

MARCHEX INC
Form SB-2/A
January 11, 2005
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As filed with the Securities and Exchange Commission on January 11, 2005

Registration Number 333-121213

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

AMENDMENT NO. 1 TO
FORM SB-2
REGISTRATION STATEMENT

Under

THE SECURITIES ACT OF 1933

Marchex, Inc.

(Name of small business issuer in its charter)

Delaware (State or other jurisdiction of incorporation or organization) Marchex, Inc.	7389 (Primary standard industrial classification code number)	35-2194038 (I.R.S. employer identification number) Russell C. Horowitz
413 Pine Street, Suite 500 Seattle, Washington 98101 (206) 331-3300		Chairman and Chief Executive Officer Marchex, Inc. 413 Pine Street, Suite 500 Seattle, Washington 98101 (206) 331-3300
(Address and telephone number of principal executive offices and principal place of business)		(Name, address and telephone number of agent for service)

Copies to:

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Nixon Peabody LLP

Wilson Sonsini Goodrich & Rosati

100 Summer Street

701 Fifth Avenue, Suite 5100

Boston, MA 02110

Seattle, WA 98104

(617) 345-1000

(206) 883-2500

Approximate date of commencement of proposed sale to the public:

As soon as practicable after the effective date hereof.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box: "

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

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

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

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box: "

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Proposed Maximum	Amount of
	Aggregate	Registration
Offering Price ⁽¹⁾		Fee ⁽⁵⁾
Class B Common Stock, \$0.01 par value per share ⁽²⁾⁽³⁾		
% Convertible Exchangeable Preferred Stock, \$0.01 par value per share ⁽²⁾⁽⁴⁾		
% Convertible Subordinated Debentures ⁽²⁾		
Total	\$210,000,000	\$24,717

⁽¹⁾Estimated solely for the purpose of computing the amount of the registration fee pursuant to Rule 457(o) under the Securities Act of 1933, as amended.

⁽²⁾Includes an indeterminate number of shares of Class B common stock (including an indeterminate number of shares of Class B common stock issuable to satisfy the dividend make-whole payment and interest make-whole payment pursuant to the terms of the % Convertible Exchangeable Preferred Stock or the % Convertible Subordinated Debentures) and % Convertible Exchangeable Preferred Stock, each as may be issued at indeterminate prices, but with an aggregate offering price not to exceed \$, plus such indeterminate number of shares of Class B common stock issuable upon conversion of % Convertible Exchangeable Preferred Stock or the % Convertible Subordinated Debentures and such indeterminate number of % Convertible Subordinated Debentures that may be exchanged for % Convertible Exchangeable Preferred Stock for which no separate consideration will be received.

⁽³⁾Includes shares of Class B common stock which the underwriters have an option to purchase.

⁽⁴⁾Includes shares of % Convertible Exchangeable Preferred Stock which the underwriters have an option to purchase.

⁽⁵⁾Includes \$21,186 which was previously paid in connection with the initial filing of this Registration Statement.

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

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EXPLANATORY NOTE

This Registration Statement relates to the concurrent offering by Marchex, Inc. of its Class B common stock and its % convertible exchangeable preferred stock. The completion of the Class B common stock offering is not contingent upon the completion of the preferred stock offering. The completion of the preferred stock offering is contingent upon the completion of the Class B common stock offering. This Registration Statement contains alternate sections, paragraphs, sentences and phrases, which will be contained in two forms of prospectuses covered by this Registration Statement, as follows: (1) one prospectus to be used in connection with an offering by Marchex, Inc. of its shares of Class B common stock (the common prospectus); and (2) one prospectus to be used in connection with an offering by Marchex, Inc. of its % convertible exchangeable preferred stock (the preferred prospectus). Those sections, paragraphs, sentences or phrases that will appear in the preferred prospectus but not in the common prospectus are marked at the beginning of such section, paragraph, sentence or phrase by the symbol [P], and those appearing only in the common prospectus are designated by the symbol [C]. Unless indicated with a [P] or [C], the language herein will appear in both forms of prospectus. Prior to this Registration Statement being declared effective by the SEC, we will file each prospectus used in its entirety.

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The information in this prospectus is not complete and may be changed. We may not sell these securities until the Securities and Exchange Commission declares our registration statement effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

[C]

Subject to completion, dated January 11, 2005

7,000,000 Shares

MARCHEX, INC.

Class B Common Stock

\$ per share

-
- Marchex, Inc. is offering 7,000,000 shares of Class B common stock.
 - The closing of this offering is subject to the concurrent closing of the Name Development asset acquisition described in this prospectus but is not contingent upon the closing of the concurrent convertible exchangeable preferred stock offering.
 - Simultaneously with this offering of Class B common stock, Marchex is offering 200,000 shares of % convertible exchangeable preferred stock, excluding up to 30,000 shares available to cover over-allotments, by means of a separate prospectus.
 - The last reported sale price of our Class B common stock on January 7, 2005 was \$20.49 per share.
 - Class B common stock trading symbol: Nasdaq National Market MCHX

This investment involves risks. See Risk Factors beginning on page 15.

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Public offering price	\$	\$
Underwriting discount	\$	\$
Proceeds, before expenses, to Marchex, Inc	\$	\$

The underwriters have a 30-day option to purchase up to 1,050,000 additional shares of Class B common stock from us to cover over-allotments, if any.

Our officers, directors and employees may purchase up to 1.0% of the shares of Class B common stock offered hereby, excluding the over-allotment, at the public offering price. At our request, the underwriters have reserved shares of Class B common stock at the public offering price for this purpose. Any reserved shares which are not purchased will be offered by the underwriters to the general public on the same basis as the other shares offered by this prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved of anyone's investment in these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

Piper Jaffray

RBC Capital Markets

Thomas Weisel Partners LLC

Sanders Morris Harris

The date of this prospectus is , 2005.

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[P]

Subject to completion, dated January 11, 2005

200,000 Shares

MARCHEX, INC.

% Convertible Exchangeable Preferred Stock

(Cumulative Dividend, Liquidation Preference of \$250 per share)

- Marchex, Inc. is offering 200,000 shares of % convertible exchangeable preferred stock, par value \$0.01 per share.
- Dividends will be cumulative from the date of original issue at the annual rate of % of the liquidation preference of the preferred stock, payable quarterly on the day of , , and , commencing , 2005. Any dividends must be declared by our board of directors and must come from funds which are legally available for dividend payments.
- The preferred stock is convertible at the option of the holder at any time, unless previously redeemed or exchanged, into our Class B common stock, par value \$0.01 per share, at an initial conversion price of \$ (equivalent to a conversion rate of approximately shares of Class B common stock for each share of preferred stock). The initial conversion price is subject to adjustment in certain events.
- At any time, we may elect to automatically convert some or all of the preferred stock into shares of our Class B common stock if the closing price of our Class B common stock has exceeded \$, subject to adjustment, which is 150% of the conversion price for at least 20 of the 30 consecutive trading days ending within 5 trading days prior to the notice of automatic conversion.
- Prior to , 2008, the preferred stock is not redeemable at our option. Thereafter, the preferred stock is redeemable at our option, in whole or in part, at the declining redemption prices set forth herein, together with accrued dividends to, but excluding the redemption date.
- The preferred stock is exchangeable, in whole but not in part, at our option on any dividend payment date beginning , 2006, for our % convertible subordinated debentures at the rate of \$250 principal amount of debentures for each share of preferred stock. The debentures, if issued upon exchange of the preferred stock, will mature on the twenty-five year anniversary of the exchange date. The debentures, if issued, will have terms substantially similar to those of the preferred stock.
- The preferred stock has no maturity date and voting rights prior to conversion into Class B common stock, except under limited circumstances.
- Shares of our Class B common stock are listed on the Nasdaq National Market under the symbol MCHX. The last reported sale price of our Class B common stock on January 7, 2005 was \$20.49 per share. We have applied to list the preferred stock on the Nasdaq National Market under the symbol MCHXP.

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- If we elect to automatically convert some or all of the preferred stock prior to _____, 2008, we will make an additional payment on the preferred stock equal to the aggregate amount of dividends that would have accrued and become payable on the preferred stock from _____, 2005 through and including _____, 2008, less any dividends already paid on the preferred stock.
- Simultaneously with this offering of preferred stock, Marchex is offering 7,000,000 shares of Class B common stock, excluding up to 1,050,000 shares available to cover over-allotments, by means of a separate prospectus.
- The closing of this offering is subject to the concurrent closing of the Name Development asset acquisition described in this prospectus and the closing of the concurrent Class B common stock offering.

This investment involves risks. See Risk Factors beginning on page 15.

	Per Share	Total
Public offering price	\$	\$
Underwriting discount	\$	\$
Proceeds, before expenses, to Marchex, Inc.	\$	\$

The offering prices set forth above do not include accrued dividends, if any. Dividends on the preferred stock will accrue from the date of original issuance of the preferred stock, expected to be _____, 2005.

The underwriters have a 30-day option to purchase up to 30,000 additional shares of preferred stock from us to cover over-allotments, if any.

Neither the Securities and Exchange Commission nor any state securities commission has approved of anyone's investment in these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

Piper Jaffray

RBC Capital Markets

Thomas Weisel Partners LLC

The date of this prospectus is _____, 2005.

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You should rely only on the information contained in this prospectus. We have not, and the underwriters have not, authorized any other person to provide you with different information. This prospectus is not an offer to sell, nor is it seeking an offer to buy, these securities in any state where the offer or sale is not permitted. The information in this prospectus is complete and accurate as of the date on the front cover, but the information may have changed since that date.

Unless otherwise specified or the context otherwise requires, references in this prospectus to we, our and us refer to Marchex, Inc. and its wholly-owned subsidiaries, including Enhance Interactive, Inc. (formerly ah-ha.com, Inc.), TrafficLeader, Inc. (formerly Sitewise Marketing, Inc.) and goClick.com, Inc., on a consolidated basis.

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Unless otherwise specified or the context otherwise requires, references in this prospectus to *we*, *our* and *us* refer to Marchex, Inc. and its wholly-owned subsidiaries, including Enhance Interactive, Inc. (formerly ah-ha.com, Inc.), TrafficLeader, Inc. (formerly Sitewise Marketing, Inc.) and goClick.com, Inc., on a consolidated basis.

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PROSPECTUS SUMMARY

The items in the following summary are described in more detail later in this prospectus. This summary provides an overview of selected information about us, the offerings and the proposed Name Development asset acquisition contained elsewhere in this prospectus and does not contain all the information you should consider. Therefore, you should also read the more detailed information set out in this prospectus, the financial statements and the other information incorporated by reference into this prospectus.

Overview

We provide technology-based merchant services that facilitate and drive growth in 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 efficiently market and sell their products and services across multiple online distribution channels, including search engines, product shopping engines, directories and other selected Web properties.

Upon the completion of the Name Development asset acquisition, we believe we will be among the leaders in the direct navigation market. We will own a proprietary base of online user traffic that represented more than 17 million unique visitors in November 2004, searching for information, products and services. This user traffic is generated from a portfolio of Web properties, or Internet domains, which are generally reflective of commercially-relevant search terms in many of the Internet's most popular and dynamic vertical commerce categories, and may include geographically-targeted elements. The total number of Web properties in the portfolio, including Marchex's existing Web properties, is more than 200,000. Key vertical commerce categories include: travel, financial services, insurance, real estate, auto, health, technology and electronics, personals, jobs, professional services, home and garden, Web and telecom services, education, and entertainment. The online user traffic is primarily monetized with pay-per-click listings that are relevant to the Web properties. As such, the Web properties connect online users searching for specific information with relevant advertisements.

With the Name Development asset acquisition, we believe we will be one of the few companies that owns both proprietary search engine marketing services and a critical mass of proprietary online user traffic.

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Merchants transacting online is a large and growing trend. Our services facilitate and support the efficient and cost-effective marketing and selling of goods and services online through the most rapidly-developing forms of search-based marketing methods. We accomplish this by providing multiple services:

- ***Pay-Per-Click Services.*** We deliver pay-per-click advertising listings that are reflective of our merchant advertisers' products and services to online users in response to their keyword search queries. These pay-per-click listings are generally ordered in the search results based on the amount our merchant advertisers choose to pay for a targeted placement. These targeted listings are displayed to consumers and businesses through our distribution network of leading search engines, product shopping engines, directories and other Web properties.
- ***Feed Management Services.*** We leverage our proprietary technology to crawl and extract relevant product content from merchant advertisers' databases and Web sites to create highly-targeted product and service listings, which we deliver into our distribution network. These feed management listings are ordered in the results based on relevance to user search queries. Our trusted feed relationships with our distribution partners enable merchant advertisers to deliver comprehensive and up-to-date product and service listings to some of the Web's largest search engines, product shopping engines and directories.
- ***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 search engines and pay-per-click networks using our bid management services; and (2) evaluate the effectiveness of online advertising campaigns using our conversion tracking and detailed reporting services.
- ***Search Engine Optimization Services.*** We optimize key attributes of merchant advertiser Web sites to ensure the greatest opportunity for proper indexing, listing and inclusion in the editorial results of algorithmic search engines.
- ***Outsourced Search Marketing Services Platform.*** We provide large aggregators of advertisers, such as yellow page companies, with an outsourced, integrated platform to enable them to market performance-based advertising and search marketing services directly to their customers.

We distribute performance-based advertisements through our broad network of distribution partners comprising many of the leading search engines, product shopping engines, directories and other Web properties. Our sources of distribution include industry leaders such as Yahoo!, Google, Shopping.com and many others.

Pending Name Development Asset Acquisition

Description of the Asset Acquisition

On November 19, 2004, we entered into an agreement to acquire certain assets of Name Development, a corporation operating in the direct navigation market. Direct navigation is one of the methods that consumers use to search for information, products or services online. Direct navigation is primarily characterized by online users directly accessing a Web site by: (1) typing descriptive keywords or keyword strings into the uniform resource locator, or URL, address box of an Internet browser; or (2) accessing bookmarked Web sites. It can also include navigating through referring or partner traffic sources. Name Development owns and maintains a portfolio of Internet domains, or Web properties, that are generally reflective of online user search terms, descriptive keywords and keyword strings. Name Development has entered into agreements with advertising service providers to monetize its online user traffic with pay-per-click listings. As such, Name Development is able to connect online users searching for specific information with relevant advertisements.

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Upon completion of the asset acquisition, we believe we will be among the leaders in the direct navigation market due to our proprietary ownership of online user traffic, which totaled more than 17 million unique visitors in November 2004. This user traffic is generated from a portfolio of Web properties, which are generally reflective of commercially-relevant search terms in many of the Internet's most popular vertical commerce categories, and may include geographically-targeted elements. The total number of Web properties in the portfolio, including Marchex's existing Web properties, is more than 200,000. Key vertical commerce categories include: travel, financial services, insurance, real estate, auto, health, technology and electronics, personals, jobs, professional services, home and garden, Web and telecom services, education and entertainment.

Name Development's revenue increased 260% from \$3.5 million for the fiscal year ended June 30, 2003 to \$12.5 million for the fiscal year ended June 30, 2004. For the corresponding periods, income from operations grew from \$3.2 million to \$12.6 million. For the nine months ended September 30, 2004, revenues were \$15.5 million and income from operations was \$14.9 million.

We expect to account for the Name Development asset acquisition as a business combination. The closing of the transaction is conditioned on a number of factors, including the successful completion of these offerings to finance the purchase by us. For more information on the asset acquisition, see Name Development Asset Acquisition.

Anticipated Benefits of the Asset Acquisition

We believe that the Name Development asset acquisition will provide us with several benefits, including:

- ***A Defensible, Proprietary Source of Targeted Traffic.*** We believe that we will have an exclusive position due to the nature of Internet domain registration, which is similar to owning real-estate in that each Internet domain name is unique. The asset acquisition will provide us with Web properties that collectively generated more than 17 million unique visitors in November 2004. The total number of Web properties in the portfolio, including Marchex's existing Web properties, is more than 200,000.
- ***Synergies with our Existing Search Engine Marketing Services Platform.*** We believe that our technology platform, combined with the acquired assets, gives us an advantage in extending market share within the direct navigation market and expanding our participation in the search advertising market and in key commerce verticals.
- ***Platform to Extend Expansion Initiatives.*** We intend to use the asset acquisition to supplement our planned expansion, both domestically and internationally.

Transaction Structure

The aggregate consideration to be paid under the asset purchase agreement is an amount of cash equal to \$155.2 million and the number of shares of our Class B common stock obtained by dividing \$9.0 million by the average of the last quoted sale price for shares of our Class B common stock on the Nasdaq National Market for the ten trading days immediately prior to the closing.

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The asset purchase agreement contains customary representations and warranties and requires Name Development's sole stockholder to indemnify us for various liabilities arising under the agreement, subject to

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various limitations and conditions. At the closing of the asset acquisition, we will deposit into escrow, for a period of eighteen months from the closing date, an amount of cash equal to \$24.6 million to secure the sole stockholder's indemnification and other obligations under the asset purchase agreement.

The asset acquisition is contingent on customary closing conditions, including the closing by us of financing sufficient to consummate such acquisition. If the closing does not occur on or before June 30, 2005, we may be required to pay Name Development a termination fee of \$1.5 million through a combination of cash and equity. We have also agreed to file a registration statement to register the shares of Class B common stock issued as equity consideration in the transaction or any shares of Class B common stock issued in connection with payment of the termination fee for resale on Form S-3 once we become eligible to file such a registration statement with the SEC.

Industry Overview

Performance-Based Advertising

As technology and the Internet continue to evolve, consumers are becoming increasingly confident that they can find comprehensive product information and securely transact online. As consumers spend more time and money online, advertisers are turning to the Internet to market their products and services. Businesses of all sizes can benefit from the Internet's potential to efficiently and cost-effectively reach consumers. Internet advertising enables merchant advertisers to measure the effectiveness of their advertising campaigns and to revise them in response to real-time feedback and market factors. Within the Internet advertising market, paid search has become one of the fastest growing sectors. Merchant advertisers are increasingly turning to performance-based online advertising due to its competitive return-on-investment and consumers increasing receptiveness to this medium.

Direct Navigation

Currently, there are three primary means through which online users access and search for information, products and services: search engines and directories, commerce portals and direct navigation Web properties. Direct navigation is primarily characterized by online users directly accessing a Web site by: (1) typing descriptive keywords or keyword strings into the uniform resource locator, or URL, address box of an Internet browser; or (2) accessing bookmarked Web sites. It can also include navigating through referring or partner traffic sources.

First Albany Capital estimates that the paid search market will reach \$4.5 billion in revenue in 2004, and we believe the direct navigation market currently represents more than 10% of the global search market and is growing at comparable annual rates. According to WebSideStory, Inc.'s StatMarket division, in September 2004 more than 67% of daily global Internet users arrived at Web sites by direct navigation defined as typing a URL into a browser address bar or using a bookmark rather than through search engines and Web links, compared to approximately 53% in February 2002. The growth of the direct navigation market is a result of consumers' increasing sophistication in utilizing the Internet as a resource tool, coupled with their desire to quickly find targeted information, and their trust and experience that the depth and breadth of available and relevant online information extends to Web sites named by descriptive keywords. Direct navigation and the use of search engines, however, are not mutually exclusive. We believe that many of the commercially relevant Web properties which we will own as part of the Name Development asset acquisition may be beneficiaries of search engine traffic.

Strategy

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We intend to leverage our senior management's experience, our financial and human resources, and our existing operations to provide technology-based merchant services that facilitate and drive growth in online transactions. Key elements of our strategy include the following initiatives:

- Provide quality services in support of merchants and partners;
- Increase the number of merchants served;

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- Develop new markets;
- Extend presence in the direct navigation market; and
- Pursue selective acquisition and consolidation opportunities.

Acquisitions

Acquisition initiatives have played an important part in our corporate history, since our incorporation on January 17, 2003, and are a component of our strategy. Including the proposed Name Development asset acquisition, we will have made four acquisitions since our inception.

- On February 28, 2003, we acquired eFamily together with its direct wholly-owned subsidiary Enhance Interactive.
- On October 24, 2003, we acquired TrafficLeader.
- On July 27, 2004, we acquired goClick.
- In conjunction with this offering, we will acquire certain assets of Name Development.

Our Relationship with Our Founding Executive Officers

As of December 31, 2004, Russell C. Horowitz, Ethan A. Caldwell, Peter Christothoulou and John Keister, our founding executive officers, beneficially owned 54% of our outstanding capital stock, which represented 93% of the combined voting power of our outstanding capital stock. Upon completion of the Class B common stock and preferred stock offerings, these founding executive officers will beneficially own 42% of all of our outstanding capital stock, excluding any shares that may be purchased by them in the Class B common stock and preferred stock offerings and the shares of Class B common stock issuable upon conversion of the preferred stock being offered in the preferred stock offering, which will represent 91% of the combined voting power of our outstanding capital stock.

Concurrent Offerings

[C] Simultaneously with this offering of Class B common stock, Marchex is offering 200,000 shares of preferred stock, excluding up to 30,000 shares available to cover over-allotments by means of a separate prospectus. The closing of this offering is subject to the concurrent closing of the Name Development asset acquisition described in this prospectus but is not contingent upon the closing of the concurrent preferred stock offering. In the event we elect not to consummate the preferred stock offering, we will increase the size of the Class B common stock offering accordingly.

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[P] Simultaneously with this offering of preferred stock, Marchex is offering 7,000,000 shares of Class B common stock, excluding up to 1,050,000 shares available to cover over-allotments by means of a separate prospectus. The closing of this offering is subject to the concurrent closing of the Name Development asset acquisition described in this prospectus and the closing of the concurrent Class B common stock offering.

Office Location

Our principal executive offices are located at 413 Pine Street, Suite 500, Seattle, Washington 98101, and our telephone number is (206) 331-3300. We maintain a number of Web sites, including our corporate Web site at www.marchex.com. The information on our Web sites is not incorporated by reference into and does not form a part of this prospectus.

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[C] The Offering

Class B common stock offered by Marchex, Inc.	7,000,000 shares
Common stock outstanding after the offering:	
Class A common stock (twenty-five votes per share)	11,987,500 shares
Class B common stock (one vote per share)	20,421,539 shares
Total	32,409,039 shares
Offering Price	\$ per share
Concurrent Offering	In a separate, concurrent offering, we are offering 200,000 shares of % convertible exchangeable preferred stock which are initially convertible into shares of Class B common stock, excluding a maximum of 30,000 shares which may be issued upon exercise in full of the underwriter's over-allotment option. The preferred stock offering is being made exclusively by a separate prospectus.
Use of Proceeds	We intend to use the net proceeds from this offering, together with the net proceeds from the preferred stock offering, to pay for the pending Name Development asset acquisition and for working capital and other general corporate purposes, including potential future acquisitions. See Use of Proceeds.
Nasdaq National Market Symbol for the Class B common stock	MCHX
Risk Factors	You should carefully read and consider the information set forth under the caption Risk Factors and all other information set forth in this prospectus before investing in Marchex's Class B common stock.

The number of shares of common stock to be outstanding after this offering is 32,409,039, based on 25,409,039 shares outstanding as of September 30, 2004. This number of shares:

- excludes 4,938,603 shares of Class B common stock reserved for issuance and not exercised under our 2003 amended and restated stock incentive plan as of September 30, 2004 and 278,915 shares of Class B common stock reserved for issuance and not purchased under our 2004 employee stock purchase plan as of September 30, 2004. As of September 30, 2004, 3,571,167 shares were subject to outstanding options, with a weighted average exercise price of \$4.02 per share;
- excludes 262,500 shares of Class A common stock that are held in treasury;

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- excludes the exercise of warrants to purchase 120,000 shares of Class B common stock with an exercise price of \$8.45 per share which were issued as compensation to the underwriters in connection with our initial public offering in April 2004;
- excludes 439,239 shares of Class B common stock to be issued in connection with the Name Development asset acquisition assuming that \$20.49 per share, the last reported sale price of our Class B common stock on January 7, 2005, is the applicable price for determining the number of shares to be issued; and
- excludes shares of Class B common stock issuable upon the conversion of the preferred stock.

Unless we indicate otherwise, in preparing this prospectus we have *not* given effect to the exercise by the underwriters of the over-allotment option granted to them to purchase an additional 1,050,000 shares of Class B common stock in the offering.

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

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[P] The Offering

Securities Offered by Marchex, Inc.	200,000 shares of % convertible exchangeable preferred stock, par value \$0.01 per share, plus an additional 30,000 shares of preferred stock if the underwriters exercise their over-allotment option in full.
Dividends	Dividends will be cumulative from the date of original issue at the annual rate of % of the liquidation preference of the preferred stock, payable quarterly on the day of , and , commencing , 2005. Any dividends must be declared by our board of directors and must come from funds which are legally available for dividend payments.
Conversion Rights	Unless we redeem or exchange the preferred stock, the preferred stock can be converted at your option at any time into shares of Class B common stock, par value \$0.01 per share, at an initial conversion price of \$ (equivalent to a conversion rate of approximately shares of Class B common stock for each share of preferred stock). The initial conversion price with respect to the preferred stock is subject to adjustment in certain events, including a non-stock fundamental change or a common stock fundamental change, which are explained in more detail under the section entitled Description of Preferred Stock Conversion Rights Conversion Price Adjustment Merger, Consolidation or Sale of Assets.
Automatic Conversion	We may elect to automatically convert some or all of the preferred stock if the closing price of our Class B common stock has exceeded 150% of the conversion price for at least 20 out of 30 consecutive trading days ending within five trading days prior to the notice of automatic conversion.
Dividend Make-Whole Payment	If we elect to automatically convert some or all of the preferred stock prior to , 2008, we will make an additional payment on the preferred stock equal to the aggregate amount of cumulative dividends that would have accrued and become payable on the preferred stock from , 2005 through and including , 2008, less any dividends already paid on the preferred stock. This additional payment is payable by us in cash or, at our option, in shares of our Class B common stock, or a combination of cash and shares of our Class B common stock.
Liquidation Preference	\$250 per share of preferred stock, plus accrued and unpaid dividends.
Optional Redemption	On or after , 2008, we may redeem the preferred stock, in whole or in part, at our option at the redemption prices set forth in this prospectus, together with accrued dividends to, but excluding, the redemption date. See the section entitled Description of Preferred Stock Optional Redemption below.

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Voting Rights	Except as provided by law and in other limited situations described in this prospectus, you will not be entitled to any voting rights. However, you will, among other things, be entitled to vote as a separate class to elect two directors if we have not paid the equivalent of six or more quarterly dividends, whether or not consecutive. These voting rights will continue until we pay the full accrued but unpaid dividends on the preferred stock.
Exchange Provisions	At our option, we may exchange the preferred stock in whole, but not in part, on any dividend payment date beginning on _____, 2006 for our _____% convertible subordinated debentures. If we elect to exchange the preferred stock for debentures, the exchange rate will be \$250 principal amount of debentures for each share of preferred stock. The debentures, if issued upon exchange of the preferred stock, will mature 25 years after the exchange date.
Debentures	The debentures, if issued upon exchange of the preferred stock, will have the following terms:
Interest Rate	The debentures will have an interest rate of _____% per year. Interest will be payable on _____ and _____ of each year, beginning on the first interest payment date after the exchange date.
Redemption	On or after _____, 2008 we may redeem the debentures at the redemption prices listed in this prospectus, plus accrued interest.
Maturity	The debentures will mature 25 years after the exchange date.
Conversion	The debentures may be converted at any time prior to maturity into Class B common stock at the same conversion price applicable to the preferred stock.
Automatic Conversion	We may automatically convert the debentures at any time prior to maturity under the same terms applicable to the preferred stock.
Interest Make-Whole Payment	If we elect to automatically convert some or all of the debentures prior to _____, 2008, we will make an additional payment on the debentures equal to the value of the aggregate amount of interest that would have accrued and become payable on the debentures from the date of issuance upon the exchange through and including _____, 2008, less any interest already paid on the debentures. This additional payment is payable by us in cash or, at our option, in shares of our Class B common stock, or a combination of cash and shares of our Class B common stock.
Subordination	The debentures are subordinated to all existing and future senior indebtedness and are effectively subordinated to all of the indebtedness and other liabilities, including trade and other payables, of our subsidiaries. As of September 30, 2004, we had approximately \$6.8 million of indebtedness and other liabilities

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outstanding to which the debentures would have been effectively subordinated, including trade and other payables, but excluding intercompany liabilities. The indenture governing the debentures does not limit the amount of indebtedness, including senior indebtedness, that we and our subsidiaries may incur. See the section entitled "Description of the Debentures Subordination" below.

Concurrent Offering

In a separate, concurrent offering, we are offering 7,000,000 shares of our Class B common stock, excluding a maximum of 1,050,000 shares which may be issued upon exercise in full of the underwriter's over-allotment option. The Class B common stock offering is being made exclusively by a separate prospectus.

Use of Proceeds

We intend to use the net proceeds from this offering, together with the net proceeds from the preferred stock offering, to pay for the pending Name Development asset acquisition and for working capital and other general corporate purposes, including potential future acquisitions. See "Use of Proceeds."

Proposed Nasdaq National Market Symbol for the Preferred Stock MCHXP

Nasdaq National Market Symbol for the Class B Common Stock MCHX

Risk Factors

You should carefully read and consider the information set forth under the caption "Risk Factors" and all other information set forth in this prospectus before investing in Marchex's preferred stock.

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Summary Consolidated Financial Data

The following tables summarize historical and pro forma consolidated financial data regarding our business and should be read together with Management's Discussion and Analysis of Financial Condition and Results of Operations and our historical and pro forma consolidated financial statements and the related notes included elsewhere in this prospectus. The summary information presented for the period from January 17, 2003 (inception) to September 30, 2003, the period from January 17, 2003 (inception) to December 31, 2003, and the nine months ended September 30, 2004 has been derived from our consolidated financial statements included elsewhere in this prospectus. The results of operations of Enhance Interactive are also derived from financial statements included elsewhere in this prospectus and have been presented as the Predecessor for the year ended December 31, 2002 and for the period from January 1, 2003 to February 28, 2003. See subsection Presentation of Financial Reporting Periods on page 51 for a further description of the basis of presentation of the 2003 period and of other financial reporting periods.

The unaudited pro forma condensed consolidated statement of operations data for the year ended December 31, 2003 give effect to: (1) our 2003 acquisitions of Enhance Interactive and TrafficLeader and our 2004 acquisition of goClick; and (2) our proposed Name Development asset acquisition and the offerings, as if they had all occurred on January 1, 2003. The unaudited pro forma condensed consolidated statements of operations for the year ended December 31, 2003 are based upon the historical results of operations of Marchex for the period from January 17, 2003 (inception) through December 31, 2003, the Predecessor for the period from January 1, 2003 through February 28, 2003, TrafficLeader for the period from January 1, 2003 through October 23, 2003 and goClick and Name Development for the year ended December 31, 2003. The unaudited pro forma condensed consolidated statement of operations data for the nine months ended September 30, 2004 give effect to: (1) our 2004 acquisition of goClick; and (2) our proposed Name Development asset acquisition and the offerings, as if they had all occurred on January 1, 2003. The unaudited pro forma condensed consolidated statement of operations for the nine months ended September 30, 2004 are based upon the historical results of operations of Marchex for the nine months ended September 30, 2004, goClick for the period from January 1, 2004 through July 26, 2004 and for Name Development for the nine months ended September 30, 2004.

The summary unaudited pro forma condensed consolidated statement of operations data are presented for illustrative purposes only and do not represent what our results of operations actually would have been if the transactions referred to above had occurred as of the dates indicated or what our results of operations will be for future periods.

In addition, the completion of the Class B common stock offering is not contingent upon the completion of the preferred stock offering. In the event we elect not to consummate the preferred stock offering, we will increase the size of the Class B common stock offering accordingly, which is not given effect in the following tables.

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	Predecessor Periods		Successor Periods				
						Nine months ended September 30,	
	Year ended December 31, 2002	Period from January 1 to February 28, 2003	Marchex Period from January 17, (inception) to December 31, 2003	Pro Forma Marchex, Prior and Pending Acquisitions and Offering 2003	Marchex Period from January 17, (inception) to September 30, 2003	Marchex 2004	Pro Forma Marchex, Prior and Pending Acquisitions and Offering 2004
Consolidated Statement of Operations							
Data:							
Revenue	\$ 10,070,507	\$ 3,071,055	\$ 19,892,158	\$ 34,993,516	\$ 12,431,493	\$ 28,682,924	\$ 47,890,567
Expenses:							
Service costs	6,334,173	1,732,813	11,292,070	19,431,873	6,806,021	18,142,886	21,186,372
Sales and marketing	1,821,237	365,043	2,460,683	3,341,578	1,592,722	3,196,996	3,217,449
Product development	811,673	144,479	1,291,422	1,613,807	844,399	1,636,321	1,733,063
General and administrative	976,881	234,667	2,743,919	3,476,947	1,816,522	2,613,932	3,439,835
Acquisition-related retention consideration			283,269	283,269		374,858	374,858
Facility relocation						199,960	199,960
Stock-based compensation	364,693	38,981	2,125,110	2,659,280	1,587,476	721,403	721,403
Amortization of intangible assets			3,023,408	20,774,974	2,028,244	3,473,976	14,460,401
Total operating expenses	10,308,657	2,515,983	23,219,881	51,581,728	14,675,384	30,360,332	45,333,341
Gain on sale of intangible assets, net				965,297			1,507,498
Income (loss) from operations	(238,150)	555,072	(3,327,723)	(15,622,915)	(2,243,891)	(1,677,408)	4,064,724
Other income (expense)	5,491	1,529	74,059	70,148	33,502	218,974	226,878
Income (loss) before provision for income taxes	(232,659)	556,601	(3,253,664)	(15,552,767)	(2,210,389)	(1,458,434)	4,291,602
Income tax expense (benefit)	(142,876)	224,082	(1,084,312)	(5,609,792)	(783,231)	(118,016)	2,076,639
Net income (loss)	(89,783)	332,519	(2,169,352)	(9,942,975)	(1,427,158)	(1,340,418)	2,214,963
Accrual of convertible preferred stock dividends				2,500,000			1,875,000
Accretion of redemption value of redeemable convertible preferred stock			1,318,885	1,318,885	911,620	420,430	420,430
Net income (loss) applicable to common stockholders	\$ (89,783)	\$ 332,519	\$ (3,488,237)	\$ (13,761,860)	\$ (2,338,778)	\$ (1,760,848)	\$ (80,467)
Consolidated Statement of Cash Flows							
Data:							
Cash flows from operating activities	\$ 1,539,808	\$ 353,053	\$ 2,907,053		\$ 1,738,073	\$ 2,335,785	
Other Financial Data:							
Operating income before amortization (OIBA) ⁽¹⁾	\$ 126,543	\$ 594,053	\$ 1,820,795	\$ 7,811,339	\$ 1,371,829	\$ 2,517,971	\$ 19,246,528

Footnote on page 14.

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The following table sets forth our consolidated balance sheet data as of September 30, 2004 on:

- an actual basis;
- a pro forma basis to give effect to: (1) the sale of 7,000,000 shares of Class B common stock at the price of \$20.49 per share, the last reported sale price of our Class B common stock on January 7, 2005, less \$8.1 million in estimated underwriting discounts and estimated offering expenses; and (2) the sale of 200,000 shares of preferred stock at the price of \$250 per share, less \$1.8 million in estimated underwriting discounts and estimated offering expenses; and
- a pro forma as adjusted basis to also give effect to the Name Development asset acquisition.

	As of September 30, 2004		
	Actual	Pro forma	Pro forma, as adjusted
Consolidated Balance Sheet Data:			
Cash and cash equivalents	\$ 24,772,316	\$ 208,380,816	\$ 53,230,816
Total current assets	28,008,769	211,617,269	56,583,223
Total assets	62,504,069	246,112,569	255,582,569
Total current liabilities	7,270,020	7,270,020	7,740,020
Total stockholders' equity	54,463,628	238,072,128	247,072,128

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The following table provides a reconciliation of Income (loss) from operations and Net income (loss) applicable to common stockholders to the non-GAAP measure of OIBA.

	Predecessor Periods		Successor Periods				
						Nine months ended	
						September 30	
				Pro Forma			Pro Forma
			Marchex	Marchex		Marchex	Marchex
				Prior and Pending Acquisitions and Offering	Marchex Period from January 17, (inception) to September 30, 2003		Prior and Pending Acquisitions and Offering
	Year ended December 31, 2002	Period from January 1 to February 28, 2003	Period from January 17, (inception) to December 31, 2003	2003	2003	2004	2004
Operating income before amortization (OIBA) ⁽¹⁾	\$ 126,543	\$ 594,053	\$ 1,820,795	\$ 7,811,339	\$ 1,371,829	\$ 2,517,971	\$ 19,246,528
Stock-based compensation	(364,693)	(38,981)	(2,125,110)	(2,659,280)	(1,587,476)	(721,403)	(721,403)
Amortization of intangible assets			(3,023,408)	(20,774,974)	(2,028,244)	(3,473,976)	(14,460,401)
Income (loss) from operations	(238,150)	555,072	(3,327,723)	(15,622,915)	(2,243,891)	(1,677,408)	4,064,724
Other income (expense)							
Interest income	5,491	1,529	45,874	53,989	33,502	163,808	169,304
Interest expense						(3,728)	(3,728)
Adjustment to fair value of redemption obligation			25,500	25,500		55,250	55,250
Other			2,685	(9,341)		3,644	6,052
Total other income	5,491	1,529	74,059	70,148	33,502	218,974	226,878
Income (loss) before provision for income taxes	(232,659)	556,601	(3,253,664)	(15,552,767)	(2,210,389)	(1,458,434)	4,291,602
Income tax expense (benefit)	(142,876)	224,082	(1,084,312)	(5,609,792)	(783,231)	(118,016)	2,076,639
Net income (loss)	(89,783)	332,519	(2,169,352)	(9,942,975)	(1,427,158)	(1,340,418)	2,214,963
Accrual of convertible stock dividends				2,500,000			1,875,000
Accretion to redemption value of redeemable convertible preferred stock			1,318,885	1,318,885	911,620	420,430	420,430
Net income (loss) applicable to common stockholders	\$ (89,783)	\$ 332,519	\$ (3,488,237)	\$ (13,761,860)	\$ (2,338,778)	\$ (1,760,848)	\$ (80,467)

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

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

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RISK FACTORS

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

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 and in November 2004 entered into an agreement to acquire certain assets of Name Development.

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 certain 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 distribution partners or a decrease in revenue from certain distribution partners 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 approximately 19% of our total revenue for the nine months ended September 30, 2004 and was responsible for 100% of the revenue of Name Development during the same period. For the year ended December 31, 2003, distribution through Yahoo! and its subsidiaries collectively represented less than 10% of Marchex's 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.

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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. According to comScore Media Metrix qSearch, Yahoo! Search accounted for 27% of the online searches in the United States in May 2004 and Google accounted for 37%. 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 third-party 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 does not continue to 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, including claims of trademark infringement in connection with an acquisition of previously-owned Internet domain names, 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

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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

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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 or other intellectual property 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, services and property 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.

Following the offerings, we may need additional funding to meet our obligations and to pursue our business strategy. Additional funding may not be available to us and our financial condition could therefore be adversely affected.

We have allocated a substantial portion of the net proceeds of the offerings to the proposed Name Development asset acquisition. Following the offerings, we may require additional funding to meet our ongoing obligations and to pursue our business strategy, which may include the selective acquisition of businesses and technologies. In addition, we have incurred and we may incur certain obligations in the future, including:

- We may be obligated to make performance payments based on 2004 earnings to the original shareholders and certain employees of eFamily and its wholly-owned subsidiary, Enhance Interactive, which we acquired in February 2003, with a maximum remaining aggregate payment obligation of \$10.0 million.
- We may also be obligated to make revenue-based performance payments based on 2004 results to the original shareholders of TrafficLeader, which we acquired in October 2003, with a maximum aggregate payment obligation of \$1.0 million.
- Upon the issuance of preferred stock as contemplated in the preferred stock offering, we will become obligated to pay dividends to the holders of such stock.
- If debentures are issued upon exchange of the preferred stock, we will become obligated to make interest payments to the holders of the debentures.

Following the offerings, there can be no assurance that additional financing arrangements will be available in amounts or on terms acceptable to us, if at all. Furthermore, the sale of additional equity or convertible securities will result in further dilution to existing stockholders. 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 includes identifying, structuring, completing and integrating 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.

Acquisitions are accompanied by a number of risks that could harm 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 could be diverted from our ongoing business concerns;

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- While integrating new companies, we may lose key executives or other employees of these companies;
- We may issue shares of our Class B common stock as consideration for acquisitions which may result in ownership dilution to our stockholders;
- 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 founding 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 member of our senior management team is an at-will employee and may voluntarily terminate his employment with us at any time with minimal notice. Russell C. Horowitz, Ethan A. Caldwell, Peter Christothoulou and John Keister, our founding executive officers, each own shares of fully vested Class A common stock. 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 December 31, 2004, Russell C. Horowitz, Ethan A. Caldwell, Peter Christothoulou and John Keister together controlled 93% of the combined voting power of our outstanding capital stock. Upon completion of the offerings, these founding executive officers together will control 91% of the combined voting power of all of our outstanding capital stock, excluding any shares that may be purchased by them in the offerings and shares of Class B common stock issuable upon conversion of preferred 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 founding executive officers, for any reason, or any conflict among our founding 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.

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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 our other personnel. 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.

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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 Stock 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 on or after July 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

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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.

Recently adopted changes in accounting rules and regulations, such as expensing of stock options and shares issued through the employee stock purchase plan, will result in unfavorable accounting charges and may require us to change our compensation policies.

Accounting methods and policies regarding expensing stock options are subject to 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. On December 16, 2004, the FASB adopted a revised final statement of financial accounting standards which requires us, as a small business issuer, to expense the fair value of stock options granted for periods beginning after December 15, 2005. In addition, under the FASB's final rules on employee stock purchase plans, we will incur an expense. We rely heavily on stock options to compensate existing employees and attract new employees. In light of these new requirements to expense stock options and shares issued under the employee stock purchase plan, we may 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 and we may need to compensate our employees with greater amounts of cash or other incentives. If we do not reduce our reliance on stock options and the employee stock purchase plan, our reported losses will increase. Further 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. These rules also require that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. 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.

We have substantial goodwill 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. Any impairment charges or changes to the estimated amortization periods could have a material adverse effect on our financial results.

Risks Relating to the Name Development Asset Acquisition

We may not be able to complete the transactions contemplated by this prospectus, which could negatively impact our reputation and prospects.

The Name Development asset acquisition is dependent upon the successful completion of the simultaneous offerings of our Class B common stock and our preferred stock. We will be unable to finance the proposed asset acquisition without the funding from the net proceeds of these offerings. The closing of the proposed asset acquisition is also dependent on certain closing conditions, which if not met or not waived by Name

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Development or us, as the case might be, would release the parties from the terms of the asset purchase agreement. If we were unable to meet our obligations under the agreement, we would be obligated to pay a termination fee to Name Development of approximately \$1.5 million in a combination of cash and shares of our Class B common stock.

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We have expended significant time, resources and manpower to pursue the asset acquisition and related financings, which could have been used for other purposes and opportunities. If the proposed asset acquisition and offerings are not consummated, we will have incurred significant expense which may affect our financial results. We will also have potentially foregone other transactions or devoted resources that could have been directed to our current operations during that period.

Acquisitions are a component of our strategy. Our successful execution of this strategy relies in part on our reputation for delivering value for our target partners and our ability to demonstrate a successful transaction record. A failure to complete this transaction would, at this juncture in our corporate history, negatively impact our reputation and could adversely affect our prospects for future acquisitions or the terms on which we may complete such acquisitions.

We may not be able to realize the intended and anticipated benefits from the Name Development asset acquisition, which could affect the value of the asset acquisition to our business strategy and our ability to meet our financial obligations and targets.

We may not be able to realize the intended and anticipated benefits that we currently expect from the Name Development asset acquisition. These intended and anticipated benefits include increasing our cash flow from operations, growing our merchant network, broadening our distribution offerings and delivering services that strengthen our merchant relationships.

Factors that could affect our ability to achieve these benefits include:

- Name Development currently earns 100% of its revenue through the outsourcing of its pay-per-click listings to one major provider, Yahoo! In order to achieve the desired financial results from this asset acquisition, we will need to transition the existing commercial relationship on similar or better terms, develop other relationships for the delivery of pay-per-click listings or provide pay-per-click listings directly from our merchant advertisers, or some combination of the above. Our execution of this aspect of the acquired assets will be a significant factor in determining whether we realize the anticipated economic benefits.
- We will need to continue to acquire commercially valuable Internet domain names to grow our presence in the field of direct navigation. We will need to continuously improve our technologies to acquire valuable Internet domain names as competition in the marketplace for appropriate Internet domain names intensifies. Our domain name acquisition efforts are subject to rules and guidelines established by registries which maintain Internet domain name registrations and the registrars which process and facilitate Internet domain name registrations. The registries and registrars may change the rules and guidelines for acquiring Internet domains in ways that may prove detrimental to our domain acquisition efforts.
- The business of Name Development is dependent on current technologies and user practices. If browser or search technologies were to change significantly, the practice of direct navigation may be altered to our disadvantage.
- Some of our existing distribution partners may perceive Name Development as a competitive threat and therefore may decide to terminate their agreements with us because of the Name Development asset acquisition.
- We intend to apply our technology and expertise to geography-specific Web properties that we believe are under-commercialized and not yet mature from a monetization perspective. However, if the current disparities in traffic and monetization of such search terms do not narrow in a favorable way, we may expend significant company resources on business efforts that do not realize the results we expect.

If the acquired business is not integrated into our business as we anticipate, we may not be able to achieve these benefits or realize the value paid for the asset acquisition, which could materially harm our business, financial condition and results of operations.

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We may experience unforeseen liabilities in connection with the Name Development asset acquisition or our acquisition of other Internet domain names, which could negatively impact our financial results.

The Name Development asset acquisition involves the acquisition of a large number of previously-owned Internet domain names. Furthermore, we have separately acquired and intend to continue to acquire in the future additional previously-owned Internet domain names. In some cases, these acquired names may have trademark significance that is not readily apparent to us or is not identified by us in the bulk purchasing process. As a result we may face demands by third party trademark owners asserting infringement or dilution of their rights and seeking transfer of acquired Internet domain names under the Uniform Domain Name Dispute Resolution Policy administered by ICANN or actions under the U.S. Anti-Cybersquatting Consumer Protection Act.

We intend to review each claim or demand which may arise from time to time on its merits on a case-by-case basis with the assistance of counsel and we intend to transfer any rights acquired by us to any party that has demonstrated a valid prior right or claim. We cannot, however, guarantee that we will be able to resolve these disputes without litigation. The potential violation of third party intellectual property rights and potential causes of action under consumer protection laws may subject us to unforeseen liabilities including injunctions and judgments for money damages.

Regulation could reduce the value of the Internet domain names acquired or negatively impact the Internet domain acquisition process, which could significantly impair the value of the asset acquisition.

The Name Development business includes the registrations of thousands of Internet domain names both in the United States and internationally. Name Development acquires previously-owned Internet domain names that have expired and have been offered for sale by Internet domain name registrars following the period of permitted reclamation by their prior owners. Furthermore, we have separately acquired and intend to continue to acquire in the future additional previously-owned Internet domain names.

The acquisition of Internet domain names generally is governed by regulatory bodies. The regulation of Internet domain names in the United States and in foreign countries is subject to change. Regulatory bodies could establish additional requirements for previously-owned Internet domain names or modify the requirements for holding Internet domain names. As a result, we might not acquire or maintain names that contribute to our financial results in the same manner as reflected in the historical financial results of Name Development. Because certain Internet domain names are important assets which support the valuation of the Name Development asset acquisition, a failure to acquire or maintain such Internet domain names could adversely affect our financial results and our growth. Any impairment in the value of these important assets could cause our stock price to decline.

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.

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We currently or potentially compete with a variety of companies, including FindWhat.com, Google, Microsoft 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 us on 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.

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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;

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- 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.

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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 two non-provisional patent applications based on the two 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 and the trading price of our preferred 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.

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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 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.

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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 and these laws may introduce requirements for user consent and other restrictions. These proposed laws are intended to target

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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.

On November 19, 2004, the federal government passed legislation placing a three-year ban on state and local governments' imposition of new taxes on Internet access or electronic commerce transactions. Unless the ban is extended, state and local governments may begin to levy additional taxes on Internet access and electronic commerce transactions upon the legislation's expiration in November 2007. 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.

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[P] Risks Relating to this Offering

We may not be able to complete the proposed offering of our Class B common stock.

We may not be able to complete the offering of 7,000,000 shares of our Class B common stock being conducted concurrently with this offering, or such offering may not raise the amount of proceeds we expect. If we are unable to complete the Class B common stock offering, we may not be able to execute fully on our contemplated acquisition strategy and the information in this prospectus regarding the Class B common stock offering would not be applicable or would need to be revised, perhaps significantly.

Our Class B common stock price has been and is likely to continue to be highly volatile. The price of our Class B common stock, and therefore the value of the preferred stock, may fluctuate significantly, which may make it difficult for holders to resell the preferred stock or the shares of our Class B common stock issuable upon conversion thereof when desired or at attractive prices.

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. Since our initial public offering, the closing sale price of our Class B common stock on the Nasdaq National Market ranged from \$8.56 to \$21.00 per share through December 31, 2004, and the last reported sale price on January 7, 2005 was \$20.49 per share. 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;
- potential loss or reduced contributions from distribution partners or merchant advertisers;
- 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.

Because the shares of the preferred stock are convertible into shares of Class B common stock, volatility or depressed prices for our Class B common stock could have a similar effect on the value of the preferred stock. Holders who receive Class B common stock upon conversion also will be subject to the risk of volatility and depressed prices of our Class B common stock.

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If we, or our existing stockholders, sell additional shares of our Class B common stock after this offering, the market price of our Class B common stock could decline.

We have a substantial number of shares of Class B common stock that are eligible for resale following the offering, including:

- Upon completion of the offerings, we will have 20,421,539 shares of Class B common stock outstanding and 21,471,539 shares if the underwriters exercise their over-allotment option in full. We will have 16,452,159 shares of our common stock subject to lock-up for 90 days following the offering by executive officers, directors and certain of our stockholders.
- As of September 30, 2004, we had issued options for approximately 3,571,167 shares of Class B common stock, of which options for 970,244 shares were exercisable as of such date. We have also issued shares in connection with our initial financing and our prior acquisitions, of which 20,279,063 are eligible for resale under Rule 144.
- As of September 30, 2004, we had 111,578,461 shares of authorized but unissued shares of our Class B common stock that are available for future sale.
- Approximately 11,987,500 of our shares of Class A common stock and 8,725,104 of our shares of Class B common stock are subject to piggyback registration rights. Following the Name Development asset acquisition 439,239 shares of our Class B common stock will be subject to Form S-3 registration rights assuming that \$20.49 per share, the last reported sale price of our Class B common stock on January 7, 2005, is the applicable price for determining the number of shares to be issued; these shares will not be subject to lock-up following the acquisition. We also may enter into additional registration rights agreements in the future in connection with any subsequent acquisitions we may undertake. Any sales of our common stock under these registration rights arrangements with these stockholders could be negatively perceived in the trading markets and negatively affect the price of our common stock.

The market price of our Class B common stock could decline as a result of sales of a large number of shares of our Class B common stock in the market after this offering, or the perception that such sales could occur. These sales, or the possibility that these sales may occur, could make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate.

Following this offering, conversion of our convertible preferred stock will dilute the interests of our existing Class B common stockholders.

The conversion of some or all of the preferred stock will dilute the interests of our existing Class B common stockholders. Sales in the public market of shares of Class B common stock issued upon conversion would apply downward pressure on the prevailing market price. In addition, the very issuance of the preferred stock represents a future issuance, and perhaps a future sale, of our Class B common stock to be acquired upon conversion, which could depress trading prices for our Class B common stock.

There is currently no public market for the preferred stock or the debentures, and the market price of the preferred stock may decline after you invest.

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There is currently no public market for the preferred stock or the debentures. Although we have applied for inclusion of the preferred stock on the Nasdaq National Market, there is no guarantee that these securities will be accepted for trading or if accepted that an active or liquid trading market will develop for the preferred stock. If an active trading market does not develop, the market price and liquidity of the preferred stock will be adversely affected. Even if an active trading market for the preferred stock were to develop, the preferred stock could trade for less than the public offering price, depending on many factors, including prevailing interest rates, our operating results and the markets for similar securities, and such active trading market could cease to continue at any time. In addition, if the preferred stock is exchanged for debentures, we are not obligated to list the debentures and cannot assure you that a market for the debentures will develop.

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We will require a significant amount of cash to meet the dividend obligations under the terms of the preferred stock. Our ability to generate cash depends on many factors beyond our control. If we cannot generate the required cash, we may not be able to make the preferred stock dividend payments.

Our ability to meet the dividend payments under the terms of the preferred stock, and to fund planned capital expenditures and potential acquisitions will depend on our ability to generate cash in the future. Our ability to generate cash, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control.

Our future financial results could be subject to fluctuations. Our business may not be able to generate sufficient cash flow from our operations or future financings may not be available to us in an amount sufficient to enable us to meet our payment obligations, including the accrued dividends under the terms of the preferred stock, or to fund our other liquidity needs. Our inability to meet our payment obligations would require us to pursue one or more alternative strategies, such as selling assets, refinancing, restructuring or selling equity capital. However, alternative strategies may not be feasible at the time or may not prove adequate, which could cause us to default on our obligations and would impair our liquidity.

We may not be able to pay dividends on the preferred stock, which could impair the value of your investment.

Under Delaware law, dividends to stockholders may be made only from the surplus of a company, or, in certain situations, from the net profits for the current fiscal year or the fiscal year before which the dividend is declared. Our ability to pay dividends in the future will depend on our financial results, liquidity and financial condition. We can not be sure that we will have the surplus or profits to make periodic dividend payments, and we can not be sure that we will be able to pay the periodic installments of the dividend on the preferred stock.

There may be tax consequences to you if we exchange your preferred stock for debentures.

An exchange of the preferred stock for debentures will be a taxable event for federal income tax purposes which may result in tax liability to the holders without any corresponding receipt of cash by the holder. Such an exchange may be taxable as a dividend distribution to the extent of our current and accumulated earnings and profits, and may be subject to withholding tax if the exchanging stockholder is a Non-U.S. Holder.

Our current and future payment obligations or indebtedness will have priority over a preferred stock liquidation preference and accrued dividend payment obligation in the event of our liquidation, dissolution or winding-up.

The terms of the preferred stock do not contain any financial or operating covenants that would prohibit or limit us or our subsidiaries from incurring indebtedness or other liabilities, pledging assets to secure such indebtedness and liabilities, paying dividends, or issuing securities or repurchasing securities issued by us or any of our subsidiaries. The incurrence of indebtedness by us or our subsidiaries and, in particular, the granting of a security interest to secure the indebtedness could adversely affect our ability to pay accrued dividends under the terms of the preferred stock.

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If we incur indebtedness, the holders of that debt will have prior rights with respect to any proceeds distributed in connection with any insolvency, liquidation, reorganization, dissolution or other winding-up of us. This may have the effect of reducing the amount of proceeds in connection with any insolvency, liquidation, reorganization or other winding-up of us paid to you as a holder of the preferred stock.

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Our founding 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 December 31, 2004, Russell C. Horowitz, Ethan A. Caldwell, Peter Christothoulou and John Keister, our founding executive officers, beneficially owned 96% of the outstanding shares of our Class A common stock, which shares represented 93% of the combined voting power of all outstanding shares of our capital stock. Upon completion of the offerings, these founding executive officers together will control 91% of the combined voting power of all outstanding shares of our capital stock, excluding any shares that may be purchased by them in the offerings and shares of Class B common stock issuable upon conversion of preferred 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 these founding 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 these founding 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, these founding executive officers will be in a position to continue to control all fundamental matters affecting our company, including any merger involving, sale of substantially all of the assets of, or change in control of, our company.

The ability of these founding executive officers to control our company may result in our Class B common stock trading at a price lower than the price at which it would trade if these founding 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.

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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. The application of Section 203 of the Delaware General Corporation Law could have the effect of delaying or preventing a change of control of our company.

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[C] Risks Relating to this Offering

We may not be able to complete the proposed offering of our preferred stock.

We may not be able to complete the offering of 200,000 shares of our preferred stock being conducted concurrently with this offering of Class B common stock, or such offering may not raise the amount of proceeds we expect and we may be unable to increase the size of the Class B common stock offering to compensate accordingly. If we are unable to complete the preferred stock offering, we may not be able to execute fully on our contemplated acquisition strategy and the information in this prospectus regarding the preferred stock offering would not be applicable or would need to be revised, perhaps significantly.

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. Since our initial public offering, the closing sale price of our Class B common stock on the Nasdaq National Market ranged from \$8.56 to \$21.00 per share through December 31, 2004 and the last reported sale price on January 7, 2005 was \$20.49 per share. 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;
- potential loss or reduced contributions from distribution partners or merchant advertisers;
- changes in earnings estimates or recommendations by analysts;

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- 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.

If we, or our existing stockholders, sell additional shares of our Class B common stock after this offering, the market price of our Class B common stock could decline.

We have a substantial number of shares of Class B common stock that are eligible for resale following the offering, including:

- Upon completion of the offerings, we will have 20,421,539 shares of Class B common stock outstanding and 21,471,539 shares if the underwriters exercise their over-allotment option in full. We will have 16,452,159 shares of our common stock subject to lock-up for 90 days following the offering by executive officers, directors and certain of our stockholders.

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- As of September 30, 2004, we had issued options for 3,571,167 shares of Class B common stock, of which options for 970,244 shares were exercisable as of such date. We have also issued shares in connection with our initial financing and our prior acquisitions, of which 20,279,063 are eligible for resale under Rule 144.
- As of September 30, 2004, we had 111,578,461 shares of authorized but unissued shares of our Class B common stock that are available for future sale.
- Approximately 11,987,500 of our shares of Class A common stock and 8,725,104 of our shares of Class B common stock are subject to piggyback registration rights. Following the Name Development asset acquisition 439,239 shares of our Class B common stock will be subject to Form S-3 registration rights assuming that \$20.49 per share, the last reported sale price of our Class B common stock on January 7, 2005, is the applicable price for determining the number of shares to be issued; these shares will not be subject to lock-up following the acquisition. We also may enter into additional registration rights agreements in the future in connection with any subsequent acquisitions we may undertake. Any sales of our common stock under these registration rights arrangements with these stockholders could be negatively perceived in the trading markets and negatively affect the price of our common stock.

The market price of our Class B common stock could decline as a result of sales of a large number of shares of our Class B common stock in the market after this offering, or the perception that such sales could occur. These sales, or the possibility that these sales may occur, could make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate.

Following this offering, conversion of our convertible preferred stock will dilute the interests of our existing Class B common stockholders.

The conversion of some or all of the preferred stock will dilute the interests of our existing Class B common stockholders. Sales in the public market of shares of Class B common stock issued upon conversion would apply downward pressure on the prevailing market price. In addition, the mere issuance of the preferred stock represents a future issuance, and perhaps a future sale, of our Class B common stock to be acquired upon conversion, which could depress trading prices for our Class B common stock.

Our founding 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 December 31, 2004, Russell C. Horowitz, Ethan A. Caldwell, Peter Christothoulou and John Keister, our founding executive officers, beneficially owned 96% of the outstanding shares of our Class A common stock, which shares represented 93% of the combined voting power of all outstanding shares of our capital stock. Upon completion of the offerings, these founding executive officers together will control 91% of the combined voting power of all outstanding shares of our capital stock, excluding any shares that may be purchased by them in the offerings and shares of Class B common stock issuable upon conversion of the preferred 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 these founding 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.

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Further, as long as these founding 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, these founding executive officers will be in a position to continue to control all fundamental matters affecting our company, including any merger involving, sale of substantially all of the assets of, or change in control of, our company.

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The ability of these founding executive officers to control our company may result in our Class B common stock trading at a price lower than the price at which it would trade if these founding 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. The application of Section 203 of the Delaware General Corporation Law could have the effect of delaying or preventing a change of control of our company.

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 and to make periodic installments of the dividend on the preferred stock. 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.

The rights of holders of the Class B common stock will be junior to the rights of holders of the preferred stock in the event of our liquidation, dissolution or winding-up.

The terms of the preferred stock provide that holders will receive a preference over the other equity securities of the company upon its liquidation, dissolution or winding-up. This liquidation preference is equal to \$250 per share of preferred stock plus all accrued and unpaid dividends through the distribution date. These rights of payment are senior to the liquidation rights of the holders of the Class B common stock.

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This may have the effect of reducing the amount of proceeds in connection with any insolvency, liquidation, reorganization or other winding-up of us paid to you as holder of the Class B common stock.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus includes forward-looking statements, principally in the sections entitled Prospectus Summary, Risk Factors, Management's Discussion and Analysis of Financial Condition and Results of Operation and Business. All statements other than statements of historical facts contained in this prospectus, including statements regarding the benefits and risks associated with the pending Name Development asset acquisition, our future operating results, financial position, and business strategy, expectations regarding our growth and the growth of the industry in which we operate, and plans and objectives of management for future operations, are forward-looking statements. The words believe, may, estimate, continue, anticipate, intend, expect and similar expressions, as they relate to us, are intended to identify forward-looking statements.

Any or all of our forward-looking statements in this prospectus may turn out to be inaccurate. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. They may be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties, including the risks, uncertainties and assumptions described in Risk Factors. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this prospectus may not occur as contemplated, and actual results could differ materially from those anticipated or implied by the forward-looking statements.

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

You should not unduly rely on these forward-looking statements, which speak only as of the date of this prospectus. Unless required by law, we undertake no obligation to publicly update or revise any forward-looking statements to reflect new information or future events or otherwise. You should, however, review the factors and risks we describe in the reports we will file from time to time with the SEC after the date of this prospectus. See Where You Can Find More Information.

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[P] RATIO OF EARNINGS TO FIXED CHARGES AND PREFERRED STOCK DIVIDENDS

The following table sets forth our deficiency of earnings to combined fixed charges and preferred stock dividends for the periods indicated. For the periods indicated below, earnings were insufficient to cover fixed charges. For this reason, no ratios are provided.

	Period from January 17, (inception) to December 31, 2003	Nine months ended September 30, 2004
Loss from continuing operations before income taxes	\$ (3,253,664)	\$ (1,458,434)
Fixed charges:		
Interest expense		3,728
Assumed interest component of rental expenses ⁽¹⁾	120,333	133,892
Total fixed charges	120,333	137,620
Adjusted loss	(3,133,331)	(1,320,814)
Total fixed charges	120,333	137,620
Preferred share dividends		
Combined fixed charges and preferred stock dividend	120,333	137,620
Deficiency of earnings to combined fixed charges and preferred stock dividends	\$ (3,253,664)	\$ (1,458,434)

⁽¹⁾ Estimated as one-third of operating lease expense.

Table of Contents**[P] USE OF PROCEEDS**

We estimate that the net proceeds from the sale of 200,000 shares of our % convertible exchangeable preferred stock in this offering will be approximately \$48.3 million, after deducting the estimated underwriting discounts of approximately \$1.8 million. If the underwriters exercise the over-allotment option in full, we estimate that the net proceeds will be approximately \$55.5 million. Concurrently with this offering, we are offering 7,000,000 shares of our Class B common stock. We estimate that the net proceeds from the Class B common stock offering will be approximately \$135.4 million, after deducting the estimated underwriting discounts and commissions of approximately \$7.2 million and estimated offering expenses of approximately \$900,000. If the underwriters exercise the over-allotment option in full, we estimate that the net proceeds from the Class B common stock offering will be approximately \$155.8 million. The closing of this offering is subject to the concurrent closing of the Name Development asset acquisition described in this prospectus and the closing of the concurrent Class B common stock offering.

We expect to use the net proceeds from this offering and our concurrent Class B common stock offering approximately as follows:

	Amount	Percentage of Net Proceeds
	(in millions)	
Name Development asset acquisition	\$ 155.2	85%
Asset acquisition fees and expenses	0.5	
Working capital and other general corporate purposes, including potential future acquisitions	27.9	15%
	\$ 183.6	100%

Table of Contents**[C] USE OF PROCEEDS**

We estimate that the net proceeds from the sale of 7,000,000 shares of our Class B common stock in this offering will be approximately \$135.4 million, after deducting the estimated underwriting discounts of approximately \$7.2 million and estimated offering expenses of approximately \$900,000. If the underwriters exercise the over-allotment option in full, we estimate that the net proceeds will be approximately \$155.8 million. Concurrently with this offering, we are offering 200,000 shares of our % convertible exchangeable preferred stock. We estimate that the net proceeds from the preferred stock offering will be approximately \$48.3 million, after deducting the estimated underwriting discounts and commissions of approximately \$1.8 million. If the underwriters exercise the over-allotment option in full, we estimate that the net proceeds from the preferred stock offering will be approximately \$55.5 million. The closing of this offering is subject to the concurrent closing of the Name Development asset acquisition described in this prospectus but is not contingent upon the closing of the concurrent preferred stock offering. In the event we elect not to consummate the preferred stock offering, we will increase the size of the Class B common stock offering accordingly.

We expect to use the net proceeds from this offering and our concurrent preferred stock offering approximately as follows:

	Amount	Percentage of Net Proceeds
	(in millions)	
Name Development asset acquisition	\$ 155.2	85%
Asset acquisition fees and expenses	0.5	
Working capital and other general corporate purposes, including potential future acquisitions	27.9	15%
	\$ 183.6	100%

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PRICE RANGE OF CLASS B COMMON STOCK

Our Class B common stock has been traded on the Nasdaq National Market under the symbol MCHX since March 31, 2004 when we completed our initial public offering at a price of \$6.50 per share. Prior to that time, there was no public market for our Class B common stock. As of September 30, 2004, there were approximately 144 holders of record of our Class B common stock. The following table sets forth, for the periods indicated, the high and low closing sales prices for Marchex's Class B common stock as reported on the Nasdaq National Market:

	High	Low
Year ended December 31, 2004		
First Quarter (Beginning March 31, 2004)	\$ 8.88	\$ 8.88
Second Quarter	\$ 13.28	\$ 9.50
Third Quarter	\$ 13.35	\$ 8.56
Fourth Quarter	\$ 21.00	\$ 12.40
Year ended December 31, 2005		
First Quarter (through January 7, 2005)	\$ 22.09	\$ 20.39

The last reported closing sale price of our Class B common stock on the Nasdaq National Market on January 7, 2005 was \$20.49 per share.

DIVIDEND POLICY

We currently intend to pay cash dividends on the preferred stock. Dividends on the preferred stock are cumulative, meaning that if they are not paid they continue to accrue and must be paid prior to the payment of any dividends on our common stock. [P] For a discussion of dividends payable on the preferred stock, please see Description of Preferred Stock Dividends.

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

Table of Contents**CAPITALIZATION**

The following table sets forth our capitalization as of September 30, 2004 on:

- an actual basis;
- a pro forma basis to give effect to: (1) the sale of 7,000,000 shares of Class B common stock at the price of \$20.49 per share, the last reported sale price of our Class B common stock on January 7, 2005, less \$8.1 million in estimated underwriting discounts and commissions and estimated offering expenses; and (2) the sale of 200,000 shares of preferred stock at the price of \$250 per share, less \$1.8 million in estimated underwriting discounts and commissions and estimated offering expenses; and
- a pro forma as adjusted basis to also give effect to the Name Development asset acquisition.

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

	As of September 30, 2004		
	Actual	Pro Forma	Pro Forma, as adjusted
Cash and cash equivalents	\$ 24,772,316	\$ 208,380,816	\$ 53,230,816
Stockholders' equity:			
% convertible exchangeable preferred stock, \$.01 par value: 1,000,000 authorized; none issued and outstanding, actual and 200,000 issued and outstanding pro forma and pro forma as adjusted	\$	\$ 48,250,000	\$ 48,250,000
Common stock, \$.01 par value: 137,500,000 shares authorized;			
Class A: 12,500,000 shares authorized; 12,250,000 shares issued and 11,987,500 shares outstanding, actual, pro forma and pro forma as adjusted	122,500	122,500	122,500
Class B: 125,000,000 shares authorized; 13,421,539 shares issued and outstanding, actual, including 114,583 shares of restricted stock; 20,421,539 shares issued and outstanding pro forma; 20,860,778 shares issued and outstanding pro forma as adjusted	134,216	204,216	208,608
Treasury stock: 262,500 shares of Class A common stock actual, pro forma and pro forma as adjusted			
Additional paid-in capital	60,146,934	195,435,434	204,431,042
Deferred stock-based compensation	(690,937)	(690,937)	(690,937)
Accumulated deficit	(5,249,085)	(5,249,085)	(5,249,085)
Total stockholders' equity	54,463,628	238,072,128	247,072,128
Total capitalization	\$ 54,463,628	\$ 238,072,128	\$ 247,072,128

The above discussion and table exclude:

- 4,938,603 shares of Class B common stock reserved for issuance and not exercised under our 2003 amended and restated stock incentive plan as of September 30, 2004 and 278,915 shares of Class B common stock reserved for issuance and not purchased under our 2004 employee stock purchase plan as of September 30, 2004. As of September 30, 2004, 3,571,167 shares were subject to outstanding options under our 2003 amended and restated stock incentive plan, which options are at a weighted average exercise price of \$4.02 per share.
- 120,000 shares of Class B common stock issuable upon the exercise of the warrants at an exercise price of \$8.45 per share issued to the underwriters in connection with our initial public offering in April 2004.
- shares of our Class B common stock issuable upon conversion of the preferred stock.

In addition, the completion of the Class B common stock offering is not contingent upon the completion of the preferred stock offering. In the event we elect not to consummate the preferred stock offering, we will increase the size of the Class B common stock offering accordingly, which is not given effect in the above table.

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NAME DEVELOPMENT ASSET ACQUISITION

Description of the Asset Acquisition

On November 19, 2004, we entered into an agreement to acquire certain assets of Name Development Ltd., or Name Development, a corporation operating in the direct navigation market. Direct navigation is one of the methods that online consumers use to search for information, products or services online. Direct navigation is primarily characterized by online users directly accessing a Web site by: (1) typing descriptive keywords or keyword strings into the uniform resource locator, or URL, address box of an Internet browser; or (2) accessing bookmarked Web sites. It can also include navigating through referring or partner traffic sources. Name Development owns and maintains a portfolio of Web properties, that are generally reflective of online user search terms, descriptive keywords and keyword strings. Name Development has entered into agreements with advertising service providers to monetize its online user traffic with pay-per-click listings. As such, Name Development is able to connect online users searching for specific information with relevant advertisements.

Upon completion of the asset acquisition, we believe we will be among the leaders in the direct navigation market due to our proprietary ownership of online user traffic, which totaled more than 17 million unique visitors in November 2004. This user traffic is generated from a portfolio of Web properties that are generally reflective of commercially-relevant search terms in many of the Internet's most popular and dynamic vertical commerce categories and may include geographically-targeted elements. The total number of Web properties in the portfolio, including Marchex's existing Web properties, is more than 200,000. Key vertical commerce categories include: travel, financial services, insurance, real estate, auto, health, technology and electronics, personals, jobs, home and garden, Web and telecom services, education, and entertainment.

Name Development's revenues increased 260% from \$3.5 million for the fiscal year ended June 30, 2003 to \$12.5 million for the fiscal year ended June 30, 2004. For the corresponding periods, income from operations grew from \$3.2 million to \$12.6 million. For the nine months ended September 30, 2004, revenues were \$15.5 million and income from operations was \$14.9 million.

We expect to account for the Name Development asset acquisition as a business combination.

Anticipated Benefits of the Asset Acquisition

We believe that the Name Development asset acquisition will provide us with several benefits, including:

- ***A Defensible, Proprietary Source of Targeted Traffic.*** We believe that we will have an exclusive position due to the nature of Internet domain registration, which is similar to owning real-estate in that each Internet domain name is unique. The asset acquisition will provide us with Web properties that collectively generated more than 17 million unique visitors in November 2004. The total number of Web properties in the portfolio, including Marchex's existing Web properties, is more than 200,000.
- ***Synergies with our Existing Search Engine Marketing Services Platform.*** We believe that our technology platform, combined with the Name Development asset acquisition, gives us an advantage in extending market share within the direct navigation market, expanding our participation in the search advertising market and in key commerce verticals. For example, we

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believe that: (1) there may be opportunities to work with monetization providers to improve the categorization and revenue generation of individual Web properties; (2) there may be opportunities to leverage our database of current search-related information to improve and automate selection and acquisition of complementary Web properties; (3) there may be opportunities to generate incremental user traffic to selected Web properties through leveraging our existing distribution network; (4) there may be opportunities to leverage our experience in working with a variety of online providers to add dynamic content and relevant advertiser listings, including product shopping listings and classified listings, to increase the user utility of the Web properties; and (5) there may

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be opportunities, over time, to supplement existing listings on certain Web properties with our performance-based advertisements.

- ***Platform to Extend Expansion Initiatives.*** Over time, we intend to use the asset acquisition to supplement our planned expansion, both domestically and internationally.

Transaction Structure

The aggregate consideration to be paid under the asset purchase agreement is an amount of cash equal to \$155.2 million plus the number of shares of our Class B common stock obtained by dividing \$9.0 million by the average of the last quoted sale price for shares of our Class B common stock on the Nasdaq National Market for the ten trading days immediately prior to the closing.

The asset purchase agreement contains customary representations and warranties and requires Name Development's sole stockholder to indemnify us for various liabilities arising under the agreement, subject to various limitations and conditions. At the closing, we will deposit into escrow for a period of eighteen months from the closing an amount of cash equal to \$24.6 million to secure the sole stockholder's indemnification and other obligations under the asset purchase agreement.

The asset acquisition is contingent on customary closing conditions, including the closing by us of financing sufficient to consummate such acquisition. If the closing does not occur on or before June 30, 2005, we may be required to pay Name Development a termination fee of \$1.5 million through a combination of cash and equity. We have also agreed to file a registration statement to register the shares of Class B common stock issued as the equity consideration thereunder or any shares of Class B common stock issued in connection with payment of the termination fee for resale on Form S-3 once we become eligible to file such a registration statement with the SEC.

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SUMMARY UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

The following tables present a summary of our unaudited pro forma condensed consolidated statements of operations for the year ended December 31, 2003 and for the nine months ended September 30, 2004. You should read this financial data together with Unaudited Pro Forma Condensed Consolidated Statements of Operations, Quarterly Results of Operations, Management's Discussion and Analysis of Financial Condition and Results of Operations, our historical audited consolidated financial statements and the related notes and the historical audited and unaudited financial statements of TrafficLeader, goClick.com and Name Development appearing elsewhere in this prospectus.

The unaudited pro forma condensed consolidated statement of operations data for the year ended December 31, 2003 give effect to: (1) our 2003 acquisitions of Enhance Interactive and TrafficLeader and our 2004 acquisition of goClick; and (2) our proposed Name Development asset acquisition and the offerings, as if they had all occurred on January 1, 2003. The unaudited pro forma condensed consolidated statements of operations for the year ended December 31, 2003 are based upon the historical results of operations of Marchex for the period from January 17, 2003 (inception) through December 31, 2003, the Predecessor for the period from January 1, 2003 through February 28, 2003, TrafficLeader for the period from January 1, 2003 through October 23, 2003 and goClick and Name Development for the year ended December 31, 2003.

The summary unaudited pro forma condensed consolidated statement of operations data are presented for illustrative purposes only and do not represent what our results of operations actually would have been if the transactions referred to above had occurred as of the dates indicated or what our results of operations will be for future periods.

In addition, the completion of the Class B common stock offering is not contingent upon the completion of the preferred stock offering. In the event we elect not to consummate the preferred stock offering, we will increase the size of the Class B common stock offering accordingly, which is not given effect in the following tables.

Table of Contents**Year ended December 31, 2003**

	Predecessor		Successor Periods			
	Period					
	Period from January 1 to February 28, 2003	Marchex Period from January 17, (inception) to December 31, 2003	Pro Forma Marchex and Prior Acquisitions 2003	Pending Asset Acquisition and Offering 2003	Adjustments	Pro Forma Marchex, Prior and Pending Acquisitions and Offering 2003
Unaudited Pro Forma Statement of Operations:						
Revenue	\$ 3,071,055	\$ 19,892,158	\$ 30,657,395	\$ 4,336,121	\$	\$ 34,993,516
Expenses:						
Service costs	1,732,813	11,292,070	18,528,420	1,238,536	(335,083) ⁽¹⁾	19,431,873
Sales and marketing	365,043	2,460,683	3,341,578			3,341,578
Product development	144,479	1,291,422	1,613,807			1,613,807
General and administrative	234,667	2,743,919	3,404,305	72,642		3,476,947
Acquisition-related retention consideration		283,269	283,269			283,269
Facility relocation						
Stock-based compensation	38,981	2,125,110	2,659,280			2,659,280
Amortization of intangible assets		3,023,408	6,186,641		14,588,333 ⁽¹⁾	20,774,974
Total operating expenses	2,515,983	23,219,881	36,017,300	1,311,178	14,253,250	51,581,728
Gain on sale of intangible assets, net				965,297		965,297
Income (loss) from operations	555,072	(3,327,723)	(5,359,905)	3,990,240	(14,253,250)	(15,622,915)
Other income (expense)	1,529	74,059	81,381	(11,233)		70,148
Income (loss) before provision for income taxes	556,601	(3,253,664)	(5,278,524)	3,979,007	(14,253,250)	(15,552,767)
Income tax expense (benefit)	224,082	(1,084,312)	(1,705,580)	441,588	(4,345,800) ⁽²⁾	(5,609,792)
Net income (loss)	332,519	(2,169,352)	(3,572,944)	3,537,419	(9,907,450)	(9,942,975)
Accrual of convertible preferred stock dividends				2,500,000 ⁽³⁾		2,500,000 ⁽³⁾
Accretion of redemption value of redeemable convertible preferred stock		1,318,885	1,318,885			1,318,885
Net Income (loss) applicable to common stockholders	\$ 332,519	\$ (3,488,237)	\$ (4,891,829)	\$ (1,037,419)	\$ (9,907,450)	\$ (13,761,860)
Other Financial Data:						
Operating income before amortization (OIBA) ⁽⁴⁾	\$ 594,053	\$ 1,820,795	\$ 3,486,016	\$ 3,990,240		\$ 7,811,339

⁽¹⁾Represents the amortization of identifiable intangible assets associated with the Name Development asset acquisition, which are amortized over their useful lives ranging from 12 to 60 months, amortization of \$14.6 million in the first twelve months and \$25.5 million in the first twenty-one months following the acquisition. Name Development, for the year ended December 31, 2003 and the nine months ended September 30, 2004, recorded approximately \$335,000 and \$529,000, respectively, of amortization included in service costs related to the above noted intangible assets.

⁽²⁾Represents pro forma income tax expense (benefit) as though Name Development was taxed as a C corporation for the periods presented with an effective federal and state combined rate of 38%. Name Development is organized under the corporate law of the British Virgin Islands and is not subject to income tax in the British Virgin Islands. Name Development had e-commerce activities in several other governmental jurisdictions and as such, had recognized a provision for taxes in these foreign jurisdictions. A 1% change in the effective federal and state combined rate would modify income tax expense (benefit) by (\$103,000) for the twelve month period ended December 31, 2003 and \$46,000 for the nine months ended September 30, 2004.

⁽³⁾Represents preferred stock dividends related to the proposed preferred stock offering. Based upon an estimated preferred stock offering of \$50.0 million with an estimated 5% dividend rate, the accrual of the convertible preferred dividend for the twelve month period ended December 31, 2003 would be approximately \$2.5 million.

Footnote continued on page 47.

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The unaudited pro forma condensed consolidated statement of operations data for the nine months ended September 30, 2004 give effect to: (1) our 2004 acquisition of goClick; and (2) our proposed Name Development asset acquisition and the offerings, as if they had all occurred on January 1, 2003. The unaudited pro forma condensed consolidated statement of operations for the nine months ended September 30, 2004 are based upon the historical results of operations of Marchex for the nine months ended September 30, 2004, goClick for the period from January 1, 2004 through July 26, 2004 and for Name Development for the nine months ended September 30, 2004.

Nine months ended September 30, 2004					
	Marchex	Pro Forma Marchex and Prior Acquisitions	Pending Asset Acquisition and Offering	Adjustments	Pro Forma Marchex, Prior and Pending Acquisitions and Offering
Unaudited Pro Forma Statement of Operations:					
Revenue	\$ 28,682,924	\$ 32,434,453	\$ 15,456,114	\$	\$ 47,890,567
Expenses:					
Service costs	18,142,886	20,473,056	1,242,744	(529,428) ⁽¹⁾	21,186,372
Sales and marketing	3,196,996	3,217,449			3,217,449
Product development	1,636,321	1,733,063			1,733,063
General and administrative	2,613,932	2,646,440	793,395		3,439,835
Acquisition-related retention consideration	374,858	374,858			374,858
Facility relocation	199,960	199,960			199,960
Stock-based compensation	721,403	721,403			721,403
Amortization of intangible assets	3,473,976	3,594,151		10,866,250 ⁽¹⁾	14,460,401
Total operating expenses	30,360,332	32,960,380	2,036,139	10,336,822	45,333,341
Gain on sale of intangible assets, net			1,507,498		1,507,498
Income (loss) from operations	(1,677,408)	(525,927)	14,927,473	(10,336,822)	4,064,724
Other income (expense)	218,974	224,470	2,408		226,878
Income (loss) before provision for income taxes	(1,458,434)	(301,457)	14,929,881	(10,336,822)	4,291,602
Income tax expense (benefit)	(118,016)	331,277	1,387,434	357,928 ⁽²⁾	2,076,639
Net income (loss)	(1,340,418)	(632,734)	13,542,447	(10,694,750)	2,214,963
Accrual of convertible preferred stock dividends			1,875,000 ⁽³⁾		1,875,000 ⁽³⁾
Accretion of redemption value of redeemable convertible preferred stock	420,430	420,430			420,430
Net income (loss) applicable to common stockholders	\$ (1,760,848)	\$ (1,053,164)	\$ 11,667,447	\$ (10,694,750)	\$ (80,467)
Other Financial Data:					
Operating income before amortization (OIBA) ⁽⁴⁾	\$ 2,517,971	\$ 3,789,627	\$ 14,927,473		\$ 19,246,528

⁽¹⁾ Represents the amortization of identifiable intangible assets associated with the acquisition of Name Development, which are amortized over their useful lives ranging from 12 to 60 months, amortization of \$14.6 million in the first twelve months and \$25.5 million in the first twenty-one months following the Name Development asset acquisition, for the year ended December 31, 2003 and the nine months ended September 30, 2004, recorded approximately \$335,000 and \$529,000, respectively, of amortization included in service costs related to the above noted intangible assets.

⁽²⁾ Represents pro forma income tax expense (benefit) as though Name Development was taxed as a C corporation for the periods presented with an effective federal and state combined rate of 38%. Name Development is organized under the corporate laws of the British Virgin Islands and is not subject to income tax in the British Virgin Islands. Name Development had e-commerce activities in several other governmental jurisdictions and as such, had recognized a provision for taxes in these foreign jurisdictions. A 1% change in the effective federal and state combined rate would modify income tax expense (benefit) by (\$103,000) for the twelve month period ended December 31, 2003 and \$46,000 for the nine months ended September 30, 2004.

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⁽³⁾Represents preferred stock dividends related to the proposed preferred stock offering. Based upon an estimated preferred stock offering of \$50.0 million with an estimated 5% dividend rate, the accrual of the convertible preferred dividend for the nine months ended September 30, 2004 would be approximately \$1.9 million.

Footnote continued on page 47.

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The following table provides a reconciliation of Income (loss) from operations and Net income (loss) applicable to common stockholders to the non-GAAP measure of OIBA.

	Year ended December 31, 2003					Nine months ended September 30, 2004			
Predecessor	Successor Period					Successor Period			
Period	Successor Period					Successor Period			
Period from January 1 to February 2003	Marchex Period from January 17, (inception) to December 31, 2003	Pro Forma Marchex and Prior Acquisitions 2003	Pending Acquisition and Offering 2003	Pro Forma Marchex, Prior and Pending Acquisitions and Offering 2003		Marchex	Pro Forma Marchex and Prior Acquisitions	Pending Asset Acquisition and Offering	Pro Forma Marchex, Prior and Pending Acquisitions and Offering
Operating income before amortization (OIBA) ⁽⁴⁾	\$ 594,053	\$ 1,820,795	\$ 3,486,016	\$ 3,990,240	\$ 7,811,339	\$ 2,517,971	\$ 3,789,627	\$ 14,927,473	\$ 19,246,528
Stock-based compensation	(38,981)	(2,125,110)	(2,659,280)		(2,659,280)	(721,403)	(721,403)		(721,403)
Amortization of intangible assets		(3,023,408)	(6,186,641)		(20,774,974)	(3,473,976)	(3,594,151)		(14,460,401)
Income (loss) from operations	555,072	(3,327,723)	(5,359,905)	3,990,240	(15,622,915)	(1,677,408)	(525,927)	14,927,473	4,064,724
Other income (expense):	1,529	74,059	81,381	(11,233)	70,148	218,974	224,470	2,408	226,878
Income (loss) before provision for income taxes	556,601	(3,253,664)	(5,278,524)	3,979,007	(15,552,767)	(1,458,434)	(301,457)	14,929,881	4,291,602
Income tax expense (benefit)	224,082	(1,084,312)	(1,705,580)	441,588	(5,609,792)	(118,016)	331,277	1,387,434	2,076,639
Net income (loss)	332,519	(2,169,352)	(3,572,944)	3,537,419	(9,942,975)	(1,340,418)	(632,734)	13,542,447	2,214,963
Accrual of convertible preferred stock dividends				2,500,000	2,500,000			1,875,000	1,875,000
Accretion of redemption value of redeemable convertible preferred stock		1,318,885	1,318,885		1,318,885	420,430	420,430		420,430
Net income (loss) applicable to common stockholders	\$ 332,519	\$ (3,488,237)	\$ (4,891,829)	\$ 1,037,419	\$ (13,761,860)	\$ (1,760,848)	\$ (1,053,164)	\$ 11,667,447	\$ (80,467)

⁽⁴⁾ We report operating income before amortization (OIBA) that is a supplemental measure to GAAP. OIBA represents income (loss) from operations before: (1) stock-based compensation expense; and (2) amortization of intangible assets. This measure, among other things, is one of the primary metrics by which we evaluate the performance of our business. Additionally, management uses adjusted OIBA which excludes acquisition-related retention consideration as we view this as part of the earn-out consideration from the transaction. Adjusted OIBA is the basis on which our internal budgets are based and by which management is currently evaluated. Management believes that investors should have access to, and we are obligated to provide, the same set of tools that we use in analyzing our results. This non-GAAP measure should be considered in addition to results prepared in accordance with GAAP, and should not be considered in isolation, as a substitute for, or superior to, GAAP results. We believe this measure is useful to investors because it represents our consolidated operating results, taking

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

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

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

Overview

We provide technology-based merchant services that facilitate and drive growth in 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 efficiently market and sell their products and services across multiple online distribution channels, including search engines, product shopping engines, directories and other selected Web properties.

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

- **Pay-Per-Click Services.** We deliver pay-per-click advertising listings that are reflective of our merchant advertisers' products and services to online users in response to their keyword search queries. These pay-per-click listings are generally ordered in the search results based on the amount our merchant advertisers choose to pay for a targeted placement. These targeted listings are displayed to consumers and businesses through our distribution network of leading search engines, product shopping engines, directories and other Web properties.
- **Feed Management Services.** We leverage our proprietary technology to crawl and extract relevant product content from merchant advertisers' databases and Web sites to create highly-targeted product and service listings, which we deliver into our distribution network. These feed management listings are ordered in the results based on relevance to user search queries. Our trusted feed relationships with our distribution partners enable merchant advertisers to deliver comprehensive and up-to-date product and service listings to some of the Web's largest search engines, product shopping engines and directories.
- **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 search engines and pay-per-click networks using our bid management services; and (2) evaluate the effectiveness of online advertising campaigns using our conversion tracking and detailed reporting services.
- **Search Engine Optimization Services.** We optimize key attributes of merchant advertiser Web sites to ensure the greatest opportunity for proper indexing, listing and inclusion in the editorial results of algorithmic search engines.

We were incorporated in Delaware on January 17, 2003. Acquisition initiatives have played an important part in our corporate history to date. Excluding the pending Name Development asset acquisition, we have completed three acquisitions since our inception including:

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- 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.

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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. Any payments made under this obligation will be accounted for as additional goodwill. For the 2003 calendar year, the earn-out consideration paid was approximately \$3.2 million.

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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. Any payments made under this obligation will be accounted for as compensation. For the 2003 calendar year, the retention consideration was approximately \$283,000. For the nine months ended September 30, 2004, we recorded an additional \$375,000 in retention-related consideration as compensation expense for such period. The actual amount for the calendar year 2004 has not yet been determined.

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.

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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 prior to the closing of our initial public offering in April 2004; plus
- 137,500 shares of restricted Class B common stock which vest over a three-year period in six month installments of 16.67%; 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 chief executive officer and chief technology officer 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 \$1.0 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.

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The shares of Class B common stock were valued at \$9.55 per share, for accounting purposes, for an aggregate amount of \$4.1 million.

Pending Name Development Asset Acquisition

On November 19, 2004, we signed an asset purchase agreement with Name Development. Pursuant to this agreement, we will acquire substantially all of the assets of Name Development for the following consideration:

- \$155.2 million in cash; plus
- \$9.0 million in shares of Class B common stock, based on the average of the last quoted sale price for shares of Class B common stock on the Nasdaq National Market for the 10 trading days immediately prior to the closing.

Under the terms of the agreement, we will acquire only the identified assets of Name Development, including its inventory of Internet domain names, revenue-generating contracts, technology and systems, for the operation of the Name Development direct navigation business. We will not assume any other obligations with respect to Name Development in this asset acquisition.

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We expect to account for the Name Development asset acquisition as a business combination. The closing of the transaction is conditioned on a number of factors, including the closing by us of financing sufficient to consummate such acquisition. For more information on the asset acquisition, see Name Development Asset Acquisition.

Consolidated Statements of Operations

Our consolidated statements of operations, stockholders' equity, and cash flows have been presented for:

- the period of January 17, 2003 (inception) to September 30, 2003;
- the period of January 17, 2003 (inception) to December 31, 2003; and
- the nine months ended September 30, 2004.

The statements of operations, stockholders' equity and cash flows have been presented for the Predecessor, Enhance Interactive:

- for the year ended December 31, 2002; and
- the period of January 1, 2003 to February 28, 2003.

Business planning and other activities related to our business began in late 2002. We were organized and incorporated in Delaware in January 2003. Included in the results of operations subsequent to our incorporation in January 2003 are reimbursements to certain founding executive officers for approximately \$86,000 in general and administrative pre-incorporation costs. Included in property and equipment are purchases from certain of our founding executive 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 within Marchex 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 periods of: (1) February 28, 2003 through December 31, 2003; (2) October 24, 2003 through December 31, 2003; and (3) July 27, 2004 through September 30, 2004, all goodwill, intangible assets and liabilities resulting from the respective Enhance Interactive, TrafficLeader and goClick 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, stockholders' equity, and cash flows reflecting Enhance Interactive's historical results have been presented for the year ended December 31, 2002 and the period from January 1, 2003 through February 28, 2003.

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

Presentation of Financial Reporting Periods

For purposes of our discussion, we have included the results of operations of the Predecessor, Enhance Interactive. The comparative periods presented are for:

- the results of Enhance Interactive for the year ended December 31, 2002 (2002 period), compared to the combined results for the period of January 17, 2003 (inception) to December 31, 2003 and the results of Enhance Interactive for the period of January 1, 2003 to February 28, 2003 (2003 period); and

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- the nine months ended September 30, 2003 (the combined periods of Marchex's results from January 17, 2003 (inception) to September 30, 2003 and the Predecessor's results for the period of January 1, 2003 to February 28, 2003), compared to the nine months ended September 30, 2004.

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. During this period we had no revenues. Accordingly, our activities were different from the operating activities of Enhance Interactive.

Revenue

We currently generate revenue through our 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 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: (1) evidence of an arrangement exists; (2) the arrangement fee is fixed and determinable; and (3) 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, directory and product shopping engine results within our distribution network. Generally, the feed management listings are presented in a different section of the a Web page than the pay-per-click listings. For this service, revenue is generated when an online user clicks on a feed management listing from search engine, directory or product shopping engine results. Each click-through on an advertisement listing represents a completed transaction for which the merchant advertiser pays for on a per-click basis. The placement of a feed management result is largely determined by its relevancy, as determined by the distribution partner.

Search Marketing Services

Merchant advertisers pay us additional fees for services such as advertising campaign management services and search 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.

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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 and seasonal purchasing cycles of many merchant advertisers. 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 periods presented primarily include:

- user acquisition costs;

- amortization of intangible assets;
- credit card processing fees;
- network operations;
- serving our search results;
- maintaining our Web sites;
- network fees;

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- 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; and
- stock-based compensation of related personnel.

User Acquisition Costs

For the periods presented the largest component of our service costs consist of user acquisition costs that relate primarily to payments to our distribution partners for access to their online 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: (1) pro-rata over the term the fixed payment covers; or (2) 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

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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.

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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;
- professional services, including accounting, legal and insurance;
- bad debt provisions;
- facilities costs; and
- other general corporate expenses.

Acquisition-Related Retention Consideration

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

The contingent payment obligation is calculated based on the formula of 5.56% of Enhance Interactive's earnings before taxes for each of the calendar years 2003 and 2004, up to a maximum payout cap of \$1.0 million in the aggregate. To the extent we make any payments under this obligation, we will account for such amounts as compensation. For the 2003 calendar year, the retention consideration was approximately \$283,000. For the nine months ended September 30, 2004, we recorded an additional \$375,000 in retention-related consideration as compensation expense for such period. The actual amount for the calendar year 2004 has not yet been determined.

Stock-Based Compensation

Stock-based compensation consists of the following components:

- the intrinsic value of employee option and restricted stock issuances in cases where the fair value of the underlying stock was greater than the exercise price on the date of the grant;
- the fair value of non-employee option issuances; and
- the amount by which the fair value of our Class B common stock exceeds the exercise price at the end of the period for certain options.

We used variable accounting for the options to purchase 125,000 shares of our Class B common stock that were issued under our stock incentive plan. These options were held in escrow until February 28, 2004 as security for the indemnification obligations under the Enhance Interactive merger agreement, and these options were subject to forfeiture during the escrow period. We accounted for these options as variable awards until February 28, 2004.

Amortization of Intangibles

Amortization of intangible assets relates to intangible assets identified in connection with our acquisitions.

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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 Internet 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

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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, those underwriters were also granted warrants, exercisable over a four-year period commencing April 5, 2005 date and ending April 5, 2009, 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.

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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 redemption amount at the earliest redemption date.

Results of Operations

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

Revenue. Revenue increased 128%, from \$10.1 million in the 2002 period to \$23.0 million in the 2003 period. This increase was primarily attributable to an increase in performance-based advertising services from \$9.3 million in the 2002 period to \$21.7 million in the 2003 period. Of this \$12.4 million increase, 34% related to an increase in the number of merchant advertisers, while 66% related to an increase in the average revenue per merchant advertiser.

We believe the increase in revenue is primarily attributable to the growth of our revenue resulting from 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 increased from approximately 290 in December 2002 to approximately 410 in December 2003. We also believe the foregoing factors, combined with our sales efforts and improved operational controls, have contributed to the increase in the number of merchant advertisers. \$1.2 million of the increase in revenue in the 2003 period is also attributable to the acquisition of TrafficLeader in October 2003, which added 11 unique distribution partners and more than 280 merchant advertisers. TrafficLeader's operating results were included in the 2003 period as of the acquisition date of October 24, 2003.

Expenses

Service Costs. Service costs increased 106%, from \$6.3 million in the 2002 period to \$13.0 million in the 2003 period. The net increase in costs was mainly attributable to an increase in payments to distribution partners of \$6.2 million, an increase in credit card processing fees of \$333,000, an increase in personnel costs of \$171,000, a decrease in technology licensing costs of \$104,000, and an increase in facility and other costs of \$91,000. This net increase related to a greater number of searches, an increase in database and hardware capacity requirements as a result of an increase in our distribution partner base and corresponding number of searches, an increase in the number of personnel required to support our services and increased fees paid to outside service providers. Service costs represented 63% of revenue in the 2002 period and 57% of revenue in the 2003 period. As a percentage of revenue, the decrease in service costs for the 2003 period compared to the 2002 period was primarily a result of network operation expenses containing fixed costs and also not increasing at a higher rate than revenue. The decrease in the 2003 period was partially offset by the impact of \$943,000 in service costs and the impact as a percentage of revenue resulting from the October 2003 acquisition of TrafficLeader and its feed management services. 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.

Sales and Marketing. Sales and marketing expense increased 55%, from \$1.8 million in the 2002 period to \$2.8 million in the 2003 period. As a percentage of revenue, sales and marketing expenses were 18% in the 2002 period and 12% in the 2003 period. The increase in dollars was primarily related to an increase in personnel costs of \$614,000, primarily due to an increase in the number of employees, including \$72,000 resulting from the acquisition of TrafficLeader in October 2003. The remaining increase is related to increases in outside marketing activities, rent, travel and other operating costs arising from operations in multiple jurisdictions.

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Product Development. Product development expenses increased 77%, from \$812,000 in the 2002 period to \$1.4 million in the 2003 period. As a percentage of revenue, product development expenses were 8% in the 2002 period and 6% in the 2003 period. As a percentage of revenue, the decrease in product development expenses in the 2003 period compared to the 2002 period was primarily a result of the allocation of product development expenses over a larger revenue base. The increase in dollars was primarily due to an increase in personnel costs of \$461,000, primarily due to an increase in the number of employees, including \$40,000 resulting from the acquisition of TrafficLeader in October 2003, and rent and other operating expenses of \$163,000 arising from operations in multiple jurisdictions.

General and Administrative. General and administrative expenses increased 205%, from \$977,000 in the 2002 period to \$3.0 million in the 2003 period. As a percentage of revenue, general and administrative expenses were 10% in the 2002 period and 13% in the 2003 period. The increase in the dollars was due to an increase in personnel costs of \$640,000, an increase in professional fees of \$617,000, an increase in travel of \$288,000, an increase in insurance of \$74,000, an increase in bad debt expense of \$126,000, and an increase in facility and other operating expenses of \$257,000.

Many of these costs and increases in costs as a percentage of revenue in the 2003 period result from operating in multiple jurisdictions commencing in 2003 and increased operating activity, including approximately \$136,000 in general and administrative expenses from the acquisition of TrafficLeader in October 2003.

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

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

Stock-Based Compensation. The amortization of stock-based compensation increased 493%, from \$365,000 in the 2002 period to \$2.2 million in the 2003 period. During the 2002 period, the components of stock-based compensation were service costs of \$3,000, sales and marketing of \$149,000, product development of \$57,000 and general and administrative of \$156,000. The 2002 period amount related primarily to the January 2002 sale of 2,031,666 shares to employees for cash consideration totaling \$10,000; \$357,000 in stock-based compensation was recorded in connection with the share issuance based on the difference between the cash consideration and the estimated fair value. During the 2003 period, the components of stock-based compensation were service costs of \$10,000, sales and marketing of \$423,000, product development of \$279,000 and general and administrative of \$1.5 million.

Amounts in the 2003 period related primarily to the vesting of stock options granted to employees in which the exercise price was less than the fair value of the shares at the date of grant, and \$112,000 related to restricted stock issued to employees for future services in connection with the acquisition of TrafficLeader. The 2003 period also includes \$781,000 of stock-based compensation for options to purchase 125,000 shares of Class B common stock, which were being held in escrow as security for the indemnification obligations under the

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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.

Under variable plan accounting, compensation expense is measured quarterly as the amount by which the fair value of the shares of our Class B common stock covered by the option grant exceeds the exercise price and is recognized over the vesting period thereof. Increases or decreases in the fair value of our Class B common stock between the date of grant and the date of exercise result in a corresponding increase or decrease in the measure of compensation expense.

Amortization of Identifiable Intangibles. Intangible amortization expense increased from zero in the 2002 period to \$3.0 million in the 2003 period as a result of amortizing identifiable intangibles associated with the purchase of Enhance Interactive and TrafficLeader. Of the \$3.0 million intangible amortization expense in the 2003 period, \$123,000 was associated with the acquisition of TrafficLeader. During the 2003 period, the components of amortization of intangibles were service costs of \$2.2 million, sales and marketing of \$348,000, and general and administrative of \$458,000.

Our application of purchase accounting resulted in the recording of all assets and liabilities from our acquisitions of Enhance Interactive and TrafficLeader at their estimated fair values on the acquisition dates of February 28, 2003 and October 24, 2003, respectively. For the period of February 28, 2003, through December 31, 2003, all goodwill, identifiable intangible assets and liabilities resulting from the Enhance Interactive and TrafficLeader acquisitions have been recorded in our financial statements. The identified intangibles amounted to \$9.7 million, including \$1.3 million associated with TrafficLeader, 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.

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

The adjustment to fair value of the redemption obligation went from zero in the 2002 period to \$26,000 in the 2003 period. As of the date of acquisition of TrafficLeader, a redemption obligation was recorded at fair value in the amount of \$81,000. The \$26,000 adjustment reflects the decrease in the fair value of the obligation to \$55,000 as of December 31, 2003. This obligation was eliminated with the closing of our initial public offering in April 2004.

Income Taxes. The income tax benefit increased from \$143,000 in the 2002 period to \$860,000 in the 2003 period. The 2002 period effective tax rate benefit of 61% differed from the expected effective rate of 34% primarily due to our reversing \$208,000 of the valuation allowance on deferred tax assets and due to the effective rate impact of the \$133,000 of non-deductible stock-based compensation during the 2002 period.

During the 2002 period, Enhance Interactive determined that it was more likely than not, based on improved operating performance, that it would realize all of the available net deferred tax assets. The income tax effective rate was 32% in the 2003 period. This differed from the expected rate of 34% primarily due to state income taxes offset by non-deductible stock compensation amounts.

The 2003 period was also impacted by the following factors:

- On February 28, 2003 and October 24, 2003, in connection with the application of purchase accounting for our respective acquisitions of Enhance Interactive and TrafficLeader, we

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recorded net deferred tax liabilities of approximately \$3.5 million, including \$482,000 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.

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

Accretion to Redemption Value of Redeemable Convertible Preferred Stock. The accretion to redemption value of preferred stock was \$1.3 million in the 2003 period. The accretion to the redemption value recorded during the period is based upon 6,724,063 shares of Series A preferred stock outstanding as of December 31, 2003 with a dividend rate of 8% per annum.

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

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

Revenue. Revenue increased 85%, from \$15.5 million in the nine months ended September 30, 2003 to \$28.7 million in the same period in 2004. This increase was primarily attributable to our performance-based advertising services, which increased by approximately \$12.7 million in the nine months ended September 30, 2004. Of this increase approximately 77% related to an increase in the average revenue per merchant advertiser, while approximately 23% related to an increase in the number of merchant advertisers.

We believe the increase in revenue is primarily attributable to the growth of our revenue resulting from 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 the increase in the average revenue per merchant advertiser. The increase in revenue in the nine months ended September 30, 2004 is also attributable to the acquisition of TrafficLeader in October 2003, which added 11 unique distribution partners and more than 280 merchant advertisers and the acquisition of goClick in July 2004 which added more than 40 unique distribution partners and more than 5,000 unique merchant advertisers. 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.

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Expenses

Service Costs. Service costs increased 112%, from \$8.5 million in the nine months ended September 30, 2003 to \$18.1 million in the same period in 2004. This increase was primarily attributable to an increase of \$8.1 million in payments to distribution partners, an increase in personnel costs of \$942,000, an increase in facility and other costs of \$310,000, an increase in payment processing fees of \$163,000 and an increase in production technology and bandwidth costs of \$118,000.

Service costs as a percentage of revenue were 63% in the nine months ended September 30, 2004 as compared to 55% in the same period in 2003. As a percentage of revenue, the increase in service costs for the nine months ended September 30, 2004 period as compared to the same period 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 nine months ended September 30, 2004. 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.

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. The increase in services 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. We expect that service costs will continue to increase in absolute dollars, since we anticipate expanding our operations.

Sales and Marketing. Sales and marketing expenses increased 63%, from \$2.0 million in the nine months ended September 30, 2003 to \$3.2 million in the same period in 2004. The increase in dollars was primarily attributable to an increase in personnel costs of \$893,000, an increase in travel costs of \$166,000 and an increase in other expenses of \$181,000. As a percentage of revenue, sales and marketing expenses were 13% and 11% for the nine months ended September 30, 2003 and 2004, respectively. 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.

Product Development. Product development expenses increased 65%, from \$989,000 in the nine months ended September 30, 2003 to \$1.6 million in the same period in 2004. The increase in dollars was primarily attributable to an increase in personnel costs of \$530,000, an increase in travel costs 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 nine months ended September 30, 2003 and 2004. 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.

General and Administrative. General and administrative expenses increased 27%, from \$2.1 million in the nine months ended September 30, 2003 to \$2.6 million in the same period in 2004. As a percentage of revenue, general and administrative expenses decreased to 9% in the nine months ended September 30, 2004 as compared to 13% in the same period in 2003. As a percentage of revenue, the decrease in general and administrative expenses in the nine months ended September 30, 2004 as compared to the same period in 2003 was primarily a result of general and administrative expenses being compared to a larger revenue base.

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The net increase in the dollars was primarily due to an increase in personnel costs of \$754,000, a decrease in travel costs of \$106,000, an increase in insurance of \$74,000, an increase in bad debt expense of \$133,000 and a decrease in other expenses of \$292,000. Many of these costs in the nine months ended September 30, 2004 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.

Acquisition-Related Retention Consideration. Acquisition-related retention consideration increased 100%, from zero in the nine months ended September 30, 2003 to \$375,000 in the same period in 2004. A ratable proportion of the annual estimated acquisition-related retention consideration was recorded for the nine months ended September 30, 2004. During the nine months ended September 30, 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 \$45,000, sales and marketing of \$127,000, product development of \$138,000, and general and administrative of \$65,000.

The acquisition-related retention consideration was calculated as part of the contingent, earnings-based payment obligation to certain employees of Enhance Interactive and is equal to 5.56% of Enhance Interactive's earnings before taxes in excess of \$3.5 million for the 2004 period of which \$375,000 has been recorded as acquisition-related retention consideration including employer payroll-related taxes. 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.

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 56%, from \$1.6 million in the nine months ended September 30, 2003 to \$721,000 in the same period in 2004. During the nine months ended September 30, 2004, the components of stock-based compensation were service costs of \$9,000, sales and marketing of \$124,000, product development of \$47,000 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.

The nine months ended September 30, 2003 includes \$603,000 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

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common stock between the date of grant and the date of exercise result in a corresponding increase or decrease in the measure of compensation expense.

Amortization of Intangibles. Intangible amortization expense increased 71%, from \$2.0 million for the nine months ended September 30, 2003 to \$3.5 million in the same period in 2004. The increase is associated with the acquisitions of Enhance Interactive, TrafficLeader, and goClick. During the nine months ended September 30, 2004, the components of amortization of intangibles were service costs of \$2.4 million, sales and marketing of \$533,000 and general and administrative of \$494,000.

Our purchase accounting resulted in all assets and liabilities from our acquisition of Enhance Interactive, TrafficLeader and goClick 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 approximately \$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 525%, from \$35,000 in the nine months ended September 30, 2003 to \$219,000 in the same period in 2004. 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 nine months ended September 30, 2004 as compared to the same period in 2003. Interest income increased as a result of the impact of the initial public offering on the average cash balances in the nine months ended September 30, 2004.

Income Taxes. The income tax benefit decreased 79%, from \$559,000 in the nine months ended September 30, 2003 to \$118,000 in the same period in 2004.

In the nine months ended September 30, 2003, the effective tax rate benefit of 34% equaled the expected rate but was impacted by state income taxes in addition to non-deductible stock compensation amounts. The income tax effective rate benefit was 8% in the nine months ended September 30, 2004. 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 \$482,000 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.

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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 we recognized tax-effected benefits of approximately \$231,000 and \$180,000 respectively, which were recorded as credits to additional paid in capital.

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Accretion to Redemption Value of Redeemable Convertible Preferred Stock. The accretion to redemption value of preferred stock decreased 54%, from \$912,000 in the nine months ended September 30, 2003 to \$420,000 in the same period in 2004. The accretion to the redemption value recorded during these periods 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.

Net Income (Loss) Applicable to Common Stockholders. The net loss applicable to common stockholders decreased 12%, from \$2.0 million in the nine months ended September 30, 2003 period to \$1.8 million in the same period in 2004. The decrease was primarily attributable to revenue increasing at a faster rate than sales and marketing, product development and general and administrative expenses, a decrease in accretion to redemption value of the Series A redeemable convertible preferred stock of \$491,000, a decrease in stock-based compensation of \$905,000, partially offset by an increase in service costs as a percentage of revenue, an increase in amortization of intangible assets of \$1.4 million, an increase in acquisition-related retention consideration of \$375,000 and an increase in facility relocation costs of \$200,000.

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 GAAP information and to present to the readers of the financial statements the same information that management considers in assessing our 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 our 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: (1) the acquisition-related retention consideration, as we view this as part of the earn-out incentives related to our acquisition of Enhance Interactive; and (2) a facility relocation expense. Both of these items are viewed as non-recurring in nature. The Enhance Interactive earn-out consideration is recorded for its respective calendar year, and the facility relocation expense was recorded in the nine months ended September 30, 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 is 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.

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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 address the limitations of these non-GAAP measures presented by providing the comparable GAAP measure with equal or

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greater prominence, GAAP financial statements and detailed descriptions of the reconciling items and adjustments, including quantifying such items, to derive the non-GAAP measure.

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

- stock-based compensation consists of restricted stock and options expense, which relates mostly to restricted stock and options issued in connection with acquisitions. We view this expense as part of transaction costs which are not paid in cash. Stock-based compensation also includes the expense associated with certain employee stock options where on the date of grant the fair value of the underlying stock exceeded the exercise price.
- amortization of intangible assets is a non-cash expense relating primarily to acquisitions. At the time of an acquisition, the intangible assets of the acquired company, such as distribution partner relationships and merchant advertiser customer relationships are valued and amortized over their estimated lives. While it is likely that we will have significant intangible amortization expense as we continue to acquire companies, we believe that since intangibles represent costs incurred by the acquired company to build value prior to the acquisition, they were part of transaction costs and will not be replaced with cash costs when the intangibles are fully amortized.

The following is a reconciliation of income (loss) from operations and net income (loss) applicable to common stockholders to the non-GAAP measure of operating income before amortization, also referred to as OIBA, for the year ended December 31, 2002, the period of January 1, 2003 to February 28, 2003 and the period of January 17, 2003 (inception) to September 30, 2003, the period from January 17, 2003 (inception) to December 31, 2003 and for the nine months ended September 30, 2004.

	Predecessor Periods		Successor Periods		
	Year ended December 31, 2002	Period from January 1 to February 28, 2003	Period from January 17, (inception) to December 31, 2003	Period from January 17, (inception) to September 30, 2003	Nine months ended September 30, 2004
Operating income before amortization	\$ 126,543	\$ 594,053	\$ 1,820,795	\$ 1,371,829	\$ 2,517,971
Stock-based compensation	(364,693)	(38,981)	(2,125,110)	(1,587,476)	(721,403)
Amortization of intangible assets			(3,023,408)	(2,028,244)	(3,473,976)
Income (loss) from operations	(238,150)	555,072	(3,327,723)	(2,243,891)	(1,677,408)
Other income:					
Interest income	5,491	1,529	45,874	33,502	163,808
Interest expense					(3,728)
Adjustment to fair value of redemption obligation			25,500		55,250
Other			2,685		3,644
Total other income	5,491	1,529	74,059	33,502	218,974
Income (loss) before provision for income taxes	(232,659)	556,601	(3,253,664)	(2,210,389)	(1,458,434)
Income tax expense (benefit)	(142,876)	224,082	(1,084,312)	(783,231)	(118,016)

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Net income (loss)	(89,783)	332,519	(2,169,352)	(1,427,158)	(1,340,418)
Accretion to redemption value of redeemable convertible preferred stock			1,318,885	911,620	420,430
Net income (loss) applicable to common stockholders	\$ (89,783)	\$ 332,519	\$ (3,488,237)	\$ (2,338,778)	\$ (1,760,848)

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OIBA increased from \$127,000 in the 2002 period to \$2.4 million in the 2003 period. The increase was primarily attributable to increased operating activity that resulted in an increase in revenue of \$12.9 million offset by an increase in operating expenses of \$10.6 million, excluding stock-based compensation expense and amortization of intangible assets. OIBA increased in the nine months ended September 30, 2004 by \$552,000, or 28%, as compared to the same period in 2003. This increase 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, an increase in acquisition-related retention consideration of \$375,000 and an increase in facility relocation costs of \$200,000.

Table of Contents**Quarterly Results of Operations**

The following tables set forth our unaudited quarterly results of operations data for the eight most recent quarters and periods ended September 30, 2004, as well as such data expressed as a percentage of our revenues for the periods presented. The information in the tables below should be read in conjunction with our consolidated financial statements and the notes thereto included elsewhere in this prospectus. We have prepared this information on the same basis as the consolidated financial statements and the information includes all adjustments, consisting only of normal recurring adjustments, that we consider necessary for a fair statement of our financial position and operating results for the quarters or other periods presented. Our quarterly operating results have varied substantially in the past and may vary substantially in the future. You should not draw any conclusions about our future results from the results of operations for any particular quarter or period presented.

	Predecessor Periods			Successor Periods					
	Quarter ended Dec 31, 2002	Period from Jan 1 to Feb 28, 2003	Period from Jan 17, (inception) to March 31, 2003	Quarter ended					
				June 30, 2003	Sept 30, 2003	Dec 31, 2003	March 31, 2004	June 30, 2004	Sept 30, 2004
Consolidated Statement of Operations Data:									
Revenue	\$ 3,642,928	\$ 3,071,055	\$ 1,715,933	\$ 5,356,286	\$ 5,359,274	\$ 7,460,665	\$ 7,601,911	\$ 8,865,178	\$ 12,215,835
Expenses:									
Service costs ⁽¹⁾	2,170,479	1,732,813	883,280	2,955,535	2,967,206	4,486,049	4,779,575	5,743,815	7,619,496
Sales and marketing ⁽¹⁾	684,853	365,043	214,615	654,182	723,753	868,133	1,009,972	1,030,710	1,156,314
Product development ⁽¹⁾	322,543	144,479	104,947	354,927	384,248	447,300	505,535	528,306	602,478
General and administrative ⁽¹⁾	357,837	234,667	426,919	729,856	659,177	927,967	694,748	846,680	1,072,505
Acquisition-related retention consideration ⁽²⁾						283,269	132,936	122,724	119,198
Facility relocation							230,459		(30,499)
Stock-based compensation ⁽³⁾	2,421	38,981	710,991	550,078	326,407	537,634	360,764	235,234	125,405
Amortization of intangible assets ⁽⁴⁾			290,087	869,588	869,588	994,145	1,034,868	1,034,643	1,404,464
Total operating expenses	3,538,133	2,515,983	2,630,839	6,114,166	5,930,379	8,544,497	8,748,857	9,542,112	12,069,361
Income (loss) from operations	104,795	555,072	(914,906)	(757,880)	(571,105)	(1,083,832)	(1,146,946)	(676,934)	146,474
Other income:									
Interest income	2,967	1,529	3,092	13,479	16,931	12,372	11,016	70,329	82,462
Interest expense							(325)	(1,488)	(1,915)
Adjustment to fair value of redemption obligation						25,500	55,250		
Other						2,685	3,644		
Total other income	2,967	1,529	3,092	13,479	16,931	40,557	69,585	68,841	80,547
Income (loss) before provision for income taxes	107,762	556,601	(911,814)	(744,401)	(554,174)	(1,043,275)	(1,077,361)	(608,093)	227,021
Income tax expense (benefit)	47,841	224,082	(323,092)	(263,771)	(196,368)	(301,081)	(53,700)	(147,103)	82,787
Net income (loss)	59,921	332,519	(588,722)	(480,630)	(357,806)	(742,194)	(1,023,661)	(460,990)	144,234
Accretion to redemption value of redeemable convertible preferred stock			119,081	385,274	407,265	407,265	402,679	17,751	

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Net income (loss) applicable to common stockholders	\$	59,921	\$	332,519	\$	(707,803)	\$	(865,904)	\$	(765,071)	\$	(1,149,459)	\$	(1,426,340)	\$	(478,741)	\$	144,234
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Other Financial Data:

Operating income before amortization (OIBA)	\$	107,216	\$	594,053	\$	86,172	\$	661,786	\$	624,890	\$	447,947	\$	248,686	\$	592,943	\$	1,676,343
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(1) Excludes acquisition-related retention consideration, stock-based compensation and amortization of intangible assets

(2) Components of acquisition-related retention consideration:

Service costs	\$		\$		\$		\$		\$		\$	33,723	\$	15,826	\$	14,604	\$	14,185
Sales and marketing												96,262		45,175		41,726		40,503
Product development												104,233		48,916		45,162		43,865
General and administrative												49,051		23,019		21,232		20,645

(3) Components of stock-based compensation:

Service costs	\$	285	\$	190	\$		\$	9,776	\$	4,050	\$	2,250	\$	2,250				
Sales and marketing		1,073		715		128,993		99,861		87,720		105,297		67,546		49,042		7,573
Product development		315		37,710		69,769		95,108		38,348		37,855		21,902		12,675		12,653
General and administrative		748		366		512,229		355,109		200,339		384,706		267,266		171,267		102,929

(4) Components of amortization of intangible assets:

Service costs	\$		\$		\$	215,087	\$	644,588	\$	644,588	\$	712,694	\$	734,868	\$	734,643	\$	978,389
Sales and marketing						29,167		87,500		87,500		143,951		162,500		162,500		207,527
Product development																		
General and administrative						45,833		137,500		137,500		137,500		137,500		137,500		218,548

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	Predecessor Periods		Successor Periods						
			Period from	Quarter ended					
	Quarter ended Dec 31, 2002	Period from Jan 1 to Feb 28, 2003	Jan 17, (inception) to March 31, 2003	June 30, 2003	Sept 30, 2003	Dec 31, 2003	March 31, 2004	June 30, 2004	Sept 30, 2004
Consolidated Statement of Operations Data:									
Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Expenses:									
Service costs	59.6	56.4	51.5	55.2	55.4	60.1	62.9	64.8	62.4
Sales and marketing	18.8	11.9	12.5	12.2	13.5	11.6	13.3	11.6	9.5
Product development	8.9	4.7	6.1	6.6	7.2	6.0	6.7	6.0	4.9
General and administrative	9.8	7.6	24.9	13.6	12.3	12.4	9.1	9.6	8.8
Acquisition-related retention consideration						3.8	1.7	1.4	1.0
Facility relocation							3.0		(0.2)
Stock-based compensation	0.1	1.3	41.4	10.3	6.1	7.2	4.7	2.7	1.0
Amortization of intangible assets			16.9	16.2	16.2	13.3	13.6	11.7	11.5
Total operating expenses	97.2	81.9	153.3	114.1	110.7	114.4	115.0	107.8	98.9
Income (loss) from operations	2.8	18.1	(53.3)	(14.1)	(10.7)	(14.4)	(15.0)	(7.8)	1.2
Other income:									
Interest income	0.1		0.2	0.3	0.3	0.2	0.1	0.8	0.7
Interest expense									
Adjustment to fair value of redemption obligation									
Other						0.3	0.7		
Total other income	0.1		0.2	0.3	0.3	0.5	0.8	0.8	0.7
Income (loss) before provision for income taxes	3.0	18.1	(53.1)	(13.9)	(10.3)	(14.0)	(14.2)	(7.0)	1.9
Income tax expense (benefit)	1.3	7.3	(18.8)	(4.9)	(3.7)	(4.0)	(0.7)	(1.7)	0.7
Net income (loss)	1.6	10.8	(34.3)	(9.0)	(6.7)	(9.9)	(13.5)	(5.3)	1.2
Accretion to redemption value of redeemable convertible preferred stock			6.9	7.2	7.6	5.5	5.3	0.2	
Net income (loss) applicable to common stockholders	1.6	10.8	(41.2)	(16.2)	(14.3)	(15.4)	(18.8)	(5.5)	1.2

For purposes of discussion, we have included the results of operations of the Predecessor, Enhance Interactive. The results of operations of TrafficLeader have been included since the acquisition date of October 24, 2003. The results of operations of goClick have been included since the acquisition date of July 27, 2004. The results of operations for the quarter ended March 31, 2003 as discussed below are based on the combined periods including our results from January 17, 2003 (inception) to March 31, 2003 and Enhance Interactive's results from January 1, 2003 to February 28, 2003 (quarter ended March 31, 2003). From January 17, 2003 (inception) through February 28, 2003, we were involved in

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business and product development, as well as financing and acquisition initiatives and accordingly, our activities were different from the operating activities of Enhance Interactive. For further discussion of the presentation of Financial Reporting Periods, see page 51.

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Revenue

Revenue progressively increased in the quarters presented due primarily to an increase in the number of and growth of distribution partners, an increase in the number of and average revenue per merchant advertiser, and an overall increase in the number of searches and resulting click-throughs performed by users of our services. Revenue also increased as a result of the acquisitions of TrafficLeader on October 24, 2003 and goClick on July 27, 2004.

Expenses

Service costs increased mainly as a result of increases each quarter in payments to distribution partners, costs of processing larger numbers of transactions, such as related credit card processing fees, and personnel and facility costs. Service costs generally decreased as a percentage of revenue in the 2003 quarters as compared to the 2002 quarters. The decrease in the percentage of revenue during this period is attributable to fixed network costs not increasing as revenue has grown, as well as economies of scale in our support and network infrastructure being realized, and certain variable costs having increased at a lower rate than revenue. Service costs increased as a percentage of revenue beginning in the quarter ended December 31, 2003 primarily as a result of increased additional fixed costs for network operations incurred in anticipation of additional expansion and the impact as a percentage of revenue from the service cost level from the October 2003 acquisition of TrafficLeader and their feed management services. Payments to feed management services distribution partners account for higher user acquisition costs as a percentage of revenue relative to overall service cost percentage. Sales and marketing expense, product development expense, and general and administrative expense generally increased over the quarters presented, largely as a result of increases in personnel associated with selling, developing, and supporting our services. The progressive increases in the quarters are also related to increases in outside marketing activities, rent, travel and other operating costs arising from maintaining operations in multiple jurisdictions. Periods beginning after the acquisition of TrafficLeader acquisition in October 2003 were also impacted by the inclusion of TrafficLeader personnel in those periods.

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 stock-based compensation in the 2003 quarters related primarily to:

- employee stock options, for which the exercise price was less than the fair value on the date of grant, and
- the options to purchase 125,000 shares of Class B common stock held in escrow as security for the indemnification obligations under the Enhance Interactive acquisition agreement.

These options were subject to forfeiture, until the expiration of the escrow period on February 28, 2004. Accordingly, these options have been accounted for as variable awards during the escrow period. Under variable plan accounting, compensation expense is measured quarterly as the amount by which the fair market 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.

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The amortization of stock-based compensation increased in the periods subsequent to the acquisition of October 2003 acquisition of TrafficLeader primarily due to amounts recognized for restricted shares issued to employees in connection with the acquisition of TrafficLeader. Amounts in the 2004 quarters 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 to a lesser extent included the restricted stock issued to employees for future services in connection with the acquisition of TrafficLeader.

Amortization of intangible assets expense in the initial three quarters of 2003 resulted from amortizing identifiable intangibles associated with the purchase of Enhance Interactive. Amortization of intangible assets expense increased in the periods subsequent to the October 2003 acquisition of TrafficLeader and the July 2004 acquisition of goClick as a result of the additional amortization of identifiable intangibles associated with these acquisitions.

The following table provides a reconciliation of Income (loss) from operations and Net income (loss) applicable to common stockholders to the non-GAAP measure of operating income before amortization for the eight most recent quarters and/or periods ended September 30, 2004.

	Predecessor Periods			Successor Periods					
	Quarter ended Dec 31, 2002	Period from Jan 1 to Feb 28, 2003	Period from January 17, (inception) to March 31, 2003	Quarter ended					
				June 30, 2003	Sept 30, 2003	Dec 31, 2003	March 31, 2004	June 30, 2004	Sept 30, 2004
Operating income before amortization (OIBA) ⁽¹⁾	\$ 107,216	\$ 594,053	\$ 86,172	\$ 661,786	\$ 624,890	\$ 447,947	\$ 248,686	\$ 592,943	\$ 1,676,343
Stock-based compensation	(2,421)	(38,981)	(710,991)	(550,078)	(326,407)	(537,634)	(360,764)	(235,234)	(125,405)
Amortization of intangible assets			(290,087)	(869,588)	(869,588)	(994,145)	(1,034,868)	(1,034,643)	(1,404,464)
Income (loss) from operations	104,795	555,072	(914,906)	(757,880)	(571,105)	(1,083,832)	(1,146,946)	(676,934)	146,474
Other income:									
Interest income	2,967	1,529	3,092	13,479	16,931	12,372	11,016	70,329	82,462
Interest expense							(325)	(1,488)	(1,915)
Adjustment to fair value of redemption obligation						25,500	55,250		
Other						2,685	3,644		
Total other income	2,967	1,529	3,092	13,479	16,931	40,557	69,585	68,841	80,547
Income (loss) before provision for income taxes	107,762	556,601	(911,814)	(744,401)	(554,174)	(1,043,275)	(1,077,361)	(608,093)	227,021
Income tax expense (benefit)	47,841	224,082	(323,092)	(263,771)	(196,368)	(301,081)	(53,700)	(147,103)	82,787
Net income (loss)	59,921	332,519	(588,722)	(480,630)	(357,806)	(742,194)	(1,023,661)	(460,990)	144,234
Accretion to redemption value of redeemable convertible preferred stock			119,081	385,274	407,265	407,265	402,679	17,751	
Net income (loss) applicable to common stockholders	\$ 59,921	\$ 332,519	\$ (707,803)	\$ (865,904)	\$ (765,071)	\$ (1,149,459)	\$ (1,426,340)	\$ (478,741)	\$ 144,234

⁽¹⁾We report operating income before amortization (OIBA) that is a supplemental measure to GAAP. OIBA represents income (loss) from operations plus: (1) stock-based compensation expense; and (2) amortization of intangible assets. This measure, among other things, is one of the primary metrics by which we evaluate the performance of our business. Additionally, management uses adjusted OIBA which excludes acquisition-related retention consideration as we view this as part of the earn-out consideration from the transaction. Adjusted OIBA is the basis on which our internal budgets are based and by which management is currently evaluated. Management believes that investors should have access to, and we are obligated to provide, the same set of tools that we use in analyzing our results. This non-GAAP measure should be considered in addition to results prepared in accordance with GAAP, but should not be considered in isolation, as a substitute for, or superior to GAAP results. We believe this measure is useful to investors because it represents our consolidated operating results, taking into account depreciation, which we believe is an ongoing cost of doing business, but excluding the effects of certain other non-cash expenses. OIBA has certain limitations in that it does not take into account the impact to our statement of operations of certain expenses including non-cash stock-based compensation associated with our employees and acquisition-related accounting. We endeavor to compensate for the limitations of the non-GAAP measure presented by providing the comparable GAAP measure with equal or greater prominence, GAAP financial statements and detailed descriptions of the reconciling items and adjustments, including quantifying such items, to derive the non-GAAP measure.

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Results of Operations for Name Development

On November 19, 2004, we entered into an agreement to acquire certain assets of Name Development, a corporation operating in the direct navigation market. We expect to account for the Name Development asset acquisition as a business combination. The closing of the transaction is conditioned on a number of factors, including the successful completion of these offerings to finance the purchase by us. For more information on the asset acquisition, see Name Development Asset Acquisition.

Comparison of the fiscal year ended June 30, 2003 (2003 fiscal year) to the fiscal year ended June 30, 2004 (2004 fiscal year)

Revenue. Revenue increased 260%, from \$3.5 million in the 2003 fiscal year to \$12.5 million in the 2004 fiscal year. This revenue increased year over year primarily as a result of:

- a new agreement signed in December 2003 with a pay-per-click listings provider with improved revenue-per-click characteristics and improved revenue sharing terms;
- as of June 30, 2004 compared to June 30, 2003, an increase of 10% in the number of Web properties in the network; and
- an increase in the overall number of users initiating searches on Web properties in the network.

Expenses

Service Costs. Service costs increased by \$393,000 or 37% for the 2004 fiscal year compared to the 2003 fiscal year. This increase was primarily attributable to an increase of \$266,000 in amortization of Web property name registration and renewal fees and an increase of \$46,000 in third party network costs.

The increase in amortization of Web property name registration and renewal fees is the result of a greater number of Web property names purchased and held in the 2004 fiscal year. We expect the amortization of Web property names and renewal registration fees to increase in absolute dollars to the extent that we expand the purchasing of Web property names. We also expect that the cost per Web property, given the competitive landscape of Web property acquisition, to increase in the future.

Third party network costs associated with the serving of search results has increased due to higher levels of operating activities and search results.

General and Administrative Expenses. General and administrative expenses increased 44% from \$49,000 in the 2003 fiscal year to \$71,000 in the 2004 fiscal year. As of percentage of revenue, general and administrative expenses were 1% in both the 2003 and 2004 fiscal years. The increase in the dollars was primarily due to an increase in administrative professional fees resulting from increased operating activity. We expect

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that general and administrative expenses will increase in absolute dollars to the extent that we expand operations, which could include an increase in the number of personnel to administer operations, tracking and administering Web properties, as well as other costs such as insurance, professional fees and additional costs associated with internal controls.

Sales and marketing and product development expenses are expected to increase in absolute dollars in the future as we expect to add personnel to enhance the service offerings associated with the network of Web properties.

Gains on Sales of Intangible Assets, Net. Gains from the sale of Web property intangible assets are reported net of selling costs, the unamortized cost basis and prepaid registration fees of the assets sold on the statement of operations. These amounts increased from \$796,000 in the 2003 fiscal year to \$1.6 million in the 2004 fiscal year based on an increase in both the number of Web properties sold and the average sales price per Internet domain.

Income Taxes. Name Development was organized under the laws of the British Virgin Islands and was not subject to income tax in the British Virgin Islands. Name Development had e-commerce activities in several foreign jurisdictions and has recorded an income tax provision based on an apportionment of its income. The income tax expense increased from \$487,000 in the 2003 fiscal year to \$1.2 million in the 2004 fiscal year primarily based on increased revenue, overall operating activity and therefore income apportioned to foreign jurisdictions.

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Net Income. Net income increased from \$2.7 million in the 2003 fiscal year to \$11.5 million in the 2004 fiscal year. The increase was primarily attributable to an increase in revenue and a decrease in amortization and service costs as a percentage of revenue.

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. 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 nine months ended September 30, 2004 of \$2.3 million consisted primarily of a net loss of \$1.3 million adjusted for non-cash items of \$5.5 million, including depreciation, amortization of intangibles, allowance for doubtful accounts, merchant advertiser credits and stock-based compensation, and \$1.8 million used by working capital and other activities. Cash provided by operating activities for the nine months ended September 30, 2003 of \$2.1 million consisted primarily of a net loss of \$1.1 million adjusted for non-cash items of \$4.3 million, including depreciation and amortization of intangibles, allowance for doubtful accounts, merchant advertiser credits and stock-based compensation and approximately \$1.1 million used by working capital and other activities.

With respect to most of our pay-per-click advertising services, we receive payments 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 our 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 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 nine months ended September 30, 2004 of \$11.2 million was primarily attributable to the acquisition of goClick of approximately \$7.3 million, the Enhance earn-out obligation payment of \$3.2 million and purchases of property and equipment of \$627,000. Cash used in investing activities for the

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nine months ended September 30, 2003 of \$13.9 million was primarily attributable to the acquisition of Enhance Interactive of \$13.3 million and purchases of property and equipment of \$442,000.

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 nine months ended September 30, 2004 of approximately \$27.6 million was primarily attributable to net proceeds from our initial public offering. Cash provided by financing activities for the nine months ended September 30, 2003 of \$20.3 million relate to proceeds from employees exercising stock options and proceeds from the sale of Class A and Class B common stock and Series A redeemable convertible preferred stock in the aggregate.

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 \$10.0 million for Enhance Interactive for the calendar year 2004 and \$1.0 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.

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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:

	<u>Total</u>	<u>less than 1 year</u>	<u>1-3 years</u>	<u>4-5 years</u>	<u>After 5 years</u>
Contractual Obligations:					
Operating leases	\$ 3,204,000	\$ 268,000	\$ 2,025,000	\$ 911,000	\$
Earn-out obligation associated with Enhance Interactive ⁽¹⁾	Up to 9,997,000	Up to 9,997,000			
Earn-out obligation associated with acquisition of TrafficLeader ⁽²⁾	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	\$

⁽¹⁾ 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 calendar 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.

⁽²⁾ 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 chief executive officer and chief technology officer 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.

On November 19, 2004, we entered into an asset purchase agreement with Name Development which provides that in the event that we do not close the contemplated asset acquisition as a result of our failure to meet our closing obligations, we may be required to pay a termination fee to Name Development equal to \$1.5 million consisting of: (1) expense reimbursement for Name Development's reasonable administrative, legal and accounting expenses incurred in connection with the agreement and contemplated transactions in a minimum amount of \$600,000 payable in cash but which amount shall not exceed \$750,000; and (2) the issuance of our Class B common stock with a value (calculated based on the average closing price of the shares on the Nasdaq National Market for the 10 trading days ending on June 30, 2005) equal to \$1.5 million less the amount of the expense reimbursement.

On July 27, 2004, we acquired goClick for approximately \$7.5 million in net cash and acquisition costs. Additionally, we issued 433,541 shares of Class B common stock, which shares were valued at \$9.55 per share, for accounting purposes, for an aggregate amount of \$4.1 million.

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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.

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Upon the issuance of the preferred stock, we will have a dividend payment obligation under the terms of the preferred stock. Under Delaware law, dividends to stockholders may be made only from the surplus of a company, or, in certain situations, from the net profits for the current fiscal year before the dividend is declared by the board of directors. If we were to exchange the preferred stock for debentures, we would assume the principal and interest payment obligations under the terms of the debentures. Our ability to pay dividends under the preferred stock or to make payments of principal and interest under the debentures in the future will depend on our financial results, liquidity and financial condition. [P] For the terms of the preferred stock and debentures, respectively, see Description of Preferred Stock and Description of Debentures.

Except for our proposed Name Development asset acquisition and related offerings, based on our operating plans we believe that the remaining proceeds from our initial public offering, together with existing resources and cash flow provided by ongoing 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.

Pending Asset Acquisition

Management of Name Development's assets will have different working capital requirements than our existing business. The direct navigation business requires the continued acquisition of relevant Internet domain names. The quality of the Internet domain names will impact the value to merchant advertisers or aggregators as a source of customers, which in turn impacts the potential revenue from the Internet domain names. This ongoing investment requires cash flow or capital reserves to make purchases of Internet domain names and registration fees in advance of collecting any associated revenue that may be generated from these assets.

Name Development's cash provided by operating activities for the nine months ended September 30, 2004 was significantly higher than the twelve months ended December 31, 2003 primarily due to the increase in net income offset by larger working capital needs associated with accounts receivable.

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.

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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 merchant advertisers 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 merchant advertisers 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 Asset." (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.

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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. Recent changes to applicable accounting standards will require us to record the fair value of options as an expense for periods beginning after December 15, 2005. 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.

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Allowance for Doubtful Accounts and 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 the historical rate of incentives earned and used by merchant advertisers compared to the related revenues recognized by us. Material differences may result in the amount and timing of our revenue for any period if our management made different judgments and estimates.

Related Party Transactions

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

Recent Accounting Pronouncements

SFAS No. 123-R replaces SFAS No. 123, *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*. As originally issued, SFAS No. 123 established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that pronouncement permitted entities to continue applying the intrinsic-value-based model of APB Opinion No. 25, provided that the financial statements disclosed the pro forma net income or loss based on the preferable fair-value method.

The Company is required to apply SFAS No. 123-R as of the interim reporting period that begins after December 15, 2005. Thus, the Company's consolidated financial statements will reflect an expense for (a) all share-based compensation arrangements granted after January 1, 2006 and for any such arrangements that are modified, cancelled, or repurchased after that date, and (b) the portion of previous share-based awards for which the requisite service has not been rendered as of that date, based on the grant-date estimated fair value of those awards.

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BUSINESS

Overview

We provide technology-based merchant services that facilitate and drive growth in 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 efficiently market and sell their products and services across multiple online distribution channels, including search engines, product shopping engines, directories and other selected Web properties.

Upon completion of our Name Development asset acquisition, we believe we will be among the leaders in the direct navigation market. We will own a proprietary base of online user traffic that represented more than 17 million unique visitors in November 2004, searching for information, products and services. This user traffic is generated from a portfolio of Web properties that are generally reflective of commercially-relevant search terms in many of the Internet's most popular and dynamic vertical commerce categories and may include geographically-targeted elements. The total number of Web properties in the portfolio, including Marchex's existing Web properties, is more than 200,000. Key vertical commerce categories include: travel, financial services, insurance, real estate, auto, health, technology and electronics, personals, jobs, professional services, home and garden, Web and telecom services, education, and entertainment. The online user traffic is primarily monetized with pay-per-click listings that are relevant to the Web properties. As such, the Web properties connect online users searching for specific information with relevant advertisements.

With the Name Development asset acquisition, we believe we will be one of the few companies that owns both proprietary search engine marketing services and a critical mass of proprietary online user traffic.

We intend to continue introducing products and services that will enable merchants to successfully acquire customers and transact online. While we currently provide performance-based advertising and search marketing services, in the future we may provide additional, complementary services. We also intend to grow proprietary

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traffic sources, consistent with our Name Development asset acquisition, that can drive potential customers to our merchants.

Merchants transacting online is a large and growing trend. Our services facilitate and support the efficient and cost-effective marketing and selling of goods and services online through the most rapidly-developing forms of search-based marketing methods. We accomplish this by providing multiple services:

- ***Pay-Per-Click Services.*** We deliver pay-per-click advertising listings that are reflective of our merchant advertisers' products and services to online users in response to their keyword search queries. These pay-per-click listings are generally ordered in the search results based on the amount our merchant advertisers choose to pay for a targeted placement. These targeted listings are displayed to consumers and businesses through our distribution network of leading search engines, product shopping engines, directories and other Web properties.
- ***Feed Management Services.*** We leverage our proprietary technology to crawl and extract relevant product content from merchant advertisers' databases and Web sites to create highly-targeted product and service listings, which we deliver into our distribution network. These feed management listings are ordered in the results based on relevance to user search queries. Our trusted feed relationships with our distribution partners enable merchant advertisers to deliver comprehensive and up-to-date product and service listings to some of the Web's largest search engines, product shopping engines and directories.
- ***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 search engines and pay-per-click networks using our bid management services; and (2) evaluate the effectiveness of online advertising campaigns using our conversion tracking and detailed reporting services.
- ***Search Engine Optimization Services.*** We optimize key attributes of merchant advertiser Web sites to ensure the greatest opportunity for proper indexing, listing and inclusion in the editorial results of algorithmic search engines.
- ***Outsourced Search Marketing Services Platform.*** We provide large aggregators of advertisers, such as yellow page companies, with an outsourced, integrated platform to enable them to market performance-based advertising and search marketing services directly to their customers.

We distribute performance-based advertisements through our broad network of distribution partners comprising many of the leading search engines, product shopping engines, directories and other Web properties. Our sources of distribution include industry leaders such as Yahoo!, Google, Shopping.com and many others.

We were incorporated in Delaware on January 17, 2003. Acquisition initiatives have played an important part in our corporate history to date and are a component of our overall strategy. With the proposed Name Development asset acquisition, we will have made four acquisitions since our inception including:

- On February 28, 2003, we acquired eFamily together with its direct wholly-owned subsidiary Enhance Interactive.
- On October 24, 2003, we acquired TrafficLeader.

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- On July 27, 2004, we acquired goClick.
- In conjunction with this offering, we will acquire certain assets of Name Development.

Pending Name Development Asset Acquisition

Description of the Asset Acquisition

On November 19, 2004, we entered into an agreement to acquire certain assets of Name Development, a corporation operating in the direct navigation market. Direct navigation is one of the methods that online

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consumers use to search for information, products or services online. Direct navigation is primarily characterized by online users directly accessing a Web site by: (1) typing descriptive keywords or keyword strings into the uniform resource locator, or URL, address box of an Internet browser; or (2) accessing bookmarked Web sites. It can also include navigating through referring or partner traffic sources. Name Development owns and maintains a portfolio of Web properties, that are generally reflective of online user search terms, descriptive keywords and keyword strings. Name Development has entered into agreements with advertising service providers to monetize its online user traffic, generated through direct navigation means, with pay-per-click listings. As such, Name Development is able to connect online users searching for specific information with relevant advertisements.

Upon completion of the asset acquisition, we believe we will be among the leaders in the direct navigation market due to our proprietary ownership of online user traffic totaling more than 17 million unique visitors in November 2004. This user traffic is generated from a portfolio of Web properties that are generally reflective of commercially-relevant search terms in many of the Internet's most popular and dynamic vertical commerce categories and may include geographically-targeted elements. The total number of Web properties in the portfolio, including Marchex's existing Web properties, is more than 200,000. Key vertical commerce categories include: travel, financial services, insurance, real estate, auto, health, technology and electronics, personals, jobs, professional services, home and garden, Web and telecom services, education, and entertainment. The online user traffic is primarily monetized with pay-per-click listings that are relevant to the Web property. As such, the Web properties facilitate the introduction of online users searching for specific information to targeted advertisements.

Name Development's revenue increased 260% from \$3.5 million for the fiscal year ended June 30, 2003 to \$12.5 million for the fiscal year ended June 30, 2004. For the corresponding periods, income from operations has grown from \$3.2 million to \$12.6 million. For the nine months ended September 30, 2004, revenues were \$15.5 million and income from operations was \$14.9 million.

We expect to account for the Name Development asset acquisition as a business combination.

Anticipated Benefits of the Asset Acquisition

We believe that the Name Development asset acquisition will provide us with several benefits, including:

- ***A Defensible, Proprietary Source of Targeted Traffic.*** We believe that we will have an exclusive position due to the nature of Internet domains registration, which is similar to owning real-estate in that each Internet domain name is unique. The asset acquisition will provide us with Web properties that collectively generated more than 17 million monthly unique visitors in November 2004. The total number of Web properties in the portfolio, including Marchex's existing Web properties, is more than 200,000.
- ***Synergies with our Existing Search Engine Marketing Services Platform.*** We believe that our technology platform, combined with the Name Development asset acquisition, gives us an advantage in extending market share within the direct navigation market, expanding our participation in the search advertising market and in key commerce verticals. For example, we believe that: (1) there may be opportunities to work with monetization providers to improve the categorization and revenue generation of individual Web properties; (2) there may be opportunities to leverage our database of current search-related information to improve and automate selection and acquisition of complementary Web properties; (3) there may be opportunities to generate incremental user traffic to selected Web properties through leveraging our existing distribution network; (4) there may be opportunities to leverage our experience in working with a variety of online providers to add dynamic content and relevant advertiser listings, including product shopping listings and classified listings, to increase the user utility of the Web properties; and (5) there may be opportunities, over time, to supplement existing listings on certain Web properties with our

performance-based advertisements.

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- ***Platform to Extend Expansion Initiatives.*** We intend to use the asset acquisition to supplement our planned expansion, both domestically and internationally.

Industry Overview

Performance-Based Advertising

As technology and the Internet continue to evolve, consumers are becoming increasingly confident that they can find comprehensive product information and securely transact online. As consumers spend more time and money online, advertisers are turning to the Internet to market their products and services. Businesses of all sizes can benefit from the Internet's potential to efficiently and cost-effectively reach consumers. With the U.S. Census Bureau reporting more than 23 million small businesses alone, we believe there is a large opportunity to sell online performance-based advertising services to businesses of all sizes. As a reflection of the potential impact of the Internet as an advertising medium, PricewaterhouseCoopers estimates that global Internet advertising will grow from \$12.2 billion in 2004 to \$18.9 billion in 2008. Internet advertising enables merchant advertisers to measure the effectiveness of their advertising campaigns and to revise them in response to real-time feedback and market factors. Traditional forms of advertising are not as targeted and do not permit evaluation of results in as timely and accurate a manner.

Within the Internet advertising market, paid search has become one of the fastest growing sectors. First Albany Capital estimates that paid search will grow 191% from \$4.5 billion in 2004 to \$13.1 billion in 2008. According to the Kelsey Group, only 17% of small and medium businesses in the United States currently utilize search marketing methods, but that number is expected to grow as more merchants experience the benefits. In addition, according to PricewaterhouseCoopers, 40% of Internet advertising in the second quarter of 2004 was performance-based, as opposed to 31% in the second quarter of 2003. Merchant advertisers are increasingly turning to performance-based online advertising for the following reasons:

- ***Competitive Return-On-Investment.*** Merchant advertisers have experienced competitive returns on their online advertising campaigns. As advertisers have analyzed their marketing programs, they have determined that they are able to pay more for their programs while still generating an acceptable return-on-investment. As a result, First Albany Capital estimates that the average price-per-click will increase at a compound annual growth rate, or CAGR, of 7% from 2003 to 2008.
- ***Consumers Increasing Receptiveness to Performance-Based Advertising.*** Due to the relevancy and appropriate placement of advertisements, First Albany Capital estimates that the rate at which consumers click through performance-based advertisements will grow at a CAGR of 21% from 2003 to 2008.

Direct Navigation

Navigating and searching for information online has continued to evolve as users have become increasingly sophisticated. This continuing evolution has translated into a need for information providers to more efficiently provide highly-targeted, relevant information. Currently, there are three primary means through which online users access and search for information, products and services: search engines, commerce portals and direct navigation Web properties. Direct navigation is primarily characterized by online users directly accessing a Web site by: (1) typing descriptive keywords or keyword strings into the uniform resource locator, or URL, address box of an Internet browser; or (2) accessing bookmarked Web sites. It can also include navigating through referring or partner traffic sources.

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First Albany Capital estimates that the paid search market will reach \$4.5 billion in revenue in 2004, and we believe the direct navigation market currently represents more than 10% of the global search market and is growing at comparable annual rates. According to WebSideStory, Inc.'s StatMarket division, in September 2004 more than 67% of daily global Internet users arrived at Web sites by direct navigation defined as typing a URL into a browser address bar or using a bookmark rather than through search engines and Web links, compared to approximately 53% in February 2002. The growth of the direct navigation market is a result of consumers' increasing sophistication in utilizing the Internet as a resource tool, coupled with their desire to quickly find targeted information, and their trust and experience that the depth and breadth of available and relevant online information extends to Web sites named by descriptive keywords. Direct navigation and the use of search engines, however, are not mutually exclusive. We believe that many of the commercially relevant Web properties which we will own as part of the Name Development asset acquisition may be beneficiaries of search engine and directory traffic.

Strategy

We intend to leverage our senior management's experience, our financial and human resources and our existing operations to provide technology-based merchant services that facilitate and drive growth in online transactions. Key elements of our strategy include the following initiatives:

- ***Provide Quality Services in Support of Merchants and Partners.*** We believe providing high quality services will make us more valuable to our merchants and partners. We are building proprietary products and services that we believe are innovative and provide a high degree of utility. We intend to continue investing our resources to create or develop new products, technologies and business models. We intend to expand our services by providing systems and information that help merchant advertisers maximize the performance of online marketing budgets and by working with partners to develop and market new products. For example, the services we have developed include:

a search engine inclusion and optimization platform for merchant advertisers who want the greatest opportunity for proper indexing, listing and inclusion of their product and services in the editorial results of algorithmic search engines;

an advertising campaign management platform for merchant advertisers who want to continuously track, monitor and optimize the placement of performance-based search advertising campaigns across a number of search engines and pay-per-click networks; and

an outsourced search marketing services platform for large aggregators of advertisers, such as yellow page companies, who want an integrated platform to market performance-based advertising and search marketing services directly to their customers.

- ***Increase the Number of Merchants Served.*** We believe we will continue to grow our base of merchant advertisers and strive to build merchant loyalty by providing merchants with a consistently high level of service and support as well as the ability to achieve their target return-on-investment thresholds. We intend to increase the number of merchants served through:

direct sales efforts, including strategic sales and telesales initiatives;

referral arrangements with entities that can promote our services to potential merchants, such as advertising agencies; and

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partnerships with large aggregators of advertisers, such as regional yellow page companies.

- ***Develop New Markets.*** We intend to analyze opportunities and may seek to expand our technology-based services into new categories or new geographies where our services can be replicated on a cost effective basis, or where the creation or development of a service may be appropriate. We anticipate utilizing various strategies to enter new markets, including: developing

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strategic relationships; acquiring products that address a new category or opportunity; acquiring country-specific properties; and creating joint venture relationships and internal initiatives where existing services can be extended internationally. For example, the Name Development asset acquisition will diversify our business and will allow us to enter the direct navigation market.

- ***Extend Presence in the Direct Navigation Market.*** With the closing of the Name Development asset acquisition, we will implement numerous initiatives to increase the traffic and monetization of the acquired network of Web properties, including enhancing the utility of the Web properties, broadening our geographic presence and making selective purchases of complementary Web properties.
- ***Pursue Selective Acquisition and Consolidation Opportunities.*** We plan to selectively pursue strategic acquisitions. We apply rigorous evaluation criteria to acquisitions that are intended to enhance our strategic position, strengthen our financial profile, augment our points of defensibility and increase shareholder value. We do this through focusing on acquisition opportunities that represent a combination of the following characteristics:

under-leveraged and under-commercialized assets;

opportunities for business model, product or service innovation and evolution;

critical mass of transactions volume, merchants, traffic, revenue and profits;

business defensibility;

revenue growth and expanding margins and operating profitability or the characteristics to achieve significant scale and profitability; and

an opportunity to enhance efficiencies and provide incremental growth opportunities for our operating businesses.

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Our Services

Through our suite of search marketing services, we have partnered with a diverse set of Internet traffic partners in order to provide our merchant advertisers with access to a large base of potential, targeted customers. Our distribution strategy has been focused on building a broad footprint with primary online traffic sources, including search engines, directory sites and commerce portals, and with the Name Development asset acquisition, direct navigation Web properties. Additionally, we have focused on developing services and technologies to expand the suite of search-based marketing products we provide to online merchant advertisers. We believe that offering a holistic approach of search engine marketing services enables us to extend our reach to a broad base of customers and offer solutions that can generally address all the needs of a customer interested in search marketing.

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Our services are used to support and build the businesses of our merchant advertisers. We enable merchants to market and sell their products and services online through the following technology-based services:

Service	Description
Performance-Based Advertising Services	<p>Performance-based advertising services enable merchants to reach their target audience through search, product shopping and directory results.</p> <ul style="list-style-type: none"> • Pay-per-click services. With pay-per-click services, the amount that a merchant advertiser pays for the click-through influences the rank of its listings within the applicable results set.
Search Marketing Services	<ul style="list-style-type: none"> • Feed management services. With feed management services, the ranking of a merchant's listing is influenced by the relevance of the product or service in relation to the user search query. Search marketing services are designed to assist merchant advertisers who want to acquire customers through search-based marketing methods, optimize the performance of their online advertising campaigns by tracking and analyzing historical results and refine their Web sites for increased relevance in algorithmic search engine indexes. • Advertising campaign management services. Advertising campaign management services enable merchant advertisers to: (1) track, monitor and optimize the placement of performance-based search advertising campaigns across a number of search engines and pay-per-click networks using our bid management services; and (2) evaluate the effectiveness of their online advertising campaigns using our conversion tracking and detailed reporting services.
Outsourced Search Marketing Services Platform	<ul style="list-style-type: none"> • Search engine optimization services. Search engine optimization services enable merchant advertisers to optimize key attributes of their Web sites to ensure the greatest opportunity for proper indexing, listing and inclusion in the editorial results of algorithmic search engines. Outsourced search marketing services are designed to enable large advertiser aggregator partners with an outsourced, integrated search management platform to market performance-based advertising and search marketing services to their customers.

In the nine month period ending September 30, 2004, performance-based advertising services comprised more than 91% of our total revenue while search marketing services and outsourced search marketing services accounted for less than 9% of total revenue.

We currently provide these services through our operating subsidiaries Enhance Interactive, goClick and TrafficLeader. Enhance Interactive and goClick primarily manage our pay-per-click services while TrafficLeader primarily manages our feed management services, search marketing services and outsourced search marketing services. All of our services currently run on, or are being migrated to run on, a common technology architecture. As we continue to develop our services and implement new technologies and services, we believe the breadth of our marketing solutions will lead to cross leverage through technical integration.

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Performance-Based Advertising Services

Merchant advertisers utilize our performance-based advertising services to reach millions of individuals and businesses who search online for information on products and services. According to a Pricewaterhouse Coopers April 2004 report, performance-based advertising is one of the most rapidly growing segments of Internet advertising, as it is one of the most efficient and effective means to generate competitive returns-on-investment for advertisers. Accordingly, we are building appropriate services to leverage this trend.

On any given search engine results page, the listings that appear can either be categorized as sponsored listings or editorial listings. By leveraging the combination of our pay-per-click and feed management performance-based advertising services, merchant advertisers can ensure the broadest coverage within a given results page in response to a user search query, since our pay-per-click management service ensures merchant advertisement appearance within sponsored listings, and our feed management service ensures merchant advertisement appearance within editorial listings. The following is a description of our performance-based advertising services:

Pay-Per-Click Services. Our pay-per-click services enable merchant advertisers to market their products and services through targeted pay-per-click listings that we distribute through search engine or directory results when a user searches for information, products or services. We provide our services to thousands of merchant advertisers who want to drive customer leads to their Web sites. Our services enable merchants to purchase keywords or keyword strings, based on an amount they choose for a targeted placement, that are specific to their products and services and their marketing objectives.

Merchant advertisers find us directly through our Web site and through contact with our internal telesales force, and we reach out to find merchant advertisers through direct sales efforts, through third-party referral programs and through a variety of marketing activities that include trade shows, targeted mailings, online advertisements, e-mails and other promotional materials sent directly to merchant advertisers, advertising agencies and search engine marketers.

We believe that pay-per-click services are an important complement to algorithmic search and feed management technologies as they enable merchants to place relevant listings on a search engine results page related to a specific user information request. This process has the dual benefit of: (1) enhancing the user experience by placing relevant targeted listings at the portion of a search page dedicated to sponsored listings; and (2) connecting merchant advertisers with targeted customer leads.

When merchant advertisers submit advertisement listings to our service, we review them for relevance and for conformity with our editorial guidelines. We may also assist merchant advertisers in optimizing their advertisement campaigns by recommending relevant keywords or keyword strings based on their Web sites and product or service offerings.

The pay-per-click results distributed by our services are prioritized for users by the amount the merchant advertiser is willing to pay each time a user clicks on the merchant's advertisement. Merchant advertisers pay us when a click-through occurs on their advertisement.

Feed Management Services. Our feed management services deliver targeted advertiser listings into some of the Internet's most visited search engines and product shopping engines. Feed management leverages our proprietary technology to crawl and extract relevant product data and content from a merchant advertiser database and Web site, and to create highly relevant, optimized URL strings and advertisement listings. Increased listing relevancy frequently translates into a better search experience for users, allowing them to find targeted results in response to

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their search queries, and a competitive return-on-investment for merchant advertisers, as higher relevance typically leads to increased click-through and conversion rates, or customer acquisitions.

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Once our technology has crawled, extracted, optimized and refined the merchant advertiser URL strings and advertisement listings, such strings and listings are automatically tagged and placed into partner search and directory indexes. These URL strings and listings map directly to user search queries that link back to specific product pages when clicked, which we believe typically leads to competitive advertiser conversion rates.

We believe that most algorithmic search engines crawl the Web approximately every seven days. When a merchant's Web site is crawled by algorithmic technology, many product and service listings tend to be excluded due to the nature of most merchant advertisers' product databases, which contain complex structures and are dynamically-updated. Our trusted feed relationships with our distribution partners allow us to deliver every merchant advertiser's product and to provide updated content in frequent intervals, as we regularly refresh the listings with the most up-to-date information. This is a significant benefit for our merchant advertisers as we maximize the number of selling opportunities and for our distribution partners as we increase the relevance of a user search experience.

We believe that feed management is an important complement to algorithmic search technologies since merchant advertisers provide us with direct access to their internal product databases. Often, only once a feed management service has crawled, replicated and optimized hundreds or thousands of individual product and informational Web pages for a merchant advertiser do links to these pages appear within search engine results. We believe the indexing and subsequent listing of these Web pages made possible by feed management enhances the overall relevancy of the search engines with which the company partners. We also believe feed management is complementary to pay-per-click services as merchants: (1) can leverage our technology to create detailed listings for each of their products; and (2) can leverage our extensive keyword query string database to identify many relevant keyword listings often overlooked in the manual pay-per-click listing creation process.

Merchant advertiser URL strings and advertisement listings are typically ordered based on relevance to the user search query. Merchant advertisers generally pay us a fixed price for each click received on each URL string and advertisement listing.

Additionally, by leveraging proprietary technology, we can analyze an advertiser's database as well as thousands to millions of actual, relevant user search queries to create additional, unique merchant advertiser listings that drive targeted traffic resulting in highly competitive conversion, or customer acquisition, rates. These additional unique listings are generally included as part of our basic feed management service.

Search Marketing Services

Our search marketing services are designed to assist merchant advertisers who want to acquire customers through search-based marketing methods, optimize the performance of their online advertising campaigns through tracking and analyzing historical results and refine their Web sites for increased relevance in algorithmic search engine indexes. The following is a description of our search marketing services:

Advertising Campaign Management Services. Through our advertising campaign management services, merchant advertisers continuously track, monitor and optimize the placement of performance-based search advertising campaigns across a number of search engines and pay-per-click networks and track the effectiveness of their online advertising campaigns through the use of the following services:

- Bid management services. Our bid management services allow our merchant advertisers to consolidate the purchasing, management, optimization and reporting aspects of performance based search advertising campaigns. We have partnerships with leading search and product shopping engines that allow us to place and manage our clients' paid listings directly within their account management systems.

- Conversion tracking and detailed reporting services. Our detailed reporting services enable merchants to track the effectiveness of their online advertising campaigns through conversion tracking and detailed reporting tools. By developing a common technology architecture underneath our platform of search marketing services, we are able to analyze the effectiveness of our merchant

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partners advertising campaigns across a wide array of services and provide detailed reporting, such as: revenue per month statistics, number of orders, average order size and conversion rate and revenue by keyword and revenue by distribution source.

Our advertising campaign management services broaden the potential reach of a merchant's advertising campaign by including multiple distribution partners as options for bid placement. Merchant advertisers pay us a pre-negotiated rate when a click through occurs on their advertisement. Also, with our analytic tool set, merchants are effectively able to track the effectiveness of their online advertising campaigns through the use of conversion tracking and analytic services.

Search Engine Optimization Services. Our search engine optimization technology optimizes key attributes of merchant advertisers' Web sites to ensure the greatest opportunity for proper indexing, listing and inclusion in the editorial results of algorithmic search engines. By leveraging our experience in the search industry and relationships with search engine distribution partners, we have architected a flexible technology platform that is designed to enable us to efficiently optimize our merchant partner Web sites in order to meet the ever changing technical standards of our distribution partners.

We primarily attract merchant advertisers with product databases who want to increase their online sales and achieve targeted return-on-investment metrics. Potential merchant advertisers find our services and we find them through a variety of means, including contact by our direct sales staff, through marketing efforts such as trade shows or advertising, and through third-party referral programs. Merchant advertisers pay us fees to optimize their site for inclusion in algorithmic search results.

Outsourced Search Marketing Services Platform

Our ability to build and integrate all of our marketing services on a common technology platform provides us with the opportunity to create an outsourced solution for strategic partners who have several hundred to several thousand direct merchant relationships. As part of our search management service we can enable a strategic partner or aggregator of merchant partner relationships with all or any part of our suite of search marketing services. For example, we currently enable a major regional yellow page company with our advertising campaign management and feed management technology platform which it can market to its local online yellow page merchants.

Partners can leverage this service in one of two ways, including: (1) as a fully outsourced solution, in which we manage and fulfill search marketing campaigns, and also delivers reporting on behalf of our partners; or (2) a partner-hosted solution that allows aggregators, such as yellow page companies, to easily manage campaigns internally and service their customers more directly. We principally receive payment for our outsourced search marketing services through a combination of variable licensing fees associated with total revenue generated using our technology platform, flat rate licensing fees for the use of our technology platform and per-click payments for clicks delivered from our pay-per-click and feed management network.

Our Distribution Network

We have built a broad distribution network for our marketing services comprised of many of the leading search engines, product shopping engines, directories and selected Web properties. With the Name Development asset acquisition, we will acquire a proprietary source of direct navigation traffic.

Table of Contents***Performance-Based Advertising Distribution***

We distribute merchant advertisement listings and advertiser URL strings through hundreds of traffic sources, including search and product shopping engines, directories and Web properties. Distribution sources for our marketing services platform include:

Selected Search Engines and Directories	Selected Product Shopping Engines
Google	CNet's MySimon
LookSmart	Google's
Switchboard	Froogle.com
Valueclick's Search123	NexTag
24/7 Search	PriceGrabber.com
Yahoo!	Shopping.com
	Yahoo!Shopping

Yahoo!, primarily through its subsidiaries, such as Overture and Yahoo!Shopping, is our largest distribution partner, accounting for approximately 19% of our total revenue for the nine months ended September 30, 2004. Prior to this period, distribution through Yahoo! and its subsidiaries collectively represented less than 10% of our total revenue. Over the past year, we have enhanced and grown this relationship with additional agreements with Yahoo! and its subsidiaries. Additionally, we have enhanced existing relationships with various other partners, including LookSmart and Switchboard, and created several new relationships, including CNet's MySimon and Shopping.com. We intend to continue enhancing our existing partner relationships and create new ones, where appropriate.

Payment arrangements with our distribution partners 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.

Direct Navigation Distribution

Upon completion of the Name Development asset acquisition, we believe we will be among the leaders in the direct navigation market due to our proprietary ownership of online user traffic, which totaled more than 17 million unique visitors in November 2004. This user traffic is

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generated from a portfolio of Web properties that are generally reflective of commercially-relevant search terms in many of the Internet's most popular and dynamic vertical commerce categories and may include geographically-targeted elements. The total number of Web properties in the portfolio, including Marchex's existing Web properties, is more than 200,000. These vertical commerce categories include: travel, financial services, insurance, real estate, auto, health, technology and electronics, personals, jobs, professional services, home and garden, Web and telecom services, education and entertainment. The online user traffic is primarily monetized with pay-per-click listings that are relevant to the Web properties. As such, the Web properties connect online users searching for specific information with relevant advertisements.

Online users can navigate the Web properties through a number of ways. For example, an online user who is specifically interested in going to Las Vegas for a vacation may enter *www.lasvegasvacations.com* directly into the Web address or URL box of their Internet browser. Once the user has arrived at the Web property they will find relevant product listings and information. As the user finds relevant information and clicks on a particular listing, Name Development receives a pay-per-click fee.

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The following represents a sampling of the Web properties we will acquire as part of the Name Development asset acquisition and their corresponding vertical commerce category:

Vertical Commerce Category	Active Web Property Examples
Travel	<ul style="list-style-type: none"> • FranceVacation.com • LasVegasVacations.com
Financial Services	<ul style="list-style-type: none"> • TravelAustralia.com • AutoLender.com • Debts.com
Insurance	<ul style="list-style-type: none"> • LoanConsolidation.com • AffordableInsurance.com • InsuranceOnline.com
Real Estate	<ul style="list-style-type: none"> • UnemploymentInsurance.com • ApartmentFind.com • HouseLoans.com
Auto	<ul style="list-style-type: none"> • LAProperties.com • AffordableCars.com • CarSeller.com
Health	<ul style="list-style-type: none"> • LeaseCars.com • HealthAdvisor.com • MedicalSearch.com
Technology and Electronics	<ul style="list-style-type: none"> • NaturalDiets.com • 3g.com • NetworkServers.com
Personals	<ul style="list-style-type: none"> • VideoCamera.com • FriendsOnline.com • LoveFinder.com
Jobs	<ul style="list-style-type: none"> • SingleMatch.com • CareerInfo.com • BayAreaJobs.com
Professional Services	<ul style="list-style-type: none"> • SoftwareJob.com • PhysicianOnline.com • TaxesOnline.com

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Home and Garden

- TortLawyers.com
- BathroomHardware.com

- CarpetCleaners.com

Web and Telecom Services

- HomeDecoration.com
- ComputerNetworking.com

- TelecomConsultants.com

Education

- WirelessDevelopers.com
- USColleges.com

- VirtualEducation.com

Entertainment

- LearningVideos.com
- ActionMovies.com

- HollywoodMovies.com

- TicketsUnlimited.com

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Sales, Marketing & Business Development

As of December 1, 2004, we had 53 full-time employee equivalents in our sales department, 11 full-time employee equivalents in our business development department and 5 full-time employee equivalents in our marketing department. Our sales department focuses on adding new merchant advertisers to our operating businesses, while our business development department focuses on servicing existing distribution partnerships and selectively adding new distribution partners. Our marketing department focuses on promoting our services through affiliate relationships, press coverage, and industry exposure. Advertising and promotion of our services is broken into five main categories: direct sales, agency sales, super aggregator sales, online promotion, and referral agreements.

- ***Direct Sales.*** Our sales staff targets new merchant advertiser relationships through telesales efforts, direct marketing, and attendance at industry events.
- ***Agency Sales.*** Our agency program includes a group within the sales team that targets interactive agencies and other entities that service merchant advertisers. This sales group focuses on in-person and remote presentations of our services to agencies, and is also periodically engaged in various marketing initiatives at industry trade shows and conferences. Our agency agreements may include a combination of revenue sharing, performance-based fees and other costs.
- ***Super Aggregator Sales.*** Our super aggregator program includes a group within the sales team that targets large aggregators of merchant advertisers. An example of a large aggregator relationship would be our partnership with a large regional yellow page company whereupon we supply a comprehensive, outsourced search marketing platform that integrates our advertising campaign management and feed management platforms for their merchant advertisers. Our super aggregator agreements include a combination of revenue sharing, licensing revenue and per-click fees.
- ***Online Promotion.*** We engage in certain advertising and direct marketing focused on acquiring new merchant advertisers and new distribution partners.
- ***Referral Agreements.*** We seek to build referral arrangements with entities that can promote our services to large numbers of potential advertisers. Our referral partner agreements are based on a combination of revenue sharing and performance-based fees.

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

Information Technology and Systems

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

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

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

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

Competition

Performance-Based Advertising

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

We pursue a strategy that we believe allows us to work with all relevant companies in the industry, even those companies that may be perceived as our competitors. We intend to continue with a strategy that allows us to consider and pursue business arrangements with all companies in our industry.

We provide our services to: (1) merchant advertisers who advertise online; (2) partners who provide a distribution network for online advertising; and (3) other intermediaries who may provide purchasing and/or sales opportunities, including advertising agencies, search engine marketing companies and search engine optimization companies. We depend on maintaining and continually expanding our network of partners and merchants to generate transactions online. As a result, we may work with, and compete with, those who:

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

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

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

We are also affected by the competition among destination Web sites that reach users or customers of search services. While thousands of smaller outlets are available to customers, several large media and search engine companies, such as AOL, Google, Microsoft through MSN Search and Yahoo!, through its subsidiaries, dominate online user traffic. The online search industry continues to experience consolidation of major Web sites and search engines, which has the effect of increasing the negotiating power of these parties in relation to smaller providers. The major destination Web sites and distribution providers may have leverage to demand more favorable contract terms, such as pricing, renewal and termination provisions.

Direct Navigation

The direct navigation market is primarily categorized into two parts: (1) Web property owners, which are the entities that own the Internet domain and potentially monetize it through performance-based integrations with third parties, including pay-per-click integrations; and (2) Web property monetization providers, which are companies that provide the monetization engine for Web property owners, including pay-per-click providers. We believe that the segment of the direct navigation market that directly owns and monetizes Internet domains with performance-based advertising is highly fragmented, and that, after the closing of the transaction, we will be among the leaders in this segment.

While the availability of a high quality portfolio of multiple Internet domain names is limited and difficult to attain, the barriers to entry in the direct navigation market are also low as the cost of registering an individual Internet domain name is not significant. We expect competition to intensify as more analysis is conducted on, and more companies enter, the direct navigation market. This could adversely affect our competitive position and relatively small market share in the direct navigation industry.

Intellectual Property and Proprietary Rights

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

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

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

- US Provisional Patent Application Serial Number 60/504,963, of Horowitz et al., entitled Performance-Based Online Advertising System and Method, was filed on September 23, 2003,

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with subsequent non-provisional US and PCT patent applications filed on September 23, 2004, and which are currently pending. These patent applications describe a system, method, and computer program product for implementing a performance-based online service for advertisers that provide the ability for advertisers to purchase various advertising products.

- US Provisional Patent Application Serial Number 60/523,688, of Horowitz et al., entitled "Online Advertising System and Method," was filed on November 21, 2003, with subsequent non-provisional US and PCT patent applications filed on November 19, 2004, and which are currently pending. This patent application describes an online advertising system, method, and computer program product configured to present an advertiser with keyword-driven pricing for advertisements.

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

We have been issued registered trademarks in the United States covering certain goods and services for Marchex, Direct Search Inclusion, goClick.com, Sitewise and TrafficLeader. We have also applied for registered trademark status for Enhance Interactive in the United States. In addition, we have been issued registered trademarks for Marchex in Australia, Benelux, China, France, Germany, Japan, Italy, Spain, Sweden, Republic of Korea, Russian Federation and the United Kingdom. We have also applied for registered trademark status for Marchex in a number of other foreign jurisdictions. We do not know whether we will be able to successfully defend our proprietary rights since the validity, enforceability and scope of protection of proprietary rights in Internet-related industries are uncertain and still evolving.

Regulation

The manner in which existing laws and regulations should be applied to the Internet in general, and how they relate to our businesses in particular, is unclear in many cases. Such uncertainty arises under existing laws regulating matters, including user privacy, defamation, pricing, advertising, taxation, gambling, sweepstakes, promotions, content regulation, quality of products and services, and intellectual property ownership and infringement.

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

Several new federal laws that could have an impact on our business have already been adopted. The Digital Millennium Copyright Act is intended to reduce the liability of online service providers for listing or linking to third party Web properties that include materials that infringe copyrights or rights of others. The Children's Online Protection Act and the Children's Online Privacy Protection Act are intended to restrict the distribution of certain materials deemed harmful to children and impose additional restrictions on the ability of online services to collect user information from minors. In addition, the Protection of Children from Sexual Predators Act requires online services providers to report evidence of violations of federal child pornography laws under certain circumstances. The foregoing legislation may impose significant additional costs on our business or subject us to additional liabilities, if we were not to comply fully with their terms, whether intentionally or not. If we did not meet the safe harbor requirements of the Digital Millennium Copyright Act, we could be exposed to copyright actions, which could be costly and time-consuming. The Children's Online Protection Act and the Children's Online Privacy Protection Act impose fines and penalties to persons and operators that are not fully compliant with their requirements. The federal government could impose penalties on those parties that do not

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meet the full compliance practices of the Protection of Children from Sexual Predators Act. We intend to fully comply with the laws and regulations that govern our industry, and we employ internal resources and incur outside professional fees to establish, review and maintain policies and procedures to reduce the risk of noncompliance.

Our purchase of assets from Name Development will subject us to a new and rapidly developing body of regulations. The acquisition of Internet domain names generally is governed by Internet regulatory bodies, predominantly the Internet Corporation for Assigned Names and Numbers (ICANN). The regulation of Internet domain names in the United States and in foreign countries is subject to change. ICANN and other regulatory bodies could establish additional requirements for previously owned Internet domain names or modify the requirements for holding Internet domain names.

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

Employees

As of December 1, 2004, we employed a total of 207 full-time employee equivalents. We have never had a work stoppage, and none of our employees are represented by a labor union. We consider our employee relationships to be positive. If we were unable to retain our key employees or we were unable to maintain adequate staffing of qualified employees, particularly during peak sales seasons, our business would be adversely affected.

Properties

We do not own real estate property. Our corporate offices are located at 413 Pine Street, Suite 500, Seattle, Washington. In March 2004, we entered into a sublease agreement for our current corporate office space in Seattle, Washington, and this commitment extends through 2009. The sublease agreement provides for the leasing of 11,400 square feet of office space at \$16,150 per month, increasing to 26,788 square feet at \$37,950 per month, over the term of the agreement ending in 2009. With respect to our additional office space at 2101 Fourth Avenue, Suite 1980, Seattle, Washington, we currently have approximately 5,331 square feet under lease agreements expiring in June 2006 at a monthly rental of \$10,440. We also have offices located at 360 West 4800 North, Provo, Utah, that are comprised of approximately 13,050 square feet under a sublease agreement expiring in May 2005, at a monthly rental of \$16,802. Additionally, we have offices located at 2986 Crescent Avenue, Eugene, Oregon, that are comprised of 6,725 square feet under a lease agreement expiring in October 2006 at a monthly rental of \$10,087 per month.

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

Legal Proceedings

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

Table of Contents**MANAGEMENT****Executive Officers and Directors**

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

Name	Age	Position(s)
Russell C. Horowitz	38	Chairman of the Board of Directors, Chief Executive Officer and Treasurer
Michael A. Arends	34	Chief Financial Officer
Ethan A. Caldwell	36	Chief Administrative Officer, General Counsel and Secretary
Peter Christothoulou	33	Chief Strategy Officer
John Keister	38	President, Chief Operating Officer and Director
Walter Korman	31	Senior Vice President of Engineering
Dennis Cline ⁽¹⁾⁽²⁾⁽³⁾	44	Director
Jonathan Fram ⁽¹⁾⁽²⁾⁽³⁾	47	Director
Rick Thompson ⁽¹⁾⁽²⁾⁽³⁾	45	Director

⁽¹⁾ Member of the Audit Committee.

⁽²⁾ Member of the Nominating and Governance Committee.

⁽³⁾ Member of the Compensation Committee.

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

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

Ethan A. Caldwell. Mr. Caldwell is a founding executive officer and has served as our Chief Administrative Officer, General Counsel and Secretary since our inception in January 2003. From January 2001 to December 2002, Mr. Caldwell reviewed, together with our other founding executive officers, new business opportunities in the retail, media, finance and technology industries. Mr. Caldwell was previously Senior Vice

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President, General Counsel and Corporate Secretary of Go2Net, from November 1996, until its merger with InfoSpace in October 2000. Mr. Caldwell assisted in the integration of Go2Net with InfoSpace through December 2000. Mr. Caldwell received his J.D. from the University of Maryland and his B.A. in Political Science from Occidental College.

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

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

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

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

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

Rick Thompson. Mr. Thompson has served as a member of our board of directors since May 2003. Mr. Thompson has been the Vice President for the Extended Windows Platform Group at Microsoft since December 2002. From February 2001 to November 2002, Mr. Thompson was a business consultant to retail

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automotive, packaged goods and health and fitness companies, with a particular focus on providing product and market analysis services and management consulting. From May 2000 through January 2001, Mr. Thompson was the CFO and EVP for Product Development for Go2Net. Prior to Go2Net, from October 1987 to June 1999, Mr. Thompson was the Vice President of Hardware for Microsoft and from July 1999 to May 2000, Mr. Thompson was the Vice President of Xbox for Microsoft. Mr. Thompson received B.A. degrees in Economics and in French from Bates College.

Election of Directors and Officers

Our board of directors currently consists of the following five members: (1) Russell C. Horowitz (Chairman); (2) John Keister; (3) Dennis Cline; (4) Jonathan Fram; and (5) Rick Thompson. Messrs. Horowitz and Keister are the only management members of our board of directors and were selected as directors pursuant to a voting provision in the stockholders' agreement that automatically terminated upon the closing of our initial public offering. Messrs. Cline, Fram and Thompson are independent directors as defined by the applicable rules of the National Association of Securities Dealers, Inc. listing standards. We refer to these directors as our independent directors. There are no family relationships among any of our directors and executive officers.

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

Board Committees

Audit Committee

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

Compensation Committee

The compensation committee of our board of directors is comprised of Messrs. Cline, Fram and Thompson, each of whom is an independent director. The compensation committee acts pursuant to a formal charter adopted by the board, which is available on our Web site. The compensation committee reviews and evaluates the compensation and benefits of all of our officers, including the compensation of our CEO, reviews general policy matters relating to compensation and employee benefits, and makes recommendations concerning these matters to our board of directors. The compensation committee also administers our stock incentive plan and our employee stock purchase plan. Mr. Cline currently serves as the chairman of the compensation committee. For a more detailed description of these plans, please see Benefit Plans.

Nominating and Governance Committee

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

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

Code of Conduct and Code of Ethics

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

Corporate Governance Guidelines

Our board of directors has adopted corporate governance guidelines to ensure effective corporate governance. These guidelines provide that our independent directors shall meet regularly (not less than two times per year) in executive session at which only our independent directors shall be present.

Disclosure Committee

The disclosure committee is comprised of Mr. Ethan Caldwell, our General Counsel, and Mr. Jeff Thielman, our Controller. The disclosure committee acts pursuant to a formal charter adopted by our Chief Executive Officer and our Chief Financial Officer, which is available on our Web site. The disclosure committee is responsible for designing and establishing and monitoring the integrity and effectiveness of controls and other procedures that are designed to ensure that: (1) information required to be disclosed by us in the reports we file with the Securities and Exchange Commission under the Securities Exchange Act, and other information that we disclose to the investment community is recorded, processed, summarized and reported accurately and on a timely basis and in accordance with Securities and Exchange Commission rules and regulations; and (2) information is accumulated and communicated to management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding such required disclosure and to assist such officers in fulfilling their responsibility for overseeing the accuracy and timeliness of our disclosures and in certifying our periodic reports under the Securities Exchange Act.

Compensation of Directors

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

Compensation Committee Interlocks and Insider Participation

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

Table of Contents**Executive Compensation**

The following table sets forth the compensation earned by our Chief Executive Officer and our Chief Financial Officer for services rendered in all capacities during the period from our inception, January 17, 2003, to December 31, 2004. No other executive officer's total annual salary and bonus for 2003 exceeds \$100,000. We refer to these executives as our named executive officers elsewhere in this prospectus.

Summary Compensation Table

Name	Principal Position	Year	Annual Compensation			Long-term Compensation
			Salary	Bonus	All Other Compensation	Securities Underlying Options
Russell C. Horowitz ⁽¹⁾	Chief Executive Officer	2004	\$ 50,000	\$ 0	*	0
		2003	\$ 39,712	\$ 0	*	0
Michael A. Arends ⁽²⁾	Chief Financial Officer	2004	\$ 140,250	\$ 0	*	0
		2003	\$ 104,000	\$ 0	*	450,000

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

⁽²⁾Mr. Arends joined Marchex as of May 1, 2003, and his salary compensation commenced as of that date. Mr. Arends' initial annual base salary of \$156,000 was adjusted to \$135,000 upon the closing of our initial public offering in April of 2004 in accordance with his employment agreement.

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

The following table sets forth information with respect to stock options granted to our named executive officers during the fiscal year ended December 31, 2004.

Option Grants in Fiscal Year 2004

Name	Number of Securities underlying options granted	Percentage of Total Options Granted to Employees	Exercise Price Per Share	Expiration Date
Russell C. Horowitz	0	0%	N/A	N/A
Michael A. Arends	0	0%	N/A	N/A

The following table sets forth information regarding unexercised options held as of December 31, 2004, by our named executive officers.

Aggregate Option Exercises/Option Values During 2004 and Fiscal Year-End Option Values

Name	Number of Shares Acquired on Exercise		Number of Securities Underlying Unexercised Options At December 31, 2004		Value of Unexercised In-the- Money Options At December 31, 2004	
	Exercised	Value Realized	Exercisable	Unexercisable	Exercisable	Unexercisable
Russell C. Horowitz	N/A	N/A	N/A	N/A	N/A	N/A
Michael A. Arends	N/A	N/A	164,583	285,417	\$ 2,845,829	\$ 4,904,172

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Employment Contract with Named Executive Officers

Russell C. Horowitz

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

Michael A. Arends

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

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

In the event that either: (1) Russell C. Horowitz ceases to be a Marchex employee for any reason; or (2) a change in control occurs while Mr. Arends is employed by Marchex, all options or other equity awards held by Mr. Arends with respect to our Class B common stock shall become fully vested. For purposes of this provision, a change in control occurs if one person or entity acquires control of 50% or more of our common stock entitled to vote for directors, but does not occur as a result of an acquisition by Marchex or any corporation controlled by Marchex.

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

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

Benefit Plans

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

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

Marchex has reserved 6,288,901 shares of Class B common stock for issuance under the plan. The plan also provides for annual increases in the number of shares available for issuance under the plan, on the first day of our fiscal year, equal to 5% of the outstanding shares of Class B common stock (including any shares of Class B common stock issuable upon conversion of any outstanding capital stock) on such date. The total number of

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shares of Class B common stock for which options designated as ISOs may be granted shall not exceed 8,000,000. As of September 30, 2004, options to purchase 3,571,167 shares of Class B common stock were outstanding. As of September 30, 2004, options to purchase 75,350 shares of Class B common stock had been exercised under the plan.

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

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

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

Employee Stock Purchase Plan. Our 2004 employee stock purchase plan, effective on March 30, 2004, was adopted by our board of directors and approved by our stockholders on February 15, 2004. This plan will be intended to qualify under Section 423 of the Internal Revenue Code and will permit eligible employees to purchase our Class B common stock for amounts up to 15% of their compensation in offering periods under the plan. Under the purchase plan, no employee will be permitted to purchase stock worth more than \$25,000 in any calendar year, valued as of the first day of each offering period. We have authorized an aggregate of 300,000 shares of our Class B common stock for issuance under the purchase plan to participating employees.

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

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

401(k) Plan (TrafficLeader). Our subsidiary, TrafficLeader, sponsors a 401(k) plan covering its employees. The 401(k) plan is intended to qualify under Section 401(a) of the Internal Revenue Code of 1986, as amended, so that contributions to the 401(k) plan by employees or by TrafficLeader and the investment earnings thereon, are not taxable to employees until withdrawn from the 401(k) plan, and so that contributions by TrafficLeader, if any, will be deductible by TrafficLeader when made. Under the 401(k) plan, employees may elect to reduce their current compensation by up to the statutorily prescribed annual limit and to have the amount of such reduction contributed to the 401(k) plan. The

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401(k) plan permits, but does not require, additional matching and non- elective contributions to the 401(k) plan by TrafficLeader on behalf of all eligible participants in the 401(k) plan. To date, no matching or non-elective contributions have been made by TrafficLeader to the 401(k) plan.

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Limitations on Directors Liability and Indemnification Matters

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

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

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

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

Table of Contents**CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS****Organizational Transactions**

Russell C. Horowitz, Ethan A. Caldwell, Peter Christothoulou, John Keister and Victor Oquendo, our initial stockholders, were involved in our initial funding and by reason of such involvement would be deemed to be acting as promoters as such term is defined by Rule 405 of Regulation C under the Act. Following our inception, in January 2003, we issued an aggregate of 12,250,000 shares of our Class A common stock to these individuals at a purchase price of \$0.01 per share for a total purchase price of \$122,500 and 1,000,000 shares of our Class B common stock for the benefit of Russell C. Horowitz individually or a Russell C. Horowitz designated affiliated entity, at a purchase price of \$0.01 per share for a total purchase price of \$10,000.

As part of our original organization, we purchased certain property and equipment from Russell C. Horowitz and an affiliated entity for approximately \$57,000 and from Ethan A. Caldwell for approximately \$4,000. The original cost of the property and equipment was \$70,000 and \$4,000, respectively. The purchase price for such property and equipment was based on the estimated fair market value of the property and equipment as determined by our initial stockholders.

Private Placement Financing

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

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

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

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⁽²⁾Hippo Beach Trust is the sole member of Rainwater River Authority, LLC. The beneficial owner of the shares held by such trust is Mr. David M. Horowitz, the brother of Mr. Russell C. Horowitz.

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

⁽⁴⁾The record holders of these securities consist of: (1) MARCH Investments, LLC; and (2) Pemrose, LLC. See footnote (1) in Security Ownership of Certain Beneficial Ownership and Management for a description of Mr. Horowitz's relationship to these entities. It also includes 5,000 shares issued to an Individual Retirement Account for the benefit of Mr. Horowitz.

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

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

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

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In connection with the sale of the preferred stock, the investors were granted customary piggyback registration rights which are triggered by this offering. Notwithstanding the foregoing, the underwriters can limit the number of shares to be included in such registration. See Description of Capital Stock for a more complete description of these registration rights.

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

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**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS
AND MANAGEMENT**

The following table sets forth information regarding the beneficial ownership of our common stock as of December 31, 2004 and as adjusted to reflect the sale of the Class B common stock in the offering by:

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

Percentage of beneficial ownership is based on 25,498,961 shares of common stock outstanding as of December 31, 2004 and 32,938,200 shares of common stock outstanding after completion of the Class B common stock offering, including 439,239 shares of Class B common stock that we estimate we will issue in connection with the closing of the Name Development asset acquisition assuming that \$20.49 per share, the last reported sale price of our Class B common stock on January 7, 2005, is the applicable price for determining the number of shares to be issued. This percentage also assumes that the underwriters will not exercise their over-allotment option to purchase an additional 1,050,000 shares of Class B common stock from us. This percentage also excludes the shares of Class B common stock issuable upon conversion of the preferred stock being offered in the preferred stock offering. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, shares of common stock subject to options held by that person that are currently exercisable or exercisable within 60 days of December 31, 2004, are deemed outstanding. These shares are not, however, deemed outstanding for the purposes of computing the percentage ownership of any other person. Except as otherwise noted below, the address for each beneficial owner listed below is c/o Marchex, Inc., 413 Pine Street, Suite 500, Seattle, Washington 98101.

Name of Beneficial Owner	Number of Shares Owned	Percentage of Shares Outstanding	
		Before Offering	After Offering
Russell C. Horowitz ⁽¹⁾	9,525,040	37.4%	28.9%
Michael A. Arends ⁽²⁾	208,083	*	*
John Keister ⁽³⁾	2,695,160	10.6%	8.2%
Rainwater River Authority, LLC ⁽⁴⁾	804,500	3.2%	2.4%
Twin Oaks Plateau, LLC ⁽⁵⁾	500,000	2.0%	1.5%
Dennis Cline ⁽⁶⁾	110,000	*	*
Jonathan Fram ⁽⁷⁾	25,000	*	*
Rick Thompson ⁽⁸⁾	1,218,333	4.8%	3.7%
All directors and executive officers as a group (9 persons) ⁽⁹⁾	15,395,992	59.8%	46.4%

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

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

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

⁽¹⁾Includes: (1) 8,026,707 shares of our Class A common stock held by MARRCH Investments, LLC; (2) 1,400,000 shares of our Class B common stock held by MARRCH Investments, LLC; and (3) 83,333 shares of our Class B common stock held by Pemrose, LLC. Mr. Horowitz is the managing member of these entities and, as such, may be deemed to exercise voting and investment power over the shares held by all of these entities. It also includes 5,000 shares of our Class B common stock held in an Individual Retirement Account for the benefit of Mr. Horowitz and 10,000 shares of our Class B common stock.

Footnotes continued on following page

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⁽²⁾Includes: (1) 164,583 shares of our Class B common stock issuable upon exercise of options; (2) 11,500 shares of our Class B common stock; (3) 10,500 shares of our Class B common stock held by the Nicole Marie Arends 2003 Trust for the benefit of Nicole Marie Arends, the daughter of Mr. Arends, for which shares Mr. Arends disclaims beneficial ownership; (4) 15,000 shares of Class B common stock held in an Individual Retirement Account for the benefit of Mr. Arends; and (5) 6,500 shares of Class B common stock held in an Individual Retirement Account for the benefit of Diana Arends, Mr. Arends' s wife.

⁽³⁾Includes: (1) 2,000,167 shares of our Class A common stock; (2) 6,160 shares of our Class B common stock held in an Individual Retirement Account for the benefit of Mr. Keister; (3) 58,657 shares of our Class B common stock held in a Grantor Retained Annuity Trust, of which Mr. Keister is the grantor; and (5) 630,176 shares of our Class B common stock.

⁽⁴⁾Hippo Beach Trust is the sole member of Rainwater River Authority, LLC. The beneficial owner of the shares held by such trust is Mr. David M. Horowitz. The address for Rainwater River Authority, LLC is: 10900 NE 8th Street, Suite 900, Bellevue, Washington 98004.

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

⁽⁶⁾Consists of 100,000 shares held by DMC Investments, LLC, a limited liability company of which Mr. Cline is the managing member and 10,000 shares of Class B common stock subject to options that are currently exercisable or exercisable within 60 days of December 31, 2004.

⁽⁷⁾Consists of 15,000 shares held by the Jonathan and Leslie Fram Trust for the benefit of Mr. Fram and Leslie Fram, Stanford Fram, Timothy Fram and Sarah Fram, Mr. Fram' s wife and children, and 10,000 shares of Class B common stock subject to options that are currently exercisable or exercisable within 60 days of December 31, 2004.

⁽⁸⁾Includes: (1) 1,158,333 shares of our Class B common stock; (2) 30,000 shares of our Class B common stock held by the Daniel Thompson Trust for the benefit of Daniel Thompson, Mr. Thompson' s son; (3) 20,000 shares of our Class B common stock held by the Ellen Thompson Trust for the benefit of Ellen Thompson, Mr. Thompson' s daughter; and (4) 10,000 shares of Class B common stock subject to options that are currently exercisable or exercisable within 60 days of December 31, 2004. Mr. Thompson disclaims beneficial ownership for the shares in this section (2) and (3).

⁽⁹⁾Includes an aggregate of: (1) 11,537,500 shares of our Class A common stock; (2) 3,610,159 shares of our Class B common stock (including 60,500 shares for which beneficial ownership has been disclaimed); and (3) 248,333 shares of our Class B common stock subject to options that are currently exercisable or exercisable within 60 days of December 31, 2004.

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DESCRIPTION OF CAPITAL STOCK

General

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

Authorized and Outstanding Capital Stock

Marchex is authorized to issue 12,500,000 shares of Class A common stock, \$0.01 par value per share, 125,000,000 shares of Class B common stock, \$0.01 par value per share and 1,000,000 shares of undesignated preferred stock, \$0.01 par value per share.

Prior to Completion of the Offering. As of September 30, 2004, there were 25,409,039 shares of common stock outstanding that were held by 149 stockholders of record. Of these shares:

- 11,987,500 shares were issued as Class A common stock, and as of this date were held by 5 stockholders of record, and
- 13,421,539 shares were issued as Class B common stock, and as of this date were held by 144 stockholders of record.

As of September 30, 2004, we had options outstanding for the purchase of an aggregate of 3,571,167 shares of Class B common stock with a weighted average exercise price of \$4.02 per share. These options were issued under our 2003 amended and restated stock incentive plan, which is discussed in more detail below.

Upon Completion of the Offering. Our authorized capital stock, following the completion of the Class B common stock and preferred stock offerings, will consist of shares of common stock and preferred stock:

- with 12,500,000 shares authorized as our Class A common stock, \$0.01 par value per share, of which 11,987,500 will be outstanding and 262,500 will be held in treasury;
- with 125,000,000 shares authorized as our Class B common stock, \$0.01 par value per share, of which 20,421,539 will be outstanding (21,471,539 shares if the underwriters' over-allotment option is exercised in full); and
- with 1,000,000 shares authorized as our % convertible exchangeable preferred stock, \$0.01 par value per share, of which 200,000 will be outstanding (230,000 shares if the underwriters' over-allotment option is exercised in full).

In the event we elect not to consummate the preferred stock offering, we will increase the size of the Class B common stock offering accordingly.

Common Stock

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

Each share of Class A common stock is convertible, at the holder's option, into one share of Class B common stock. Our Class B common stock is not convertible into our Class A common stock. Subject to the prior rights of

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any of our outstanding preferred stock to receive dividends and distributions, holders of our common stock are entitled to receive ratably any dividends that may be declared by the board of directors out of funds legally available and are entitled to receive, pro rata, all of our assets available for distribution to such holders upon our liquidation, dissolution or winding up. The outstanding shares of Class A common stock and Class B common stock are, and the shares of Class B common stock to be issued upon completion of the Class B common stock offering will be, fully paid and non-assessable.

Preferred Stock

Our board of directors has the authority, without further action by the stockholders, to issue up to 1,000,000 shares of preferred stock, \$0.01 par value, in one or more series. Our board of directors also has the authority to designate the rights, preferences, privileges and restrictions of each such series, including dividend rights, dividend rates, conversion rights, voting rights, terms of redemption, redemption prices, liquidation preferences and the number of shares constituting any series. The issuance of preferred stock may have the effect of delaying, deferring or preventing a change in control of Marchex without further action by the stockholders. The issuance of preferred stock with voting and conversion rights may also adversely affect the voting power of the holders of Class B common stock. In certain circumstances, an issuance of preferred stock could have the effect of decreasing the market price of the Class B common stock.

The shares of the preferred stock, when issued and sold for the consideration contemplated by the preferred stock offering, will be duly and validly issued, fully paid and nonassessable and the holders thereof will have no preemptive rights in connection therewith. The preferred stock will not be subject to any sinking fund or other obligation of Marchex to redeem or retire the preferred stock. Unless earlier converted, exchanged or redeemed by Marchex, the preferred stock will have a perpetual maturity. Any preferred stock converted, exchanged or redeemed or otherwise acquired by us will, upon cancellation of such shares, have the status of authorized but unissued shares of preferred stock.

[P] % Convertible Exchangeable Preferred Stock

The preferred stock is discussed below under the caption Description of Preferred Stock.

[C] Proposed Terms of Preferred Stock

We are concurrently offering, with a separate prospectus, 200,000 shares of our % convertible exchangeable preferred stock. The closing of this offering is subject to the concurrent closing of the Name Development asset acquisition described in this prospectus but is not contingent upon the closing of the concurrent preferred stock offering. The following summary of the proposed terms of the preferred stock is not complete and is subject to, and qualified in its entirety by reference to, our certificate of incorporation and the certificate of designation governing the preferred stock.

General. Each share of preferred stock will have a liquidation preference of \$250 plus all accrued and unpaid dividends through the distribution date, which is the amount a holder of one share of preferred stock would be entitled to receive if our company were liquidated. We will pay cumulative, cash dividends on the preferred stock at an annual rate of % of the liquidation preference of the preferred stock.

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Optional Conversion by Holders. Holders of the preferred stock will have the right to convert some or all of their shares of preferred stock into shares of our Class B common stock, unless we have already redeemed them. The initial conversion price will be \$ per share. At that price, holders of the preferred stock would receive approximately shares of our Class B common stock for each share of preferred stock. Holders of preferred stock will not be entitled to any accrued or unpaid dividends upon conversion. The conversion price will be adjusted if specified dilutive events or specified transactions occur.

Optional Conversion by Us. We may elect to convert some or all of the preferred stock into shares of our Class B common stock if the closing price of our Class B common stock has exceeded 150% of the conversion price of

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the preferred stock for at least 20 out of 30 consecutive trading days ending within five trading days prior to the notice of automatic conversion. If we elect to automatically convert some or all of the preferred stock prior to _____, 2008, we will also make an additional payment for accrued but unpaid dividends in cash or, at our option, in shares of our Class B common stock or a combination of cash and shares of our Class B common stock, with the Class B common stock valued at 97.5% of the average closing price for the five trading days immediately preceding the second trading day prior to the date of automatic conversion.

Redemption of the Preferred Stock by Us. Beginning on _____, 2008, we will have the right to redeem some or all of the preferred stock at a redemption price equal to \$ _____ per share, plus accrued and unpaid dividends to, but excluding, the date of redemption. The redemption price will decline until it equals \$250 per share on _____, 2015, and will remain at \$250 per share thereafter until redeemed. We will pay this redemption price out of legally available funds.

Ranking. The preferred stock will rank:

- junior to all our existing and future indebtedness and other obligations;
- junior to any of our capital stock or preferred stock which provides that it be ranked senior to the preferred stock and which receives the requisite approval of the holders of the preferred stock; and
- equal with any of our preferred stock issued in the future which provides that it be ranked equal with the preferred stock and which receives the requisite approval of the holders of the preferred stock.

Exchange Provisions. We may exchange the preferred stock in whole, but not in part, for debentures on any dividend payment date on or after _____, 2006, at the rate of \$250 principal amount of debentures for each outstanding share of the preferred stock. On the date of this exchange, rights as a stockholder of Marchex will cease, and the shares of preferred stock will no longer be outstanding and will only represent the right to receive the debentures and any accrued and unpaid dividends. We may not exercise our option to exchange the preferred stock for the debentures if full cumulative dividends on the preferred stock have not been paid or set aside for payment, or if an event of default under the indenture has occurred and is continuing.

Voting Rights. Holders of the preferred stock will be entitled to elect two additional directors to the board of directors if we have not declared or paid dividends on the preferred stock for a total of six quarterly periods. These voting rights and the terms of office of the additional directors will terminate when we have declared and either paid or set aside for payment accrued and unpaid dividends.

In addition, the vote or consent of at least a majority of the holders of the preferred stock will be required to take specified actions or enter into specified transactions that would adversely effect the preferred stock.

Warrants to Representatives in Initial Public Offering

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At the closing of our initial public offering in April 2004, we sold warrants to purchase shares of our Class B common stock to Sanders Morris Harris Inc. and National Securities Corporation, as representatives of the underwriters for our initial public offering, for nominal consideration.

These representatives, or their designees, may exercise warrants to purchase up to 120,000 shares of Class B common stock over a period commencing on April 5, 2005 and ending April 5, 2009 for an exercise price of \$8.45 per share. We have reserved an equivalent number of shares of Class B common stock for issuance upon exercise of the warrants. The holders of the warrants will not possess any rights as a stockholder unless the warrants are exercised. These warrants grant to the holders thereof certain piggyback registration rights for the shares of Class B common stock issuable upon exercise thereof, as set forth in more detail below.

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Stock Consideration in the Traffic Leader Acquisition

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

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

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

Registration Rights

As of September 30, 2004, the holders of an aggregate of 20,712,604 shares of our Class A and Class B common stock are entitled to rights to register these shares under the Securities Act. These rights are provided under: (1) the stockholders' agreement entered into with certain investors, dated as of January 23, 2003; (2) the stock transfer and restriction agreement entered into with the holders of those shares of Class B common stock which were issued in connection with the acquisition of TrafficLeader, dated as of October 24, 2003; (3) the warrant agreement issued to Sanders Morris Harris Inc., dated as of April 5, 2004; (4) the warrant agreement issued to National Securities Corporation, dated as of April 5, 2004; (5) the registration rights agreement entered into with the holder of those shares of Class B common stock which were issued in connection with the acquisition of goClick, dated as of July 27, 2004; and (6) the asset purchase agreement entered into in connection with the acquisition of certain assets of Name Development, dated as of November 19, 2004. With the exception of the Name Development asset purchase agreement, each of these holders are entitled to customary piggyback registration rights upon request at our expense subject to the right of underwriters to limit the number of shares included in such registration and underwriting. The piggyback registration rights granted to Sanders Morris Harris Inc. and National Securities Corporation in connection with our initial public offering are not effective until April 5, 2005 and will therefore not be triggered by this offering. In connection with the Name Development asset acquisition, we have also agreed to file a registration statement to register the shares of Class B common stock issued as part of the equity consideration thereunder or any shares of Class B common stock issued in connection with payment of the termination fee pursuant to the asset purchase agreement for resale on Form S-3 once we become eligible to file such a registration statement with the SEC. This offering will trigger piggyback registration rights with respect to holders of an aggregate of 20,712,604 shares of our Class A and Class B common stock which have been waived in connection with this offering.

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

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Drag Along Rights

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

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

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

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

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

2003 Stock Incentive Plan

See "Management Benefit Plans" for a complete explanation of the plan.

2004 Employee Stock Purchase Plan

See "Management Benefit Plans" for a complete explanation of the plan.

Anti-Takeover Provisions Affecting Stockholders

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As of December 31, 2004, our founding executive officers control ninety-three percent (93%) of the combined voting power of our outstanding capital stock, which could be deemed to have an anti-takeover effect.

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

- any breach of the director's duty of loyalty to us or our stockholders;
- acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law;
- acts or omissions in respect of certain unlawful dividend payments or stock redemptions or repurchases; or
- any transaction from which such director derives improper personal benefit.

Our by-laws provide that we shall, to the extent permitted by Delaware law, indemnify and advance expenses to our currently acting and former directors, officers, employees and agents or director, officers, employees and agents of other corporations, partnerships, joint ventures, trusts or other enterprises if serving at our request

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arising in connection with their acting in such capacities. We have entered into indemnification agreements with each of our directors and executive officers.

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

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

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

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

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

Nasdaq National Market Listing

Marchex's Class B common stock is listed on the Nasdaq National Market under the trading symbol MCHX. We have applied to have the preferred stock listed on the Nasdaq National Market under the trading symbol MCHXP.

Transfer Agent and Registrar

The transfer agent and registrar for our Class B common stock is Mellon Investor Services LLC.

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[P] DESCRIPTION OF PREFERRED STOCK

The following is a summary of some, but not all, of the terms of the preferred stock. You should refer to the actual terms of the preferred stock and the certificate of designation filed with the Secretary of State of the State of Delaware and filed as an exhibit to this registration statement. As used in this description, the words we, us or our do not include any current or future subsidiary of Marchex.

General

Our board of directors has the authority, without stockholder approval, to issue up to 1,000,000 shares of preferred stock in one or more series and to determine the rights, privileges and limitations of the preferred stock. The rights, preferences, powers and limitations on different series of preferred stock may differ with respect to dividend rates, amounts payable on liquidation, voting rights, conversion rights, redemption provisions, sinking fund provisions, and purchase funds and other matters.

In the description, we refer to our % convertible exchangeable preferred stock as the preferred stock. The shares of preferred stock, when issued and sold in the manner contemplated by this prospectus, will be duly and validly issued, fully paid and nonassessable. You will not have any preemptive rights if we issue other series of preferred stock. The preferred stock is not subject to any sinking fund. We have no obligation to retire the preferred stock. The preferred stock has a perpetual maturity, subject to your right to convert the preferred stock and our right to auto-convert the preferred stock and exchange or redeem the preferred stock at our option. Any preferred stock converted, exchanged or redeemed or acquired by us will, upon cancellation, have the status of authorized but unissued shares of preferred stock. We will be able to reissue these cancelled shares of preferred stock.

Dividends

When and if declared by our board of directors out of the legally available funds, you will be entitled to receive cash dividends at an annual rate of % of the liquidation preference of the preferred stock. Dividends will be payable quarterly on , , and , beginning 2005. In the case of any accrued but unpaid dividends, we will pay dividends at additional times and for interim periods, if any, as determined by our board of directors. Dividends on the preferred stock will be cumulative from the issue date. Dividends will be payable to holders of record as they appear on our stock books not more than 60 days nor less than 10 days preceding the payment dates, as fixed by our board of directors. If the preferred stock is called for redemption on a redemption date between the dividend record date and the dividend payment date and you do not convert the preferred stock (as described below), you shall receive the dividend payment together with all other accrued and unpaid dividends on the redemption date instead of receiving the dividend on the dividend date. Dividends payable on the preferred stock for any period greater or less than a full dividend period will be computed on the basis of a 360-day year consisting of twelve 30-day months. Accrued but unpaid dividends will not bear interest.

If we do not pay or set aside dividends in full on the preferred stock and any other preferred stock ranking on the same basis as to dividends, all dividends declared upon shares of the preferred stock and any other preferred stock will be declared on a pro rata basis. For these purposes, pro rata means that the amount of dividends declared per share on the preferred stock and any other preferred stock bear to each other will be the same ratio that accrued and unpaid dividends per share on the shares of the preferred stock and such other preferred stock bear to each other. Except as described above, we will not be able to redeem, purchase or otherwise acquire any of our stock ranking on the same basis as the preferred stock as to dividends or liquidation preferences unless we have paid or set aside full cumulative dividends, if any, accrued on all outstanding shares of preferred stock.

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Unless we have paid or set aside full cumulative dividends, if any, accrued on all outstanding shares of preferred stock and any other of our preferred stock ranking on the same basis as to dividends:

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