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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

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**FORM 10-Q**

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

For the quarterly period ended September 30, 2015

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number 000-50658

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**Marchex, Inc.**

(Exact name of Registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**35-2194038**  
(I.R.S. Employer  
Identification No.)

**520 Pike Street, Suite 2000  
Seattle, Washington 98101**  
(Address of principal executive offices)

**Registrant's telephone number, including area code: (206) 331-3300**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its Corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date.

Class	Outstanding at November 3, 2015
<b>Class A common stock, par value \$.01 per share</b>	<b>5,232,636</b>
<b>Class B common stock, par value \$.01 per share</b>	<b>36,832,385</b>

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Marchex, Inc.

Form 10-Q

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**Part I—Financial Information****Item 1. Condensed Consolidated Financial Statements**

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

	<u>December 31,</u> <u>2014</u>	<u>September 30,</u> <u>2015</u>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 80,032	\$ 108,936
Accounts receivable, net	25,941	25,862
Prepaid expenses and other current assets	3,143	1,996
Refundable taxes	131	135
Total current assets	<u>109,247</u>	<u>136,929</u>
Property and equipment, net	5,430	6,238
Intangible and other assets, net	313	233
Goodwill	65,679	63,305
Total assets	<u>\$ 180,669</u>	<u>\$ 206,705</u>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 13,766	\$ 12,105
Accrued expenses and other current liabilities	7,515	7,743
Deferred revenue	2,117	1,328
Total current liabilities	<u>23,398</u>	<u>21,176</u>
Other non-current liabilities	1,118	779
Total liabilities	<u>24,516</u>	<u>21,955</u>
Stockholders' equity:		
Class A common stock	55	55
Class B common stock	373	369
Treasury stock	(2,503)	(91)
Additional paid-in capital	348,467	349,194
Accumulated deficit	<u>(190,239)</u>	<u>(164,777)</u>
Total stockholders' equity	<u>156,153</u>	<u>184,750</u>
Total liabilities and stockholders' equity	<u>\$ 180,669</u>	<u>\$ 206,705</u>

See accompanying notes to condensed consolidated financial statements.

**MARCHEX, INC. AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Operations**  
(in thousands, except per share amounts)  
(unaudited)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2014	2015	2014	2015
Revenue	\$142,374	\$108,113	\$ 47,238	\$36,852
Expenses:				
Service costs (1)	94,226	59,166	31,270	20,003
Sales and marketing	8,759	11,969	2,814	4,266
Product development	22,599	23,608	7,581	7,769
General and administrative	16,127	14,925	5,380	4,721
Amortization of intangible assets from acquisitions (2)	434	—	—	—
Acquisition and disposition related costs	(68)	199	—	81
Total operating expenses	<u>142,077</u>	<u>109,867</u>	<u>47,045</u>	<u>36,840</u>
Income (loss) from operations	297	(1,754)	193	12
Other income (expense):				
Interest and line of credit expense, net	(56)	(48)	(19)	(11)
Other	13	(4)	—	(1)
Total other expense	<u>(43)</u>	<u>(52)</u>	<u>(19)</u>	<u>(12)</u>
Income (loss) from continuing operations before provision for income taxes	254	(1,806)	174	—
Income tax expense	22,901	11	22,642	191
Net loss from continuing operations	<u>(22,647)</u>	<u>(1,817)</u>	<u>(22,468)</u>	<u>(191)</u>
Discontinued operations:				
Income from discontinued operations, net of tax	2,708	5,084	694	37
Gain on sale of discontinued operations, net of tax	278	22,195	278	163
Discontinued operations, net of tax	<u>2,986</u>	<u>27,279</u>	<u>972</u>	<u>200</u>
Net income (loss)	<u>(19,661)</u>	<u>25,462</u>	<u>(21,496)</u>	<u>9</u>
Dividends paid to participating securities	(98)	(37)	(29)	—
Net income (loss) applicable to common stockholders	<u>\$ (19,759)</u>	<u>\$ 25,425</u>	<u>\$ (21,525)</u>	<u>\$ 9</u>
Basic and diluted net income (loss) per share applicable to Class A and Class B common stockholders:				
Continuing operations	\$ (0.57)	\$ (0.04)	\$ (0.55)	\$ (0.00)
Discontinued operations, net of tax	0.07	0.66	0.03	0.00
Basic and diluted net income (loss) per share applicable to Class A and Class B common stockholders	\$ (0.50)	\$ 0.62	\$ (0.52)	\$ 0.00
Dividends paid per share	\$ 0.06	\$ 0.04	\$ 0.02	\$ —
Shares used to calculate basic net income (loss) per share applicable to common stockholders:				
Class A	6,062	5,233	5,233	5,233
Class B	33,546	35,980	36,041	36,120
Shares used to calculate diluted net income (loss) per share applicable to common stockholders:				
Class A	6,062	5,233	5,233	5,233
Class B	39,608	41,213	41,274	41,353
(1) Excludes amortization of intangible assets from acquisitions				
(2) Components of amortization of intangible assets from acquisitions:				
Service costs	<u>\$ 434</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

See accompanying notes to condensed consolidated financial statements.

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

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2014</b>	<b>2015</b>
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$(19,661)	\$ 25,462
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Amortization and depreciation	3,195	2,735
Acquisition and disposition related costs	(68)	—
Allowance for doubtful accounts and advertiser credits	949	678
Gain on sale of discontinued operations	(422)	(22,195)
Stock-based compensation	9,024	7,809
Deferred income taxes	24,390	—
Change in certain assets and liabilities:		
Accounts receivable, net	(4,475)	(599)
Refundable taxes	5	(4)
Prepaid expenses, other current assets and other assets	(26)	484
Accounts payable	4,628	(1,472)
Accrued expenses and other current liabilities	646	230
Deferred revenue	204	(789)
Other non-current liabilities	(272)	(339)
Net cash provided by operating activities	<u>18,117</u>	<u>12,000</u>
<b>Cash flows from investing activities:</b>		
Proceeds from sale of discontinued operations, net of costs	304	25,249
Purchases of property and equipment	(2,297)	(3,623)
Purchases of intangible assets and changes in other non-current assets	(185)	(46)
Net cash provided by (used in) investing activities	<u>(2,178)</u>	<u>21,580</u>
<b>Cash flows from financing activities:</b>		
Proceeds from offering, net	32,527	—
Tax withholding related to restricted stock awards	(467)	(74)
Common stock dividend payments	(2,474)	(1,685)
Repurchase of Class B common stock	—	(3,201)
Proceeds from exercises of stock options and issuance of restricted stock to employees, net of repurchases of forfeited unvested restricted stock	4,166	204
Proceeds from employee stock purchase plan	49	80
Net cash provided by (used in) financing activities	<u>33,801</u>	<u>(4,676)</u>
Net increase in cash and cash equivalents	49,740	28,904
Cash and cash equivalents at beginning of period	<u>30,912</u>	<u>80,032</u>
Cash and cash equivalents at end of period	<u>\$ 80,652</u>	<u>\$108,936</u>

See accompanying notes to condensed consolidated financial statements.

**MARCHEX, INC. AND SUBSIDIARIES**  
**Notes To Condensed Consolidated Financial Statements**  
**(unaudited)**

**(1) Description of Business and Basis of Presentation**

Marchex, Inc. (the “Company”) was incorporated in the state of Delaware on January 17, 2003. The Company is a mobile advertising analytics company that helps connect online behavior to real-world, offline actions. The Company provides products and services for businesses of all sizes that focus on consumer phone calls to drive sales. The Company’s technology can facilitate call quality, analyze phone calls in real time and measure the outcomes of calls while its technology platform delivers performance-based, pay-for-call advertising across numerous mobile and online publishers to connect consumers with businesses over the phone. The Company also provides performance-based online advertising that connects advertisers with consumers across our owned websites as well as third party websites.

The accompanying unaudited condensed consolidated financial statements of Marchex, Inc. and its wholly-owned subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for annual financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included.

Operating results for the three and nine months ended September 30, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015, or for any other period. The consolidated balance sheet at December 31, 2014 has been derived from the audited consolidated financial statements at that date but does not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements. These condensed consolidated financial statements and notes should be read in conjunction with the Company’s audited consolidated financial statements and accompanying notes included in the Annual Report on Form 10-K for the year ended December 31, 2014 filed with the SEC.

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All inter-company transactions and balances have been eliminated in consolidation. Certain reclassifications have been made to the condensed consolidated financial statements in the prior period to conform to the current period presentation.

In July 2013, the Company sold certain assets related to Archeo’s pay-per-click advertising services and, in April 2015, the Company sold certain assets related to Archeo’s domain operations, including the bulk of its domain name portfolio. The operating results related to these dispositions are shown as discontinued operations in the condensed consolidated statements of operations for all periods presented (see *Note 14. Discontinued Operations*). Unless otherwise indicated, information presented in the notes to the condensed consolidated financial statements relates only to the Company’s continuing operations.

**(2) Significant Accounting Policies**

The preparation of financial statements in conformity with generally accepted accounting principles (“GAAP”) in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These judgments are difficult as matters that are inherently uncertain directly impact their valuation and accounting. Actual results may vary from management’s estimates and assumptions.

***Recent Accounting Pronouncement(s) Not Yet Effective***

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606) (ASU 2014-09)*, which amends the existing accounting standards for revenue recognition. ASU 2014-09 requires an entity to recognize the amount of revenue to which it expects to be entitled when products or services are transferred to customers. On July 9, 2015, the FASB voted to approve a one year delay of the effective date. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is permitted as of annual and interim reporting periods in fiscal years beginning after December 15, 2016.

ASU 2014-09 may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. We are currently in the process of evaluating the impact of adoption of ASU 2014-09 on our consolidated financial statements.

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### Revenues

The following table presents the Company's revenues by segment for the periods presented (in thousands):

	Nine months ended September 30,		Three months ended September 30,	
	2014	2015	2014	2015
Call-Driven	\$ 137,728	\$ 105,621	\$ 46,379	\$ 36,135
Archeo	4,646	2,492	859	717
Total Revenue	<u>\$ 142,374</u>	<u>\$ 108,113</u>	<u>\$ 47,238</u>	<u>\$ 36,852</u>

Call-Driven revenue consists of payments from advertisers for pay-for-call marketing services and for use of the Company's call analytics technology. Call-Driven revenue also consists of payments from reseller partners for use of the Company's technology platform and marketing services, which they offer to their small business customers, as well as payments from advertisers for cost-per-action marketing services. Archeo revenue includes revenue generated from advertisements on the Company's network of owned and operated websites and third-party distribution. See *Note 6. Segment Reporting and Geographic Information* for further discussion regarding the Company's operating segments.

The following table presents the Company's revenues, by revenue source, for the periods presented (in thousands):

	Nine months ended September 30,		Three months ended September 30,	
	2014	2015	2014	2015
Partner and Other Revenue Sources	\$ 140,304	\$ 107,470	\$ 46,914	\$ 36,678
Proprietary Website Traffic Sources	2,070	643	324	174
Total Revenue	<u>\$ 142,374</u>	<u>\$ 108,113</u>	<u>\$ 47,238</u>	<u>\$ 36,852</u>

The Company's partner network revenues are primarily generated using third party distribution networks to deliver the pay-for-call and pay-for-click advertisers' listings. The distribution network includes mobile and online search engines and applications, directories, destination sites, shopping engines, third party Internet domains or websites, other targeted web and mobile-based content, mobile carriers and other offline sources. The Company generates revenue upon delivery of qualified and reported phone calls or click-throughs to our advertisers or to advertising services providers' listings. The Company also generates revenue from cost-per-action services, which occurs when a user makes a phone call from the Company's advertiser's listing or is redirected from one of the Company's websites or a third party website in the Company's distribution network to an advertiser website and completes the specified action. The Company pays a revenue share to the distribution partners to access their mobile, online, offline and other user traffic. Other revenues include call provisioning and call tracking services, presence management services, campaign management services and outsourced search marketing platforms.

The Company's proprietary website traffic revenues are generated from its portfolio of owned websites which are monetized with pay-for-call or pay-per-click listings that are relevant to the websites, as well as other forms of advertising, including banner advertising and sponsorships. When an online user navigates to one of the Company's owned and operated websites and calls or clicks on a particular listing or completes the specified action, the Company receives a fee.

**(3) Stock-based Compensation Plans**

Stock-based compensation expense has been included in the same lines as compensation paid to the same employees in the condensed consolidated statement of operations. Stock-based compensation expense was included in the following operating expense categories as follows (in thousands):

	Nine months ended September 30,		Three months ended September 30,	
	2014	2015	2014	2015
Service costs	\$1,010	\$1,046	\$ 371	\$ 273
Sales and marketing	659	893	224	339
Product development	2,017	1,843	666	620
General and administrative	5,327	4,027	1,759	1,119
<b>Total stock-based compensation</b>	<b>\$9,013</b>	<b>\$7,809</b>	<b>\$ 3,020</b>	<b>\$ 2,351</b>

FASB ASC 718 requires the benefits of tax deductions in excess of the stock-based compensation cost to be classified as financing cash inflows in the condensed consolidated statement of cash flows. In addition, a tax benefit and a credit to additional paid-in capital for the excess deductions is not recognized until that deduction reduces taxes payable. For the nine months ended September 30, 2014 and 2015, the Company incurred excess tax deductions of \$6.5 million and \$323,000, respectively, which were not recorded because the Company is in a cumulative loss carryforward position for income taxes.

The Company uses the Black-Scholes option pricing model to estimate the per share fair value of stock option grants with time-based vesting. The Black-Scholes model relies on a number of key assumptions to calculate estimated fair values. For the quarters ended September 30, 2014 and 2015, the expected life of each award granted was determined based on historical experience with similar awards, giving consideration to contractual terms, anticipated exercise patterns, vesting schedules and forfeitures. Expected volatility is based on historical volatility levels of the Company's Class B common stock and the expected volatility of companies in similar industries that have similar vesting and contractual terms. The risk-free interest rate is based on the implied yield currently available on U.S. Treasury issues with terms approximately equal to the expected life of the option. The Company uses an expected annual dividend yield in consideration of the Company's common stock dividend payments.

The following weighted average assumptions were used in determining the fair value of time-vested stock option grants for the periods presented:

	Nine months ended September 30,		Three months ended September 30,	
	2014	2015	2014	2015
Expected life (in years)	4.0	4.0-6.25	4.0	4.0-6.25
Risk-free interest rate	1.26%	1.13%-1.56%	1.45%	1.15%-1.56%
Expected volatility	55%-62%	59%-65%	62%	59%-60%
Expected dividend yield	0.76%	0.00%-0.36%	0.76%	0.00%

Stock option activity during the nine months ended September 30, 2015 is summarized as follows:

	Shares	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value (in thousands)
Balance at December 31, 2014	7,797,228	\$ 7.90	6.58	\$ 800
Options granted	1,921,215	4.05		
Options forfeited	(233,750)	6.27		
Options expired	(277,991)	7.43		
Options exercised	(48,654)	3.95		
Balance at September 30, 2015	<u>9,158,048</u>	\$ 7.07	6.53	\$ 119

The Company issues restricted stock awards and restricted stock units to employees for future services and in connection with acquisitions. Restricted stock units entitle the holder to receive one share of the Company's Class B common stock upon satisfaction of certain service conditions. Restricted stock awards and restricted stock units are generally measured at fair value on the date of grant based on the number of awards granted and the quoted price of the Company's common stock. Restricted stock awards and restricted stock units are accounted for under FASB ASC 718 using the straight-line method net of estimated forfeitures.



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Restricted stock awards and restricted stock unit activity during the nine months ended September 30, 2015 is summarized as follows:

	Shares/ Units	Weighted average grant date fair value
Unvested balance at December 31, 2014	2,140,762	\$ 6.55
Granted	1,193,837	4.26
Vested	(727,716)	7.51
Forfeited	(127,707)	5.64
Unvested balance at September 30, 2015	<u>2,479,176</u>	\$ 5.21

In the nine months ended September 30, 2014 and 2015, the Company repurchased 41,287 shares and 14,754 shares, respectively, from certain executives for minimum withholding taxes on 143,650 and 54,600 restricted stock award vests, respectively. The number of shares repurchased was based on the value on the vesting date of the restricted stock awards equivalent to the value of the executives' minimum withholding taxes of \$467,000 and \$74,000, respectively, which was remitted in cash to the appropriate taxing authorities. The payments are reflected as a financing activity within the consolidated statement of cash flows when paid. The payments had the effect of share repurchases by the Company as they reduced the number of shares that would have otherwise been issued on the vesting date and were recorded as a reduction of additional paid-in capital.

In February 2015, vesting of approximately 139,000 stock options and 108,000 restricted stock awards were fully accelerated in connection with an executive's employment agreement.

#### **(4) Net Income Per Share**

The Company computes net income per share of Class A and Class B common stock using the two class method. Under the provisions of the two class method, basic net income per share is computed by dividing net income applicable to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income applicable to common stockholders by the weighted average number of common and dilutive common equivalent shares outstanding during the period. The computation of the diluted net income per share of Class B common stock assumes the conversion of Class A common stock to Class B common stock, while the diluted net income per share of Class A common stock does not assume the conversion of those shares.

In accordance with the two class method, the undistributed earnings for each period are allocated based on the contractual participation rights of the Class A and Class B common shares and the restricted shares as if the earnings for the year had been distributed. Considering the terms of the Company's charter which provides that, if and when dividends are declared on our common stock in accordance with Delaware General Corporation Law, equivalent dividends shall be paid with respect to the shares of Class A common stock and Class B common stock and that both classes of common stock have identical dividend rights and would share equally in our net assets in the event of liquidation, we have allocated undistributed losses on a proportionate basis. Additionally, the Company has paid dividends equally to both classes of common stock and the unvested restricted shares since it initiated a quarterly cash dividend in November 2006.

Instruments granted in unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents, whether paid or unpaid, are participating securities prior to vesting. As such, the Company's restricted stock awards are considered participating securities for purposes of calculating earnings per share. Under the two class method, dividends paid on unvested restricted stock are allocated to these participating securities and therefore impacts the calculation of amounts allocated to common stock.

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The following table calculates net income (loss) applicable to common stockholders used to compute basic net income per share for the periods ended (in thousands, except per share amounts):

	Nine months ended September 30,			
	2014		2015	
	Class A	Class B	Class A	Class B
<b>Numerator:</b>				
Net loss from continuing operations	\$(3,479)	\$(19,168)	\$ (235)	\$(1,582)
Dividends paid to participating securities	—	(98)	—	(37)
Net loss from continuing operations applicable to common stockholders	\$(3,479)	\$(19,266)	\$ (235)	\$(1,619)
Discontinued operations, net of tax	457	2,529	3,464	23,815
Net income (loss) applicable to common stockholders	<u>\$(3,022)</u>	<u>\$(16,737)</u>	<u>\$3,229</u>	<u>\$22,196</u>
<b>Denominator:</b>				
Weighted average number of shares outstanding used to calculate basic net income (loss) per share	<u>6,062</u>	<u>33,546</u>	<u>5,233</u>	<u>35,980</u>
<b>Basic net income (loss) per share:</b>				
Net loss from continuing operations applicable to common stockholders	\$ (0.57)	\$ (0.57)	\$ (0.04)	\$ (0.04)
Discontinued operations, net of tax	0.07	0.07	0.66	0.66
Basic net income (loss) per share applicable to common stockholders	<u>\$ (0.50)</u>	<u>\$ (0.50)</u>	<u>\$ 0.62</u>	<u>\$ 0.62</u>

	Three months ended September 30,			
	2014		2015	
	Class A	Class B	Class A	Class B
<b>Numerator:</b>				
Net loss from continuing operations	\$(2,852)	\$(19,616)	\$ (24)	\$(167)
Dividends paid to participating securities	—	(29)	—	—
Net loss from continuing operations applicable to common stockholders	\$(2,852)	\$(19,645)	\$ (24)	\$(167)
Discontinued operations, net of tax	123	849	25	175
Net income (loss) applicable to common stockholders	<u>\$(2,729)</u>	<u>\$(18,796)</u>	<u>\$ 1</u>	<u>\$ 8</u>
<b>Denominator:</b>				
Weighted average number of shares outstanding used to calculate basic net income (loss) per share	<u>5,233</u>	<u>36,041</u>	<u>5,233</u>	<u>36,120</u>
<b>Basic net income (loss) per share:</b>				
Net loss from continuing operations applicable to common stockholders	\$ (0.55)	\$ (0.55)	\$ (0.00)	\$ (0.00)
Discontinued operations, net of tax	0.03	0.03	0.00	0.00
Basic net income (loss) per share applicable to common stockholders	<u>\$ (0.52)</u>	<u>\$ (0.52)</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>

The following table calculates net income to diluted net income applicable to common stockholders used to compute diluted net income per share for the periods ended (in thousands, except per share amounts):

	Nine months ended September 30,			
	2014		2015	
	Class A	Class B	Class A	Class B
<b>Numerator:</b>				
Net loss from continuing operations	\$(3,479)	\$(19,168)	\$ (235)	\$(1,582)
Dividends paid to participating securities	—	(98)	—	(37)
Reallocation of net income for Class A shares as a result of conversion of Class A to Class B shares	—	(3,479)	—	(235)
Net loss from continuing operations applicable to common stockholders	\$(3,479)	\$(22,745)	\$ (235)	\$(1,854)
Discontinued operations, net of tax	457	2,529	3,464	23,815
Reallocation of discontinued operations for Class A shares as a result of conversion of Class A to Class B shares	—	457	—	3,464
Discontinued operations, net of tax	<u>\$ 457</u>	<u>\$ 2,986</u>	<u>\$3,464</u>	<u>\$27,279</u>

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Net income (loss) applicable to common stockholders	<u>\$ (3,022)</u>	<u>\$ (19,759)</u>	<u>\$ 3,229</u>	<u>\$ 25,425</u>
Denominator:				
Weighted average number of shares outstanding used to calculate basic net income (loss) per share	6,062	33,546	5,233	35,980
Conversion of Class A to Class B common shares outstanding	—	6,062	—	5,233
Weighted average number of shares outstanding used to calculate diluted net income (loss) per share	<u>6,062</u>	<u>39,608</u>	<u>5,233</u>	<u>41,213</u>
Diluted net income (loss) per share:				
Net loss from continuing operations applicable to common stockholders	\$ (0.57)	\$ (0.57)	\$ (0.04)	\$ (0.04)
Discontinued operations, net of tax	0.07	0.07	0.66	0.66
Diluted net income (loss) per share applicable to common stockholders	<u>\$ (0.50)</u>	<u>\$ (0.50)</u>	<u>\$ 0.62</u>	<u>\$ 0.62</u>
<b>Three months ended September 30,</b>				
<b>2014</b>				
<b>2015</b>				
	<b>Class A</b>	<b>Class B</b>	<b>Class A</b>	<b>Class B</b>
Numerator:				
Net loss from continuing operations	\$ (2,852)	\$ (19,616)	\$ (24)	\$ (167)
Dividends paid to participating securities	—	(29)	—	—
Reallocation of net loss for Class A shares as a result of conversion of Class A to Class B shares	—	(2,852)	—	(24)
Net loss from continuing operations applicable to common stockholders	<u>\$ (2,852)</u>	<u>\$ (22,497)</u>	<u>\$ (24)</u>	<u>\$ (191)</u>
Discontinued operations, net of tax	123	849	25	175
Reallocation of discontinued operations for Class A shares as a result of conversion of Class A to Class B shares	—	123	—	25
Discontinued operations, net of tax	<u>\$ 123</u>	<u>\$ 972</u>	<u>\$ 25</u>	<u>\$ 200</u>
Net income (loss) applicable to common stockholders	<u>\$ (2,729)</u>	<u>\$ (21,525)</u>	<u>\$ 1</u>	<u>\$ 9</u>
Denominator:				
Weighted average number of shares outstanding used to calculate basic net income (loss) per share	5,233	36,041	5,233	36,120
Conversion of Class A to Class B common shares outstanding	—	5,233	—	5,233
Weighted average number of shares outstanding used to calculate diluted net income (loss) per share	<u>5,233</u>	<u>41,274</u>	<u>5,233</u>	<u>41,353</u>
Diluted net income (loss) per share:				
Net loss from continuing operations applicable to common stockholders	\$ (0.55)	\$ (0.55)	\$ (0.00)	\$ (0.00)
Discontinued operations, net of tax	0.03	0.03	0.00	0.00
Diluted net income (loss) per share applicable to common stockholders	<u>\$ (0.52)</u>	<u>\$ (0.52)</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>

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

- For both the three and nine months ended September 30, 2014 outstanding options to acquire 7,833 shares of Class B common stock. For both the three and nine months ended September 30, 2015, outstanding options to acquire 9,158 shares of outstanding Class B common stock.
- For the three and nine months ended September 30, 2014 and 2015, 1,503 and 1,052 shares of unvested Class B restricted common shares, respectively.
- For the three and nine months ended September 30, 2014 and 2015 1,103 and 1,427 restricted stock units, respectively.

**(5) Concentrations**

The Company maintains substantially all of its cash and cash equivalents with one financial institution. During the three months ended September 30, 2015, the Company held cash equivalents in a commercial paper sweep account with the same financial institution, which were fully liquidated prior to September 30, 2015.

A significant majority of the Company's revenue earned from advertisers is generated through arrangements with distribution partners. The Company may not be successful in renewing any of these agreements or, if they are renewed, they may not be on terms as favorable as current agreements. The Company may not be successful in entering into agreements with new distribution partners or advertisers on commercially acceptable terms. In addition, several of these distribution partners or advertisers may be considered potential competitors. There were no distribution partners representing more than 10% of consolidated revenue for the nine months ended September 30, 2015. One distribution partner was paid less than 20% of consolidated revenue for the nine months ended September 30, 2014.

The advertisers representing more than 10% of consolidated revenue are as follows (in percentages):

	Nine months ended September 30,		Three months ended September 30,	
	2014	2015	2014	2015
Advertiser A	23%	30%	24%	28%
Advertiser B	*	20%	*	19%
Advertiser C	34%	*	33%	*

Advertiser A is also a distribution partner.

The outstanding receivable balance for each advertiser representing more than 10% of accounts receivable is as follows (in percentages):

	At December 31, 2014	At September 30, 2015
Advertiser A	41%	34%
Advertiser B	16%	18%

\* Less than 10%

In certain cases, the Company may engage directly with one or more advertising agencies who act on an advertiser's behalf. In addition, an advertising agency may represent more than one advertiser that utilizes the Company's products and services. For the three and nine months ended September 30, 2014, no advertising agency represented more than 10% of consolidated revenue, and, as of December 31, 2014, one advertising agency represented 13% of consolidated accounts receivable. For the three and nine months ended September 30, 2015, there was one advertising agency which represented 17% and 19%, respectively, of consolidated revenue and, as of September 30, 2015, represented 15% of the consolidated accounts receivable balance.

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

Operating segments are revenue-producing components of the enterprise for which separate financial information is produced internally for the Company's management. In July 2013, the Company sold certain assets related to Archeo's pay-per-click advertising services and, in April 2015, the Company sold certain assets related to Archeo's domain operations, including the bulk of its domain name portfolio. As a result, the operating results related to these dispositions are shown as discontinued operations, net of tax in the condensed consolidated statements of operations for all periods presented and are excluded from segment reporting. See *Note 14. Discontinued Operations* for further discussion.

The Company's Call-Driven segment comprises its performance-based advertising business focused on driving, analyzing and measuring phone calls and the related outcomes. The Archeo segment comprises the Company's click-based advertising business. Call-Driven segment expenses include both direct costs incurred by the segment business as well as corporate overhead costs. Archeo segment expenses only include direct costs incurred by the segment. Segment expenses exclude the following: stock-based compensation, amortization of intangible assets from acquisitions, acquisition and disposition related costs, and other income (expense).

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A measure of segment assets is not currently provided to the Company's chief operating decision maker and has therefore not been disclosed. The carrying amount of goodwill by operating segment at September 30, 2015 was approximately \$63.3 million and \$0 for Call-Driven and Archeo, respectively.

Selected segment information (in thousands):

	Nine months ended September 30, 2015		
	Call-Driven	Archeo	Total
Revenue	\$ 105,621	\$ 2,492	\$ 108,113
Operating expenses	99,412	2,447	101,859
Segment profit	\$ 6,209	\$ 45	\$ 6,254
Less reconciling items:			
Stock based compensation			7,809
Acquisition and disposition related costs			199
Other expense			52
Loss from continuing operations before provision for income taxes			\$ (1,806)

	Nine months ended September 30, 2014		
	Call-Driven	Archeo	Total
Revenue	\$ 137,728	\$ 4,646	\$ 142,374
Operating expenses	129,140	3,558	132,698
Segment profit	\$ 8,588	\$ 1,088	\$ 9,676
Less reconciling items:			
Stock based compensation			9,013
Amortization of intangible assets from acquisitions			434
Acquisition and disposition related costs			(68)
Other expense			43
Income from continuing operations before provision for income taxes			\$ 254

	Three months ended September 30, 2015		
	Call-Driven	Archeo	Total
Revenue	\$ 36,135	\$ 717	\$ 36,852
Operating expenses	33,958	450	34,408
Segment profit	\$ 2,177	\$ 267	\$ 2,444
Less reconciling items:			
Stock based compensation			2,351
Acquisition and disposition related costs			81
Other expense			12
Loss from continuing operations before provision for income taxes			\$ —

	Three months ended September 30, 2014		
	Call-Driven	Archeo	Total
Revenue	\$ 46,379	\$ 859	\$ 47,238
Operating expenses	43,100	925	44,025
Segment profit (loss)	\$ 3,279	\$ (66)	\$ 3,213
Less reconciling items:			
Stock based compensation			3,020
Other expense			19
Income from continuing operations before provision for income taxes			\$ 174

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Revenues from advertisers by geographical areas are tracked on the basis of the location of the advertiser. The vast majority of the Company's revenue and accounts receivable are derived from domestic sales to advertisers engaged in various mobile, online and other activities.

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

	Nine months ended September 30,		Three months ended September 30,	
	2014	2015	2014	2015
United States	97%	97%	97%	97%
Canada	3%	3%	3%	3%
Other countries	*	*	*	*
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

\* Less than 1% of revenue.

### (7) Property and Equipment

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

	At December 31, 2014	At September 30, 2015
Computer and other related equipment	\$ 18,662	\$ 21,190
Purchased and internally developed software	7,836	7,890
Furniture and fixtures	1,416	1,733
Leasehold improvements	1,834	2,081
	<u>\$ 29,748</u>	<u>\$ 32,894</u>
Less: accumulated depreciation and amortization	(24,318)	(26,656)
Property and equipment, net	<u>\$ 5,430</u>	<u>\$ 6,238</u>

Depreciation and amortization expense related to property and equipment was approximately \$863,000 and \$885,000 for the three months ended September 30, 2014 and 2015, respectively, and was approximately \$2.6 million for both the nine months ended September 30, 2014 and 2015.

### (8) Commitments

The Company has commitments for future payments related to office facilities leases and other contractual obligations. The Company leases its office facilities under operating lease agreements expiring through 2018. The Company recognizes rent expense under such agreements on a straight-line basis over the lease term with any lease incentive amortized as a reduction of rent expense over the lease term. The Company also has other contractual obligations expiring over varying time periods through 2018. Other contractual obligations primarily relate to minimum contractual payments due to distribution partners and other outside service providers.

Future minimum payments are approximately as follows (in thousands):

	Facilities operating leases	Other contractual obligations	Total
2015	\$ 571	\$ 1,291	\$ 1,862
2016	2,313	3,054	5,367
2017	2,373	86	2,459
2018	577	1	578
2019 and after	—	—	—
Total minimum payments	<u>\$ 5,834</u>	<u>\$ 4,432</u>	<u>\$10,266</u>

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Rent expense incurred by the Company was approximately \$467,000 and \$460,000 for the three months ended September 30, 2014 and 2015, respectively, and was \$1.4 million for both the nine months ended September 30, 2014 and 2015, respectively.

### **(9) Credit Agreement**

In April 2008, the Company entered into a credit agreement providing for a senior secured \$30 million revolving credit facility (“Credit Agreement”). The Credit Agreement, as amended, matures on April 1, 2017. Interest on outstanding balances under the Credit Agreement will accrue at LIBOR plus an applicable margin rate, as determined under the agreement and has an unused commitment fee. The Credit Agreement contains certain customary representations and warranties, financial covenants, events of default and is secured by substantially all of the assets of the Company. During the nine months ended September 30, 2014 and 2015, the Company had no borrowings under the Credit Agreement.

In April 2015, the Company signed an amendment to the Credit Agreement which clarified the LIBOR rate as determined under the Credit Agreement cannot be below zero percent (0%) and added a financial covenant limiting outstanding balances under the Credit Agreement not to exceed a collateral value as defined in the Credit Agreement.

### **(10) Contingencies and Taxes**

#### **(a) Contingencies**

The Company is involved in legal and administrative proceedings and claims of various types from time to time. While any litigation contains an element of uncertainty, the Company is not aware of any legal proceedings or claims which are pending that the Company believes, based on current knowledge, will have, individually or taken together, a material adverse effect on the Company’s financial condition or results of operations or liquidity. In some agreements to which the Company is a party, the Company has agreed to indemnification provisions of varying scope and terms with advertisers, vendors and other parties with respect to certain matters, including, but not limited to, losses arising out of the Company’s breach of agreements or representations and warranties made by the Company, services to be provided by the Company and intellectual property infringement claims made by third parties. As a result of these provisions, the Company may from time to time provide certain levels of financial support to its contract parties to seek to minimize the impact of any associated litigation in which it may be involved. To date, there have been no known events or circumstances that have resulted in any material costs related to these indemnification provisions and no liabilities therefore have been recorded in the accompanying unaudited condensed consolidated financial statements. However, the maximum potential amount of the future payments we could be required to make under these indemnification provisions could be material.

#### **(b) Taxes**

At September 30, 2015, based upon both positive and negative evidence available, we determined that it is not more likely than not that our deferred tax assets of \$34.8 million will be realized and accordingly, we have recorded a 100% valuation allowance against these deferred tax assets. We initially increased the valuation allowance to 100% during the third quarter of 2014. In assessing the realizability of deferred tax assets, the Company considered whether it is more likely than not that some or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which those temporary differences are deductible. The Company considered the future reversal of deferred tax liabilities, carryback potential, projected taxable income, and tax planning strategies as well as its history of taxable income or losses in the relevant jurisdictions in making this assessment. The Company has incurred taxable losses from 2012 to 2014. Based on the level of historical taxable losses and the uncertainty of projections for future taxable income over the periods for which the deferred tax assets are deductible, the Company concluded that it is not more likely than not that the gross deferred tax assets will be realized.

From time to time, various state, federal and other jurisdictional tax authorities undertake audits of the Company and its filings. In evaluating the exposure associated with various tax filing positions, the Company on occasion accrues charges for uncertain positions. Resolution of uncertain tax positions will impact our effective tax rate when settled. The Company does not have any significant interest or penalty accruals. The provision for income taxes includes the impact of contingency provisions and changes to contingencies that are considered appropriate. The Company files U.S. federal, certain U.S. states, and certain foreign tax returns. Generally, U.S. federal, U.S. state, and foreign tax returns filed for years after 2010 are within the statute of limitations and are under examination or may be subject to examination.

**(11) Goodwill**

Changes in the carrying amount of goodwill during the nine months ended September 30, 2015 are as follows (in thousands):

	<u>Call Driven</u>	<u>Archeo</u>	<u>Total</u>
Balance as of December 31, 2014	\$63,305	\$ 2,374	\$65,679
Sale of certain assets related to domain operations	—	(2,374)	(2,374)
Balance as of September 30, 2015	<u>\$63,305</u>	<u>\$ —</u>	<u>\$63,305</u>

The decrease in goodwill is related to the 2015 sale of certain assets related to Archeo's domain operations, including the bulk of its domain name portfolio. The assets sold constitute a business within the Archeo reporting unit. Goodwill was allocated to the sold business based on its relative fair value compared to the remainder of the Archeo reporting unit.

The Company reviews goodwill for impairment annually on November 30 and whenever events or changes in circumstances indicate the carrying value of goodwill may not be recoverable. When evaluating goodwill for impairment, the Company may first perform a qualitative assessment to determine if the fair value of the reporting unit is more likely than not greater than its carrying amount. The testing of goodwill and other intangible assets for impairment requires the Company to make significant estimates about its future performance and cash flows, as well as other assumptions. Events and circumstances considered in determining whether the carrying value of goodwill may not be recoverable include, but are not limited to: significant changes in performance relative to expected operating results; significant changes in the use of the assets; and significant changes in competition and market dynamics. These estimates are inherently uncertain and can be affected by numerous factors, including changes in economic, industry or market conditions, changes in business operations, a loss of a significant customer, changes in competition or changes in the share price of the Company's common stock and market capitalization. Significant and sustained declines in the Company's stock price and market capitalization, a significant decline in its expected future cash flows or a significant adverse change in the Company's business climate, among other factors, could result in the need to perform an impairment analysis in future periods. The Company cannot accurately predict the amount and timing of any future impairment of goodwill or other intangible assets. Should the value of goodwill or other intangible assets become impaired, the Company would record an impairment charge, which could have an adverse effect on its financial condition and results of operations.

The current business environment is subject to evolving market conditions and requires significant management judgment to interpret the potential impact to our assumptions. At various points in time during the nine months ended September 30, 2015 and the period from October 1, 2015 to November 3, 2015, the Company's stock price approached or dropped below the then book value. To the extent that changes in the current business environment impact the Company's ability to achieve levels of forecasted operating results and cash flows, if the Company's stock price were to trade below book value per share for an extended period of time and/or should other events occur indicating the remaining carrying value of our assets might be impaired, the Company would test its goodwill and intangible assets for impairment and may recognize an impairment loss to the extent that the carrying amount exceeds such asset's fair value. The Company will continue to monitor its financial performance, stock price and other factors in order to determine if there are any indicators of impairment prior to its annual impairment evaluation in November 2015.

**(12) Intangible and other assets, net**

Intangible and other assets, net consisted of the following (in thousands):

	<u>At December 31, 2014</u>	<u>At September 30, 2015</u>
Internet domain names	\$ 14,607	\$ 748
Less accumulated amortization	(14,499)	(720)
Internet domain names, net	108	28
Other assets:		
Other	205	205
Total intangibles and other assets, net	<u>\$ 313</u>	<u>\$ 233</u>

The Company capitalizes costs incurred to acquire domain names or URLs, which include the initial registration fees, and are included in Intangible and other assets, net on the condensed consolidated balance sheet. The capitalized costs are amortized over the expected useful life of the domain names on a straight-line basis. The net carrying value of Internet domain names as of December 31, 2014 related to both domain names held for use and available for sale. During the nine months ended September 30, 2015, the Company sold certain assets related to Archeo's domain operations, including the bulk of its domain name portfolio. As a result, the net carrying value of Internet domain names as of September 30, 2015 primarily related to domains held for use.

Amortization expense for internet domain names was \$29,000 and \$19,000 for the three months ended September 30, 2014 and 2015, respectively, and was \$98,000 and \$67,000 for the nine months ended September 30, 2014 and 2015, respectively. Based upon the current amount of domains subject to amortization, and, as a result of the sale of the majority of the Company's domain names in April 2015, the estimated expense for the next five years is as follows: \$14,000 for the remainder of 2015 and \$14,000 thereafter.



**(13) Common Stock**

In November 2014, the Company's board of directors authorized a new share repurchase program (the "2014 Repurchase Program"), which supersedes and replaces any prior repurchase programs. Under the 2014 Repurchase Program, the Company is authorized to repurchase up to 3 million shares of the Company's Class B common stock in the aggregate through open market and privately negotiated transactions, at such times and in such amounts as the Company deems appropriate. Repurchases may also be made under a Rule 10b5-1 plan, which would permit shares to be repurchased when the Company might otherwise be precluded from doing so under insider trading laws. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements, capital availability, and other market conditions. The 2014 Repurchase Program does not have an expiration date and may be expanded, limited or terminated at any time without prior notice. During the nine months ended September 30, 2015, the Company repurchased 781,000 shares of Class B common stock for \$3.2 million. During the nine months ended September 30, 2014, the Company did not repurchase any shares of Class B common stock under the prior stock repurchase program.

During the nine months ended September 30, 2014 and 2015, the Company's board of directors approved and the Company retired 239,087 and 1,261,742 shares, respectively, of treasury stock.

During the nine months ended September 30, 2015 the Company paid aggregate dividends of \$1.7 million to shareholders of record on February 11, 2015 and May 7, 2015. We do not anticipate declaring or paying further dividends in the foreseeable future.

**(14) Discontinued Operations**

In July 2013, the Company sold certain assets related to Archeo's pay-per-click advertising services and, in April 2015, the Company sold certain assets related to Archeo's domain operations, including the bulk of its domain name portfolio. These disposals meet the requirements of FASB ASC 205-20, "Discontinued Operations", for presentation as discontinued operations. As a result, the operating results related to these dispositions are shown as discontinued operations, net of tax. The operating results for the discontinued operations were as follows (in thousands):

	Nine months ended September 30,		Three months ended September 30,	
	2014	2015	2014	2015
Revenue	\$6,979	\$7,081	\$ 1,943	\$ —
Expenses:				
Service costs	2,502	1,663	785	—
Sales and marketing	388	334	126	—
Income from discontinued operations before provision for income taxes	4,089	5,084	1,032	—
Income tax expense (benefit)	1,381	—	338	(37)
Income from discontinued operations, net of tax	\$2,708	\$5,084	\$ 694	\$ 37

The discontinued operations incurred amortization of \$15,000 and \$0 for the three months ended September 30, 2014 and 2015, respectively, and amortization of \$101,000 and \$16,000 for the nine months ended September 30, 2014 and 2015, respectively.

The cash proceeds from the sale of the pay-per-click assets and assets related to Archeo's domain operations were approximately \$1.4 million and \$28.1 million, respectively. Both sales include contingent earn-out consideration payments that depend upon the achievement of certain thresholds and will be recognized as income when received.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We use words such as "believes," "intends," "expects," "anticipates," "plans," "may," "will" and similar expressions to identify forward-looking statements. All forward-looking statements, including, but not limited to, statements regarding our future operating results, financial position, prospects, acquisitions, dispositions 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 inherently uncertain as they are based on our expectations and assumptions concerning future events. We may not actually achieve the plans, intentions or expectations disclosed in*

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our forward-looking statements we make. There are a number of important factors that could cause the actual results of Marchex to differ materially from those indicated by such forward-looking statements. Any or all of our forward-looking statements in this report 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 but not limited to the risks, uncertainties and assumptions described in this report, in Part II, Item 1A. under the caption “Risk Factors” and elsewhere in this report and in our Annual Report on Form 10-K for the year ended December 31, 2014 and those described from time to time in our future reports filed with the SEC. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this report may not occur as contemplated and actual results could differ materially from those anticipated or implied by the forward-looking statements. All forward-looking statements in this report are made as of the date hereof, based on information available to us as of the date hereof, and we assume no obligation to update any forward-looking statement.

The following discussion and analysis provides information that we believe is relevant to an assessment and understanding of our results of operation and financial condition. You should read this analysis in conjunction with the attached condensed consolidated financial statements and related notes thereto, and with our audited consolidated financial statements and the notes thereto, included in our Annual Report on Form 10-K for the year ended December 31, 2014.

## Overview

References herein to “we,” “us” or “our” refer to Marchex, Inc. and its wholly-owned subsidiaries unless the context specifically states or implies otherwise.

Marchex, Inc. is a mobile advertising analytics company that helps connect online behavior to real-world, offline actions. We provide products and services for businesses of all sizes that focus on consumer phone calls to drive sales. Our technology can facilitate call quality, analyze phone calls in real time and measure the outcomes of calls while our technology platform can deliver performance-based, pay-for-call advertising across numerous mobile and online publishers to connect consumers with businesses over the phone.

Our technology-based products and services enable our customers to connect with consumers across third-party mobile and online channels. We have direct relationships with large national advertisers and advertising agencies which utilize our products and services to plan, execute and measure their call-focused advertising campaigns. We also provide private-label performance marketing solutions for small-and medium-sized businesses (“SMBs”) through a network of large reseller partners, which include Yellow Pages publishers, media and telecommunications companies and vertical marketing service providers. We enable these partners to sell pay-for-call advertising, call-analytics, search engine marketing and other digital marketing services to their small business customers. We execute these campaigns for them using our technology. Our primary product offerings are:

- **Marchex Call Analytics.** Our Marchex Call Analytics technology platform provides data and insights that can measure the performance of mobile, online and offline advertising for advertisers and small business resellers. Our analytics technology tracks calls and helps advertisers understand which marketing channels, advertisements, keywords and creatives are driving calls to their business, allowing them to optimize their advertising expenditures across media channels. Call Analytics also includes call recording, call quality filtering and real-time call intelligence to provide insights into what is happening during a call and to measure the outcome of calls and return on investment. Advertisers may pay us a fee for each call or call related data element they receive from calls including call-based ads we distribute through our sources of call distribution or for each phone number tracked based on pre-negotiated rates.
- **Marchex Call Marketplace.** Through the Marchex Call Marketplace, we deliver a variety of call advertising products and services to national advertisers, advertising agencies and small advertiser reseller partners. The Marchex Call Marketplace is a mobile advertising solution focused on delivering customers on a pay-for-call or cost-per-action basis. We offer exclusive and preferred ad placements across numerous mobile and online media sources to drive advertiser qualified calls to their businesses. It leverages our Marchex Call Analytics platform to secure call tracking numbers and to provide qualified calls to advertisers by blocking spam and other telemarketing calls while working to optimize the return on investment for advertisers’ marketing investment.
- **Local Leads.** Our Local Leads platform is a white-labeled, full service advertising solution for small business resellers, such as Yellow Pages providers and vertical marketing service providers, to sell call advertising, search marketing and other lead generation products through their existing sales channels to their small business advertisers. These calls and leads are then fulfilled by us across our distribution network, including mobile sources, and search engines. The lead services we offer to small business advertisers through our Local Leads platform include pay-for-call, search marketing and ad creation and include advanced features such as call tracking, geo-targeting, campaign management, reporting and analytics. The Local Leads platform is highly scalable and has the capacity to support hundreds of thousands of advertiser accounts. Reseller partners and publishers generally pay us account fees and agency fees for our products in the form of a

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percentage of the cost of every click or call delivered to their advertisers. Through our contract with Yellowpages.com LLC (“YP”), we generate revenues from our local leads platform. We also have a separate pay-for-call services arrangement with YP. We recently extended these agreements through December 31, 2016. The primary local leads platform arrangement includes certain minimum fee commitments by YP from July 1, 2015 through June 30, 2016 and provides YP additional flexibility to migrate active accounts to itself or a third-party provider prior to the end of an advertiser contract. YP is our largest reseller partner and was responsible for 28% and 30% of our total revenues in the three and nine months ended September 30, 2015, respectively. We also have a separate distribution partner agreement with YP.

In addition to our Call-Driven operations, our Archeo division provides performance-based online advertising that connects advertisers with consumers across our owned websites as well as third party websites. Our portfolio of websites contains locally-focused sites such as Yellow.com, OpenList.com and geo-targeted sites. We monetize this portfolio generally via pay-per-click and banner advertising. Historically, we also made available for sale domains from our portfolio of over 200,000 websites to third parties. In April 2015, we sold certain assets related to Archeo’s domain operations, including the bulk of its domain name portfolio. The operating results related to this disposition are shown as discontinued operations in the condensed consolidated statements of operations for all periods presented.

We generate revenue from two business segments. Call-Driven revenue consists of payments from advertisers for pay-for-call marketing services and for use of our call analytics technology. Call-Driven revenue also consists of payments from our reseller partners for use of our technology platform and marketing services, which they offer to their small business customers, as well as payments from advertisers for cost-per-action services. Archeo revenue includes revenue generated from advertisements on our network of owned and operated websites and third-party distribution. Call-Driven revenue accounted for more than 98% of total revenue for both the three months ended September 30, 2014 and 2015, respectively. We operate primarily in domestic markets. For details on revenue by segment and geographical area for the three and nine months ended September 30, 2014 and 2015, see *Note 6. Segment Reporting and Geographic Information* of the notes to our condensed consolidated financial statements.

We were incorporated in Delaware on January 17, 2003. Acquisition initiatives have played an important part in our corporate history to date.

We currently have offices in Seattle, Washington; Las Vegas, Nevada; and New York, New York. In October 2015, we opened offices in Sydney, Australia and in San Francisco, California.

### ***Consolidated Statements of Operations***

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 being recorded at their estimated fair values on the respective acquisition dates. All goodwill, intangible assets and liabilities resulting from the acquisitions have been recorded in our financial statements.

In July 2013, we sold certain assets related to our pay-per-click advertising services and, in April 2015, we sold certain assets related to Archeo’s domain operations, including the bulk of its domain name portfolio. The operating results related to these dispositions have been classified and presented as discontinued operations, net of tax, in the condensed consolidated statements of operations for all periods presented (see *Note 14. Discontinued Operations*).

### ***Presentation of Financial Reporting Periods***

The comparative periods presented are for the three and nine months ended September 30, 2014 and 2015.

### ***Revenue***

We currently generate revenue through our call advertising services, pay-per-click advertising, local leads platform, which includes our call and click services, and our proprietary website traffic.

Our performance-based advertising services include call advertising, pay-per-click services, and cost-per-action services. These primary sources amounted to 80% or more of our revenues in all periods presented. Our other sources of revenue include the local leads platform, which enables partner resellers to sell call advertising and/or search marketing products and campaign management services. These secondary sources amounted to 20% or less 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.

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In certain cases, we record revenue based on available and reported preliminary information from third parties. Collection on the related receivables may vary from reported information based upon third party refinement of the estimated and reported amounts owing that occurs subsequent to period ends.

### ***Performance-Based Advertising Services***

In providing call advertising services and pay-per-click advertising, we generate revenue upon our delivery of qualified and reported phone calls or click-throughs to our advertisers or advertising service providers' listings. These advertisers and advertising service providers pay us a designated transaction fee for each phone call or click-through, which occurs when a user makes a phone call or clicks on any of their advertisement listings after it has been placed by us or by our distribution partners. Each phone call or click-through on an advertisement listing represents a completed transaction. The advertisement listings are displayed within our distribution network, which includes mobile and online search engines and applications, directories, destination sites, shopping engines, third party Internet domains or websites, our portfolio of owned websites, other targeted web and mobile-based content and offline sources. We also generate revenue from cost-per-action services, which occurs when a user accessing our distribution network completes a specified action.

We generate revenue from reseller partners and publishers utilizing our Local Leads platform to sell call advertising and/or search marketing and other lead generation products. We are paid account fees and also agency fees for our products in the form of a percentage of the cost of every call or click delivered to advertisers. The reseller partners or publishers engage the advertisers and are the primary obligor, and we, in certain instances, are only financially liable to the publishers in our capacity as a collection agency for the amount collected from the advertisers. We recognize revenue for these fees under the net revenue recognition method. In limited arrangements resellers pay us a fee for fulfilling an advertiser's campaign in our distribution network and we act as the primary obligor. We recognize revenue for these fees under the gross revenue recognition method.

In providing pay-per-click contextual targeting services, advertisers purchase keywords or keyword strings, based on an amount they choose for a targeted placement on vertically-focused websites or specific pages of a website that are specific to their products or services and their marketing objectives. The contextual results distributed by our services are prioritized for users by the amount the advertiser is willing to pay each time a user clicks on the merchant's advertisement and the relevance of the merchant's advertisement, which is dictated by historical click-through rates. Advertisers pay us when a click-through occurs on their advertisement. In July 2013, we sold certain assets related to our pay-per-click contextual advertising services. The results of operations of these certain pay-per-click assets have been presented in the condensed consolidated financial statements as discontinued operations.

### ***Search Marketing Services***

Advertisers pay us additional fees for services such as campaign management. 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 advertisers. We may also charge initial set-up, account, service or inclusion fees as part of our services.

Banner advertising revenue may be based on a fixed fee per click and is generated and recognized on click-through activity. In other 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 advertisers and are recognized ratably over the longer of the term of the contract or the average expected advertiser relationship period, which generally ranges from twelve months to more than two years. Other account and service fees are recognized in the month or period to which the account fee or services relate.

Historically, we have generated revenue from domain name sales. In April 2015, we sold certain assets related to Archeo's domain operations, including the bulk of its domain name portfolio. The operating results related to this disposition are shown as discontinued operations in the condensed consolidated statements of operations for all periods presented.

### ***Industry and Market Factors***

We enter into agreements with various mobile, online and offline distribution partners to provide distribution for pay-for-call and pay-per-click advertisement listings which contain call tracking numbers and/or URL strings of our advertisers. We generally pay distribution partners based on a percentage of revenue or a fixed amount for each phone call or per click-through on these listings. The level of phone calls and 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. If we do not add new distribution partners, renew our current distribution partner agreements, 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 ability to grow will be impacted by our ability to increase our distribution, which impacts the number of mobile and Internet users who have access to our advertisers' listings and the rate at which our advertisers are able to convert calls and clicks from these mobile and Internet users into completed transactions, such as a purchase or sign up. Our ability to grow also depends on our ability to continue to increase the number of advertisers who use our services and the amount these advertisers spend on our services.

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We have revenue concentrations with certain large advertisers. Most of these customers are not subject to long term contracts with us and are generally able to reduce advertising spending at any time and for any reason. A significant reduction in advertising spending by our largest customers, or the loss of one or more of these customers, if not replaced by new customers or an increase in business from existing customers, would adversely affect revenues and profitability. This could have a material adverse effect on our results of operations and financial condition.

We anticipate that these variables will fluctuate in the future, affecting our ability to grow and our financial results. In particular, it is difficult to project the number of phone calls or other actions which will be delivered to our advertisers and how much advertisers will spend with us, and it is even more difficult to anticipate the average revenue per phone call or other action. It is also difficult to anticipate the impact of worldwide and domestic economic conditions on advertising budgets.

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 mobile and Internet usage and seasonal purchasing cycles of many advertisers. Our experience has shown that during the spring and summer months, mobile and Internet usage is lower than during other times of the year and during the latter part of the fourth quarter of the calendar year we generally experience lower call volume and reduced demand for calls from our advertising customers. The extent to which usage and call volume may decrease during these off-peak periods is difficult to predict. Prolonged or severe decreases in usage and call volume during these periods may adversely affect our growth rate and results and in turn the market price of our securities. In the first quarter of the calendar year, this trend generally reverses with increased mobile and Internet usage and often new budgets at the beginning of the year for many of our customers with fiscal years ending December 31. The seasonal purchasing cycles of some customers in certain industries may also be higher in the first half versus the latter half of the calendar year. Additionally, the current business environment has generally resulted in advertisers and reseller partners reducing advertising and marketing services budgets or changing such budgets throughout the year, which we expect will impact our quarterly results of operations in addition to the typical seasonality seen in our industry.

### **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 include:

- user acquisition costs;
- amortization of intangible assets;
- license and content fees;
- credit card processing fees;
- network operations;
- serving our search results;
- telecommunication costs, including the use of phone numbers relating to our call products and services;
- maintaining our websites;
- domain name registration renewal fees;
- domain name costs;
- network fees;
- fees paid to outside service providers;
- delivering customer service;
- depreciation of our websites, network equipment and software;
- colocation service charges of our website equipment;
- bandwidth and software license fees;
- payroll and related expenses of related personnel; and
- stock-based compensation of related personnel.

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### ***User Acquisition Costs***

For the periods presented the largest component of our service costs consist of user acquisition costs that relate primarily to payments made to distribution partners for access to their mobile, online, offline or other user traffic. We enter into agreements of varying durations with distribution partners that integrate our services into their websites and indexes. The primary economic structure of the distribution partner agreements is a variable payment based on a specified percentage of revenue. These variable payments are often subject to minimum payment amounts per phone call or click-through. Other payment structures that to a lesser degree exist include:

- fixed payments, based on a guaranteed minimum amount of usage delivered;
- variable payments based on a specified metric, such as number of paid phone calls or click-throughs; and
- a combination arrangement with both fixed and variable amounts that may be paid in advance.

We expense user acquisition costs based on whether the agreement provides for fixed or variable payments. Agreements with fixed payments with minimum guaranteed amounts of usage are expensed as the greater of the pro-rata amount over the term of arrangement or the actual usage delivered to date based on the contractual revenue share. Agreements with variable payments based on a percentage of revenue, number of paid phone calls, click-throughs, or other metrics are expensed as incurred based on the volume of the underlying activity or revenue multiplied by the agreed-upon price or rate.

### **Sales and Marketing**

Sales and marketing expenses consist primarily of:

- payroll and related expenses for personnel engaged in marketing and sales functions;
- advertising and promotional expenditures including online and outside marketing activities;
- cost of systems used to sell to and serve advertisers; and
- stock-based compensation of related personnel.

### **Product Development**

Product development costs consist primarily of expenses incurred in the research and development, creation and enhancement of our websites and services.

Our research and development expenses include:

- payroll and related expenses for personnel;
- costs of computer hardware and software;
- costs incurred in developing features and functionality of the services we offer; and
- stock-based compensation of related personnel.

For the periods presented, substantially all of our product development expenses are research and development.

Product development costs are expensed as incurred or capitalized into property and equipment whereby costs incurred in the preliminary project and post-implementation stages of an internal use software project are expensed as incurred and that certain costs incurred in the application development stage of a project are 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;
- other general corporate expenses; and
- stock-based compensation of related personnel.

## **Stock-Based Compensation**

We measure stock-based compensation cost at the grant date based on the fair value of the award and recognize it as expense, net of estimated forfeitures, over the vesting or service period, as applicable, of the stock award using the straight-line method. Stock-based compensation expense has been included in the same lines as compensation paid to the same employees in the condensed consolidated statements of operations.

## **Amortization of Intangibles from Acquisitions**

Amortization of intangible assets, excluding goodwill, relates to distributor relationships identified in connection with our acquisitions.

## **Provision for Income Taxes**

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 law is recognized in results of operations in the period that includes the enactment date. In the first quarter of 2014, we adopted ASU 2013-11 whereby we reclassified uncertain tax positions of \$534,000 from other non-current liabilities to deferred tax assets. Uncertain tax positions as of September 30, 2015 amounted to \$717,000.

At September 30, 2015, based upon both positive and negative evidence available, we determined that it is not more likely than not that our deferred tax assets of \$34.8 million will be realized and accordingly, we have recorded a 100% valuation allowance against these deferred tax assets. During the nine months ended September 30, 2015 our deferred tax assets and valuation allowance decreased approximately \$10 million primarily due to the April 2015 sale of certain assets related to Archeo's domain operations, including the bulk of our domain portfolio. We initially increased the valuation allowance to 100% during the third quarter of 2014. In assessing the realizability of deferred tax assets, we considered whether it is more likely than not that some or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which those temporary differences are deductible. We considered the future reversal of deferred tax liabilities, carryback potential, projected taxable income, and tax planning strategies as well as our history of taxable income or losses in the relevant jurisdictions in making this assessment. We incurred taxable losses in 2012, 2013, and 2014 of \$3.5 million, \$7.6 million, and \$10.9 million, respectively. During the third quarter of 2014, a significant customer cancelled its arrangement with us resulting in lower projected revenue and profitability. Based on the level of historical taxable losses and the uncertainty of projections for future taxable income over the periods for which the deferred tax assets are deductible, we concluded that it is not more likely than not that the gross deferred tax assets will be realized. Should we determine in the future that all or part of the deferred tax assets will be realized, a tax benefit will be recorded in the period such determination is made.

At September 30, 2015, based upon both positive and negative evidence available, we determined it is not more likely than not that deferred tax assets of \$6.0 million, primarily relating to NOL carryforwards in certain state, city, and foreign jurisdictions, will be realizable and, accordingly, maintained a 100% valuation allowance against these deferred tax assets. We do not have a history of taxable income in the relevant jurisdictions and the state and foreign NOL carryforwards will more likely than not expire unutilized. These state, city and other foreign jurisdiction NOL carryforwards begin to expire in 2025.

As of September 30, 2015, we have certain federal NOLs of \$1.7 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 these NOL carryforwards are limited such that substantially all of these federal NOL will never be available. Accordingly, we have not recorded a deferred tax asset for these NOLs.

As of September 30, 2015, we have federal NOL carryforwards, excluding those acquired, of \$22.4 million, which begin to expire in 2032. In connection with the 2011 Jingle acquisition, we acquired and recorded federal NOL carryforwards that may be utilized of approximately \$7.0 million of which \$2.6 million was utilized in 2011. These acquired NOL carryforwards will begin to expire in 2026. Where there is a "change in ownership" within the meaning of Section 382 of the Internal Revenue Code ("Code"), the acquired federal NOL carryforwards are subject to an annual limitation. We believe that such an ownership change had occurred at Jingle, and that the utilization of the carryforwards is limited such that the majority of the NOL carryforwards will never be utilized. Accordingly, we have not recorded those amounts we believe we will not be able to utilize and have not included those NOL carryforwards in our deferred tax assets.

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From time to time, various state, federal, and other jurisdictional tax authorities undertake reviews of us and our filings. We believe any adjustments that may ultimately be required as a result of any of these reviews will not be material to the financial statements.

### Results of Operations

The following table presents certain of our operating results as a percentage of revenue for the periods indicated:

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2014	2015	2014	2015
Revenue	100%	100%	100%	100%
Expenses:				
Service costs	66%	55%	66%	54%
Sales and marketing	6%	11%	6%	12%
Product development	16%	22%	16%	21%
General and administrative	11%	14%	12%	13%
Amortization of intangible assets from acquisitions	1%	0%	0%	0%
Acquisition and disposition related costs	0%	0%	0%	0%
Total operating expenses	100%	102%	100%	100%
Income (loss) from operations	0%	(2%)	0%	0%
Other expense	0%	0%	0%	0%
Income (loss) from continuing operations before provision for income taxes	0%	(2%)	0%	0%
Income tax expense	16%	0%	48%	1%
Net loss from continuing operations	(16%)	(2%)	(48%)	(1%)
Discontinued operations, net of tax	2%	26%	2%	1%
Net income (loss)	(14%)	24%	(46%)	0%
Dividends paid to participating securities	0%	0%	0%	0%
Net income (loss) applicable to common stockholders	(14%)	24%	(46%)	0%

### Segment Operating Results

We have organized our operations into two segments: (1) the Call-Driven segment which is comprised of our performance-based advertising business focused on driving, analyzing and measuring phone calls and the related outcomes; and (2) the Archeo segment which is comprised of our click-based advertising and Internet domain name operations.

	Nine months ended September 30,		Three months ended September 30,	
	2014	2015	2014	2015
<b>Call-driven</b>				
Revenue	\$ 137,728	\$ 105,621	\$ 46,379	\$ 36,135
Operating Expenses	129,140	99,412	43,100	33,958
Segment profit	\$ 8,588	\$ 6,209	\$ 3,279	\$ 2,177
<b>Archeo</b>				
Revenue	\$ 4,646	\$ 2,492	\$ 859	\$ 717
Operating Expenses	3,558	2,447	925	450
Segment profit (loss)	\$ 1,088	\$ 45	\$ (66)	\$ 267
Reconciliation of segment profit from operations to income (loss) from continuing operations before provision for income taxes:				
Total segment profit	\$ 9,676	\$ 6,254	\$ 3,213	\$ 2,444
Less reconciling items:				
Stock based compensation	9,013	7,809	3,020	2,351





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extend the contracts now set to expire in December 2016, and, if renewed, the contracts may be on less favorable terms to us, any of which could have a material adverse effect on our future operating results. YP accounted for 24% and 28% of total revenues for the three months ended September 30, 2014 and 2015, respectively, and 23% and 30% for the nine months ended September 30, 2014 and 2015, respectively.

We also have arrangements with advertising agencies, such as Resolution Media and OMD Digital, who act on an advertiser's behalf and may represent more than one advertiser that utilizes our products and services. Our primary arrangement with Resolution Media is for pay-for-call services whereby we charge an agreed-upon price for qualified calls or leads from our network and call analytic services. Resolution Media accounted for less than 10% of total revenues for both the three and nine months ended September 30, 2014 and approximately 17% and 19% of total revenues for the three and nine months ended September 30, 2015, respectively, of which the majority related to a single advertiser, State Farm. State Farm, who utilizes our services through Resolution Media and OMD Digital, accounted for less than 10% of total revenue for both the three and nine months ended September 30, 2014, and 19% and 20% of total revenues for the three and nine months ended September 30, 2015, respectively.

Our Archeo revenues decreased 17% from \$859,000 for the three months ended September 30, 2014 to \$717,000 in the same period for 2015 and decreased 46% from \$4.6 million for the nine months ended September 30, 2014 to \$2.5 million for the same period in 2015. These decreases were primarily due to lower revenues from cost-per-actions from resellers related to our local search and directory web sites.

In April 2015, we sold certain assets related to Archeo's domain operations, including the bulk of our domain portfolio. The operating results of this disposition are shown as discontinued operations in the condensed consolidated statement of operations. Subsequent to this sale, we do not anticipate generating significant revenue from domain sales or pay-per-click listings presented on our web sites.

The following table shows our revenues, by revenue source, for the periods presented (in thousands):

	Nine months ended September 30,		Three months ended September 30,	
	2014	2015	2014	2015
Partner and Other Revenue Sources	\$140,304	\$107,470	\$46,914	\$36,678
Proprietary Web site Traffic Sources	2,070	643	324	174
<b>Total Revenue</b>	<b>\$142,374</b>	<b>\$108,113</b>	<b>\$47,238</b>	<b>\$36,852</b>

Our partner network revenues are primarily generated using third party distribution networks to deliver pay-for-call, pay-for-click and cost-per-action advertisers' listings. The distribution network includes mobile and online search engine applications, directories, destination sites, shopping engines, third party internet domains or websites, other targeted web and mobile-based content and offline sources. We generate revenue upon delivery of qualified and reported phone calls or click-throughs to our advertisers or to advertising services providers' listings. We pay a revenue share to the distribution partners to access their mobile, online, offline or other user traffic. We also generate revenue from cost-per-action services, which occurs when a user makes a phone call from our advertiser's listing or is redirected from one of our websites or a third party website in our distribution network to an advertiser and completes the specified action. Other revenues include our call provisioning and call tracking services, campaign management services, outsourced search marketing platforms and historically, our presence management services. The partner and other revenues decreased 22% from \$46.9 million for the three months ended September 30, 2014 to \$36.7 million for the same period in 2015. The partner and other revenues decreased 23% from \$140.3 million for the nine months ended September 30, 2014 to \$107.5 million for the same period in 2015. The decreases were primarily due to a decrease in our pay-for-call revenues, primarily related to our arrangement with Allstate, which was partially offset by net increases in other advertiser budgets, and decreases in our presence management revenues due to fewer advertisers utilizing our services.

Our proprietary website traffic revenues are generated from our portfolio of owned websites which are monetized with pay-for-call or pay-per-click listings that are relevant to the websites, as well as other forms of advertising, including banner advertising and sponsorships. When an online user navigates to one of our websites and calls or clicks on a particular listing or completes the specified action, we receive a fee. Our proprietary website traffic revenues decreased approximately 46% from \$324,000 for the three months ended September 30, 2014 to \$174,000 in the same period in 2015 and approximately 69% from \$2.1 million for the nine months ended September 30, 2014 to \$643,000 for the same period in 2015. These decreases were primarily due to a decrease in revenues from cost-per-actions due to lower budgets from resellers related to our local search and directory web sites.

Our ability to maintain and grow our revenues will depend in part on maintaining and increasing the number and volume of transactions with advertisers and advertising services providers and maintaining and increasing the number of phone calls and the other actions performed by users of our services through our distribution partners. We believe this is dependent in part on delivering

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quality traffic that ultimately results in purchases or conversions as well as providing through our call analytics platform quality data and insights that can measure the performance of advertising spend for our advertisers and advertising service providers. Companies distributing advertising through mobile and internet based sources have experienced, and are likely to continue to experience consolidation. If we do not add new distribution partners, renew our current distribution partner agreements, replace traffic lost from terminated distribution agreements with other sources, or if our distribution partners' businesses do not grow or are adversely affected, our revenue and results of operations may be materially and adversely affected. If revenue grows and the volume of transactions and traffic increases, we will need to expand our network infrastructure. Inefficiencies in our network infrastructure to scale and adapt to higher call volumes could materially and adversely affect our revenue and results of operations.

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 phone calls and other actions we will deliver to our advertisers and how much advertisers will spend with us, and it is even more difficult to anticipate the average revenue per phone call or other actions. It is also difficult to anticipate the impact of worldwide economic conditions on advertising budgets.

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 mobile and internet usage and seasonal purchasing cycles of many advertisers. Our experience has shown that during the spring and summer months, mobile and Internet usage is lower than during other times of the year and during the latter part of the fourth quarter of the calendar year we generally experience lower call volume and reduced demand for calls from our call advertising customers. The extent to which usage and call volume may decrease during these off-peak periods is difficult to predict. Prolonged or severe decreases in usage and call volume during these periods may adversely affect our growth rate and results and in turn the market price of our securities. In the first quarter of the calendar year, this trend generally reverses with increased mobile and internet usage and often new budgets at the beginning of the year for many of our customers with fiscal years ending December 31. The seasonal purchasing cycles of some customers in certain industries may also be higher in the first half versus the latter half of the calendar year. Additionally, the current business environment has generally resulted in advertisers and reseller partners reducing advertising and marketing services budgets or changing such budgets throughout the year, which we expect will impact our quarterly results of operations in addition to the typical seasonality seen in our industry.

### **Expenses**

Expenses were as follows (in thousands):

	Nine months ended September 30,				Three months ended September 30,			
	2014	% of revenue	2015	% of revenue	2014	% of revenue	2015	% of revenue
Service costs	\$ 94,226	66%	\$ 59,166	55%	\$31,270	66%	\$20,003	54%
Sales and marketing	8,759	6%	11,969	11%	2,814	6%	4,266	12%
Product development	22,599	16%	23,608	22%	7,581	16%	7,769	21%
General and administrative	16,127	11%	14,925	14%	5,380	12%	4,721	13%
Amortization of intangible assets from acquisitions	434	1%	—	0%	—	0%	—	0%
Acquisition and disposition related costs	(68)	0%	199	0%	—	0%	81	0%
	<u>\$142,077</u>	<u>100%</u>	<u>\$109,867</u>	<u>102%</u>	<u>\$47,045</u>	<u>100%</u>	<u>\$36,840</u>	<u>100%</u>

Stock-based compensation has been included in the same lines as compensation paid to the same employees in the condensed consolidated statements of operations. Stock-based compensation expense was included in the following operating expense categories as follows (in thousands):

	Nine months ended September 30,		Three months ended September 30,	
	2014	2015	2014	2015
Service costs	\$1,010	\$1,046	\$ 371	\$ 273
Sales and marketing	659	893	224	339
Product development	2,017	1,843	666	620
General and administrative	5,327	4,027	1,759	1,119
Total stock-based compensation	<u>\$9,013</u>	<u>\$7,809</u>	<u>\$ 3,020</u>	<u>\$ 2,351</u>

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See *Note 3. Stock-based Compensation Plans* of the condensed consolidated financial statements as well as our Critical Accounting Policies for additional information about stock-based compensation.

*Service Costs.* Service costs decreased 36% from \$31.3 million in the three months ended September 30, 2014 to \$20.0 million in the same period in 2015. The decrease was primarily attributable to a decrease in distribution partner payments, personnel costs, and stock-based compensation totaling \$11.3 million.

Service costs represented 66% of revenue in the three months ended September 30, 2014 as compared to 54% in 2015. The 2015 decrease as a percentage of revenue in service costs was primarily a result of a decrease in distribution partner payments and to a lesser extent revenues from our local leads platform comprising a higher proportion of revenue compared to the 2014 period. Proprietary website traffic and local leads platform revenues have a lower service cost as a percentage of revenue relative to our overall service cost percentage.

Service costs decreased 37% from \$94.2 million in the nine months ended September 30, 2014 to \$59.2 million in the same period in 2015. Service costs represented 66% of revenue in the nine months ended September 30, 2014 as compared to 55% in 2015. The decrease was primarily due to a decrease in distribution partner payments and personnel costs totaling \$35.4 million, offset partially by an increase in communication and network costs and stock based compensation totaling \$504,000.

We expect that user acquisition costs and revenue shares to distribution partners are likely to increase prospectively given the competitive landscape for distribution partners. To the extent that payments to pay-for-call, pay-per-click or cost-per-action distribution partners make up a larger percentage of future operations, or the addition or renewal of existing distribution partner agreements are on terms less favorable to us, we expect that service costs will increase as a percentage of revenue. To the extent of revenue declines in these areas, we expect revenue shares to distribution partners to decrease in absolute dollars. Our other sources of revenues, such as our proprietary website traffic sources and local leads platform, have no corresponding distribution partner payments and accordingly have a lower service cost as a percentage of revenue relative to our overall service cost percentage. In addition, advertisers from whom we generate a portion of our call advertising revenues through our local leads platform generally have lower service costs as a percentage of revenue relative to our overall service cost percentage. To the extent our proprietary traffic sources and local leads platform make up a smaller percentage of our future operations, we expect that service costs will increase as a percentage of revenue. We expect service costs as a percentage of revenue in the near term to be relatively stable to modestly higher relative to the most recent quarterly period. In the longer term an increase in the proportion of partner and other revenue sources and additional investment in our communications and network may increase service costs as a percentage of revenue. We also expect that in the longer term service costs will increase in absolute dollars in connection with any revenue increase as a result of costs associated with the expansion of our operations and network infrastructure as we scale and adapt to increases in the volume of transactions, calls, and traffic and as we invest in our platforms.

*Sales and Marketing.* Sales and marketing expenses increased 52% from \$2.8 million for the three months ended September 30, 2014 to \$4.3 million in the same period in 2015. As a percentage of revenue, sales and marketing expenses were 6% and 12% for the three months ended September 30, 2014 and 2015, respectively. The increase in dollars and percentage of revenue was primarily attributable to an increase in personnel costs, stock-based compensation, outside marketing activities and fees paid to outside service providers totaling \$1.3 million. The increase as a percentage of revenue was also attributable to lower revenues.

Sales and marketing expenses increased 37% from \$8.8 million for the nine months ended September 30, 2014 to \$12.0 million in the same period in 2014. As a percentage of revenue, sales and marketing expenses were 6% and 11% for the nine months ended September 30, 2014 and 2015, respectively. The increase in dollars was primarily attributable to an increase in personnel costs, stock-based compensation, outside marketing activities and fees paid to outside service providers totaling \$3.0 million.

We expect some volatility in sales and marketing expenses based on the timing of marketing initiatives but expect sales and marketing expenses in the near term quarter to be relatively stable in absolute dollars. We expect that sales and marketing expenses will increase in the longer term as we expand our sales force. We expect that sales and marketing expenses will increase in connection with any revenue increase to the extent that we also increase our marketing activities and correspondingly could increase as a percentage of revenue.

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*Product Development.* Product development expenses increased 2% from \$7.6 million for the three months ended September 30, 2014 to \$7.8 million in the same period in 2015. The net increase in dollars was primarily due to an increase in personnel costs of \$271,000, offset partially by a decrease in travel costs and fees paid to outside service providers totaling \$114,000. As a percentage of revenue, product development expenses were 16% and 21% for the three months ended September 30, 2014 and 2015, respectively. The increase as a percentage of revenue was primarily due to lower revenues.

Product development expenses increased 4% from \$22.6 million for the nine months ended September 30, 2014 to \$23.6 million in the same period in 2015. As a percentage of revenue, product development expenses were 16% and 22% for the nine months ended September 30, 2014 and 2015, respectively. The net increase in dollars was primarily due to an increase in personnel costs, net of stock based compensation, of \$688,000 and increases in depreciation, travel costs and facility costs of \$296,000. In the near term, we expect product development expenditures to be relatively stable to modestly lower in absolute dollars. In the longer term, 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 and as a result of additional stock based compensation expense.

*General and Administrative.* General and administrative expenses decreased 12% from \$5.4 million in the three months ended September 30, 2014 to \$4.7 million in the same period in 2015. The decrease was primarily due to a decrease in stock-based compensation of \$640,000. As a percentage of revenue, general and administrative expenses were 12% and 13% for the three months ended September 30, 2014 and 2015, respectively. The increase as a percentage of revenue was primarily due to lower revenues.

General and administrative expenses decreased 7% from \$16.1 million in the nine months ended September 30, 2014 to \$14.9 million in the same period in 2015. The decrease was primarily due to a decrease in personnel costs and stock-based compensation totaling \$1.6 million. As a percentage of revenue, general and administrative expenses were 11% and 14% for the nine months ended September 30, 2014 and 2015, respectively. The increase as a percentage of revenue was primarily due to lower revenues.

We expect our general and administrative expenses to be relatively stable to modestly lower in the near term. We expect that our general and administrative expenses will increase in the longer term to the extent that we expand our operations, including internationally, and incur additional costs in connection with being a public company, including expenses related to professional fees and insurance, and as a result of stock based compensation expense. We also expect fluctuations in our general and administrative expenses to the extent the recognition timing of stock compensation is impacted by market conditions relating to our stock price.

*Segment Profit.* Call-Driven segment profit decreased 34% from \$3.3 million for the three months ended September 30, 2014 to \$2.2 million in the same period in 2015. Call-Driven segment profit decreased 28% from \$8.6 million for the nine months ended September 30, 2014 to \$6.2 million in the same period in 2015. The decrease in profit was due primarily to a decrease in call-driven revenues.

Archeo segment profit was \$(66,000) for the three months ended September 30, 2014 compared to \$267,000 in the same period in 2015. The increase in the segment profit for the three month period was primarily due to lower operating expenses for this segment. Archeo segment profit was \$1.1 million for the nine months ended September 30, 2014 compared to \$45,000 in the same period in 2015. The decrease in profit for the nine month period was due primarily to a decrease in revenue in cost per actions related to our local search and directory web sites.

*Amortization of Intangible Assets from Acquisitions.* Intangible amortization expense was \$0 and \$434,000 for the three and nine months ended September 30, 2014, respectively, and \$0 in the same periods in 2015. There was no intangible amortization expense in 2015, as the intangible assets related to the April 2011 Jingle acquisition were fully amortized during 2014.

Our purchase accounting resulted in all assets and liabilities from our acquisitions being recorded at their estimated fair values on their respective acquisition dates. All goodwill, identifiable intangible assets and liabilities resulting from our acquisitions have been recorded in our condensed consolidated financial statements. 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.

At September 30, 2015, our goodwill balance of \$63.3 million related to our call driven reporting unit. During the three months ended June 30, 2015, Archeo goodwill decreased from \$2.4 million to \$0 due to the sale of certain assets related to Archeo's domain operations. The assets sold constitute a business within the Archeo reporting unit. Goodwill was allocated to the sold business based on its relative fair value compared to the remainder of the Archeo reporting unit.

The Company reviews goodwill for impairment annually on November 30 and whenever events or changes in circumstances indicate the carrying value of goodwill may not be recoverable. When evaluating goodwill for impairment, the Company may first perform a qualitative assessment to determine if the fair value of the reporting unit is more likely than not greater than its carrying amount. The testing of goodwill and other intangible assets for impairment requires the Company to make significant estimates about its future performance and cash flows, as well as other assumptions. Events and circumstances considered in determining whether the carrying value of goodwill may not be recoverable include, but are not limited to: significant changes in performance relative to

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expected operating results; significant changes in the use of the assets; and significant changes in competition and market dynamics. These estimates are inherently uncertain and can be affected by numerous factors, including changes in economic, industry or market conditions, changes in business operations, a loss of a significant customer, changes in competition or changes in the share price of the Company's common stock and market capitalization. Significant and sustained declines in the Company's stock price and market capitalization, a significant decline in its expected future cash flows or a significant adverse change in the Company's business climate, among other factors, could result in the need to perform an impairment analysis in future periods. The Company cannot accurately predict the amount and timing of any future impairment of goodwill or other intangible assets. Should the value of goodwill or other intangible assets become impaired, the Company would record an impairment charge, which could have an adverse effect on its financial condition and results of operations.

The current business environment is subject to evolving market conditions and requires significant management judgment to interpret the potential impact to our assumptions. At various points in time during the nine months ended September 30, 2015 and from October 1, 2015 to November 3, 2015, the Company's stock price approached or dropped below the then book value. To the extent that changes in the current business environment impact our ability to achieve levels of forecasted operating results and cash flows, if the Company's stock price were to trade below book value per share for an extended period of time and/or should other events occur indicating the remaining carrying value of our assets might be impaired, we would test our goodwill and intangible assets for impairment and may recognize an impairment loss to the extent that the carrying amount exceeds such asset's fair value. We will continue to monitor our financial performance, stock price and other factors in order to determine if there are any indicators of impairment prior to our annual impairment evaluation in November 2015.

*Income Taxes.* Income tax expense from continuing operations was \$22.6 million and \$22.9 million for the three and nine months ended September 30, 2014, respectively, compared to income tax expense of \$191,000 and \$11,000 in the same periods in 2015. Tax expense has decreased for the three and nine months ended September 30, 2015 as compared to the three and nine months ended September 30, 2014 primarily as a result of increasing the valuation allowance during the period ended September 30, 2014.

*Discontinued Operations, net of tax.* In July 2013, we sold certain assets related to Archeo's pay-per-click advertising services and in April 2015, we sold certain assets related to Archeo's domain operations, including the bulk of its domain name portfolio. These disposals meet the requirements of Accounting Standards Codification 205-20, *Discontinued Operations*, for presentation as discontinued operations. As a result, the operating results related to these dispositions are shown as discontinued operations, net of tax. We received cash consideration at closing of \$28.1 million and the sale includes contingent earn-out payments that depend on the achievement of certain sales thresholds. As a result of the sale, the Company recognized a gain on sale of discontinued operations, net of tax of \$22.2 million during the nine months ended September 30, 2015. Income from discontinued operations, net of tax was \$694,000 and \$2.7 million for the three and nine months ended September 30, 2014, respectively, and \$37,000 and \$5.1 million for the same respective periods in 2015. See *Note 14. Discontinued Operations* for further discussion.

*Net Income.* Net income increased from a net loss of \$21.5 million in the three months ended September 30, 2014 to net income of \$9,000 in the same period in 2015. Net income increased from a net loss of \$19.7 million in the nine months ended September 30, 2014 compared to net income of \$25.5 million in the same period in 2015. The increase in net income for both periods was primarily related to the gain that resulted from the sale of Archeo's domain operations in April 2015 and the establishment of a 100% valuation allowance on the Company's deferred tax assets during the three month period ended September 30, 2014.

## **Liquidity and Capital Resources**

As of September 30, 2015, we had cash and cash equivalents of \$108.9 million and we had current and long term contractual obligations of \$10.3 million, of which \$5.8 million is for rent under our facility leases.

Cash provided by operating activities for the nine months ended September 30, 2015 of approximately \$12.0 million consisted primarily of net income of \$25.5 million, adjusted for the gain on sale of discontinued operations of \$22.2 million, non-cash items of \$11.2 million, including depreciation and amortization, allowance for doubtful accounts and advertiser credits, and stock-based compensation, and approximately \$2.5 million used in working capital and other activities. Cash provided by operating activities for the nine months ended September 30, 2014 of approximately \$18.1 million consisted primarily of a net loss of \$19.7 million, adjusted for non-cash items of \$37.5 million, including depreciation, amortization of intangible assets, allowance for doubtful accounts and advertiser credits, stock-based compensation, and deferred income taxes that includes a \$22.3 million increase in the valuation allowance, \$422,000 of gain on sale of discontinued operations, and approximately \$709,000 provided by working capital and other activities.

With respect to a significant portion of our call-based and pay-per-click advertising services, the amount payable to our distribution partners will be calculated at the end of a calendar month, with a payment period following the delivery of the phone calls or click-throughs. These services constituted the majority of revenues for the three and nine months ended September 30, 2014 and 2015. We generally receive payment from advertisers in close proximity to the timing of the corresponding payments to the

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distribution partners who provide placement for the listings. In certain cases, payments to distribution partners are paid in advance or are fixed in advance based on a guaranteed minimum amount of usage delivered. We have no corresponding payments to distribution partners related to our proprietary website traffic revenues.

Nearly all of the reseller partner arrangements are billed on a monthly basis following the month of our phone call or 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, reseller partner payments are generally received two to four weeks following payment to the distribution partners. We also have payment arrangements with advertising agencies whereby we receive payment after the agency's advertiser pays the agency, which is generally between 60 and 120 days or longer, following the delivery of services. We expect that in the future periods, if the amounts from our reseller partner and agency arrangements account for a greater percentage of our operating activity, working capital requirements will increase as a result.

We have payment arrangements with reseller partners, particularly related to our local leads and call advertising services or proprietary website traffic sources, such as YP, SuperMedia Inc., hibu, The Cobalt Group, and Yellow Media Inc., whereby we receive payment between 30 and 60 days following the delivery of services. We also have a payment arrangement with Resolution Media and OMD Digital, advertising agencies related to our call marketplace and call analytics services, whereby we receive payment when the agency's advertiser pays the agency, which is between 60 and 90 days following the delivery of services and in some instances may be longer.

For the nine months ended and as of September 30, 2015 amounts from these partners and agencies totaled 65% of revenue and \$17.4 million in accounts receivable. Based on the timing of payments, we generally have this level of amounts in outstanding accounts receivable at any given time from these partners and advertising agencies. A single advertiser, State Farm, who represented the majority of the revenue and accounts receivable generated by Resolution Media, accounted for 20% of total revenues and 18% of accounts receivable for the nine months ended and as of September 30, 2015.

We recently amended our arrangements with YP, extending them through December 31, 2016. The primary local leads platform arrangement includes certain minimum fee commitments by YP from July 1, 2015 through June 30, 2016 and provides YP additional flexibility to migrate active accounts to itself or a third-party provider prior to the end of an advertiser contract. We also have a separate distribution partner agreement with YP. There can be no assurance that our business with them in the future will continue at or near current revenue and contribution levels, that we will be able to renew and extend the contracts set to expire in December 2016, and if renewed, the contracts may be on less favorable terms to us, any of which could have a material adverse effect on our future operating results. Net accounts receivable balances outstanding at September 30, 2015 from YP totaled \$8.7 million.

In April 2015, we sold certain assets related to Archeo's domain operations, including the bulk of its domain name portfolio. The Archeo domain operations were accounted for as discontinued operations. We received cash consideration at closing of \$28.1 million and the sale includes contingent earn-out consideration payments that depend on the achievement of certain sales thresholds. These assets contributed approximately \$7.1 million of revenue and \$5.0 million in operating income from January 1, 2015 through the disposal date in April 2015. Subsequent to this sale, we do not anticipate generating significant revenue from domain sales, which will have an adverse impact on cash flows from operations in future periods.

Cash provided by investing activities for the nine months ended September 30, 2015 of approximately \$21.6 million was primarily attributable to cash from the sale of the bulk of Archeo's domain operations, net of transaction costs, of \$25.3 million. These amounts were partially offset by purchases for property and equipment of \$3.6 million and purchases of intangible and other noncurrent assets of \$46,000. Cash used in investing activities for the nine months ended September 30, 2014 of approximately \$2.2 million was primarily attributable to purchases for property and equipment of \$2.3 million and purchases of intangible and noncurrent assets of domain names of \$185,000, which was partially offset by proceeds from sale of discontinued operations of \$304,000 related to an earn-out consideration payment from the July 2013 sale of certain pay-per-click advertising services.

Cash used in financing activities for the nine months ended September 30, 2015 of approximately \$4.7 million was primarily attributable to the payment of common stock dividends and repurchases of Class B common stock. Cash provided by financing activities for the nine months ended September 30, 2014 of approximately \$33.8 million was primarily attributable to proceeds from a follow-on offering, net of offering costs paid, of \$32.5 million and employee stock option exercises of \$4.2 million, which was partially offset by payment of common stock dividends and minimum tax withholding payments related to certain executive restricted stock award vests totaling approximately \$2.9 million. In April 2014, we completed a follow-on public offering in which we sold an aggregate of 3.4 million shares of our Class B common stock, which includes the exercise of the underwriters' option to purchase 514,100 additional shares, at a public offering price of \$10.50 per share. In addition, another 3.2 million shares were sold by the selling stockholders, which include the exercise of the underwriter's option to purchase 343,000 additional shares. We received aggregate net proceeds of \$32.5 million, after deducting underwriting discounts and commissions and offering expenses paid. We did not receive any of the proceeds from the sales of shares by the selling stockholders.

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The following table summarizes our contractual obligations as of September 30, 2015, and the effect these obligations are expected to have on our liquidity and cash flows in future periods (in thousands).

	<u>Total</u>	<u>Less than 1 year</u>	<u>1-3 years</u>	<u>4-5 years</u>
Contractual Obligations:				
Operating leases	\$ 5,834	\$ 2,306	\$ 3,528	\$ —
Other contractual obligations	4,432	3,989	443	—
Total contractual obligations (1),(2)	<u>\$10,266</u>	<u>\$ 6,295</u>	<u>\$ 3,971</u>	<u>\$ —</u>

- (1) In February 2005, we entered into a license agreement with an advertising partner which provides for a contingent royalty based on a discounted rate of 3% (3.75% under certain circumstances) of certain of our gross revenues payable on a quarterly basis through December 2016. The royalty payment is recognized as incurred in service costs and is not included in the above schedule.
- (2) Our tax contingencies of \$717,000 are not included due to their uncertainty.

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. Furthermore, we expect that capital expenditures may increase in future periods, particularly if our operating activity increases.

On April 1, 2008, we entered into a three year credit agreement which provides us with a \$30 million senior secured revolving credit line, which may be used for various corporate purposes including financing permitted acquisitions, subject to compliance with applicable covenants. The Credit Agreement, as amended, matures on April 1, 2017. During the nine months ended September 30, 2014 and 2015, we had no borrowings under the Credit Agreement.

In April 2015, in connection with our sale of the bulk of our domain portfolio, we signed an amendment to the Credit Agreement which clarified the LIBOR rate as determined under the Credit Agreement cannot be below zero percent (0%) and added a financial covenant limiting outstanding balances under the Credit Agreement not to exceed a collateral value as defined in the Credit Agreement.

In November 2014, our board of directors authorized a new share repurchase program (the "2014 Repurchase Program") which supersedes and replaces any prior repurchase programs. Under the 2014 Repurchase Program, we are authorized to repurchase up to 3 million shares of our Class B common stock in the aggregate through open market and privately negotiated transactions, at such times and in such amounts as we deem appropriate. Repurchases may also be made under a Rule 10b5-1 plan, which would permit shares to be repurchased when we might otherwise be precluded from doing so under insider trading laws. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements, capital availability, and other market conditions. The 2014 Repurchase Program does not have an expiration date and may be expanded, limited or terminated at any time without prior notice. During the nine months ended September 30, 2015, approximately 781,000 shares of Class B common stock were repurchased.

In 2015, quarterly dividends of \$0.02 per share were paid on February 17 and May 18 to the holders of record as of the close of business on February 11 and May 7, respectively. The aggregate quarterly dividends paid in February and May were \$1.7 million. We do not anticipate declaring or paying dividends subsequent to the May 2015 dividend in the foreseeable future.

Based on our operating plans we believe that our existing credit availability, 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.

### 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 using accounting principles generally accepted in the United States of America for interim financial information. 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



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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;
- Allowance for doubtful accounts, advertiser credits; and
- Provision for income taxes.

### **Revenue**

We currently generate revenue by delivering call and click-based advertising products that enable advertisers of all sizes to reach consumers across online, mobile and offline sources. Our primary source of revenue is performance-based advertising, which includes pay-for-call advertising, pay-per-click advertising, and cost-per-action services. For pay-for-call and pay-per-click advertising, revenue is recognized upon delivery of qualified and reported phone calls or click-throughs to our advertisers or advertising service providers' listing which occurs when a mobile, online or offline user makes a phone call or clicks on any of their advertisements after it has been placed by us or by our distribution partners. Each phone call or click-through on an advertisement listing represents a completed transaction. For cost-per-action services, revenue is recognized when a user makes a phone call from our advertiser's listing or is redirected from one of our websites or a third party website in our distribution network to an advertiser website and completes the specified action. In certain cases, we record revenue based on available and reported preliminary information from third parties. Collection on the related receivables may vary from reported information based upon third party refinement of the estimated and reported amounts owing that occurs subsequent to period ends.

We have entered into agreements with various distribution partners in order to expand our distribution network, which includes search engines, directories, product shopping engines, third party vertical and branded websites, mobile and offline sources, and our portfolio of owned websites, on which we include our advertisers' listings. We generally pay distribution partners based on a specified percentage of revenue or a fixed amount per phone call or 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 advertiser. In accordance with FASB ASC 605, the revenue derived from advertisers who receive paid introductions through us as supplied by distribution partners is reported gross based upon the amounts received from the advertiser. We also recognize revenue for certain agency contracts with advertisers under the net revenue recognition method. Under these specific agreements, we purchase listings on behalf of advertisers from search engines and directories. We are paid account fees and also agency fees based on the total amount of the purchase made on behalf of these advertisers. Under these agreements, our advertisers are primarily responsible for choosing the publisher and determining pricing, and we in certain instances, are only financially liable to the publisher for the amount collected from our advertisers. This creates a sequential liability for media purchases made on behalf of advertisers. In certain instances, the web publishers engage the advertisers directly and we are paid an agency fee based on the total amount of the purchase made by the advertiser. In limited arrangements, resellers pay us a fee for fulfilling an advertiser's campaign in our distribution network and we act as the primary obligor. We recognize revenue for these fees under the gross revenue recognition method.

We apply FASB ASC 605 to account for revenue arrangements with multiple deliverables. FASB ASC 605 addresses certain aspects of accounting by a vendor for arrangements under which the vendor will perform multiple revenue-generating activities. When an arrangement involves multiple deliverables, the entire fee from the arrangement is allocated to each respective deliverable based on its relative selling price and recognized when revenue recognition criteria for each deliverable are met. The selling price for each deliverable is established based on the sales price charged when the same deliverable is sold separately, the price at which a third party sells the same or similar and largely interchangeable deliverable on a standalone basis or the estimated selling price if the deliverable were to be sold separately.

### **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 FASB ASC 350 "Goodwill and Intangible Assets" whereby 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. FASB ASC 350 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 FASB ASC 360.

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The Company reviews goodwill for impairment annually on November 30 and whenever events or changes in circumstances indicate the carrying value of goodwill may not be recoverable. When evaluating goodwill for impairment, the Company may first perform a qualitative assessment to determine if the fair value of the reporting unit is more likely than not greater than its carrying amount. The testing of goodwill and other intangible assets for impairment requires the Company to make significant estimates about its future performance and cash flows, as well as other assumptions. Events and circumstances considered in determining whether the carrying value of goodwill may not be recoverable include, but are not limited to: significant changes in performance relative to expected operating results; significant changes in the use of the assets; and significant changes in competition and market dynamics. These estimates are inherently uncertain and can be affected by numerous factors, including changes in economic, industry or market conditions, changes in business operations, a loss of a significant customer, changes in competition or changes in the share price of the Company's common stock and market capitalization. Significant and sustained declines in the Company's stock price and market capitalization, a significant decline in its expected future cash flows or a significant adverse change in the Company's business climate, among other factors, could result in the need to perform an impairment analysis in future periods. The Company cannot accurately predict the amount and timing of any future impairment of goodwill or other intangible assets. Should the value of goodwill or other intangible assets become impaired, the Company would record an impairment charge, which could have an adverse effect on its financial condition and results of operations.

The current business environment is subject to evolving market conditions and requires significant management judgment to interpret the potential impact to our assumptions. At various points in time during the nine months ended September 30, 2015 and the period from October 1, 2015 to November 3, 2015, the Company's stock price approached or dropped below the then book value. To the extent that changes in the current business environment impact our ability to achieve levels of forecasted operating results and cash flows, if the Company's stock price were to trade below book value per share for an extended period of time and/or should other events occur indicating the remaining carrying value of our assets might be impaired, we would test our goodwill and intangible assets for impairment and may recognize an impairment loss to the extent that the carrying amount exceeds such asset's fair value. We will continue to monitor our financial performance, stock price and other factors in order to determine if there are any indicators of impairment prior to our annual impairment evaluation in November 2015.

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

### ***Stock-Based Compensation***

FASB ASC 718 requires the measurement and recognition of compensation for all stock-based awards made to employees, non-employees and directors including stock options, restricted stock issuances, and restricted stock units based on estimated fair values. Under the fair value recognition provisions, we recognize stock-based compensation net of an estimated forfeiture rate, and therefore only recognize compensation for those shares expected to vest over the requisite service period.

We generally use the Black-Scholes option pricing model as our method of valuation for stock-based awards with time-based vesting. Our determination of the fair value of stock-based awards on the date of grant using an option pricing model is affected by our stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to the expected life of the award, our expected stock price, volatility over the term of the award and actual and projected exercise behaviors. For stock-based awards with time-based vesting, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. We estimate the forfeiture rate based on historical experience of our stock-based awards that are granted, exercised and cancelled. If our actual forfeiture rate is materially different from our estimate, the stock-based compensation expense could be significantly different from what we have recorded in the current period. For equity awards with vesting based on a combination of certain service and market conditions, we factor an estimated probability of achieving certain service and market conditions and recognize compensation over the requisite service period of the award. We use a binomial lattice model to determine the fair value for each tranche and a Monte Carlo simulation to determine the derived service period for each tranche.

Although the fair value of stock-based awards is determined in accordance with FASB ASC 718, the assumptions used in calculating fair value of stock-based awards, the use of the Black-Scholes option pricing model, and the use of the binomial lattice model and a Monte Carlo simulation are highly subjective, and other reasonable assumptions could provide differing results. As a result, if factors change and we use different assumptions, our stock-based compensation expense could be materially different in the future. See *Note 3. Stock-based Compensation Plans* in the condensed consolidated financial statements for additional information.

FASB ASC 718 requires the benefits of tax deductions in excess of the stock-based compensation cost to be classified as financing cash inflows. In addition, a tax benefit and a credit to additional paid-in capital for the excess deductions are not recognized until that deduction reduces taxes payable.

### ***Allowance for Doubtful Accounts and Advertiser Credits***

Accounts receivable balances are presented net of allowance for doubtful accounts and 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 accounts receivable for collectability 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 advertiser credits and adjustments based upon our analysis of historical credits. Material differences may result in the amount and timing of our revenue for any period if our management made different judgments and estimates.

### ***Provision for Income Taxes***

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 law is recognized in results of operations in the period that includes the enactment date. In the first quarter of 2014, we adopted ASU 2013-11 whereby we reclassified uncertain tax positions of \$534,000 from other non-current liabilities to deferred tax assets. Uncertain tax positions as of September 30, 2015 amounted to \$717,000.

At September 30, 2015 based upon both positive and negative evidence available, we determined that it is not more likely than not that our deferred tax assets of \$34.8 million will be realized and accordingly, we have recorded a 100% valuation allowance against these deferred tax assets. During the nine months ended September 30, 2015 as compared to December 31, 2014, our deferred tax assets and valuation allowance decreased approximately \$10 million primarily due to the April 2015 sale of certain assets related to Archeo's domain operations, including the bulk of our domain portfolio. We initially increased the valuation allowance to 100% during the third quarter of 2014. In assessing the realizability of deferred tax assets, we considered whether it is more likely than not that some or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which those temporary differences are deductible. We considered the future reversal of deferred tax liabilities, carryback potential, projected taxable income, and tax planning strategies as well as our history of taxable income or losses in the relevant jurisdictions in making this assessment. We incurred taxable losses in 2012, 2013, and 2014 of \$3.5 million, \$7.6 million, and \$10.9 million, respectively. During the third quarter of 2014, a significant customer cancelled its arrangement with us resulting in lower projected revenue and profitability. Based on the level of historical taxable losses and the uncertainty of projections for future taxable income over the periods for which the deferred tax assets are deductible, we concluded that it is not more likely than not that the gross deferred tax assets will be realized. Should we determine in the future that all or part of the deferred tax assets will be realized, a tax benefit will be recorded in the period such determination is made.

At September 30, 2015, based upon both positive and negative evidence available, we determined it is not more likely than not that deferred tax assets of \$6.0 million, primarily relating to NOL carryforwards in certain state, city, and foreign jurisdictions, will be realizable and, accordingly, maintained a 100% valuation allowance against these deferred tax assets. We do not have a history of taxable income in the relevant jurisdictions and the state and foreign NOL carryforwards will more likely than not expire unutilized. These state, city and other foreign jurisdiction NOL carryforwards begin to expire in 2025.

As of September 30, 2015, we have certain federal NOLs of \$1.7 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 these NOL carryforwards are limited such that substantially all of these federal NOL will never be available. Accordingly, we have not recorded a deferred tax asset for these NOLs.

As of September 30, 2015, we have federal NOL carryforwards, excluding those acquired, of \$22.4 million, which begin to expire in 2032. In connection with the 2011 Jingle acquisition, we acquired and recorded federal NOL carryforwards that may be utilized of approximately \$7.0 million of which \$2.6 million was utilized in 2011. These acquired NOL carryforwards will begin to expire in 2026. Where there is a "change in ownership" within the meaning of Section 382 of the Internal Revenue Code ("Code"), the acquired federal NOL carryforwards are subject to an annual limitation. We believe that such an ownership change had occurred at Jingle, and that the utilization of the carryforwards is limited such that the majority of the NOL carryforwards will never be utilized. Accordingly, we have not recorded those amounts we believe we will not be able to utilize and have not included those NOL carryforwards in our deferred tax assets.

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From time to time, various state, federal, and other jurisdictional tax authorities undertake reviews of us and our filings. We believe any adjustments that may ultimately be required as a result of any of these reviews will not be material to the financial statements.

### ***Recent Accounting Pronouncement Not Yet Effective***

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606) (ASU 2014-09)*, which amends the existing accounting standards for revenue recognition. ASU 2014-09 requires an entity to recognize the amount of revenue to which it expects to be entitled when products or services are transferred to customers. In July 2015, the FASB voted to approve a one year delay of the effective date. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is permitted as of annual and interim reporting periods in fiscal years beginning after December 15, 2016. ASU 2014-09 may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. We are currently in the process of evaluating the impact of adoption of ASU 2014-09 on our consolidated financial statements.

### **Where You Can Find More Information**

Our filings with the Securities and Exchange Commission, or SEC, including our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports are available on our website at [www.marchex.com](http://www.marchex.com), free of charge, as soon as reasonably practicable after the electronic filing of these reports with the SEC. The information contained on our website is not a part of this Quarterly Report on Form 10-Q.

Investors and others should note that we announce material financial information to our investors using our investor relations website, press releases, SEC filings, and public conference calls and webcasts. We also use the following social media channels as a means of disclosing information about us, our services, and other matters, and for complying with our disclosure obligations under Regulation FD:

- Marchex Twitter Account (<https://twitter.com/marchex>)
- Marchex Company Blog (<http://blog.marchex.com/>)

The information we post through these social media channels may be deemed material. Accordingly, investors should monitor the above account and the blog, in addition to following our investor relations website, press releases, SEC filings, and public conference calls and webcasts. This list may be updated from time to time. The information we post through these channels is not a part of this Quarterly Report on Form 10-Q.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Our exposure to market risk is limited to interest income sensitivity, which is affected by changes in the general level of U.S. interest rates, particularly because the majority of our investments are in short-term, money market funds. Due to the nature of our short-term investments, we believe that we are not subject to any material market risk exposure. We do not have any material foreign currency or other derivative financial instruments.

Our existing credit facility bears interest at a rate which will be, at our option, either: (i) the applicable margin rate (depending on our leverage) plus the one-month LIBOR rate reset daily, or (ii) the applicable margin rate plus the 1, 2, 3, or 6-month LIBOR rate where the LIBOR rate cannot be below zero percent (0%) under both options. This facility is exposed to market rate fluctuations and may impact the interest paid on any borrowings under the credit facility. Currently, we have no borrowings under this facility; however, an increase in interest rates would impact interest expense on future borrowings.

### **Item 4. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our chief executive officer and our chief financial officer, of the effectiveness of our “disclosure controls and procedures” (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934). Based on this evaluation, our chief executive officer and our chief financial officer have concluded that, as of the date of the evaluation, our disclosure controls and procedures were effective.

## Changes in Internal Control over Financial Reporting

During the quarter ended September 30, 2015, no change was made to our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## Limitations on the Effectiveness of Controls

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, cannot provide absolute assurance of achieving the desired control objectives.

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

## Part II—Other Information

### Item 1. Legal Proceedings

We are not a party to any material legal proceedings. 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.

### Item 1A. Risk Factors

Set forth below and elsewhere in this report and in other documents we file with the SEC are risks and uncertainties that could cause our actual results to materially differ from the results contemplated by the forward-looking statements contained in this report and in other documents we file with the SEC. Some of the risk factors were previously disclosed in our December 31, 2014 Annual Report on Form 10-K. They have been updated to include information as of November 6, 2015.

## Risks Relating to Our Company

### **We have largely incurred net losses since our inception, and we may incur net losses in the foreseeable future.**

We had an accumulated deficit of \$164.8 million as of September 30, 2015. Our net expenses may increase based on the initiatives we undertake which for instance, may include increasing our sales and marketing activities, hiring additional personnel, incurring additional costs as a result of being a public company, acquiring additional businesses and making additional equity grants to our employees.

### **We are dependent on certain distribution partners, 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 calls and traffic to our advertisers. Our largest distribution partner was paid less than 10% of total revenues for the nine months ended September 30, 2015. Our existing agreements with many of our other 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 phone calls or 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 or that we will be able to maintain the applicable variable payment terms at their current levels. A loss of any of these distribution partners or a decrease in revenue due to lower calls and traffic or less favorable variable payment terms from any one of these distribution relationships could have a material adverse effect on our business, financial condition and results of operations.

Companies distributing advertising through mobile or online Internet have experienced, and will likely continue to experience, consolidation. This consolidation has reduced the number of partners that control the mobile and online advertising outlets with the most user calls and traffic. According to the comScore qSearch analysis of the U.S. desktop search marketplace for September 2015, Yahoo! and Microsoft accounted for 12.6% and 20.7%, respectively, of the core search market in the United States and Google accounted for 63.9%. As a result, the larger distribution partners have greater control over determining the market terms of distribution, including placement of call and click-based advertisements and cost of placement. In addition, many participants in the performance-based advertising and search marketing industries control significant portions of mobile and online 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.

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**We rely on certain advertiser reseller partners and agencies, including YP, hibu, Inc., The Cobalt Group, Yodle, Resolution Media, OMD Digital, and Yellow Media, Inc. for the purchase of various advertising and marketing services, as well as to provide us with a large number of advertisers. A loss of certain advertiser reseller partners and agencies or a decrease in revenue from these reseller partners and agencies could adversely affect our business. Such advertisers are subject to varying terms and conditions, which may result in claims or credit risks to us.**

We benefit from the established relationships and national sales teams that certain of our reseller partners, who are leading reseller partners of advertisers and advertising agencies, have in place throughout the U.S. and international markets. These advertiser reseller partners and agencies refer or bring advertisers to us for the purchase of various advertising products and services. We derive a sizeable portion of our total revenue through these advertiser reseller partners and agencies. Additionally, these advertiser reseller partners and agencies may decide to operate the advertising services we perform internally with their own teams and technology. A loss of certain advertiser reseller partners and agencies or a decrease in revenue from these clients could adversely affect our business.

Through our contract with Yellowpages.com LLC ("YP"), we generate revenues from our local leads platform. We also have a separate pay-for-call arrangement with YP. We recently extended these arrangements through December 31, 2016. The primary local leads platform arrangements includes certain minimum fee commitments by YP from July 1, 2015 through June 30, 2016 and provides YP additional flexibility to migrate active accounts to itself or a third-party provider prior to the end of an advertiser contract. YP is our largest reseller partner and was responsible for 30% of our total revenues for the nine months ended September 30, 2015. We expect YP may decrease the number of new advertiser accounts with us and may elect to migrate certain active accounts to itself or a third party provider which would result in fewer small business accounts and related revenues, as well as reduced contribution and profitability. We also have a separate distribution partner agreement with YP. There can be no assurance that our business with them in the future will continue at or near current revenue and contribution levels, that we will be able to renew and extend the contracts now set to expire in December 2016, and, if renewed, the contracts may be on less favorable terms to us, any of which could have a material adverse effect on our future operating results.

We also have arrangements with advertising agencies, such as Resolution Media and OMD Digital, who act on an advertiser's behalf and may represent more than one advertiser that utilizes our products and services. Our primary arrangement with Resolution Media is for pay-for-call services whereby we charge an agreed-upon price for qualified calls or leads from our network and call analytic services. Resolution Media accounted for 19% of total revenues for the nine months ended September 30, 2015.

These reseller partners and agencies may in certain cases be subject to negotiated terms and conditions separate from those applied to advertising clients. In some cases, the applicable contract terms may be the result of legacy or industry association documentation or simply customized advertising solutions for large reseller partners and agencies. In any case, as a consequence of such varying terms and conditions, we may be subject to claims or credit risks that we may otherwise mitigate more efficiently across our automated advertiser management platform.

These claims and risks may vary depending on the nature of the aggregated client base. Among other claims, we may be subject to disputes based on third party tracking information or analysis. We may also be subject to differing credit profiles and risks based on the agency relationship associated with these advertisers. For such advertisers, payment may be made on an invoice basis, unlike our retail platform, which in many instances is paid in advance of the service. In some limited circumstances we may also have accepted individual advertiser payment liability in place of liability of the advertising agency or media advisor.

**We received approximately 66% and 61% of our revenue from our five largest customers for the year ended December 31, 2014 and the nine months ended September 30, 2015, respectively, and the loss of one or more of these customers could adversely impact our results of operations and financial condition.**

Our five largest customers accounted for approximately 66% and 61% of our total revenues for the year ended December 31, 2014 and the nine months ended September 30, 2015, respectively. In 2015, YP and Resolution Media were our largest customers and were responsible for 30% and 19% of our total revenues, respectively, for the nine months ended September 30, 2015.

Through our primary contract with YP, we generate revenues from our local leads platform. We also have a separate pay-for-call services arrangement with YP. We recently extended these arrangements through December 31, 2016. The primary local leads platform arrangements includes certain minimum fee commitments by YP from July 1, 2015 through June 30, 2016 and provides YP additional flexibility to migrate active accounts to itself or a third-party provider prior to the end of an advertiser contract. We expect YP may decrease the number of new advertiser accounts with us and may elect to migrate certain active accounts to itself or a third party provider which would result in fewer small business accounts and related revenues, as well as reduced contribution and profitability. We also have a separate distribution partner agreement with YP. There can be no assurance that our business with them in the future will

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continue at or near current revenue and contribution levels, that we will be able to renew and extend the contracts now set to expire in December 2016, and, if renewed, the contracts may be on less favorable terms to us, any of which could have a material adverse effect on our future operating results.

Our primary arrangement with Resolution Media, who acts as an agent on advertisers' behalf, is for pay-for-call services whereby we charge an agreed upon price for qualified calls or leads from our network and call analytic services. A single advertiser, State Farm, represented the majority of the revenue generated by Resolution Media for the nine months ended September 30, 2015. State Farm, who utilizes our services through Resolution Media and OMD Digital, accounted for 20% of total revenues for the nine months ended September 30, 2015.

In September 2014, Allstate ceased purchases of the pay-for-call services and we do not expect Allstate will purchase additional pay-for-call services in the foreseeable future. Allstate was responsible for 28% of our total revenues for the year ended December 31, 2014.

Many of our largest customers are not subject to long term contracts with us and are generally able to reduce advertising spending at any time and for any reason. In some cases, we engage with our customers through advertising agencies, who act on behalf of the customer. Advertising agencies may place insertion orders with us for particular advertising campaigns for a set period of time and are not obligated to commit beyond the campaign governed by a particular insertion order and may also cancel the campaign prior to completion. Advertising agencies also have relationships with many different providers, each of whom may be running portions of the advertising campaign. A significant reduction in advertising spending by our largest customers, or the loss of one or more of these customers, if not replaced by new customers or an increase in business from existing customers, would have a material adverse effect on our future operating results.

### **Our large customers have substantial negotiating leverage, which may require that we agree to terms and conditions that may have an adverse effect on our business.**

Our large customers have substantial purchasing power and leverage in negotiating contractual arrangements with us. These customers may seek for us to develop additional features, may require penalties for failure to deliver such features, may seek discounted product or service pricing, and may seek more favorable contractual terms. As we sell more products and services to this class of customer, we may be required to agree to such terms and conditions. Such large customers also have substantial leverage in negotiating resolution of any disagreements or disputes that may arise. Any of the foregoing factors could result in a material adverse effect on our business, financial condition and results of operations.

### **If some of our customers experience financial distress or suffer disruptions in their business, their weakened financial position could negatively affect our own financial position and results.**

We have a diverse customer base and, at any given time, one or more customers may experience financial distress, file for bankruptcy protection, go out of business, or suffer disruptions in their business. If a customer with whom we do a substantial amount of business experiences financial difficulty or suffers disruptions in their business, it could delay or jeopardize the collection of accounts receivable, result in significant reductions in services provided by us and may have a material adverse effect on our results of operations and liquidity.

### **We may incur liabilities for the activities of our advertisers, reseller partners, distribution partners and other users of our services, which could adversely affect our business.**

Many of our advertisement distribution processes are automated. In some cases, advertisers or reseller partners use our online tools and account management systems to create and submit advertiser listings and in other cases we create and submit advertising listings on behalf of our advertisers or reseller partners. These advertiser listings are submitted in a bulk data feed or through the distribution partners' user interface. Although we monitor our distribution partners on an ongoing basis primarily for traffic quality, these partners control the distribution of the advertiser listings provided in the data feed or user interface submissions.

We have a large number of distribution partners who display our advertiser listings on their networks. Our advertiser listings are delivered to our distribution partners in an automated fashion through an XML data feed or data dump or through the distribution partners' user interface. Our distribution partners are contractually required to use the listings created by our advertiser customers in accordance with applicable laws and regulations and in conformity with the publication restrictions in our agreements, which are intended to promote the quality and validity of the traffic provided to our advertisers. Nonetheless, we do not operationally control or manage these distribution partners or third parties they may contract with and any breach of these agreements on the part of any distribution partner or its affiliates could result in liability for our business. These agreements include indemnification obligations on the part of our distribution partners, but there is no guarantee that we would be able to collect against offending distribution partners or their affiliates in the event of a claim under these indemnification provisions. Alternatively, we may incur substantial costs as part of

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our indemnification obligations to distribution partners for liability they may incur as a result of displaying content we have provided them. Any costs incurred as a result of activities of our distribution partners and their third party partners could have a material adverse effect on our business, operating results and financial condition.

We do not conduct a manual editorial review of a substantial number of the advertiser listings directly submitted by advertisers or reseller partners online, nor do we manually review the display of the vast majority of the advertiser listings by our distribution partners submitted to us by XML data feeds or data dumps or the distribution partners' user interface. Likewise, in cases where we provide editorial or value-added services for our large reseller partners or agencies, such as ad creation and optimization for local advertisers or landing pages and micro-sites for pay-for-call customers, we rely on the content and information provided to us by these agents on behalf of their individual advertisers. We do not investigate the individual business activities of these advertisers other than the information provided to us or in some cases review of advertiser websites. We may not successfully avoid liability for unlawful activities carried out by our advertisers or reseller partners and other users of our services or unpermitted uses of our advertiser listings by distribution partners and their affiliates.

Our potential liability for unlawful activities of our advertisers and other users of our services or unpermitted uses of our advertiser listings and advertising services and platform by distribution partners and reseller partners and agencies could require us to implement measures to reduce our exposure to such liability, which may require us, among other things, to spend substantial resources, to discontinue certain service offerings or to terminate certain distribution partner relationships. For example, as a result of the actions of advertisers in our network, we may be subject to private or governmental actions relating to a wide variety of issues, such as privacy, gambling, promotions, and intellectual property ownership and infringement. Under agreements with certain of our larger distribution partners, we may be required to indemnify these distribution partners against liabilities or losses resulting from the content of our advertiser listings, or resulting from third party intellectual property infringement claims. Although our advertisers agree to indemnify us with respect to claims arising from these listings, we may not be able to recover all or any of the liabilities or losses incurred by us as a result of the activities of our advertisers.

Our insurance policies may not provide coverage for liability arising out of activities of users of our services. In addition, our reliance on some content and information provided to us by our large advertiser reseller partners and agencies may expose us to liability not covered by our insurance policies. 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 insurance policies may not provide coverage for liability arising out of activities of users of our services. In addition, our reliance on some content and information provided to us by our large advertiser reseller partners and agencies may expose us to liability not covered by our insurance policies. 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.

### **If we do not maintain and grow a critical mass of advertisers and distribution partners, the value of our services could be adversely affected.**

Our success depends, in large part, on the maintenance and growth of a critical mass of advertisers and distribution partners and a continued interest in our pay-for-call, performance-based advertising, call analytics and search marketing services. Advertisers will generally seek the most competitive return on investment from advertising and marketing services. Distribution partners will also seek the most favorable payment terms available in the market. Advertisers and distribution partners may change providers or the volume of business with a provider, unless the product and terms are competitive. In this environment, we must compete to acquire and maintain our network of advertisers and distribution partners. If our business is unable to maintain and grow our base of 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. Our business also depends in part on certain of our large reseller partners and agencies to grow their base of advertisers as these advertisers become increasingly important to our business and our ability to attract additional distribution partners and opportunities. Similarly, if our distribution network does not grow and does not continue to improve over time, current and prospective advertisers and reseller partners and agencies may reduce or terminate this portion of their business with us. Any decline in the number of advertisers and distribution partners could adversely affect the value of our services.

### **The mobile advertising market may develop more slowly than expected, which could harm our business.**

If the market for mobile marketing and advertising develops more slowly than we expect, our business could suffer. Our future success is highly dependent on the commitment of advertisers and marketers to mobile communications as an advertising and marketing medium, the willingness of our potential advertisers to outsource their mobile advertising and marketing needs, and our ability to sell our mobile advertising services to reseller partners and agencies. The mobile advertising and marketing market is relatively new and rapidly evolving. Businesses, including current and potential advertisers, may find mobile advertising or marketing to be less effective than traditional advertising media or marketing methods or other technologies for promoting their products and



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services. As a result, the future demand and market acceptance for mobile marketing and advertising is uncertain. Many of our current or potential advertisers have little or no experience using mobile communications for advertising or marketing purposes and have allocated only a limited portion of their advertising or marketing budgets to mobile communications advertising or marketing, and there is no certainty that they will allocate more funds in the future, if any. Funds to these types of campaigns may fluctuate greatly as different agencies and advertisers test and refine their overall marketing strategies to include mobile advertising and analytics tools. The adoption rate and budget commitments may vary from period to period as agencies and advertisers determine the appropriate mix of media and lead sources in short term and longer term campaigns.

**We are dependent upon the quality of mobile, online, offline and other traffic sources in our network to provide value to our advertisers and the advertisers of our reseller partners and agencies, and any failure in our quality control could have a material adverse effect on the value of our services to our advertisers and adversely affect our revenues.**

We utilize certain monitoring processes with respect to the quality of the mobile, online, offline and other traffic sources that we deliver to our advertisers. Among the factors we seek to monitor are sources and causes of low quality phone calls such as unwanted telemarketer calls and clicks such as non-human processes, including robots, spiders or other software, the mechanical automation of clicking, and other types of invalid clicks, click fraud, or click spam, the purpose of which is something other than to view the underlying content. Additionally, we also seek to identify other indicators which may suggest that a user may not be targeted by or desirable to our advertisers. Even with such monitoring in place, there is a risk that a certain amount of low quality mobile, online, offline and other traffic or traffic that is deemed to be less valuable by our advertisers will be delivered to such advertisers, which may be detrimental to those relationships. We have regularly refunded fees that our advertisers had paid to us which were attributed to low quality mobile, online, offline and other traffic. If we are unable to stop or reduce low quality Internet traffic and low quality phone calls, these refunds may increase. Low quality mobile, online, offline and other traffic may further prevent us from growing our base of advertisers and cause us to lose relationships with existing advertisers, or become the target of litigation, both of which would adversely affect our revenues.

**We depend on being able to secure enough phone numbers to support our advertisers and other users of our services and any obstacles that we face which prevent us from meeting this demand could adversely affect our business.**

We utilize phone numbers as part of a number of information and analytic services to advertisers, such as our pay-for-call, call tracking and call analytics services. Our services that utilize phone numbers are designed to enable advertisers and other users of our services to utilize mobile, online and offline advertising and to help measure the effectiveness of mobile, online and offline advertising campaigns. We secure a majority of our phone numbers through telecommunication carriers that we have contracted with and a smaller number through the 800 Service Management System, and such telecommunication carriers provide the underlying telephone service. Our telecommunications carriers and telephone number acquisition process are subject to the rules and guidelines established by the Federal Communications Commission. Furthermore, to the extent we offer call recording and pay-for-call services, we may be directly subject to certain telecommunications-related regulations. The Federal Communications Commission and our telecommunication carriers may change the rules and guidelines for securing phone numbers or change the requirements for retaining the phone numbers we have already secured. As a result, we may not be able to secure or retain sufficient phone numbers needed for our services. We may also be limited in the number of available telecommunications carriers or vendors to provide such phone numbers to us in the event of any industry consolidations.

**Our automated voice and mobile advertising-based technologies are heavily reliant on vendors.**

Certain voice and mobile advertising-based products are heavily reliant on vendors. The free directory product that we provide relies on technology provided by third party vendors that include voice recognition software and business, government and residence data listings. We cannot guarantee that the technology, data and services provided by our third party vendors will be of sufficient quality to meet the demands of our customers and partners. Further, we cannot guarantee that the technologies, data and services will be available to us in the future on acceptable terms, if at all. Any perception by our customers or partners that our voice and mobile advertising-based products are incomplete or not of sufficient quality could lead to a loss in confidence by our customers or partners, which in turn could lead to a decline in revenues. If we are unable to continue maintaining, advancing and improving our voice and mobile advertising-based products, our operating results may be adversely affected.

**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 operate without infringing on the intellectual property rights of others. There can be no guarantee that any of our intellectual property will not be challenged by third parties. We may be subject to patent infringement claims or other intellectual property infringement claims, and claims of copyright infringement with respect to certain of our proprietary websites that would be costly to defend and could limit our ability to use certain critical technologies.

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The expansion of our call advertising business increases the potential intellectual property infringement claims we may be subject to, particularly in light of the large number of patents which have been issued (or are pending) in the telecommunications field over the last several decades, both in the U.S. and internationally. Jingle, which we acquired in 2011, was subject to patent infringement claims, which were unsuccessful at trial. We resolved this matter and obtained a license to the patents at issue.

We believe that a consolidation of patent portfolios by major technology companies and independent asset holding companies will increase the chances of aggressive assertions of patent and other intellectual property claims. Within the technology telecommunications and online sectors, among other related sectors, we have witnessed various claim holders and alleged rights holders pursue business strategies devoted to extracting settlements or license fees for a wide range of basic and commonly accepted methods and practices. We may be subject to those intellectual property claims in the ordinary course of our business. Also, our partners and customers may also find that they are subject to similar claims, in which case we may be included in any related process or dispute settlement.

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 prevent us from using critical technologies which could have a material adverse effect on our business.

### **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 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. There can be no assurance that if we were to need additional funds to meet these obligations that additional financing arrangements would be available in amounts or on terms acceptable to us, if at all. Furthermore, 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;
- 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;
- 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; and
- We may be exposed to investigations and/or audits by federal, state or other taxing authorities.

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

**Our expanding international operations subject us to additional risks and uncertainties and we may not be successful with our strategy to continue to expand such operations.**

One potential area of growth for us is in international markets. We have initiated operations, through our subsidiaries, in other countries. Currently, we have operations in Canada, Ireland and the United Kingdom and digital services in Australia and New Zealand. We are exploring customer opportunities internationally. Our international expansion and the integration of international operations present unique challenges and risks. Compliance with complex foreign and U.S. laws and regulations that apply to our international operations increases our cost of doing business in international jurisdictions and could interfere with our ability to offer our products and services to one or more countries or expose us or our employees to fines and penalties. We may also have to offer our products and services in a modified format which may not be as compelling to certain customers. Our continued international expansion also subjects us to increased foreign currency exchange rate risks and will require additional management attention and resources. We cannot assure you that we will be successful in our international expansion. There are risks inherent in conducting business in international markets, including:

- the need to localize our products and services to foreign customers' preferences and customs;
- difficulties in managing operations due to language barriers, distance, staffing and cultural differences;
- application of foreign laws and regulations to us, in particular data and privacy regulations in Europe and other international jurisdictions, which may impose significantly more liability and product limitations on service providers in our industry;
- compliance with anti-bribery laws, such as the Foreign Corrupt Practices Act and the UK Anti-Bribery Act;
- tariffs and other trade barriers;
- fluctuations in currency exchange rates;
- establishing management systems and infrastructures;
- reduced protection for intellectual property rights in some countries;
- changes in foreign political and economic conditions;
- compliance with the laws of numerous taxing jurisdictions, both foreign and domestic;
- foreign exchange controls that might prevent us from repatriating cash earned outside the United States;
- the complexity and potentially adverse tax consequences of U.S. tax laws as they relate to our international operations;
- increased costs to establish and maintain effective controls at foreign locations; and
- overall higher costs of doing business internationally.

Our failure to address these risks adequately could materially and adversely affect our business, revenue, results of operations and financial condition.

**The loss of our senior management, including our executive founders, could harm our current and future operations and prospects.**

We are heavily dependent upon the continued services of executive founders, 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. 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 customers and employees under our standard confidentiality agreement. Further, as of September 30, 2015, Russell C. Horowitz, Ethan A. Caldwell and Peter Christothoulou, our executive founders, together controlled 79% of the combined voting power of our outstanding capital stock. Their collective voting control is not tied to their continued employment with Marchex. The loss of the services of any member of our senior management, including our executive founders, for any reason, or any conflict among our executive founders, could harm our current and future operations and prospects.

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

Our performance is largely dependent upon the talents and efforts of highly skilled individuals. In order to fully implement our business plan, we will need to retain our current qualified personnel, as well as attract and retain additional qualified personnel. Thus, our success will, in significant part, depend upon our retention of current personnel as well as 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.

**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. If we are unable to maintain sufficient insurance as a public company to cover liability claims made against 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.

**It may be 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 Global Select 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 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 changes may deter qualified individuals from accepting these roles. Further, applicable rules and regulations of the Securities and Exchange Commission and the NASDAQ Stock Market 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 Global Select 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 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 effectiveness of our controls over financial reporting. Our current and future compliance with the annual internal control report requirement will depend on the effectiveness of our financial reporting and data systems and controls across our operating subsidiaries. We expect these systems and controls to become increasingly complex to the extent that we integrate acquisitions and our business grows. To effectively manage this growth, we will need to continue to improve our operational, financial and management controls and our reporting systems and procedures. We cannot be certain that these measures will ensure that we design, implement and maintain adequate controls over our financial processes and reporting in the future. Any failure to implement required new or improved controls, or difficulties encountered in their implementation or operation, could harm our operating results or cause us to fail to meet our financial reporting obligations. Inadequate 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.

**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 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. Events and circumstances considered in determining whether the carrying value of goodwill may not be recoverable include, but are not limited to: significant changes in performance relative to expected operating results; significant changes in the use of the assets; and significant changes in competition and market dynamics. These estimates are inherently uncertain and can be affected by numerous factors, including changes in economic, industry or market conditions, changes in business operations, a loss of a significant customer, changes in competition or changes in the share price of our common stock and market capitalization. Significant and sustained declines in the stock price and market capitalization, a significant decline in expected future cash flows or a significant adverse change in the business climate, among other factors, could result in the need to perform an impairment analysis in future periods. We cannot accurately predict the amount and timing of any future impairment of goodwill or other intangible assets. Should the value of goodwill or other intangible assets become impaired, we would record an impairment charge, which could have an adverse effect on its financial condition and results of operations.

The current business environment is subject to evolving market conditions and requires significant management judgment to interpret the potential impact to our assumptions. At various points in time during the nine months ended September 30, 2015 and the period from October 1, 2015 to November 3, 2015, our stock price approached or dropped below the then book value per share. To the extent that changes in the current business environment impact our ability to achieve levels of forecasted operating results and cash flows, if the stock price were to trade below book value per share for an extended period of time and/or should other events occur indicating the remaining carrying value of our assets might be impaired, we would test goodwill and intangible assets for impairment and may recognize an impairment loss to the extent that the carrying amount exceeds such asset's fair value.

We recorded a substantial non-cash impairment charge for goodwill and intangible assets during the fourth quarter of 2008 as a result of the impact of the adverse economic environment including the deterioration in the equity and credit markets. During the fourth quarter of 2012, we recorded a non-cash impairment charge for goodwill of \$15.8 million within the Archeo reporting unit as a result of lower projected revenue growth rates and profitability levels compared to historical results and other market-based factors. In the third quarter of 2014, we performed impairment testing in accordance with ASC 350 and in light of the macroeconomic and competitive environments, customer changes, lower projected revenue and profitability and a significant decrease in our market

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capitalization at the end of September 2014. We also performed a review on certain of our intangible assets under ASC 360. As a result of this testing, we concluded that there was no impairment of goodwill and intangible assets. We performed our annual impairment testing as of November 30, 2014 and determined that there was no impairment of goodwill and intangible assets. We may be required to record a future charge to earnings in our financial statements during the period in which any additional 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.

### **We may be required to increase or decrease the valuation allowance against our deferred tax assets.**

Factors in our ability to realize a tax benefit from our deferred tax assets include tax attributes and operating results of acquired businesses, the nature, extent and periods that temporary differences are expected to reverse and our expectations about future operating results. We regularly review our deferred tax assets to assess whether or not it is more likely than not that the deferred tax assets will be realized, and if necessary, increase or decrease the valuation allowance for portions of such assets to reduce the carrying value. At the end of the fourth quarter of 2012, we recognized a partial valuation allowance of \$16.4 million on our federal deferred tax assets which reduced our net deferred assets to \$28.5 million. At the end of the second quarter of 2013, our gross deferred tax assets increased by approximately \$651,000 due primarily to the 2012 and 2013 research and development credit which was reinstated as part of the 2012 American Taxpayer Relief Act signed into law in January 2013. This increase was offset by a corresponding increase in our valuation allowance. We increased the valuation allowance by \$22.3 million to record a full valuation allowance against our deferred tax assets as of September 30, 2014 resulting in a corresponding income tax expense of \$22.3 million for the third quarter of 2014. As of September 30, 2015, our deferred tax assets were \$34.8 million and we have provided a full valuation allowance on the Company's deferred tax assets as we believe it is not more likely than not that these assets will be realized.

### **We do not control the means by which users access our websites, and material changes to current navigation practices or technologies or marketing practices or significant increases in our marketing costs could result in a material adverse effect on our business.**

The success of our proprietary website traffic sources depends in large part upon consumer access to our websites. Consumers access our websites primarily through the following methods: directly accessing our websites by typing descriptive keywords or keyword strings into the uniform resource locator ("URL") address box of an Internet browser; accessing our websites by clicking on bookmarked websites; and accessing our websites through search engines and directories.

Each of these methods requires the use of a third party product or service, such as an Internet browser or search engine application or directory. Internet browsers may provide alternatives to the URL address box to locate websites, and search engines may from time to time change and establish rules regarding the indexing and optimization of websites. We also market certain websites through search engine applications. Historically, we have limited our search engine marketing to less than five leading search engines.

Product developments and market practices for these means of access to our websites are not within our control. We may experience a decline in traffic to our websites if third party browser technologies or search engine methodologies and rules are changed to our disadvantage. We have experienced abrupt search engine algorithm and policy changes in the past. We expect the search engine applications we utilize to market and drive users to our websites to continue to periodically change their algorithms, policies and technologies. These changes may result in an interruption in users' ability to access our websites or impair our ability to maintain and grow the number of users who visit our websites. We may also be forced to significantly increase marketing expenditures in the event that market prices for online advertising and paid-listings escalate. Any of these changes could have a material adverse effect on our business.

### **We may experience unforeseen liabilities arising out of third party domain names included in our distribution network, which could negatively impact our financial results.**

We display pay-for-call or pay-per-click listings on third party domain names and third party websites that are part of our distribution network, which could subject us to a wide variety of civil claims including intellectual property ownership and infringement.

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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.

### **We may continue to explore various strategic alternatives for our remaining Archeo assets.**

In November 2012, we announced our intention to pursue the spin-off of our Archeo assets and, in September 2013, following a strategic review; we announced the suspension of the planned spin-off of the Archeo assets in its previously announced form. At such time, we announced our intention to explore various strategic alternatives for the Archeo assets. In April 2015, we sold certain assets related to Archeo's domain operations, including the bulk of its domain name portfolio. We received cash consideration at closing of \$28.1 million and the sale includes contingent earn-out consideration payments that depend on the achievement of certain sales thresholds. Archeo continues to operate as an independent division of the Company. We are pursuing other strategic alternatives for the remaining Archeo assets going forward but we cannot predict whether those efforts will be successful.

### **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 the following areas:

- sales to advertisers of pay-for-call services;
- delivery of pay-for-call advertising to end users or customers of advertisers through mobile and online destination websites or other offline distribution outlets;
- sales to advertisers of call tracking and call analytics;
- services and outsourcing of technologies that allow advertisers to manage their advertising campaigns across multiple networks and track the success of these campaigns;
- aggregation or optimization of online advertising for distribution through mobile and online search engines and applications, product shopping engines, directories, websites or other offline outlets;
- provision of local and vertical websites containing information and user feedback designed to attract users and help consumers make better, more informed local decisions, while providing targeted advertising inventory for advertisers;
- delivery of online advertising to end users or customers of advertisers through mobile and online destination websites or other offline distribution outlets; and
- local search sales training.

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

We currently or potentially compete with leading search engines and digital advertising networks such as Google and Microsoft. We also compete with call analytics technology providers such as Twilio, Telemetrics, Invoca, DialogTech and Convirza. As we continue to advance our data analytics technologies, we anticipate facing increasing competition from companies providing more broad advertising solutions, such as data management companies like Datalogix. We also face competition on the call supply side, where competing mobile ad companies like xAd look to outbid, partner with or otherwise secure sources of call supply we utilize. Many of these actual or perceived competitors also currently or may in the future have business relationships with us, particularly in distribution. However, such 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. 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.

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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 mobile and 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.

### **We face competition from traditional media companies, and we may not be included in the advertising budgets of large advertisers, which could harm our operating results.**

In addition to digital/online companies, we face competition from companies that offer traditional media advertising opportunities. Most large advertisers have set advertising budgets, a very small portion of which is allocated to Internet advertising. We expect that large advertisers will continue to focus most of their advertising efforts on traditional media. If we fail to convince these companies to spend a portion of their advertising budgets with us, or if our existing advertisers reduce the amount they spend on our programs, our operating results would be harmed.

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

The market for our products and services is characterized by rapid change in business models and technological infrastructure, and we will need to constantly adapt to changing markets and technologies to provide new and competitive products and services. If we are unable to ensure that our users, advertisers, reseller partners, and distribution partners have a high-quality experience with our products and services, then they may become dissatisfied and move to competitors' products and services. Accordingly, our future success will depend, in part, upon our ability to develop and offer competitive products and services for both our target market and for applications in new markets. We may not, however, be able to successfully do so, and our competitors may develop innovations that render our products and services obsolete or uncompetitive.

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

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

- fire;
- floods;
- network failure;
- hardware failure;
- software failure;
- power loss;
- telecommunications failures;
- break-ins;
- terrorism, war or sabotage;
- computer viruses;
- denial of service attacks;



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- penetration of our network by unauthorized computer users and “hackers” and other similar events;
- natural disasters, including, but not limited to, hurricanes, tornadoes, and earthquakes; 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, including sensitive customer 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 advertisers, reseller partners, 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. Furthermore, some of these events could disrupt the economy and/or our customers’ business activities and in turn materially affect our operating results.

### **We rely on third party technology, platforms, carriers, communications providers, and 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 are unable to handle current or higher volumes of use, 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 colocation providers.

We also rely on a select group of third party providers for components of our technology platform and support for our advertising and call-based services, such as hardware and software providers, telecommunications carriers and Voice over Internet Protocol (VoIP) providers, credit card processors and domain name registrars. As a result, key operational resources of our business are concentrated with a limited number of third party providers. A failure or limitation of service or available capacity by any of these third party providers could adversely affect our business and reputation. Furthermore, if any of these significant providers are unable to provide the levels of service and dedicated resources over time that we required in our business, we may not be able to replace certain of these providers in a manner that is efficient, cost-effective or satisfactory to our customers, and as a result our business could be materially and adversely affected. Short term or repeat problems with any of these service providers could provide an interruption of service or service quality impairment to significant customers, which could also impact materially our revenue in any period due to credits or potential loss of significant customers.

### **If our security measures, including those of our vendors or partners, are breached or are perceived as not being secure, we may lose advertisers, reseller partners and distribution partners and as a result we may incur significant legal and financial exposure and suffer an adverse effect on our business.**

We store and transmit data and information about our advertisers, reseller partners, distribution partners and their respective users. We also work with vendors and partners who may come into contact with certain data, such as carriers, colocation and data storage facilities and distribution partners referring callers. We deploy security measures to protect this data and information, as do third parties we utilize to assist in data and information storage. Our security measures and those of the third parties we partner with to assist in data and information storage, as well as to assist in the delivery of services to our advertisers, may suffer breaches. Security breaches of our data storage systems or our third party colocation and technology providers we utilize to store data and information relating to our advertisers, reseller partners, distribution partners and their respective users could expose us to significant potential liability. Similarly, security breaches of our vendors and partners, or ineffective data security by our vendors or partners, may result in similar significant liability. In addition, security breaches, actual or perceived, could result in legal liability, government fines, and the loss of advertisers, reseller partners and distribution partners that could potentially have an adverse effect on our business.

**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 the following issued patents and pending patent applications:

- U.S. Patent Number 7,668,950 entitled “Automatically Updating Performance-Based Online Advertising System and Method” was issued February 23, 2010.
- U.S. Patent Number 8,442,862 entitled “Method and System for Tracking Telephone Calls” was issued on May 14, 2013 and a corresponding divisional Patent Application Number 13/294,436 was filed November 11, 2011. The following divisional applications of Patent Application Number 13/294,436 were also filed: 14/045,536 titled “Method and System for Phone Number Cleaning” was filed November 3, 2013; 14/058,037 titled “Method and System for Collecting Data from Advertising Campaigns Including Phone Number Placement Techniques” was filed November 18, 2013; 14/058,080 titled “Method and System for Monitoring Campaign Referral Sources” was filed November 18, 2013, and 14/065,345 titled “Method and System for Tracking Telephone Calls” was filed November 28, 2013.
- U.S. Patent Number 6,822,663 entitled “Transform Rule Generator for Web-Based Markup Languages” was issued November 23, 2004.
- U.S. Patent Number 8,583,571 entitled “Facility for Reconciliation of Business Records Using Genetic Algorithms” was issued November 12, 2013.
- U.S. Patent Number 8,433,048 entitled “System and Method to Direct Telephone Calls to Advertisers” was issued April 30, 2013.
- U.S. Patent Application Number 12/829,373 entitled “System and Method for Calling Advertised Telephone Numbers on a Computing Device” was filed July 1, 2010.
- U.S. Patent Number 8,259,915 entitled “System and Method to Analyze Calls to Advertised Telephone Numbers” was issued September 4, 2012 and its continuation Patent Number 8,788,344 was issued July 22, 2014.
- U.S. Patent Application Number 13/176,709 entitled “Method and System for Automatically Generating Advertising Creatives” was filed July 5, 2011.
- U.S. Patent Number 8,630,393 entitled “Systems and Methods for Blocking Telephone Calls” was issued January 14, 2014.
- U.S. Patent Number 7,212,615 entitled “Criteria Based Marketing For Telephone Directory Assistance” was issued May 1, 2007 and owned by Jingle Networks, which we acquired in 2011.
- U.S. Patent Number 7,702,084 entitled “Toll-Free Directory Assistance With Preferred Advertisement Listing” was issued April 20, 2010.
- U.S. Patent Number 7,961,861 entitled “Telephone Search Supported By Response Location Advertising” was issued June 14, 2011.
- U.S. Patent Application Number 11/290,148 entitled “Telephone Search Supported By Advertising Based On Past History Of Requests” was filed November 29, 2005.
- U.S. Patent Number 8,175,231 entitled “Toll-Free Directory Assistance With Automatic Selection Of An Advertisement From A Category” issued May 8, 2012.
- U.S. Patent Number 8,107,602 entitled “Directory Assistance With Data Processing Station” was issued January 31, 2012.
- U.S. Patent Number 8,929,522 entitled “System and Method to Customize a Connection Interface for Multimodal Connection to a Telephone Number” was issued January 16, 2015.
- U.S. Patent Number 8,634,520 entitled “Call Tracking System Utilizing an Automated Filtering Function” was issued January 21, 2014.
- U.S. Patent Number 8,671,020 entitled “Call Tracking System Utilizing a Pooling Algorithm” was issued March 11, 2014.
- U.S. Patent Number 8,687,782 entitled “Call Tracking System Utilizing a Sampling Algorithm” was issued April 1, 2014.
- U.S. Patent Application Number 13/865,966 entitled “Correlated Consumer Telephone Numbers and User Identifiers for Advertising Retargeting” was filed April 18, 2013, claiming priority to U.S. Patent Application Number 61/801,893 entitled “Cross-Channel Targeting Using Historical Online and Call Data” filed March 15, 2013.

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- U.S. Patent Number 9,118,751 entitled “System and Method for Analyzing and Classifying Calls without Transcription” was issued August 25, 2015 and its continuation U.S. Patent Application Number 14/834,196 entitled “System and Method for Analyzing and Classifying Calls without Transcription” was filed August 24, 2015.
- U.S. Patent Application Number 14/045,118 entitled “System and Method for Analyzing and Classifying Calls Without Transcription via Keyword Spotting” was filed October 3, 2013.
- U.S. Patent Application Number 14,550,089 entitled “Identifying Call Characteristics to Detect Fraudulent Call Activity and Take Corrective Action Without Using Recording, Transcription or Caller ID” was filed November 21, 2014.
- U.S. Patent Application Number 14,550,203 entitled “Analyzing Voice Characteristics to Detect Fraudulent Call Activity and Take Corrective Action Without Using Recording, Transcription or Caller ID” was filed November 21, 2014.
- U.S. Patent Application Number 14/714,141 entitled “Call Analytics for Mobile Advertising” was filed May 15, 2015.
- U.S. Patent Application Number 14/721,912 entitled Identifying Call Components to Detect Call Traffic Pumping and Taking Corrective Action without Using Recording, Transcription or Caller ID” was filed May 26, 2015, claiming priority to 62/159,086 filed May 8, 2015.

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. We may decide not to protect certain intellectual properties or business methods which may later turn out to be significant to us. 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 trademarks, trade names 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.

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 advertisers. If we are unable to protect our intellectual property rights from unauthorized use, our competitive position could be adversely affected.

### **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 sued by others seeking to invalidate our patents or prevent the issuance of future patents. We may also become subject to interference proceedings conducted in the patent and trademark offices of various countries to determine the priority of inventions. The defense and prosecution, if necessary, of intellectual property suits, interference proceedings and related legal and administrative proceedings is costly and may divert our technical and management personnel from their normal responsibilities. We may not prevail in any of these suits. An adverse determination of any litigation or defense proceedings could put our patents at risk of being invalidated or interpreted narrowly and could put our patent applications at risk of not being issued. Furthermore, because of the substantial amount of discovery required in connection with intellectual property litigation, there is a risk that some of our confidential information could be compromised by disclosure during this type of litigation. In addition, during the course of this kind of litigation, there could be public announcements of the results of hearings, motions or other interim proceedings or developments in the litigation. If securities analysts or investors perceive these results to be negative, it could have an adverse effect on the trading price of our Class B common stock.

### **Our quarterly results of operations might fluctuate due to seasonality, which could adversely affect our growth rate and in turn the market price of our securities.**

Our quarterly results have fluctuated in the past and may fluctuate in the future due to seasonal fluctuations in the level of mobile and Internet usage and seasonal purchasing cycles of many advertisers. Our experience has shown that during the spring and summer months, mobile and Internet usage is generally lower than during other times of the year and during the latter part of the fourth quarter of the calendar year we generally experience lower call volume and reduced demand for calls from our mobile call advertising customers. The extent to which usage and call volume may decrease during these off-peak periods is difficult to predict. Prolonged or severe decreases in usage and call volume during these periods may adversely affect our growth rate and results and in turn the market price of our securities. In the first quarter of the calendar year, this trend generally reverses with increased mobile and Internet usage and often new budgets at the beginning of the year for many of our customers with fiscal years ending December 31. The seasonal purchasing cycles of some customers in certain industries may also be higher in the first half versus the latter half of the calendar year. Additionally, the current business environment has resulted in many advertisers and reseller partners reducing advertising and marketing services budgets or changing such budgets throughout the year, which we expect may impact our quarterly results of operations in addition to typical seasonality seen in our industry.

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### **We are susceptible to general economic conditions, and a downturn in advertising and marketing spending by advertisers 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 advertiser-consumer transactions. Deterioration in economic conditions could cause decreases in or delays in advertising spending and reduce and/or negatively impact our short term ability to grow our revenues. Further, any decreased collectability of accounts receivable or early termination of agreements due to deterioration in economic conditions could negatively impact our results of operations.

### **We depend on the growth of mobile technologies, the Internet and the Internet infrastructure for our future growth and any decrease in growth or anticipated growth in mobile and Internet usage could adversely affect our business prospects.**

Our future revenue and profits, if any, depend upon the continued widespread use of mobile technologies and the Internet as an effective commercial and business medium. Factors which could reduce the widespread use of mobile technologies (including mobile devices, in particular) and the Internet include:

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

In particular, concerns over the security of online transactions and the privacy of users, including the risk of identity theft, may inhibit the growth of Internet usage, including commercial transactions. In order for the mobile and 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 in anticipated mobile and Internet growth and 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 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 could reduce our net revenue and gross margin and negatively impact our standing with applicable credit card authorization agencies. In addition, under limited circumstances, we extend credit to 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.

### **Regulation of E-Commerce, Online Tracking, Online Data Collection, and Use of the Internet may adversely affect our business and operating results.**

Mobile and online search, e-commerce and related businesses face uncertainty related to new or future government regulation at the federal, state, and international levels regarding e-commerce, online tracking, online data collection, and use of the Internet. Due to the rapid growth and widespread use of the Internet, state and federal legislatures (both domestically and abroad) have enacted and may continue to enact various laws and regulations relating to the Internet. Individual states may also enact consumer protection laws that are more restrictive than the ones that already exist.

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Furthermore, the application of existing laws and regulations to companies that engage in e-commerce, or otherwise interact with the Internet remains somewhat unclear. For example, as a result of the actions of advertisers in our network, we may be subject to existing laws and regulations relating to a wide variety of issues such as consumer privacy, gambling, sweepstakes, advertising, promotions, defamation, pricing, taxation, financial market regulation, quality of products and services, computer trespass, spyware, adware, child protection and intellectual property ownership and infringement. In addition, it is not clear whether existing laws that require licenses or permits for certain of our advertisers' lines of business apply to us, including those related to insurance and securities brokerage, law offices and pharmacies. Existing federal and state laws that may affect the growth and profitability of our business include, among others:

- The Digital Millennium Copyright Act (DMCA) provides protection from copyright liability for online service providers that list or link to third party websites. We currently qualify for the safe harbor under the DMCA; however, if it were determined that we did not meet the safe harbor requirements, we could be exposed to copyright infringement litigation, which could be costly and time-consuming.
- The Children's Online Privacy Protection Act (COPPA) restricts the online collection of personal information about children and the use of that information. The Federal Trade Commission (FTC) has the authority to impose fines and penalties upon website operators and online service providers that do not comply with the law. We do not currently offer any websites or online services "directed to children," nor do we knowingly collect personal information from children.
- The Protection of Children from Sexual Predators Act requires online service providers to report evidence of violations of federal child pornography laws under certain circumstances.
- The Controlling the Assault of Non-Solicited Pornography and Marketing (CAN SPAM) Act of 2003 establishes requirements for those who send commercial e-mails, spells out penalties for entities that transmit noncompliant commercial e-mail and/or whose products are advertised in noncompliant commercial e-mail and gives consumers the right to opt-out of receiving commercial e-mails. The majority of the states also have adopted similar statutes governing the transmission of commercial e-mail. The FTC and the states, as applicable, are authorized to enforce the CAN-SPAM Act and the state-specific statutes, respectively. CAN-SPAM gives the Department of Justice the authority to enforce its criminal sanctions. Other federal and state agencies can enforce the law against organizations under their jurisdiction, and companies that provide Internet access may sue violators as well.
- The Electronic Communications Privacy Act prevents private entities from disclosing Internet subscriber records and the contents of electronic communications, subject to certain exceptions.
- The Computer Fraud and Abuse Act and other federal and state laws protect computer users from unauthorized computer access/hacking, and other actions by third parties which may be viewed as a violation of privacy. Courts may apply each of these laws in unintended and unexpected ways. As a company that provides services over the Internet as well as call recording and call tracking services, we may be subject to an action brought under any of these or future laws.
- Among the types of legislation currently being considered at the federal and state levels are consumer laws regulating for the use of certain types of software applications or downloads and the use of "cookies." These proposed laws are intended to target specific types of software applications often referred to as "spyware," "invasiveware" or "adware," and may also cover certain applications currently used in the online advertising industry to serve and distribute advertisements. In addition, the FTC has sought inquiry regarding the implementation of a "do-not-track" requirement. Federal legislation is also expected to be introduced that would regulate "online behavioral advertising" practices. If passed, these laws would impose new obligations for companies that use such software applications or technologies. At least one state already has enacted a law, which went into effect in January 2014, regarding online tracking.

Many Internet services are automated, and companies such as ours may be unknowing conduits for illegal or prohibited materials. It is possible that some courts may impose a strict liability standard or require such companies to monitor their customers' conduct. Although we would not be responsible or involved in any way in such illegal conduct, it is possible that we would somehow be held responsible for the actions of our advertisers or distribution partners.

We may also be subject to costs and liabilities with respect to privacy issues. Several companies have incurred penalties for failing to abide by the representations made in their public-facing privacy policies. In addition, several states have passed laws that require businesses to implement and maintain reasonable security procedures and practices to protect sensitive personal information and to provide notice to consumers in the event of a security breach. Further, it is anticipated that additional federal and state privacy-related legislation will be enacted. Such legislation could negatively affect our business.

In addition, foreign countries may enact laws that could negatively impact our business and/or may prosecute us for violating existing laws. Such laws might include EU member country conforming legislation under applicable EU Privacy, eCommerce, and Data Protection Directives (and similar legislation in other countries where we may have operations). Any costs incurred in addressing foreign laws could negatively affect the viability of our business. Our exposure to this risk will increase to the extent we expand our operations internationally.

**Federal and state regulation of telecommunications may adversely affect our business and operating results.**

Subsidiaries of the Company provide information and analytics services to certain advertisers and reseller partners that may include information services. In connection therewith, the Company, through its subsidiaries, obtains certain telecommunications products and services from carriers in order to deliver these packages of information and analytic services.

Telecommunications laws and regulations (and interpretations thereof) are evolving in response to rapid changes in the telecommunications industry. If our carrier partners were to be subject to any changes in applicable law or regulation (or interpretations thereof), or additional taxes or surcharges, then we in turn may be subject to increased costs for their products and services or receive products and services that may be of less value to our customers, which in turn could adversely affect our business and operating results. Furthermore, our call recording and pay-for-call services may directly subject us to certain telecommunications-related regulations. Finally, in the event that any federal or state regulators were to expand the scope of applicable laws and regulations or their application to include certain end users and information service providers, then our business and operating results could also be adversely affected. The following existing and possible future federal and state laws could impact the growth and profitability of our business:

- The Communications Act of 1934, as amended by the Telecommunications Act of 1996 (the “Act”), and the regulations promulgated by the Federal Communications Commission under Title II of the Act, may impose federal licensing, reporting and other regulatory obligations on the Company. To the extent we contract with and use the networks of voice over IP service providers, new legislation or FCC regulation in this area could restrict our business, prevent us from offering service or increase our cost of doing business. There are an increasing number of regulations and rulings that specifically address access to commerce and communications services on the Internet, including IP telephony. We are unable to predict the impact, if any, that future legislation, legal decisions or regulations concerning voice services offered via the Internet may have on our business, financial condition, and results of operations.
- The U.S. Congress, the FCC, state legislatures or state agencies may target, among other things, access or settlement charges, imposing taxes related to Internet communications, imposing tariffs or other regulations based on encryption concerns, or the characteristics and quality of products and services that we may offer. Any new laws or regulations concerning these or other areas of our business could restrict our growth or increase our cost of doing business.
- The FCC has initiated a proceeding regarding the regulation of broadband services. The increasing growth of the broadband IP telephony market and popularity of broadband IP telephony products and services heighten the risk that the FCC or other legislative bodies will seek to regulate broadband IP telephony and the Internet. In addition, large, established telecommunication companies may devote substantial lobbying efforts to influence the regulation of the broadband IP telephony market, which may be contrary to our interests.
- There is risk that a regulatory agency will require us to conform to rules that are unsuitable for IP communications technologies or rules that cannot be complied with due to the nature and efficiencies of IP routing, or are unnecessary or unreasonable in light of the manner in which we offer voice-related services such as call recording and pay-for-call services to our customers.
- Federal and state telemarketing laws including the Telephone Consumer Protection Act, the Telemarketing Sales Rule, the Telemarketing Consumer Fraud and Abuse Prevention Act and the rules and regulations promulgated thereunder.
- Laws affecting telephone call recording and data protection, such as consent and personal data statutes. Under the federal Wiretap Act, at least one party taking part in a call must be notified if the call is being recorded. Under this law, and most state laws, there is nothing illegal about one of the parties to a telephone call recording the conversation. However, several states (i.e., California, Connecticut, Florida, Illinois, Maryland, Massachusetts, Michigan, Montana, Nevada, New Hampshire, Pennsylvania and Washington) require that all parties consent when one party wants to record a telephone conversation. The telephone recording laws in other states, like federal law, require only one party to be aware of the recording. A Wiretap Act violation is a Class D felony; the maximum authorized penalties for a violation of section 2511(1) of the Wiretap Act are imprisonment of not more than five years and a fine under Title 18. Authorized fines are typically not more than \$250,000 for individuals or \$500,000 for an organization, unless there is a substantial loss. State laws impose similar penalties.
- The Communications Assistance for Law Enforcement Act may require that the Company undertake material modifications to its platforms and processes to permit wiretapping and other access for law enforcement personnel.
- Under various Orders of the Federal Communications Commission, the Company may be required to make material retroactive and prospective contributions to funds intended to support Universal Service, Telecommunications Relay Service, Local Number Portability, the North American Numbering Plan and the budget of the Federal Communications Commission.

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- Laws in most states of the United States of America may require registration or licensing of one or more subsidiaries of the Company, and may impose additional taxes, fees or telecommunications surcharges on the provision of the Company's services which the Company may not be able to pass through to customers.
- Our international operations may expose us to telecommunications regulations in the countries where we are operating and these regulations could negatively affect the viability of our business.

**State and local governments may in the future be permitted to levy additional taxes on Internet access and electronic commerce transactions, which could result in a decrease in the level of usage of our services. In addition, we may be required to pay additional income, sales, or other taxes.**

The federal government passed legislation placing a ban on state and local governments' imposition of new taxes on Internet access or electronic commerce transactions through the Internet Tax Freedom Act, which was extended through December 11, 2015. The proposed Marketplace Fairness Act, if enacted into law, would allow states to require online and other out of state merchants to collect and remit sales and use tax on products and services that they may sell. An increase in taxes may make electronic commerce transactions less attractive for advertisers and businesses, which could result in a decrease in the level of usage of our services. Additionally, from time to time, various state, federal and other jurisdictional tax authorities undertake reviews of the Company and the Company's filings. In evaluating the exposure associated with various tax filing positions, the Company on occasion accrues charges for probable exposures. We cannot predict the outcome of any of these reviews.

### **Risks Relating to Ownership of our Class B common stock**

**Our Class B common stock prices have been and are likely to continue to be highly volatile.**

The trading prices of our Class B common stock have been and are 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 Global Select Market ranged from \$3.00 to \$26.14 per share through September 30, 2015. Our stock prices 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 acquisitions;
- actual or anticipated fluctuations in our operating results;
- lawsuits initiated against us or lawsuits initiated by us;
- announcements of acquisitions or technical innovations;
- potential loss or reduced contributions from distribution partners, reseller partners and agencies, or advertisers;
- changes in growth or earnings estimates or recommendations by analysts;
- changes in the market valuations of similar companies;
- changes in our industry and the overall economic environment;
- volume of shares of Class B common stock available for public sale, including upon conversion of Class A common stock or upon exercise of stock options;
- Class B common stock repurchases under our share repurchase program;
- sales and purchases of stock by us or by our stockholders, including sales by certain of our executive officers and directors pursuant to written pre-determined selling and purchase plans under Rule 10b5-1 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"); and
- short sales, hedging and other derivative transactions on shares of our Class B common stock.

In addition, the stock market in general, and the NASDAQ Global Select Market and the market for mobile and 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.

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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 securities analysts do not continue to publish research or publish negative research about our business, our stock price and trading volume could decline.**

The trading market for our Class B common stock depends in part on the research and reports that securities analysts publish about us or our business. If one or more of the analysts who covers us downgrades our stock or publishes negative research about our business, our stock price would likely decline. If one or more of these analysts ceases coverage of our company or fails to publish reports on us regularly, we could lose visibility in the market for our stock and demand for our stock could decrease, which could cause our stock price or trading volume to decline.

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

As of September 30, 2015, Russell C. Horowitz, Ethan A. Caldwell and Peter Christothoulou, our executive founders, beneficially owned 100% of the outstanding shares of our Class A common stock, which shares represented 78% of the combined voting power of all outstanding shares of our capital stock. These executive founders together control 79% of the combined voting power of all outstanding shares of our capital stock. The holders of our Class A common stock and Class B common stock have identical rights except that the holders of our Class B common stock are entitled to one vote per share, while holders of our Class A common stock are entitled to twenty-five votes per share on all matters to be voted on by stockholders. This concentration of control could be disadvantageous to our other stockholders with interests different from those of these executive founders. 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 executive founders have a controlling interest, they will continue to be able to elect all or a majority of our board of directors and generally be able to determine the outcome of all corporate actions requiring stockholder approval. As a result, these executive founders 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 executive founders to control our company may result in our Class B common stock trading at a price lower than the price at which such stock would trade if these executive founders 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 may not pay dividends on our Class B common stock in the future which could impair the value of such 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 or the fiscal year before which the dividend is declared. We have initiated and paid a quarterly dividend on our Class B common stock from November 2006 through May 2015. Our ability to pay dividends in the future will depend on our financial results, liquidity and financial condition. We currently do not anticipate declaring or paying dividends in the foreseeable future.



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

During the third quarter of 2015, share repurchase activity was as follows:

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares (or approximate dollar value) that may yet be purchased under the plans or programs (1)
July 1, 2015 – July 31, 2015(2)	22,905	\$ 4.39	21,499	2,005,576
August 1, 2015 – August 31, 2015 (2)	134,508	3.80	128,852	1,876,724
September 1, 2015 – September 30, 2015 (2)	327,828	3.97	326,078	1,550,646
Total Class B Common Shares	485,241	\$ 3.94	476,429	1,550,646

- (1) In November 2014, we established a 2014 share repurchase program, which supersedes and replaces any prior repurchase programs, and authorized the Company to repurchase up to three million shares in the aggregate of the Company's Class B common stock. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements, capital availability, and other market conditions.
- (2) Includes shares of restricted equity subject to vesting which were issued to certain employees. We repurchased 1,406 shares, 5,656 shares, and 1,750 shares, which were not already vested, for \$0.01 per share upon termination of employment for the months ended July 31, August 31, and September 30, 2015, respectively.

### Item 4. Mine Safety Disclosures

Not applicable.

### Item 6. Exhibits

*Exhibits:*

- †31(i) Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- †31(ii) Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- ††32 Certification of Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- †101.INS XBRL Instance Document.
- †101.SCH XBRL Taxonomy Extension Schema Document.
- †101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
- †101.DEF XBRL Taxonomy Extension Definition Linkbase Document.
- †101.LAB XBRL Taxonomy Extension Labels Linkbase Document.
- †101.PRE XBRL Taxonomy Presentation Linkbase Document.

† Filed herewith.

†† Furnished herewith.



**CERTIFICATION PURSUANT TO RULES 13a-14(a) AND 15d-14(a),  
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

**Principal Executive Officer**

I, Peter Christothoulou, certify that:

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

Date: November 6, 2015

/s/ PETER CHRISTOTHOULOU

**Peter Christothoulou**  
**Chief Executive Officer**  
**(Principal Executive Officer)**

**CERTIFICATION PURSUANT TO RULES 13a-14(a) AND 15d-14(a),  
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

**Principal Financial Officer**

I, Michael A. Arends, certify that:

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

Date: November 6, 2015

/s/ MICHAEL A. ARENDS

**Michael A. Arends**  
**Chief Financial Officer**  
**(Principal Financial Officer)**

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER  
PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE  
SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Marchex, Inc. (the "Company") for the quarter ended September 30, 2015 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Peter Christothoulou, as Chief Executive Officer of the Company, and Michael A. Arends, as Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, to the best of his knowledge, respectively, that:

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

Dated: November 6, 2015

By: \_\_\_\_\_ /S/ PETER CHRISTOTHOULOU

**Name: Peter Christothoulou**  
**Title: Chief Executive Officer**  
**(Principal Executive Officer)**

Dated: November 6, 2015

By: \_\_\_\_\_ /S/ MICHAEL A. ARENDS

**Name: Michael A. Arends**  
**Title: Chief Financial Officer**  
**(Principal Financial Officer)**