LookSmart, Ltd.
625 Second Street
San Francisco, CA 94107
Telephone: (415) 348-7000
Facsimile: (415) 348-7034

August 28, 2003

Via ASX Online
Company Announcements Office
Australian Stock Exchange
4th Floor, 20 Bridge Street
Sydney NSW 2000 Australia

Re: Announcement for Immediate Release -- Appendix 4D

Ladies and Gentlemen:

On behalf of LookSmart, Ltd. (Nasdaq: LOOK) (ASX: LOK), transmitted hereby is Appendix 4D for the six month period ended 30 June 2003 for immediate release. The information for the Appendix 4D is included in the Quarterly Report on Form 10-Q attached hereto. In addition, LookSmart's net tangible asset backing per ordinary share is as follows (in U.S. dollars):

Date	Net Tangible Asset Backing Per Ordinary Share
30 June 2002	$0.14
30 June 2003	$0.60

Very truly yours,

LOOKSMART LTD.

/s/ Erik F. Riegler
Erik F. Riegler, Esq.
Corporate Counsel

Attachment

U.S. 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 June 30, 2003

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: 000-26357

LOOKSMART, LTD.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**13-3904355**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

625 Second Street
San Francisco, California 94107
(Address of Principal Executive Offices and Zip Code)
(415) 348-7000
(Registrant's Telephone Number, Including Area Code)

Check whether the registrant: (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes ☒ No ☐

As of July 31, 2003, there were 105,424,114 shares of the registrant's common stock outstanding.

FORM 10-Q

INDEX

PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LOOKSMART, LTD.

CONDENSED CONSOLIDATED BALANCE SHEETS
(In Thousands, except per share data)
(Unaudited)

	June 30, 2003	December 31, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 57,241	$ 47,696
Short-term investments	163	3,568
Trade accounts receivable, net	17,840	15,852
Prepaid expenses	1,460	2,048
Other current assets	841	1,866
Total current assets	77,545	71,030
Property and equipment, net	9,470	9,404
Security deposits and other assets	6,023	5,086
Intangible assets, net	6,504	6,182
Goodwill	8,963	8,852
Total assets	$ 108,505	$ 100,554
LIABILITIES & STOCKHOLDERS' EQUITY		
Current liabilities:		
Long term debt, current portion	$ 383	$ 1,188
Trade accounts payable	2,038	3,333
Other accrued liabilities	21,709	18,429
Deferred revenue	5,971	7,798
Total current liabilities	30,101	30,748
Long term debt	1,041	983
Other long term liabilities	—	921
Total liabilities	31,142	32,652
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Common stock, $.001 par value; Authorized: 200,000 at June 30, 2003 and December 31, 2002; Issued and Outstanding: 104,601 and 101,421 at June 30, 2003 and December 31, 2002	103	100
Additional paid-in capital	256,038	249,244
Other equity	1,082	718
Accumulated deficit	(179,860)	(182,160)
Total stockholders' equity	77,363	67,902
Total liabilities and stockholders' equity	$ 108,505	$ 100,554

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

LOOKSMART, LTD.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME/(LOSS)
(In Thousands, except per share data)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Revenues:				
Listings	$ 34,645	$ 17,169	$ 64,078	$ 33,510
Licensing	3,762	3,791	7,731	7,500
Total revenues	38,407	20,960	71,809	41,010
Cost of revenues	18,788	7,917	35,455	13,036
Gross profit	19,619	13,043	36,354	27,974
Operating expenses:				
Sales and marketing	6,292	4,254	11,629	11,436
Product development	7,759	5,163	14,941	12,180
General and administrative	3,552	2,294	6,606	4,990
Total operating expenses	17,603	11,711	33,176	28,606
Income (loss) from operations	2,016	1,332	3,178	(632)
Non-operating income (expense):				
Interest and other non-operating income (expense), net	(65)	(1,276)	84	(2,613)
Share of joint venture loss	(307)	(852)	(563)	(1,929)
Income (loss) from continuing operations before income taxes and extraordinary gain	1,644	(796)	2,699	(5,174)
Income tax expense	(485)	(10)	(601)	(24)
Income (loss) from continuing operations before extraordinary gain	1,159	(806)	2,098	(5,198)
Loss from discontinued operations	—	—	—	(972)
Income (loss) before extraordinary gain	1,159	(806)	2,098	(6,170)
Extraordinary gain from the purchase of BTLS joint venture entities, net of tax	—	—	202	—
Net income (loss)	1,159	(806)	2,300	(6,170)
Other comprehensive income (loss):				
Change in unrealized gain on securities during the period	—	(4)	—	197
Change in translation adjustment	147	(1)	215	(1)
Comprehensive income (loss)	$ 1,306	$ (811)	$ 2,515	$ (5,974)

LOOKSMART, LTD.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME/(LOSS)
(In Thousands, except per share data)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Net income (loss) per share:				
Basic net income (loss) per share:				
Income (loss) from continuing operations	$ 0.01	$ (0.01)	$ 0.02	$ (0.05)
Loss from discontinued operations	—	—	—	(0.01)
Extraordinary gain from the purchase of BTLS joint venture entities, net of tax	—	—	0.00	—
Net income (loss)	$ 0.01	$ (0.01)	$ 0.02	$ (0.06)
Diluted net income (loss) per share:				
Income (loss) from continuing operations	$ 0.01	$ (0.01)	$ 0.02	$ (0.05)
Loss from discontinued operations	—	—	—	(0.01)
Extraordinary gain from the purchase of BTLS Joint Venture entities, net of tax	—	—	0.00	—
Net income (loss)	$ 0.01	$ (0.01)	$ 0.02	$ (0.06)
Weighted average shares outstanding used in per share calculation—basic	102,693	96,690	101,102	96,082
Weighted average shares outstanding used in per share calculation—diluted	110,324	96,690	108,682	96,082

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

LOOKSMART, LTD.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)
(Unaudited)

	Six Months Ended June 30, 2003	Six Months Ended June 30, 2002
Cash flows from operating activities:		
Net income (loss)	$ 2,300	$ (6,170)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Share of joint venture loss	563	1,929
Depreciation and amortization	3,852	3,775
Stock based compensation	1,154	1,462
Loss from sale of assets and other non-cash charges	(15)	226
Loss from discontinued operations	—	972
Extraordinary gain from the purchase of BTLS joint venture entities	(202)	—
Changes in operating assets and liabilities, net of effects of acquisitions and disposals:		
Trade accounts receivable	(1,988)	531
Prepaid expenses	588	655
Other assets	(884)	342
Trade accounts payable	(1,295)	(1,052)
Other accrued liabilities	4,141	2,771
Deferred revenue	(1,827)	(859)
Net cash provided by operating activities	6,387	4,582
Cash flows from investing activities:		
Acquisition of assets	(612)	—
Proceeds from sale of short-term investments	3,405	13,347
Funding to joint venture and subsidiaries	(500)	(266)
Restricted cash	—	623
Payments for property, equipment and capitalized software development	(2,533)	(2,296)
Proceeds from the sale of property and equipment	1	94
Business acquisition, cash acquired	—	311
Net cash (used in) provided by investing activities	(239)	11,813
Cash flows from financing activities:		
Repayment of notes and leases	(858)	(965)
Proceeds from issuance of common stock	4,040	2,324
Net cash provided by financing activities	3,182	1,359
Effect of exchange rate changes on cash	215	197
Increase in cash and cash equivalents	9,545	17,951
Cash and cash equivalents, beginning of period	47,696	29,766
Cash and cash equivalents, end of period	$ 57,241	$ 47,717

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

LOOKSMART, LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Summary of Significant Accounting Policies

Nature of Business and Principles of Consolidation

LookSmart, Ltd. (the Company) is a leading provider of Internet search solutions for portals, Internet service providers and media companies, as well as a leading provider of marketing products for advertisers who want to be included in relevant search results.

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. Investments in 20% to 50% owned partnerships and affiliates are accounted for by the equity method and investments in less than 20% owned affiliates, over which the Company does not exert any significant influence, are accounted for by the cost method.

Use of Estimates

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States. This requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain prior year's balances have been reclassified to conform to the current year's presentation.

Concentration of Business Risk

The Company derived approximately 65% and 48% of listings revenues in the three months ended June 30, 2003 and 2002, respectively, and 64% and 41% of listings revenues in the six months ended June 30, 2003 and 2002, respectively, from its relationship with Microsoft. The agreement expires on December 3, 2003.

The Company derives all of its licensing revenue from its agreement with Microsoft, which expires on December 3, 2003.

Stock-Based Compensation

The Company accounts for stock-based employee compensation under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," (APB No. 25) and related interpretations. Under APB No. 25, compensation cost is equal to the difference, if any, on the date of grant between the fair value of the Company's stock and the amount an employee must pay to acquire the stock. SFAS No. 123, "Accounting for Stock-based Compensation," established accounting and disclosure requirements using a fair value based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Company has elected to continue to apply the intrinsic value based method of accounting described above, and has adopted the disclosure requirements of SFAS No. 123 and related SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure".

LOOKSMART, LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Unaudited)

The following table illustrates the effect on net income (loss) and net income (loss) per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Net income (loss) as reported	$ 1,159	$ (806)	$ 2,300	$ (6,170)
Add: Stock-based employee compensation expense (benefit) included in reported net income (loss), net of related tax effects	185	(1,438)	1,154	1,462
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of tax	(4,559)	(8,961)	(7,419)	(13,838)
Pro forma net loss	$ (3,215)	$ (11,205)	$ (3,965)	$ (18,546)
Basic net loss per share				
As reported	$ 0.01	$ (0.01)	$ 0.02	$ (0.06)
Pro forma	$ (0.03)	$ (0.12)	$ (0.04)	$ (0.19)
Diluted net income (loss) per share				
As reported	$ 0.01	$ (0.01)	$ 0.02	$ (0.06)
Pro forma	$ (0.03)	$ (0.12)	$ (0.04)	$ (0.19)

Net Income (Loss) Per Share

SFAS No. 128, “Earnings per Share,” establishes standards for computing and presenting earnings per share. Basic earnings per share is calculated using the weighted average shares of common stock outstanding. Diluted earnings per share is calculated using the weighted average number of common and potentially dilutive common shares outstanding during the period, using the as-if converted method for convertible preferred stock and the treasury stock method for options and warrants.

Segment Information

Starting on January 1, 2003, the Company has two operating segments: listings and licensing. The Company exited the ecommerce segment after the second quarter of 2002 and ceased reporting the advertising segment after the fourth quarter of 2002, as it no longer manages advertising as a separate product. With the exception of accounts receivable and deferred revenue and goodwill, information (for the purposes of making decisions about allocating resources) available to the chief operating decision makers, the Chief Executive Officer and the Chief Financial Officer, of the Company does not include allocations of assets and liabilities or operating costs to the Company’s segments.

Combined international revenues from the Company’s foreign subsidiaries were less than 10% of total revenue in the six months ended June 30, 2003 and 2002 and were derived from its operations in Australia, Japan and the United Kingdom, all of which were individually less than 10% of total revenue for the three and six months ended June 30, 2003 and 2002.

As of June 30, 2003 and December 31, 2002, all of the Company’s accounts receivable, intangible assets and goodwill related to the listings segment.

LOOKSMART, LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Unaudited)

As of June 30, 2003 and December 31, 2002, deferred revenue by segments was as follows (in thousands):

	June 30, 2003	December 31, 2002
Listings	$ 4,855	$ 3,983
Licensing	1,116	3,815
Total	$ 5,971	$ 7,798

Recently Issued Accounting Pronouncements

In November 2002, the EITF reached a consensus on Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." This issue addresses how revenue arrangements with multiple deliverables should be divided into separate units of accounting and how the arrangement consideration should be allocated to the identified separate accounting units. EITF No. 00-21 is effective for fiscal periods beginning after June 15, 2003. The Company anticipates that the adoption of EITF 00-21 will not have a significant impact on its results of operations and financial position.

In January 2003, the FASB issued FIN No. 46, "Consolidation of Variable Interest Entities." FIN No. 46 expands upon and strengthens existing accounting guidance that addresses when a company should include in its financial statements the assets, liabilities and activities of another entity. A variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN No. 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or is entitled to receive a majority of the entity's residual returns or both. The consolidation requirements of FIN No. 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after June 15, 2003. Disclosure requirements apply to any financial statements issued after January 31, 2003. The Company has considered the provisions of FIN No. 46 and believes it will not be necessary to include in the Company's financial statements any assets, liabilities, or activities of BT LookSmart, Ltd., its joint venture with British Telecommunications. The Company will continue to evaluate the impact of FIN No. 46 on the consolidated financial statements and related disclosures.

In May 2003, the FASB issued SFAS No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS 149 provides for certain changes in the accounting treatment of derivative contracts and is effective for contracts entered into or modified after June 30, 2003, except for certain provisions that relate to SFAS No. 133 Implementation Issues that have been effective for fiscal quarters that began prior to June 15, 2003, which will continue to be applied in accordance with their respective effective dates. The guidance will be applied prospectively. Management anticipates that the adoption of SFAS No. 149 will not have a material impact on the Company's consolidated financial statements.

Also in May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This new statement changes the accounting for certain financial instruments that, under previous guidance, issuers could account for as equity. It requires that those instruments be classified as liabilities in balance sheets. Most of the guidance in SFAS 150 is effective for all financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the Company's third quarter of 2003. Management anticipates that the adoption of SFAS No. 150 will not have a material impact on the Company's consolidated financial statements.

LOOKSMART, LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Unaudited)

2. Unaudited Interim Financial Information

The accompanying unaudited condensed consolidated financial statements reflect all adjustments which are normal and recurring in nature and, in the opinion of management, are necessary for a fair statement of the results of operations for the periods shown. The results of operations for such periods are not necessarily indicative of the results expected for any full fiscal year or for any future period.

Certain information and note disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the Securities and Exchange Commission's rules and regulations. These unaudited interim condensed consolidated financial statements should be read in conjunction with LookSmart's audited consolidated financial statements and notes for the year ended December 31, 2002 included in its Annual Report on Form 10-K, as amended, filed with the Securities and Exchange Commission.

3. Acquisitions

WiseNut, Inc.

On April 2, 2002, the Company completed the acquisition of WiseNut, Inc. ("WiseNut"), a search engine technology company. The Company issued 2,646,000 shares of common stock at a price per share of $2.47, assumed 296,000 stock options with a fair value of $0.7 million, incurred direct costs of the transaction in the amount of $0.5 million and recorded a liability in the amount of $0.9 million for all the outstanding capital stock of WiseNut. Of the total assumed stock options, approximately 132,000 stock options with an intrinsic value of $0.4 million were unvested. In accordance with FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation," these unvested options were accounted for as deferred stock-based compensation and are being recognized over their related vesting periods.

The common stock issued was valued in accordance with EITF Issue No. 99-12, "Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination," using the average of the closing prices of the Company's common stock for the two days prior to, the date of and the two days after the announcement date of March 12, 2002. The assumed stock options were valued using the Black-Scholes valuation model using a volatility rate of 130%, a risk-free interest rate of 4.3% and an estimated life of four years.

The allocation of the purchase price was to tangible and intangible assets, unearned compensation and liabilities assumed. Approximately $6.5 million was allocated to existing search technology and $0.1 million was allocated to an existing customer contract. These amounts were determined through established valuation techniques in the technology industry. Technology acquired is amortized over a seven-year period and the acquired customer contract was amortized through November 2002, when the contract expired.

Under the terms of the acquisition agreement, 1.2 million shares of common stock were placed in an escrow account to secure certain seller representations and warranties for a period of up to 18 months.

During the three months ended June 30, 2003, 0.4 million escrow shares were released in accordance with the agreement. The fair value of these shares was recorded as goodwill and assigned to the Listings segment.

LOOKSMART, LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED (Unaudited)

The following table presents details of WiseNut's assets and liabilities acquired by the Company as of the acquisition date (in thousands):

Cash and cash equivalents	$	311
Other current assets		165
Fixed assets		1,327
Technology		6,460
Customer contract		80
Accrued liabilities		(195)
Deferred compensation		378
Net assets acquired	$	8,526

The following pro forma results of operations reflect the combined results of LookSmart and Wisenut for the six months ended June 30, 2002, as if the business combination occurred as of the beginning of the year.

		Six Months Ended June 30, 2002
Revenue	$	41,080
Net loss		(7,724)
Earnings (loss) per share – basic and diluted	$	(0.08)
Weighted average shares outstanding used in per share calculation – basic and diluted		96,082

Grub, Inc.

In January 2003, the Company acquired intellectual property rights from Grub, Inc. and an individual for total consideration of $1.3 million, consisting of $0.6 million cash payment, including $12,000 of direct costs and the issuance of 217,000 shares of LookSmart common stock valued at $0.7 million.

The intellectual property rights are classified as intangible assets on the balance sheet and have an estimated useful life of three years.

4. Goodwill and Intangible Assets

The Company's intangible assets consist primarily of purchased technology and have estimated useful lives of three to seven years. The Company has reassessed the expected useful lives of existing intangible assets upon the adoption of SFAS 142 Goodwill and Other Intangible Assets. This reassessment did not result in any significant changes to the useful lives.

LOOKSMART, LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Unaudited)

Goodwill and intangible assets are as follows (in thousands):

	June 30, 2003	December 31, 2002
Goodwill	$ 11,657	$ 11,546
Less accumulated amortization	2,694	2,694
Goodwill	$ 8,963	$ 8,852
Intangible assets	$ 9,763	$ 8,474
Less accumulated amortization	3,259	2,292
Intangible assets, net	$ 6,504	$ 6,182

Intangible asset amortization expense was $0.5 million and $0.4 million for the three months ended June 30, 2003 and 2002 and $1.0 million and $0.6 million for the six months ended June 30, 2003 and 2002, respectively, and was included in cost of revenue and product development costs. Estimated future intangible amortization expense is as follows (in thousands):

Year	Estimated Amortization of Intangibles
2003	$ 1,758
2004	1,357
2005	1,357
2006	923
2007	923
Thereafter	1,154

5. Commitments and Contingencies

Legal Proceedings

In May 2002, Legal Staffing Partners, Inc., an express listing customer, filed a proposed class action lawsuit in Superior Court in San Francisco County. The complaint alleged breach of contract, unfair business practices and false advertising in connection with the launch of the Company's new Small Business Listings product announced in April 2002. The complaint sought restitution, unspecified compensatory damages, injunctive relief and attorneys' fees. In July 2002, Curt Kramer, an express listing customer, filed a proposed class action lawsuit in Superior Court in San Francisco County alleging claims that were substantially similar to those alleged by Legal Staffing Partners. In October 2002, the two plaintiffs agreed to withdraw their complaints and file a single consolidated amended complaint containing substantially the same allegations as the prior two complaints. In November 2002, the Company filed a motion to dismiss the claims in the amended complaint. The court denied the motion in January 2003. The Company filed an answer to the amended complaint in January 2003. Plaintiffs have served document and deposition requests, but no other discovery is being sought at this time. In June 2003, the Company reached a tentative agreement to settle the matter that is subject to the execution of a definitive agreement and approval of the Superior Court.

From time to time the Company is involved in lawsuits, claims, investigations and proceedings, in addition to those identified above, consisting of intellectual property, commercial, employment and other matters, which arise in the ordinary course of business. In accordance with SFAS No. 5, the Company makes a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at

LOOKSMART, LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Unaudited)

least quarterly and adjusted to reflect the effects of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Litigation is inherently unpredictable. However, the Company believes that it has valid defenses with respect to the legal matters pending against it. It is possible, nevertheless, that cash flows or results of operations could be affected in any particular period by the resolution of one or more of these contingencies.

Joint Venture Funding

Pursuant to the settlement agreement with BT for the dissolution of the joint venture, the Company and BT are jointly liable for the costs incurred to close the operations of the joint venture. The Company does not expect to incur significant additional expenses to dissolve the joint venture.

Indemnities

In the normal course of business, the Company makes indemnities, commitments and guarantees under which it may be required to make payments in relation to certain transactions. These indemnities include intellectual property indemnities to the Company's customers in connection with the sales of its products, indemnities to distribution partners in connection with the distribution of the Company's listings, indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease, and indemnities to directors and officers of the Company to the maximum extent permitted under the laws of the State of Delaware.

6. Net Income (Loss) Per Share:

In accordance with the requirements of SFAS No. 128, a reconciliation of the numerator and denominator of basic and diluted loss per share is provided as follows (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Numerator—Basic and diluted:				
Net income (loss)	$ 1,159	$ (806)	$ 2,300	$ (6,170)
Denominator				
Weighted average common shares outstanding:				
Shares used to compute basic EPS	102,693	96,690	101,102	96,082
Dilutive common equivalent shares:				
Options	6,419	—	6,368	—
Warrants	415	—	415	—
Escrow Shares	797	—	797	—
Shares used to compute diluted EPS	110,324	96,690	108,682	96,082
Net income (loss) per share:				
Basic	$ 0.01	$ (0.01)	$ 0.02	$ (0.06)
Diluted	$ 0.01	$ (0.01)	$ 0.02	$ (0.06)

Options and warrants to purchase common stock are not included in the diluted income (loss) per share calculations if their effect is antidilutive. The antidilutive securities included potential common stock relating to stock options and warrants as follows (in thousands):

LOOKSMART, LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED
(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Options	548	506	569	663
Warrants	32	42	32	134
Total antidilutive shares	580	548	601	797

7. Related Party Transactions:

In June 2003, the Company consolidated its receivable from BT LookSmart and its payable to BT LookSmart into its investment in the BT LookSmart joint venture. The Company also wrote down the investment by $0.3 million. The remaining investment balance at June 30, 2003 is $0.4 million which reflects the estimated value upon final liquidation of the joint venture.

In April 2002, the Company loaned an executive officer of the Company $0.3 million. The loan is interest-free and may be forgiven ratably over a period of four years, subject to certain performance measures being met. In addition, the Company has agreed to pay taxes due related to forgiveness of the loan and imputed interest. The amount forgiven, plus imputed interest and payments to cover taxes were charged to operations ratably over the life of the loan was $0.1 million for the three and six months ended June 30, 2003, respectively. Due to the resignation of the executive officer, the outstanding unforgiven balance of $0.2 million is due no later than April 30, 2004.

8. Loss from Discontinued Operations

In the first quarter of 2002, the Company transferred its 52.8% ownership interest in its consolidated subsidiary, Futurecorp, to the minority shareholders. The Company paid Futurecorp AU$90,000 (approximately US$47,000) and issued 16,437 shares of LookSmart common stock in connection with the transfer. As required by SFAS No. 144, the Company reported the results of operations of this component as a loss from discontinued operations of $1.0 million, which includes a $1.0 million loss on disposal in the six months ended June 30, 2002. Revenue included in the loss on disposal was $0 and $0.6 million in the six months ended June 30, 2003 and 2002, respectively. Pretax net income (loss) reported in discontinued operations was $0 and $63,000 in the six months ended June 30, 2003 and 2002, respectively. Loss from discontinued operations was $0 in 2003 and $1.0 million in 2002.

9. Extraordinary Gain on Acquisition of Joint Venture Entities

In the first quarter of 2003, the Company recognized an extraordinary gain, net of tax, of $0.2 million in connection with the dissolution of BT LookSmart and the assumption of its Japan and United Kingdom operations. This amount represents the fair value of net assets of the Japan and United Kingdom operating entities of BT LookSmart. The Company acquired these net assets on March 14, 2003 for nominal consideration. The results of these operating entities have been included in the Company’s consolidated financial statements as of March 1, 2003.

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

The following discussion should be read in conjunction with the consolidated financial statements and the notes to those statements which appear elsewhere in this Quarterly Report on Form 10-Q. The following discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We use words such as "believes," "intends," "expects," "anticipates," "plans," "may," "will" and similar expressions to identify forward-looking statements. All forward-looking statements, including but not limited to, projections or estimates concerning our business, including demand for our products and services, mix of revenue streams, ability to control and/or reduce operating expenses, anticipated cost of revenues, expenses and operating results, cost savings, product development efforts, general outlook of our business and industry, opportunities abroad, competitive position, stock compensation and adequate liquidity to fund our operations and meet our other cash requirements for the next 12 months, are inherently uncertain as they are based on our expectations and assumptions concerning future events. These forward-looking statements are subject to numerous known and unknown risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements for many reasons, including our ability to maintain net profitability in future quarters, our continuing relationship with Microsoft, our ability to expand our network of distribution partners, the success of our listings business and all other risks described below in the section entitled "Factors Affecting Operating Results" and elsewhere in this report. All forward-looking statements in this document are made as of the date hereof, based on information available to us as of the date hereof, and we assume no obligation to update any forward-looking statements.

Overview

LookSmart is a leading provider of Internet search solutions for portals, Internet service providers and media companies, as well as a leading provider of marketing products for advertisers who want to be included in relevant search results. Our LookListings suite of products provides businesses of all sizes the opportunity to have listings for their company and products included in our broadly distributed web search results, so that their listings are available to Internet users at the moment when they are searching for relevant information. By enabling advertisers to reach millions of users in a highly targeted search context, we provide a proven method of acquiring customers, converting advertising leads into sales and generating useful marketing information for individual customer campaigns. Our campaign reporting technology enables advertisers to monitor the performance of their search marketing campaigns and request additions or changes to their listings through the use of password-protected online accounts.

We distribute our search results across a distribution network by partnering with leading Internet portals, Internet service providers (ISPs), search engines and media companies, primarily Microsoft's MSN. These companies have increasingly recognized the valuable nature of search services for their web sites. We offer distribution partners a search solution with two important benefits. First, our search solution provides highly relevant search results for their users, which can help to maintain the users' satisfaction and increase repeat visits of those users. Second, we share with our distribution partners a portion of the listings revenues that we generate from clicks on paid listings in those search results.

Critical Accounting Policies

The financial condition and results of operations of the Company are based upon certain critical accounting policies, which include estimates, assumptions, and judgments on the part of management. The following discussion highlights those policies and the underlying estimates and assumptions, which management considers critical to an understanding of the financial information in this report.

Revenue Recognition. The Company generates revenues from listings and licensing. We exited the ecommerce segment after the second quarter of 2002 and ceased reporting the advertising segment after the fourth quarter of 2002, as we no longer manage advertising as a separate product. Revenues associated with listings products, including directory listings and affiliate commissions are generally recognized once collectibility is established, as delivery of services occurs, once all performance obligations have been satisfied, and when no refund obligations exist. Upfront fees are recognized ratably over the longer of the term of the contract or the expected relationship with the customer, which is currently estimated to be twelve months. This estimate is reviewed on an annual basis.

Affiliate revenues are included in listings revenue and are based on commissions received for participation in affiliate programs. Affiliate programs are programs operated by affiliate network services or online merchants, in which merchants pay traffic providers on a cost-per-acquisition basis. By participating in affiliate programs, we generate revenues when Internet users make a purchase from a participating merchant's web site after clicking on the merchant's listing in our search results. Revenues from affiliates are earned on a per-sale basis or as a percentage of sale rather than a per-click basis. Revenue is recognized in the period in which a merchant finalizes a sale and reports to the Company via its affiliate network.

Advertising revenues are included in listings revenue and are recognized as impressions or clicks are delivered over the period in which the advertisement is displayed, provided that no significant Company obligations remain at the end of the period and collection of the resulting receivable is reasonably assured. Company obligations typically include guarantees of a minimum number of "impressions." An impression is an appearance of an advertisement in pages viewed by users of the Company's or its partners' online properties.

Revenues associated with our licensing agreement with Microsoft are recognized in the period in which URLs are added to the database and the database is delivered to Microsoft, per the agreement, all performance obligations have been satisfied, and no refund obligations exist. Payments from Microsoft received in advance of delivery are recorded as deferred revenues. We recognize quarterly licensing revenues under this contract based on the number of URL listings added to our database during the quarter relative to the total number of URL listings we are required to add to our database during the relevant six-month period. As a result, to the extent that we satisfy our database update obligations unevenly, the revenues we recognize under this contract may be skewed on a quarter-to-quarter basis.

Determination of collectibility of payments requires significant judgment on the part of management and includes performing initial and ongoing credit evaluations of customers. The Company provides a reserve for doubtful accounts receivable based upon expected collectibility, which reflects management's judgment based on ongoing credit evaluation. In addition, the Company provides a reserve against revenue for estimated credits resulting from billing adjustments and sales adjustments in the event of product returns. The amount of this reserve is evaluated quarterly based upon historical trends.

Stock-Based Compensation. The Company accounts for stock-based employee compensation arrangements in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," ("APB No. 25") and related interpretations, and complies with the disclosure provisions of SFAS No. 123, "Accounting for Stock-based Compensation" and SFAS No. 148 "Accounting for Stock-Based Compensation - Transition and Disclosure." The disclosure provisions of SFAS No. 123 and SFAS No. 148 require judgments by management as to the estimated lives of the outstanding options. Management has based the estimated life of the options on historical option exercise patterns. If the estimated life of the options increases, the valuation of the options will increase as well.

As a result of the repricing of stock options, which primarily occurred in the first quarter of 2001, the Company will incur a charge for compensation expense or a reversal of a charge in connection with variable accounting for outstanding repriced stock options, depending on the market price of the Company's common stock at the end of each quarter.

Goodwill and Intangible Assets. We have recorded goodwill and intangible assets in connection with our business acquisitions. Management exercises judgment in the assessment of the related useful lives, and the fair value and recoverability of these assets. The majority of intangible assets are amortized over three to seven years, the period of expected benefit. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," the Company periodically reassesses the valuation of intangible assets to conform to changes in management's estimates of future performance. Management considers existing and anticipated competitive and economic conditions in such assessments. Goodwill is reviewed for impairment at least annually. The Company did not record a goodwill impairment charge in the first half of 2003. Cash flow forecasts used in evaluation of goodwill and intangibles are based on trends of historical performance and management's estimate of future performance.

Internal Use Software Development Costs. The Company accounts for internal use software in accordance with American Institute of Certified Public Accountants ("AICPA") Statement of Position No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" (SOP 98-1). In accordance with the capitalization criteria of SOP 98-1, the Company has capitalized external direct costs of materials and services consumed in developing and obtaining internal-use computer software and the payroll and payroll-related costs of employees who devote time to the internal-use computer software project.

Management's judgment is required in determining the point at which various projects enter the stages at which costs may be capitalized, in assessing the ongoing value of the capitalized costs, and in determining the estimated useful lives over which the costs are amortized. We expect to continue to invest in internally developed software and to capitalize these costs in accordance with SOP 98-1.

Deferred Taxes. We recognize deferred tax assets and liabilities based on the differences between the financial statement carrying values and the tax bases of assets and liabilities. LookSmart regularly reviews its deferred tax assets for recoverability and establishes a valuation allowance based on historical taxable income, projected future taxable income, and the expected timing of the reversals of existing temporary differences. If we operate at a loss or are unable to generate sufficient future taxable income, or if there is a material change in the actual effective tax rates or time period within which the underlying temporary differences become taxable or deductible, we could be required to increase the valuation allowance against all or a significant portion of our deferred tax assets which could substantially increase our effective tax rate for such period. Alternatively, if our future taxable income is significantly higher than expected and/or we are able to utilize our tax credits, we may be required to reverse all or a significant part of our valuation allowance against such deferred tax assets which could substantially reduce our effective tax rate for such period. Therefore, any significant changes in statutory tax rates or the amount of our valuation allowance could have a material impact on the value of our deferred tax assets and liabilities, and our reported financial results.

Allowance for Doubtful Accounts. The Company maintains an allowance for doubtful accounts for estimated losses resulting from the failure of our customers to make required payments. This valuation allowance is reviewed on a periodic basis to determine whether a provision or reversal is required. The review is based on factors including the application of historical collection rates to current receivables. The Company will record a reversal of its allowance for doubtful accounts if there is a significant improvement in collection rates or economic conditions are more favorable than the Company has anticipated. Additional allowances for doubtful accounts may be required if there is deterioration in past due balances, if economic conditions are less favorable than the Company has anticipated or for customer-specific circumstances, such as bankruptcy. Management's judgment is required in the periodic review of whether a provision or reversal is warranted.

Results of Operations

Revenues

Starting on January 1, 2003, LookSmart began reporting two operating segments: listings and licensing. We exited the ecommerce segment after the second quarter of 2002 and ceased reporting the advertising segment after the fourth quarter of 2002, as we no longer manage advertising as a separate product. For purposes of historical comparison, advertising and ecommerce are included in the listings segment on our statement of operations for 2003 and 2002.

Listings. We derive listings revenues from our LookListings suite of products, including Directory Listings, affiliate partner commissions, Small Business Listings, Sponsored Listings, Index Listings and advertising. Revenues from Directory Listings, Sponsored Listings, Index Listings and Small Business Listings are primarily composed of per-click fees that we charge customers and often also include one-time review fees or set-up fees when generating listings for customers and including them in our directories.

Listings revenues include revenues generated through our participation in affiliate programs. Affiliate programs are programs operated by affiliate network services or online merchants, in which merchants pay traffic providers on a cost-per-acquisition basis. By participating in affiliate programs, we generate revenues when Internet users make a purchase from a participating merchant's web site after clicking on the merchant's listing in our search results.

Advertising revenues, which are now included in listings revenues, are typically derived from short-term agreements requiring the Company to deliver a minimum number of graphical advertising impressions or clicks over the term of the agreement. We offer advertisers the ability to specify the category of traffic for their advertisements. Some advertising categories are priced at a premium, depending on the associated economic value, the location of the advertisement on the page and the size of the audience requesting the page.

Listings revenues were $34.6 million and $64.1 million for the three and six months ended June 30, 2003, representing a 102% and 91% increase over listings revenue of $17.2 million and $33.5 million for the three and six months ended June 30, 2002, respectively. The growth is due to a 54% increase in URL's as of June 30, 2003 compared to June 30, 2002 and the addition of 17,000 new customers since June 30, 2002. Listings revenue accounted for 90% and 89% of total revenues for the three and six months ended June 30, 2003, compared to 82% for both the three and six months ended June 30, 2002.

We believe listings revenues will continue to grow both in absolute dollars and as a proportion of our overall revenues as paid inclusion continues to be adopted by customers as an effective marketing tool. Our listings revenues depend on the number of queries delivered by our distribution partners, particularly Microsoft. See below. Changes in our distribution network may cause listings revenues to fluctuate over time.

Paid clicks increased to 210.3 million and 386.5 million for the three and six months ended June 30, 2003. This represents an increase of 141% and 145% compared to 87.3 million and 157.7 million in the three and six months ended June 30, 2002. The Company expects paid clicks to increase as we grow our listings business. However, paid clicks are dependent on our relationship with Microsoft. See below.

Listings revenue per click, the average cost per click to advertisers, decreased slightly to $0.16 per click for both the three and six months ended June 30, 2003 from $0.19 per click for the three months ended June 30, 2002 and $0.18 for the six months ended June 30, 2002. Declining rates for our domestic listings resulted in a decline of $0.02 for the three months ended June 30, 2003 and $0.01 for the six months ended June 30, 2003. In addition, the overall revenue per click declined $0.01 for the three and six months ended June 30, 2003 due to the integration of our newly acquired United Kingdom and Japanese subsidiaries, which have historically received listings revenue per click at a slightly lower rate than the United States. The Company expects revenue per click to remain relatively constant in the near term.

We derived 65% and 64% of our listings revenues in the three and six months ended June 30, 2003 respectively and 48% and 41% of our listings revenues in the three and six months ended June 30, 2002, respectively, from our relationship with Microsoft. Internet search traffic is increasingly concentrated among a small number of portals and ISPs, of which Microsoft is one. The increase in the proportion of our listings revenues attributable to Microsoft was due primarily to the growing popularity of Microsoft's MSN search service among Internet users and changes in Microsoft's search service which resulted in more clicks on our search results, contributing 67% and 78% of the increase for the three and six months ended June 30, 2003 compared to the three and six months ended June 30, 2002. Revenue associated with our newly acquired United Kingdom and Japan subsidiaries accounted for 12% and 5% of the growth for the three and six months ended June 30, 2003, respectively, compared to the three and six months ended June 30, 2002.

In the first quarter of 2003, Microsoft announced its intention to increase its investment in its MSN search services, particularly its technology-based crawling and indexing software and algorithmic search capabilities. Microsoft has indicated that it may combine the current directory and index layers of search results on its web sites into a single set of search results. If Microsoft does elect to combine these layers, any renewed distribution agreement would likely result in significantly lower paid clicks and listings revenues. In any event, we may be unable to renew the distribution agreement on terms that are as favorable as the current agreement, if at all.

In July 2003, Microsoft conducted a test on a small percentage of searches on its web site in the United Kingdom that eliminated the directory layer of search results in which our listings currently appear. Microsoft has indicated that it will expand this test across all searches on its web site in the United Kingdom starting as early as September 2003. The change would significantly reduce the paid clicks we receive in that geographic market during the remainder of the term of the agreement unless Microsoft elects to adopt another of our listings products. We do not believe this change will be material to our operating results during the remainder of the term of the agreement.

Microsoft has also indicated that it intends to conduct a similar test on a small percentage of searches on its web site in the United States starting in October 2003. Microsoft has indicated it does not intend to expand the test in the United States before the expiration of the agreement. Therefore, we do not expect that the test will significantly impact our listings revenues during the remainder of the term of the agreement. However, the test results will affect Microsoft's decision to renew the distribution agreement, and whether to continue to distribute some or all of our paid listings after the agreement expires. Depending on the results of these tests, Microsoft may remove the directory layer in its current form from its web site in the United States at the expiration of the agreement.

Microsoft has indicated that it will test a variety of alternative implementations during the next several months, some of which may include our paid listings in current and newly-developed formats. If adopted, these implementations could preserve a majority of our paid clicks and listings revenues. As a result, it is difficult to determine exactly how any proposed change will affect our revenue after the agreement expires. If the agreement is not renewed on terms that include the distribution of our paid listings on its MSN search results pages, then our business and financial results will be materially and adversely affected.

Licensing. We license our database content to Microsoft and customize it for their use. Licensing revenue was $3.8 million and

$7.7 million for the three and six months ended June 30, 2003, respectively, compared to $3.8 million and $7.5 million for the three and six months ended June 30, 2002, respectively. We expect revenues from licensing to fluctuate from period to period because these revenues are dependent upon the terms of our licensing arrangement and the timing of our delivery of URLs during each six-month period. The Company derives all of its licensing revenue from its agreement with Microsoft, which expires on December 3, 2003.

We are likely to remain dependent upon Microsoft for licensing revenues in the remainder of 2003. Based on our discussions with Microsoft, it is likely that the licensing portion of the agreement will be renewed, but that it will result in less licensing revenue than under the current agreement. After the agreement expires, Microsoft has the right to continue to use the content we delivered during the term of the agreement. Microsoft also has the right to sublicense these rights to others, both during and for up to two years after the term of the agreement.

Cost of Revenues

Cost of revenues primarily consists of revenue-sharing payments to distribution partners, connectivity costs, sales operations personnel and amortization of certain intangible assets. In cases where there is no LookSmart branding or other direct sales or marketing effort associated with the generation of listings revenues, payments to distribution partners are reflected as cost of revenue. The cost of revenue associated with affiliate partner commissions consists of fees paid to distribution partners based on the affiliate vendor commissions earned by the Company. Cost of revenues also consists of personnel costs of our sales operations employees, including stock-based compensation, equipment depreciation, expenses relating to hosting advertising operations and commissions paid to advertising agencies. Payments to distribution partners for referral of customers to our LookListings program are reflected as sales and marketing expense because LookSmart branding is associated with the promotion of these products.

Cost of revenues were $18.8 million and $35.5 million for the three and six months ended June 30, 2003, respectively, representing an increase of 137% and 172% over cost of revenues of $7.9 million and $13.0 million for the three and six months ended June 30, 2002, respectively. Distribution costs as a percentage of revenue increased to 53% for both the three and six months ended June 30, 2003 from 42% and 38% for the three and six months ended June 30, 2002, respectively.

The increases in cost of revenues and distribution costs as a percentage of revenue were primarily attributable to the growth in revenue. This resulted in an increase in our distribution costs of 6% and 7% for the three months ended June 30, 2003 compared to the three and six months ended June 30, 2003 from higher contractual revenue sharing costs due to the tiered structure of a certain of our revenue sharing agreements, most notably with Microsoft. Additionally, our distribution costs increased 3% and 8% for the three and six months ended June 30, 2003 compared to the three and six months ended June 30, 2002 related to revenue sharing obligations on Small Business Listings clicks with our partners, which began in the second quarter of 2002. We expect distribution costs as a percent of revenue to be approximately 53-55% in 2003, assuming no significant changes to our current distribution levels. If we enter into agreements with additional significant distribution partners, average distribution costs as a percentage of revenue may increase.

Operating Expenses

For purposes of managing our resources, we do not track operating expenses by reportable segment, but treat these as shared overhead of our reportable segments.

Sales and Marketing. Sales and marketing expenses include salaries, commissions, stock-based compensation and other costs of employment for the Company's sales force, sales administration and customer service staff, payments to distribution partners for directing online users to LookSmart search results and referring Small Business customers when LookSmart branding is used, overhead, facilities, allocation of depreciation and the provision for and reversals of reserves for doubtful trade receivables. Sales and marketing expenses also include the costs of advertising, trade shows and public relations activities. Sales and marketing expenses changed as follows (dollar figures are in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Amortization of deferred stock compensation	$ 12	$ 245	$ 35	$ 512
Stock compensation related to variable options	14	(657)	275	118
Bad debt provision (reversal)	475	—	(6)	580
Other sales and marketing expense	5,791	4,666	11,325	10,226
Total sales and marketing expense	$ 6,292	$ 4,254	$ 11,629	$ 11,436
As % of revenue	16%	20%	16%	28%

Amortization of deferred stock compensation is related to stock granted to employees at less than market value. This expense will continue to decline in 2003 as it becomes fully amortized.

Stock compensation related to variable options is the result of repriced stock options. It is based on the Company's stock price at the end of each quarter and will continue to fluctuate as the Company's stock price fluctuates.

Bad debt provision for the three months ended June 30, 2003 increased $0.5 million from the second quarter of 2002 and bad debt provision for the six months ended June 30, 2003 decreased $0.6 million from the six months ended June 30, 2002.

In the first quarter of 2003, the Company reversed $0.5 million of reserves for bad debts. The reversal was due to the improvement in the Company's rate of collections and the application of the improved collection rates to the Company's domestic accounts receivable. In the second quarter of 2003, the Company recorded a bad debt provision of $0.5 million, which related primarily to the accounts receivable of the newly acquired United Kingdom and Japanese subsidiaries.

Other sales and marketing expenses for the three and six months ended June 30, 2003, increased 24% and 11% from the three and six months ended June 30, 2002. This increase was due primarily to expenses in our newly acquired United Kingdom and Japanese subsidiaries. We expect these costs to remain relatively constant or increase slightly, as revenues increase, for the remainder of the year.

Product Development. Product development costs include all costs related to the development and engineering of new products and continued development of our search databases and customer account features. These costs include salaries and associated costs of employment, including stock-based compensation, overhead, facilities and amortization of intangible assets. Costs related to the development of software for internal use in the business, including salaries and associated costs of employment are capitalized. Software licensing and computer equipment depreciation related to supporting product development functions are also included in product development expenses. Product development expenses were as follows (dollar figures are in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	**2002**	**2003**	**2002**
Amortization of deferred stock compensation	$ 39	$ 279	$ 88	$ 523
Stock compensation related to variable options	102	(820)	622	148
Other product development expense	7,618	5,704	14,231	11,509
Total product development expense	$ 7,759	$ 5,163	$ 14,941	$ 12,180
As % of revenue	20%	25%	21%	30%

Amortization of deferred stock compensation is related to stock granted to employees at less than market value. This expense will continue to decline in 2003 as it becomes fully amortized.

Stock compensation related to variable options is the result of repriced stock options. It is based on the Company's stock price at the end of the period and will continue to fluctuate as the Company's stock price fluctuates.

The increase in other product development expenses of 34% and 24% for the three and six months ended June 30, 2003 compared to 2002 was due primarily to $1.1 million of additional salary and benefit expenses incurred through June 30, 2003 as we continue to invest in enhancements to our search algorithm, our editorial model and our paid inclusion platform and $1.5 million in costs incurred in the second quarter of 2003 associated with our newly acquired United Kingdom and Japanese subsidiaries. We expect these costs to continue to increase as we develop new products for the remainder of 2003. Where appropriate, we will capitalize these costs in accordance with SOP 98-1.

General and Administrative. General and administrative expenses include overhead costs such as executive management, human resources, finance, legal and facilities personnel. These costs include salaries and associated costs of employment, including stock-based compensation, overhead, facilities and allocation of depreciation. General and administrative expenses also include legal, tax and accounting consulting and professional service fees. General and administrative expenses were as follows (dollar figures are in thousands):

	Three Months Ended June 30, 2003	Three Months Ended June 30, 2002	Six Months Ended June 30, 2003	Six Months Ended June 30, 2002
Amortization of deferred stock compensation	$ 2	$ 27	$ 7	$ 69
Stock compensation related to variable options	17	(476)	127	85
Other general and administrative expense	3,533	2,743	6,472	4,836
Total general and administrative expense	$ 3,552	$ 2,294	$ 6,606	$ 4,990
As % of revenue	9%	11%	9%	12%

Amortization of deferred stock compensation is related to stock granted to employees at less than market value. This expense will continue to decline in 2003 as it becomes fully amortized.

Stock compensation related to variable options is the result of repriced stock options. It is based on the Company's stock price at the end of the period and will continue to fluctuate as the Company's stock price fluctuates.

Other general and administrative expense increased 29% and 34% in the three and six months ended June 30, 2003 compared to 2002, respectively, which was primarily due to an increase of $0.2 million and $0.5 million additional consulting fees related to tax consulting, audit fees and consulting fees related to compliance with the Sarbanes-Oxley Act over the three and six months ended June 30, 2003. In addition, other general and administrative expenses increased $0.4 million and $0.6 million for the three and six months ended June 30, 2003 compared to the three and six months ended June 30, 2002 related to the proposed settlement of pending litigation related to our small business product. Other general and administrative expenses may vary significantly over time, due to changes in amounts spent on litigation, tax consulting, Sarbanes-Oxley and other regulatory compliance.

Non-Operating Expenses

Interest and Other Non-Operating Income (expenses), net. Interest and other non-operating income (expense), net was an expense of $0.1 million and income of $0.1 million for the three and six months ended June 30, 2003, respectively, compared to expense of $1.3 million and $2.6 million for the three and six months ended June 30, 2002, respectively. This decrease was primarily the result of the settlement of the Company's loan with Transceptgate, a subsidiary of BT in December 2002.

Share of Joint Venture Loss. Share of joint venture loss includes LookSmart's 50% share of the loss of BT LookSmart. The Company recorded $0.3 million and $0.6 million of equity losses for the three and six months ended June 30, 2003, respectively, compared to $0.9 million and $1.9 million in expense recorded in the three and six months ended June 30, 2002, respectively. In December 2002, LookSmart entered into a settlement agreement with BT to terminate the joint venture. The decrease in the equity losses compared to the prior year was a result of the joint venture winding down operations. The joint venture investment balance at June 30, 2003 approximates the expected distribution of joint venture assets. We do not expect significant gains or losses from the joint venture in the future.

Income Tax Expense

The provision for income taxes was $0.5 million and $0.6 million for the three and six months ended June 30, 2003 compared to $10,000 and $24,000 for the three and six months ended June 30, 2002. Our effective tax rate was 30% and 22% for the three and six months ended June 30, 2003, respectively and was due primarily to statutory tax rates associated with doing business in countries where there are no historical losses to offset current income and federal alternative minimum taxes. The Company did not incur tax expense on 2002 U.S. net income due to loss carryforwards and tax credits. Income tax expense for the three and six months ended June 30, 2002 was primarily associated with our Australian operations. The effective tax rate in the upcoming quarters and for the year ending December 31, 2003 may vary due to a variety of factors, including but not limited to the relative income contribution by tax jurisdiction, changes in statutory tax rates, the amount of tax exempt interest income generated during the year, the ability to utilize foreign tax credits and foreign net operating losses, and any non-deductible items related to acquisitions or other non-recurring charges.

Loss from Discontinued Operations

In the first quarter of 2002, the Company transferred its 52.8% ownership interest in its consolidated subsidiary, Futurecorp, to the minority shareholders and discontinued operations of Futurecorp. As required by SFAS No. 144, the Company reported the results of operations of this component as a loss from discontinued operations of $1.0 million in 2002, which includes a $1.0 million loss on disposal. Revenue included in the loss on disposal was $0 and $0.6 million in the six months ended June 30, 2003 and 2002, respectively. Pretax net income (loss) reported in discontinued operations was $0 and $63,000 in the six months ended June 30, 2003 and 2002, respectively.

Extraordinary Gain on Acquisition of BT LookSmart Entities

In February 2000, LookSmart entered into a joint venture agreement with British Telecommunications (BT). LookSmart and BT took an equal equity interest in the joint venture, BT LookSmart, which provided localized directory services in

Europe and Asia. We accounted for our investment in the joint venture using the equity method of accounting. Our share of the joint venture's net loss is reported as non-operating income or expense.

In December 2002, LookSmart entered into a settlement agreement with BT to terminate the joint venture. LookSmart and BT are jointly liable for the estimated settlement costs of $2.3 million expected to be incurred during the dissolution of the joint venture. These estimated costs were recorded in the fourth quarter of 2002 by the joint venture.

In the first quarter of 2003, as part of the dissolution of the joint venture, BT LookSmart transferred ownership of its directories and of its European and Japanese subsidiaries to LookSmart. The Company received net assets of $0.2 million along with the ongoing operating and revenue-generating relationships contained in these entities as part of the dissolution and settlement for nominal consideration. In connection with the acquisition of the joint venture entities, the Company recorded an extraordinary gain of $0.2 million, which represents the fair value of net assets we recorded in excess of the consideration paid upon the acquisition.

Liquidity and Capital Resources

The Company invests cash pending use in investment grade debt and equity instruments with maturities of less than one year, with the intent to make such funds available for operating purposes. As of June 30, 2003, the Company had $57.2 million of unrestricted cash, cash equivalents and short-term investments.

Operating activities provided $6.4 million of cash in the six months ended June 30, 2003 compared to $4.6 million in the six months ended June 30, 2002. The improvement in cash provided by operating activities is primarily attributable to increased revenue in the six months ended June 30, 2003 compared to the same period in 2002.

Net cash used in investing activities was $0.2 million in the six months ended June 30, 2003, compared to cash provided by investing activities of $11.8 million in the six months ended June 30, 2002. For the six months ended June 30, 2002, the Company sold short-term investments of $13.3 million compared to sales of $3.4 million for the six months ended June 30, 2003. Additionally, investment activity increased during the six months ended June 30, 2003 associated with the acquisition of property and equipment and capitalized software. We expect to invest a total of approximately $6.0 to $7.0 million in capital expenditures in 2003.

Net cash provided by financing activities was $3.2 million for the six months ended June 30, 2003, compared to $1.4 million for the six months ended June 30, 2002. The cash provided by financing activities in both periods was due primarily to proceeds received from the issuance of common stock in connection with employee stock option exercises.

We believe that our working capital will provide adequate liquidity to fund our operations and meet other cash requirements for the next 12 months. If operations do not perform as expected, management may seek to raise additional capital through public or private debt or equity financings in order to fund our operations and capital expenditures, take advantage of favorable business opportunities, develop and upgrade our technology infrastructure, develop new product and service offerings, take advantage of favorable conditions in capital markets or respond to competitive pressures. In addition, unanticipated developments in the short term, such as the entry into agreements requiring large cash payments or the acquisition of businesses with negative cash flows, may necessitate additional financing. We cannot assure you that additional financing will be available on terms favorable to us, or at all. If we issue additional equity or convertible debt securities, our existing stockholders may experience substantial dilution.

Off-Balance Sheet Arrangements

We do not have any off balance-sheet arrangements or investments in special purpose entities. Additionally, we are not a party to any derivative contracts or synthetic leases.

Contractual Obligations and Commercial Commitments

We incur various contractual obligations and commercial commitments in our normal course of business. Such obligations and commitments primarily consist of the following:

Capital Lease Obligations—We have one capital lease for the purchase of telephone equipment.

Operating Lease Obligations—We have operating leases covering facilities in San Francisco, New York and Los Angeles and various international offices. We also have some minor operating leases relating to equipment rentals that amount to less than $0.3 million per year.

Note Obligations —We have entered into note agreements to finance an insurance policy and to finance tenant improvements.

Guarantees Under Letters of Credit—We have obtained standby letters of credit from time to time as security for certain liabilities. At June 30, 2003, outstanding letters of credit related to security of building leases and the repayment of a loan to finance insurance premiums and totaled $3.2 million.

Recently Issued Accounting Pronouncements

See Note 1 in the Notes to Condensed Consolidated Financial Statements.

FACTORS AFFECTING OPERATING RESULTS

You should carefully consider the risks described below before making an investment decision regarding our common stock. If any of the following risks actually occurs, our business, financial condition and results of operations could be harmed. In that case, the trading price of our common stock could decline and you could lose all or part of your investment.

If we do not renew our distribution agreement with Microsoft after its expiration in December 2003, our business and financial results would be materially and adversely affected

Microsoft accounted for approximately 73% of our paid clicks and 65% of our listings revenues in the second quarter of 2003. We are likely to remain significantly dependent upon Microsoft for listings revenues in 2003. Our distribution agreement with Microsoft expires on December 3, 2003. If we do not renew our distribution agreement with Microsoft, or if we enter a new agreement with reduced or limited distribution of our paid listings, then our listings revenues will decline significantly.

In the first quarter of 2003, Microsoft announced its intention to increase its investment in its MSN search services, particularly its technology-based crawling and indexing software and algorithmic search capabilities. Microsoft has indicated that it may combine the current directory and index layers of search results on its web sites into a single set of search results. If Microsoft does elect to combine these layers, any renewed distribution agreement would likely result in significantly lower paid clicks and listings revenues. In any event, we may be unable to renew the distribution agreement on terms that are as favorable as the current agreement, if at all.

In July 2003, Microsoft conducted a test on a small percentage of searches on its web site in the United Kingdom that eliminated the directory layer of search results in which our listings currently appear. Microsoft has indicated that it will expand this test across all searches on its web site in the United Kingdom starting as early as September 2003. The change would significantly reduce the paid clicks we receive in that geographic market during the remainder of the term of the agreement unless Microsoft elects to adopt another of our listings products. We do not believe this change will be material to our operating results during the remainder of the term of the agreement.

Microsoft has also indicated that it intends to conduct a similar test on a small percentage of searches on its web site in the United States starting in October 2003. Microsoft has indicated it does not intend to expand the test in the United States before the expiration of the agreement. Therefore, we do not expect that the test will significantly impact our listings revenues during the remainder of the term of the agreement. However, the test results will affect Microsoft's decision to renew the distribution agreement, and whether to continue to distribute some or all of our paid listings after the agreement expires. Depending on the results of these tests, Microsoft may remove the directory layer in its current form from its web site in the United States at the expiration of the agreement.

Microsoft has indicated that it will test a variety of alternative implementations during the next several months, some of which may include our paid listings in current and newly-developed formats. If adopted, these implementations could preserve a majority of our paid clicks and listings revenues. As a result, it is difficult to determine exactly how any proposed change will affect our revenue after the agreement expires. If the agreement is not renewed on terms that include the distribution of our paid listings on its MSN search results pages, then our business and financial results will be materially and adversely affected.

If we do not renew our licensing agreement with Microsoft after its expiration in December 2003, our business and financial results would be materially and adversely affected

Revenues from the licensing portion of our agreement with Microsoft accounted for all of our licensing revenues in the second quarter of 2003. We are likely to remain dependent upon Microsoft for licensing revenues in the remainder of 2003. Based on our discussions with Microsoft, it is likely that the licensing portion of the agreement will be renewed, but that it will result in less licensing revenue than under the current agreement. After the agreement expires, Microsoft has the right to continue to use the content we delivered during the term of the agreement. Microsoft also has the right to sublicense these rights to others, both during and for up to two years after the term of the agreement.

We recently achieved profitability and may not be able to maintain profitability in future quarters

We reached profitability for the first time in the fourth quarter of 2002. Prior to that time, we incurred net losses in every quarter since inception, including net losses of approximately $6.6 million in the first three quarters of 2002, $59.6 million in 2001, $62.6 million in 2000 and $64.7 million in 1999. As of June 30, 2003, we had an accumulated deficit of $179.9 million. We may be unable to maintain profitability in future quarters, depending on our ability to contain expenses, grow revenues and maintain and expand our distribution network. We expect to spend significant amounts to:

- maintain and expand our network of distribution partners and make revenue sharing payments to our distribution partners,
- continue to develop and expand our databases of Internet listings, both in the U.S. and abroad,
- develop new listings products and enhance our search services,
- develop our international business, particularly in the United Kingdom, Australia and Japan, and
- acquire complementary technologies and businesses.

Because of the foregoing factors, and others outlined in this report, we may be unable to maintain profitability on a quarterly or annual basis.

We rely primarily on our network of distribution partners to generate paid clicks; if we were unable to maintain and expand this network, our ability to generate revenues would be seriously harmed

Our ability to generate paid clicks depends on the distribution of our listings through our network of portals, ISPs and media companies. Because our revenues depend on clicks on our customers' listings, growth in our listings business depends on increasing the volume of traffic on our distribution network. We have invested, and will continue to invest, a significant amount of our human and capital resources to expand this network. However, we face competition from other paid listing providers, some of whom have greater technical and capital resources than we do. We cannot assure you that we will maintain and expand our distribution network on financially favorable terms, if at all. If we are unsuccessful in maintaining and expanding our distribution network, then our ability to generate revenues would be seriously harmed.

Our quarterly revenues and operating results may fluctuate for many reasons, each of which may negatively affect our stock price

Our revenues and operating results may fluctuate significantly from quarter to quarter as a result of a variety of factors, including:

- changes in our distribution network, such as the gain or loss of distribution partners, changes to the terms of our distribution agreements, or changes by our distribution partners in their web sites that affect the number of clicks on our search results,
- the number of advertisers who purchase our listings, or the number of listings purchased by our large business customers,
- the cost-per-click we receive from advertisers, or other factors that affect the demand for, and prevailing prices of, Internet advertising and marketing services,
- the timing of revenue recognition under our listings and licensing contracts,
- the timing of our entry into and termination of new contracts for distribution and licensing,
- technical difficulties and systems downtime or failures, whether caused by us, third party service providers or hackers, and whether occurring on our web site or the web sites of our distribution partners,
- the effect of variable accounting for stock options, which requires that we book an operating expense in connection with some of our outstanding stock options at the end of each quarter, depending on the closing price of our common stock on the last trading day of the quarter and the number of stock options subject to variable accounting, or
- the timing of our delivery of URL listings under our contract with Microsoft. We recognize quarterly licensing revenues under this contract based on the number of URL listings added to our database during the quarter relative to the total number of URL listings we are required to add to our database during the relevant six-month period. As a result, to the extent that we satisfy our database update obligations unevenly, the revenues we recognize under this contract may be skewed on a quarter-to-quarter basis.

Our expenses are based in part on expectations of future revenues and, to a large extent, are fixed. We may be unable to adjust spending quickly enough to compensate for any unexpected revenue shortfall. Our operating results may vary as a result of changes in our expenses and costs. Also, we may incur stock compensation expenses as a result of changes in our stock price, and these expenses could negatively affect our net income. Due to the above factors, we believe that period-to-period comparisons of our financial results are not necessarily meaningful, and you should not rely on them as indicators of our future performance. If our financial results in any future period fall below the expectations of securities analysts and investors, the market price of our securities would likely decline.

Our revenues are concentrated in the listings segment and our growth prospects depend on the success of our listings business; if we were unable to continue to grow revenues in this segment, our results of operations and financial conditions would suffer

To increase our revenues and maintain profitability, we will need to continue expanding our listings business. Listings accounted for $34.6 million or 90.2% of our revenues in the second quarter of 2003. Our success will depend upon the extent to which advertisers choose to use our listings products. Some of our products will require both modification of existing software and systems and the creation or acquisition of new software and systems. We may lack the managerial, editorial and technical resources necessary to expand our product offerings in a timely manner. Even if we expand our product offerings, customers may not adopt our products at projected rates. For these and other reasons, these initiatives may not generate sufficient revenues to reach our profitability goals. If we are unable to generate significant additional revenues from our listings business, our results of operations and financial condition will suffer.

Although we expect our listings revenues to continue to increase as an absolute number and as a percentage of total revenues, this may not occur due to continued weakness in the online advertising market, reductions in advertising expenditures, and downward pressure on advertising rates industry-wide. We compete with traditional media such as television, radio and print, as well as online advertisers and high-traffic web sites, for a share of our customers' total advertising expenditures. We have experienced, and may continue to experience, downward pressure on advertising prices in the industry due to cost-cutting efforts by businesses and the increasing amount of advertising inventory becoming available on the Internet. As the Internet evolves, advertisers may find search marketing to be a less effective means of promoting their products or services relative to other advertising media and may reduce or eliminate their expenditures on search marketing. Many potential advertisers and advertising agencies have only limited experience advertising on the Internet and have not devoted a significant portion of their advertising expenditures to search marketing. Acceptance of the search marketing among advertisers will depend, to a large extent, on its perceived effectiveness and the continued growth of commercial usage of the Internet.

We may face liability for claims related to our listings business, and these claims may be costly to resolve

We offer listings services and make listings information available to users of our search services, both on our web site and our distribution partners' web sites. Although we do not believe that the services we offer or the listings in our database violate any rights of others, we cannot assure you that others will not assert claims against us in the future or that these claims will not be successful. We have been subject to purported class action lawsuits in connection with our listings services, and we or our distribution partners could be subject to other claims for defamation, invasion of privacy, trademark infringement, product liability, breach of contract, unfair advertising, unfair competition or other theories based on our listings and services. In addition, we are obligated under some agreements to indemnify our partners in the event that they are subject to claims that our listings or services infringe on the rights of others. Regardless of whether such claims result in liability to us or our distribution partners, we could incur significant costs and diversion of management time in investigating and defending against them. Our insurance may not adequately cover claims of this type, if at all.

We face risks of claims from third parties for intellectual property infringement and other matters that could adversely affect our business

We make Internet search services available to our users through the use of our proprietary algorithms and databases. This creates the potential for claims to be made against us, either directly or through indemnification provisions in contracts with partners and customers. These claims might, for example, be made for trademark, copyright or patent infringement, defamation, negligence, personal injury, invasion of privacy or other claims. Allegations are made against us from time to time concerning these types of matters. Litigating these claims could consume significant amounts of time and money, divert management's attention and resources, cause delays in integrating acquired technology or releasing new products, or require us to enter into royalty or licensing agreements. Royalty or licensing agreements, if required, may not be available on acceptable terms, if at all. If a court were to determine that some aspect of our search services or listings infringed upon or violated the rights of others, we could be prevented from offering some or all of our services, which would negatively impact our revenues and business. There can be no assurance that our services do not infringe the intellectual property rights of third parties. A successful claim of infringement against us and our failure or inability to license the infringed or similar technology could have a material adverse effect on our business, operating results and financial condition.

We face growing competitive pressures in the search marketing industry which, if this trend towards increasing competitive pressures were to continue, could materially and adversely affect our financial results

We compete in the relatively new and rapidly evolving paid inclusion industry, which presents many uncertainties that could require us to further refine our business model. Our success will depend on many factors, including our ability to:

- profitably establish and expand our listings product offerings,
- compete with our competitors, some of whom have greater capital or technical resources than we do,

- expand and maintain our network of distribution relationships, thereby increasing the amount of traffic using our search results, and
- attract and retain a large number of advertisers from a variety of industries.

We compete with companies that provide pay-for-placement products, paid inclusion products, and other forms of search marketing, including About.com's Sprinks, AOL Time Warner, Ask Jeeves, FindWhat, Google, Inktomi, Microsoft's MSN, Terra Lycos and Yahoo. In the paid inclusion field, we compete for advertisers on the basis of the relevance of our search results, the price per click charged to advertisers, the volume of clicks that we can deliver to advertisers, tracking and reporting of campaign results, customer service and other factors. Some of our competitors have greater capital or technical resources, larger distribution networks or proprietary user bases, longer operating histories and greater brand recognition than we have.

The search industry has recently experienced rapid consolidation, particularly with the acquisitions of companies offering algorithmic search indices and paid inclusion programs. In March 2003, Yahoo acquired Inktomi, which offers a paid inclusion program for its algorithmic search index. In April 2003, Overture Services acquired AltaVista and the web search unit of FAST Search & Transfer, each of which also offers a paid inclusion program and algorithmic search indices. In July 2003, Yahoo announced its intention to acquire Overture Services. Industry consolidation may result in larger competitors with a greater focus on paid inclusion products. If these industry trends continue, or if we are unable to compete in the paid inclusion industry, our financial results may suffer.

We may be unable to collect invoiced amounts from some of our customers, which could materially and adversely impact our business

We derive a significant portion of our revenues from the sale of listings to companies that represent credit risks. Some of our customers have gone out of business, have limited operating histories or are operating at a loss. Moreover, many of these companies have limited cash reserves and limited access to additional capital. We have in some cases experienced difficulties collecting outstanding accounts receivable and our allowance for doubtful accounts receivable as of June 30, 2003 was $2.8 million or 15% of our total accounts receivable. We may continue to have these difficulties in the future, and if a significant part of our customer base experiences financial difficulties or is unable or unwilling to pay our search marketing fees for any reason, our business will suffer.

Our acquisition of businesses and technologies may be costly and time-consuming; acquisitions will likely also dilute our existing stockholders

If we are presented with appropriate opportunities, we intend to make acquisitions of, or significant investments in, complementary companies or technologies to increase our technological capabilities and expand our service offerings. Acquisitions may divert the attention of management from the day-to-day operations of LookSmart. It may be difficult to retain key management and technical personnel of the acquired company during the transition period following an acquisition. Acquisitions or other strategic transactions may also result in dilution to our existing stockholders if we issue additional equity securities and may increase our debt. We may also be required to amortize significant amounts of intangible assets or record impairment of goodwill in connection with future acquisitions, which would adversely affect our operating results.

We have acquired businesses and technologies, including the acquisition of WiseNut, Inc. in the second quarter of 2002 and the acquisition of the intellectual property assets of Grub, Inc. in the first quarter of 2003. Integration of acquired companies and technologies into LookSmart could be expensive, time-consuming and strain our managerial resources. We may not be successful in integrating any acquired businesses or technologies and these transactions may not achieve anticipated business benefits.

Our stock price is extremely volatile, and such volatility may hinder investors' ability to resell their shares for a profit

The stock market has experienced significant price and volume fluctuations in recent years, and the stock prices of Internet companies have been extremely volatile. Because of our limited operating history, it is extremely difficult to evaluate our business and prospects. You should evaluate our business in light of the risks, uncertainties, expenses, delays and difficulties associated with managing and growing a relatively new business, many of which are beyond our control. Our stock price may decline, and you may not be able to sell your shares for a profit, as a result of a number of factors including:

- changes in the market valuations of Internet companies in general and comparable companies in particular,

- quarterly fluctuations in our operating results,
- the termination or expiration of our distribution agreements,
- our potential failure to meet our forecasts or analyst expectations on a quarterly basis,
- changes in ratings or financial estimates by analysts,
- announcements of new partnerships, technological innovations, acquisitions or products or services by us or our competitors,
- the sales of substantial amounts of our common stock in the public market by participants in our pre-IPO equity financings or by owners of businesses we have acquired, or the perception that such sales could occur,
- the exchange by CDI holders of CDIs for shares of common stock and resale of such shares in the Nasdaq National Market (as of July 31, 2003, the CDIs registered for trading on the Australian Stock Exchange were exchangeable into an aggregate of approximately 16.5 million shares of common stock), or
- conditions or trends in the Internet that suggest a decline in rates of growth of advertising-based Internet companies.

In the past, securities class action litigation has often been instituted after periods of volatility in the market price of a company's securities. A securities class action suit against us could result in substantial costs and the diversion of management's attention and resources, regardless of the merits or outcome of the case.

We may need additional capital in the future to support our growth and, if such additional financing is not available to us in the future, our business, liquidity and results of operations will be materially and adversely impacted

Although we believe that our working capital will provide adequate liquidity to fund our operations and meet our other cash requirements for the foreseeable future, unanticipated developments in the short term, such as the entry into agreements which require large cash payments or the acquisition of businesses with negative cash flows, may necessitate additional financing. We may seek to raise additional capital through public or private debt or equity financings in order to:

- fund our operations and capital expenditures,
- take advantage of favorable business opportunities, including geographic expansion or acquisitions of complementary businesses or technologies,
- develop and upgrade our technology infrastructure,
- develop new product and service offerings,
- take advantage of favorable conditions in capital markets, or
- respond to competitive pressures.

The capital markets, and in particular the public equity market for Internet companies, have historically been volatile. It is difficult to predict when, if at all, it will be possible for Internet companies to raise capital through these markets. We cannot assure you that the additional financing will be available on terms favorable to us, or at all. If we issue additional equity or convertible debt securities, our existing stockholders may experience substantial dilution.

We face capacity constraints on our software and infrastructure systems that may be costly and time-consuming to resolve

We have developed custom, proprietary software for use by our editors to create the LookSmart directories, and we also use proprietary and licensed software to search the database, distribute the directories and serve advertising to associated web pages. Any of these software systems may contain undetected errors, defects or bugs or may fail to operate with other software applications. The following developments may strain our capacity and result in technical difficulties with our web site or the web sites of our distribution partners:

- substantial increases in editorial activity or the number of listings in our directory,
- customization of our directory for distribution to particular partners,
- substantial increases in the number of search queries to our database, or
- the addition of new products, features or changes in our directory structure.

If we fail to address these issues in a timely manner, we may lose the confidence of advertisers and partners, our revenues may decline and our business could suffer. In addition, as we expand our service offerings and enter into new business areas, we may be required to significantly modify and expand our software and infrastructure systems. If we fail to accomplish these tasks in a timely manner, our business will likely suffer.

Any failure in the performance of our operating systems could harm our business and reputation

Any system failure, including network, software or hardware failure, whether caused by us, a third party service provider, power interruptions, unauthorized intruders and hackers, or natural disasters, that causes an interruption in our service or a decrease in the responsiveness of the web pages that we serve could result in reduced clicks and revenues. A system failure that prevents us from tracking paid clicks or reporting accurate information to our customers' online accounts could adversely affect our reputation and financial results. The occurrence of a natural disaster or unanticipated problems at our principal headquarters or at a third-party facility could cause interruptions or delays in our business, loss of data or could render us unable to provide some services. Our California facilities exist on or near known earthquake fault zones and a significant earthquake could cause an interruption in our services. We do not have back-up sites for our main customer operations center and editorial department which are both located at our San Francisco, California office. An interruption in our ability to provide customer support and editorial services would adversely affect our business.

Our users, partners and customers depend on ISPs, online service providers and other third parties for access to the LookSmart search results. These service providers have experienced significant outages in the past and could experience outages, delays and other operating difficulties in the future. The occurrence of any or all of these events could adversely affect our reputation, brand and business, which could have a material adverse effect on our financial results.

We have an agreement with Savvis Communications, Inc. to house equipment for web serving and networking and to provide network connectivity services. We also have an agreement with AboveNet Commuincations, Inc. to house equipment for networking and to provide network connectivity services. Our network connectivity and network hardware infrastructure are fully redundant at separate locations. However, we do not presently maintain fully redundant click tracking, customer account and web serving systems at separate locations. Accordingly, our operations depend on Savvis and AboveNet to protect the systems in its data center from system failures, earthquake, fire, power loss, water damage, telecommunications failure, hackers, vandalism and similar events. Neither Savvis nor AboveNet guarantees that our Internet access will be uninterrupted, error-free or secure. We have deployed firewall hardware at each facility to thwart hacker attacks. We have not developed a disaster recovery plan to respond in the event of a catastrophic loss of our primary systems. Although we maintain property insurance and business interruption insurance, we cannot guarantee that our insurance will be adequate to compensate us for all losses that may occur as a result of a catastrophic system failure.

Our success depends on our ability to attract and retain key personnel; if we were unable to continue to attract and retain key personnel in the future, our business could be materially and adversely impacted

Our success depends, in part, on the continued service of our key management personnel. The loss of the services of any of our key employees could adversely affect our business. Our success also depends on our ability to identify, attract, retain and motivate highly skilled search development, technical, marketing and other management personnel. We cannot assure you that we will be able to retain our key employees or that we can identify, attract and retain highly skilled personnel in the future.

If we become subject to unfair hiring claims, we could be prevented from hiring needed personnel, incur liability for damages and incur substantial costs in defending ourselves

Companies in our industry whose employees accept positions with competitors frequently claim that these competitors have engaged in unfair hiring practices or that the employment of these persons would involve the disclosure or use of trade secrets. These claims could prevent us from hiring personnel or cause us to incur liability for damages. We could also incur substantial costs in defending ourselves or our employees against these claims, regardless of their merits. Defending ourselves from these claims could also divert the attention of our management away from our operations.

We may incur unforeseen expenses and liabilities in connection with the dissolution of BT LookSmart

In the fourth quarter of 2002, we and BT agreed to close our joint venture, BT LookSmart. We are still in the process of dissolving the joint venture and may incur unforeseen expenses in connection with the dissolution. Also, we have assumed the operations of BT LookSmart in the United Kingdom and Japan and we may incur costs in excess of the amounts we forecasted in connection with the operation of those businesses.

Our business prospects depend on the continued growth in the use of the Internet; if such growth in usage were to subside or stop completely, our business could be materially and adversely impacted

Our business is dependent upon continued growth in the use of the Internet as a medium for search marketing and commercial transactions. Internet usage for these purposes may not grow at projected rates for various reasons, such as:

- user inability or frustration in locating and accessing required information;
- actual or perceived lack of security of information;
- limitations of the Internet infrastructure resulting in traffic congestion, reduced reliability or increased access costs;
- inconsistent quality of service,
- government regulation, such as tax or privacy laws, and
- uncertainty regarding intellectual property ownership and rights on the Internet.

If these or other factors negatively affect the growth in the commercial use of the Internet, our business could be harmed.

Privacy-related regulation of the Internet could limit the ways we currently collect and use personal information which could decrease our advertising revenues or increase our costs

Internet user privacy has become an issue both in the United States and abroad. The Federal Trade Commission and government agencies in some states and countries have investigated some Internet companies, and lawsuits have been filed against some Internet companies, regarding their handling or use of personal information. Any laws imposed to protect the privacy of Internet users may affect the way in which we collect and use personal information. We could incur additional expenses if new laws or court judgments, in the United States or abroad, regarding the use of personal information are introduced or if any agency chooses to investigate our privacy practices.

As is typical with most web sites, our web site places information, known as cookies, on a user’s hard drive, generally without the user’s knowledge or consent. This technology enables web site operators to target specific users with a particular advertisement and to limit the number of times a user is shown a particular advertisement. Although some Internet browsers allow users to modify their browser settings to remove cookies at any time or to prevent cookies from being stored on their hard drives, many consumers are not aware of this option or are not knowledgeable enough to use this option. Some privacy advocates and governmental bodies have suggested limiting or eliminating the use of cookies. If this technology is reduced or limited, the Internet may become less attractive to advertisers and sponsors, which could result in a decline in our revenues.

We and some of our partners or advertisers retain information about our users. If others were able to penetrate the network security of these user databases and access or misappropriate this information, we and our partners or advertisers could be subject to liability. These claims may result in litigation, our involvement in which, regardless of the outcome, could require us to expend significant time and financial resources.

New regulation of search engines may adversely affect the commercial use of our search service and our financial results

The Federal Trade Commission, in response to a petition from a private organization, reviewed the way in which search engines disclose paid placement or paid inclusion practices to Internet users. Recently, the FTC staff issued guidance on the matter

in the form of letters to the petitioner and to members of the industry, including LookSmart. The letters stated the staff's position on what disclosures are necessary to avoid misleading users about the possible effects of paid placement or paid inclusion listings on the search results. This guidance may differ from the existing practices of some in the industry, including our practices and those of some of our distribution partners. The FTC has not yet taken any enforcement action to date against us or any of our distribution partners. If the FTC were to require changes in the labeling or other disclosure of our listings, it may reduce the desirability of our services, and our business and the business of some of our distribution partners could be harmed. We and some of our distribution partners have recently adjusted the disclosures on our search results pages on a voluntary basis, or are likely to do so in the future, and such disclosures may reduce the desirability of our listings, which could adversely affect our business.

New tax treatment of companies engaged in Internet commerce may adversely affect the commercial use of our search service and our financial results

Tax authorities at the international, federal, state and local levels are currently reviewing the appropriate tax treatment of companies engaged in Internet commerce. New or revised state tax regulations may subject us or our advertisers to additional state sales, income and other taxes. We cannot predict the effect of current attempts to impose sales, income or other taxes on commerce over the Internet. New or revised taxes and, in particular, sales taxes, would likely increase the cost of doing business online and decrease the attractiveness of advertising and selling goods and services over the Internet. Any of these events could have an adverse effect on our business and results of operations.

Provisions of Delaware corporate law and provisions of our charter and bylaws may discourage a takeover attempt

Our charter and bylaws and provisions of Delaware law may deter or prevent a takeover attempt, including an attempt that might result in a premium over the market price for our common stock. Our board of directors has the authority to issue shares of preferred stock and to determine the price, rights, preferences and restrictions, including voting rights, of those shares without any further vote or action by the stockholders. The issuance of preferred stock, while providing desirable flexibility in connection with possible acquisitions and other corporate purposes, could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock. In addition, our charter and bylaws provide for a classified board of directors. These provisions, along with Section 203 of the Delaware General Corporation Law, prohibiting certain business combinations with an interested stockholder, could discourage potential acquisition proposals and could delay or prevent a change of control.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk. The Company's exposure to market risk for interest rate changes relates primarily to its short-term investments of restricted cash. The Company had no derivative financial instruments as of June 30, 2003 or 2002. The Company invests in debt instruments of high-quality corporate issuers with original maturities greater than three months and current maturities less than twelve months. The amount of credit exposure to any one issue and issuer is limited.

Foreign Currency Risk. International revenues from the Company's foreign subsidiaries were less than 10% of total revenues in the quarters ended June 30, 2003 and 2002, and were derived entirely from our Australian operations. The Company's international business is subject to risks typical of an international business, including but not limited to differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions and foreign exchange rate volatility, particularly the exchange rate between the Australian dollar and the United States dollar. The effect of foreign exchange rate fluctuations on the Company for quarters ended June 30, 2003 and 2002 were not material.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

Changes in internal control over financial reporting. There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In May 2002, Legal Staffing Partners, Inc., an express listing customer, filed a proposed class action lawsuit in Superior Court in San Francisco County. The complaint alleged breach of contract, unfair business practices and false advertising in connection with the launch of the Company's new Small Business Listings product announced in April 2002. The complaint sought restitution, unspecified compensatory damages, injunctive relief and attorneys' fees. In July 2002, Curt Kramer, an express listing customer, filed a proposed class action lawsuit in Superior Court in San Francisco County alleging claims that were substantially similar to those alleged by Legal Staffing Partners. In October 2002, the two plaintiffs agreed to withdraw their complaints and file a single consolidated amended complaint containing substantially the same allegations as the prior two complaints. In November 2002, the Company filed a motion to dismiss the claims in the amended complaint. The court denied the motion in January 2003. The Company filed an answer to the amended complaint in January 2003. Plaintiffs have served document and deposition requests, but no other discovery is being sought at this time. In June 2003, the Company reached a tentative agreement to settle the matter that is subject to the execution of a definitive agreement and approval of the Superior Court.

The Company is not a party to any other material legal proceedings.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On June 10, 2003, the Company held its annual stockholder meeting. At the meeting, a quorum of the stockholders of the Company considered three proposals: (1) the election of two directors (Jason Kellerman and Greg Santora) to the board of directors, (2) the ratification of the appointment of the Company's independent accountants, PricewaterhouseCoopers LLP, for the fiscal year ending December 31, 2003, and (3) approval of the amended and restated 1998 Stock Plan. The remaining directors Castagna, Dial, Ellery, Sanders, Thornley and West, were incumbent directors who did not stand for election at the meeting. The following table shows the results of the voting on these matters.

Proposal	Description	For	Against	Abstain
1	Nominees for directors:			
	Jason Kellerman	61,703,794	—	895,639
	Greg Santora	61,685,620	—	913,813
2	Ratification of PricewaterhouseCoopers as independent accountants	62,364,333	212,871	22,229
3	Approval of Amended and Restated 1998 Stock Plan	54,511,112	7,829,771	258,550

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Please see the exhibit list following the signature of this report.

(b) Form 8-K

The Company filed Current Reports on Form 8-K on May 5, 2003 (first quarter 2003 financial results), May 28, 2003 (Chief Financial Officer transition plan) and July 29, 2003 (second quarter 2003 financial results).

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: August 14, 2003

LOOKSMART, LTD.

By: /s/ DIANNE DUBOIS

Dianne Dubois
Chief Financial Officer
(Principal Accounting and Financial Officer)

EXHIBIT INDEX

Exhibit Number	Description of Document
3.1(1)	Restated Certificate of Incorporation
3.2(1)	Bylaws
4.1(2)	Form of Specimen Stock Certificate
4.2(1)	Second Amended and Restated Investor Rights Agreement dated March 24, 1999
10.1(1)	Form of Indemnification Agreement entered into between the Registrant and each of its directors and officers
10.2(1)	Amended and Restated 1998 Stock Plan
10.3(1)	1999 Employee Stock Purchase Plan
10.4+(1)	License and Update Agreement with Microsoft Corporation
10.6+(1)	Development Agreement with Cox Interactive Media, Inc.
10.7(3)	Zeal Media, Inc. 1999 Stock Plan
10.8(5)	Wisenut, Inc. 1999 Stock Incentive Plan
10.12(1)	Lease Agreement with Rosenberg SOMA Investments III, LLC for property located at 625 Second Street, San Francisco, California, dated May 5, 1999
10.13(1)	Consent to Sublease Agreement with Ninety Park Property LLC, and First Manhattan Consulting Group Inc. for property located at 90 Park Avenue, New York, New York, dated October 22, 1998
10.14(1)	Lease Agreement with Euro Asia Properties Pty Ltd for property located at Level 5, 388 Lonsdale Street, Melbourne, Australia, dated September 1, 1998
10.15(1)	Lease Agreement with Tonicalon Pty Limited for property located at Level 3, 68 Alfred Street, Milsons Point, Sydney, Australia, dated June 1, 1999
10.16(1)	Summary Plan Description of 401(k) Plan
10.21(4)	Employment Agreement with Kevin Berk dated September 29, 2000
10.22(4)	Employment Agreement with Brian Goler dated September 29, 2000
10.24(6)	Secured Promissory Note between LookSmart, Ltd. and Dianne Dubois, dated April 2, 2002
10.25(6)	Side Letter between LookSmart, Ltd. and Dianne Dubois, dated July 16, 2002
10.26+(6)	Amendment No. 4 to the License and Update Agreement between LookSmart, Ltd. and Microsoft Corporation dated as of April 9, 2002
10.27(7)	Letter agreement between the Registrant and Robert Goldberg dated March 4, 2002
10.28(7)	Letter agreement between the Registrant and Brian Cowley dated May 30, 2002
10.29(7)	Letter agreement between the Registrant and Martin Roberts dated July 1, 2002
10.30(7)	Letter agreement between the Registrant and Jason Kellerman dated September 24, 2002
10.31(8)	Settlement Agreement between the Registrant, Transceptgate Ltd., LookSmart Barbados, Inc., BT LookSmart, Ltd. and British Telecommunications Plc., dated December 3, 2002
10.32(9)	Letter agreement between the Registrant and Peter Adams dated September 17, 2001
10.33(10)	Source Code License Agreement between the Registrant and Viator Ventures, Inc., dated October 26, 2001
10.34++(10)	Co-Location Services Agreement between the Registrant and Savvis Communications Corporation dated February 19, 2003
10.35	Settlement Agreement and Release between the Registrant and Dianne Dubois dated May 27, 2003
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) Filed in connection with the Company's Registration Statement on Form S-1 (File No. 333-80581) filed with the SEC on June 14, 1999.
(2) Filed in connection with the Company's Amendment No. 1 to the Registration Statement on Form S-1 (File No. 333-80581) filed with the SEC on July 27, 1999.
(3) Filed in connection with the Company's Registration Statement on Form S-8 filed with the SEC on, December 7, 2000.
(4) Filed in connection with the Company's Annual Report on Form 10-K filed with the SEC on March 16, 2001.
(5) Filed in connection with the Company's Registration Statement on Form S-8 filed with the SEC on April 18, 2002.
(6) Filed in connection with the Company's Quarterly Report on Form 10-Q filed with the SEC on August 14, 2002.

(7) Filed in connection with the Company's Quarterly Report on Form 10-Q filed with the SEC on November 12, 2002.
(8) Filed in connection with the Company's Annual Report on Form 10-K filed with the SEC on March 14, 2003.
(9) Filed in connection with the Company's Quarterly Report on Form 10-Q filed with the SEC on May 15, 2003.
(10) Filed in connection with the Company's Annual Report on Form 10-K/A filed with the SEC on August 5, 2003.
(+) Confidential treatment has been granted with respect to portions of the exhibit.
(++) Confidential treatment has been requested with respect to portions of the exhibit.

Exhibit 10.35

SETTLEMENT AGREEMENT AND RELEASE

This Settlement Agreement and Release (this "Agreement"), dated May 27, 2003, is made by and between LookSmart, Ltd., a Delaware corporation (the "Company"), and Dianne Dubois, residing in San Francisco, California (the "Employee").

WHEREAS, Employee is employed by the Company as Chief Financial Officer; and

WHEREAS, the Company and Employee have entered into a Confidentiality Agreement (the "Confidentiality Agreement"), an Indemnification Agreement (the "Indemnification Agreement"), and a Secured Promissory Note (the "Secured Promissory Note");

NOW THEREFORE, in consideration of the mutual promises made herein, the Company and Employee (collectively referred to as the "Parties") hereby agree as follows:

1. Consideration.

(a) The Company agrees, contingent upon Employee's completing a smooth Transition Period:

(i) to continue Employee's employment, under the existing terms except that Employee will no longer earn leave after the Transition Period, from the date hereof through the earlier of December 31, 2003, or the date Employee accepts other employment in order for Employee to transfer her Company knowledge and responsibilities to one or more other Company employees. If Employee accepts other employment before December 31, 2003, the Company will pay Employee a lump sum equivalent to the amount of her base salary, less normal withholding, from such date through December 31, 2003;

(ii) to reimburse Employee for any business-related use of her cellular telephone during the Transition Period; and

(iii) to provide a reference for Employee from the Chief Executive Officer.

(b) Employee agrees:

(i) to resign her title as Chief Financial Officer at the end of the Transition Period by submitting to the Company her resignation in the form attached hereto as Attachment A;

(ii) to perform her duties as mutually agreed in a professional and timely manner through the Transition Period, and following the Transition Period to assist with the transition of her responsibilities through the earlier of December 31, 2003, or the date Employee accepts other employment. As used herein, "Transition Period" shall mean the period from the date hereof up to and including August 31, 2003.

2. Confidential Information. Employee shall continue to maintain the confidentiality of all confidential and proprietary information of the Company and shall continue to comply with the terms and conditions of the Confidentiality Agreement between Employee and the Company. Employee shall return all the Company property and confidential and proprietary information in her possession to the Company on the last day of her employment or such earlier time as the Company requires.

3. Release of Claims. Employee agrees that the foregoing consideration represents settlement in full of all outstanding obligations owed to Employee by the Company as of the date hereof. Employee, on behalf of herself, and her heirs, family members, executors, successors and assigns, hereby fully and forever releases the Company and all of its past, present and future officers, agents, directors, employees, investors, shareholders, administrators, affiliates, divisions, subsidiaries, parents, predecessor and successor corporations, successors and assigns (collectively, the "Company Released Parties"), from, and agrees not to sue or otherwise institute or cause to be instituted any legal or administrative proceedings concerning, any loss, damage, claim, duty, obligation or cause of action relating to any matters of any kind, whether presently known or unknown, suspected or unsuspected, that she may possess arising from any omissions, acts or facts in connection with her employment relationship with the Company that have occurred up until and including the date of this Agreement, including without limitation:

(a) any and all claims relating to or arising from the termination of Employee's employment relationship with the Company;

(b) any and all claims relating to, or arising from, the granting of stock options to Employee or Employee's actual purchase of shares of stock of the Company, including, without limitation, any claims for fraud, misrepresentation, breach of fiduciary duty, breach of duty under applicable state corporate law, and securities fraud under any state or federal law;

(c) any and all claims for wrongful discharge of employment; termination in violation of public policy; discrimination (whether based on age, sex, national origin or other protected status); breach of contract, both express and implied; breach of a covenant of good faith and fair dealing, both express and implied; promissory estoppel; negligent or intentional infliction of emotional distress; negligent or intentional misrepresentation; negligent or intentional interference with contract or prospective economic advantage; unfair business practices; defamation; libel; slander; negligence; personal injury; assault; battery; invasion of privacy; false imprisonment; or conversion;

(d) any and all claims for violation of any federal, state or municipal statute, including, but not limited to, Title VII of the Civil Rights Act of 1964, the Civil Rights Act of 1991, the Age Discrimination in Employment Act of 1967, the Americans with Disabilities Act of 1990, the Fair Labor Standards Act, the Employee Retirement Income Security Act of 1974, The Worker Adjustment and Retraining Notification Act, the California Fair Employment and Housing Act, and Labor Code section 201, *et seq.* and section 970, *et seq.* and all amendments to each such Act as well as the regulations issued thereunder;

(e) any and all claims for violation of the federal, or any state, constitution;

(f) any and all claims arising out of any other laws and regulations relating to employment or employment discrimination; and

(g) any and all claims for attorneys' fees and costs.

Employee agrees that the release set forth in this section shall be and remain in effect in all respects as a complete general release as to the matters described above. This release does not extend to any obligations incurred under this Agreement.

4. Acknowledgment of Waiver of Claims under ADEA. Employee acknowledges that she is waiving and releasing any rights she may have under the Age Discrimination in Employment Act of 1967 (the "ADEA") and that this waiver and release is knowing and voluntary. Employee and the Company agree that this waiver and release do not apply to any rights or claims that may arise under the ADEA after the date of this Agreement. Employee acknowledges that the consideration given for this Agreement is in addition to anything of value to which Employee was already entitled. Employee further acknowledges and agrees that she has been advised by this writing that (a) she should consult with an attorney prior to executing this Agreement**; (b) she has had at least twenty-one (21) days within which to consider this Agreement; (c) she has seven (7) days following the execution and delivery of this Agreement by the parties to revoke the Agreement;** and (d) this Agreement shall not be effective until such revocation period has expired. Any revocation should be in writing and delivered to the General Counsel of LookSmart, Ltd., 625 Second Street, San Francisco, CA 94107, by close of business on the seventh (7^{th}) day from the date that Employee has executed and delivered this Agreement to the Company.

5. Civil Code Section 1542. Employee represents that she is not aware of any claims against the Company other than the claims that are released by this Agreement. Employee acknowledges and agrees that she has been (or has had the opportunity to be) advised by legal counsel and is familiar with the provisions of California Civil Code Section 1542, which provides as follows:

> **A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM MUST HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR.**

Employee, being aware of said code section, expressly agrees to waive any and all rights she may have thereunder, as well as under any other statute or common law principles of similar effect.

6. Execution of Release Agreement. On the last day of her employment, Employee shall execute and deliver to the Company a release that includes the same provisions as Sections 3, 4, 5 and 7 through 21, inclusive, hereof. Employee's failure to reexecute the Agreement on that date shall constitute a material breach of this Agreement.

7. No Pending or Future Lawsuits. Employee represents that she has no lawsuits, claims or actions pending in her name, or on behalf of any other person or entity, against the Company or any other Company Released Party. Employee also represents that she does not intend to bring any claims on her own behalf or on behalf of any other person or entity against the Company or any other Company Released Party.

8. No Cooperation. Employee agrees she will not act in any manner that might damage the business of the Company. Employee agrees that she will not counsel or assist any attorneys or their clients in the presentation or prosecution of any disputes, differences, grievances, claims, charges, or complaints by any third party against the Company and/or any other Company Released Party, unless under a subpoena or other court order to do so.

9. Non-Disparagement. The Company agrees to refrain from any defamation, libel or slander of Employee. Employee agrees to refrain from any defamation, libel or slander of the Company or any other Company Released Party or tortious interference with the contracts and relationships of the Company and its respective officers, directors, employees, investors, shareholders, administrators, affiliates, divisions, subsidiaries, predecessor and successor corporations and assigns.

10. No Admission of Liability. Employee understands and acknowledges that this Agreement constitutes a compromise and settlement of disputed claims. No action taken by the Company or any other Company Released Party, either previously or in connection with this Agreement, shall be deemed or construed to be (a) an admission of the truth or falsity of any claims heretofore made or (b) an acknowledgment or admission by the Company or any other Company Released Party of any fault or liability whatsoever to the Employee or to any third party.

11. Costs. The Parties shall each bear their own costs, expert fees, attorneys' fees and other fees and expenses incurred in connection with this Agreement.

12. Arbitration. The Parties agree that any and all disputes arising out of or relating to the terms of this Agreement or its interpretation shall be subject to binding arbitration, to the extent permitted by law, in San Francisco, California, before the American Arbitration Association under its National Rules for the Resolution of Employment Disputes. **Employee agrees and hereby waives her right to jury trial as to matters arising out of or relating to the terms of this Agreement to the extent permitted by law.** The Parties agree that the prevailing party in any arbitration shall be entitled to enforce the arbitration award in any court of competent jurisdiction. Notwithstanding the foregoing provisions of this Section 12, Employee or the Company may seek and obtain otherwise available injunctive relief in court for any violation of obligations concerning confidential and proprietary information that cannot be adequately remedied at law or in arbitration.

13. Authority. Employee represents and warrants that she has the capacity to act on her own behalf and on behalf of all who might claim through him to bind them to the terms and conditions of this Agreement.

14. No Representations. Employee represents that she has had the opportunity to consult with an attorney, and has carefully read and understands the scope and effect of the provisions of this Agreement. Neither party has relied upon any representations or statements made by the other party hereto which are not specifically set forth in this Agreement.

15. Severability. In the event that any provision hereof becomes or is declared by a court of competent jurisdiction to be illegal, unenforceable or void, this Agreement shall continue in full force and effect without said provision.

16. Entire Agreement. This Agreement, the Confidentiality Agreement, the Indemnification Agreement, and the Secured Promissory Note represent the entire agreement and understanding between the Company and Employee concerning Employee's separation from the Company, and supersede and replace any and all prior agreements and understandings concerning Employee's employment relationship with the Company and her compensation by the Company.

17. No Oral Modification. This Agreement may only be amended in writing signed by Employee and an authorized officer of the Company.

18. Governing Law. This Agreement shall be governed by the internal substantive laws, but not the choice of law rules, of the State of California.

19. Effective Date. This Agreement is effective eight (8) days after it has been signed by both Parties.

20. Counterparts. This Agreement may be executed in counterparts, and each counterpart shall have the same force and effect as an original and shall constitute an effective, binding agreement on the part of each of the undersigned.

21. Voluntary Execution of Agreement. This Agreement is executed voluntarily and without any duress or undue influence on the part or behalf of the Parties hereto, with the full intent of releasing all claims. The Parties acknowledge that:

(a) They have read this Agreement;

(b) They have been represented in the preparation, negotiation, and execution of this Agreement by legal counsel of their own choice or that they have voluntarily declined to seek such counsel;

(c) They understand the terms and consequences of this Agreement and of the releases it contains; and

(d) They are fully aware of the legal and binding effect of this Agreement.

IN WITNESS WHEREOF, the Parties have executed this Agreement on the date first set forth above.

LOOKSMART, LTD.

By: /s/ JASON KELLERMAN

Chief Executive Officer

/s/ DIANNE DUBOIS

Dianne Dubois

Attachment A

Date: August 31, 2003

To: LookSmart, Ltd.

Please be advised that, effective immediately, I hereby resign my title of Chief Financial Officer with LookSmart, Ltd.

Very truly yours,

Dianne Dubois

Exhibit 31.1

CERTIFICATION

I, Jason Kellerman, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of LookSmart, Ltd.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2003

/s/ JASON KELLERMAN

Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, Dianne Dubois, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of LookSmart, Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2003

/s/ DIANNE DUBOIS

Chief Financial Officer

Exhibit 32.1

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

I, Jason Kellerman, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of LookSmart, Ltd. on Form 10-Q for the fiscal quarter ended June 30, 2003 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of LookSmart, Ltd.

By:	/s/ JASON KELLERMAN
Name:	**Jason Kellerman**
Title:	**President and Chief Executive Officer**

I, Dianne Dubois, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of LookSmart, Ltd. on Form 10-Q for the fiscal quarter ended June 30, 2003 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of LookSmart, Ltd.

By:	/s/ DIANNE DUBOIS
Name:	**Dianne Dubois**
Title:	**Chief Financial Officer**