

MARKETWATCH INC
Form 10-Q
November 12, 2004
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2004

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 000-50562

MARKETWATCH, INC.

(Formerly MarketWatch.com, Inc.)

Edgar Filing: MARKETWATCH INC - Form 10-Q

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE
(State or Other Jurisdiction of
Incorporation or Organization)

27-0064104
(I.R.S. Employer
Identification Number)

825 Battery Street, San Francisco, California 94111

(Address of Principal Executive Offices)

Registrant's Telephone Number, Including Area Code: (415) 733-0500

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

Indication by check mark whether the registrant is an accelerated filer (as defined by Rule 12b-2 of the Exchange Act): YES NO

The number of shares of the registrant's Common Stock outstanding as of November 1, 2004 was 25,905,396.

Table of Contents

MARKETWATCH, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE PERIOD ENDED SEPTEMBER 30, 2004

TABLE OF CONTENTS

	<u>Page No.</u>
<u>PART I. FINANCIAL INFORMATION</u>	
Item 1. <u>Interim Condensed Consolidated Financial Statements:</u>	
<u>Condensed Consolidated Balance Sheets at September 30, 2004 (unaudited) and December 31, 2003</u>	3
<u>Unaudited Condensed Consolidated Statements of Operations for the three months ended September 30, 2004 and September 30, 2003, and the nine months ended September 30, 2004 and September 30, 2003</u>	4
<u>Unaudited Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2004 and September 30, 2003</u>	5
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	13
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	30
Item 4. <u>Controls and Procedures</u>	31
<u>PART II. OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	31
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	33
Item 6. <u>Exhibits</u>	33
<u>SIGNATURES</u>	34
<u>INDEX TO EXHIBITS</u>	35

Table of Contents**Part I FINANCIAL INFORMATION****ITEM 1. INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****MarketWatch, Inc.****Condensed Consolidated Balance Sheets**

(in thousands)

	<u>September 30, 2004</u>	<u>December 31, 2003</u>
	<u>(unaudited)</u>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 56,383	\$ 48,079
Restricted cash	920	
Accounts receivable, net	12,687	7,022
Prepaid expenses	2,298	685
	<u>72,288</u>	<u>55,786</u>
Total current assets	72,288	55,786
Property and equipment, net	3,844	4,387
Goodwill	88,389	22,429
Intangibles, net	6,973	
Prepaid acquisition costs		2,498
Restricted cash, net of current portion	175	
Other assets	1,165	128
	<u>172,834</u>	<u>85,228</u>
Total assets	\$ 172,834	\$ 85,228
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 4,590	\$ 1,216
Accrued expenses	11,535	6,605
Capital lease obligations	487	
Deferred revenue	7,058	1,377
	<u>23,670</u>	<u>9,198</u>
Total current liabilities	23,670	9,198
Other liabilities	1,095	865
	<u>24,765</u>	<u>10,063</u>
Total liabilities	24,765	10,063
Stockholders' equity:		
Preferred stock		
Common stock	254	180
Additional paid-in capital	394,276	323,141
Deferred stock-based compensation	(37)	

Edgar Filing: MARKETWATCH INC - Form 10-Q

Accumulated comprehensive loss	(15)	
Accumulated deficit	(246,409)	(248,156)
	<hr/>	<hr/>
Total stockholders' equity	148,069	75,165
	<hr/>	<hr/>
Total liabilities and stockholders' equity	\$ 172,834	\$ 85,228
	<hr/>	<hr/>

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Table of Contents**MarketWatch, Inc.****Unaudited Condensed Consolidated Statements of Operations**

(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net revenues:				
Advertising	\$ 7,145	\$ 5,907	\$ 22,812	\$ 16,481
Licensing	12,113	5,214	33,578	16,176
Subscription	516	455	1,389	1,137
Total net revenues	19,774	11,576	57,779	33,794
Cost of net revenues	6,247	4,508	17,958	13,137
Gross profit	13,527	7,068	39,821	20,657
Operating expenses:				
Product development	4,498	1,444	13,485	5,040
General and administrative	4,416	2,812	12,897	8,542
Sales and marketing	3,641	2,534	11,292	7,439
Amortization of intangibles	148		709	
Total operating expenses	12,703	6,790	38,383	21,021
Income (loss) from operations	824	278	1,438	(364)
Interest income, net of expense	154	115	363	384
Provision for income taxes	(29)		(54)	(3)
Net income	\$ 949	\$ 393	\$ 1,747	\$ 17
Basic net income per share	\$ 0.04	\$ 0.02	\$ 0.07	\$ 0.00
Diluted net income per share	\$ 0.04	\$ 0.02	\$ 0.07	\$ 0.00
Shares used in the calculation of basic net income per share	25,190	17,382	24,427	17,267
Shares used in the calculation of diluted net income per share	26,833	18,754	26,468	18,503

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Table of Contents**MarketWatch, Inc.****Unaudited Condensed Consolidated Statements of Cash Flows**

(in thousands)

	Nine Months Ended September 30,	
	2004	2003
Cash flows from operating activities:		
Net income	\$ 1,747	\$ 17
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for (recovery of) doubtful accounts	282	(66)
Depreciation and amortization	3,669	2,883
Non-cash charges from stockholder		56
Amortization of deferred stock compensation	17	
Loss on disposal of equipment	2	
Changes in operating assets and liabilities, net of acquired amounts:		
Accounts receivable	(5,422)	(374)
Prepaid expenses and other assets	(776)	(540)
Accounts payable and accrued expenses	4,246	1,571
Deferred revenue	586	547
Net cash provided by operating activities	4,351	4,094
Cash flows used in investing activities:		
Purchase of property and equipment	(513)	(778)
Decrease in restricted cash	850	
Acquisition of business, net of cash acquired	(5,950)	(313)
Net cash used in investing activities	(5,613)	(1,091)
Cash flows provided by financing activities:		
Principal payments under capital lease obligations	(586)	
Issuance of common stock	10,167	1,524
Net cash provided by financing activities	9,581	1,524
Effect of exchange rate changes on cash and cash equivalents	(15)	
Net change in cash and cash equivalents	8,304	4,527
Cash and cash equivalents at the beginning of the period	48,079	43,328
Cash and cash equivalents at the end of the period	\$ 56,383	\$ 47,855
Supplemental disclosure of non-cash investing activity:		
Acquisition cost for Pinnacor included in prepaid expenses and accounts payable	\$	\$ 686

Edgar Filing: MARKETWATCH INC - Form 10-Q

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Table of Contents

MarketWatch, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

Note 1 - Organization and Nature of Business

The Company

MarketWatch, Inc. (the Company), is a leading multi-media publisher of business and financial news and provider of information and analytical tools. It was formed on October 29, 1997 in the state of Delaware as a limited liability company and was jointly owned by Data Broadcasting Corporation (DBC), now known as Interactive Data Corporation (IDC), and CBS Broadcasting Inc. (CBS), with each member owning a 50% interest in the Company. In January 1999, the Company reorganized as a corporation and completed an initial public offering of 3,162,500 shares of common stock. After the initial public offering, CBS and IDC each owned approximately 38% of the Company. In January 2001, an affiliate of Pearson plc (Pearson) acquired IDC's complete stake in the Company. On January 16, 2004, the Company completed the acquisition of Pinnacor Inc. (Pinnacor), formerly known as ScreamingMedia, a provider of information services and analytical applications to financial services companies and global corporations. After the acquisition, CBS and Pearson each owned approximately 24% of the Company. On August 4, 2004, the Company changed its name from MarketWatch.com, Inc. to MarketWatch, Inc.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of the Company, the interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods. The results of operations for the three and nine months ended September 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004 or for any future period. The balance sheet at December 31, 2003 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. These consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

During the nine months ended September 30, 2004 the Company re-classified certain liabilities previously disclosed as short term liabilities and liabilities previously disclosed in accounts payable into other liabilities and accrued expenses, respectively. Prior periods have been adjusted to be comparable with the current period presentation.

Note 2 - Stock-Based Compensation

The Company accounts for its stock-based employee compensation agreements in accordance with the provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and its related interpretations, and has adopted the disclosure-only alternative of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123), as amended by Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, an Amendment of FASB Statement No. 123. In accounting for stock-based transactions with non-employees, the Company records compensation expense in accordance with SFAS No. 123 and Emerging Issues Task Force 96-18, Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services.

The following table illustrates the effect on income and earnings per share if the Company had applied the fair-value recognition provisions of SFAS No. 123 to stock-based employee compensation. The estimated fair value of each Company option is calculated using the Black-Scholes option-pricing model.

Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net income:				
As reported	\$ 949	\$ 393	\$ 1,747	\$ 17
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	5		17	
Deduct: Stock-based employee compensation expense determined under fair value based method, net of related tax effects	(868)	(646)	(2,302)	(2,091)
Pro forma net income (loss)	\$ 86	\$ (253)	\$ (538)	\$ (2,074)
Net income (loss) per share:				
As reported, basic	\$ 0.04	\$ 0.02	\$ 0.07	\$ 0.00
As reported, diluted	\$ 0.04	\$ 0.02	\$ 0.07	\$ 0.00
Pro forma net income (loss) per share, basic	\$ 0.00	\$ (0.01)	\$ (0.02)	\$ (0.12)
Pro forma net income (loss) per share, diluted	\$ 0.00	\$ (0.01)	\$ (0.02)	\$ (0.12)

The Company calculated the fair value compensation expense associated with its stock-based employee compensation plans using the Black-Scholes model. The following weighted average assumptions were used related to option grants:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Stock Options				
Expected dividend	0%	0%	0%	0%
Risk-free interest rate	3.1%	1.9%	2.8%	2.3%
Expected volatility	54%	55%	52%	73%
Expected life (in years)	4	4	4	4
Employee Stock Purchase Plan				
Expected dividend	0%	0%	0%	0%
Risk-free interest rate	1.8%	1.2%	1.4%	1.4%
Expected volatility	58%	60%	51%	76%
Expected life (in months)	6	6	6	6

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's stock options have characteristics significantly different from those of traded options, and because changes with respect to the subjective assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock options.

Because additional stock options are expected to be granted each year, the above pro forma disclosures are not representative of pro forma effects on reported financial results for future periods.

Note 3 - Net Income Per Share

The Company computes net income per share in accordance with Statement of Financial Accounting Standards No. 128, Earnings Per Share (SFAS No. 128). Under the provisions of SFAS No. 128, basic net income per common share

Table of Contents

(Basic EPS) is computed by dividing net income by the weighted average number of common shares outstanding. Diluted net income per common share (Diluted EPS) is computed by dividing net income by the weighted average number of common shares and dilutive common share equivalents.

Common equivalent shares of 1,637,406 and 1,372,061 were included in the computation of diluted net income per share for the three months ended September 30, 2004 and 2003, respectively, and 2,040,932 and 1,236,108 were included in the computation of diluted net income per share for the nine months ended September 30, 2004 and 2003, respectively. The common equivalent shares were related to shares issuable upon the exercise of stock options. Options to purchase 522,486 and 407,671 shares of common stock were excluded from the computation of diluted net loss per share for the three and nine months ended September 30, 2004, respectively, as the inclusion would have been anti-dilutive.

Note 4 - Acquisitions

On January 16, 2004, the Company completed the acquisition of Pinnacor Inc. Under the terms of the agreement, a new company (Holdco) with two wholly-owned subsidiaries, Pine Merger Sub, Inc. (Pine Merger Sub) and Maple Merger Sub, Inc. (Maple Merger Sub), were formed to combine the businesses of the Company and Pinnacor. Each Company stockholder received one share of Holdco common stock for each share of the Company common stock held by such stockholder. Each Pinnacor stockholder received either \$2.42 in cash or 0.2659 of a share of Holdco common stock for each share of Pinnacor common stock held by such stockholder, subject to proration. Upon closing of the acquisition, Maple Merger Sub merged with and into MarketWatch, which was the surviving corporation, and Pine Merger Sub merged with and into Pinnacor, which was the surviving corporation. MarketWatch and Pinnacor became a wholly-owned subsidiary of Holdco, which was renamed MarketWatch.com, Inc. MarketWatch, one of Holdco's operating subsidiaries after the merger, was renamed MarketWatch Media, Inc. and Pinnacor, the other Holdco operating subsidiary after the merger, continued to be named Pinnacor Inc. Shortly after the acquisition, each of MarketWatch Media, Inc. and Pinnacor Inc. merged into MarketWatch.com, Inc. On August 4, 2004, the Company changed its name from MarketWatch.com, Inc. to MarketWatch, Inc.

The purchase price of \$107.7 million was determined as follows (in thousands):

Fair value of common stock	\$ 53,676
Fair value of options and warrants	6,718
Cash	44,002
Direct transaction costs	3,342
	<u> </u>
	<u>\$ 107,738</u>

The fair value of the common stock was determined based on 6,141,435 shares of the Company common stock issued and priced using the average market price of the common stock over the five-day period surrounding the date the acquisition was announced in July 2003. The fair value of the Company's stock options and warrants issued was determined using the Black-Scholes option-pricing model. The following assumptions were used to perform the calculations: expected life of 48 months for options and a remaining contractual life of eight to ten months for warrants, risk-free interest rate of 1.51%, expected volatility of 60% and no expected dividend yield.

The preliminary allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values was as follows (in thousands):

Edgar Filing: MARKETWATCH INC - Form 10-Q

Cash acquired	\$ 41,270
Other tangible assets acquired	6,661
Amortizable intangible assets:	
Developed technology	4,050
Acquired customer base	3,750
In-process research and development	300
Goodwill	65,960
	<u>121,991</u>
Liabilities assumed	(14,307)
Deferred stock-based compensation	54
	<u>54</u>
Total	<u>\$ 107,738</u>

Table of Contents

The assets will be amortized over a period of years shown on the following table:

Developed technology	4 years
Acquired customer base	7 years
Fixed assets acquired	1 to 5 years

A preliminary estimate of \$65.4 million has been allocated to goodwill and adjustments made to goodwill at September 30, 2004 increased the balance to \$66.0 million (See Note 5). Goodwill represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired, and is not deductible for tax purposes. Goodwill will not be amortized and will be tested for impairment, at least annually. The purchase price allocation for Pinnacor is subject to revision as more detailed analysis is completed and additional information on the fair value of Pinnacor's assets and liabilities becomes available. Any change in the fair value of the net assets of Pinnacor will change the amount of the purchase price allocable to goodwill.

The following attributes of the combination of the two businesses were considered significant factors to the establishment of the purchase price, resulting in the recognition of goodwill:

Pinnacor's acquired technology included certain additional products that would allow the combined company to develop more comprehensive products and pursue expanded market opportunities.

The ability to hire the Pinnacor workforce, which included a significant number of experienced engineering, development and technical staff with specialized knowledge of the sector in which the combined company operates.

Potential operating synergies are anticipated to arise, including cost savings from the elimination of redundant data content provision, data center operations and expenses associated with operating as a public company and limited reductions in overlapping staffing positions and general facility costs.

The following unaudited pro forma information presents a summary of the results of operations of the Company assuming the acquisition of Pinnacor occurred on January 1, 2003, respectively (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net revenues	\$ 19,774	\$ 19,922	\$ 58,646	\$ 58,922
Net income (loss)	\$ 949	\$ (590)	\$ 1,719	\$ (1,809)
Net income (loss) per share:				
Basic	\$ 0.04	\$ (0.03)	\$ 0.07	\$ (0.08)
Diluted	\$ 0.04	\$ (0.03)	\$ 0.06	\$ (0.08)

Note 5 - Goodwill and Intangible Assets*Intangible Assets*

Intangible assets consisted of the following (in thousands):

	September 30, 2004		
	Gross Carrying Amount	Accumulated Amortization	Net Intangible Assets
Developed technology	\$ 4,214	\$ 747	\$ 3,467
Acquired customer base	3,915	409	3,506
	<u>\$ 8,129</u>	<u>\$ 1,156</u>	<u>\$ 6,973</u>

Table of Contents

The fair value underlying the \$300,000 assigned to in-process research and development (IPR&D) from the Pinnacor acquisition was expensed immediately during the quarter ended March 31, 2004 as amortization of intangibles and was determined by identifying the research projects in areas which technological feasibility had not been established and there was no alternative future use. Intangibles for developed technology and acquired customer base are being amortized over a period of 4 to 7 years, respectively. The amortization expense related to identifiable intangible assets is expected to be \$1.9 million for the year ending December 31, 2004 and \$1.7 million, \$1.7 million, \$1.6 million and \$578,000 for the years ending December 31, 2005, 2006, 2007 and 2008, respectively and \$1.0 million thereafter. The weighted average amortization period is 4 and 6.8 years for developed technology and acquired customer base, respectively.

Goodwill

Goodwill consisted of the following (in thousands):

Balance at December 31, 2003	\$ 22,429
Goodwill acquired during period	65,425
Goodwill adjustments pertaining to preliminary purchase price allocation	535
	<hr/>
Balance at September 30, 2004	\$ 88,389
	<hr/>

The increase in goodwill at September 30, 2004 was due to the acquisition of Pinnacor on January 16, 2004 (See Note 4). The goodwill adjustments were primarily related to the recognition of additional liabilities, offset by an increase in the estimated value of a marketable security, both as a result of the Pinnacor acquisition.

Note 6 - Related Party Transactions

Under its license agreement with CBS, the Company expensed \$810,000 and \$746,000 for the three months ended September 30, 2004 and 2003, respectively, and \$1.8 million and \$2.2 million for the nine months ended September 30, 2004 and 2003, respectively, related to the licensing of CBS news content and trademarks. In addition, the Company recorded advertising expenses of \$0 at rate card value for the three months ended September 30, 2004 and 2003, and \$0 and \$56,000 for the nine months ended September 30, 2004 and 2003, respectively, for in-kind advertising and promotion provided by CBS. Rental payments to CBS for leasing of certain facilities were \$315,000 and \$320,000 for the three months ended September 30, 2004 and 2003, respectively, and \$937,000 and \$949,000 for the nine months ended September 30, 2004 and 2003, respectively.

Licensing revenues from FT.com and Financial Times, subsidiaries of Pearson plc, were \$329,000 and \$367,000 for the three months ended September 30, 2004 and 2003, respectively, and \$1.1 million and \$1.2 million for the nine months ended September 30, 2004 and 2003, respectively. The Company recognized costs to IDC of \$136,000 and \$119,000 for the three months ended September 30, 2004 and 2003, respectively, and \$484,000 and \$516,000 for the nine months ended September 30, 2004 and 2003, respectively, for data feeds. In March 2003, IDC purchased Comstock, Inc. and the Company expensed \$491,000 for the three months ended September 30, 2004 and \$1.4 million for the nine months ended September 30, 2004 for data feeds from Comstock, Inc. Direct charges for subscription revenues for certain IDC data feeds were \$5,000 and \$9,000 for the three months ended September 30, 2004 and 2003, respectively, and \$18,000 and \$30,000 for the nine months ended September 30, 2004 and 2003, respectively. In addition, the Company recognized revenues of \$602,000 and \$610,000 for the three months ended September 30, 2004 and 2003, respectively, and \$1.9 million for the nine months ended September 30, 2004 and 2003 from television and radio programming on CBS stations. The Company recognized costs to CBS of \$333,000 and \$337,000 for the three months

Edgar Filing: MARKETWATCH INC - Form 10-Q

ended September 30, 2004 and 2003, respectively, and \$1.0 million and \$923,000 for the nine months ended September 30, 2004 and 2003, respectively, for production of television and radio programming.

At September 30, 2004 and December 31, 2003, \$7,000 and \$453,000, respectively, were included in accounts receivable for radio and television revenue due from CBS. In addition, \$7,000 and \$11,000, respectively, were included in the Company's accounts receivable related to licensing and subscription revenues due from IDC, and \$102,000 and \$92,000, respectively, were included in the Company's accounts receivable related to licensing revenues due from FT.com and Financial Times, subsidiaries of Pearson plc. At September 30, 2004 and December 31, 2003, the Company had a liability of \$1.0 million and \$972,000, respectively, recorded for CBS royalty fees, a liability of \$286,000 and \$266,000, respectively, owed to CBS for television production and facilities costs, and a liability of \$654,000 and \$203,000, respectively, to IDC and Comstock, Inc. for data feeds.

Table of Contents

Note 7 - Segment Reporting

The Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information, establishes standards for reporting information about operating segments in a company's financial statements. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The Company operates in one reportable segment.

Note 8 - Litigation and Asserted Claims

In 2001, several plaintiffs filed class action lawsuits in federal court against the Company, certain of its current and former officers and directors and its underwriters in connection with its January 1999 initial public offering. The complaints generally assert claims under the Securities Act, the Exchange Act and rules promulgated by the Securities and Exchange Commission. The complaints seek class action certification, unspecified damages in an amount to be determined at trial, and costs associated with the litigation, including attorneys' fees. The action against the Company is being coordinated with approximately three hundred other nearly identical actions filed against other companies. On June 25, 2003, a committee of the Company's board of directors approved a Memorandum of Understanding (MOU), which has now been memorialized in a settlement agreement and related agreements that set forth the terms of a settlement between the Company, the plaintiff class and a vast majority of the other approximately 300 issuer defendants. Among other provisions, the settlement provides for a release of the Company and the individual defendants for the conduct alleged in the action to be wrongful. The Company would agree to undertake certain responsibilities, including agreeing to assign, not assert, or release certain potential claims the Company may have against its underwriters. No estimate can be made of the possible loss or possible range of losses associated with the resolution of this matter and it is anticipated that any potential financial obligation of the Company to plaintiffs pursuant to the terms of the settlement agreement and related agreements will be covered by existing insurance. Therefore, the Company does not expect that the settlement will involve any material payment by the Company and no liability associated with these lawsuits has been recorded at September 30, 2004. The settlement agreement has been submitted to the Court for approval. Approval by the Court cannot be assured. On October 13, 2004, the Court certified a class in six of the approximately 300 other nearly identical actions and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. Plaintiffs have not yet moved to certify a class in the Company's case.

On June 7, 2002, an action was commenced against Pinnacor alleging a breach of contract claim and, as amended, sought damages in the amount of \$290,280. On February 7, 2003, Pinnacor filed counterclaims against the plaintiff for breach of contract, breach of warranty and misrepresentation. Motions for summary judgment were filed in early 2003. These motions are still pending. The Company has established an appropriate accrual based on the expected outcome of the legal proceeding and does not expect the ultimate resolution of the claim to have a material impact on the balance sheet, results of operations and cash flows.

On July 24, 2003, a shareholder class action lawsuit was filed against Pinnacor, Pinnacor's then-current directors, a then-current Pinnacor officer, and the Company in the Delaware Court of Chancery. The lawsuit alleged that Pinnacor's directors breached their fiduciary duties in proceeding with the acquisition by agreeing to an inadequate proposed purchase price and alleged that the Company aided and abetted these breaches of fiduciary duty in some unspecified way. The parties have settled the action, pursuant to which the Company has paid plaintiff's counsel \$300,000 in attorney's fees and \$15,000 in actual costs. The action has been dismissed with prejudice and all defendants have been released from liability. The Company has accrued the costs associated with this matter as of September 30, 2004 and the fees were paid in October 2004.

On September 8, 2003, an action was commenced in the Supreme Court of the State of New York against Tendagio, Inc. (formerly Inlumen, Inc.), Pinnacor and several unnamed defendants. The lawsuit alleged a breach of contract claim and a fraudulent conveyance claim. In April 2004, the Company served upon the plaintiff its cross motion for summary judgment seeking dismissal of the complaint with prejudice. In May

Edgar Filing: MARKETWATCH INC - Form 10-Q

2004, the Company was served with plaintiff's cross motion seeking dismissal of the action in its entirety, without prejudice, or alternatively, additional time to respond to defendant's summary judgment motions. In July 2004, the parties settled the action, pursuant to which the action has been dismissed with prejudice, all defendants have been released from liability and the Company has no financial obligation to the plaintiff.

On October 18, 2004, an action was commenced in the United States District Court for the Southern District of New York against the Company. The lawsuit alleges a breach of contract claim in the amount of \$400,000. The Company is currently drafting an answer to the complaint. No estimate can be made of the possible loss or possible range of losses associated with the resolution of this matter. As a result, no losses have been accrued in the Company's financial statements as of September 30, 2004. Accordingly, the result of this lawsuit could have a material impact on the balance sheet, results of operations and cash flows.

Table of Contents

On or about November 2, 2004, a former employee of Pinnacor Inc. filed a demand for arbitration before Judicial Arbitration and Mediation Services seeking compensation related to the termination agreement he entered into with the Company. The former employee claims he is entitled to lost wages of \$284,375 plus certain additional fees and damages. The Company's management has not had an opportunity to review and evaluate this claim. The Company has established an appropriate accrual based on the expected outcome of the legal proceeding and does not expect the ultimate resolution of the claim to have a material impact on the balance sheet, results of operations and cash flows.

On or about November 5, 2004, a shareholder class action lawsuit was filed against the Company, the Company's directors, and Viacom, Inc. (Viacom) in the Delaware Court of Chancery in connection with an amendment to a Schedule 13D filed by Viacom. The lawsuit alleges, among other things, that the Company's directors breached their fiduciary duties. The Complaint seeks, among other things, a court order, an injunction and unspecified damages. The Company's management has not had an opportunity to review and evaluate this claim. As a result, no losses have been accrued in the Company's financial statements as of September 30, 2004. Accordingly, the result of this lawsuit could have a material impact on the balance sheet, results of operations and cash flows.

On November 5, 2004, the Company received a preliminary report from a third party auditor representing a data provider. The audit was routine in nature and intended to ensure the Company's compliance with the data vendor's contractual obligations. Although the Company has not yet received any formal notification from the data provider, the preliminary report reflects a potential exposure of approximately \$7.4 million, with a possible additional liability for retroactive payment of 8% thereon. Until the Company receives a formal demand letter, the Company's management cannot fully review and evaluate the claim and no estimate can be made of the possible loss or possible range of losses associated with the resolution of this matter. As a result, no losses have been accrued in the Company's financial statements as of September 30, 2004. The result of this audit resolution could have a material impact on the balance sheet, results of operations and cash flow.

In addition, the Company from time to time is subject to legal proceedings and claims in the ordinary course of business. The Company is not currently aware of any other legal proceedings or claims that will have a material adverse effect on its financial position or results of operations.

Note 9 - Recent Accounting Pronouncements

In March 2004, the FASB issued a proposed Statement, Share-Based Payment, an amendment of FASB Statements Nos. 123 and 95, that addresses the accounting for share-based payment transactions in which a Company receives employee services in exchange for either equity instruments of the Company or liabilities that are based on the fair value of the Company's equity instruments or that may be settled by the issuance of such equity instruments. The proposed statement would eliminate the ability to account for share-based compensation transactions using the intrinsic method that the Company currently uses and generally would require that such transactions be accounted for using a fair-value-based method and recognized as expense in the consolidated statement of operations. In October 2004, the FASB decided to defer the effective date for public companies to interim and annual periods beginning after June 15, 2005. It is expected that the final standard will be issued before December 31, 2004 and should it be finalized in its current form, it will have a significant impact on the consolidated statement of operations as the Company will be required to expense the fair value of stock option grants and stock purchases under employee stock purchase plan.

In September 2004, the EITF delayed the effective date for the recognition and measurement guidance previously discussed under EITF Issue No. 03-01, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments (EITF 03-01) as included in paragraphs 10-20 of the proposed statement. The proposed statement will clarify the meaning of other-than-temporary impairment and its application to investments in debt and equity securities, in particular investments within the scope of FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, and investments accounted for under the cost method. The Company is currently evaluating

the effect of this proposed statement on its financial position and results of operations.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding our expectations, beliefs, intentions or future strategies that are signified by the words expects, anticipates, intends, believes, or similar language. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements. In evaluating our business, prospective investors should carefully consider the information set forth below under the caption Factors That May Affect Our Operating Results in addition to the other information set forth herein. We caution investors that our business and financial performance are subject to substantial risks and uncertainties.

Overview

Since our formation, we have operated as a multi-media publisher of financial news, with services including news articles, feature columns, financial programming and analytic tools, such as stock quotes and charting. On August 4, 2004, we changed our name from MarketWatch.com, Inc. to MarketWatch, Inc.

We generate our net revenues from three primary sources: the sale of advertising on our Web sites, broadcast properties and membership center; the license of our content; and our newsletter and other subscription products. We operate in one reportable segment.

Advertising revenues, which account for a significant portion of our total revenues, are primarily derived from the sale of advertisements and sponsorships on our Web sites as well as advertising from our television and radio broadcasts. We believe advertising on our Web properties will continue to be a significant revenue opportunity. We believe our Web sites attract the type of users desirable to advertisers and our products offer advertisers a strong, consistent brand with the opportunity to target their campaigns on the site of their choice or run a campaign across all our Web sites. In the second half of calendar 2003 and the first nine months of 2004, with the improvement in the U.S. economy and the movement of some traditional advertisers onto the Internet, our advertising sales have improved. A recent study by Deutsche Bank indicates that online advertising spending in the United States is estimated to grow on average between 20-40% over the next few years. We believe we are positioned to take advantage of the increased interest of advertisers in the Web. However, advertising spending is particularly sensitive to economic and market conditions, as evidenced by the softening in our advertising revenues during the uncertain times in the U.S. economy during the last several years. In addition, there continues to be a level of uncertainty by advertisers as to whether the Internet is a viable advertising vehicle for branding. As a result, we may not be able to grow or sustain our advertising sales, which would have a materially adverse impact our ability to remain cash flow positive and generate net income.

Licensing revenues, which also account for a significant portion of our total revenues, consist of revenues earned from the licensing of content and tools. In January 2004, we acquired Pinnacor Inc., an outsource provider of information and analytical applications to financial services companies and global corporations. With the acquisition of Pinnacor, we believe we have positioned ourselves to be a leading provider of online business news and financial applications and a more effective competitor in a rapidly changing and competitive environment. We also believe the addition of Pinnacor's technological expertise and staff will improve our ability to develop and bring new products and services to market. However, we also face the challenges of successfully completing the integration of Pinnacor and correcting the disruption to sales momentum caused by the uncertainties created by the six-month delay between signing of the acquisition agreement and closing of the transaction. In addition, we have incurred declines in licensing sales in recent years as a substantial portion of our licensing revenue is derived from financial services companies, which have been adversely affected by economic downturns. We could experience a decline in licensing revenues if we fail to successfully complete the integration of Pinnacor successfully, do not diversify our client base, or experience higher attrition rates, which would have a materially adverse impact our ability to remain cash flow positive and generate net income.

Edgar Filing: MARKETWATCH INC - Form 10-Q

Subscription revenue is derived from customer subscriptions to our newsletters and third-party online services. Our subscriptions services were launched in April 2002 with the acquisition of the Hulbert Digest. Our subscription products also include the Retirement Weekly, The Technical Indicator, EFT Trader and Herb Greenberg's RealityCheck newsletters and Hulbert Interactive, an online investment screener. We expect our subscription revenue to remain a relatively insignificant proportion of revenue for the foreseeable future. We have recently implemented a new e-commerce system that we believe will enable us to better develop and launch a variety of subscription products. As subscriptions are a relatively new service for us, we may not be able to develop products marketable to our users or launch them in a timely manner, both of which would cause a decline in revenues and adversely affect our financial results and cash flow.

Table of Contents

We currently have several agreements with our principal stockholders, including a license agreement with CBS Broadcasting Inc., or CBS, whereby it licenses its trademark and certain news content to us for royalties approximating 8% of all of our net revenues other than revenue attributable to Pearson plc and specified other revenue, including revenue attributable to Pinnacor for the twelve months period prior to the acquisition. The license agreement expires in October 2005. As of September 30, 2004, CBS and an affiliate of Pearson plc collectively hold approximately 44% of our outstanding common stock.

On April 1, 2004, we announced the signing of an agreement with Thomson Financial in which we agreed to produce an exclusive real-time financial newswire service for distribution by Thomson Financial and its affiliates. As part of the agreement, Thomson Financial will pay us fees for our production and editorial support for the term of the agreement. Beginning on the first anniversary date of the signing of the agreement, we will share in the profits of the news service after Thomson Financial's recovery of specified marketing and distribution costs. We have been building the editorial and production infrastructure and the service is expected to launch by December 31, 2004. As this service is new, we may incur unforeseen operational difficulties and delays. Also, our arrangement with Thomson Financial is unproven; we cannot assure you that we will succeed in generating significant revenues from this arrangement.

Our ability to generate significant revenue or obtain profitability in the future is uncertain. Further, in view of the rapidly evolving nature of our business, we may have difficulty accurately forecasting our revenues. Therefore, we believe that period-to-period comparisons of our financial results are not necessarily meaningful and you should not rely upon them as an indication of our future performance. To date, we have incurred substantial costs to create, introduce and enhance our services, to develop content, to build brand awareness and to grow our business. Although we achieved net income in fiscal 2003 and the first nine months of 2004 and were cash flow positive and generated cash flow for the twelve months ended December 31, 2003 and nine months ended September 30, 2004, we may not generate net income or positive cash flow for future periods. We may also incur additional costs and expenses related to content creation, technology, marketing or acquisitions of businesses and technologies to respond to changes in our rapidly evolving industry. These costs could have an adverse effect on our future financial condition or operating results.

Results of Operations

Net Revenues

Net revenues are derived from the sale of advertising on our Web sites, advertising revenue from sponsored links, advertising revenues from our television and radio broadcasts, other premium products and fees from our membership center, licensing of content, and subscription sales of our newsletters.

Net revenues of \$19.8 million in the three months ended September 30, 2004 increased \$8.2 million, or 71%, from \$11.6 million in the same period last year. Total net revenues of \$57.8 million in the nine months ended September 30, 2004 increased \$24.0 million, or 71%, from \$33.8 million in the same period last year. Advertising revenue of \$7.1 million for the three months ended September 30, 2004 increased \$1.2 million, or 20%, from \$5.9 million for the three months ended September 30, 2003. Advertising revenue of \$22.8 million for the nine months ended September 30, 2004 increased \$6.3 million, or 38%, from \$16.5 for the nine months ended September 30, 2003. Advertising revenue increased, as compared to prior year, as a result of a 55% and 33% increase in the average revenue per advertiser for the three and nine months ended September 30, 2004, respectively.

Licensing revenue of \$12.1 million for the three months ended September 30, 2004 increased \$6.9 million, or 133%, from \$5.2 million for the three months ended September 30, 2003. Licensing revenue of \$33.6 million for the nine months ended September 30, 2004 increased \$17.4

Edgar Filing: MARKETWATCH INC - Form 10-Q

million, or 107%, from \$16.2 million for the nine months ended September 30, 2003. For the three and nine month periods ended September 30, 2004, the increase in licensing revenue, as compared to prior year, was primarily the result of the Pinnacor acquisition, which accounted for 78% and 92% respectively of the increase. In addition, licensing fees received under the Thomson Financial agreement accounted for 25% and 14% of the increase for the three and nine month periods ended September 30, 2004, respectively. Excluding the licensing revenue from Thomson Financial and the Pinnacor licensing revenue, license revenue for the three and nine months ended September 30, 2004 decreased by 6% and 8%, respectively, primarily due to a slight erosion in the existing licensing customer base as a result of a consolidation of the financial services industry.

Subscription revenue of \$516,000 in the three months ended September 30, 2004 increased \$61,000, or 13%, from \$455,000 in the same period last year. Subscription revenue of \$1.4 million in the nine months ended September 30, 2004 increased \$252,000, or 22%, from \$1.1 million in the same period last year. The increase in subscription revenue, as compared to prior year, was primarily due to the launch of The Technical Indicator subscription product in July 2003 and the Retirement Weekly subscription product in October 2003.

Table of Contents

Substantially all of our advertising customers purchase advertising under short-term contracts. Our advertising revenues would be materially adversely affected if we were unable to renew advertising contracts with existing customers or obtain new customers. We expect to continue to derive a significant amount of our future net revenues from selling advertisements. The market for Web advertising is intensely competitive; therefore advertising rates could be subject to additional pricing pressure in the future. If we are forced to reduce our advertising rates or we experience lower CPMs (cost per thousand page views) across our Web sites for any reason, future advertising revenues could be materially adversely affected.

Licensing revenues depend on customer contract renewals and could decrease further if customers choose to renew for lesser amounts, do not renew, or we do not obtain new customers. A significant amount of our licensing revenue is earned from brokerages and financial services companies, which have experienced hardship due to past economic downturns. The amount of licensing revenues depends, in part, on the number of users these customers have each month. If the number of users were to decrease, our licensing revenue would decrease. The growth of our licensing revenues could also be limited as there are a limited number of brokerages and financial services companies to license our content as a result of a consolidation of the financial services industry. In addition, certain license contracts guarantee the performance of our Web sites. If our sites do not perform as guaranteed, licensing revenue would be adversely affected.

Cost of Net Revenues

Cost of net revenues primarily consists of news staff compensation, royalties payable to CBS and content providers, bandwidth costs associated with serving pages on our Web properties and licensing clients, fees paid for data, Web site infrastructure costs, costs of serving ads, exchange fees for communication lines, amortization of purchased technology and costs related to subscriptions, including printing and mailing costs.

Cost of net revenues increased by 38% to \$6.2 million for the three months ended September 30, 2004 from \$4.5 million for the three months ended September 30, 2003 and increased 37% to \$18.0 million for the nine months ended September 30, 2004 from \$13.1 million for the nine months ended September 30, 2003. Of the aggregate increase in cost of net revenues for the three and nine month periods, 35% and 57%, respectively, of the increase was attributable to additional data production fees, primarily due to the additional feeds to serve the contracts purchased in the Pinnacor acquisition. Employee costs for news and operations attributed to 23% and 16% of the increase for the three and nine months ended September 30, 2004, respectively, primarily resulting from an increase in headcount due to the Pinnacor acquisition and development of newswire services for Thomson Financial. Consulting costs attributed to 15% and 5% of the increase for the three and nine months ended September 30, 2004, respectively, primarily resulting from the development of the Thomson Financial service. In addition, 15% of the increase for the three and nine month periods was due to amortization expense relating to the developed technology purchased in the acquisition of Pinnacor. As a percentage of net revenues, cost of net revenues were 32% and 39% for the three months ended September 30, 2004 and 2003, respectively and 31% and 39% for the nine months ended September 30, 2004 and 2003, respectively.

We recently received a preliminary report from a third party auditor representing a data provider reflecting a potential exposure of \$7.4 million with possible additional interest charges at 8%. Until we receive a formal demand letter, our management cannot fully review and evaluate the claim and no estimate can be made of the possible loss or possible range of losses associated with the resolution of this matter. As a result, no losses have been accrued in the financial statements as of September 30, 2004.

Product Development

Product development expenses primarily consist of fees paid for data, compensation and benefits for Web site developers, designers and engineers to maintain the sites and software engineers and expenses for contract programmers and developers.

Product development expenses increased by 221% to \$4.5 million for the three months ended September 30, 2004 from \$1.4 million for the three months ended September 30, 2003 and increased 170% to \$13.5 million for the nine months ended September 30, 2004 from \$5.0 million for the nine months ended September 30, 2003. Of the aggregate increase in product development expenses for the three and nine month periods, 62% and 63%, respectively, of the increase was attributable to higher compensation expense and overhead costs primarily due to an increase in product development related headcount due to the Pinnacor acquisition. In addition, 37% and 34% of the increase for the three and nine month periods, respectively, was attributable to an increase in data feeds, also as a result of the Pinnacor acquisition. As a percentage of net revenues, product development expenses were 23% and 12% for the three months ended September 30, 2004 and 2003, respectively and 23% and 15% for the nine months ended September 30, 2004 and 2003, respectively.

Table of Contents

General and Administrative

General and administrative expenses primarily consist of compensation and benefits for finance, business development, legal and administrative personnel, public company expenses, professional fees, corporate depreciation charges and charges for bad debt.

General and administrative expenses increased by 57% to \$4.4 million for the three months ended September 30, 2004 from \$2.8 million for the three months ended September 30, 2003 and increased 52% to \$12.9 million for the nine months ended September 30, 2004 from \$8.5 million for the nine months ended September 30, 2003. Of the aggregate increase in general and administrative expenses for the three months ended September 30, 2004, 49% of the increase resulted from higher compensation expense and overhead costs due to additional headcount as a result of the Pinnacor acquisition as well as costs incurred with the transition of our Chief Financial Officer, 10% of the increase was due to higher taxes as a result of an increased presence in New York and higher asset valuation due to the acquisition of Pinnacor, and 8% of the increase was attributable to higher legal fees primarily related to costs associated with the SEC investigation of a former employee. In addition, an increase in professional fees attributed to 18% of the aggregate increase primarily related to consulting fees associated with the implementation of Section 404 of the Sarbanes-Oxley Act of 2002 and an increase in audit fees. Of the aggregate increase in general and administrative expenses for the nine months ended September 30, 2004, 26% was attributable to increased compensation expense and overhead costs, 15% was due to higher taxes, 18% was attributable to professional fees, 14% from higher legal fees and 8% of the increase was attributable to an increased provision for doubtful accounts resulting from higher accounts receivable balances. As a percentage of net revenues, general and administrative costs were 22% and 24% for the three months ended September 30, 2004 and 2003, respectively and 22% and 25% for the nine months ended September 30, 2004 and 2003, respectively.

Sales and Marketing

Sales and marketing expenses primarily consist of online and offline advertisements, promotional materials and compensation, benefits and sales commissions to our direct sales force and marketing personnel.

Sales and marketing expenses increased 44% to \$3.6 million for the three months ended September 30, 2004 from \$2.5 million for the three months ended September 30, 2003 and increased 53% to \$11.3 million for the nine months ended September 30, 2004 from \$7.4 million for the nine months ended September 30, 2003. Of the aggregate increase in sales and marketing expenses for the three and nine months ended September 30, 2004, 75% and 70%, respectively, of the increase was attributable to higher compensation expense primarily due to an increase in headcount and commissions for licensing sales as a result of the Pinnacor acquisition and an increase in commissions for higher advertising sales. In addition, 13% and 9% of the increase for the three and nine months ended September 30, 2004, respectively, was attributable to an increase in legal costs associated with the review and drafting of our license agreements. As a percentage of net revenues, sales and marketing expenses were 18% and 22% for the three months ended September 30, 2004 and 2003, respectively and 20% and 22% for the nine months ended September 30, 2004 and 2003, respectively.

Amortization of Intangibles

Amortization of intangibles was \$415,000 and \$0 for the three months ended September 30, 2004 and 2003, respectively, and \$1.5 million and \$0 for the nine months ended September 30, 2004 and 2003, respectively, of which \$267,000 and \$747,000 was expensed to cost of revenues for the three and nine months ended September 30, 2004, respectively. The increase in amortization for the three and nine months ended September 30, 2004 as compared to the same periods in 2003 was due to amortization of intangible assets resulting from the Pinnacor acquisition. In January 2004, we assigned \$300,000 to in-process research and development in the Pinnacor acquisition and determined that technological

feasibility had not been established and there was no alternative future use. We expensed the value of the in-process research and development of \$300,000 at the time of acquisition (See Note 5).

Interest Income, net of expense

Interest income, net of expense, increased 34% to \$154,000 for the three months ended September 30, 2004 from \$115,000 for the three months ended September 30, 2003 and decreased 5% to \$363,000 for the nine months ended September 30, 2004 from \$384,000 for the nine months ended September 30, 2003. The increase for the three months ended September 30, 2004 was attributable to a \$56,000 increase in interest income as a result of higher interest rates earned on our investment account offset by \$17,000 in interest paid on our capital leases, which were acquired from Pinnacor. The decrease for the nine months ended September 30, 2004 was primarily due to \$48,000 in interest paid on our capital leases offset by a \$29,000 increase in interest income primarily as a result of interest income earned on a certificate of deposit account acquired from Pinnacor.

Table of Contents

Liquidity and Capital Resources

Since our inception in October 1997, we have funded our operations primarily from cash contributed and advanced by IDC and CBS, revenues from advertising, licensing and subscription sales and the proceeds from our initial public offering. Our cash and cash equivalents totaled \$56.4 million at September 30, 2004, compared to \$48.1 million at December 31, 2003.

Cash provided by operating activities was \$4.4 million for the nine months ended September 30, 2004, primarily due to net income of \$1.7 million and an adjustment for the effect of non-cash charges for depreciation and amortization of \$3.7 million, an increase in accounts payable and accrued expenses of \$4.2 million and an increase in deferred revenue of \$586,000, offset by an increase in accounts receivable and prepaid expenses of \$6.2 million. The increase in accounts receivable, prepaid expenses, accounts payable and accrued expenses and deferred revenue as compared to the same period last year was primarily due to the increased level of activity after the acquisition of Pinnacor. The increase in depreciation and amortization was primarily due to the amortization of intangibles resulting from the Pinnacor acquisition.

Cash provided by operating activities was \$4.1 million for the nine months ended September 30, 2003, primarily due to net income of \$17,000 and an adjustment for the effect of non-cash charges for depreciation and amortization of \$2.9 million, an increase in accounts payable and accrued expenses of \$1.6 million and an increase in deferred revenue of \$547,000, offset by an increase in prepaid expenses and accounts receivable of \$914,000.

Cash used in investing activities was \$5.7 million for the nine months ended September 30, 2004 and primarily consisted of net cash paid for the acquisition of Pinnacor and payments for purchases of computer hardware, computer software and leasehold improvements to leased facilities.

Cash used in investing activities was \$1.1 million for the nine months ended September 30, 2003 and consisted of payments of acquisition costs for the pending acquisition of Pinnacor and payments for purchases of computer hardware and software.

Cash provided by financing activities was \$9.6 million for the nine months ended September 30, 2004 and reflected proceeds from the sale of common stock through our employee stock purchase plan in February and August 2004 and stock option exercises during the nine-month period aggregating \$10.2 million, offset by \$586,000 in principal payments under capital lease obligations assumed in the Pinnacor acquisition.

Cash provided by financing activities was \$1.5 million for the nine months ended September 30, 2003 and primarily reflected proceeds from the sale of common stock through the employee stock purchase plan in February and August 2003 and stock option exercises during the nine-month period.

We believe our current cash position will be sufficient to meet our anticipated needs for working capital and capital expenditures for at least the next 12 months. We may need to raise funds sooner if we acquire any additional businesses, products or technologies. If additional funds were raised through the issuance of equity securities, the percentage ownership of our then-current stockholders would be reduced. However, if CBS and/or Pearson elect to maintain their percentage interest pursuant to the exercise of their participation rights under their stockholders' agreement with us, then CBS and/or Pearson would not necessarily suffer a reduction in their respective ownership. Furthermore, such equity securities may have rights, preferences or privileges senior to those of our common stock.

Contractual Obligations and Commercial Commitments

We incur various contractual obligations and commercial commitments in our normal course of business. Such obligations and commitments consisted of the following as of September 30, 2004.

Operating lease obligations We have various operating leases covering facilities in San Francisco, California; Minneapolis, Minnesota; New York, New York; Washington DC; Los Angeles, California; Chicago, Illinois; Boston, Massachusetts; Dallas, Texas; Coral Gables, Florida; and London.

Table of Contents

Net operating lease commitments as of September 30, 2004 can be summarized as follows (in thousands):

	<u>Gross Lease Commitments</u>	<u>Sublease Income</u>	<u>Net Lease Commitments</u>
Remainder of 2004	\$ 705	\$ (95)	\$ 610
2005	2,837	(187)	2,650
2006	2,685		2,685
2007	2,760		2,760
2008	1,805		1,805
Due after 5 years	743		743
	<u> </u>	<u> </u>	<u> </u>
Total	\$ 11,535	\$ (282)	\$ 11,253
	<u> </u>	<u> </u>	<u> </u>

As of September 30, 2004, principal payments required on our capital lease obligations are \$159,000 and \$329,000 for the years ending December 31, 2004 and 2005, respectively.

Recent Accounting Pronouncements

In March 2004, the FASB issued a proposed Statement, Share-Based Payment, an amendment of FASB Statements Nos. 123 and 95, that addresses the accounting for share-based payment transactions in which a Company receives employee services in exchange for either equity instruments of the Company or liabilities that are based on the fair value of the Company's equity instruments or that may be settled by the issuance of such equity instruments. The proposed statement would eliminate the ability to account for share-based compensation transactions using the intrinsic method that the Company currently uses and generally would require that such transactions be accounted for using a fair-value-based method and recognized as expense in the consolidated statement of operations. In October 2004, the FASB decided to defer the effective date for public companies to interim and annual periods beginning after June 15, 2005. It is expected that the final standard will be issued before December 31, 2004 and should it be finalized in its current form, it will have a significant impact on our consolidated statement of operations as we will be required to expense the fair value of stock option grants and stock purchases under our employee stock purchase plan.

In September 2004, the EITF delayed the effective date for the recognition and measurement guidance previously discussed under EITF Issue No. 03-01, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments (EITF 03-01) as included in paragraphs 10-20 of the proposed statement. The proposed statement will clarify the meaning of other-than-temporary impairment and its application to investments in debt and equity securities, in particular investments within the scope of FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, and investments accounted for under the cost method. We are currently evaluating the effect of this proposed statement on our financial position and results of operations.

Factors that May Affect Our Operating Results

We may experience potential fluctuations in our quarterly operating results, face unpredictability of future revenue and incur losses in the future.

Edgar Filing: MARKETWATCH INC - Form 10-Q

Our quarterly operating results may fluctuate significantly in the future as a result of a variety of factors, many of which are outside our control. These factors include:

fluctuations in traffic levels on our Web sites, which can be significant as a result of business, financial and other news events;

fluctuating and unpredictable demand for advertising on our Web sites as well as on the Web in general;

reductions in rates paid for Web advertising resulting from softening demand, competition, or other factors;

changes in demand for licenses of our technology and news;

our development efforts and the efforts of our competitors to introduce new products and services;

our ability to enter into or renew on favorable terms our marketing and distribution agreements;

seasonal fluctuations of advertising revenue as advertisers spend less in the first and third calendar quarters and user traffic on our Web sites have historically been lower during the summer and during year-end vacation and holiday periods;

Table of Contents

continued delivery of content from our data vendors on a timely and quality basis;

technical difficulties or system downtime affecting the Web generally or the operation of our Web sites; and

economic conditions specific to the Web as well as general economic conditions.

Although we generated net income and were cash flow positive for the year ended December 31, 2003 and nine months ended September 30, 2004, you should not rely on the results for prior periods as an indication of future performance. We may not be cash flow positive or generate net income for future periods.

Over time our revenues have come from a mix of advertising, content licensing and subscription service fees. We expect our quarterly revenues and operating results to be particularly affected by changes in the level of our advertising and licensing revenue for each quarter. Our operating expenses are based on our current expectations of our future revenues and are relatively fixed in the short term. If we have lower revenues than we expect, we may not be able to quickly reduce our spending in response. We also may, from time to time, make certain pricing, service or marketing decisions that adversely affect our revenues in a given quarterly or annual period. Any shortfall in our revenues would have a direct impact on our operating results for a particular quarter and these fluctuations could affect the market price of our common stock in a manner unrelated to our long-term operating performance.

We depend on advertising revenues to grow our business and maintain profitability, and if advertising revenues were to decline, our results of operations and business would be harmed.

Revenues from advertising are important to our business. In the past few years there was a significant softening in demand for advertising services due to decreased spending on Web advertising by companies and general uncertainty about the economy. In addition, continuing or threatened conflict or military action involving the United States has disrupted businesses, which has curbed spending by companies or otherwise, slowed down economic recovery. In the latter quarters of 2003 and the first nine months of 2004, web advertising expenditures have begun to show widespread signs of recovery. However, continued uncertainty about the extent and speed of recovery of the Web advertising market could harm our company's business.

A portion of our online advertising revenue comes from financial services companies that were adversely affected by the market downturns over the last several years, which resulted in these companies spending less for online advertising, or going out of business. Furthermore, some of the existing brokerage and financial services companies and customers that we target have merged, and additional mergers may occur in the future, which would further reduce the number of our existing and potential customers. If we do not continue to diversify our advertiser base and attract advertisers from other industries, our business could be adversely affected. Moreover, diversification of our advertising base may require that we adapt to different requirements and expectations that new advertisers may have with respect to advertising programs that could result in our incurring significant marketing, sales, development and other expenses that may depress our earnings.

In addition, sales of advertisements occur under short-term contracts, which are difficult to forecast accurately. Advertisers generally have the right to cancel an advertising campaign on short notice without penalty. Accordingly, the cancellation or deferral of advertising agreements could have a material adverse effect on our financial results.

Changes in current advertising pricing models could seriously harm our operating results.

No standard has been widely accepted to measure the effectiveness of Web advertising, so different pricing models are used to sell advertising on the Web. It is difficult to predict which, if any, will emerge as the industry standard. This makes it difficult to project our future advertising rates and revenues. For example, advertising rates based on the number of click throughs, or user requests for additional information made by clicking on the advertisement, instead of rates based solely on the number of impressions, or times an advertisement is displayed, could adversely affect our revenues.

The growth of our advertising business depends on the acceptance of the Web as an effective advertising medium.

Generally, we compete with traditional advertising media, such as print, radio and television, for a share of advertisers' total advertising budgets. Our advertising business would fail to expand or our advertising revenue would decrease if the Web were not perceived as an effective advertising medium. Also, advertisers that have traditionally relied upon other advertising media may be reluctant to advertise on the Web, especially given the general uncertainty in the economy. Advertisers that already have invested substantial resources in other advertising methods may be reluctant to adopt a new advertising strategy and may find it more difficult to measure the effectiveness of Web advertising. Therefore, advertising revenues would be adversely affected if our Web sites are not perceived to offer desirable opportunities for online advertising.

Table of Contents

We may be susceptible to third-party software programs that serve pop-up advertisements or prevent advertisements from being served on our Web sites.

Third-party software programs are increasingly used to deliver selected advertisements based on Web sites visited by a user. These advertisements usually are in the form of pop-up ads that are often based on the content the user is viewing at a particular time. Often this software is downloaded onto the user's computer without the user's knowledge, understanding or consent, as the software often comes bundled with other applications that the user downloads, such as file-sharing software or media players. The software can then track the user's Web surfing habits and display content, such as pop-up ads, that most users do not realize are not connected to the Web site they are then viewing. The pop-up ads may compete with the advertising, services and products that we may sell on our Web sites, potentially infringe third-party intellectual property rights, and could lead to confusion for our customers as the pop-up software deceives the user as to the origin of the advertisement. Also, our customers may blame us for defects in the services and products promoted by the pop-up ads or for fraud perpetrated against them in connection with such pop-up ads, either of which could damage our reputation or result in the incurrence of significant damages by us. If the prevalence of such forms of software continues to increase and no restrictions are placed on their usage, our business may be harmed.

In addition, our advertising revenues could be adversely affected if filter software programs that limit or prevent advertising from being delivered to a Web user's computer are widely adopted and limit the commercial viability of Web advertising.

We depend on licensing revenues to grow our business and maintain profitability, and if licensing revenues were to decline, our business could be harmed.

Revenues from the licensing of our content, applications and tools to customers are important to our business. Licensing revenues depend on new customer contracts, on our ability to successfully implement the contract and on customer contract renewals, and could decrease if we do not generate new licensing business or existing customers renew for lesser amounts, terminate early or forego renewal. Our ability to retain existing customers and attract new customers depends on our ability to develop new products and services and market acceptance of such products and services, neither of which may occur. Furthermore, as we derive a significant percentage of our licensing revenue from specific market segments such as brokerages, financial services companies, banks and asset management providers, consolidation in these market segments have in the past caused, and could in the future, cause us to have a reduced number of existing and potential customers. If we do not diversify our client base and continue to attract customers from other industries, our business could be adversely affected.

Furthermore, we receive a portion of the data incorporated in our licensing products from third parties, some of which are competitors. For example, we receive data from Multex/Reuters. If they or others perceive us as a competitor, they may discontinue providing services to us. Also, some of our third-party data providers have restrictions on access to and use of their data, which may make our licensing of products incorporating such data less attractive to our existing and potential customers which in turn may adversely affect our licensing revenue. We also rely on these providers to continue to provide information on a timely and consistent manner.

We may fail to realize the anticipated benefits of our acquisition of Pinnacor if we do not successfully implement our integration strategy.

Our failure to meet the challenges involved in successfully integrating our operations with Pinnacor's operations or otherwise to realize any of the anticipated benefits of the acquisition, including cost savings, could seriously harm the results of our operations. Integrating Pinnacor's operations is a complex, time-consuming and expensive process that, without proper planning and implementation, could cause significant disruptions. The successful integration of Pinnacor's operations involves a number of risks, many of which are outside of our control:

the impairment of relationships with Pinnacor s customers as a result of the acquisition and our ability to re-engage these customers during the integration process;

Table of Contents

the difficulty of assimilating the operations and personnel of Pinnacor, which are principally located in New York and Iowa, with and into our operations, which are headquartered in Northern California and Minneapolis;

the potential disruption of our ongoing business and distraction of management;

the difficulty of incorporating acquired technology and rights into our products and unanticipated expenses related to such integration;

the failure to further successfully develop acquired technology resulting in the impairment of amounts currently capitalized as intangible assets;

the impairment of relationships with Pinnacor's former employees or our own employees as a result of any integration of new management personnel;

the incurrence of charges relating to impairment of goodwill or other intangible assets acquired in the acquisition; and

undiscovered and unknown liabilities, or misrepresentations of liabilities, relating to Pinnacor's business that become known to us after the acquisition.

To realize the anticipated benefits of the acquisition, management must implement a business plan that will:

effectively combine Pinnacor's financial applications and customization capabilities with our news, tools and charting capabilities to offer new and existing customers a broader set of content and applications;

successfully leverage the opportunities for cross-promotion of our expanded products and services to our existing customers and Pinnacor's former customers and coordinate sales and marketing efforts to effectively communicate these new capabilities; and

retain existing customer and vendor relationships by demonstrating to them that the acquisition did not adversely affect customer service standards or business focus.

Our management may not succeed in minimizing the risks associated with integrating Pinnacor's business or executing its integration goals. We cannot assure you that any cost savings, greater economies of scale and other operational efficiencies, as well as revenue enhancement opportunities anticipated from the acquisition, will occur. For example, during the six-month period between signing and closing of the acquisition, the Pinnacor business slowed significantly because its customers held off signing or upgrading contracts until completion of the acquisition. The revenue contribution from Pinnacor to our organic licensing business also was much smaller than anticipated. In addition, our operating expenses increased due to the increased headcount, expanded operations and expenses and charges related to the acquisition. To the extent that our expenses increase but revenues do not, there are unanticipated expenses relating to the integration process, or there are significant costs associated with presently unknown liabilities, our business, operating results and financial condition may be materially and adversely affected. Failure to successfully integrate Pinnacor's business also may adversely affect the trading price of our stock.

We may fail to realize the benefits of our service production agreement with Thomson Financial.

Edgar Filing: MARKETWATCH INC - Form 10-Q

Our failure to meet the challenges involved in successfully developing a real-time financial newswire service with Thomson Financial or otherwise to realize any of the benefits of the relationship, could adversely affect our results of operations. Developing the real-time newswire service for Thomson has been a complex, time-consuming and expensive process requiring significant planning and careful implementation. The successful development of the newswire service involves a number of risks, many of which are outside of our control:

the potential disruption of our ongoing business and distraction of management;

the failure to budget our costs accurately; and

the failure by Thomson to aggressively market and promote the newswire service or to establish a sufficient price for the newswire service.

Table of Contents

To realize the benefits of the relationship with Thomson, management must successfully implement a business plan that:

effectively develops the editorial production support for the newswire service; and

successfully leverages the opportunities for cross-promotion of our expanded products and services to our existing customers and Thomson's customers.

Our management may not succeed in minimizing the risks associated with developing the financial newswire service with Thomson which could adversely affect our results of operations.

We are in a highly competitive industry and some of our competitors may be more successful in attracting and retaining customers.

The market for Internet services and products is relatively new, intensely competitive and rapidly changing. The number of Web sites on the Internet competing for consumers' attention and spending has proliferated and we expect that competition will continue to intensify.

We compete, directly and indirectly, for advertisers, viewers, members, licensing customers and content providers with the following categories of companies:

publishers and distributors of traditional off-line media, such as television, radio and print, including those targeted to business, finance and investing needs, many of which have established or may establish Web sites, such as The Wall Street Journal and CNN;

general purpose consumer online services such as AOL and MSN, each of which provides access to financial and business-related content and services;

Web sites targeted to business, finance and investing needs, such as TheStreet.com and the Motley Fool;

Web search and retrieval and other online services, such as Google, Yahoo!, Lycos and other high-traffic Web sites, which offer quotes, financial news and other programming and links to other business and finance-related Web sites;

data companies that provide value-added tools, including charts, portfolios and stock screeners, such as Reuters;

providers of standardized and customized investment research tools, such as SmartMoney;

publishers of financial news, such as Reuters and Dow Jones;

application service providers and information aggregators, such as Edgar Online, who aggregate information and either host private-label applications that use such data or deliver such data in the form of feeds to customers;

financial software vendors, that have already, or may in the future, develop extensions to their software capabilities to be able to manage external information as efficiently as internal information; and

in-house development staffs of customers who develop technology solutions, often in conjunction with consulting and systems integration firms.

We anticipate that the number of direct and indirect competitors will increase in the future. We also expect consolidation among our current competitors, which would increase their size and ability to market their products. Many of our existing competitors, as well as a number of potential new competitors, have longer operating histories in the Web market, greater name and brand recognition, a larger customer base, higher amounts of user traffic and significantly greater financial, technical and marketing resources. Such competitors may be able to undertake more extensive marketing campaigns, adopt more aggressive pricing policies, make more attractive offers to potential employees, marketing and distribution partners, advertisers and content providers and may be able to respond more quickly to new or emerging technologies and changes in Web user requirements.

Table of Contents

Further, we cannot assure you that our competitors will not develop products and services that are equal or superior to, or that achieve greater market acceptance than, our offerings. Increased competition could also result in price reductions for our advertising or licensed content and tools, reduced margins, operating losses or loss of market share, any of which would materially adversely affect our business, results of operations and financial condition.

If we cannot continue to develop and market new and enhanced products and services that achieve market acceptance in a timely manner, our revenues may suffer.

We believe that our Web sites will be more attractive to advertisers if we develop a larger audience comprised of demographically favorable users which depends substantially on the introduction of enhanced products and services. If the subscription products or other services we introduce are not favorably received, we may not attract new users and our current users may not continue to access our Web sites or use our services as frequently, which would make us less attractive to advertisers. New users could also choose competitive Web sites or services over ours. Moreover, if our new services do not achieve sufficient market acceptance and generate the anticipated revenues, we would not be able to recoup the costs of developing, marketing and maintaining such services.

We may also experience difficulties that could delay or prevent us from introducing new services. Furthermore, these services may contain errors that are discovered after the services are introduced. We may need to significantly modify the design of these services on our Web sites to correct these errors. Our business could be adversely affected if we experience difficulties in introducing new services or if users do not accept these new services.

We depend on key personnel who may not continue to work for the company.

We believe that our future success will depend in part on our continued ability to attract, integrate, retain and motivate highly qualified sales, technical, editorial and managerial personnel, and on the continued service of our senior management. Although we have employment agreements with some of our key executives, nothing prevents them from terminating their employment with us, at any time, for any reason. If we cannot successfully attract, retain and motivate a sufficient number of qualified personnel, it may harm our ability to successfully conduct our business in the future.

Our business will be adversely affected if we do not develop and maintain an effective sales force.

We depend on our sales force to sell advertising on our Web sites and license our content. This involves a number of risks including:

our sales personnel have, in a number of cases, only worked for us for a short period of time;

our ability to hire, retain, integrate and motivate sales and sales support personnel;

the length of time it takes new sales personnel to become productive; and

Edgar Filing: MARKETWATCH INC - Form 10-Q

the competition we face from other companies in hiring and retaining sales personnel.

If we are unable to attract and retain an appropriate sales force, our revenue may fail to increase or may decline.

Several large stockholders beneficially own a substantial amount of our common stock, and acting together have substantial control over the management of our company.

As of September 30, 2004, CBS and Pearson collectively beneficially own approximately 44% of our outstanding common stock, and together with General Atlantic Partners 69, L.P. and their affiliates, collectively own approximately 52% of our outstanding common stock. As a result of their ownership, they collectively will be able to control all matters requiring stockholder approval, should they act together, including the election of directors, amendments to our charter documents and approval of significant corporate transactions. Such concentration of ownership may also have the effect of delaying or preventing a change in control of us even if such a change of control may be beneficial to our stockholders. Currently, CBS

Table of Contents

has two representatives, and each of Pearson and General Atlantic Partners has one representative, on our board of directors. Pursuant to contractual arrangements, CBS has the right to nominate one additional, and Pearson has the right to nominate two additional, representatives to our board. The interests of our directors and significant stockholders may differ from yours and they may not necessarily act in accordance with your interests.

We depend on CBS for a number of services and other rights, and our business may be materially adversely affected if CBS were to terminate its strategic relationship with us.

We have a license agreement with CBS to use the CBS name and logo, as well as CBS Television Network news content in connection with the operation of the CBS.MarketWatch.com Web site. This license agreement will expire on October 29, 2005 and CBS has no obligation to renew it. Also, under specific circumstances, CBS may terminate the license agreement earlier. If we were not able to renew our license agreement with CBS or if CBS were to terminate the license agreement earlier than October 29, 2005, we would need to change the name of the CBS.MarketWatch.com Web site and devote resources toward building a new brand name for the Web site. Regardless of such expenditures, we may not be able to continue to attract a sufficient amount of user traffic and advertisers to our Web sites without the CBS name and logo or promotion from CBS.

Furthermore, we are subject to a number of restrictions in consideration for the license grant and the provision of news content from CBS. For example, CBS can require us to remove any content on our Web sites that CBS determines conflicts with, interferes with or is detrimental to its reputation or business or that CBS deems inappropriate. We are also required to conform to CBS's guidelines for the use of its trademarks. CBS has the right to approve all materials, such as marketing materials, that include any CBS trademarks. CBS also has control over the visual and editorial presentation of television news content provided by CBS on our Web sites. Because of these restrictions, we may be limited in performing our desired marketing and branding activities using the CBS trademark, and if we fail to comply with CBS's restrictions, CBS may terminate the license agreement.

The interests of CBS and Pearson could conflict with the interests of our other stockholders and, given their substantial stock ownership in the Company, we may not be able to resolve any future conflict with either of them on terms favorable to us.

CBS and Pearson may experience conflicts of interest in their business dealings with us with respect to decisions involving business opportunities and other similar matters. For example:

CBS could license its name and logo to other Web sites or Internet services that deliver general news, sports and entertainment. These sites or services could also offer financial news, so long as delivering comprehensive stock quotes and financial news to consumers in the English language is not their primary function and their principal theme and format;

Pearson could also establish an advertising-supported Web site that does not have as its primary function and its principal theme and format the delivery of financial news and stock quotes;

CBS or Pearson could license their respective content to other Web sites or Internet services; or

CBS or Pearson could make certain investments in other Web sites or Internet services.

Edgar Filing: MARKETWATCH INC - Form 10-Q

The occurrence of any of the above actions could adversely affect our business. For example, these sites or services supported by CBS or Pearson could compete with us or CBS and Pearson might promote these other sites or services more actively than they promote our Web sites and services.

The successful operation of our business depends upon the supply of critical elements from other companies and any interruption in that supply could cause service interruptions or reduce the quality of our product and service offerings.

We depend on multiple information providers, such as Comtex, FT Interactive Data, Dow Jones and Thomson Financial Corporation, to provide information and data feeds on a timely basis. Our Web sites could experience disruptions or interruptions in service due to the failure or delay in the transmission or receipt of this information by our information

Table of Contents

providers which would be beyond our control. In addition, our customers depend on Internet service providers, online service providers and other Web site operators for access to our Web sites. We have experienced outages in the past, and could experience outages, delays and other difficulties due to system failures unrelated to our systems in the future. These occurrences could diminish Web users' experience or even result in users perceiving our Web sites as not functioning properly and therefore result in the loss of these users to other Web sites or sources to obtain their business, financial and other news and information.

Furthermore, we incorporate the data we receive from third parties, such as Multex/Reuters, into our licensing products. If such third party data providers or others perceive us as a competitor, they may discontinue providing services to us. Also, some of our third party data providers have restrictions on access to and use of these data, which may make our licensing products incorporating such data less attractive to our existing and potential customers, which in turn may adversely affect our licensing revenue.

We depend on the continued growth in use of the Web, particularly for financial news and information, as well as in the continued performance and reliability of the Web.

Because we expect to depend significantly on advertising revenue for the foreseeable future, our business depends on businesses and consumers continuing to increase their use of the Web for obtaining news and financial information as well as for conducting commercial transactions. Our advertising revenue and therefore our business would be adversely affected if Web usage does not continue to grow. Web usage may be inhibited for a number of reasons, such as:

inadequate network infrastructure;

security concerns;

inconsistent quality of service; and

availability of cost-effective, high-speed service.

In the event Web usage grows, the Internet infrastructure may not be able to support the demands placed on it by this growth or its performance and reliability may decline. Web sites have experienced interruptions in their service as a result of outages and other delays occurring throughout the Internet network infrastructure. If these outages or delays frequently occur in the future, Web usage in general and usage of our Web sites in particular, could grow more slowly or decline.

We depend on our strategic relationships with other Web sites.

We depend on establishing and maintaining distribution relationships with high-traffic Web sites for a portion of our traffic. There is intense competition for placements on these sites, and we may not be able to enter into such relationships on commercially reasonable terms, if at all. Even if we enter into distribution relationships with these Web sites, they themselves may not attract a significant number of users and therefore, our Web sites may not receive the desired traffic from these relationships. Moreover, we may have to pay significant fees to establish or maintain these types of relationships.

Occasionally, we enter into agreements with advertisers, content providers or other high-traffic Web sites that require us to exclusively feature these parties in certain sections of our Web sites. Existing and future exclusivity arrangements may prevent us from entering into other content agreements, advertising or sponsorship arrangements or other strategic relationships. Many companies we may pursue for a strategic relationship also offer competing services. As a result, these competitors may be reluctant to enter into strategic relationships with us. Our business could be adversely affected if we do not establish and maintain additional strategic relationships on commercially reasonable terms or if any of our strategic relationships do not result in increased use of our Web sites.

We depend on third-party software to track and measure the delivery of advertisements and it could be difficult to replace these services.

It is important to our advertisers that we accurately measure the demographics of our user base and the delivery of advertisements on our Web sites. We depend on third-party software to provide these measurement services. If the third-party is unable to provide these services in the future, we would be required to perform them ourselves or obtain them from another provider. This could cause us to incur additional costs or cause interruptions in our business during the time we are replacing these services. Companies may not advertise on our Web sites or may pay less for advertising if they do not perceive our measurements or measurements made by third parties to be reliable.

Table of Contents

We depend upon the stability and success of the financial markets.

The target customers for some of our products include a range of financial services organizations, including investment advisors, brokerage firms and banks. The success of many of our customers is intrinsically linked to the financial markets. We believe that demand for our products could be disproportionately affected by fluctuations, disruptions, instability or downturns in the financial markets that may cause customers or potential customers to exit the industry or delay, cancel or reduce any planned expenditures for our products. In addition, a slowdown in the formation of new financial services organizations could cause a decline in demand for our products. The uncertainty about the extent and speed of recovery of the financial markets could negatively impact the demand for our products, which could have a materially adverse effect on our business and results of operations.

Acquisitions and strategic investments may result in increased expenses, difficulties in integrating target companies and diversion of management's attention.

We anticipate that from time to time we may review one or more acquisitions or strategic investments or other opportunities to expand our range of technology, services and products and to gain access to new markets. Growth through acquisitions or strategic investments entails many risks, including the following:

management's attention may be diverted during the acquisition and integration process;

costs, delays and difficulties of integrating the acquired company's operations, technologies and personnel into our existing operations, organization and culture; and

higher than expected expenses resulting from any undisclosed or potential legal liabilities of the acquired company, including intellectual property, employment, warranty, or product liability-related problems.

For example, the revenue contribution from Pinnacor to our organic licensing business was smaller than anticipated. In addition, our operating expenses have increased due to the increased headcount, expanded operations and expenses and charges related to the acquisition. To the extent that our expenses increase but revenues do not, there are unanticipated expenses relating to the ongoing integration process, or there are significant costs associated with presently unknown liabilities, our business, operating results and financial condition may be materially and adversely affected.

If realized, any of these risks could have a material adverse effect on our business, financial condition and operating results, which may adversely affect the trading price of our stock.

Protecting our intellectual property rights may be costly and difficult.

We rely primarily on a combination of copyrights, trademarks, trade secret laws, our user policy and content license agreement and user agreement restrictions on disclosure and use to protect our intellectual property, such as our content, copyrights, trademarks and trade secrets. We also enter into confidentiality agreements with our employees and consultants, and seek to control access to and distribution of our

Edgar Filing: MARKETWATCH INC - Form 10-Q

proprietary information. We have several trademark registrations in the United States, a trademark in certain European jurisdictions and pending applications in the United States and in certain foreign jurisdictions. The protective steps we have taken may be ineffective. Despite these precautions, it may be possible for a third-party to copy or otherwise obtain, misappropriate, infringe and use the content on our Web sites or our other intellectual property without authorization. We may be unable to detect the unauthorized use of, or take appropriate steps to protect, or enforce our intellectual property rights. A failure to adequately protect our intellectual property could seriously harm our operating results, financial condition and business, including brand the value of our proprietary content and our ability to compete effectively. In addition, we may need to engage in litigation in order to enforce our intellectual property rights in the future or to determine the validity and scope of the proprietary rights of others. Such litigation could result in substantial costs and diversion of management and other resources, either of which could have an adverse effect on our business, operating results and financial condition.

Table of Contents

We may be subject to intellectual property infringement claims, relating to third party technology or use of third party data or content that would be costly to defend and may limit our ability to use certain technologies, data or content in the future.

We license certain technology, data and content from third parties. In these license agreements, the licensors generally agree to defend, indemnify and hold us harmless from any claim by a third-party that the licensed technology, data or content infringes any third party's intellectual property rights. However, we cannot assure you that the outcome of any litigation between such licensors and a third-party or between us and a third-party will not lead to royalty or other fee obligations for which we are not indemnified or for which such indemnification is insufficient or unavailable from the licensors, or that we will be able to obtain any additional license to use the technology, data or content on commercially reasonable terms, if at all. The loss of or inability to obtain or maintain any of these technology, data or content licenses could result in delays in the introduction of new services until equivalent technology, data or content, if available, is identified, licensed and integrated.

We may be subject to liability for financial information included in our online services.

We disseminate financial information through a variety of services, including general reporting of financial information on our web sites, and stock recommendations, commentary and analysis to subscribers of our subscription products. In addition, we also periodically enter into arrangements to offer third-party financial products, services, or content via distribution on our web properties, including real-time stock quotes, trading information and research reports. It is possible that, if any financial information provided directly by us contains errors or is otherwise negligently provided to users, claims may be made against us. We also may be subject to claims concerning errors in financial products, services or content provided by third parties by virtue of our involvement in marketing, branding, or providing access to them, even if we do not ourselves host, operate or provide these products, services or content. While our web properties contain cautionary language disclaiming liability for errors contained in the financial information we provide, and our agreements with third party providers often provide that we will be indemnified against liabilities relating to errors contained in such parties' products, services or content, our cautionary language and indemnification protection may not be adequate. Claims have been threatened and have been brought against us, and we may continue to receive claims, from individuals for trading losses in securities allegedly incurred as a result of errors contained, or securities commentary or analysis provided, in financial products, services or content provided by us or our third-party providers. The law relating to the liability of providers of online services for activities of their users is currently unsettled in the United States. Due to the unsettled nature of the law in this area, our defense of any such claims could be costly, involve significant distraction of our management and other resources, and damage our reputation, even if the claims do not ultimately result in liability.

We may have difficulty scaling and adapting our existing architecture to accommodate increased traffic and technology advances.

Our business relies on our ability to serve Web pages in a consistent and timely manner. In the past, our Web sites have experienced significant increases in traffic when there were significant business or financial news stories. In addition, the number of our users has increased over time and we are seeking to further increase our user base. If the traffic on our Web sites grows at a rate that our current communication lines cannot support, our Web pages will be served at a slower rate or we will be unable to serve pages at all.

We also rely on certain third-party providers for a significant amount of our current bandwidth capacity. If these providers are unable to maintain their service level agreements or we are unable to obtain additional bandwidth as our traffic grows, our business would be adversely affected. Our Web sites have in the past and may in the future experience slower response times and other problems for a variety of reasons. Also, our Web sites have in the past and may in the future experience down time and other problems due to server problems or capacity.

Edgar Filing: MARKETWATCH INC - Form 10-Q

If we fail to keep pace with rapid technological change, changing customer demands and evolving industry standards, we will not be able to compete.

Our market is characterized by rapidly changing technology, evolving industry standards and frequent new product announcements, which are exacerbated by the growth of the Web and the intense competition in our industry. The process of developing new products and services related to our business is complex and uncertain, and failure to anticipate the changing needs of our users and customers and emerging technological and market trends could significantly harm our results of operations. In order to successfully adapt to our rapidly changing market, we must continually improve the performance, features and reliability of our products and services. We could incur substantial costs improving our products, services or infrastructure in order to adapt to these changes and compete within our industry. Our business could be adversely affected if we were to incur significant costs without adequate results or if we were unable to successfully adapt to these changes.

Table of Contents

Legal uncertainties and government regulation of the Internet could inhibit the growth of the Internet.

Many legal questions relating to the Internet remain unclear and these areas of uncertainty may be resolved in ways that damage our business. It may take years to determine whether and how existing laws governing matters such as intellectual property, privacy, libel and taxation apply to the Internet. In addition, new laws and regulations that apply directly to Internet communications, commerce and advertising are becoming more prevalent. For example, the U.S. Congress has passed Internet-related legislation concerning copyrights, taxation and the online privacy of children. Further, President Bush recently signed into law the Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003, also known as the CAN-SPAM Act of 2003. This federal law, which became effective on January 1, 2004, established uniform standards, penalties, and an enforcement regime for the sending of unsolicited commercial email. As the use of the Internet grows, there may be calls for further regulation, such as more stringent consumer protection laws. Finally, our distribution arrangements and customer contracts could subject us to the laws of foreign jurisdictions in unpredictable ways.

These developments could affect us adversely in a number of ways. New regulations could make the Internet less attractive to users, resulting in slower growth in its use and acceptance than is currently expected. The new legislations, such as the anti-spam laws, could lessen our ability to effectively market our products and services and/or harm our advertising and licensing revenues. Moreover, we may be affected indirectly by legislation that fundamentally alters the practicality or cost-effectiveness of utilizing the Internet, including the cost of transmitting over various forms of network architecture, such as telephone networks or cable systems, or the imposition of various forms of taxation on Internet-related activities. Complying with new regulations could result in additional cost to us, which could reduce our profit margins or leave us at risk of potentially costly legal action.

Web security concerns could hinder Internet commerce.

The need to securely transmit confidential information over the Internet has been a significant barrier to electronic commerce and communications over the Web. Any well-publicized compromise of security could deter more people from using the Web or from using it to conduct commercial transactions that involve transmitting confidential information, such as stock trades or purchases of goods or services. Because many of our advertisers seek to encourage people to use the Web to conduct financial transactions or purchase goods or services, our business could be adversely affected if Internet commerce declines due to security concerns.

We could face liability related to our storage of personal information about our users.

Our data privacy policy is not to willfully disclose any individually identifiable information about any user to a third party other than on a confidential basis to our agents and independent contract service providers without the user's consent. Despite this policy, however, if unauthorized third persons were able to penetrate our network security or otherwise misappropriate our users' personal information or credit card information, we could be subject to liability, including claims for unauthorized purchases with credit card information, impersonation or other similar fraud claims, and misuses of personal information, such as for unauthorized marketing purposes. New privacy legislation may further increase this type of liability. California, for example, recently passed a privacy law that would apply to a security breach that affects unencrypted, computerized personal information of a California resident. Furthermore, we could incur additional expenses if additional regulations regarding the use of personal information were introduced or if federal or state agencies were to investigate our privacy practices. Due to concerns about user privacy issues, existing and potential advertisers may be deferred from purchasing certain types of advertising, which could harm our future advertising revenue.

Edgar Filing: MARKETWATCH INC - Form 10-Q

Furthermore, some of the licensing tools we have created and currently market to existing and potential customers require users to disclose personally identifiable information and allow us access to such confidential information. Due to concerns about user privacy issues, existing and potential licensing customers may be deterred from licensing these tools, which could harm our future licensing revenue.

We could face liability for the information displayed on our Web sites or distributed to our customers.

We may be subject to claims for libel, slander, defamation, negligence, copyright or trademark infringement or claims based on other theories of legal liability relating to the information we publish on our Web sites or license to our customers. These types of claims have been brought, sometimes successfully, against online services as well as other print publications in the past. We could also be subject to claims based upon the content that is accessible from our Web sites through links to other Web sites. Moreover, because we license some data and content from third parties, we may have further exposure to these

Table of Contents

types of claims. Although we generally will obtain representations as to the origin and ownership of content licensed from third parties and generally will obtain indemnification from these third parties to cover a breach of any such representation, we may not receive representations or indemnification that are sufficient to cover all liability relating to the third-party content.

Moreover, the indemnification provided by these parties may be insufficient to provide adequate compensation for any breach of such representations. Our defense of any action brought against us based upon the content that is accessible from our Web sites could be costly and involve significant distraction of our management's time and other resources. Although we carry general liability insurance, our insurance may not cover claims of these types or may be inadequate to indemnify us for all liability that may be imposed on us.

Unauthorized break-ins and other disruptions to our site could harm our business.

Our servers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays or loss of data. In addition, unauthorized persons may improperly access our data. A number of popular Web sites have experienced attacks from hackers and other intrusions. Any disruption resulting from these actions may harm our business and may be very expensive to remedy, may not be fully covered by our insurance and could damage our reputation and discourage new and existing users from using our site. We may also incur significant costs to protect our Web sites against the threat of security breaches. We also provide indemnification to some of our licensing customers for unauthorized access to and use of customer data as a result of break-ins and other unauthorized access. Our defense of any action brought against us based upon improper access to confidential customer data or indemnification of our licensing customers for similar claims brought against them could be costly and involve significant distraction of our management and other resources. Also, our operations are dependent upon our ability to protect systems against damage from fire, earthquakes, power loss, telecommunications failure, and other events beyond our control. Our insurance policies have coverage limits and therefore our insurance may not adequately compensate us for any losses that may occur due to any failures or interruptions in our systems.

Our business would be harmed by significant disruptions at our data centers due to the occurrence of a natural disaster, terrorist attack or other catastrophic event.

Our Web sites and substantially all of our content licensing business are hosted in our data centers in New York, New York and Lisle, Illinois. The operation of our Web sites and the provision of content to our customers would be disrupted if one or both of our data centers fails as a result of fire, floods, power loss, telecommunications failures, break-ins and similar events. In addition, New York is a metropolitan area with greater susceptibility to terrorist attacks. We do not have multiple site capacity for all of our services in the event of any such disruption.

Our stock price is volatile and could fluctuate significantly.

The trading price of our stock has been and may continue to be subject to wide fluctuations. During the last 52 week period ended September 30, 2004, the closing sale prices of our common stock on the NASDAQ National Market ranged from \$7.70 to \$14.12. Our stock price may fluctuate in response to a number of events and factors, such as quarterly variations in operating results, announcements of technological innovations or new products and media properties by us or our competitors, changes in financial estimates and recommendations by securities analysts, the operating and stock price performance of other companies that investors may deem comparable, news reports relating to trends in our markets and general economic conditions. In addition, the stock market in general, and the market prices for Internet-related companies in particular, have experienced extreme volatility. These broad market and industry fluctuations may adversely affect the price of our common stock, regardless of our operating performance.

Our ability to pay dividends is limited.

We currently intend to retain all future earnings to fund the development and growth of our business and, therefore, do not anticipate paying any dividends. We cannot predict if and when we will achieve sufficient net profits to declare dividends. Our plan not to declare any dividends could adversely affect the market price of our common stock particularly in light of the recent market trend to favor dividend paying stocks due to the equalization of tax rates on dividend income as compared to capital gains.

Table of Contents

If we are unable to complete our assessment as to the adequacy of our internal control over financial reporting as of December 31, 2004 and future year-ends as required by Section 404 of the Sarbanes-Oxley Act of 2002, investors could lose confidence in the reliability of our financial statements, which could result in a decrease in the value of our Common Stock.

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, the Securities and Exchange Commission adopted rules requiring public companies to include a report of management on the company's internal control over financial reporting in their annual reports on Form 10-K. This report is required to contain an assessment by management of the effectiveness of such company's internal controls over financial reporting. In addition, the public accounting firm auditing a public company's financial statements must attest to and report on management's assessment of the effectiveness of the company's internal controls over financial reporting. While we are expending significant resources in developing the necessary documentation and testing procedures required by Section 404, there is a significant risk that we may fail to comply with the requirements of Section 404 or may be required to disclose material weaknesses in our system of internal controls over financial reporting. This could result in an adverse reaction in the financial markets due to a loss of confidence in the reliability of our financial statements, which could have a material adverse effect on the Company's stock price and valuation.

New laws and regulations affecting corporate governance may impede our ability to retain and attract Board members and executive officers, will increase the costs associated with being a public company.

The Sarbanes-Oxley Act of 2002 and the related SEC and NASDAQ rules are designed to enhance corporate responsibility through new corporate governance and disclosure obligations, increase auditor independence, and impose tougher penalties for securities fraud. This act and the related new rules and regulations have had the effect of increasing the complexity and cost of our company's corporate governance and the time our executive officers spend on such issues, and may increase the risk of personal liability for our board members, Chief Executive Officer, Chief Financial Officer and other executives involved in our company's corporate governance process. As a result, it may become more difficult for us to attract and retain board members and executive officers involved in the corporate governance process.

During 2004 we have experienced, and will continue to experience, increased costs associated with being a public company, including additional professional and independent auditor fees. In particular, the costs of compliance with Section 404 of the Sarbanes-Oxley Act have been significant and because of the uncertainty surrounding the definition of some of the rules it is not possible to quantify additional possible costs associated with compliance with these rules.

Some anti-takeover provisions contained in our bylaws, as well as provisions of Delaware law, could limit a takeover attempt.

Pursuant to our bylaws, a special meeting of stockholders may be called only by the Chairman of the board of directors, a majority of the board of directors, the Chief Executive Officer or by any holder of at least 25% of our common stock. Also, nomination of directors at the annual meeting and the bringing of business before an annual or special meeting of stockholders require prior written notice and adherence to specific procedures.

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation law, which prevents some stockholders from engaging in certain business combinations without specified required approvals of either our board of directors or our stockholders.

Edgar Filing: MARKETWATCH INC - Form 10-Q

Any provision of our bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could have a continuing negative impact on the price that some investors are willing to pay for our common stock.

We Are Involved in Litigation and Are At Risk of Additional Litigation

We are a party to the litigation described in Part II, Item 1, Legal Proceedings. The defense of such litigation has increased our expenses and diverted our management's attention and resources. Furthermore, we may in the future be the target of other litigation.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest rate sensitivity. The primary objective of our investment activities is to preserve principal while maximizing the income we receive from our investments without significantly increasing risk. Some of the securities that we have invested in

Table of Contents

may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with a fixed interest rate at the then-prevailing rate and the prevailing interest rate later rises, the principal amount of our investment will probably decline. To minimize this risk, we maintain our portfolio of cash in money market funds and cash equivalents. In general, money market funds and short-term investments are not subject to market risk because the interest paid on such funds fluctuates with the prevailing interest rate. As of September 30, 2004, all of our investments mature in 90 days or less.

Exchange Rate Sensitivity. The majority of our revenue, expense and capital purchasing activities are transacted in U.S. dollars. However, we do enter into transactions in other currencies, primarily the British pound. We currently do not hedge our exposure to foreign exchange rate fluctuations. However, in order to limit such exposure, some contracts with our international customers are denominated in U.S. dollars and certain cash balance are maintained in U.S. dollars. Changes in exchange rates have not had a material effect on our business.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in this report.

There has been no change in our internal controls over financial reporting that occurred during our most recent fiscal quarter that has materially affected or is reasonably likely to materially affect our internal controls over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In 2001, several plaintiffs filed class action lawsuits in federal court against the Company, certain of its current and former officers and directors and its underwriters in connection with its January 1999 initial public offering. The complaints generally assert claims under the Securities Act, the Exchange Act and rules promulgated by the Securities and Exchange Commission. The complaints seek class action certification, unspecified damages in an amount to be determined at trial, and costs associated with the litigation, including attorneys' fees. The action against the Company is being coordinated with approximately three hundred other nearly identical actions filed against other companies. On June 25, 2003, a committee of the Company's board of directors approved a Memorandum of Understanding (MOU), which has now been memorialized in a settlement agreement, and related agreements that set forth the terms of a settlement between the Company, the plaintiff class and the vast majority of the other approximately 300 issuer defendants. Among other provisions, the settlement provides for a release of the Company and the individual defendants for the conduct alleged in the action to be wrongful. The Company would agree to undertake certain responsibilities, including agreeing to assign away, not assert, or release certain potential claims the Company may have against its underwriters. No estimate can be made of the possible loss or possible range of losses associated with the resolution of this matter and it is anticipated that any potential financial obligation of the Company to plaintiffs pursuant to the terms of the settlement agreement and related agreements will be covered by existing insurance. Therefore, the Company does not expect that the settlement will involve any material payment by the Company and no liability associated with these lawsuits has been recorded at September 30, 2004. The settlement agreement has been submitted to the Court for approval. Approval by the Court cannot be assured. On October 13, 2004, the Court certified a class in six of the approximately 300 other nearly identical actions and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining

Edgar Filing: MARKETWATCH INC - Form 10-Q

cases. Plaintiffs have not yet moved to certify a class in the Company's case.

On June 7, 2002, an action was commenced in the United States District Court for the District of Massachusetts by Teragram Corporation against Pinnacor, Inc. The lawsuit alleged a breach of contract claim against Pinnacor and, as amended, sought damages in the amount of \$290,280. On February 7, 2003, Pinnacor filed counterclaims against Teragram for breach of contract, breach of warranty and misrepresentation. Teragram and Pinnacor each filed the respective Motions for Summary Judgment on March 13, 2003 and April 3, 2003. These motions are still pending before the Court. The Company has established an appropriate accrual based on the expected outcome of the legal proceeding and does not expect the ultimate resolution of the claim to have a material impact on the balance sheet, results of operations and cash flows.

On July 24, 2003, a shareholder class action lawsuit was filed against Pinnacor, Pinnacor's then-current directors, a then-current Pinnacor officer, and the Company in the Delaware Court of Chancery. The lawsuit alleged that Pinnacor's directors breached their fiduciary duties in proceeding with the acquisition by agreeing to an inadequate proposed purchase price and alleged that the Company aided and abetted these breaches of fiduciary duty in some unspecified way. The parties have settled the action, pursuant to which the Company paid plaintiff's counsel \$300,000 in attorney's fees and \$15,000 in actual costs. The action has been dismissed with prejudice and all defendants have been released from liability. The Company has accrued the costs associated with this matter as of September 30, 2004 and the fees were paid in October 2004.

Table of Contents

On September 8, 2003, an action was commenced in the Supreme Court of the State of New York by Praedium II Broadstone LLC against Tendagio, Inc. (formerly, Inlumen, Inc.), Pinnacor Inc., and several unnamed defendants. The lawsuit alleged a breach of contract claim against Tendagio and a fraudulent conveyance claim against Tendagio and Pinnacor, and sought damages in excess of \$6,000,000 and an order setting aside the conveyance of assets made by Inlumen to Pinnacor in October 2002 in connection with Pinnacor's purchase of certain assets from Inlumen. Pinnacor filed an answer to the lawsuit in which it sought dismissal of all claims against Pinnacor. On March 10, 2004, Defendant Tendagio filed a Motion for Summary Judgment to dismiss the Complaint. On April 26, 2004, the Company served upon the Plaintiff its Cross Motion for Summary Judgment seeking dismissal of the Complaint, with prejudice. On May 10, 2004, the Company was served with Plaintiff's Cross Motion seeking dismissal of the action in its entirety, without prejudice, or alternatively, additional time to respond to Defendant's Summary Judgment Motions. In July 2004, the parties settled the action, pursuant to which the action has been dismissed with prejudice, all defendants have been released from liability and the Company has no financial obligation to the Plaintiff.

On December 19, 2003, the Securities and Exchange Commission notified Thom Calandra, our former chief commentator and author of The Calandra Report, that it was conducting an inquiry regarding possible violations of the federal securities laws by Mr. Calandra. In connection with the SEC's inquiry, the Company received requests and subpoenas from the SEC to produce documents and other relevant information concerning these matters, including subpoenas to produce the stock trading records of four executive officers. The Company is fully cooperating with the SEC.

On October 18, 2004, an action was commenced in the United States District Court for the Southern District of New York against the Company by an individual. The lawsuit alleges the following claims against the Company: breach of contract, violation of New York labor laws, unjust enrichment, promissory estoppel, equitable estoppel and breach of covenant of fair dealing, in the amount of \$400,000. The claims arise out of a Letter of Engagement dated November 9, 2002 allegedly entered into between the Company and the Plaintiff. The Company is currently preparing a response to the Complaint. No estimate can be made of the possible loss or possible range of losses associated with the resolution of this matter. As a result, no losses have been accrued in the Company's financial statements as of September 30, 2004. Accordingly, the result of this lawsuit could have a material impact on the balance sheet, results of operations and cash flows.

On or about November 2, 2004, a former employee of Pinnacor Inc. filed a demand for arbitration before Judicial Arbitration and Mediation Services seeking compensation related to the termination agreement he entered into with the Company. The former employee claims he is entitled to lost wages of \$284,375 plus certain additional fees and damages. The Company's management has not had an opportunity to review and evaluate this claim. The Company has established an appropriate accrual based on the expected outcome of the legal proceeding, and does not expect the ultimate resolution of the claim to have a material impact on the balance sheet, results of operations and cash flows.

On or about November 5, 2004, a shareholder class action lawsuit was filed against the Company, the Company's directors, and Viacom, Inc. (Viacom) in the Delaware Court of Chancery in connection with an amendment to a Schedule 13D filed by Viacom. The lawsuit alleges, among other things, that the Company's directors breached their fiduciary duties. The Complaint seeks, among other things, a court order, an injunction and unspecified damages. The Company's management has not had an opportunity to review and evaluate this claim. As a result, no losses have been accrued in the Company's financial statements as of September 30, 2004. Accordingly, the result of this lawsuit could have a material impact on the balance sheet, results of operations and cash flows.

On November 5, 2004, the Company received a preliminary report from a third party auditor representing a data provider. The audit was routine in nature and intended to ensure the Company's compliance with the data vendor's contractual obligations. Although the Company has not yet received any formal notification from the data provider, the preliminary report reflects a potential exposure of approximately \$7.4 million, with a possible additional liability for retroactive payment of 8% thereon. Until the Company receives a formal demand letter, the Company's management cannot fully review and evaluate the claim and no estimate can be made of the possible loss or possible range of losses associated with the resolution of this matter. As a result, no losses have been accrued in the Company's financial statements as of September 30, 2004. The result of this audit resolution could have a material impact on the balance sheet, results of operations and cash flows.

Edgar Filing: MARKETWATCH INC - Form 10-Q

In addition, from time to time, we are subject to legal proceedings and claims in the ordinary course of business. We are not currently aware of any other legal proceedings or claims that will have a material adverse effect on our financial position or results of operations.

Table of Contents**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The Company held its 2004 Annual Meeting of Stockholders on August 4, 2004. The following proposals were voted on by the Company stockholders and results obtained thereon:

Proposal 1: Election of Directors

The election of the members of the Board of Directors of the Company was approved as follows:

	<u>In Favor</u>	<u>Withheld</u>
Lawrence S. Kramer	23,858,919	284,302
Peter Glusker	24,024,588	118,633
Christie Hefner	24,027,864	115,357
Andrew Heyward	24,025,250	117,971
David C. Hodgson	24,027,864	115,357
Philip Hoffman	24,025,721	117,500
Zachary Leonard	24,024,679	118,542
Robert H. Lessin	24,029,369	113,852
Douglas McCormick	23,799,285	343,936
David Moore	24,029,290	113,931
Jeffrey F. Rayport	23,799,622	343,599

Mr. Zachary Leonard subsequently resigned as a Board member effective as of September 24, 2004.

Proposal 2: Ratification of Appointment of Independent Registered Public Accounting Firm

PricewaterhouseCoopers LLP was ratified as the Company's Independent Registered Public Accounting Firm for fiscal year 2004 with 24,112,402 in favor, 29,863 against, and 956 abstentions.

Proposal 3: Approval of the amendment of the Company's Amended and Restated Certificate of Incorporation to change the name of the Company from MarketWatch.com, Inc. to MarketWatch, Inc. was approved with 24,095,405 in favor, 45,652 against, and 2,164 abstentions.

ITEM 6. EXHIBITS

A. Index to Exhibits

Edgar Filing: MARKETWATCH INC - Form 10-Q

The exhibits filed as part of this Form 10-Q are listed in the Index to Exhibits immediately preceding such exhibits, which Index to Exhibits is incorporated herein by reference.

Table of Contents

MarketWatch, Inc.

SIGNATURES

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

MarketWatch, Inc.

(Registrant)

Dated: November 12, 2004

By: /s/ PAUL J. MATTISON

Paul J. Mattison
Chief Financial Officer
(Principal Financial and Accounting Officer)

Table of Contents

INDEX TO EXHIBITS

Exhibit

Number Exhibit Title

- | <u>Number</u> | <u>Exhibit Title</u> |
|---------------|---|
| 10.44 | Amended and Restated Employment Agreement between the Company and Lawrence Kramer, effective as of July 1, 2004 (Incorporated by reference to Exhibit 10.1, filed with Registrant's Current Report on Form 8-K filed on September 29, 2004) |
| 10.45 | Option Agreement of Paul J. Mattison, dated as of September 17, 2004 (Incorporated by reference to Exhibit 10.1, filed with Registrant's Current Report on Form 8-K filed on September 21, 2004) |
| 10.46 | Restricted Stock Bonus Award Agreement of Lawrence S. Kramer, dated as of September 24, 2004 (Incorporated by reference to Exhibit 10.2, filed with Registrant's Current Report on Form 8-K filed on September 29, 2004) |
| 10.47 | Form of Option Agreement for Employees under the 2004 Stock Incentive Plan (Incorporated by reference to Exhibit 10.3, filed with Registrant's Current Report on Form 8-K filed on September 29, 2004) |
| 10.48 | Amended and Restated Non-Employee Director Option Program (Incorporated by reference to Exhibit 10.4, filed with Registrant's Current Report on Form 8-K filed on September 29, 2004) |
| 10.49 | Form of Option Agreement for Directors under the 2004 Stock Incentive Plan (Incorporated by reference to Exhibit 10.5, filed with Registrant's Current Report on Form 8-K filed on September 29, 2004) |
| 10.50 | Separation Agreement between the Company and Joan Platt effective September 7, 2004 |
| 10.51 | Offer Letter for offer of employment between the Company and Paul J. Mattison effective September 7, 2004 |
| 31.1 | Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification of the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |