724,063 outstanding shares of the Company's Series A redeemable convertible preferred stock automatically converted into 6,724,063 shares of Class B common stock and the Series A redeemable convertible preferred stock was automatically retired. Subsequent to the initial public offering, the authorized number of shares of preferred stock is 1,000,000 and the authorized number of shares of the Class B common stock is 125,000,000. The Board has the authority to issue up to 1,000,000 shares of preferred stock, $0.01 par value, in one or more series and has 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.

On February 15, 2004, the Company's board of directors and shareholders approved the 2004 Employee Stock Purchase Plan, which became effective on March 30, 2004. 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 the three-month offering period. A total of 300,000 shares have been initially reserved under the plan.

(3) (a) Significant Accounting Policies

The Company's significant accounting policies are disclosed in the Company's final prospectus dated March 30, 2004 for its initial public offering filed with the Securities and Exchange Commission. The Company's significant accounting policies have not materially changed during the quarter ended September 30, 2004.

(b) Stock-based Compensation

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.

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 Period	Successor Periods			
	Period from January 1 to February 28, 2003	Period from January 17, (inception) to September 30, 2003	Nine months ended September 30, 2004	Quarter ended September 30, 2003	Quarter ended September 30, 2004
Net income (loss) applicable to common stockholders:					
As reported	$ 332,519	(2,338,778)	(1,760,848)	(765,071)	144,234
Add: stock-based employee compensation expense included in reported net income (loss), net of related tax effect	38,428	1,020,889	627,213	198,757	122,363
Deduct: stock-based employee compensation expense determined under fair-value-based method for all awards, net of related tax effect	(42,375)	(1,449,094)	(3,019,403)	(486,415)	(968,481)
Pro forma	$ 328,572	(2,766,983)	(4,153,038)	(1,052,729)	(701,884)
Net income (loss) per share applicable to common stockholders:					
As reported (basic and diluted)		$ (0.18)	$ (0.08)	$ (0.06)	$ 0.01
Pro forma (basic and diluted)		$ (0.21)	$ (0.20)	$ (0.08)	$ (0.03)

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.*

(4) Net Income (Loss) Per Share

The Company's basic and diluted net income (loss) per share is presented for the period from January 17, 2003 (inception) to September 30, 2003, for the nine months ended September 30, 2004 and for the quarters ended September 30, 2003 and 2004. Basic net income (loss) per share is computed by dividing net income (loss) applicable to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing net income (loss) applicable to common stockholders by the weighted average number of common and dilutive common equivalent shares outstanding during the period. Net income (loss) applicable to common stockholders consists of net income (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 September 30, 2003, for the nine months ended September 30, 2004 and for the quarter ended September 30, 2003, basic and diluted net loss per share are the same.

The following table reconciles the Company's reported net income (loss) applicable to common stockholders used to compute basic and diluted net income (loss) per share for the period from January 17, 2003 (inception) to September 30, 2003, for the nine months ended September 30, 2004 and for the quarters ended September 30, 2003 and 2004:

	Successor Periods			
	Period from January 17, (inception) to September 30, 2003	Nine months ended September 30, 2004	Quarter ended September 30, 2003	Quarter ended September 30, 2004
Numerator:				
Net income (loss)	(1,427,158)	(1,340,418)	(357,806)	144,234
Accretion to redemption value of Series A redeemable convertible preferred stock	911,620	420,430	407,265	—
Net income (loss) applicable to common stockholders	(2,338,778)	(1,760,848)	(765,071)	144,234
Denominator:				
Weighted average common shares outstanding excluding unvested common shares subject to repurchase or cancellation	13,203,398	20,971,993	12,992,500	25,166,363
Weighted average number of shares outstanding used to calculate basic net income (loss) per share	13,203,398	20,971,993	12,992,500	25,166,363
Effect of dilutive securities				
Weighted average stock options and warrants and unvested common shares subject to repurchase or cancellation	—	—	—	1,802,477
Weighted average number of shares outstanding used to calculate diluted net income (loss) per share	13,203,398	20,971,993	12,992,500	26,968,840
Basic and diluted net income (loss) per share applicable to common stockholders	$ (0.18)	$ (0.08)	$ (0.06)	$ 0.01

The computation of diluted net loss per share during the period from January 17, 2003 (inception) to September 30, 2003, for the nine months ended September 30, 2004, and for the quarter ended September 30, 2003, 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 at September 30, 2003. On April 5, 2004, 6,724,063 shares of the Company's Series A redeemable convertible preferred stock automatically converted into 6,724,063 shares of Class B common stock;

- Outstanding options at September 30, 2003 to acquire: (a) 2,421,500 shares of Class B common stock with a weighted average exercise price of $1.67 per share; and (b) 273,350 options to acquire shares of Class B common stock with an exercise price equal to the initial public offering price; provided that in the event that twelve months from the option grant date the Company had not completed a firm commitment initial public offering with gross proceeds of at least $20 million, these options were to have an exercise price equal to the then determined fair market value. Outstanding options at September 30, 2004 to acquire 3,571,167 shares of Class B common stock with a weighted average exercise price of $4.02 per share;
- Warrants to acquire 120,000 shares of Class B common stock at an exercise price equal to $8.45 per share at September 30, 2004; and
- 108,462 Class B restricted common shares issued in connection with the October 2003 acquisition of TrafficLeader at September 30, 2004. These shares were for future services that vest over 3 years. Additionally, these unvested shares were excluded from the computation of basic net income (loss) per share.

(5) 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 revenue earned from merchant advertisers is generated through arrangements with distribution partners. 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 consolidated revenue is as follows:

	Predecessor Period	Successor Periods			
	Period from January 1 to February 28, 2003	Period from January 17, (inception) to September 30, 2003	Nine months ended September 30, 2004	Quarter ended September 30, 2003	Quarter ended September 30, 2004
Distribution Partner A	12%	8%	4%	9%	5%
Distribution Partner B	—	—	19%	—	15%
Distribution Partner C	—	—	9%	—	17%

(6) 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:

	Predecessor Period	Successor Periods			
	Period from January 1 to February 28, 2003	Period from January 17, (inception) to September 30, 2003	Nine months ended September 30, 2004	Quarter ended September 30, 2003	Quarter ended September 30, 2004
United States	90%	90%	90%	91%	85%
Canada	5%	5%	4%	3%	5%
Other countries	5%	5%	6%	6%	10%
	100%	100%	100%	100%	100%

(7) Facility Relocation

As part of its anticipated expansion, in March 2004, the Company entered into a sublease agreement for new office facilities in Seattle, Washington and relocated from its original office facilities also located in Seattle, Washington. Future minimum payments related to these new facilities as of September 30, 2004 are as follows: $74,000 in 2004, $340,000 in 2005, $422,000 in 2006, and $455,000 in each of 2007, 2008 and 2009. The remaining lease obligation for the previous office facilities extends through June 30, 2006 and totaled $219,000 as of September 30, 2004. In March 2004, the Company accrued for lease and related costs of $230,000 for the estimated future obligations of non-cancelable lease and other payments for the original facilities. For the quarter ended September 30, 2004, the Company reduced the lease and related costs accrual by $30,000 based on a revised estimate for subtenant income.

The remaining lease accrual is based on estimates of vacancy period and sublease income. The actual vacancy periods may differ from these estimates, and sublease income may not materialize. Accordingly, these estimates may be adjusted in future periods. The remaining liability at September 30, 2004 was $110,000, of which $59,000 was the current portion.

(8) Acquisition of goClick.com, Inc.

On July 27, 2004, the Company acquired 100% of the outstanding stock of goClick. goClick is a provider of marketing technology and services for small merchants. As a result of the acquisition, the Company obtained customer-facing technologies and a broader base of merchant advertisers and distribution partners. The purchase price consideration consisted of cash and acquisition costs of approximately $8,586,000 and 433,541 shares of Class B common stock. The shares of Class B common stock were valued at $9.55 per share (for accounting purposes) for an aggregate amount of $4.14 million. The holder of such shares is entitled to customary piggyback registration rights.

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

Current assets, including acquired cash and cash equivalents of $1,037,756	$ 1,060,078
Property and equipment	27,819
Intangible assets	3,260,000
Goodwill	9,387,023
Total assets acquired	13,734,920
Current liabilities	1,008,853
Net assets acquired	$12,726,067

The acquired intangible assets in the amount of $3,260,000 have a weighted average useful life of approximately 1.9 years. The identifiable intangible assets are comprised of a merchant advertiser customer base with a value of approximately $500,000 (2-year weighted-average useful life), distribution partner base with a value of approximately $700,000 (3-year weighted-average useful life), non-compete agreement with a value of approximately $900,000 (2-year weighted average useful life), trademarks/domain names with a value of approximately $60,000 (3-year weighted average useful life), and acquired technology with a value of $1,100,000 (1-year weighted average useful life). The goodwill of $9,387,023 and the acquired intangible assets with a value of $3,260,000 are deductible for tax purposes. The estimated fair value of assets and liabilities assumed are based upon preliminary estimates and may vary from the final allocation of the purchase price consideration.

The following table presents pro forma results of operations for the nine months ended September 30, 2004 as if the acquisition of goClick had occurred as of the beginning of the period. The pro forma results of operations for the nine months ended September 30, 2004 are based on the historical results of operations of goClick for the period from January 1, 2004 to July 26, 2004 and the historical results of the Company for the nine months ended September 30, 2004. The following table also presents pro forma results of operations for the nine months ended September 30, 2003 as if the acquisition of goClick and the 2003 acquisitions of TrafficLeader and the Predecessor had occurred as of the beginning of the period. The pro forma results of operations for the nine months ended September 2003 are based on the historical results of operations of goClick and TrafficLeader for the nine months ended September 30, 2003, the historical results of the Company for the period from January 17, 2003 (inception) to September 30, 2003, and the Predecessor for the two months ended February 28, 2003.

	January 2003 to September 30, 2003	Nine months ended September 30, 2004
Revenue	$ 21,702,111	32,434,453
Net loss	(1,737,401)	(1,275,065)
Net loss applicable to common stockholders	(2,649,021)	(1,695,495)
Net loss per share applicable to common stockholders:		
Basic and diluted loss per share	$ (.19)	(.08)

The pro forma information is not necessarily indicative of the combined results that would have occurred had the acquisitions taken place at January 1, 2003 or at January 1, 2004, nor is it necessarily indicative of results that may occur in the future.

Item 2. Management's Discussion and Analysis.

This Quarterly Report on Form 10-QSB contains forward-looking statements that involve substantial risks and uncertainties. All statements, other than statements of historical facts, included on this Quarterly Report regarding our strategy, future operations, future financial position, future revenue, projected costs, prospects, plans and objectives of management are forward-looking statements. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. Actual results or events could differ materially from the plans, intentions and expectations disclosed in the forward-looking statements we make. There are a number of important factors that could cause our actual results to differ materially from those indicated by forward-looking statements. Some, but not all, of these factors are described in the "Risk Factors" section and elsewhere in this Quarterly Report. We disclaim any intention or obligation to update any forward-looking statements.

The following discussion and analysis provides information that we believe is relevant to an assessment and understanding of our results of operation and financial condition. You should read this analysis in conjunction with the attached condensed financial statements and related notes thereto, and with the audited consolidated financial statements and the notes thereto of the Predecessor to Marchex, Inc. as of February 28, 2003 and for the period from January 1, 2003 through February 28, 2003 and of Marchex, Inc. as of December 31, 2003 and for the period from January 17, 2003 (inception) through December 31, 2003, included in our final prospectus dated March 30, 2004 filed with the Securities and Exchange Commission.

Overview

We provide a suite of technology-based services for merchants that enable, facilitate and drive growth in both customers and online transactions. We connect merchants with consumers who are searching for information, products and services on the Internet. Our platform of integrated performance-based advertising and search marketing services enables merchants to more effectively market and sell their products and services across multiple online distribution channels, including search engines, product shopping engines and directories.

We currently provide our merchant advertisers with the following technology-based services:

- ***Pay-Per-Click Services.*** Through our pay-per-click services, we help merchant advertisers create keyword listings that describe their products or services which we market to millions of consumers and businesses primarily through advertising listings included in search engine and directory results.
- ***Feed Management Services.*** Through our feed management services, which include paid inclusion services, we deliver highly-targeted merchant advertiser product and service listings that otherwise may not have been indexed into search engines, product shopping engines or directories.
- ***Advertising Campaign Management Services.*** Through our advertising campaign management services, we enable merchant advertisers to (1) track, monitor and optimize the placement of performance-based search advertising campaigns across a number of performance-based search advertising engines and networks using our bid management service and (2) track the effectiveness of their online advertising campaigns using our conversion tracking and analytics services.
- ***Search Management Services.*** Through our search management services, we enable super merchant aggregators, such as BellSouth, to utilize an outsourced, integrated platform to market our performance-based advertising and search marketing services directly to their merchants.
- ***Search Engine Optimization Services.*** Through our search engine optimization services, we optimize key indicators of merchant advertiser Web sites to ensure the greatest opportunity for proper indexing, listing and inclusion in the editorial results set of algorithmic search engines.

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. On July 27, 2004, we acquired goClick, which was incorporated in Connecticut on October 25, 2000.

From January 17, 2003 (inception) through February 28, 2003, we were involved in business and product development, as well as financing and acquisition initiatives.

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

Prior 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, of which $3.5 million has been paid and up to a maximum obligation of $10.0 million remains.

The additional consideration consists of two components:

- A contingent earnings-based payment to the original stockholders ("earn-out consideration"); and
- 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 nine months ended September 30, 2004, we recorded an additional $375,000 in retention-related consideration as compensation for such period, although the actual amount for the calendar year 2004 has not yet been determined. With respect to the quarter ended September 30, 2004, we recorded $119,000 in retention-related consideration.

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, which had a redemption right that terminated upon the closing of our initial public offering in April 2004; 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 $1.0 million.

With respect to the second and third components, the total value of the shares and the redemption right was recorded at $3.9 million. Prior to its expiration, the redemption right required us to buy back the 425,000 shares for $8.00 per share, but only at the election of the holders of 75% of such shares in the event we had not completed a firm commitment initial public offering with gross proceeds of at least $20.0 million prior to October 24, 2005.

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

In the event that 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.

goClick

In July 2004, we acquired goClick, a Norwalk, Connecticut-based company for the following consideration:

- $7.5 million in net cash and acquisition costs; plus
- 433,541 shares of Class B common stock.

The shares of Class B common stock were valued at $9.55 per share (for accounting purposes) for an aggregate amount of $4.14 million.

Consolidated Statements of Operations

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, TrafficLeader and goClick are included in our consolidated financial statements since the date of their respective acquisitions in February 2003, October 2003 and July 2004.

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, TrafficLeader and goClick being recorded at their estimated fair values on their respective acquisition dates. 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 acquisition of Enhance Interactive are not comparable to the financial statements of Enhance Interactive presented for prior periods. The consolidated statements of operations and cash flows reflecting Enhance Interactive's historical results have been presented for the period from January 1, 2003 through February 28, 2003.

eFamily and its wholly-owned subsidiary Enhance Interactive are described as Enhance Interactive in this Management's Discussion and Analysis. In the accompanying condensed consolidated financial statements, the statements of operations, stockholders' equity, and cash flows reflecting Enhance Interactive results have been presented as the "Predecessor" for 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 comparative periods presented are:

- the quarters ended September 30, 2003 and 2004; and
- the combined periods of January 17, 2003 (inception) to September 30, 2003 and Enhance Interactive's results from January 1, 2003 to February 28, 2003 (2003 period) compared to the nine months ended September 30, 2004 (2004 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 (the date we acquired Enhance Interactive). From our inception through the date of our acquisition of Enhance Interactive, 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.

Revenue

We currently generate revenue through our suite of services, including our pay-per-click services, feed management services, advertising campaign management services, search management services and search optimization services.

Our primary sources of revenue are the performance-based advertising services, which include pay-per-click services and feed management services. These primary sources amounted to greater than 91% of our revenues in all periods presented. Our secondary sources of revenue are our advertising campaign management services, search management services and search engine optimization services. These secondary sources amounted to less than 9% of our revenues in all periods presented. We have no barter transactions.

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.

Performance-Based Advertising Services

In providing pay-per-click advertising services, 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.

In providing feed management services, 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 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.

Search Marketing Services

Merchant advertisers pay us additional fees for such services as advertising campaign management services, search management services and search engine optimization services. 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. 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 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. Revenues from these subscription arrangements are recognized ratably over the service period.

Industry and Market Factors

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 current 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 current 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

Our service costs represent the cost of providing our performance-based advertising services and our search marketing services. The service costs that we have incurred in the presented periods include primarily the costs of:

- user acquisition costs;
- network operations;
- serving our search results;
- maintaining our Web sites;
- credit card processing fees;
- network fees;
- fees paid to outside service providers;
- delivering customer service;
- depreciation of our 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 of related personnel; and
- amortization of intangible assets.

User Acquisition Costs

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 we may use to a lesser degree 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.

Our method of expensing user acquisition costs is based on whether the agreement provides for fixed or variable payments. Agreements with fixed payments are generally expensed at the greater of (a) pro-rata over the term the fixed payment covers or (b) usage delivered to date divided by the guaranteed minimum amount of usage delivered. Agreements with variable payments 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 sites and services.

Our 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 our 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 costs;
- professional services (including accounting, legal and insurance); and
- other general corporate expenses.

Acquisition-Related Retention Consideration

Acquisition-related retention consideration results from the 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 "Prior 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 the 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 of $1.0 million in the aggregate. To the extent we make any payments under this obligation, we will account for such amounts as compensation. For the nine months ended September 30, 2004, we recorded an additional $375,000 in retention-related consideration as compensation for such period. The actual amount for the calendar year 2004 has not yet been determined. With respect to the quarter ended September 30, 2004, we recorded $119,000 in retention-related consideration.

Stock-Based Compensation

Stock-based compensation consists of the following:

- the intrinsic value of employee option and restricted stock issuance where the fair market value of the underlying stock exceeded the exercise price on the date of the grant;
- the fair value of non-employee option issuances; and
- the amount by which the fair market value of our Class B common stock exceeded the exercise price at the end of the period for certain options.

We used variable accounting for options to purchase 125,000 shares of our Class B common stock that are issued under our Stock Incentive Plan. These options were held in escrow until February 28, 2004 as security for the indemnification obligations under the Enhance Interactive merger agreement, and were subject to forfeiture. We accounted for them as variable awards until the expiration of the agreed-upon escrow period on February 28, 2004.

Amortization of Intangibles

Amortization of identifiable intangible assets relates to intangible assets identified in connection with the purchase of Enhance Interactive, TrafficLeader and goClick.

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. Intangible assets identified in connection with the purchase of goClick were valued at $3.3 million at the acquisition date of July 27, 2004.

The intangible assets have been identified as:

- non-competition agreements;
- trade and domain names;
- distributor relationships;
- 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 September 30, 2004, we had net operating loss, or NOL, carryforwards of $1.8 million, which will begin to expire in 2019. The Tax Reform Act of 1986 limits the use of 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.

Initial Public Offering

On March 30, 2004 we commenced an initial public offering of 4.6 million shares of our Class B common stock. The closing of our initial public offering took place on April 5, 2004. The proceeds of our initial public offering, net of cash offering expenses, were approximately $27.2 million. In connection with our initial public offering, the underwriters were also granted warrants, exercisable over a four-year period commencing one year from the offering date and ending five years from the offering date, to purchase 120,000 shares of Class B common stock at an exercise price equal to $8.45 per share. Net proceeds have been or are expected to be used to pay for product and business development, acquisitions and strategic relationships, capital expenditures, personnel, facilities, earn-out obligations and working capital and other general corporate purposes.

Accretion to Redemption Value of Redeemable Convertible Preferred Stock

All 6,724,063 shares of our outstanding Series A redeemable convertible preferred stock were automatically converted into 6,724,063 shares of Class B common stock upon the closing of our initial public offering in April 2004. Prior to this conversion, holders of our Series A redeemable convertible preferred stock were 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 our board of directors. Upon the conversion of the Series A redeemable convertible preferred stock, dividend rights were automatically terminated and any rights to past dividends were forgiven.

Prior to the automatic conversion, we accounted 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 was equal to the redemption amount at the earliest redemption date.

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Results of Operations

The following table presents certain financial data, derived from our unaudited statements of operations, as a percentage of total revenue for the period indicated. The operating results for the predecessor period of January 1, 2003 to February 28, 2003 and the successor periods of January 17, 2003 (inception) to September 30, 2003, the nine months ended September 30, 2004 and the quarters ended September 30, 2003 and 2004 are not necessarily indicative of the results that may be expected for the full year or any future period.

	Predecessor Period	Successor Periods			
	Period from January 1 to February 28, 2003	Period from January 17 (inception) to September 30, 2003	Nine months ended September 30, 2004	Quarter ended September 30, 2003	Quarter ended September 30, 2004
Revenue	100.0%	100.0%	100.0%	100.0%	100.0%
Expenses:					
Service costs	56.4%	54.7%	63.3%	55.4%	62.4%
Sales and marketing	11.9%	12.8%	11.1%	13.5%	9.5%
Product development	4.7%	6.8%	5.7%	7.2%	4.9%
General and administrative	7.6%	14.6%	9.1%	12.3%	8.8%
Acquisition-related retention consideration	0.0%	0.0%	1.3%	0.0%	1.0%
Facility relocation	0.0%	0.0%	0.7%	0.0%	(0.2)%
Stock-based compensation	1.3%	12.8%	2.5%	6.1%	1.0%
Amortization of intangible assets	0.0%	16.3%	12.1%	16.2%	11.5%
Total operating expenses	81.9%	118.0%	105.8%	110.7%	98.9%
Income (loss) from operations	18.1%	(18.1)%	(5.8)%	(10.7)%	1.2%
Other income (expense):					
Interest income	0.0%	0.3%	0.6%	0.3%	0.7%
Interest expense	0.0%	0.0%	0.0%	0.0%	0.0%
Adjustment to fair value of redemption obligation	0.0%	0.0%	0.2%	0.0%	0.0%
Other	0.0%	0.0%	0.0%	0.0%	0.0%
Total other income	0.0%	0.3%	0.8%	0.3%	0.7%
Income (loss) before provision for income taxes	18.1%	(17.8)%	(5.1)%	(10.3)%	1.9%
Income tax expense (benefit)	7.3%	(6.3)%	(0.4)%	(3.7)%	0.7%
Net income (loss)	10.8%	(11.5)%	(4.7)%	(6.6)%	1.2%
Accretion to redemption value of redeemable convertible preferred stock	0.0%	7.3%	1.5%	7.6%	0.0%
Net income (loss) applicable to common stockholders	10.8%	(18.8)%	(6.2)%	(14.2)%	1.2%

Comparison of the Quarter ended September 30, 2003 to the Quarter ended September 30, 2004 and the combined periods of January 17, 2003 (inception) to September 30, 2003, and January 1, 2003 to February 28, 2003 (2003 period) to the nine months ended September 30, 2004 (2004 period).

Revenue. Revenue increased 128%, from $5.4 million in the third quarter of 2003 to $12.2 million in the same period in 2004. This increase was attributable to a $6.8 million increase for the quarter ended September 30, 2004 in performance-based advertising services. Of this increase approximately two-thirds related to an increase in the average revenue per merchant advertiser, while approximately one-third related to an increase in the number of merchant advertisers. Revenue increased 85%, from $15.5 million in the 2003 period to $28.7 million in the 2004 period. This increase was primarily attributable to our performance-based advertising services, which increased by approximately $12.7 million in the 2004 period.

We believe the increase in revenue is primarily a result of the growth of our existing distribution partners, the increased number of searches and resulting click-throughs performed by users of our services, and the addition of new distribution partners and merchant advertisers. The number of our distribution partners was approximately 390 in September 2003 and approximately 440 in September 2004. We also believe the foregoing factors, combined with our sales efforts and improved operational controls, have contributed to an increase in the average revenue per merchant advertiser. The increase in revenue in the 2004 period is also attributable to the acquisition of TrafficLeader in October 2003, which added 11 unique distribution partners and more than 280 merchant advertisers as of such acquisition in October 2003 and the acquisition of goClick in July 2004 which added more than 40 unique distribution partners and more than 5,000 unique merchant advertisers as of such acquisition in July 2004. The operating results of TrafficLeader and goClick were included as of the acquisition dates of October 24, 2003 and July 27, 2004, respectively.

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 157%, from $3.0 million in the third quarter of 2003 to $7.6 million in the same period in 2004. The increase was mainly attributable to an increase in payments to distribution partners of $4.0 million, an increase in personnel costs of $401,000, an increase in payment processing fees of $116,000, and an increase in facility and other costs of $107,000. Approximately $5.3 million and $1.2 million of the total increase in service costs for the nine months ended September 30, 2004 was attributable to the October 2003 acquisition of TrafficLeader and the July 2004 acquisition of goClick, respectively, which were not included in the same period in 2003.

This total increase also resulted from 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 an increase in fees paid to outside service providers. Service costs represented 62% of revenue in the third quarter of 2004 as compared to 55% in the same period in 2003. As a percentage of revenue, the increase in service costs for the third quarter of 2004 and the 2004 period as compared to the same periods in 2003 was primarily a result of the impact as a percentage of revenue from the service cost level from the October 2003 acquisition of TrafficLeader and their feed management services. TrafficLeader's service costs, of which feed management services is the primary component, were 78% of TrafficLeader's revenue for the 2003 period. Payments to feed management services distribution partners account for higher user acquisition costs as a percentage of revenue relative to our overall service cost percentage. To the extent that payments to feed management services distribution partners make up a larger percentage of future operations, we expect that service costs will increase as a percentage of revenue. goClick's operating activities are in the process of being integrated with our other operations. goClick's service costs did not have a significant percentage impact on the consolidated service cost percentage of revenue. We also expect that service costs will continue to increase in absolute dollars, since we anticipate expanding our operations.

Service costs increased 112%, from $8.5 million in the 2003 period to $18.1 million in the 2004 period. This increase was primarily attributable to an increase of $8.1 million in payments to distribution partners, an increase in payment processing fees of $163,000, an increase in personnel costs of $942,000, an increase in production technology and bandwidth costs of $118,000 and an increase in facility and other costs of $310,000. Service costs as a percentage of revenue were 63% in the 2004 period as compared to 55% in the 2003 period.

Sales and Marketing. Sales and marketing expenses increased 60%, from $724,000 in the third quarter of 2003 to $1.2 million in the same period in 2004. As a percentage of revenue, sales and marketing expenses were 10% and 14% for the third quarter of 2004 and 2003, respectively. The increase in dollars was primarily related to an increase in personnel costs of $313,000 primarily related to an increase in the number of employees. 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 increase, to the extent that we also increase our marketing activities.

Sales and marketing expenses increased 63%, from $2.0 million in the 2003 period to $3.2 million in the 2004 period. The increase was primarily attributable to an increase in personnel costs of $893,000, an increase in travel of $166,000 and an increase in other expenses of $181,000. As a percentage of revenue, the sales and marketing expenses were 11% and 13% for the 2004 and 2003 periods, respectively.

Product Development. Product development expenses increased 57%, from $384,000 in the third quarter of 2003 to $602,000 in the same period in 2004. As a percentage of revenue, product development expenses were 5% and 7% for third quarter of 2004 and 2003, respectively. The increase in dollars was primarily due to an increase in personnel costs of $186,000, primarily related to an increase in the number of employees. We expect that product development expenses will increase in absolute dollars as we increase the number of personnel and consultants to enhance our service offerings.

Product development expenses increased 65%, from $1.0 million in the 2003 period to $1.6 million in the 2004 period. The increase was primarily attributable to an increase in personnel costs of $530,000, an increase in travel of $39,000 and an increase in other expenses of $78,000. As a percentage of revenue, the product development expenses were 6% for both the 2004 and 2003 periods.

General and Administrative. General and administrative expenses increased 63%, from $659,000 in the third quarter of 2003 to $1.1 million in the same period in 2004. As a percentage of revenue, general and administrative expenses were 9% for the third quarter of 2004 and 12% for the same period in 2003. The net increase in the dollars was primarily due to an increase in personnel costs of $270,000, a decrease in travel costs of $62,000, an increase in insurance of $35,000, an increase in bad debt expense of $139,000 and

an increase in other expenses of $31,000. Many of these costs in the 2004 period result from operating in multiple jurisdictions commencing in 2003 and increased operating activity, including the acquisitions of TrafficLeader in October 2003 and goClick in July 2004. 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 being a public company, including expenses related to professional fees and insurance.

General and administrative expenses increased 27%, from $2.1 million in the 2003 period to $2.6 million in the 2004 period. As a percentage of revenue, general and administrative expenses decreased to 9% in the 2004 period as compared to 13% in the 2003 period. As a percentage of revenue, the decrease in general and administrative expenses in the 2004 period as compared to the 2003 period was primarily a result of general and administrative expenses being compared to a larger revenue base.

Acquisition-Related Retention Consideration. Acquisition-related retention consideration increased from zero in the third quarter of 2003 to $119,000 in the same period in 2004. During the third quarter of 2004, the components of acquisition-related retention consideration were estimated based on forecasts of the Enhance Interactive earn-out calculations. Estimated allocations were made as follows: service costs of $14,000, sales and marketing of $40,000, product development of $44,000, and general and administrative of $21,000. 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 5.56% of Enhance Interactive's earnings before taxes in excess of $3.5 million for the 2004 period of which $375,000 has been recorded as acquisition-related retention consideration including employer payroll-related taxes. A quarterly proportion of the annual estimated acquisition-related retention consideration was recorded in the third quarter of 2004. We will account for any payment amount as compensation. The acquisition-related retention consideration for the calendar years 2003 and 2004 is subject to an aggregate maximum of $1.0 million. Acquisition-related retention consideration increased 100%, from zero in the 2003 period to $375,000 in the 2004 period.

Facility Relocation. In March 2004, we entered into a sublease agreement for new and larger office facilities in Seattle, Washington, and we relocated from our original office facilities also located in Seattle, Washington. In March 2004, we accrued lease and related costs of $230,000 for the estimated future obligations of non-cancelable lease and other payments for the original facilities. In the third quarter of 2004, we reduced the lease and related costs accrual by $30,000 based on a revised estimate for subtenant income. The remaining lease obligations for the original facilities extend through June 30, 2006 and totaled $219,000 as of September 30, 2004. As of September 30, 2004, we estimate the net sublease income to be approximately $57,000 over the remaining life of the lease.

The remaining lease accrual is based on estimates of vacancy period and sublease income. The actual vacancy periods may differ from these estimates, and sublease income, if any, may not materialize. Accordingly, these estimates may be adjusted in future periods.

Stock-Based Compensation. The amortization of stock-based compensation decreased 62%, from $326,000 in the third quarter of 2003 to $125,000 in the same period in 2004. In the third quarter of 2004, the components of stock-based compensation were service costs of $2,000, sales and marketing of $7,000, product development of $13,000 and general and administrative of $103,000. The third quarter of 2003 includes $80,000 of stock-based compensation for 125,000 options issued that were held in escrow as security for the indemnification obligations under the Enhance Interactive merger agreement. These options were subject to forfeiture, until the expiration of the escrow period on February 28, 2004. Accordingly, we have accounted for these options as variable awards during the escrow period. Under variable plan accounting, compensation expense is measured quarterly as the amount by which the fair market 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 market 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 amortization of stock-based compensation decreased 56%, from $1.6 million in the 2003 period to $721,000 in the 2004 period. During the 2004 period, the components of stock-based compensation were service costs of $5,000, sales and marketing of $124,000, product development of $51,000 and general and administrative of $541,000. Amounts in the 2004 period related primarily to the vesting of stock options granted to employees in which the exercise price was less than the fair market value at the date of grant and $341,000 related to restricted stock issued to employees for future services in connection with the acquisition of TrafficLeader.

Amortization of Intangibles. Intangible amortization expense increased 62%, from $870,000 in the third quarter of 2003 to $1.4 million in the same period in 2004. The increase is associated with the acquisitions of Enhance Interactive, TrafficLeader, and goClick. During the third quarter of 2004, the components of amortization of intangibles were service costs of $978,000, sales and marketing of $207,000 and general and administrative of $219,000. Our purchase accounting resulted in all assets and liabilities from our acquisition of Enhance Interactive, TrafficLeader and goGlick being recorded at their estimated fair values on the acquisition dates of February 28, 2003, October 24, 2003, and July 27, 2004, respectively. For the period from February 28, 2003, through September 30, 2004, all goodwill, identifiable intangible assets and liabilities resulting from the Enhance Interactive, TrafficLeader and goClick acquisitions have been recorded in our financial statements. The identified intangibles amounted to $13.0 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. 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 376%, from $17,000 in the third quarter of 2003 to $81,000 in the same period in 2004. Interest income increased by $66,000 due to an increase in the average cash balance in the third quarter 2004 resulting from the Company's initial public offering, which accounts for primarily all of the increase.

Other income increased 525%, from $35,000 in the 2003 period to $219,000 in the 2004 period. The increase was primarily attributable to an increase in interest income of $130,000 and the adjustment to fair value of the TrafficLeader redemption obligation of $55,000 in the 2004 period as compared to the 2003 period.

Income Taxes. The income tax expense in the third quarter of 2004 was $83,000 as compared to an income tax benefit of $196,000 in the same period in 2003. The income tax benefit decreased 79%, from $559,000 in the 2003 period to $118,000 in the 2004 period.

In the 2003 period, the effective tax rate benefit of 35% differed from the expected effective rate of 34% primarily due to state income taxes and non-deductible stock compensation amounts. The income tax effective rate benefit was 8% in the 2004 period. This differed from the expected rate of 34% primarily due to non-deductible stock compensation amounts. The periods were 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, including $479,000 associated with the acquisition of TrafficLeader, 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, including $479,000 associated with the acquisition of TrafficLeader, related to the book basis versus tax basis of the identifiable intangible assets in the acquisitions totaling approximately $9.7 million.
- On July 27, 2004 in connection with the purchase accounting for goClick, we recorded net deferred assets of approximately $11,000 relating to the difference in the book versus tax basis of its assets and liabilities. The $9.4 million of goodwill and $3.3 million of intangible assets relating to the goClick acquisition are being deducted for tax purposes over a 15 year period.

During the period from January 1, 2003 through February 28, 2003 and in the nine months ended September 30, 2004, as a result of tax deductions from stock option exercises, Enhance Interactive and the Company recognized tax-effected benefits of approximately $231,000 and $180,000 respectively, which were recorded as credits to additional paid in capital.

Accretion to Redemption Value of Redeemable Convertible Preferred Stock. The accretion to redemption value of preferred stock decreased 100%, from $407,000 in the third quarter of 2003 to zero in the same period in 2004. The accretion to the redemption value recorded during the 2003 period is based upon 6,724,063 shares of Series A redeemable convertible preferred stock outstanding as of April 5, 2004 with a dividend rate of 8% per annum. All 6,724,063 shares of Series A redeemable convertible preferred stock automatically converted into 6,724,063 shares of Class B common stock upon the closing of the initial public offering on April 5, 2004. The accretion to redemption value of preferred stock decreased 54%, from $912,000 in the 2003 period to $420,000 in the 2004 period.

Net Income (Loss) Applicable to Common Stockholders. Net income (loss) applicable to common stockholders increased from ($765,000) in the third quarter of 2003 to $144,000 in the same period in 2004. The increase was primarily attributable to the decrease in accretion to redemption value of the Series A redeemable convertible preferred stock of $407,000 and the decrease in stock-based compensation of $201,000.

The net income (loss) applicable to common stockholders decreased 12%, from $2.0 million in the 2003 period to $1.8 million in the 2004 period.

Operating Income before Amortization. Our management believes that certain non-GAAP measures, which are calculated and presented on the basis of methodologies other than in accordance with generally accepted accounting principles (GAAP), are helpful when presented in conjunction with comparable GAAP measures. The non-GAAP measures are not meant to replace or supersede 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. OIBA represents income (loss) from operations before (1) stock-based compensation expense and (2) amortization of intangible assets. It is one of the primary metrics by which we evaluate the performance of our business.

Additionally, management uses adjusted OIBA which excludes both the acquisition-related retention consideration, as we view this as part of the earn-out incentives related to the Enhance transaction, and a facility relocation expense (benefit). Both of these items are viewed as non-recurring in nature with the facility relocation expense (benefit) recognized in the nine months ended September 30, 2004 and the earn-out consideration relating to calendar year 2004.

We refer to adjusted OIBA to facilitate accurate comparisons to our historical operating results, in making operating decisions, for internal budget planning, and in some cases to form the basis upon which management are 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. These non-GAAP measures 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 these measures are useful to investors because they represent 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 and non-recurring expenses.

OIBA and adjusted OIBA have certain limitations in that they do not take into account the impact to our statement of operations of certain expenses, including non-cash stock-based compensation associated with our employees, acquisition-related accounting and facility relocation amounts. We endeavor to compensate for the limitations of these non-GAAP measures 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 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 the 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 period of January 1, 2003 to February 28, 2003, the period of January 17, 2003 (inception) to September 30, 2003, for the nine months ended September 30, 2004 and for the quarters ended September 30, 2003 and 2004.

	Period from January 1 to February 28, 2003	Period from January 17, (inception) to September 30, 2003	Nine months ended September 30, 2004	Quarter ended September 30, 2003	Quarter ended September 30, 2004
Operating income before amortization	$ 594,053	1,371,829	2,517,971	624,890	1,676,343
Stock-based compensation	(38,981)	(1,587,476)	(721,403)	(326,407)	(125,405)
Amortization of intangible assets	—	(2,028,244)	(3,473,976)	(869,588)	(1,404,464)
Income (loss) from operations	555,072	(2,243,891)	(1,677,408)	(571,105)	146,474
Other income (expense):					
Interest income	1,529	33,502	163,808	16,931	82,462
Interest expense	—	—	(3,728)	—	(1,915)
Adjustment to fair value of redemption obligation	—	—	55,250	—	—
Other	—	—	3,644	—	—
Total other income	1,529	33,502	218,974	16,931	80,547
Income (loss) before provision for income taxes	556,601	(2,210,389)	(1,458,434)	(554,174)	227,021
Income tax expense (benefit)	224,082	(783,231)	(118,016)	(196,368)	(82,787)
Net income (loss)	332,519	(1,427,158)	(1,340,418)	(357,806)	144,234
Accretion to redemption value of redeemable convertible preferred stock	—	911,620	420,430	407,265	—
Net income (loss) applicable to common stockholders	$ 332,519	(2,338,778)	(1,760,848)	(765,071)	144,234

Operating income before amortization increased 168%, from $625,000 in the third quarter of 2003 to $1.7 million in the same period in 2004. The net increase in OIBA was primarily attributable to revenue increasing at a faster rate than sales and marketing, product development, and general and administrative expenses partially offset by an increase in service costs as a percentage of revenue.

Operating income before amortization increased 28%, from $2.0 million in the 2003 period to $2.5 million in the 2004 period. This net increase in OIBA is primarily attributable to revenue increasing at a faster rate than sales and marketing, product development, and general and administrative expenses, partially offset by an increase in service costs as a percentage of revenue, an increase in acquisition-related retention consideration of $375,000 and an increase in facility relocation costs of $200,000.

Liquidity and Capital Resources

We initially financed our company through the private sales of Marchex securities in January through May of 2003, which resulted in total proceeds of approximately $20.3 million. Primarily from such proceeds, we funded our early business operations and the acquisitions of Enhance Interactive and TrafficLeader. The acquisition of Enhance Interactive amounted to $13.3 million in net cash consideration and the acquisition of TrafficLeader amounted to $3.2 million in net cash consideration.

On April 5, 2004, we completed our initial public offering of 4.6 million shares of Class B common stock. The proceeds received in the second quarter of fiscal year 2004 from the stock offering, net of cash offering expenses and underwriter discounts, were $27.2 million. Net proceeds have been or will be used to pay for product and business development, acquisitions and strategic relationships, capital expenditures, personnel, facilities, earn-out obligations and working capital and other general corporate purposes. The acquisition of goClick amounted to $7.5 million in net cash consideration. On April 5, 2004, all of our outstanding shares of Series A redeemable convertible preferred stock, with a value of $21.8 million, were automatically converted into Class B common stock and are now included as components of stockholders' equity.

As of September 30, 2004, we had cash and cash equivalents of $24.8 million. As of September 30, 2004, we had operating lease contractual obligations of $3.2 million of which $2.8 million is for rent under our facility leases.

Cash provided by operating activities primarily consists of net income (loss) adjusted for certain non-cash items such as depreciation and amortization, tax benefit from stock options, facility relocation amounts, deferred income taxes and changes in working capital. Cash provided by operating activities for the quarter ended September 30, 2004 of approximately $2.3 million consisted primarily of net income of $144,000 adjusted for non-cash items of $2.1 million, including depreciation, amortization of intangibles, allowance for doubtful accounts, merchant advertiser credits and stock-based compensation, and approximately $104,000 provided in working capital and other activities. Cash provided by operating activities for the quarter ended September 30, 2003 of approximately $919,000 consisted primarily of a net loss of $358,000 adjusted for non-cash items of $1.3 million, including depreciation and amortization of intangibles and stock-based compensation, offset by approximately $55,000 used by working capital and other activities.

With respect to most of our pay-per-click advertising services, we receive payment prior to our delivery of related 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 earlier receipt of the cash from the merchant advertisers and the later payment to the distribution partners. These services constituted the majority of revenue in the 2003 and 2004 periods.

Nearly all of the feed management services 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. For these services, merchant advertiser's payments are generally received one to three weeks following payment to the distribution partners. We expect that in the future periods, if the feed management services account for a greater percentage of our operating activity, working capital requirements will increase as a result.

Cash used in investing activities for the quarter ended September 30, 2004 of approximately $7.4 million was primarily attributable to the acquisition of goClick of approximately $7.3 million and purchases of property and equipment of $164,000. Cash used in investing activities for the quarter ended September 30, 2003 of approximately $251,000 was related to purchases of property and equipment and deferred initial public offering costs.

As a result of our 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 September 30, 2004 totaled $1.1 million. 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.

Cash provided by financing activities for the quarter ended September 30, 2004 of approximately $95,000 was primarily attributable to net proceeds from the sale of stock through employee stock options and the employee stock purchase plan. There was no cash provided by financing activities for the quarter ended September 30, 2003.

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 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 for Enhance Interactive for the calendar years 2003 and 2004 and $1 million for TrafficLeader for the calendar year 2004.

For the calendar year 2003, the total aggregate Enhance Interactive contingent, earnings-based payment obligation was approximately $3.5 million. This payment obligation includes the earn-out consideration of approximately $3.2 million and the retention-related consideration of approximately $283,000. These amounts for the calendar year 2003 were paid in April 2004.

The following table summarizes our contractual obligations as of September 30, 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	$ 3,204,000	268,000	2,025,000	911,000	—
Earn-out obligation associated with Enhance Interactive (A)	Up to 9,997,000	Up to 9,997,000	—	—	—
Earn-out obligation associated with TrafficLeader (B)	Up to 1,000,000	Up to 1,000,000	—	—	—
Total Contractual Obligations	$ Up to 14,201,000	Up to 11,265,000	2,025,000	911,000	0

(A) 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 income before taxes does 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. As of September 30, 2004, no amount was recorded for calender year 2004 as the contingent amounts were not determinable beyond a reasonable doubt.

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 and 2004, then no amount shall be payable for the related period. Any amounts payable will be accounted for as compensation.

Based upon the calculation for the calendar year 2003, a $3.5 million payment liability was recorded for total 2003 earnings-based payment obligations and an estimate for the nine months of 2004 of $375,000 was recorded. These amounts will reduce the maximum aggregate obligation by the same amount.

(B) 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 amounts payable will be accounted for as additional goodwill.

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

We anticipate that we will need to invest working capital towards the development and expansion of our overall operations. We may also make a significant number of acquisitions, which could result in the reduction of our cash balances or the incurrence of debt. We have allocated a portion of net proceeds from our offering to fund acquisitions. Furthermore, we expect that future capital expenditures may increase in future periods, particularly if our operating activity increases.

Based on our operating plans, we believe that the proceeds from our initial public offering, together with existing resources and cash flows provided by operations, will be sufficient to fund our operations for at least twelve months. Additional equity and debt financing may be needed to support our acquisition strategy, our long-term obligations and our company's 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 condensed consolidated financial statements have been prepared with accounting principles generally accepted in the United States. The preparation of these condensed 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, merchant advertiser and incentive program 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, and beginning in October 2003, feed management services. For these particular services, revenue is recognized upon a user's click-through of a merchant advertiser listing within our 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 on which we include 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. We also recognize revenue for certain agency contracts with clients under the net revenue recognition method. Under these specific agreements, we purchase listings on behalf of merchant advertisers from search engines and directories. We are paid an agency fee based on the total amount of the purchase made on behalf of these merchant advertisers. Under these agreements, our clients are primarily responsible for choosing the publisher and determining pricing.

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 3(b) to the condensed 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 market value of the underlying stock exceeded the exercise price. SFAS No. 123, "Accounting for Stock-Based Compensation," (SFAS 123) established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans.

As allowed by SFAS 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 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. 123 and EITF No. 96-18.

We used 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 were held in escrow as security for the indemnification obligations under the Enhance Interactive merger agreement. These options were subject to forfeiture, until the expiration of the escrow period which was February 28, 2004, and, accordingly, we were required to record a compensation charge on a quarterly basis, which lowered our earnings. Under variable plan accounting, compensation expense is measured quarterly as the amount by which the fair market 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 market 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 recognized was derived based upon our determination of the fair value of our Class B common stock. We determined the fair value of our Class B common stock based upon factors, including our operating performance, issuance 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 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 3(b) to our condensed consolidated financial statements for a discussion of how our net income (loss) would have been adversely affected.

Allowance for Doubtful Accounts, Merchant Advertiser and Incentive Program 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. Under the merchant advertiser incentive program, we grant merchant advertisers credits depending upon the individual amounts of prepayments made. The incentive program reserve is determined based on historical rate of incentives earned and used by merchant advertisers compared to the related revenues recognized by the Company. Material differences may result in the amount and timing of our revenue for any period if our management made different judgments and estimates.

Risk Factors

Risks Relating to Our Company

Our limited operating history makes evaluation of our business difficult.

We were formally incorporated in January 2003. We acquired Enhance Interactive in February 2003, TrafficLeader in October 2003, and goClick in July 2004.

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. Our failure to address these risks and difficulties successfully could seriously harm us.

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

We have incurred net losses since inception and had an accumulated deficit of $5.2 million as of September 30, 2004. 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 if we will become profitable in the future. Even if we were to achieve profitability, we may not be able to sustain it.

We are dependent on our larger distribution partners, including Yahoo! and its subsidiaries, for distribution of our services, and we derive a significant portion of our total revenue through these distribution partners. A loss of a larger distribution partner or decrease in revenue from a larger distribution partner could adversely affect our business.

A relatively small number of distribution partners currently deliver a significant percentage of traffic to our merchant listings. Yahoo!, primarily through its subsidiaries, such as Inktomi and Overture, is our largest distribution partner collectively representing nearly 20% of our total revenue for the nine months ended September 30, 2004. For the year ended December 31, 2003, distribution through Yahoo! and its subsidiaries collectively represented less than 10% of our total revenue.

Our existing agreements with many of our larger distribution partners permit either company to terminate without penalty on short notice 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 larger distribution partners, but there are no guarantees that these relationships will remain in place over the short- or long-term. 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 relationships could have an adverse effect on our revenue, and the loss of any one large distribution partner could have a material adverse effect on our business, financial condition and results of operations.

Companies distributing advertising on the Internet have experienced, and will likely continue to experience, consolidation. This consolidation has reduced the number of partners that control the online advertising outlets with the most user traffic. 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. In addition, many participants in the performance-based advertising and search marketing industries control 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 over us in delivering their services, and with a lesser degree of risk.

If we do not maintain and grow a critical mass of merchant advertisers and distribution partners, the value of our services 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. Any decline in the number of merchant advertisers and distribution partners could adversely affect the value of our services.

We are dependent upon the quality of traffic in our network to provide value to our merchant advertisers, and any failure in our quality control could have a material adverse effect on the value of our services to our merchant advertisers.

We monitor the quality of the traffic that we deliver to our merchant advertisers. 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. Even with such monitoring in place, there is a risk that a certain amount of low-quality traffic or traffic that is deemed to be less valuable by our merchant advertisers will be provided to our merchant advertisers, which, if not contained, may be detrimental to those relationships. Low-quality traffic may prevent us from growing our base of merchant advertisers and cause us to lose relationships with existing merchant advertisers.

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

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 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 FindWhat.com relating to this patent. FindWhat.com is vigorously contesting Overture's patent. If we were to acquire or develop a related product or business model that Overture construes as infringing the Overture patent or if Overture construes any of our current products or business models as infringing upon the Overture patent, then we could be asked to license, re-engineer our products and services or revise our business model according to terms that may be extremely expensive and/or unreasonable. As part of our overall business relationship with Yahoo!, we have entered into various agreements to license technologies and services from Yahoo! and its subsidiaries, and expect to continue discussions with these partners to license other technologies and services, which may include the Overture patent.

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.

We may need additional funding to meet our obligations and to pursue our business strategy. Funding may not be available to us and our financial condition could therefore be adversely affected.

We may require additional funding to meet our ongoing obligations and to pursue our business strategy, which includes the selective acquisition of businesses and technologies. In addition, we have and we may incur certain obligations in the future including:

- 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, based on 2004 results, with a maximum remaining aggregate payment obligation of $10.0 million.
- We may also be obligated to make revenue-based performance payments to the original shareholders of TrafficLeader, which we acquired in October 2003, based on 2004 results, with a maximum aggregate payment obligation of $1.0 million.

There can be no assurance that any financing arrangements will be available in amounts or on terms acceptable to us, if at all. If adequate additional funds are not available, we will be required to delay, reduce the scope of or eliminate material parts of the implementation of our business strategy, including potential additional acquisitions or internally developed businesses.

Our acquisitions could divert management's attention, cause ownership dilution to our stockholders, cause our earnings to decrease and be difficult to integrate.

Our business strategy depends heavily upon our ability to identify, structure and integrate acquisitions. Acquisitions 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 to meet our objectives which include revenue growth, profitability and competitive market share. Our acquired companies 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 fail to successfully integrate our financial and management controls, technology, reporting systems and procedures, or adequately expand, train and manage our workforce;
- We could experience customer dissatisfaction or performance problems with an acquired company or technology;
- We could become subject to unknown or underestimated liabilities of an acquired entity or incur unexpected expenses or losses from such acquisitions; and
- We could 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 executive officers, could harm our current and future operations and prospects.

We are heavily dependent upon the continued services of Russell C. Horowitz, our chairman and chief executive officer, and John Keister, our president and chief operating officer, and the other members of our senior management team. Each of the members of our senior management team are at-will employees and may voluntarily terminate his employment with us at any time with minimal notice. Following any termination of employment, each of these employees would only be subject to a twelve-month non-competition and non-solicitation obligation with respect to our clients and customers under our standard confidentiality agreement.

Further, as of September 30, 2004, certain of our executive officers together controlled 93% of the voting power of our issued and outstanding capital stock. 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 executive officers, for any reason, or any conflict among our executive officers, could harm our current and future operations and prospects.

We may have difficulty attracting and retaining qualified, experienced, highly skilled personnel, which could adversely affect the implementation of our business plan.

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 adversely affect the implementation of our business plan.

If we are unable to obtain and maintain 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 may also be adversely affected if we experience difficulty in maintaining adequate directors’ and officers’ liability insurance.

We may not be able to obtain and maintain 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 that are not covered or adequately covered by insurance, our financial condition 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 our operations.

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 maintain the listing of our Class B common stock on the Nasdaq National Market.

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 boards 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 listing of our shares of Class B common stock on the Nasdaq National Market could be adversely affected.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud, which could harm our brand and operating results.

Effective internal controls are necessary for us to provide reliable and accurate financial reports and effectively prevent fraud. We have devoted significant resources and time to comply with the new internal control over financial reporting requirements of the Sarbanes-Oxley Act of 2002. In addition, Section 404 under the Sarbanes-Oxley Act of 2002 requires that we assess and our auditors attest to the design and operating effectiveness of our controls over financial reporting. Our compliance with the annual internal control report requirement for our first fiscal year ending after April 15, 2005, the requisite SEC compliance date, will depend on the effectiveness of our financial reporting and data systems and controls across our operating subsidiaries. We expect these systems and controls to become increasingly complex to the extent that we integrate acquisitions and our business grows. To effectively manage this growth, we will need to continue to improve our operational, financial and management controls and our reporting systems and procedures. We cannot be certain that these measures will ensure that we design, implement and maintain adequate controls over our financial processes and reporting in the future. Any failure to implement required new or improved controls, or difficulties encountered in their implementation or operation, could harm our operating results or cause us to fail to meet our financial reporting obligations. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our stock and our access to capital.

Changes in or interpretations of accounting rules and regulations, such as expensing of stock options and shares issued through the employee stock purchase plan, could result in unfavorable accounting charges or require us to change our compensation policies.

Accounting methods and policies regarding expensing stock options are subject to further review, interpretation and guidance from relevant accounting authorities, including the Financial Accounting Standards Board, or FASB. For example, we currently are not required to record stock-based compensation charges if an employee's stock option exercise price equals or exceeds the fair value of our common stock at the date of grant. The FASB has issued an exposure draft effective for fiscal years beginning after December 15, 2004 which, if adopted as drafted, would require the Company to expense the fair value of stock options granted. In addition, under the FASB's current proposed rules on employee stock purchase plans, we would incur an expense. If we were to change our accounting policy to record expense for the fair value of stock options granted, then our operating expenses would increase. We rely heavily on stock options to compensate existing employees and attract new employees. If we are required to expense stock options and shares issued under the employee stock purchase plan, we may then choose to reduce our reliance on these as compensation tools. If we reduce our use of stock options and the employee stock purchase plan, it may be more difficult for us to attract and retain qualified employees. If we do not reduce our reliance on stock options and the employee stock purchase plan, our reported losses would increase. Although we believe that our current practices are consistent with current accounting pronouncements, changes to interpretations of accounting methods or policies in the future may require us to adversely revise how our financial statements are prepared.

Impairment of goodwill and other intangible assets would result in a decrease in earnings.

Current accounting rules require that goodwill and other intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually. We have substantial goodwill resulting from our acquisitions and other intangible assets and we may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined.

Risks Relating to Our Business and 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.

We operate in a highly competitive and changing environment. We principally compete with other companies which offer services in five main areas:

- sales to merchant advertisers of pay-per-click services;
- sales to merchant advertisers of feed management services;
- aggregation or optimization of online advertising for distribution through search engines, product shopping engines, directories, Web sites or other outlets;
- delivery of online advertising to end users or customers of merchants through 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 24/7 Real Media, DoubleClick, FindWhat.com, Google, LookSmart, Microsoft, ValueClick and Yahoo!. Many of these actual or perceived competitors also currently or may in the future have business relationships with us, particularly in distribution. Going forward, however, these companies may terminate their relationships with us. 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.

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 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 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;
- better geographic coverage;
- larger customer bases;
- greater brand recognition; and
- significantly greater financial, marketing and other resources.

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 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 and reduce the demand for any of our services.

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

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 and reputation 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 and reputation.

We rely upon third party colocation providers to host our main servers. If 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 and reputation.

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 competitive position.

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, and patent and trademark law. To date, we have filed two provisional patent applications with the United States Patent and Trademark Office, and a non-provisional patent application based on one of the filed provisional applications in the United States and via the Patent Cooperation Treaty designating all member countries. In the future, additional patents may be filed 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 in which we may plan to 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.

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.

We may incur liabilities for the activities of users of our services and our merchant advertisers, which could adversely affect our business.

Many of our advertisement generation processes are automated and we do not conduct a manual editorial review of a substantial number of our merchant listings. We may not successfully avoid liability for unlawful activities carried out by users of our services and our merchant advertisers, or unpermitted uses of our merchant listings by distribution partners.

Our potential liability for unlawful activities of users of our services and our merchant advertisers or unpermitted uses of our merchant listings by distribution partners 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. For example, as a result of the actions of merchant advertisers in our network, we may be subject to the civil claims relating to a wide variety of issues such as privacy, gambling, promotions, and intellectual property ownership and infringement. Furthermore, under agreements with certain of our larger distribution partners, we are required to indemnify these partners against any liabilities or losses resulting from the content of our merchant listings. Although our merchant advertisers indemnify us with respect to claims arising from these listings, we may not be able to recover all or any of the liability or losses incurred by us as a result of the activities of our merchant advertisers.

Our insurance policies may not provide coverage for liability arising out of activities of users of our services. Furthermore, we may not be able to obtain or maintain adequate insurance coverage to reduce or limit the liabilities associated with our businesses. Any costs incurred as a result of such liability or asserted liability could have a material adverse effect on our business, operating results and financial condition.

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 securities.

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 in turn the market price of our securities.

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

Our 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 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 prospects.

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 prospects.

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 our net revenue and gross margin. In addition, under limited circumstances, we extend credit to merchant advertisers who may default on their accounts payable to us or fraudulently “charge-back” amounts on their credit cards for services that have already been delivered by us.

Government regulation of the Internet may adversely affect our business 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 have enacted and are considering various laws and regulations relating to the Internet. Individual states may also enact stricter consumer legislation that affects the conduct of our business.

Furthermore, the application of existing laws and regulations to Internet companies remains somewhat unclear. For example, as a result of the actions of merchant advertisers in our network, we may be subject to the application of existing laws and regulations relating to a wide variety of issues such as privacy, gambling, sweepstakes, promotions, financial market regulation, and intellectual property ownership and infringement. In addition, existing laws that regulate or require licenses or permits for certain businesses of merchant advertisers may be unclear in their application to our business, including those related to insurance and securities brokerage, law offices and pharmacies. Our business may be negatively affected by a variety of new or existing laws and regulations, which 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. The existing federal laws include, among others:

- 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 impose limitations and penalties on the transmission of unsolicited commercial electronic mail via the Internet.

Courts may apply each of 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. Among the types of legislation currently being considered at the federal and state levels are consumer laws regulating the practices for software applications or downloads and the use of “cookies”, which laws may introduce requirements for user consent and other restrictions. These proposed laws are intended to target applications often referred to as spyware, invasiveware or adware, although the scope may also include some software applications currently used in the online advertising industry to serve and distribute advertisements.

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 courts could find strict liability or impose “know your customer” standards of conduct in some circumstances. Although we may not be directly involved in any of these practices, under current and future regulation we may ultimately be held responsible for the actions of our merchant advertisers or distribution partners.

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 cost of complying with, current and possible future laws and regulations related to our business could harm our business 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 will 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 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 result in a decrease in the level of usage of our services.

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. On April 29, 2004, the U.S. Senate passed legislation banning new state taxes on Internet access for the next four years. The U.S. House of Representatives has not yet passed such legislation. Until such legislation is enacted by Congress, state and local governments may levy additional taxes on Internet access and electronic commerce transactions. An increase in 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.

Risks Relating to Our Class B Common Stock

Our stock price has been and is likely to continue to be highly volatile.

The trading price of our Class B common stock has been and is likely to continue to be highly volatile and subject to wide fluctuations. Our stock price may fluctuate in response to a number of events and factors, which may be the result of our business strategy or events 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, financings, commercial relationships, joint ventures or capital commitments;
- registration of additional shares of Class B common stock in connection with a strategic transaction;
- actual or anticipated fluctuations in our operating results;
- developments concerning our various strategic collaborations;
- lawsuits initiated against us or lawsuits initiated by us;
- announcements of acquisitions or technical innovations;
- changes in earnings estimates or recommendations by analysts;
- 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 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. Additionally, there can be no assurance that an active trading market of our Class B common stock will be sustained.

Certain of our executive officers 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.

As of September 30, 2004 Certain of our executive officers together beneficially owned 93% of the voting power of all issued and outstanding shares of our capital stock, with 92% of the total voting power based on their beneficial holdings of shares of Class A common 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 executive 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 certain of our executive 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, certain of our executive officers will be in a position to continue to control all fundamental matters affecting Marchex, including any merger involving, sale of substantially all of the assets of, or change in control of, Marchex.

The ability of certain of our executive officers to control Marchex may result in our Class B common stock trading at a price lower than the price at which it would trade if certain of our executive 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 holders of Class B common stock are not likely to receive dividends.

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

Item 3. Controls and Procedures.

An evaluation was performed under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-QSB. Based on that evaluation, our management, including our principal executive officer and principal financial officer, concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms.

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

Our management has concluded that our disclosure controls and procedures and internal controls provide reasonable assurance that the objectives of our control system are met. However, our management (including our principal executive officer and principal financial officer) does not expect that the disclosure controls and procedures or internal controls will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Due to the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, errors and instances of fraud, if any, within the Company have been or will be detected.

Part II—Other Information

Item 1. Legal Proceedings.

Not applicable with respect to the current reporting period.

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

On July 27, 2004, the sole stockholder of goClick was issued 433,541 shares of the Company's Class B common stock, which were not registered under the Securities Act of 1933, in consideration for all of the outstanding shares of goClick stock. The Company relied on Section 4(2) of the Securities Act to effect this transaction. The foregoing transaction did not involve any underwriters, underwriting discounts or commissions, or any public offering.

On March 30, 2004, our registration statement on Form SB-2 (No. 333-111096) was declared effective by the Securities and Exchange Commission, pursuant to which we registered 4,000,000 shares of our Class B common stock, and another 600,000 shares subject to the underwriters' over-allotment option. The shares of Class B common stock registered under the registration statement, including the 600,000 shares of Class B common stock covered by the over-allotment option, were sold at a price of $6.50 per share. The IPO generated gross offering proceeds of approximately $29.9 million. The closing of the IPO and the exercise in full of the underwriter's over-allotment option, took place on April 5, 2004. The managing underwriters were Sander Morris Harris, Inc. and National Securities Corporation. In connection with the IPO, we incurred $1.5 million in underwriting discounts and commissions, and approximately $1.2 million in other cash related expenses. The net proceeds from the IPO, after deducting the foregoing expenses, were approximately $27.2 million. A portion of the net proceeds were used in the acquisition of goClick, which required the Company to make a net cash payment of $7.5 million. Pending further application of the funds, as described in our registration statement on Form SB-2, we have invested the remainder of the net proceeds in short-term, investment grade, interest-bearing securities.

Item 3. Defaults Upon Senior Securities.

Not applicable with respect to the current reporting period.

Item 4. Submission of Matters to a Vote of Security Holders.

Not applicable with respect to the current reporting period.

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Item 5. Other Information.

Not applicable with respect to the current reporting period.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits:

2.1	Agreement and Plan of Merger, dated as of July 21, 2004, by and among Marchex, Inc., Project TPS, Inc., goClick.com, Inc., and the sole stockholder of goClick.com, Inc.*
10.14	Sublease Agreement, dated September 9, 2004, by and between Marchex, Inc. and G. Russell Knobel and Associates, Inc.
10.15	Commercial Lease, entered into as of September 14, 2004, by and between Marchex, Inc. and TrafficLeader, Inc. and A&A Properties Northwest.
31.1	Certification of CEO pursuant to Rule 13a-14(a) /15d-14(a).
31.2	Certification of CFO pursuant to Rule 13a-14(a) /15d-14(a).
32.1	Certification of CEO pursuant to Section 1350.
32.2	Certification of CFO pursuant to Section 1350.

* Incorporated by reference to the exhibits to the Company's Current Report on Form 8-K, dated July 27, 2004 and furnished to the SEC on August 10, 2004, File Number 000-50658.

(b) Reports on Form 8-K:

The following Current Reports on Form 8-K were furnished to the SEC during the quarter ended September 30, 2004:

Current Report dated July 29, 2004 and furnished to the SEC on July 29, 2004, reporting under Items 7 and 9, with respect to the announcement that Marchex had signed a definitive agreement to acquire goClick.

Current Report dated July 27, 2004 and furnished to the SEC on August 10, 2004, reporting under Items 2 and 7, with respect to the completion of the goClick acquisition.

Current Report dated August 5, 2004 and furnished to the SEC on August 5, 2004, reporting under Item 12, with respect to the announcement of Marchex's financial results for the quarter ended June 30, 2004.

SIGNATURE

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

MARCHEX, INC.

By:	/s/ Michael A. Arends
Name:	Michael A. Arends
Title:	Chief Financial Officer (principal accounting officer)

November 15, 2004

Exhibit 10.14

SUBLEASE AGREEMENT

This Sublease Agreement is entered into as of the 9th day of September, 2004 (this "Sublease"), by and between MARCHEX, INC. (hereinafter referred to as the "Sublessor") and G. RUSSELL KNOBEL AND ASSOCIATES, INC. (hereinafter referred to as the "Sublessee").

WITNESSETH

WHEREAS, Sublessor is the successor in interest to MARRCH Holdings LLC under that certain Sublease Agreement, dated as of October 23, 2001 (the "Original Sublease"), by and between Ecology and Environment, Inc. ("EEI") and MARRCH Holdings, LLC, pursuant to the Sublease Assignment and Assumption Agreement, dated as of January 18, 2003 (the "Sublease Assignment"), by and among MARRCH Holdings, LLC, the Sublessor and EEI for the 19th floor level (Suite 1900) of the Fourth & Blanchard Building, 2121 Fourth Avenue, Seattle, Washington 98121, whose mailing address is 2101 Fourth Avenue, Seattle, Washington, 98121 (the "Premises"), which Premises are subject to the Lease, dated as of November 6, 2000 (the "Master Lease"), by and between Selig Real Estate Holdings Five, as Lessor (the "Master Lessor") and EEI. A copy of the Master Lease is attached hereto as Exhibit A. A copy of the Original Sublease is attached hereto as Exhibit B. A copy of the Sublease Assignment and Assumption Agreement is attached hereto as Exhibit C.

WHEREAS, the Premises consists of 13,459 square feet of the leasable floor area; and

WHEREAS, the Sublessee desires to sublease from the Sublessor a portion of the Premises (that portion being referred to hereunder as the "Subleased Premises" and set forth on Exhibit D hereto); and

WHEREAS, the parties desire to enter into this Sublease Agreement to provide for the leasing by the Sublessor to the Sublessee of the Subleased Premises on the terms and conditions hereinafter provided.

NOW, THEREFORE, in consideration of the Subleased Premises and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties agree as follows:

1. Subleased Premises. The Sublessor hereby leases to the Sublessee and the Sublessee hereby leases from the Sublessor that the Subleased Premises, as depicted on the Exhibit D (consisting of one page) attached hereto and made a part hereof, containing approximately 4,073 square feet of leasable floor area, which shall be designated as Suite 1980.

2. Term. The Term of this Sublease shall commence on September 11, 2004 and terminate on June 30, 2006.

3. Rent. The Sublessee shall pay monthly rent equal to $4,073 in advance on the first day of each calendar month during the Term, except that all rent for the period of September 11, 2004 through September 30, 2004 shall be entirely abated to allow the Sublessee time to install phone, cabling, furniture and equipment. Sublessee shall also pay on a monthly basis any increases in Base Year Costs commencing with the month of January 2006. The first twelve (12) months of Term shall be the "Base Year" upon which operating expense increases, if any, would be calculated on a pro-rata basis and passed through to Sublessee. Upon the execution of this Sublease Agreement the Sublessee shall pay to Sublessor a total of $8,146 for the last month's rent (June 2006) and a security deposit equal to one (1) months rent.

4. Maintenance Responsibility. To the extent set forth in the Master Lease, if applicable, the Master Lessor shall be responsible for all maintenance of the interior and exterior of the Subleased Premises and the Building including regular maintenance of the HVAC equipment and shall pay for all utilities serving the Subleased Premises as well as standard janitorial services inside the Subleased Premises and in the Common Areas.

5. Tenant Improvements. The Sublessor shall pay to build a demising wall to separate the Subleased Premises from the Sublessor's other leased space within the Premises and will move the door to the server room from the west wall to the south wall. Sublessee shall reserve the right to move the front entry door to the Premises six (6) feet left (south) from its current location, and the right to add additional electrical power to the server room, at their expense. Sublessor shall have all of the office furniture and equipment currently in the Subleased Premises removed from the Subleased Premises by September 17, 2004. Other than as listed above, the Sublessee shall sublease the Subleased Premises in its current condition.

6. Parking. Under the terms of Paragraph 38 of the Master Lease, the Sublessor is entitled to rent ten (10) inside parking spaces at the market rate. The Sublessor hereby grants to the Sublessee its right to rent four (4) of those ten (10) inside parking spaces from the Master Lessor until the expiration of the Term and any extensions of the same. Sublessee shall have the responsibility to make arrangements for billing with the Master Lessor and must remit payment directly to Master Lessor for use of any of the four (4) spaces. Sublessor shall have no responsibility to invoice, administer or collect amounts relating to the parking spaces.

7. Commission. Sublessor shall pay a commission totaling $4,276.65 to Makensay Real Estate which is calculated based on five percent (5%) of the total base rental consideration. Payment shall be made upon commencement of this Sublease. No other commissions are known subject to this transaction.

8. Subletting/Assignment. The Sublessee shall not assign this Sublease or further sublet the Subleased Premises without first obtaining the consent of the Sublessor and the Master Lessor. The Sublessor agrees that it will not unreasonably withhold its

consent to any assignment of this Sublease. If as a result of any subletting of the Subleased Premises the Sublessee receives rent in excess of the Sublessee's minimum rent obligation to the Sublessor, the Sublessee agrees to pay to the Sublessor fifty percent (50%) of any such excess.

9. Incorporation of Master Lease. The following provisions of the Master Lease are hereby incorporated by reference: Paragraphs 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 19 (except that reference to Paragraph 3 shall be to Section 3 hereof), 20, 21, 22, 23, 24, 25, 26, 27, 28, 29, 30, 31, 32, 33, 34, 35, and 36 (the "Incorporated Provisions"). Whenever there is a reference in the Incorporated Provisions to the Lessor it shall be deemed to be a reference to the Sublessor under this Sublease, whenever there is a reference in the in the Incorporated Provisions to the Lessee it shall be deemed to be a reference to the Sublessee under this Sublease and whenever there is a reference to the Premises in the Incorporated Provisions it shall be deemed a reference to the Subleased Premises.

10. Counterparts. This Sublease Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

11. Governing Law. This Sublease Agreement shall be governed by the internal laws of the State of Washington without giving effect to the conflicts of laws principles thereof.

10. Notices. Any notices given under the terms of this Sublease Agreement shall be sent to the following address:

(a) If to Sublessor:
Marchex, Inc.
413 Pine Street, Suite 500
Seattle, Washington 98101
Attention: Ethan Caldwell, General Counsel

(b) If to Sublessee:
G. Russell Knobel & Associates, Inc.
2101 Fourth Avenue, Suite 1980
Seattle, Washington 98121
Attention: Office Manager

IN WITNESS WHEREOF, the parties hereof have executed this Sublease Agreement the day and year first above written.

Sublessor:

MARCHEX, INC.

/s/ RUSSELL C. HOROWITZ

By: Russell C. Horowitz

Its: CEO

Sublessee:

G. RUSSELL KNOBEL & ASSOCIATES, INC.

/s/ GREGORY RUND

By: Gregory Rund

Its: President

MASTER LESSOR CONSENT

Master Lessor hereby gives its consent to this Sublease as required by Paragraph 18 of the Lease, which is referred to herein as the Master Lease and is attached hereto as Exhibit A.

/s/ MARTIN SELIG

By: Martin Selig
Its: Managing Member

SUBLESSEE'S ACKNOWLEDGEMENT

County of King)
) ss.
State of Washington)

I certify that I know or have satisfactory evidence that Gregory Rund is the person who appeared before me, and said person acknowledged that he/she signed this instrument, on oath stated that he/she was authorized to execute the instrument and acknowledged it as the President of G. Russell Knobel & Associates, Inc. to be free and voluntary act of such party for the uses and purposes mentioned in this instrument.

Dated: 9-10-04

/s/ FRANK R. BUCHANAN

(signature of Notary Public)

Frank R. Buchanan

(printed name of Notary Public)

My Appointment expires: 6-24-05

County of King)
)ss.
State of Washington)

I certify that I know or have satisfactory evidence that Martin Selig is the person who appeared before me, and said person acknowledged that he/she signed this instrument, on oath stated that he/she was authorized to execute the instrument and acknowledged it as the Managing Member of Selig Real Estate Holdings Five, LLC to be free and voluntary act of such party for the uses and purposes mentioned in this instrument.

Dated: 9-15-04

/s/ JILL M. HAYES

(signature of Notary Public)

Jill M. Hayes

(printed name of Notary Public)

My Appointment expires: 6-1-06

COMMERCIAL LEASE

Parties:

This Commercial Lease Agreement (“Lease”) is entered into between Marchex, Inc., (“Lessee”) and Traffic Leader (“Lessee”), whether one or more, and A&A Properties Northwest (“Lessor”). Each Lessee is jointly and severally liable for the payment of rent and performance of all other terms of this Agreement. A judgment entered against one Lessee shall be no bar to an action against other Lessees.

Premises:

Lessor rents to Lessee, and Lessee rents from Lessor the following described premises, approximately 6700 square feet in its present state and condition, situated at 2896 Crescent Avenue, in the City of Eugene, County of Lane, State of Oregon, also described as Office Space (“the premises”), of which Lessor is the owner, together with the following furnishings and appliances: In its current build out condition.

subject to the terms and conditions in this Agreement.

Lessee’s Access To Premises:

Upon the execution of this Lease, Lessor grants to Lessee, Lessee’s employees, agents and invitees access to and from the premises by and through the building and adjoining property owned by Lessor and to use those parts of the building designated by this Lease for use by Lessee, including but not limited to toilet rooms, and unrestricted parking areas.

Term:

The term of this Lease is for 24-Months, commencing on the 1st day of November, 2004 and expiring on the 31st day of October, 2006, unless renewed or extended pursuant to the terms herein.

Use:

Lessee shall use and occupy the premise for the purpose of:

Office Space and Uses

Lessee covenants:

a. Not to use the premises for living quarters or residence.

b. To surrender the premises to Lessor at the end of the Term or any renewal period without the necessity of any notice from either Lessor or Lessee to terminate the same, and Lessee hereby expressly waives all right to any notice respecting said surrender of premises.

c. To keep the premises clean, sanitary and in good condition and, upon termination of the tenancy, return the premises to Lessor in a condition identical to that which existed when Lessee took occupancy, except for ordinary wear and tear and any additions or alterations authorized by Lessor.

d. To keep the premises in good repair at Lessee’s own expense with the exception of those repairs specifically designated as Lessor’s responsibility herein.

e. Not to make any occupancy of the Leased Premises contrary to law or contrary to any directions, rules, regulations, regulatory bodies, or officials having jurisdiction or which shall be injurious to any person or property.

f. Not to permit any waste or nuisance.

g. To keep the sidewalks, if any, in front of or adjoining the premises clean, in acceptable appearance and sanitary condition.

Notwithstanding the forgoing, Lessee shall not use the premises for the purposes of storing, manufacturing or selling any explosives, flammables or other inherently dangerous substance, chemical, thing or device.

Lessor’s Responsibility for Repairs:

All repairs, except those stipulated below, which are the responsibility of Lessor, shall be made by Lessee at Lessee’s own expense. If the Lessor pays the expenses of Lessee or any part thereof, such payment shall constitute Additional Rent, as hereinafter defined, and payable by Lessee under this Lease, due from Lessee to Lessor at the next rent day after any such payment.

Lessor shall be responsible for making only the following repairs: (check all that apply)

- ☒ The roof over the premises.
- ☒ Structural repairs to exterior walls, structural columns and structural floors which collectively enclose the premises. This shall not include storefronts.
- ☒ Heating, Ventilation and Air Conditioning systems, if, and to the extent installed by Lessor.
- ☒ Sprinkler system.
- ☐ Central vacuuming system, if applicable.
- ☐ Other:
- ☐ Other:

Hazardous Material:

Lessee hereby indemnifies and holds Lessor and Lessor's officers, directors, shareholders, managers, members, agents and employees harmless from and against, and shall reimburse Lessor and Lessor's officers, directors, shareholders, managers, members, agents and employees for, any and all "Losses" (as hereinafter defined) arising from, out of or as a consequence, directly or indirectly, of the release of any Hazardous Materials by Lessee on the premises which first occurs during the Term of this Lease, whether foreseeable or unforeseeable, and whether or not known to Lessee, it being understood and agreed that the foregoing indemnity includes, but is not limited to, all costs of removal, remediation of any kind, detoxification, clean up and disposal of such Hazardous Materials and the preparation of any closure or other required plans, all costs of determining whether the premises is in compliance and causing the premises to be in compliance with all applicable Environmental Laws, all costs and fees associated with claims for damages to persons, property, or natural resources, and Lessor's reasonable attorneys' fees and consultants' fees and court costs in respect thereto whether or not litigation or administrative proceedings shall occur, including all costs and expenses incurred or suffered by Lessor by reason of any violation of any applicable Environmental Law which occurs, or has occurred, upon the premises during the Term of this Lease, or by reason of the imposition of any governmental lien for the recovery of environmental clean-up costs expended by reason of such violation, it being expressly understood and agreed that to the extent Lessor and Lessor's officers, directors, shareholders, managers, members, agents and employees, or any of them are strictly liable under any applicable statute or regulation pertaining to the protection of the environment, this indemnity shall likewise be without regard to fault on the part of Lessee with respect to the violation of law which results in such liability. "Losses" shall mean any and all loss, claim, liability, damages, injuries to person, property or natural resources, cost, expense, action or cause of action.

Lessee hereby covenants and agrees that all obligations of Lessee under this Section shall survive any termination of the Lease, it being further understood and agreed that the rights of Lessor under this Section shall be in addition to any other rights and remedies under this Lease or at law or in equity.

Lessee shall comply with all Environmental Laws throughout the Term

Payment of Rent:

Lessee will pay to Lessor an annual rental of one hundred and twenty-one thousand and fifty Dollars ($121,050.00) payable in equal installments of Ten Thousand and Eighty Seven Dollars ($10,087.00) (the "rent") in advance on the first day of each month, except when that day falls on a weekend or a legal holiday, in which case rent is due on the next business day.

Lessee covenants to pay the rent when due and payable, without any setoff, deduction or prior demand whatsoever. Any payment by Lessee or acceptance by Lessor of a lesser amount than shall be due from Lessee to Lessor shall be treated as payment on account. The acceptance by Lessor of a check, or other instrument, for a lesser amount with an endorsement or statement thereon, or upon any letter accompanying such check or other instrument, that such lesser amount is payment in full, shall be given no effect, and Lessor may accept such check or other instrument without prejudice to any other rights or remedies which Lessor may have against Lessee.

Rent will be paid in the following manner unless Lessor designates otherwise:

Rent will be paid

☒ By mail, to:

2896 Crescent Avenue - Suite 201, Eugene, Oregon 97408.

Acceptable Forms of payment:

☒ Company check made payable to: A&A Properties NW, LLC.

☐ Personal check made payable to:

☐ Cashier's check made payable to:

☐ Credit card.

☐ Money order.

☐ Cash.

☐ Other (specify):

Prorated First Month's Rent:

For the period from Lessee's move-in date or beginning date of this agreement, whichever is earlier, through the end of the month, Lessee will pay to Lessor a prorated monthly rent of zero Dollars ($0.00). This amount will be paid on or before the date the Lessee moves in.

Returned Check and Stop Payment:

In each instance that a check or other acceptable instrument offered by Lessee to Lessor for any amount due under this Agreement or in payment of rent is returned for lack of sufficient funds, a "stop payment" or any other reason, a service charge of $100.00, which does not exceed the maximum amount allowed by applicable Oregon law, will be assessed.

Late Charges:

If Lessee fails to pay the rent in full before the end of the 5th day after it's due, Lessee will be assessed a late charge of $150.00, for the handling of such late payment, as allowed by applicable Oregon law. Lessor reserves and in no way waives the right to insist on payment of the rent in full on the date it is due. This late payment charge is in addition to any other rights or remedies of the Lessor.

Utilities:

Unless otherwise provided in this Lease, all applications and connections for necessary utility services on the demised premises shall be provided. In addition, unless otherwise provided in this Lease, the Lessor shall provide utility charges as they become due, including those for sewer, water, gas, electricity, except for the following, which will be paid by Lessee: Bathroom Supplies and Internet Services.

Lessee's Examination and Acceptance of Premises:

Lessee acknowledges that Lessee has examined the premises and Lessee's acceptance of this agreement is conclusive evidence that said leased premises are in good and satisfactory order and repair unless otherwise specified herein; and Lessee agrees that no representations as to the condition of the premises have been made and that no agreement has been made to redecorate, repair or improve the premises unless hereinafter set forth specifically in writing. Lessor will deliver the leased premises and all common areas in a habitable condition, pursuant to applicable state law. Lessee takes premises in its AS-IS condition. Lessee agrees not to damage the premises through any act or omission, and to be responsible for any damages sustained through the acts or omissions of Lessee, Lessee's employees or Lessee's invitees, licensees, and/or guests. If such damages are incurred, Lessee is required to pay for any resulting repairs at the same time and in addition to the next month's rent payment, with consequences for nonpayment identical to those for nonpayment of rent described herein.

Security Deposit:

Upon execution of this Lease, Lessee will deposit no additional sums and the approximately $5,495.46 deposited with original lease earlier with Lessor shall constitute the ("Security Deposit") as security for the performance of Lessee's obligations under this lease, including without limitation the surrender of possession of the premises to Lessor as herein provided. It is expressly understood that the Security Deposit shall not be considered an advance payment of rental or a measure of Lessor's damages in case of default by Lessee.

The Security Deposit shall be held, applied to damages or rent and returned to Lessee all in accordance with the laws of the state where the premises are located and in force at the time of execution of this lease.

Lessor may, from time to time, to the extent permitted by the laws of the state where the premises are located, without prejudice to any other remedy, use the Security Deposit to the extent necessary to make good any arrearages of rent or to satisfy any other covenant, obligation or default of Lessee hereunder, including Lessee's obligations to others due to be paid by Lessee under the provisions of this Lease. Following any such application of the Security Deposit, Lessee shall pay to Lessor on demand the amount so applied in order to restore the Security Deposit to its original amount.

If Lessor transfers Lessor's interest in the premises during the term of this Lease, Lessor may assign the Security Deposit to the transferee and thereafter shall have no further liability for the return of such Security Deposit.

Liens:

Lessee shall not do any act which shall in any way encumber the title of Lessor in and to the premises, nor shall Lessee create or permit to be created, and shall promptly discharge, any such lien (including, but not limited to, any mechanic's, contractor's, subcontractor's or material man's lien or any lien, encumbrance or charge arising out of any conditional sale, title retention agreement, chattel mortgage, security agreement, financing statement or otherwise) upon the premises or any part thereof or the income therefrom, and Lessee shall not suffer any other matter or thing whereby the estate, rights and interest of Lessor in the premises or any part thereof might be impaired.

If Lessee shall fail to cause any such lien to be discharged of record, then Lessor, after five (5) days notice of its intention to do so, shall have the right, but not the obligation, in addition to any other right or remedy, to discharge such lien either by paying the amount claimed to be due or by procuring the discharge of such lien by deposit or bonding proceedings, and in any such event Lessor shall be entitled if it so elects to compel the prosecution of an action for foreclosure of such lien by the lienor and to pay the amount of judgment in favor of the lien owner with interest, costs and allowances. Any amount

so paid by Lessor and all costs and expenses (including reasonable attorneys' fees) incurred by Lessor in connection therewith shall constitute Additional Rent payable by Lessee under this Lease, due from Lessee to Lessor at the next rent day after any such payment.

This Lease shall constitute notice that Lessor shall not be liable for any work performed or to be performed, or any materials furnished or to be furnished, at the premises for Lessee upon credit, and that no mechanic's or other lien for such work or materials shall attach to or affect the estate or interest of Lessor in and to the premises, unless specifically ordered by Lessor in writing.

Lessee shall have no power to do any act or make any contract that may create or be the foundation for any lien, mortgage or other encumbrance upon the estate of Lessor, or any other interest of Lessor in the premises, the Building or the other Improvements or any part thereof.

Return of Security Deposit:

As provided by applicable state law, within 30 days after Lessee has vacated the premises, returned keys and provided Lessor with a forwarding address, Lessor will return the deposit in full or give Lessee an itemized written statement of the reasons for, and the dollar amount of, any of the security deposit retained by Lessor, along with a check for any deposit balance.

Default and Termination for Default:

Each of the following shall be an "Event of Default":

1. Lessee shall fail to pay undisputed rent when due, the Lessor, after failure by Lessee to cure within thirty (30) days of receipt of written notice of such failure, at his option, may terminate all rights of the Lessee herein and demand surrender of the premises, after not less than thirty (30) days, written notice of such default, given in a manner required by law unless Lessee rectifies or cures the default within the said time.
2. If Lessee shall fail to pay any other undisputed payment of money, costs or expenses to be paid by Lessee under this Lease, when due, and the continuance of such failure for a period of thirty (30) days, after written notice from Lessor specifying such failure;
3. In the event of a default made by Lessee in any of the other covenants or conditions to be kept, observed and performed by Lessee, Lessee shall have thirty (30) days, after receipt of written notice thereof to cure such default. In the event that the Lessee shall fail to cure any default within the time allowed under this paragraph, Lessor may declare the term of this Lease ended and terminated by giving Lessee written notice of such intention, and if possession of the premises is not surrendered, Lessor may reenter said premises. Lessor shall have, in addition to the remedy above provided, any other right or remedy available to Lessor on account of any Lessee default, either in law or equity. Lessor shall use reasonable efforts to mitigate its damages.
4. The filing or execution or occurrence of any of the following will be considered a Default on the part of Lessee:
   - (a) A petition in bankruptcy by or against Lessee;
   - (b) A petition against or answer by Lessee seeking a reorganization, arrangement, composition, readjustment, liquidation, dissolution or other relief of the same or different kind under any provision of any bankruptcy laws;
   - (c) Adjudication of Lessee as a bankrupt or insolvent;
   - (d) An assignment by Lessee for the benefit of creditors;
   - (e) A petition against or proceeding by Lessee for, or the appointment of, a trustee, receiver, guardian, conservator or liquidator of Lessee with respect to the premises or with respect to all or substantially all of Lessee's property; or
   - (f) A petition against or proceeding by or against Lessee for its dissolution or liquidation or the taking of possession of Lessee's property by any governmental authority in connection with dissolution or liquidation.

Where in the case of a petition filed against Lessee under (a), (b), (e) or (f) above, such petition is not dismissed within ninety (90) days after the filing thereof;

- (a) Entry of an order, judgment or decree by any court of competent jurisdiction granting any prayer or demand contained in any petition under (a), (b), (e) or (f) above, which order, judgment or decree is not reversed or vacated within ninety (90) days after it is entered;
- (b) Vacation or abandonment of the premises; or
- (c) Taking by any person of Lessee's interest in this Lease upon execution, attachment or other process of law or equity.

In the event of Default on the part of Lessee, Lessor, at its option, without further notice or demand to Lessee, may, in addition to all other rights and remedies provided in this Lease, at law or in equity terminate this Lease and Lessee's right of possession of the Premises(Scott, the Lease already provides that the Lessor has rights and remedies at law or in equity as well as the right to terminate upon Default. The remaining stipulations in our view are both unnecessary and excessive.

To the fullest extent allowed by applicable state law, in the event Lessor exercises any remedy provided under this Section, all deposits theretofore made by Lessee with utility companies or under this Lease, all unearned insurance premiums and all rights of Lessee under all insurance policies required under this Lease, any pending insurance claims or condemnation awards, and all fuel and supplies on the Premises shall be deemed to be and are hereby assigned to and transferred to Lessor, to be applied in payment of Lessee's liability under this Lease.

Upon occurrence of any Event of Default, and after proper notice of default has been given, Lessor may, at its option, in addition to any other remedy or right given hereunder or by law, give notice to Lessee that this lease shall terminate upon the date specified in the notice, which date shall not be earlier than thirty (30) days after mailing or delivery of such notice.

No waiver of any default of Lessee hereunder shall be implied from any omission to take any action on account of such default if such default persists or is repeated, and no express waiver shall affect any default other than the default specified in the express waiver and that only for the time and to the extent therein stated. One or more waivers by Lessor or Lessee shall not be construed as a waiver of a subsequent breach of the same covenant, term or condition.

Any provisions for the termination of this lease shall not operate to exclude or suspend any other remedy of the Lessor for breach, or for the recovery of said rent for the full term.

Notices - Agents and Authority to Receive Legal Papers:

Any notice, which either party may or is required to give, be it for default of the terms and covenants of this Lease or any other reason, may be given by mailing the same, by certified mail, to Lessee at the premises. The Lessor, any person managing the premises and anyone designated by the Lessor as agent are authorized to accept service of process and receive other notices and demands, which may be delivered to:

☒ The Lessor, at the following address:

2896 Crescent Avenue, Eugene OR 97408 - Suite 201.

☐ The Manager, at the following address:

Acceleration:

Lessor's Default:

Lessee hereby agrees, in the event of any default by Lessor, Lessee shall, before exercising any rights that Lessee may have at law to cancel this lease, first send notice by registered or certified mail, or hand delivery, to Lessor, and shall have offered Lessor thirty (30) days in which to correct and cure the default or commence a good faith effort to cure such default.

Option To Renew:

Provided that Lessee is not in default in the performance of this lease, Lessee shall have the option to renew the lease for one additional term of Twelve months (12) months commencing at the expiration of the initial lease term. All of the terms, conditions and covenants of the lease shall apply during the renewal term except that the monthly rent shall be the sum of Ten Thousand Seven Hundred and Sixty Dollars ($10,760.00). The option shall be exercised by written notice given to Lessor not less than 90 days prior to the expiration of the initial lease term. If notice is not given in the manner provided herein within the time specified, this option shall expire.

Lessee's Failure to Take Possession:

If, after signing this Agreement, Lessee fails to take possession of the premises, Lessee will still be responsible for paying rent and complying with all other terms of this Agreement.

Lessor's Failure to Deliver Possession:

If Lessor is unable to deliver possession of the premises to Lessee for any reason not within Lessor's control, including but not limited to partial or complete destruction of the premises, Lessee will have the right to terminate this Agreement upon proper notice as required by law. In such event, Lessor's liability to Lessee will be limited to the return of all sums previously paid by Lessee to Lessor. Lessee agrees to hold Lessor and Lessor's agents harmless for loss or damage for any reason not within Lessor's control. In any case, Lessor's liability to Lessee will be limited to the return of all sums previously paid by Lessee to Lessor.

Termination of Lease - Hold Over:

Either Lessor or Lessee may terminate this lease at the expiration of said Lease or any extension thereof by giving the other thirty (30) days written notice prior to the due date.

Lessee expressly agrees to the following:

a. If Lessee, with the consent of Lessor, expressed or implied, shall hold over after the expiration of the term of this Lease, Lessee shall, in the absence of any written agreement to the contrary, continue such tenancy from month to month only, and not renewal hereof. Lessee shall be entitled to possession until Lessor has given Lessee thirty (30) days notice that such month-to-month tenancy shall be terminated. Only notice of default, as hereinafter provided, shall be required.

b. If Lessee, without the consent of Lessor, expressed or implied, shall hold over after the expiration of the term of this Lease, Lessee shall be considered a tenant at sufferance at double the rent herein provided, prorated by the day until possession is returned to Lessor.

c. Lessees holding over after or beyond the expiration of the notice period of a lawful Notice of Termination shall be Lessee holding over without the consent of the Lessor, and Lessee shall be considered a tenant at sufferance, at double the rent herein provided, prorated by the day until possession is returned to Lessor. This shall in no way limit any other remedies and rights of recovery that Lessor may have under applicable law.

Condemnation:

If any legally, constituted authority condemns the premises or such part thereof which shall make the premises unsuitable for leasing, this Lease shall cease when the public authority takes possession, and Lessor and Lessee shall account for rental as of that date. Such termination shall be without prejudice to the rights of either party to recover compensation from the condemning authority for any loss or damage caused by the condemnation. Neither party shall have any rights in or to any award made to the other by the condemning authority.

Eminent Domain:

If the premises or any part thereof or any estate therein, or any other part of the building materially affecting Lessee’s use of the premise, shall be taken by eminent domain, this lease shall terminate on the date when title vests pursuant to such taking. The rent shall be apportioned as of the termination date, and any rent paid for and period beyond that date shall be repaid to Lessee. Lessee shall not be entitled to any part of the award for such taking or any payment in lieu thereof, but Lessee may file a claim for any taking of fixtures and improvements owned by Lessee, and for moving expenses.

Assignment of Agreement and Subletting:

Lessee shall have the right without Lessor’s consent, to assign this Lease to a corporation with which Lessee may merge or consolidate, to any subsidiary of Lessee, to any corporation under common control with Lessee, or to a purchaser of substantially all of Lessee’s assets provided that (a) the net worth of such assignee after such merger, reorganization or consolidation shall be no less than that of Lessee immediately prior to such merger, reorganization or consolidation, (b) Lessee is not at such time in Default hereunder, and (c) such successor shall execute an instrument in writing fully assuming all of the obligations and liabilities imposed upon Lessee hereunder and deliver the same to Lessor; whereupon Lessee shall be discharged from any further liability hereunder.

Except as set forth above, Lessee will not sublet any part of the premises or assign this Agreement without the prior written consent of Lessor. Any such assignment or subletting without consent shall be void and, at the option of the Lessor, may terminate this lease.

No assignment or transfer of this Lease by Lessee consented to by Lessor shall be effective, unless the assignee or transferee shall, at the time of such assignment or transfer, assume all the terms, covenants and conditions of this Lease thereafter to be performed by Lessee and shall agree to be bound thereby. Notwithstanding such assignment or transfer or the acceptance by Lessor from such assignee of any rent or other monies or other performance of the obligations of Lessee hereunder, Lessee shall remain liable and obligated as a principal (and not as a surety or guarantor) to perform all the terms, conditions and covenants, including the payment of rent and other monies, herein provided to be performed by Lessee.

Violation of Laws:

Lessee, guests and invitees of either Lessee or guests will not use the premises in such a manner that violates any law, ordinance, statutes or requirement of any municipal, state or federal authority now in force, or which may hereafter be in force, pertaining to the premises, occasioned by or affecting the use thereof by Lessee.

Lessor shall comply with all laws, orders, ordinances, statutes or requirements now or hereafter affecting the premises.

Insurance:

While this Agreement is in effect, Lessor shall keep the premises insured against loss by fire and windstorm, in such amounts as Lessor shall reasonably deem appropriate. Lessee shall be responsible, at its expense, for fire and extended coverage insurance on all of its personal property, including removable trade fixtures, located in the premises.

If the premises is damaged by fire or other casualty resulting from any act or negligence of Lessee or any of Lessee's agents, employees or invitees, rent shall not be diminished or abated while such damages are under repair, and Lessee shall be responsible for the costs of repair not covered by insurance.

Lessee and Lessor shall, each at its own expense, maintain a policy or policies of comprehensive general liability insurance with respect to the respective activities of each in and on the premises with the premiums thereon fully paid on or before the due date, by companies reasonably satisfactory to Lessor and any mortgagee of Lessor and licensed to do business in the State of Oregon, such insurance to afford minimum protection of not less than One Million Dollars ($1,000,000.00) combined single limit coverage of bodily injury, property damage or combination thereof. Lessor and such other persons or entities as Lessor may designate, as their interests may appear, shall be listed as an additional insured on Lessee's policy or policies of comprehensive general liability insurance, and such policies shall provide that losses shall be paid to such insured as their interests may appear. Lessee shall provide Lessor with current Certificates of Insurance evidencing Lessee's compliance with this Paragraph along with receipts or other evidence that the premiums thereon have been paid for at least one (1) year. Lessee shall obtain the agreement of Lessee's insurers to notify Lessor of a material change of coverage or that a policy is due to expire at least thirty (30) days prior to the implementation of such change or expiration. Certificates evidencing renewals of each policy of insurance shall be delivered to Lessor at least twenty (20) days prior to the expiration dates of the respective policies. To the maximum extent permitted by insurance policies owned by Lessor or Lessee, Lessee and Lessor, for the benefit of each other, waive any and all rights of subrogation that might otherwise exist.

Lessee shall perform and satisfy all requirements of the companies writing any insurance policies referred to in this Lease so that at all times companies of good standing, satisfactory to Lessor, shall be willing to write such insurance.

In case Lessee shall at any time fail, neglect or refuse to procure or renew any insurance hereinabove provided, then Lessor shall have the right, but not the obligation, to procure or renew such insurance and any amounts paid therefore by Lessor shall be so much Additional Rent due at the next rent day after any such payment.

Lessor shall not be required to maintain insurance against thefts on or within the premises.

Tax Increase:

Lessor shall pay, prior to delinquency, all general real estate taxes and installments of special assessments coming due during the Lease term on the premises, and all personal property taxes with respect to Lessor's personal property, if any, on the premises. Lessee shall be responsible for paying all personal property taxes with respect to Lessee's personal property at the premises.

In the event there is any increase during any year of the term of this lease in the City, County or State real estate taxes over and above the amount of such taxes assessed for the tax year during which the term of this lease commences, whether because of increased rate or valuation:

- ☒ Lessor shall be solely responsible for and shall pay any such increase. Lessee shall have no responsibility or liability with regards to any such tax increase.
- ☐ Lessee shall pay to Lessor upon presentation of paid tax bills an amount equal to   % of the increase in taxes upon the land and building in which the premises are situated. In the event that such taxes are assessed for a tax year extending beyond the term of the lease, the obligation of Lessee shall be proportionate to the portion of the lease term included in such year.

Property Damage And Destruction:

A total or partial destruction of the building in which the premises may be situated shall terminate this lease.

If the premises or any part thereof or any appurtenance thereto is so damaged by fire, casualty or structural defects that the same cannot be used for Lessee's purposes, then Lessee shall have the right within ninety (90) days following damage to elect by notice to Lessor to terminate this Lease as of the date of such damage.

In the event of a partial destruction of the premises during the term hereof, which is beyond Lessee's reasonable control, from any other cause, except in the case where the premises is damaged by fire or other casualty resulting from any act or negligence of Lessee or any of Lessee's agents, employees or invitees, as previously discussed, Lessor shall forthwith repair the same. In such event Lessee shall have the right to terminate this Lease. Lessee shall be relieved from paying rent and other charges during any portion of the Lease term that the premises are inoperable or unfit for occupancy, or use, in whole or in part, for Lessee's purposes, except in the case where the premises is damaged by fire or other casualty resulting from any act or negligence of Lessee or any of Lessee's agents, employees or invitees, as previously discussed. Rentals and other charges paid in advance for any such periods shall be credited on the next ensuing payment(s), if any, but if no further payments are to be made, any such advance payments shall be refunded to Lessee. In making the repairs called for in this paragraph, Lessor shall not be liable for any delays resulting from strikes, governmental restrictions, inability to obtain necessary materials or labor or other matters which are beyond the reasonable control of Lessor.

Alterations and Repairs by Lessee:

Lessee shall not, without first obtaining the written consent of Lessor, make any alteration(s), addition(s), or improvement(s), in, to or about the premises.

During the Lease term, Lessee shall make, at Lessee's expense, following Lessor's written consent, all necessary repairs to the premises. Repairs shall include such items as routine repairs of floors, walls, ceilings, and other parts of the premises damaged or worn through normal occupancy, except for major mechanical systems or the roof, subject to the obligations of the parties otherwise set forth in this Lease.

Unless authorized by law, Lessee will not, without Lessor's prior written consent, alter, re-key or install any locks to the premises or install or alter any burglar alarm system. Except as provided by law or as authorized by the prior written consent of Lessor, such consent shall not be unreasonably withheld

Lessee, at Lessee's expense, shall have the right following Lessor's written consent, to remodel, redecorate, and make additions, improvements and replacements of and to all or any part of the premises from time to time as Lessee may deem desirable, provided the same are made in a workmanlike manner and utilizing good quality materials. Lessee shall have the right to place and install personal property, trade fixtures, equipment and other temporary installations in and upon the premises, and fasten the same to the premises. All personal property, equipment, machinery, trade fixtures and temporary installations, whether acquired by Lessee at the commencement of the Lease term or placed or installed on the premises by Lessee thereafter, shall remain Lessee's property free and clear of any claim by Lessor. Lessee shall have the right to remove the same at any time during the term of this Lease provided removal of such improvement(s) will not cause material injury to the premises. All improvements made by Lessee to the Premises which are so attached to the Premises that they cannot be removed without material injury to the Premises, shall become the property of Lessor upon installation. Not later than the last day of the Term, Lessee shall, at Lessee's expense, remove all of Lessee's personal property and those improvements made by Lessee which have not become the property of Lessor, including trade fixtures, cabinetwork, movable paneling, partitions, and the like; repair all injury done by or in connection with the installation or removal of such property and improvements; and surrender the Premises in as good condition as they were at the beginning of the Term, reasonable wear, and damage by fire, the elements, casualty, or other cause not due to the misuse or neglect by Lessee or Lessee's agents, employees, visitors, or licensees, excepted.

In any event, all property of Lessee remaining on the premises after the last day of the Term of this lease shall be conclusively deemed abandoned and may be removed by Lessor, and Lessee shall reimburse Lessor for the cost of such removal.

Lessor's Right to Access:

In the event of an emergency, to make repairs or improvements or to show the premises to prospective buyers or Lessees or to conduct an annual inspection or to address a safety or maintenance problem, for the purposes of inspecting the same, Lessor or Lessor's agents may enter the premises at reasonable hours, provided Lessor shall not thereby unreasonably interfere with Lessee's business on the premises. Except in cases of emergency, Lessee's abandonment of the premises, court order or where it is impractical to do so, Lessor shall give Lessee One Days notice before entering.

Lessee will permit Lessor at any time within ninety (90) days prior to the expiration of this lease, to place upon the premises any usual “To Let” or “For Lease” signs, and permit persons desiring to lease the same to inspect the premises thereafter.

Lessee's Maintenance:

By executing this Lease, Lessee acknowledges that the premises are in good order and repair, unless otherwise indicated herein. Lessee shall, at his own expense and at all times, maintain the premises in good and safe condition, including, unless otherwise specified herein, plate glass, electrical wiring, plumbing and heating installations and any other system or equipment upon the premises, and shall surrender the same at termination hereof, in as good condition as received, normal wear and tear excepted. Lessee shall be responsible for all repairs required, excepting the roof, exterior walls, structural foundations, and major mechanical systems, subject to the obligations of the parties otherwise set forth in this Lease.

Notice of Injuries on Premises

In the event of any significant injury or damage to Lessee, Lessee's employees, or Lessee's invitees, licensees, and/or guests, or any personal property, suffered in the leased premises or in any common area, written notice of same shall be provided by Lessee to Lessor at the address designated for delivery of notices as soon as possible but not later than five (5) days of said injury or damage. Failure to provide such notice shall constitute a breach of this Lease.

Parking:

☒ During the term of this Lease, Lessee shall have the non-exclusive use in common with Lessor, other Lessees, their guests and invitees, of the non-reserved common automobile parking areas, driveways, and footways, subject to rules and regulations for the use thereof as prescribed from time to time by Lessor. Lessor reserves the right to designate parking areas within the building or in reasonable proximity thereto, for Lessee and Lessee's agents and employees. Lessor grants the exclusive use of 17-designated parking spaces.

Lessee's Initials: __________

Signs:

Following Lessor's consent, Lessee shall have the right to place on the premises, at locations selected by Lessor, any signs which are permitted by applicable zoning ordinances and private restrictions.

Building Rules:

Lessee will comply with the rules of the building adopted and altered by Lessor from time to time and will cause all of its agents, employees, invitees and visitors to do so; all changes to such rules will be sent by Lessor to Lessee in writing. The initial rules for the building are incorporated herein for all purposes. Lessee hereby acknowledges receipt of building and/or complex rules from Lessor.

Subordination:

This Lease shall be subject and subordinate at all times to the lien of all mortgages and trust deeds in any amount or amounts whatsoever now or hereafter placed on or against the Building or the premises or on or against Lessor's interest or estate therein, all without the necessity of having further instruments executed on the part of Lessee to effectuate such subordination; provided that in the event of a foreclosure of any such mortgage or trust deed or any other action or proceeding for the enforcement thereof, or of any sale thereunder, this Lease will not be barred, terminated, cut off or foreclosed nor will the rights and possession of Lessee hereunder be disturbed if there shall exist no Event of Default with respect to the payment of rent or any other Event of Default hereunder. Lessee shall attorn to the purchaser at any such foreclosure, sale or other action or proceeding or, if requested, enter into a new lease for the balance of the Term then remaining upon the same terms and provisions as are in this Lease contained. Lessee agrees to execute and deliver upon demand such further instruments evidencing such subordination of this Lease to the lien of any such mortgages or trust deeds as may be required by Lessor.

Notwithstanding the foregoing, Lessee shall from time to time on request from Lessor execute and deliver any documents or instruments that may be required by any lender to effectuate such subordination.

Brokerage Fees, Commissions:

Lessee represents that Lessee was not shown the premises by any real estate broker or agent and that Lessee has not otherwise engaged in, any activity which could form the basis for a claim for real estate commission, brokerage fee, finder's fee or other similar charge, in connection with this Lease.

Memorandum of Lease:

The parties hereto contemplate that this Lease should not and shall not be filed for record, but in lieu thereof, at the request of either party, Lessor and Lessee shall execute a Memorandum of Lease to be recorded for the purpose of giving record notice of the appropriate provisions of this Lease.

Estoppels Certificate:

At any time and from time to time but on not less than ten (10) days prior written request by either party hereto, the other party shall execute, acknowledge and deliver to the requesting party, promptly upon request, a certificate certifying (a) that this Lease is unmodified and in full force

and effect (or, if there have been modifications, that this Lease is in full force and effect, as modified, and stating the date and nature of each modification), (b) the date, if any, to which rent and other sums payable hereunder have been paid, (c) that no notice has been received by such party of any Default which has not been cured, except as to Defaults specified in the certificate, and (d) such other matters as may be reasonably requested by the requesting party. Any such certificate may be relied upon by any prospective purchaser, mortgagee or beneficiary under any trust deed of the premises or any part thereof and by any collateral assignee of this Lease.

Indemnification of Lessor:

Lessor may, but shall not be obligated to, cure any Default by Lessee hereunder. All sums expended and all costs and expenses (including, but not limited to, reasonable attorneys' fees) incurred by Lessor pursuant to the provisions of this Lease or on account of any Default by Lessee under this Lease and all such sums shall become Additional Rent under this Lease, payable by Lessee to Lessor on the next rent date after such expenditure.

All rent and other amounts payable by Lessee under this Lease shall be and are hereby declared to be a valid and first lien upon Lessee's interest in the Premises and upon the rents, issues and profits in any manner arising or growing out of the same, and upon Lessee's interest in this Lease.

In the event of any breach or threatened breach by Lessee of any of the covenants, agreements, terms or conditions contained in this Lease, Lessor shall be entitled to enjoin such breach or threatened breach and shall have the right to invoke any right and remedy allowed at law or in equity or by statute or otherwise as though re-entry, summary proceedings and other remedies were not provided for in this Lease.

No receipt of monies by Lessor from Lessee after termination of this Lease or after the giving of any notice of termination of this Lease shall reinstate, continue or extend the Term or affect any notice theretofore given to Lessee, or operate as a waiver of Lessor's right to enforce the payment of rent and any other payments or charges herein reserved and agreed to be paid by Lessee then or thereafter falling due, or operate as a waiver of Lessor's right to recover possession of the premises, it being agreed that after the service of notice to terminate this Lease or the commencement of suit or summary proceedings, or after final order or judgment for the possession of the premises, Lessor may demand, receive and collect any monies due or thereafter falling due without, in any manner, affecting such notice, proceeding, order, suit or judgment, all such monies collected being deemed payments on account of the use and occupation of the premises or at Lessor's election on account of Lessee's liability hereunder.

Waiver:

Any waiver of a default hereunder shall not be deemed a waiver of this agreement or of any subsequent default. Acquiescence in a default shall not operate as a waiver of such default, even though such acquiescence continues for an extended period of time.

Lessor's granting of any consent under this Lease, or Lessor's failure to object to any action taken by Lessee without Lessor's consent required under this Lease, shall not be deemed a waiver by Lessor of its rights to require such consent for any further similar act by Lessee. No waiver by Lessor of any other breach of the covenants of this Lease shall be construed, taken or held to be a waiver of any other breach or to be a waiver, acquiescence in or consent to any further or succeeding breach of the same covenant. None of Lessee's covenants under this Lease, and no breach thereof, shall be waived, altered or modified except by a written instrument executed by Lessor.

Remedies – Cumulative:

No remedy conferred upon or reserved to Lessor under this Lease or under law shall be considered exclusive of any other remedy, but such remedies shall be cumulative and shall be in addition to every other remedy given hereunder or now or hereafter existing at law or in equity or by statute or otherwise, and every power and remedy given by this Lease to Lessor may be exercised from time to time and as often as occasion may arise or as may be deemed expedient, without precluding Lessor's simultaneous or later exercise of any or all other rights or remedies. No delay or omission of Lessor to exercise any right or power arising from any Default or Event of Default shall impair any such right to power or shall be construed to be a waiver of any such Default or Event of Default or acquiescence therein.

Paragraph Headings:

The headings of particular paragraphs and subparagraphs are inserted only for convenience and are not part of this Agreement and are not to act as a limitation on the scope of the particular paragraph to which the heading refers.

Court Costs and Attorneys Fees:

In any action or legal proceeding to enforce any part of this Agreement, the prevailing party shall recover reasonable attorneys' fees and court costs.

Binding on Successors:

This lease is binding upon and inures to the benefit of the heirs, successors in interest to the parties.

Entire Agreement:

This document and any Attachments constitutes the entire Agreement between the parties, and no promises or representations, other than those contained here and those implied by law, have been made by Lessor or Lessee. Any modifications to this Agreement must be in writing and signed by Lessor and Lessee.

Severability:

The provisions of this Lease are severable and in the event any provision, clause, sentence, section or part thereof is held to be invalid, illegal, unconstitutional, inapplicable or unenforceable to any person or circumstances, such invalidity, illegality, unconstitutionality, inapplicability or unenforceability shall not affect or impair any of the remaining provisions, sentences, clauses, sections, parts of the lease or their application to Tenant or other persons or circumstances. It is understood and agreed that the terms, conditions and covenants of this Lease would have been made by both parties if such invalid, illegal, unconstitutional, inapplicable or unenforceable provision, sentence, clause, section or part had not been included therein to the extent that portion of this agreement may be invalid by striking of certain words or phrases, such words or phrases shall be deemed to be stricken and the remainder of the provisions and the remainder of the other portions of this Lease agreement shall remain in full force and effect. It is further agreed that this Lease may be executed in counterparts, each of which when considered together shall constitute the original contract.

Lessee as Corporate Entity:

If Lessee is a corporation, each person executing this lease represents and warrants that he or she is duly authorized to execute and deliver this lease on behalf of the corporation. Those persons further represent that the terms of this lease are binding upon the corporation.

Additional Provisions:

Lessor grants Lessee the “Right of First Refusal” on any additional space made available for lease to the public. Lessee shall provide a “Letter of Intent To Lease” additional space within 15-days of notice from Lessor.

Lessor shall provide Internet enabled T-1 via Ethernet during the two year term of this lease as long as IP Services has internet at the facility. Tenant aggress to abide by the Acceptable Use Policy posted by IP Services on IP Services Web Portal.

Lessee acknowledges receipt of an executed copy of this Lease.

Lessor/Agent's signature: /s/ SCOTT ALDRIDGE

Title: Managing Partner, A&A Properties, NW, LLC
Date: 9-14-2004
Address: 2896 Crescent Avenue, Ste 201

Phone: 541-343-5974 X 2136

Lessee: Marchex, Inc.
By (signature): /s/ RUSSELL C. HOROWITZ

Title: CEO
Print name: Russell C. Horowitz

Lessee: Traffic Leader, Inc.
By (signature): /s/ MICHAEL ARENDS

Title: CFO
Print name: Michael Arends

Exhibit 31.1

CERTIFICATION PURSUANT TO
RULE 13a-14(a)/15d-14(a)

Principal Executive Officer

I, Russell C. Horowitz, certify that:

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

Date: November 15, 2004

/s/ Russell C. Horowitz

Russell C. Horowitz
Chief Executive Officer

Exhibit 31.2

CERTIFICATION PURSUANT TO
RULE 13a-14(a)/15d-14(a)

Principal Financial Officer

I, Michael A. Arends, certify that:

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

Date: November 15, 2004

/s/ Michael A. Arends

Michael A. Arends
Chief Financial Officer

Exhibit 32.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 1350

I, Russell C. Horowitz, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-QSB of Marchex, Inc. for the quarter ended June 30, 2004 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-QSB fairly presents in all material respects the financial condition and results of operations of Marchex, Inc.

Dated: November 15, 2004

By: /s/ Russell C. Horowitz

Name: Russell C. Horowitz
Title: Chief Executive Officer

Exhibit 32.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 1350

I, Michael A. Arends, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-QSB of Marchex, Inc. for the quarter ended June 30, 2004 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-QSB fairly presents in all material respects the financial condition and results of operations of Marchex, Inc.

Dated: November 15, 2004

By: /s/ Michael A. Arends

Name: Michael A. Arends
Title: Chief Financial Officer