MARKETWATCH INC
Form 10-Q
August 16, 2004
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**FOR THE QUARTERLY PERIOD ENDED JUNE 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.)**

**(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)**

| **DELAWARE** | **27-0064104** |
|---|---|
| **(State or Other Jurisdiction of Incorporation or Organization)** | **(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 x NO ¨

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

The number of shares of the registrant s Common Stock outstanding as of August 2, 2004 was 25,137,098.

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**MarketWatch, Inc.**

**Quarterly Report on Form 10-Q for the Period Ended JUNE 30, 2004**

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**Part I FINANCIAL INFORMATION**

**ITEM 1. INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**MarketWatch, Inc.**

**Condensed Consolidated Balance Sheets**

(in thousands)

| | June 30, 2004 (unaudited) | December 31, 2003 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $ 52,264 | $ 48,079 |
| Restricted cash | 1,496 | |
| Accounts receivable, net | 14,369 | 7,022 |
| Prepaid expenses | 1,461 | 685 |
| Total current assets | 69,590 | 55,786 |
| Property and equipment, net | 4,375 | 4,387 |
| Goodwill | 88,035 | 22,429 |
| Intangibles, net | 7,388 | |
| Prepaid acquisition costs | | 2,498 |
| Restricted cash | 649 | |
| Other assets | 1,210 | 128 |
| Total assets | $ 171,247 | $ 85,228 |
| Liabilities and Stockholders Equity | | |
| Current liabilities: | | |
| Accounts payable | $ 3,982 | $ 1,216 |
| Accrued expenses | 11,404 | 6,605 |
| Capital lease obligations | 492 | |
| Deferred revenue | 8,713 | 1,377 |
| Total current liabilities | 24,591 | 9,198 |
| Other liabilities | 1,135 | 865 |
| Total liabilities | 25,726 | 10,063 |
| Stockholders equity: | | |
| Preferred stock | | |
| Common stock | 251 | 180 |
| Additional paid-in capital | 392,647 | 323,141 |
| Deferred stock-based compensation | (42) | |

| | | |
|---|---|---|
| Comprehensive income | 23 | |
| Accumulated deficit | (247,358) | (248,156) |
| Total stockholders equity | 145,521 | 75,165 |
| Total liabilities and stockholders equity | $ 171,247 | $ 85,228 |

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

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**MarketWatch, Inc.**

**Unaudited Condensed Consolidated Statements of Operations**

(in thousands, except per share data)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2004 | 2003 | 2004 | 2003 |
| | | (as restated) | | (as restated) |
| Net revenues: | | | | |
| Advertising | $ 8,001 | $ 5,399 | $ 15,667 | $ 10,574 |
| Licensing | 11,712 | 5,342 | 21,465 | 10,962 |
| Subscription | 476 | 359 | 873 | 682 |
| Total net revenues | 20,189 | 11,100 | 38,005 | 22,218 |
| Cost of net revenues | 5,977 | 4,321 | 11,711 | 8,629 |
| Gross profit | 14,212 | 6,779 | 26,294 | 13,589 |
| Operating expenses: | | | | |
| Product development | 4,464 | 1,754 | 8,987 | 3,596 |
| General and administrative | 4,243 | 2,801 | 8,481 | 5,730 |
| Sales and marketing | 4,027 | 2,486 | 7,651 | 4,905 |
| Amortization of intangibles | 147 | | 561 | |
| Total operating expenses | 12,881 | 7,041 | 25,680 | 14,231 |
| Income (loss) from operations | 1,331 | (262) | 614 | (642) |
| Interest income, net of expense | 83 | 135 | 209 | 269 |
| Provision for income taxes | (25) | | (25) | (3) |
| Net income (loss) | $ 1,389 | $ (127) | $ 798 | $ (376) |
| Basic net income (loss) per share | $ 0.06 | $ (0.01) | $ 0.03 | $ (0.02) |
| Diluted net income (loss) per share | $ 0.05 | $ (0.01) | $ 0.03 | $ (0.02) |
| Shares used in the calculation of basic net income (loss) per share | 24,963 | 17,262 | 24,032 | 17,210 |
| Shares used in the calculation of diluted net income (loss) per share | 27,000 | 17,262 | 26,283 | 17,210 |

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

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**MarketWatch, Inc.**

**Unaudited Condensed Consolidated Statements of Cash Flows**

(in thousands)

| | Six Months Ended June 30, | |
|---|---|---|
| | **2004** | **2003** |
| | | **(as restated)** |
| Cash flows from operating activities: | | |
| Net income (loss) | $ 798 | $ (376) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Provision for bad debt | 180 | (66) |
| Depreciation and amortization | 2,598 | 2,027 |
| Non-cash charges from stockholder | | 56 |
| Amortization of deferred stock compensation | 12 | |
| Changes in operating assets and liabilities, net of acquired amounts: | | |
| Accounts receivable | (6,754) | (43) |
| Prepaid expenses and other assets | (651) | (485) |
| Accounts payable and accrued expenses | 3,544 | 1,143 |
| Deferred revenue | 2,396 | 505 |
| Net cash provided by operating activities | 2,123 | 2,761 |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (451) | (631) |
| Acquisition of business, net of cash acquired | (6,245) | |
| Net cash used in investing activities | (6,696) | (631) |
| Cash flows from financing activities: | | |
| Principal payments under capital lease obligations | (428) | |
| Issuance of common stock | 9,163 | 881 |
| Net cash provided by financing activities | 8,735 | 881 |
| Effect of exchange rate changes on cash and cash equivalents | 23 | |
| Net change in cash and cash equivalents | 4,185 | 3,011 |
| Cash and cash equivalents at the beginning of the period | 48,079 | 43,328 |
| Cash and cash equivalents at the end of the period | $ 52,264 | $ 46,339 |

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

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**MarketWatch, Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited)**

## Note 1 - Organization and Nature of Business

*The Company*

MarketWatch, Inc. (the Company ), a leading multi-media publisher of business and financial news and provider of information and analytical tools, 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 34.1% 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 six months ended June 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 first six months ended June 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 (loss) 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.

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| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2004 | 2003 | 2004 | 2003 |
| Net income (loss): | | | | |
| As reported | $ 1,389 | $ (127) | $ 798 | $ (376) |
| Add: Stock-based employee compensation expense included in reported net income, net of related tax effects | 2 | | 12 | |
| Deduct: Stock-based employee compensation expense determined under fair value based method, net of related tax effects | (665) | (729) | (1,436) | (1,444) |
| Pro forma net income (loss) | $ 726 | $ (856) | $ (626) | $ (1,820) |
| Net income (loss) per share: | | | | |
| As reported, basic | $ 0.06 | $ (0.01) | $ 0.03 | $ (0.02) |
| As reported, diluted | $ 0.05 | $ (0.01) | $ 0.03 | $ (0.02) |
| Pro forma net income (loss) per share, basic | $ 0.03 | $ (0.05) | $ (0.03) | $ (0.11) |
| Pro forma net income (loss) per share, diluted | $ 0.03 | $ (0.05) | $ (0.03) | $ (0.11) |

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 June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2004 | 2003 | 2004 | 2003 |
| Stock Options | | | | |
| Expected dividend | 0% | 0% | 0% | 0% |
| Risk-free interest rate | 2.4% | 2.4% | 2.6% | 2.5% |
| Expected volatility | 51% | 60% | 51% | 83% |
| Expected life (in years) | 4 | 4 | 4 | 4 |
| Employee Stock Purchase Plan | | | | |
| Expected dividend | 0% | 0% | 0% | 0% |
| Risk-free interest rate | 1.2% | 1.6% | 1.1% | 1.5% |
| Expected volatility | 45% | 60% | 48% | 84% |
| 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 (Loss) Per Share**

The Company computes net income (loss) 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 (loss) per common share (Basic EPS) is computed by dividing net income (loss) by the weighted average number of common shares

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

Common equivalent shares of 2,037,440 and 2,250,653 were included in the computation of diluted net income per share for the three and six months ended June 30, 2004, respectively, and were related to shares issuable upon the exercise of stock options. Diluted loss per share for the three and six-month periods ended June 30, 2003 was based only on the weighted-average number of shares outstanding during the periods, and excluded common stock equivalents, as the inclusion of any common share equivalents 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 |
| | $ 107,738 |

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

| | |
|---|---|
| Cash acquired | $ 41,270 |
| Other tangible assets acquired | 6,588 |
| Amortizable intangible assets: | |
| Developed technology | 4,050 |
| Acquired customer base | 3,750 |
| In-process research and development | 300 |
| Goodwill | 65,606 |
| | 121,564 |
| Liabilities assumed | (13,880) |
| Deferred stock-based compensation | 54 |
| Total | $ 107,738 |

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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 June 30, 2004 increased the balance to $65.6 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, 2004 and 2003, respectively (in thousands, except per share amounts):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2004 | 2003 | 2004 | 2003 |
| Net revenues | $ 20,189 | $ 19,540 | $ 38,872 | $ 39,000 |
| Net income (loss) | $ 1,389 | $ (684) | $ 770 | $ (1,219) |
| Net income (loss) per share: | | | | |
| Basic | $ 0.06 | $ (0.03) | $ 0.03 | $ (0.05) |

| | | | | |
|---|---|---|---|---|
| Diluted | $ 0.05 | $ (0.03) | $ 0.03 | $ (0.05) |

**Note 5 Goodwill and Intangible Assets**

*Intangible Assets*

Intangible assets consisted of the following (in thousands):

| | June 30, 2004 | | |
|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Intangible Assets |
| Developed technology | $ 4,214 | $ 480 | $ 3,734 |
| Acquired customer base | 3,915 | 261 | 3,654 |
| | $ 8,129 | $ 741 | $ 7,388 |

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The fair value underlying the $300,000 assigned to acquired in-process research and development ( IPR&D ) in the Pinnacor acquisition was expensed immediately during the quarter ended March 31, 2004 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.

*Goodwill*

**Goodwill consisted of the following (in thousands):**

| | |
|---|---|
| Balance at December 31, 2003 | $ 22,429 |
| Goodwill acquired during period | 65,425 |
| Goodwill adjustments | 181 |
| Balance at June 30, 2004 | $ 88,035 |

The increase in goodwill at June 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 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 $561,000 and $797,000 for the three months ended June 30, 2004 and 2003, respectively, and $1.0 million and $1.2 million for the six months ended June 30, 2004 and 2003, respectively, related to the licensing of CBS news content and trademarks. In addition, the Company recorded advertising expenses of $0 and $11,000 at rate card value for the three months ended June 30, 2004 and 2003, respectively, and $0 and $56,000 for the six months ended June 30 2004 and 2003, respectively, for in-kind advertising and promotion provided by CBS. Rental payments to CBS for leasing of certain facilities were $381,000 and $320,000 for the three months ended June 30, 2004 and 2003, respectively, and $622,000 and $629,000 for the six months ended June 30, 2004 and 2003, respectively.

Licensing revenues from FT.com and Financial Times, subsidiaries of Pearson, were $484,000 and $367,000 for the three months ended June 30, 2004 and 2003, respectively, and $801,000 and $794,000 for the six months ended June 30, 2004 and 2003, respectively. The Company recognized costs to IDC of $173,000 and $158,000 for the three months ended June 30, 2004 and 2003, respectively, and $348,000 and $397,000 for the six months ended June 30, 2004 and 2003, respectively, for data feeds. In March 2003, IDC purchased Comstock, Inc. and the Company expensed $543,000 for the three months ended June 30, 2004 and $919,000 for the six months ended June 30, 2004 for data feeds from Comstock, Inc. Direct charges for subscription revenues for certain IDC data feeds were $6,000 and $10,000 for the three months ended June 30, 2004 and 2003, respectively, and $13,000 and $22,000 for the six months ended June 30, 2004 and 2003, respectively. In addition, the Company recognized revenues of $716,000 and $621,000 for the three months ended June 30, 2004 and 2003, respectively, and $1.3 million and $1.2 million for the six months ended June 30, 2004 and 2003, respectively, from television and radio programming on CBS stations. The Company recognized costs to CBS of $342,000 for the three months ended June 30, 2004 and 2003 and $683,000 and $586,000 for the six months ended June 30, 2004 and 2003, respectively, for production of television and radio programming.

At June 30, 2004 and December 31, 2003, $12,000 and $453,000, respectively, were included in accounts receivable for radio and television revenue due from CBS. In addition, $5,000 and $11,000, respectively, were included in the Company s accounts receivable related to licensing and subscription revenues due from IDC, and $178,000 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. At June 30, 2004 and December 31, 2003, the Company had a liability of $828,000 and $972,000, respectively, recorded for CBS royalty fees, a liability of $333,000 and $266,000, respectively, owed to CBS for television production and facilities costs, and a liability of $378,000 and $203,000, respectively, to IDC and Comstock, Inc. for data feeds.

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**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 segment.

**Note 8 Restatement**

The Company has restated its consolidated statements of operations and cash flows for the three months ended March 31, 2004 and 2003, three and six months ended June 30, 2003 and three and nine months ended September 30, 2003 and its consolidated balance sheets as of March 31, 2004 and 2003, June 30, 2003 and September 30, 2003. The restatement reflects the adoption of a corrected method in which the Company calculates its quarterly CBS royalty expenses by recognizing royalty expenses based on the estimated effective annual royalty rate, which requires management to estimate the annual gross revenues subject to the CBS royalty fees and excluded revenues not subject to the CBS royalty fees, and apply the derived effective annual royalty rate to all revenues in each of the quarters within a fiscal year. Historically, the Company recognized CBS royalty expenses in the quarter in which it became obligated to pay such expenses based on the specified royalty rate applied to the relevant revenue of that quarter. The restatements have an effect on the Company s cost of net revenues, gross profits, net income (loss) and earnings (loss) per share for the restated quarterly periods.

The restatement has no impact on the Company s 2003 annual operating results, cash flow or royalty due to CBS as the restatement relates only to the timing of the accruals of the CBS royalty expenses among the quarters within the 2003 fiscal year.

The following table presents the impact of the restatement adjustments on net income (loss) for the three months ended March 31, 2004 and 2003:

| | **Three Months Ended March 31, 2004** | | **Three Months Ended March 31, 2003** | |
|---|---|---|---|---|
| | **As Previously Reported** | **As Restated** | **As Previously Reported** | **As Restated** |
| Cost of net revenues | $ 5,468 | $ 5,734 | $ 4,024 | $ 4,308 |
| Gross profit | 12,348 | 12,082 | 7,094 | 6,810 |
| Loss from operations | (451) | (717) | (96) | (383) |
| Net income (loss) | (325) | (591) | 35 | (249) |
| Net income (loss) per share basic and diluted | (0.01) | (0.03) | 0.00 | (0.01) |

The following table presents the impact of the restatement adjustments on net loss for the three and six months ended June 30, 2003:

| | Three Months Ended June 30, 2003 | | Six Months Ended June 30, 2003 | |
|---|---|---|---|---|
| | As Previously Reported | As Restated | As Previously Reported | As Restated |
| Cost of net revenues | $ 4,403 | $ 4,321 | $ 8,427 | $ 8,629 |
| Gross profit | 6,697 | 6,779 | 13,791 | 13,589 |
| Loss from operations | (344) | (262) | (440) | (642) |
| Net loss | (209) | (127) | (174) | (376) |
| Net loss per share basic and diluted | (0.01) | (0.01) | (0.01) | (0.02) |

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The following table presents the impact of the restatement adjustments on net income for the three and nine months ended September 30, 2003:

| | Three Months Ended September 30, 2003 | | Nine Months Ended September 30, 2003 | |
|---|---|---|---|---|
| | As Previously Reported | As Restated | As Previously Reported | As Restated |
| Cost of net revenues | $ 4,601 | $ 4,508 | $ 13,028 | $ 13,137 |
| Gross profit | 6,975 | 7,068 | 20,766 | 20,657 |
| Income (loss) from operations | 185 | 278 | (258) | (364) |
| Net income | 300 | 393 | 126 | 17 |
| Net income per share basic and diluted | 0.02 | 0.02 | 0.01 | 0.00 |

**Note 9 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 ) 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. It is anticipated that any potential financial obligation of the Company to plaintiffs pursuant to the terms of the MOU and related agreements will be covered by existing insurance. Therefore, the Company does not expect that the settlement will involve any payment by the Company. The MOU and related agreements are subject to a number of contingencies, including the negotiation of a settlement agreement and its approval by the Court.

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 reached a settlement and have executed a settlement agreement which is pending court approval. The settlement provides, among other things, that the action will be dismissed with prejudice and that all defendants will be released from liability, in recognition of certain additional disclosures contained in the proxy solicitation material distributed to Pinnacor stockholders. The settlement also provides for a payment to plaintiff s counsel of $300,000 in attorneys fees and up to $15,000 in actual costs. The Company has accrued costs associated with this matter.

On June 7, 2002, an action was commenced against Pinnacor alleging 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 the plaintiff for breach of contract, breach of warranty and misrepresentation. Motions for summary judgment were filed early 2003. These motions are still pending. No estimate can be made of the possible loss or possible range of loss associated with the resolution of this matter. As a result, no losses have been accrued in the Company s financial statements as of June 30, 2004.

On September 8, 2003, an action was commenced in the Supreme Court of the State of New York against 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 parties its cross motion for summary judgment seeking dismissal of the complaint with prejudice. In May 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 defendants summary judgment motions. The parties have reached a settlement of the action. The settlement is subject to execution of a final settlement agreement. The settlement provides, among other things, that the action will be dismissed with prejudice, all defendants will be released from liability and the Company has no financial obligation to the plaintiff.

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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 10 Recent Accounting Pronouncements**

In January 2003, the FASB issued Interpretation No. 46 ( FIN 46 ), Consolidation of Variable Interest Entities , which was amended by FIN 46R issued in December 2003. This interpretation of Accounting Research Bulletin (ARB) No. 51, Consolidated Financial Statements establishes accounting guidance for consolidation of a variable interest entity ( VIE ), formerly referred to as special purpose entities. FIN 46 provides guidance for determining when an entity should consolidate a VIE. The Company has never formed a VIE, and, therefore, FIN 46 is not applicable.

**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 provider of financial news and information, 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 segment.

Online advertising revenues, which account for a significant portion of our total revenues, are derived from the sale of advertisements and sponsorships on our Web sites. 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 six 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 eMarketer, an aggregator of market research, indicates that online advertising spending in the United States is estimated to grow 13% in 2004. 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 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 impact our ability to be cash flow positive and generate net income.

Licensing revenues, which account for a significant portion of our total revenues, consist of revenues earned from the licensing of our 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 ourselv