DARK BLUE SEA LIMITED
ACN 091 509 796

Company Announcement

Date: 5 November, 2008

September 2008 Quarterly Update

Dark Blue Sea Ltd (ASX listing code DBS) today released an update on its quarterly performance for the three months to 30 September, 2008.

As advised with the release of the March 2006 quarterly cash flow statement, the Company will no longer lodge Appendix 4C statements with the Australian Stock Exchange. The Company has previously announced some Key Performance Indicators (KPIs) coincident with these releases. It is the Company's intention to continue to release these KPIs on a quarterly basis.

This release contains information about:

- Key Performance Indicators
- September Quarter Trading Performance
- The Company's domain name portfolio and Domain Trading
- Strategic Outlook
- Current Financial Position
- Financial Impact of the Australian Dollar versus the US Dollar

Key Performance Indicators

The Company releases some key financial performance indicators for comparative purposes. These indicators are based on unaudited management accounts.

The updated Key Performance Indicators for the September 2008 Quarter appear on the following page.

Revenue (US$'000)	Qtr end 30.09.07	Qtr end 31.12.07	Qtr end 31.03.08	Qtr end 30.06.08	Qtr end 30.09.08
Internal Traffic – Profitable Domain Names	1,923	1,550	1,258	1,034	806
Internal Traffic – Unprofitable Domain Names	87	111	112	109	99
Total Internal Traffic	2,010	1,661	1,370	1,143	905
Internal Domain Name Sales	857	1,366	1,003	2,779	1,187
Total Internal Revenue	2,866	3,026	2,372	3,922	2,093
External Traffic	2,759	2,900	2,988	2,981	2,362
Total Traffic Revenue	4,768	4,561	4,357	4,124	3,267
Revenue Margin (%)					
Internal Traffic – Profitable Domain Names	88	85	85	85	83
Total Internal	68	69	63	76	57
External	27	26	26	24	26
Total Traffic	39	33	29	22	19
Number of Profitable Domains	153,000	152,000	116,000	96,000	87,000

A more detailed explanation on the Key Performance Indicators is provided in the "Background on Key Performance Indicators Section" below.

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September Quarter Trading Performance

The Company had a disappointing trading performance in the September quarter reflecting ongoing difficult trading conditions on the traffic / advertising side of the business and a fair domain sales performance. Overall financial performance was significantly assisted by the decline in the $A / $US exchange rate over the quarter. Further details on the $A / $US exchange rate sensitivity are presented below.

Dark Blue Sea is a US centric business that generates most of its revenue from direct navigation advertising which is part of the US online advertising industry. The key factors that are currently driving the direct navigation advertising industry are

- the weaker economic environment in the US
- generally fewer advertisers (as observed by Dark Blue Sea) leading to a reduction in bid prices and coverage and hence overall yield received by Dark Blue Sea
- changes to the way that online advertisers can place advertisements via the advertiser interfaces of the major search advertising networks; and
- an overall uncertain strategic landscape stemming from the unsuccessful takeover bid for Yahoo by Microsoft and the subsequent outsourcing of search advertising to Google by Yahoo.

Detailed commentary on each of these factors was provided in the March 2008 Quarter KPI report lodged with the ASX on May 6, 2008. Since the release of this report six months ago, trading conditions have continued to deteriorate.

From mid-September (when the credit crisis started to crescendo), the Company saw another significant deterioration in advertising performance. Whilst there has been some improvement from mid-October, there is now wide spread pessimism on the outlook for the US economy and the overall US advertising industry. This has led to reduced expectations on the outlook for the online advertising industry in 2009.

It is important to note that whilst online advertising (particularly search advertising) has been shown to be very cost effective relative to other forms of advertising, it is also very easy to cancel. Search advertising is essentially sold on a spot-market basis and the prices paid are based on real time auctions. Fewer advertisers can lead to much lower prices. In this regard, the outlook for search advertising and the Company's advertising performance remains uncertain.

Secondary market domain sales have generally performed well in the context of the weakening US economy. The Company did see some softening in sales from mid-September but domain sales performance has since rebounded to prior levels. There is ongoing work being done with the Company's main registrar partners (including GoDaddy) on improving domain sales performance. In this regard, the Company continues to remain optimistic on the outlook for secondary market domain sales.

The Company's Domain Name Portfolio and Domain Trading

As at September 30, the Company had a portfolio of approximately 570,000 domain names. Whilst broad analysis of the portfolio can be simplified into a few financial metrics (such as current advertising revenue, number of profitable domain names and value of domain sales), this obscures the true nature of the portfolio.

Like a share portfolio with (investment / trading) positions in different companies' shares, the Company's domain name portfolio has a range of different positions. In fact the Company has 570,000 different positions, each costing approximately US$7 per annum to maintain. Each position can be renewed for a further year or discontinued for no cost (other than administrative). In this regard, the Company's domain name portfolio is a very flexible investment that has progressively evolved since its establishment in 2002. As a general comment, the portfolio has evolved (and will continue to evolve) as the ways to monetise the internet have evolved. In constructing the portfolio, we try to incorporate both current monetisation opportunities as well as anticipated ones (as innovation on the internet continues).

Our main position is generic non-typo dot com domain names and this forms the core of our portfolio. It is this core which both generates advertising revenue (either currently or expected in the future) and has the possibility of being sold to retail buyers at a realistic price with a reasonable probability. In this regard it is exposed to the two main revenue streams (currently) in the domain name industry. We see generic dot com domain names, particular ones that have underlying commerciality, as enduring assets – names that will always be in demand and likely to appreciate in value as the internet grows over the next five to ten years.

The Company has a range of other positions in the portfolio as well. Different domain name extensions such as .co.uk and .com.au are one example. Like most portfolios, some of these positions will work, some won't. Some positions have worked in the past and may not in the future. This is the ongoing management challenge – structuring the portfolio appropriately within the constraints of the Company's financial resources.

Like share traders who buy and sell, other professional domain industry participants may have different views, risk profiles or financial objectives to ours. In this regard there is a reasonably active and liquid professional secondary market for domain names. It is to this market that we sold some of our (non-core) domain names to other professional domain investors in the June quarter.

Domain sales are an import source of liquidity for the Company. Cash raised from domain sales can be used to reinvest back into more domains. Alternatively, the cash can be used to pay dividends to share holders or to buy back shares.

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A full discussion on our approach to finding and valuing domain names was presented in the Managing Director's commentary of Dark Blue Sea's 2008/09 Annual Report. Recently, the Company has been undertaking an extensive review of the domain names it holds in its portfolio, particularly in the context of the weaker US online advertising industry outlook. It is worth noting that the Company's portfolio now generates more revenue from secondary market domain sales than advertising.

In this regard, we have identified a significant number of domain names for which the Company does not currently intend to renew the registration. During the quarter, the Company partnered with NameJet to auction off these domain names just prior to expiry.

Strategic Outlook

2008 has been a turbulent year for the domain name industry with most (if not all) domain name owners seeing substantial declines in advertising revenue. This is particularly the case in circumstances where there is revenue concentration on either Google or Yahoo which is most of the industry (including Dark Blue Sea's own portfolio).

Historically, the domain services businesses (i.e. those businesses which provide registration, advertising and secondary market sales services) to third-party domain name owners (including Fabulous) has generated the majority of their gross profit from intermediating advertising revenue. As the advertising component of the industry has declined, industry profitability has plummeted. Many services businesses that rely exclusively on advertising are no longer viable and the industry is ripe for consolidation.

In a strategic context, Dark Blue Sea is relatively well positioned as it has established businesses in the full range of domain name services - advertising (Fabulous), domain registration (Fabulous) and secondary market domain sales (Domain Distribution Network). Dark Blue Sea is one of the few companies in the world that can provide all these services and is probably the best integrated solution. Dark Blue Sea also has its own domain name portfolio that underwrites the entire business and is a source of liquidity if required.

Going forward, the Company sees secondary market domain name sales becoming a much more significant component of the industry (and for its own portfolio). In this regard, Dark Blue Sea is very well positioned to benefit as it was first to market with a fully scalable secondary market domain names solution through the retail registrars (via the Domain Distribution Network) and as at today remains one of only a couple of access points to that distribution channel.

In the context of the expected industry consolidation, the Company is currently exploring a range of strategic options with other domain industry service providers. Whilst it is a difficult time to consummate transactions given the industry-specific and general economic uncertainty as well as market volatility, discussions with other industry participants suggests the timing is appropriate.

Current Financial Position

As at the end of October, the Company had approximately A$2 million net cash at bank. In late September, the Company prepaid approximately US$1.2 million of domain registrations prior to the recent domain registry price increases. The Company now has limited registration related financial commitments until Q2 2009 and it is expected that this registration prepayment will progressively flow back into cash at bank over this period. The Company continues to maintain its debt facilities (A$1 million and US$4 million) which have remained substantially unused. The Company also continues to have the ability to generate liquidity reasonably quickly if required by selling some domain names to other professional domain name owners.

The key drivers for the Company's revenue are advertising and domain sales revenue from the Company's own domain name portfolio, intermediary business gross profits and the level of the $A / $US exchange rate. The main cost drivers are domain registrations for the Company's own portfolio and overheads. Most of the revenue drivers have been extremely volatile (some favourably, some not) in recent time so it is difficult to get a true reading on the financial outlook for the Company. At current levels the Company is basically running at cash flow break-even / slight profit.

Overall, the Company is very well positioned to weather the current financial storm, unlike some other industry participants that have considerable debt levels or dependence on single income streams such advertising intermediary revenues. Whilst survival is not a significant issue, restoring the Company to acceptable levels of profitability is clearly important once the storm passes and the outlook becomes clearer. In this context, the Company continues to review all of these key profit drivers in parallel with the strategic initiatives outlined above.

Financial Impact of the Australian Dollar versus the US dollar

The Company has been favourably affected by the decline in the Australian dollar versus the US dollar. Even though the Company reports in Australian dollars, most of the Company's business is transacted in US dollars. The effect is seen in the translation of balance sheet items and is explicitly recognised in the Profit and Loss. There is also a through the period effect which is not explicitly recognised but is observed as an improvement in the operating margin.

The Company's internal modelling estimates the current sensitivity on 2008/09 EBITDA to be approximately A$100,000 per one cent change. To date, during 2008/09, the exchange rate has moved favourably by approximately 30 cents.

The Company manages the operational aspects of the business from a US dollar perspective and keeps excess cash is US dollars. The Company brings back sufficient US dollars on a regular basis to fund its future Australian dollar liabilities (overheads, tax and dividends) but doesn't actively hedge for exchange rate movements. In this regard, the Company continues to be exposed favourably to a decreasing Australian dollar versus the US dollar.

Key Performance Indicators Background Information

The Company releases some key financial performance indicators for comparative purposes. These indicators are based on unaudited management accounts.

From an overall financial performance perspective, it is important to understand that the Company generates all its revenue in US dollars and it pays all its traffic sources in US dollars, so the Company earns a gross profit which is denominated in US dollars. However, the Company's overheads which are primarily staffing related are denominated in Australian dollars so the $A/$US exchange rate can have a significant impact on the Company's financial performance.

The Company generates the bulk of its revenue from selling traffic. A segmentation by traffic source provides the best indicators of the overall trends in the financial performance of the Company.

In any Internet business that generates revenue from traffic, it is important to distinguish between revenue generated from ***Internal*** and ***External*** traffic sources. ***Internal*** traffic sources are ones that are owned and operated by the Company. ***External*** traffic sources are ones that are owned by customer's of the Company.

As ***Internal*** traffic sources are controlled by the Company they form a reliable annuity style revenue stream. ***External*** traffic sources are much less reliable as they are subject to competition in the traffic market. Almost all traffic arrangements can be cancelled on short notice and contracted deals rarely extend beyond one or two years.

Dark Blue Sea's ***Internal*** traffic is almost exclusively sourced from the Company's domain name portfolio. Dark Blue Sea's ***External*** traffic sources are primarily other domain name portfolio owners. The Company uses its unique platform, good relationships with domain name portfolio owners and competitive pricing as the primary methods of acquiring and maintaining ***External*** traffic sources.

The Company earns different margins on ***Internal*** and ***External*** traffic sources. For ***Internal*** traffic sources, the main expense is domain name registration fees. These are a fixed cost and so the margins can be high and expand as the industry grows. For ***Externa***l traffic sources, the arrangements are typically revenue share based and hence the margins are much lower. Good traffic sources have excellent bargaining power.

A further segmentation of the Company's ***Internal*** traffic sources provides additional clarity. A breakdown of the Internal Revenue into the revenue that is generated from ***profitable domain names*** (i.e. those domain names that earn sufficient revenue to cover the annual registration expense) and ***unprofitable domain names***, the number of profitable domain names and the margin achieved on the profitable names is provided. It should be noted that the portfolio of profitable domain names generates the bulk of the ***Internal*** revenue and is a very high margin business.

Domain sales revenues include revenue from all domains the Company sold during the period. These include sales from the Domain Distribution Network, the Company's main web site (FabulousDomains.com) as well as ad-hoc sales (typically for a large number of domains) that are agreed external to the web site.

It should be noted that the Company has additional revenue sources that are not included in these numbers. These revenue sources do not currently have a material impact on the overall financial performance of the Company.

Accounting Treatment of the Domain Name Portfolio

For both new domain name registrations and renewals, it costs the Company US$6.86 to hold each domain name for a period of one year. The $US6.86 cost is paid in advance and so has an immediate cash flow impact. It is viewed by the Company as a prepayment of traffic for twelve months and is recorded as a short term asset in the balance sheet. Domain name registrations are also recorded as operational cash flow in the reported cash flow statements.

The Company amortises that US$6.86 short term prepaid traffic asset over the subsequent 12 month period, effectively passing that cost through as an expense in the profit and loss statement.

Notwithstanding the accounting treatment of domain name registrations and renewals, the domain name portfolio is viewed by the Company as of a capital nature, i.e.: an enduring asset having long term revenue generating capabilities.

In regard to the Company's domain name sales, the proceeds of sales are treated as operating income, and the component in excess of the registration expense is recorded as operating profit.

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About Dark Blue Sea

Dark Blue Sea is an online advertising intermediary or “internet traffic” broker servicing a global customer base from its office in Brisbane. Dark Blue Sea has developed and successfully manages a number of world-class commercial Internet properties including:

- Roar and Pageseeker, pay-per-click advertising portals;
- Fabulous, an ICANN accredited domain name registrar and domain name management system;
- Dark Blue, an online advertising affiliate network;
- The Domain Distribution Network and
- Its Domain Name Portfolio.

Fabulous, Dark Blue and Roar / PageSeeker provide a fully integrated package for the generation, management and monetization of “internet traffic”. “Internet traffic” is directly analogous to shopping centre floor traffic.

The ability to offer traffic sources and advertisers a platform consisting of an integrated domain name registrar, advertiser affiliate network and a pay-per-click advertising portal is a compelling value-added proposition that the Company believes is unique in the global marketplace.

Dark Blue Sea currently owns a portfolio of more than half a million internet domain names.

The vast majority of Dark Blue Sea’s domain names are what are termed generic keyword domain names. These are domains such as www.booksellers.com that are constructed from generic keywords or phrases (“book sellers” in this case). Users find Dark Blue Sea’s domain names by simply typing domain names such as www.booksellers.com into the address bar of their browser (e.g. Internet Explorer).

The “internet traffic” that is generated from Dark Blue Sea’s portfolio of domain names can be sold to online advertisers. Advertisers can purchase the “internet traffic” from either Roar / PageSeeker or Dark Blue, the Company’s online advertising properties. Dark Blue Sea also has commercial relationships with many other leading online advertiser networks that effectively also buy the “internet traffic” from Dark Blue Sea’s domain name portfolio.

Fabulous was developed to help the Company manage its own domain name portfolio and to provide services to other domain name portfolio owners. The Company combines the internet traffic from its own and other portfolios to try to negotiate the best possible advertising deals.

Fabulous also provides domain name registration services. Fabulous is currently the 12th largest domain name registrar in the world.

Domain names are the real estate of the internet – it is the first step for any business wanting to establish a presence on the Internet. Domain names can trade in the secondary market. Through the Domain Distribution Network, small businesses and individuals can purchase secondary market domain names through their preferred retail registrar.

The Company believes it is well-positioned in a small but important niche of rapidly growing global US$20 billion per annum online advertising market as well as the emerging domain name secondary market.

Dark Blue Sea is listed on the Australian Stock Exchange (code: DBS) and has a Level 1 over-the-counter ADR program through the Bank of New York (code: DKBLY)

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