MARCHEX INC
Form 10-Q
August 11, 2014
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2014

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

Marchex, Inc.

(Exact name of Registrant as specified in its charter)

Delaware	**35-2194038**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**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

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its Corporate Web site, 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 x 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	x
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 x

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 August 6, 2014**
Class A common stock, par value $.01 per share	5,232,636

Class B common stock, par value $.01 per share	37,567,108

Table of Contents

Marchex, Inc.

Form 10-Q

Table of Contents

Table of Contents

Part I Financial Information

Item 1. Condensed Consolidated Financial Statements

MARCHEX, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(in thousands)

(unaudited)

	December 31, 2013	June 30, 2014
Assets		
Current assets:		
Cash and cash equivalents	$ 30,912	$ 74,950
Accounts receivable, net	30,005	34,700
Prepaid expenses and other current assets	2,943	3,429
Refundable taxes	97	96
Deferred tax assets	1,016	1,251
Total current assets	64,973	114,426
Property and equipment, net	5,440	5,042
Deferred tax assets	25,138	23,012
Intangible and other assets, net	484	422
Goodwill	65,679	65,679
Intangible assets from acquisitions, net	434	
Total assets	$ 162,148	$ 208,581
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 15,922	$ 20,179
Accrued expenses and other current liabilities	7,988	8,395
Deferred revenue	1,388	2,188
Total current liabilities	25,298	30,762
Other non-current liabilities	2,095	1,322
Total liabilities	27,393	32,084
Stockholders equity:		
Class A common stock	80	55
Class B common stock	309	375
Treasury stock	(2)	(1)

Additional paid-in capital	305,517	345,382
Accumulated deficit	(171,149)	(169,314)
Total stockholders equity	134,755	176,497
Total liabilities and stockholders equity	$ 162,148	$ 208,581

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MARCHEX, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Operations

(in thousands, except per share amounts)

(unaudited)

	Six Months Ended June 30,		Three Months Ended June 30,	
	2013	2014	2013	2014
Revenue	$ 72,310	$ 100,172	$ 37,578	$ 49,676
Expenses:				
Service costs (1)	42,732	64,673	22,584	32,319
Sales and marketing (1)	5,550	6,221	2,906	2,839
Product development	13,752	15,018	6,944	7,458
General and administrative	10,323	10,747	5,526	5,386
Amortization of intangible assets from acquisitions (2)	1,791	434	736	31
Acquisition and separation related costs	654	(68)	309	(68)
Total operating expenses	74,802	97,025	39,005	47,965
Gain on sales and disposals of intangible assets, net	2,691		1,329	
Income (loss) from operations	199	3,147	(98)	1,711
Other income (expense):				
Interest income	10	1	7	1
Interest and line of credit expense	(38)	(38)	(19)	(19)
Other	(1)	13	0	(4)
Total other income (expense)	(29)	(24)	(12)	(22)
Income (loss) from continuing operations before provision for income taxes	170	3,123	(110)	1,689
Income tax expense	408	1,297	244	709
Net income (loss) from continuing operations	(238)	1,826	(354)	980
Discontinued operations, net of tax	(31)	9	0	
Net income (loss)	(269)	1,835	(354)	980
Dividends paid to participating securities		(69)		(33)
Net income (loss) applicable to common stockholders	$ (269)	$ 1,766	$ (354)	$ 947

Basic and diluted net income (loss) per share applicable to Class A and Class B common stockholders								
Continuing operations	$	(0.01)	$	0.05	$	(0.01)	$	0.02
Discontinued operations, net of tax	$	(0.00)	$	0.00	$	0.00	$	
Dividends paid per share	$		$	0.04	$		$	0.02
Shares used to calculate basic net income (loss) per share applicable to common stockholders								
Class A		9,570		6,483		9,570		5,243
Class B		25,720		32,277		25,853		35,441
Shares used to calculate diluted net income (loss) per share applicable to common stockholders								
Class A		9,570		6,483		9,570		5,243
Class B		35,290		41,658		35,423		43,453

(1) Excludes amortization of intangible assets from acquisitions

(2) Components of amortization of intangible assets from acquisitions:

Service costs	$	1,177	$	434	$	429	$	31
Sales and marketing		614				307		
Total	$	1,791	$	434	$	736	$	31

See accompanying notes to condensed consolidated financial statements.

4

Table of Contents

MARCHEX, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Six Months Ended June 30, 2013	Six Months Ended June 30, 2014
Cash flows from operating activities:		
Net income (loss)	$ (269)	$ 1,835
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization and depreciation	3,633	2,288
Gain on sales and disposals of intangible assets, net	(2,691)	
Acquisition and separation related costs		(68)
Allowance for doubtful accounts and advertiser credits	905	649
Stock-based compensation	4,533	6,000
Deferred income taxes	144	1,276
Excess tax benefit related to stock-based compensation	(196)	
Change in certain assets and liabilities:		
Accounts receivable, net	(9,019)	(5,343)
Refundable taxes	96	1
Prepaid expenses, other current assets and other assets	(661)	(92)
Accounts payable	5,845	3,920
Accrued expenses and other current liabilities	742	272
Deferred revenue	25	800
Other non-current liabilities	68	(171)
Net cash provided by operating activities	3,155	11,367
Cash flows from investing activities:		
Purchases of property and equipment	(1,725)	(1,190)
Proceeds from sales of intangible assets	2,692	
Purchases of intangible assets and changes in other non-current assets	(86)	(162)
Intangible asset deposit	80	
Net cash provided by (used in) investing activities	961	(1,352)
Cash flows from financing activities:		
Excess tax benefit related to stock-based compensation	196	
Proceeds from offering, net of costs		32,674
Tax withholding related to restricted stock awards	(1,639)	(467)
Common stock dividend payments		(1,617)
Repurchase of Class B common stock	(119)	
Proceeds from exercises of stock options and issuance of restricted stock to employees, net of repurchases of forfeited unvested restricted stock	230	3,404

Proceeds from employee stock purchase plan	28	29
Net cash provided by (used in) financing activities	(1,304)	34,023
Net increase in cash and cash equivalents	2,812	44,038
Cash and cash equivalents at beginning of period	15,930	30,912
Cash and cash equivalents at end of period	$ 18,742	$ 74,950
Supplemental disclosure of cash flow information:		
Cash paid during the period for income taxes, net of refunds	$ 52	$ 24

See accompanying notes to condensed consolidated financial statements.

5

Table of Contents

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 and call advertising technology company. The Company provides products and services for businesses of all sizes that depend on consumer phone calls to drive sales. The Company s technology platform delivers performance-based, pay-for-call advertising across numerous mobile and online publishers to connect high-intent consumers with business over the phone while its technology facilitates call quality, analyzes calls in real time and measures the outcomes of calls. The Company through its Archeo division enables the buying, selling and development of domain names. The Company also provides performance-based online advertising that connects advertisers with consumers across our owned web sites as well as third party web sites.

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 months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014, or for any other period. The balance sheet at December 31, 2013 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, 2013 filed with the SEC.

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Acquisitions are included in the Company s consolidated financial statements as of and from the date of acquisition. 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. The Company s condensed consolidated financial statements presented include the condensed consolidated balance sheets as of December 31, 2013 and June 30, 2014, the condensed consolidated statements of operations for the three and six months ended June 30, 2013 and 2014 and the condensed consolidated statements of cash flows for the six months ended June 30, 2013 and 2014.

In July 2013, the Company sold certain assets related to Archeo s pay per click advertising services. As a result, the operating results related to these certain pay per click assets 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 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.

On September 10, 2013, the Company launched its Domains Marketplace, which provides domain names available for sale and initiated plans to facilitate the active buying and transacting of domain names. Domain name sales occurring after this launch have been recognized as revenue in the condensed consolidated financial statements. Historically, the sale of domain names were not a core operation of the Company and were peripheral to the generation of advertising revenue from domain names held for use and as such domain name sales were reported as gains on sales and disposals of intangible assets, net in the condensed consolidated financial statements. Substantially all of the Company s domain names that are available for sale are also used to generate advertising revenue. The Company also continues to maintain a portfolio of domain names which are solely held for use primarily to generate advertising revenue.

Recent Accounting Pronouncement 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. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. 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. The Company is currently in the process of evaluating the impact of adoption of ASU 2014-09 on its consolidated financial statements.

Revenues

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

	Six months ended June 30,		Three months ended June 30,	
	2013	**2014**	**2013**	**2014**
Call-driven	$ 65,001	$ 91,349	$ 33,893	$ 45,857
Archeo	7,309	8,823	3,685	3,819
Total Revenue	$ 72,310	$ 100,172	$ 37,578	$ 49,676

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 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 marketing services. Archeo revenue includes revenue generated from advertisements on our network of owned and operated websites and third-party distribution, as well as from the sale of domain names occurring after the launch of the Company s Domains Marketplace in September 2013. Prior to the launch of Domains Marketplace, the sale of domain names were reported as gains on sales and disposals of intangible assets, net in the condensed consolidated financial statements and totaled $1.3 million and $2.7 million for the three and six months ended June 30, 2013, respectively, compared to $2.2 million and $4.1 million of domain sales revenue for the three and six months ended June 30, 2014, respectively. 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):

	Six months ended June 30,		Three months ended June 30,	
	2013	**2014**	**2013**	**2014**
Partner and Other Revenue Sources	$ 68,332	$ 93,390	$ 35,491	$ 46,520
Proprietary Web site Traffic Sources and Domain Names	3,978	6,782	2,087	3,156
Total Revenue	$ 72,310	$ 100,172	$ 37,578	$ 49,676

The Company s partner network revenues are primarily generated using third party distribution networks to deliver the advertisers listings. The distribution network includes mobile and online search engines and applications, directories, destination sites, shopping engines, third party Internet domains or web sites, other targeted Web-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 pays a revenue share to the distribution partners to access their mobile, online, offline and other user traffic. Other revenues include the Company s call provisioning and call tracking services, presence management services, and campaign management services.

The Company s proprietary web site traffic revenues are generated from the Company s portfolio of owned web sites which are monetized with pay-for-call or pay-per-click listings that are relevant to the web sites, and other forms of advertising, including banner advertising and sponsorships. When an online user navigates to one of the Company s owned and operated web sites and calls or clicks on a particular listing or completes the specified action, the Company receives a fee. Other proprietary web site traffic revenues include domain name sales, which were recognized as revenue with the launch of its Domains Marketplace in September 2013.

Table of Contents

(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):

	Six months ended June 30,		Three months ended June 30,	
	2013	2014	2013	2014
Service costs	$ 363	$ 644	$ 183	$ 362
Sales and marketing	262	437	202	233
Product development	766	1,351	394	692
General and administrative	3,119	3,568	1,824	1,830
Total stock-based compensation	$ 4,510	$ 6,000	$ 2,603	$ 3,117
Income tax benefit related to stock-based compensation included in net income (loss)	$ 1,251	$ 1,852	$ 742	$ 944

FASB ASC 718 requires the benefits of tax deductions in excess of the stock-based compensation cost to be classified as financing cash inflows and is shown as Excess tax benefit related to stock-based compensation on the consolidated statement of cash flows. 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. For the six months ended June 30, 2014, the Company incurred an excess tax deduction of $6.0 million for which the tax benefit was 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 June 30, 2013 and 2014, 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:

	Six months ended June 30,		Three months ended June 30,	
	2013	2014	2013	2014
Expected life (in years)	4.0	4.0	4.0	4.0

Risk-free interest rate	0.96%	1.25%	1.04%	1.25%
Expected volatility	55%	55%-60%	54%	55%-60%
Expected dividend yield	1.98%	0.76%	1.91%	0.76%

Stock option activity during the six months ended June 30, 2014 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, 2013	7,707,713	$ 7.48	6.99	$ 17,148
Options granted	1,138,286	10.15		
Options forfeited	(156,416)	5.65		
Options expired	(83,578)	11.97		
Options exercised	(625,757)	5.69		
Balance at June 30, 2014	7,980,248	$ 7.99	7.00	$ 35,805

8

Table of Contents

The Company issues restricted stock awards and restricted stock units to employees for future services and/or 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 vesting conditions. Restricted stock award and restricted stock unit grants 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 shares issued are accounted for under FASB ASC 718 using the straight-line method net of estimated forfeitures.

Restricted stock awards and restricted stock units activity during the six months ended June 30, 2014 is summarized as follows:

	Shares/ Units	Weighted average grant date fair value
Unvested balance at December 31, 2013	2,709,443	$ 5.41
Granted	618,992	10.03
Vested	(619,455)	4.66
Forfeited	(75,625)	4.25
Unvested balance at June 30, 2014	2,633,355	$ 6.70

The Company repurchased 41,287 shares from certain executives for minimum withholding taxes on 143,650 restricted stock awards that vested during 2014. 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, which was remitted in cash to the appropriate taxing authorities. The payments are reflected as a financing activity within the condensed consolidated statement of cash flows when paid.

(4) Net Income (Loss) Per Share

The Company computes net income (loss) 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 (loss) per share is computed by dividing net income (loss) applicable to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing net income (loss) applicable to common stockholders by the weighted average number of common and dilutive common equivalent shares outstanding during the period. The computation of the diluted net income (loss) 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 (loss) 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.

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

	Six months ended June 30,			
	2013		2014	
	Class A	Class B	Class A	Class B
Numerator:				
Net income (loss) from continuing operations	$ (64)	$ (174)	$ 293	$ 1,533
Dividends paid to participating securities				(69)
Net income (loss) from continuing operations applicable to common stockholders	$ (64)	$ (174)	$ 293	$ 1,464
Discontinued operations, net of tax	(9)	(22)	1	8
Net income (loss) applicable to common stockholders	$ (73)	$ (196)	$ 294	$ 1,472
Denominator:				
Weighted average number of shares outstanding used to calculate basic net income (loss) per share	9,570	25,720	6,483	32,277
Basic net income (loss) per share:				
Net income (loss) from continuing operations applicable to common stockholders	$ (0.01)	$ (0.01)	$ 0.05	$ 0.05
Discontinued operations, net of tax	(0.00)	(0.00)	0.00	0.00
Basic net income (loss) per share applicable to common stockholders	$ (0.01)	$ (0.01)	$ 0.05	$ 0.05

Table of Contents

	Three months ended June 30, 2013 Class A	2013 Class B	2014 Class A	2014 Class B
Numerator:				
Net income (loss) from continuing operations	$ (96)	$ (258)	$ 121	$ 859
Dividends paid to participating securities				(33)
Net income (loss) from continuing operations applicable to common stockholders	$ (95)	$ (258)	$ 121	$ 826
Discontinued operations, net of tax	0	0		
Net income (loss) applicable to common stockholders	$ (95)	$ (258)	$ 121	$ 826
Denominator:				
Weighted average number of shares outstanding used to calculate basic net income (loss) per share	9,570	25,853	5,243	35,441
Basic net income (loss) per share:				
Net income (loss) from continuing operations applicable to common stockholders	$ (0.01)	$ (0.01)	$ 0.02	$ 0.02
Discontinued operations, net of tax	0.00	0.00		
Basic net income (loss) per share applicable to common stockholders	$ (0.01)	$ (0.01)	$ 0.02	$ 0.02

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

	Six months ended June 30, 2013 Class A	**2013 Class B**	**2014 Class A**	**2014 Class B**
Numerator:				
Net income (loss) from continuing operations	$ (64)	$ (174)	$ 294	$ 1,532
Dividends paid to participating securities				(69)
Reallocation of net income (loss) for Class A shares as a result of conversion of Class A to Class B shares		(64)		294
Net income (loss) from continuing operations applicable to common stockholders	$ (64)	$ (238)	$ 294	$ 1,757
Discontinued operations, net of tax	(9)	(22)	1	8
Reallocation of discontinued operations for Class A shares as a result of conversion of Class A to Class B shares		(9)		1
Discontinued operations, net of tax	$ (9)	$ (31)	$ 1	$ 9

Net income (loss) applicable to common stockholders	$ (73)	$ (269)	$ 295	$ 1,766
Denominator:				
Weighted average number of shares outstanding used to calculate diluted net income (loss) per share	9,570	25,720	6,483	32,277
Weighted average stock options and common shares subject to repurchase or cancellation				2,898
Conversion of Class A to Class B common shares outstanding		9,570		6,483
Weighted average number of shares outstanding used to calculate diluted net income (loss) per share	9,570	35,290	6,483	41,658
Diluted net income (loss) per share:				
Net income (loss) from continuing operations applicable to common stockholders	$ (0.01)	$ (0.01)	$ 0.05	$ 0.05
Discontinued operations, net of tax	(0.00)	(0.00)	0.00	0.00
Diluted net income (loss) per share applicable to common stockholders	$ (0.01)	$ (0.01)	$ 0.05	$ 0.05

Table of Contents

	Three months ended June 30, 2013		2014	
	Class A	Class B	Class A	Class B
Numerator:				
Net income (loss) from continuing operations	$ (96)	$ (258)	$ 120	$ 860
Dividends paid to participating securities				(33)
Reallocation of net income (loss) for Class A shares as a result of conversion of Class A to Class B shares		(96)		120
Net income (loss) from continuing operations applicable to common stockholders	$ (95)	$ (354)	$ 120	$ 947
Discontinued operations, net of tax	0	0		
Reallocation of discontinued operations for Class A shares as a result of conversion of Class A to Class B shares		0		
Discontinued operations, net of tax	$ 0	$ 0	$	$
Net income (loss) applicable to common stockholders	$ (95)	$ (354)	$ 120	$ 947
Denominator:				
Weighted average number of shares outstanding used to calculate basic net income per share	9,570	25,853	5,243	35,441
Weighted average stock options and common shares subject to repurchase or cancellation				2,769
Conversion of Class A to Class B common shares outstanding		9,570		5.243
Weighted average number of shares outstanding used to calculate diluted net income (loss) per share	9,570	35,423	5,243	43,453
Diluted net income (loss) per share:				
Net income from continuing operations applicable to common stockholders	$ (0.01)	$ (0.01)	$ 0.02	$ 0.02
Discontinued operations, net of tax	0.00	0.00		
Diluted net income per share applicable to common stockholders	$ (0.01)	$ (0.01)	$ 0.02	$ 0.02

The weighted average number of shares used to calculate the diluted net income (loss) per share includes the weighted average number of shares from the assumed conversion of Class A common stock to Class B common stock.

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

For the three and six months ended June 30, 2013, outstanding options to acquire 7,553 shares of Class B common stock. For the three and six months ended June 30, 2014, outstanding options to acquire 2,924 shares and 2,919 of Class B common stock, respectively.

For the three and six months ended June 30, 2013 and 2014, 2,123 and 4 shares of unvested Class B restricted common shares, respectively, issued to employees and in connection with acquisitions. These shares were for future services that vest over periods ranging from one to six years.

For the three and six months ended June 30, 2013, 778 restricted stock units.

(5) Concentrations

The Company maintains substantially all of its cash and cash equivalents with one financial institution.

Table of Contents

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. In 2013 and 2014, the Company s largest distribution partner was paid less than 20% of consolidated revenue.

The advertisers representing more than 10% of consolidated revenue are as follows:

	Six months ended June 30,		Three months ended June 30,	
	2013	2014	2013	2014
Advertiser A	25%	21%	24%	22%
Advertiser B	14%	*	16%	*
Advertiser C	10%	33%	11%	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:

	At December 31, 2013	At June 30, 2014
Advertiser A	41%	28%
Advertiser B	14%	*
Advertiser C	13%	32%

* Less than 10%

(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. As a result, the operating results related to these certain pay per click assets 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 *Note14. Discontinued Operations* for further discussion.

The Company s Call-driven segment comprises its performance-based advertising business focused on driving phone calls. The Archeo segment comprises the Company s click-based advertising and Internet domain name businesses. 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 separation related costs, and other income (expense).

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 June 30, 2014 was approximately $63.3 million and $2.4 million for Call-driven and Archeo, respectively.

Selected segment information (in thousands):

	Six months ended June 30, 2014		
	Call-driven	**Archeo**	**Total**
Revenue	$ 91,349	$ 8,823	$ 100,172
Operating expenses	86,041	4,618	90,659
Segment profit	$ 5,308	$ 4,205	$ 9,513
Less reconciling items:			
Stock based compensation			6,000
Amortization of intangible assets from acquisitions			434
Acquisition and separation related costs			(68)
Other expense (income)			24
Income from continuing operations before provision for income taxes			$ 3,123

12

Table of Contents

	Six months ended June 30, 2013		
	Call-driven	Archeo	Total
Revenue	$ 65,001	$ 7,309	$ 72,310
Operating expenses	62,122	5,725	67,847
Gain on sales of intangible assets, net		2,691	2,691
Segment profit	$ 2,879	$ 4,275	$ 7,154
Less reconciling items:			
Stock based compensation			4,510
Amortization of intangible assets from acquisitions			1,791
Acquisition and separation related costs			654
Other expense (income)			29
Income from continuing operations before provision for income taxes			$ 170

	Three months ended June 30, 2014		
	Call-driven	Archeo	Total
Revenue	$ 45,857	$ 3,819	$ 49,676
Operating expenses	42,960	1,925	44,885
Segment profit	$ 2,897	$ 1,894	$ 4,791
Less reconciling items:			
Stock based compensation			3,117
Amortization of intangible assets from acquisitions			31
Acquisition and separation related costs			(68)
Other expense (income)			22
Income from continuing operations before provision for income taxes			$ 1,689

	Three months ended June 30, 2013		
	Call-driven	Archeo	Total
Revenue	$ 33,893	$ 3,685	$ 37,578
Operating expenses	32,384	2,973	35,357
Gain on sales of intangible assets, net		1,329	1,329
Segment profit	$ 1,509	$ 2,041	$ 3,550
Less reconciling items:			
Stock based compensation			2,603
Amortization of intangible assets from acquisitions			736
Acquisition and separation related costs			309
Other expense (income)			12

Loss from continuing operations before provision for income taxes	$	(110)

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):

	Six months ended June 30,		Three months ended June 30,	
	2013	2014	2013	2014
United States	94%	95%	94%	95%
Canada	6%	3%	6%	3%
Other countries	*	2%	*	2%
	100%	100%	100%	100%

* Less than 1% of revenue.

Table of Contents

(7) Property and Equipment

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

	At December 31, 2013	At June 30, 2014
Computer and other related equipment	$ 17,794	$ 18,379
Purchased and internally developed software	7,672	7,821
Furniture and fixtures	1,319	1,353
Leasehold improvements	1,829	1,834
	$ 28,614	$ 29,387
Less: accumulated depreciation and amortization	(23,174)	(24,345)
Property and equipment, net	$ 5,440	$ 5,042

The Company has capitalized certain costs of internally developed software for internal use. The estimated useful life of costs capitalized is evaluated for each specific project. Amortization begins in the period in which the software is ready for its intended use. The Company has not capitalized any internally developed costs for the three and six months ended June 30, 2013 and 2014.

Depreciation and amortization expense, related to property and equipment was approximately $853,000 and $833,000 for the three months ended June 30, 2013 and 2014, respectively, and was approximately $1.7 million for both the six months ended June 30, 2013 and 2014.

(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 2016. 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):

(in thousands)	Facilities operating leases	Other contractual obligations	Total
2014	$ 1,173	$ 1,713	$ 2,886
2015	2,271	1,996	4,267
2016	2,313	1,168	3,481
2017	2,373		2,373
2018	577		577

Total minimum payments	$ 8,707	$ 4,877	$ 13,584

Rent expense incurred by the Company was approximately $465,000 and $473,000 for the three months ended June 30, 2013 and 2014, respectively, and was $931,000 and $935,000 for the six months ended June 30, 2013 and 2014, 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). In 2011, the Company signed an amendment to the Credit Agreement, which extended the maturity period through to April 1, 2014. During the first quarter of 2014, the Company signed an amendment to the Credit Agreement, which extended the maturity period to 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 six months ended June 30, 2013 and 2014, the Company had no borrowings under the Credit Agreement.

Table of Contents

(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 we are a party, we have 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, we may from time to time provide certain levels of financial support to our contract parties to seek to minimize the impact of any associated litigation in which they 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

During the six months ended June 30, 2014, the Company s gross deferred tax assets decreased by approximately $1.9 million which includes the reclass of uncertain tax positions of $534,000 from other non-current liabilities in the condensed consolidated balance sheet with the adoption of ASU 2011-13 in the first quarter of 2014.

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. The Company adjusts these contingencies in light of changing facts and circumstances, such as the outcome of tax audits. 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 2009 are within the statute of limitations and are under examination or may be subject to examination.

(11) Goodwill

There was no change in goodwill during the six months ended June 30, 2014. The following table outlines our goodwill by segment (in thousands):

	December 31, 2013	June 30, 2014
Call-Driven	$ 63,305	$ 63,305
Archeo	2,374	2,374
Total	$ 65,679	$ 65,679

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, we 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. These estimates can be affected by numerous factors, including changes in economic, industry or market conditions, changes in business operations, 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. 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, or should other events occur indicating the remaining carrying value of its assets might be impaired, the Company would test its goodwill and intangible assets for impairment and may recognize an additional impairment loss.

Table of Contents

(12) Intangible and other assets, net

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

	At December 31, 2013	At June 30, 2014
Internet domain names	$ 14,514	$ 14,595
Less accumulated amortization	(14,376)	(14,452)
Internet domain names, net	138	143
Other assets:		
Registration fees, net	12	
Other	334	279
Total intangibles and other assets, net	$ 484	$ 422

The Company capitalizes costs incurred to acquire domain names or URLs, which include the initial registration fees, to other intangible assets, which excludes intangible assets acquired through business combinations. The capitalized costs are amortized over the expected useful life of the domain names on a straight-line basis.

On September 10, 2013, the Company launched its Domains Marketplace, which provides domain names available for sale and initiated plans to facilitate the active buying and transacting of domain names. Domain name sales occurring after this launch have been recognized as revenue in the condensed consolidated financial statements. The net carrying value of Internet domain names as of June 30, 2014 related to both domain names held for use and available for sale.

The Company also capitalizes costs incurred to renew or extend the term of the domain names or URLs to prepaid expenses and other current assets or registration fees, net. The capitalized costs are amortized over the renewal or extended period on a straight-line basis. The total amount of costs incurred for the three and six months ended June 30, 2014 to renew or extend the term for domain names was $625,000 and $1.1 million, respectively. The weighted average renewal period for registration fees as of June 30, 2014 was approximately one year.

Amortization expense for internet domain names was approximately $74,000 and $67,000 for the three months ended June 30, 2013 and 2014, respectively, and was $143,000 and $156,000 for the six months ended June 30, 2013 and 2014, respectively. Based upon the current amount of domains subject to amortization, the estimated expense for the next five years is as follows: $71,000 for the remainder of 2014, $62,000 in 2015, $10,000 in 2016, and $0 thereafter.

(13) Common Stock

In April 2014, the Company completed a follow-on public offering in which the Company sold an aggregate of 3.4 million shares of the Company s 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 includes the exercise of the underwriter s option to purchase 343,000 additional shares. The Company received aggregate net proceeds of $32.5 million, after deducting underwriting discounts and commissions and estimated offering expenses. The Company did not receive any of the proceeds from the sales of shares by the selling stockholders.

In April 2014, the Company s board of directors declared a regular quarterly dividend in the amount of $0.02 per share on the Company s Class A and Class B common stock. The Company paid these dividends on May 15, 2014 to the holders of record as of the close of business on May 5, 2014. The Company paid approximately $846,000 in quarterly dividends.

In November 2006, the Company s board of directors authorized a share repurchase program for the Company to repurchase up to 3 million shares of the Company s Class B common stock as well as the initiation of a quarterly cash dividend for the holders of the Class A and Class B common stock. The Company s board of directors has authorized increases to the share repurchase program for the Company to repurchase up to 13 million shares in the aggregate (less shares previously repurchased under the share repurchase program) of the Company s Class B common stock. Under the share repurchase program, repurchases may take place in the open market and in privately negotiated transactions and at times and in such amounts as the Company deems appropriate. 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. This stock repurchase program does not have an expiration date and may be expanded, limited or terminated at any time without prior notice. During the six months ended June 30, 2014, the Company did not repurchase any shares of Class B common stock as part of the stock repurchase program.

During the six months ended June 30, 2014, the Company retired approximately 174,808 shares of treasury stock, which was approved by the Company s board of directors.

Table of Contents

(14) Discontinued Operations

On July 19, 2013, we completed the sale of certain pay-per-click advertising services to an unrelated third party. Accordingly, we have presented the results of operations of these certain pay-per-click assets in the condensed consolidated financial statements as discontinued operations, net of tax. The operating results for the discontinued operations were as follows:

	Six months ended June 30, 2013	Six months ended June 30, 2014	Three months ended June 30, 2013	Three months ended June 30, 2014
Revenue	$ 2,923	$	$ 1,441	$
Income (loss) before provision for income taxes	(50)	14	0	
Income tax expense (benefit)	(19)	5	0	
Discontinued operations, net of tax	$ (31)	$ 9	$ 0	$

The net cash proceeds from the sale were approximately $1.1 million. The net carrying value of liabilities assumed net of goodwill associated with the component sold was approximately $435,000 resulting in a net gain of $1.5 million from the sale. The sale includes contingent earn-out consideration payments that depend upon the achievement of certain thresholds and will be recognized as income when received.

(15) Subsequent Events

In July 2014, the Company s board of directors declared a regular quarterly dividend in the amount of $0.02 per share on the Company s Class A and Class B common stock. The Company will pay these dividends on August 15, 2014 to the holders of record as of the close of business on August 5, 2014. The Company expects to pay approximately $854,000 for these quarterly dividends.

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 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 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, 2013 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, 2013.

Overview

We are a mobile and call advertising technology company. We provide products and services for businesses of all sizes that depend on consumer calls to drive sales. Our technology platform delivers performance-based, pay-for-call advertising across numerous mobile and online publishers to connect millions of high-intent consumers with businesses over the phone. Our call analytics technology facilitates call quality, analyzes calls in real time and measures the outcomes of calls to close the loop between

Table of Contents

digital marketing and offline transactions. We help large national brands and small-and medium-sized businesses (SMBs) facilitate efficient and cost-effective marketing campaigns to drive calls and customer leads to their business. With our Archeo division, we provide performance-based pay-per-click advertising services that connect advertisers with consumers across our owned web sites as well as third party web sites.

Our technology-based products and services enable our customers to connect with consumers across leading third-party mobile and online channels, as well as our proprietary network of locally-focused web sites. 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 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 millions of small business customers. We execute these campaigns for them using our technology. Our primary products are as follows:

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 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 that block spam and other telemarketing calls while working to optimize the return on investment for advertisers marketing investment.

Marchex Call Analytics. Our Marchex Call Analytics technology platform provides data and insights that 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 creative 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 rich insights into what is happening during a call and to measure the outcome of calls and return on investment. Advertisers pay us a fee for each call they receive from call-based ads we distribute through our sources of call distribution or for each phone number tracked based on a pre-negotiated rate.

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 leading search engines. The lead services we offer to small business advertisers through our Local Leads platform include products typically available only to national advertisers, including pay-for-call, search marketing and presence management 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 percentage of the cost of every click or call delivered to their advertisers. Through our contract with Yellowpages.com LLC d/b/a AT&T Interactive which is a subsidiary of AT&T (collectively, AT&T), our arrangement with AT&T relates to a business unit that is included in YP Holdings, LLC (YP) that AT&T sold a majority stake in to a private equity third party in April 2012. YP is our largest reseller partner and was responsible for 22% and 21% of our total revenues for the three and six months ended June 30, 2014 of which the majority is derived from our local leads platform.

In addition to our call-driven business, we operate our Domains Marketplace through our Archeo division, which enables the buying, selling and development of premium domain names, and includes more than 200,000 of our owned and operated web sites. Our portfolio of websites contains more than 75,000 U.S. ZIP code sites, including 90210.com and covering ZIP code areas nationwide. Our Domains Marketplace also consists of other 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 and also make these domains available for sale to third parties.

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, as well as from the sale of domain names in our Domains Marketplace. During the six months ended June 30, 2013 and 2014, call-driven revenue was more than 90% of our revenues for both periods. We operate primarily in domestic markets. For details on revenue by segment and geographical area for the three months ended June 30, 2013 and 2014, 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.

Consolidated Statements of Operations

All 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. 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, we sold certain assets related to Archeo s pay per click advertising services. As a result, the operating results related to these certain pay-per-click assets are shown as discontinued operations 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 six months ended June 30, 2013 and 2014.

Revenue

We currently generate revenue through our call advertising services, pay-per-click advertising, local leads platform that include our call and click services, proprietary web site traffic, and domain name sales.

Our primary sources of revenue are the performance-based advertising services, which include call advertising, pay-per-click services, and cost-per-action services. These primary sources amounted to more than 77% of our revenues in all periods presented. Our secondary sources of revenue are our local leads platform, which enables partner resellers to sell call advertising and/or search marketing products, campaign management services, and starting in September 2013, domain name sales through our Domains Marketplace. These secondary sources amounted to less than 23% of our revenues in all periods presented. We have no barter transactions.

On September 10, 2013, we launched our Domains Marketplace, which provides domain names available for sale and initiated plans to facilitate the active buying and transacting of domain names. Domain name sales occurring after this launch have been recognized as revenue in the condensed consolidated financial statements. Historically, the sale of domain names were not a core operation of the Company and were peripheral to the generation of advertising revenue from domain names held for use, and as such, domain name sales were reported as gains on sales and disposals of intangible assets, net in the condensed consolidated financial statements.

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.

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 web sites, our portfolio of owned web sites, other targeted Web-based content and offline sources. 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 web sites or a third party web site in our distribution network to an advertiser web site and completes the specified action.

We generate revenue from reseller partners and publishers utilizing our local leads platform to sell call advertising and/or search marketing products. We are paid account fees and also agency fees for our products in the form of a percentage of the cost of every

Table of Contents

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.

Search Marketing Services and Other

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 the account fee or services relate to.

We generate revenue from domain name sales through our Domains Marketplace. Our Domains Marketplace was launched in September 2013 and provides domain names available for sale and initiated plans to facilitate the buying and transacting of domain names. Domain name sales occurring after the launch date are recognized as revenue.

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.

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 click-throughs 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 click-through. 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. 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. 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. Our quarterly results will also be impacted by the timing of domain name sales, which we began recognizing as revenue starting in September 2013 with the launch of our Domains Marketplace.

Service Costs

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

- user acquisition costs;
- amortization of intangible assets;

Table of Contents

- 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 Web sites;
- domain name registration renewal fees;
- domain name costs;
- network fees;
- fees paid to outside service providers;
- delivering customer service;
- depreciation of our Web sites, network equipment and internally developed software;
- colocation service charges of our Web site equipment;
- bandwidth and software license fees;
- payroll and related expenses of related personnel; and
- stock-based compensation of related personnel.

User Acquisition Costs

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

Table of Contents

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 in accordance with FASB ASC 350. This statement requires that costs incurred in the preliminary project and post-implementation stages of an internal use software project be expensed as incurred and that certain costs incurred in the application development stage of a project be capitalized.

General and Administrative

General and administrative expenses consist primarily of:

- payroll and related expenses for executive and administrative personnel;
- professional services, including accounting, legal and insurance;
- bad debt provisions;
- facilities costs;
- 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 consolidated statement of operations.

Amortization of Intangibles from Acquisitions

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

The intangible assets have been identified as:

- non-competition agreements;
- trade and Internet domain names;
- distributor relationships;
- advertising relationships;
- patents; and
- acquired technology.

These assets are amortized over useful lives ranging from 12 to 84 months.

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.

Table of Contents

As of June 30, 2014, we have net deferred tax assets of $24.3 million, relating to the impairment of goodwill, amortization of intangibles assets, certain other temporary differences, federal and state net operating loss (NOL) carryforwards, and research and development credits. During the first quarter of 2014, we adopted ASU 2011-13 whereby we reclassed uncertain tax positions of $534,000 from other non-current liabilities against our deferred tax assets. At December 31, 2013 and June 30, 2014, our valuation allowance was $23.0 million and $23.1 million, respectively, against our federal, state, city and foreign net deferred tax assets, as we believe it is more likely than not that these benefits will not be realized.

Each reporting period we must assess the likelihood that our deferred tax assets will be recovered from existing deferred tax liabilities or future taxable income, and to the extent that realization is not more likely than not, a valuation allowance must be established. The establishment of a valuation allowance and increases to such an allowance may result in either an increase to income tax expense or a reduction of income tax benefit in the statement of operations. Although realization is not assured, we believe it is more likely than not, based on operating performance, existing deferred tax liabilities, projections of future taxable income and tax planning strategies, that our net deferred tax assets, excluding certain state and foreign NOL carryforwards, will be realized. In determining that it is more likely than not that our deferred tax assets will be realized, factors considered included: historical taxable income, historical trends related to advertiser usage rates, projected revenues and expenses, macroeconomic conditions and issues facing our industry, existing contracts, our ability to project future results and any appreciation of our other assets.

The majority of the net deferred tax assets are from goodwill and intangible assets recorded in connection with various acquisitions that are tax-deductible over 15 year periods. Based on projections of future taxable income and tax planning strategies, we expect to be able to recover these assets. The amount of the net deferred tax assets considered realizable, however, could be reduced in the near term if our projections of future taxable income are reduced or if we do not perform at the levels we are projecting. This may result in increases to the valuation allowance for deferred tax assets and may increase income tax expense of up to the entire net amount of deferred tax assets.

As of June 30, 2014, based upon both positive and negative evidence available, we have determined it is not more likely than not that certain deferred tax assets primarily relating to NOL carryforwards in certain state, city, and foreign jurisdictions will be realizable and accordingly, have recorded a 100% valuation allowance of $6.0 million 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. Should we determine in the future that we will be able to realize these deferred tax assets, or not be able to realize all or part of our remaining net deferred tax assets recorded as of June 30, 2014, an adjustment to the net deferred tax assets would impact net income or stockholders equity in the period such determination was made.

As of June 30, 2014, we have federal NOL carryforwards of $12.7 million, of which $4.4 million were acquired as part of the Jingle acquisition. In connection with the 2011 Jingle acquisition, we acquired federal NOL carryforwards. 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. We recorded acquired 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 and the remaining NOL carryforwards start expiring in 2032.

In addition, we had 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 approximately $1.7 million of NOL carryforwards is 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.

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.

Table of Contents

Results of Operations

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

	Six Months Ended June 30,		Three Months Ended June 30,	
	2013	2014	2013	2014
Revenue	100%	100%	100%	100%
Expenses:				
Service costs	59%	65%	60%	65%
Sales and marketing	8%	6%	8%	6%
Product development	19%	15%	18%	15%
General and administrative	14%	11%	15%	11%
Amortization of intangible assets from acquisitions	2%	0%	2%	0%
Acquisition and separation related costs	1%	0%	1%	0%
Total operating expenses	103%	97%	104%	97%
Gain on sales and disposals of intangible assets, net	3%		4%	
Income (loss) from operations	0%	3%	(0%)	3%
Other income (loss)	(0%)	(0%)	(0%)	(0%)
Income (loss) before provision for income taxes	0%	3%	(0%)	3%
Income tax expense	0%	1%	1%	1%
Net income (loss) from continuing operations	(0%)	2%	(1%)	2%
Discontinued operations, net of tax	(0%)	0%	0%	
Net income	(0%)	2%	(1%)	2%
Dividends paid to participating securities		0%		0%
Net income (loss) applicable to common stockholders	(0%)	2%	(1%)	2%

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 phone calls; and (2) the Archeo segment, which is comprised of our click-based advertising and Internet domain name businesses.

In July 2013, we sold certain assets related to Archeo s pay per click advertising services. As a result, the operating results related to these certain pay per click assets 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* in the notes to the condensed consolidated financial statements for further discussion.

Table of Contents

In September 2013, we launched our Domains Marketplace, which provides domain names available for sale and initiated plans to facilitate the buying and transacting of domain names. Domain name sales occurring after this launch are recognized as revenue with corresponding costs under service costs. Prior to this, domain name transactions were recognized in gain/loss on sale and disposal of intangible assets, net in the condensed consolidated financial statements.

	Six months ended June 30,		Three months ended June 30,	
	2013	2014	2013	2014
Call-driven				
Revenue	$ 65,001	$ 91,349	$ 33,893	$ 45,857
Operating Expenses	62,122	86,041	32,384	42,960
Segment profit	$ 2,879	$ 5,308	$ 1,509	$ 2,897
Archeo				
Revenue	$ 7,309	$ 8,823	$ 3,685	$ 3,819
Operating Expenses	5,725	4,618	2,973	1,925
Gain on sale of intangible assets, net	2,691		1,329	
Segment profit	$ 4,275	$ 4,205	$ 2,041	$ 1,894
Reconciliation of segment profit from operations to income (loss) from continuing operations before provision for income taxes:				
Total segment profit	$ 7,154	$ 9,513	$ 3,550	$ 4,791
Less reconciling items:				
Stock based compensation	4,510	6,000	2,603	3,117
Amortization of intangible assets from acquisitions	1,791	434	736	31
Acquisition and separation related costs	654	(68)	309	(68)
Other expense (income)	29	24	12	22
Income (loss) from continuing operations before provision for income taxes	$ 170	$ 3,123	$ (110)	$ 1,689

	Six months ended June 30,		Three months ended June 30,	
	2013	2014	2013	2014
Reconciliation of segment revenue to consolidated revenue				
Call-driven	$ 65,001	$ 91,349	$ 33,893	$ 45,857
Archeo	7,309	8,823	3,685	3,819
Total	$ 72,310	$ 100,172	$ 37,578	$ 49,676

Comparison of the Three months ended June 30, 2013 to the Three months ended June 30, 2014 and the Six months ended June 30, 2013 to the Six months ended June 30, 2014.

Revenue

Revenue increased 32% from $37.6 million for the three months ended June 30, 2013 to $49.7 million in the same period in 2014. Revenue increased 39% from $72.3 million for the six months ended June 30, 2013 to $100.2 million in the same period in 2014. The increases were due primarily to an increase in our call-driven revenues.

Our Call-driven revenues increased 35% from $33.9 million for the three months ended June 30, 2013 to $45.9 million in the same period in 2014. Our Call-driven revenues increased 41% from $65.0 million for the six months ended June 30, 2013 to $91.3 million in the same period in 2014. The increases were primarily due to an increase in national advertiser budgets and thousands of additional small business accounts utilizing our call analytics platform.

Our Archeo revenues were $3.7 million and $3.8 million for the three months ended June 30, 2013 and 2014, respectively. Archeo revenues for the three months ended June 30, 2014 included domain name revenues of $2.2 million with no comparable revenue in 2013. Domain name transactions totaled $1.3 million for the three months ended June 30, 2013 and were recognized as gain/loss on sale of intangible assets, net. Archeo revenues increased 21% from $7.3 million for the six months ended June 30, 2013 to $8.8 million in the same period in 2014. Archeo revenue for the six months ended June 30, 2014, included domain name revenues of $4.1 million that had no comparable revenues in the same period in 2013. Domain name transactions totaled $2.7 million for the six months ended June 30, 2013 and were recognized as gain/loss on sale of intangible assets, net. The Archeo domain name revenues were primarily offset by a decrease in revenues from our cost-per-actions from resellers related to our local search and directory web sites, our pay-per-click listings revenue and presence management due to fewer advertisers utilizing our services and lower advertiser spend amounts on our pay-per-click listings.

Table of Contents

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

	Six months ended June 30,		Three months ended June 30,	
	2013	2014	2013	2014
Partner and Other Revenue Sources	$ 68,332	$ 93,390	$ 35,491	$ 46,520
Proprietary Web site Traffic Sources and Domain Names	3,978	6,782	2,087	3,156
Total Revenue	$ 72,310	$ 100,172	$ 37,578	$ 49,676

Our 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 engine applications, directories, destination sites, shopping engines, third party Internet domains or web sites, other targeted Web-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 web sites or a third party web site in our distribution network to an advertiser web site and completes the specified action. Other revenues include our call provisioning and call tracking services, presence management services, campaign management services and outsourced search marketing platforms. The partner and other revenues increased 31% from $35.5 million for the three months ended June 30, 2013 to $46.5 million in the same period in 2014. The partner and other revenues increased 37% from $68.3 million for the six months ended June 30, 2013 to $93.4 million in the same period in 2014. The increases in both periods were primarily due to an increase in our call-driven revenues offset partially by a decrease in our pay-per-click listings revenues and presence management due to fewer advertisers utilizing our services and lower advertiser spend amounts on our pay-per-click listings.

Our proprietary web site traffic revenues are generated from our portfolio of owned web sites, which are monetized with pay-for-call or pay-per-click listings that are relevant to the web sites, as well as other forms of advertising, including banner advertising and sponsorships. When an online user navigates to one of our web sites and calls or clicks on a particular listing or completes the specified action, we receive a fee. We also generate revenue from domain name sales. Our proprietary web site traffic and domain name revenues increased $1.1 million from $2.1 million for the three months ended June 30, 2013 to $3.2 million in the same period in 2014. This increase was primarily due to domain name sales of $2.2 million that had no comparable revenue in 2013. For the three months ended June 30, 2013, domain name transactions totaled $1.3 million and were recognized as gain/loss on sale of intangible assets. This increase was offset partially by a $981,000 decrease in revenues for cost-per-actions due to lower budgets from resellers related to our local search and directory web sites. The increase was also offset to a lesser extent by a decrease in revenues generated from our pay-per-click listings on our web sites due to lower click-throughs. Our proprietary web site traffic and domain name revenues increased $2.8 million from $4.0 million for the three months ended June 30, 2013 to $6.8 million in the same period in 2014. This increase was primarily due to domain name sales of $4.1 million that had no comparable revenue in 2013. For the six months ended June 30, 2013, domain name transactions totaled $2.7 million and were recognized as gain/loss on sale of intangible assets. This increase was offset partially by a $1.0 million decrease in revenues for cost-per-actions due to lower budgets from resellers related to our local search and directory web sites. The increase was also offset to a lesser extent by a decrease in revenues generated from our pay-per-click listings on our web sites due to lower click-throughs.

Our arrangement with AT&T relates to a business unit that is included in YP Holdings, LLC that AT&T sold a majority stake in to a private equity third party in April 2012. Under our primary arrangement with YP, we generate revenues from our local leads platform to sell call advertising and /or search marketing packages through their existing sales channels, which are then fulfilled by us across our distribution network. We are paid account fees and agency fees for our products in the form of a percentage of the cost of every call or click delivered to their advertisers. In the second quarter of 2010, we signed an extension of our arrangement with YP through June 30, 2015 that includes certain provisions for new advertiser accounts and contemplated the migration of several thousand existing advertiser accounts. In July 2013, we amended our arrangement with YP, which lowered certain agency fees beginning July 1, 2013 through the end of the term. We also extended a separate pay-for-call relationship through June 2015. To the extent our revenues from large national advertisers grow at a faster rate than from YP small business accounts, our revenues from YP as a percentage of our total revenue may decrease. Additionally, YP s small business account base from their traditional business has declined, and to the extent declines occur in their business or to the extent YP decreases the number of new advertiser accounts with us, it may result in fewer small business accounts and related revenues on our platform. There can be no assurance that our business with them in the future will continue at or near current levels. YP accounted for 24% and 22% of total revenues during the three months ended June 30, 2013 and 2014, respectively. Our arrangement with Allstate Insurance Company (Allstate) is for call advertising services, which accounted for 11% and 33% of total revenues during the three months ended June 30, 2013 and 2014, respectively. Our primary arrangement with Allstate in 2014 is for pay-for-call services within our Call Marketplace whereby we charge an agreed-upon price for qualified calls or leads from our network. Allstate s budgeted spend amounts are generally higher in the first half of the year compared to the latter part of the year. There can be no assurance that our business with YP and Allstate in the future will continue at or near current levels.

Our ability to maintain and grow our revenues will depend in part on maintaining and increasing the number of phone calls and click-throughs performed by users of our service through our distribution partners and proprietary web site traffic sources and maintaining and increasing the number and volume of transactions and favorable variable payment terms with advertisers and advertising services providers, which we believe is dependent in part on marketing our web sites and delivering high quality traffic that ultimately results in purchases or conversions for our advertisers and advertising services providers. We may increase our direct monetization of our proprietary traffic sources, which may not be at the same rate levels as other advertising providers and could adversely affect our revenues and results of operations. Companies distributing advertising through the Internet and mobile sources have experienced, and will likely to continue experience consolidation. If we do not add new distribution partners, renew our current distribution partner agreements or 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 traffic volumes could materially and adversely affect our revenue and results of operations. In addition, our ability to maintain and grow revenues will also depend on maintaining and growing the number of domain name sales and the average revenue per domain. If we are unable to attract prospective buyers to purchase domains and at the price we value the domains, our revenue and results of operations could be materially and adversely affected.

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 click-throughs 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 click-through. With the recognition of domain name sales in revenue, it will be difficult to predict the number of domains that may be sold or the average revenue per domain sale. Domains sold have been through negotiated transactions and it may be difficult to determine the value of a domain to a prospective buyer. It is also difficult to anticipate the impact of worldwide economic conditions on advertising budgets.

In addition, we believe we will experience seasonality with our business. 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 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. 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 will impact our quarterly results of operations in addition to the typical seasonality seen in our industry. Our quarterly results will also be impacted by the timing of domain name sales which we began recognizing as revenue starting in September 2013 with the launch our Domains Marketplace.

Expenses

Expenses were as follows (in thousands):

	Six months ended June 30,				Three months ended June 30,			
	2013	% of revenue	2014	% of revenue	2013	% of revenue	2014	% of revenue
Service costs	$ 42,732	59%	$ 64,673	65%	$ 22,584	60%	$ 32,319	