

BANKRATE INC  
Form 10-Q  
November 08, 2004

**SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2004**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_**

**Commission File No. 0-25681**

(Exact name of registrant as specified in its charter)

**Florida**  
(State or other jurisdiction of incorporation or organization)

**65-0423422**  
(I.R.S. Employer Identification No.)

**11811 U.S. Highway One, Suite 101  
North Palm Beach, Florida**  
(Address of principal executive offices)

**33408**  
(Zip Code)

**Registrant's telephone number, including area code: (561) 630-2400**

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

Indicate by checkmark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes [  ] No [  ]

The number of outstanding shares of the issuer's common stock as of October 31, 2004 was as follows: 15,672,843 shares of Common Stock, \$.01 par value.



**Bankrate, Inc.**  
**Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2004**  
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Introductory Note

This Report and our other communications and statements may contain forward-looking statements, including statements about our beliefs, plans, objectives, goals, expectations, estimates, projections and intentions. These

statements are subject to significant risks and uncertainties and are subject to change based on various factors, many of which are beyond our control. For information concerning these factors and related matters, see Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, in this Report, and the following sections of our Annual Report on Form 10-K for the year ended December 31, 2003 (the 2003 Form 10-K): (a) Risk Factors in Item 1, Business, and (b) Introduction in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

**Part I. FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS**

**Bankrate, Inc.**  
Condensed Balance Sheets  
(Unaudited)

|  | <b>September<br/>30,<br/>2004</b> | <b>December<br/>31,<br/>2003</b> |
|--|-----------------------------------|----------------------------------|
| Assets   |                                   |                                  |
| Cash and cash equivalents  | \$ 26,906,083                     | \$ 20,874,482                    |
| Accounts receivable, net of allowance for doubtful accounts of \$300,000 and \$230,000 at September 30, 2004 and December 31, 2003, respectively |                                   | 3,936,730                        |
|  |                                   | 3,031,882                        |
| Deferred tax asset, net  |                                   | 3,400,000                        |
|  |                                   | 3,400,000                        |
| Other current assets   |                                   | 289,528                          |
|  |                                   | 343,311                          |
| Total current assets   |                                   | 34,532,341                       |
|  |                                   | 27,649,675                       |
| Furniture, fixtures and equipment, net   |                                   | 1,141,514                        |
|  |                                   | 796,928                          |
| Intangible assets, net   |                                   | 220,963                          |

|                                      |            |
|--------------------------------------|------------|
|                                      | 73,201     |
| Other assets                         |            |
|                                      | 564,744    |
|                                      | 463,463    |
| Total assets                         |            |
| \$                                   | 36,459,562 |
| \$                                   | 28,983,267 |
| Liabilities and Stockholders' Equity |            |
| Liabilities:                         |            |
| Accounts payable                     |            |
| \$                                   | 1,238,785  |
| \$                                   | 1,227,463  |
| Accrued expenses                     |            |
|                                      | 2,231,098  |
|                                      | 2,226,905  |
| Deferred revenue                     |            |
|                                      | 238,300    |
|                                      | 181,110    |
| Other current liabilities            |            |
|                                      | 82,216     |
|                                      | 116,551    |
| Total current liabilities            |            |
|                                      | 3,790,399  |
|                                      | 3,752,029  |

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|  |  |              |
|--|--|--------------|
| Other liabilities  |  | 420,537      |
|  |  | 306,274      |
| Total liabilities  |  | 4,210,936    |
|  |  | 4,058,303    |
| Stockholders' equity:  |  |              |
| Preferred stock, 10,000,000 shares authorized and undesignated   |  | -            |
|  |  | -            |
| Common stock, par value \$.01 per share-- 100,000,000 shares authorized; 15,672,635 and 15,114,371 shares issued and outstanding at September 30, 2004 and December 31, 2003, respectively |  | 156,727      |
|  |  | 151,144      |
| Additional paid in capital   |  | 66,875,782   |
|  |  | 66,091,014   |
| Accumulated deficit  |  | (34,783,883) |
| )  |  | (41,317,194) |
| )  |  |              |
| Total stockholders' equity   |  | 32,248,626   |
|  |  | 24,924,964   |
| Total liabilities and stockholders' equity   |  |              |
| \$   |  | 36,459,562   |

\$

28,983,267

See accompanying notes to condensed financial statements.



**Bankrate, Inc.**  
Condensed Statements of Operations  
(Unaudited)

|   | Three Months Ended  |                     | Nine Months Ended   |                     |
|---|---------------------|---------------------|---------------------|---------------------|
|   | September 30,       |                     | September 30,       |                     |
| Revenue:                                    | 2004                | 2003                | 2004                | 2003                |
| Online publishing                           | \$ 8,158,241        | \$ 8,113,959        | \$ 25,835,196       | \$ 23,645,492       |
| Print publishing and licensing              | 1,310,911           | 1,346,983           | 4,019,518           | 3,914,128           |
| <b>Total revenue</b>                        | <b>9,469,152</b>    | <b>9,460,942</b>    | <b>29,854,714</b>   | <b>27,559,620</b>   |
| Cost of revenue:                            |                     |                     |                     |                     |
| Online publishing                           | 1,337,122           | 1,047,608           | 4,181,027           | 3,305,365           |
| Print publishing and licensing              | 1,089,374           | 1,032,213           | 3,118,284           | 3,002,474           |
| <b>Total cost of revenue</b>                | <b>2,426,496</b>    | <b>2,079,821</b>    | <b>7,299,311</b>    | <b>6,307,839</b>    |
| <br>Gross margin                            | <br>7,042,656       | <br>7,381,121       | <br>22,555,403      | <br>21,251,781      |
| Operating expenses:                         |                     |                     |                     |                     |
| Sales                                       | 915,102             | 1,340,958           | 3,289,232           | 3,830,400           |
| Marketing                                   | 1,357,660           | 1,437,215           | 4,912,736           | 4,006,940           |
| Product development                         | 600,278             | 620,537             | 2,014,714           | 1,710,805           |
| General and administrative                  | 1,678,424           | 1,438,252           | 4,894,831           | 4,366,948           |
| Legal settlement                            | 390,000             | -                   | 390,000             | -                   |
| Severance charge                            | -                   | -                   | 260,000             | -                   |
| Depreciation and amortization               | 186,676             | 161,605             | 552,498             | 515,485             |
|   | 5,128,140           | 4,998,567           | 16,314,011          | 14,430,578          |
| <b>Income from operations</b>               | <b>1,914,516</b>    | <b>2,382,554</b>    | <b>6,241,392</b>    | <b>6,821,203</b>    |
| <br>Other income                            | <br>138,302         | <br>65,327          | <br>291,919         | <br>166,599         |
| <b>Income before income taxes</b>           | <b>2,052,818</b>    | <b>2,447,881</b>    | <b>6,533,311</b>    | <b>6,987,802</b>    |
| Income taxes                                | -                   | -                   | -                   | -                   |
| <b>Net income</b>                           | <b>\$ 2,052,818</b> | <b>\$ 2,447,881</b> | <b>\$ 6,533,311</b> | <b>\$ 6,987,802</b> |
| Basic and diluted net income per share:     |                     |                     |                     |                     |
| Basic                                       | \$ 0.13             | \$ 0.16             | \$ 0.42             | \$ 0.48             |
| Diluted                                     | \$ 0.13             | \$ 0.16             | \$ 0.41             | \$ 0.46             |
| Weighted average common shares outstanding: |                     |                     |                     |                     |
| Basic                                       | 15,506,719          | 14,941,600          | 15,395,372          | 14,528,371          |
| Diluted                                     | 15,869,708          | 15,787,803          | 15,908,487          | 15,331,077          |

See accompanying notes to condensed financial statements.

**Bankrate, Inc.**  
**Condensed Statements of Cash Flows**  
(Unaudited)

|  | <b>Nine Months Ended</b> |               |
|--|--------------------------|---------------|
|  | <b>September 30,</b>     |               |
|  | <b>2004</b>              | <b>2003</b>   |
| <b>Cash flows from operating activities:</b>   |                          |               |
| Net income   | \$ 6,533,311             | \$ 6,987,802  |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |                          |               |
| Depreciation and amortization  | 552,498                  | 515,485       |
| Bad debt expense   | 395,258                  | -             |
| <b>Changes in operating assets and liabilities:</b>                                      |                          |               |
| Increase in accounts receivable  | (1,300,106)              | (509,470)     |
| Increase in other assets   | (325,768)                | (171,815)     |
| Increase in accounts payable   | 11,322                   | 552,730       |
| Increase (decrease) in accrued expenses  | 4,193                    | (615,001)     |
| Increase in other liabilities  | 137,118                  | 118,711       |
| Net cash provided by operating activities  | 6,007,826                | 6,878,442     |
| <b>Cash flows from investing activities:</b>   |                          |               |
| Purchases of equipment   | (766,576)                | (401,103)     |
| Net cash used in investing activities  | (766,576)                | (401,103)     |
| <b>Cash flows from financing activities:</b>   |                          |               |
| Principal payments on capital lease obligations  | -                        | (1,254)       |
| Proceeds from exercise of stock options  | 790,351                  | 2,125,775     |
| Net cash provided by financing activities  | 790,351                  | 2,124,521     |
| Net increase in cash and cash equivalents  | 6,031,601                | 8,601,860     |
| Cash and equivalents, beginning of period  | 20,874,482               | 11,000,561    |
| Cash and equivalents, end of period  | \$ 26,906,083            | \$ 19,602,421 |
| <b>Supplemental disclosures of cash flow information:</b>                                |                          |               |
| Cash paid during the period for taxes  | \$ 70,600                | \$ -          |

See accompanying notes to condensed financial statements.

**BANKRATE, INC.**  
**NOTES TO CONDENSED FINANCIAL STATEMENTS**  
**September 30, 2004**  
(Unaudited)

**NOTE 1 - ORGANIZATION AND ACCOUNTING POLICIES**

**The Company**

Bankrate, Inc. (the "Company") owns and operates an Internet-based consumer banking marketplace. The Company's flagship Web site, Bankrate.com, is the Web's leading aggregator of information on more than 310 financial products, including mortgages, credit cards, new and used automobile loans, money market accounts, certificates of deposit, checking and ATM fees, home equity loans and online banking fees. Additionally, the Company provides financial applications and information to a network of distribution partners and through national and state publications. The Company is organized under the laws of the state of Florida.

**Basis of Presentation**

The unaudited interim condensed financial statements for the three and nine months ended September 30, 2004 and 2003 included herein have been prepared in accordance with the instructions for Form 10-Q under the Securities Exchange Act of 1934, as amended, and Article 10 of Regulation S-X under the Securities Act of 1933, as amended. Certain information and footnote disclosures normally included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations relating to interim financial statements.

In the opinion of management, the accompanying unaudited interim condensed financial statements reflect all adjustments, consisting only of normal, recurring adjustments, necessary to present fairly the financial position of the Company at September 30, 2004, and the results of its operations for the three and nine months ended September 30, 2004 and 2003, and its cash flows for the nine months ended September 30, 2004 and 2003. The results for the three and nine months ended September 30, 2004 are unaudited and are not necessarily indicative of the expected results for the full year or any future period.

The unaudited condensed financial statements included herein should be read in conjunction with the financial statements and related footnotes included in the Company's 2003 Form 10-K.

**Barter Revenue**

Online publishing revenue includes barter revenue, which represents the exchange by the Company of advertising space on the Company's Web site for reciprocal advertising space on other Web sites. Barter revenues and expenses are recorded at the fair market value of the advertisements delivered or received, whichever is more determinable in the circumstances. Barter transactions have been valued based on similar cash transactions that have occurred within six months prior to the date of the barter transaction. Revenue from barter transactions is recognized as income when advertisements are delivered on the Company's Web site. Barter expense is recognized when the Company's advertisements are run on the other companies' Web sites, which is typically in the same period in which barter revenue is recognized. If the advertising impressions are received from the customer prior to the Company delivering its advertising impressions, a liability is recorded. If the Company delivers its advertising impressions to the customer's Web site prior to receiving the advertising impressions, a prepaid expense is recorded. No prepaid expense or liability was recorded at September 30, 2004 and December 31, 2003. Barter revenue was approximately \$637,000, and \$835,000, and represented approximately 7% and 9% of total revenue for the three months ended September 30,

2004 and 2003, respectively, and was approximately \$2,395,000 and \$2,312,000, and represented 8% of total revenue, respectively, for the nine months ended September 30, 2004 and 2003.

**Basic and Diluted Net Income Per Share**

The Company computes basic net income per share by dividing net income for the period by the weighted average number of shares outstanding for the period. Diluted net income per share includes the effect of common stock equivalents calculated under the treasury stock method, consisting of outstanding stock options, to the extent the effect is not anti-dilutive.

The weighted average number of common shares outstanding used in computing diluted net income per share for the three and nine months ended September 30, 2004 and 2003 includes the shares resulting from the dilutive effect of outstanding stock options. For the three and nine months ended September 30, 2004, 416,775 shares attributable to the assumed exercise of outstanding stock options were excluded from the calculation of diluted net income per share because the effect was anti-dilutive. For the three and nine months ended September 30, 2003, 80,775 attributable to the assumed exercise of outstanding stock options were excluded from the calculation of diluted net income per share because the effect was anti-dilutive.

### Stock-Based Compensation

The Company applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board ( APB ) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations including Financial Accounting Standards Board ( FASB ) Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25*, issued in March 2000, to account for its fixed plan options. Under this method, compensation is recognized over the grant s vesting period only if the current market price of the underlying stock on the date of grant exceeds the exercise price. Statement of Financial Accounting Standards ( SFAS ) No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, ( SFAS No. 123 ), established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. 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. 148.

#### Pro Forma Disclosures Under SFAS No. 148

The following table provides the fair value of the options granted during the nine-month periods ended September 30, 2004 and 2003 using the Black-Scholes pricing model together with a description of the assumptions used to calculate the fair value. Options for 150,000 shares were granted during the three-month period ended September 30, 2004 and no options were granted during the same period in 2003. Options for 1,163,000 shares and 25,000 shares, respectively, were issued during the nine-month periods ended September 30, 2004 and 2003.

|                                 | Three Months Ended September |             | Nine Months Ended September 30, |         |
|---------------------------------|------------------------------|-------------|---------------------------------|---------|
|                                 | 2004                         | 30,<br>2003 | 2004                            | 2003    |
| Weighted average fair value     | \$ 6.17                      | -           | \$ 7.72                         | \$ 2.95 |
| Expected volatility             | 100%                         | -           | 100%                            | 100%    |
| Weighted average risk free rate | 3.9%                         | -           | 3.7%                            | 3%      |
| Expected lives                  | 5 years                      | -           | 5 years                         | 5 years |
| Expected dividend yield         | 0%                           | -           | 0%                              | 0%      |

The Company applies APB Opinion No. 25 in accounting for its stock-based compensation. Had the Company determined compensation cost based on the fair value at the grant date for its stock options under SFAS No. 123, the net income and net income per share would have been reported at the pro forma amounts indicated below.

|             | Three Months                |              | Nine Months                 |              |
|-------------|-----------------------------|--------------|-----------------------------|--------------|
|             | Ended September 30,<br>2004 | 2003         | Ended September 30,<br>2004 | 2003         |
| Net income: |                             |              |                             |              |
| As reported | \$ 2,052,818                | \$ 2,447,881 | \$ 6,533,311                | \$ 6,987,802 |

|   |              |              |              |              |
|---|--------------|--------------|--------------|--------------|
| Less total stock-based employee compensation determined under fair value-based method for all awards, net of related tax effect | (749,379)    | (47,044)     | (1,315,206)  | (227,900)    |
| Pro forma   | \$ 1,303,439 | \$ 2,400,837 | \$ 5,218,105 | \$ 6,759,902 |
| Basic net income per common share as reported:  |              |              |              |              |
| Basic   | \$ 0.13      | \$ 0.16      | \$ 0.42      | \$ 0.48      |
| Diluted   | 0.13         | 0.16         | 0.41         | 0.46         |
| Basic net income per common share pro forma:  |              |              |              |              |
| Basic   | 0.08         | 0.16         | 0.34         | 0.47         |
| Diluted   | 0.08         | 0.15         | 0.33         | 0.44         |
| Weighted average common shares outstanding:   |              |              |              |              |
| Basic   | 15,506,719   | 14,941,600   | 15,395,372   | 14,528,371   |
| Diluted   | 15,869,708   | 15,787,803   | 15,908,487   | 15,331,077   |

## Stockholders Equity

The activity in stockholders equity for the nine months ended September 30, 2004 is shown below.

|                              | Common Stock |            | Additional         | Accumulated     | Total         |
|------------------------------|--------------|------------|--------------------|-----------------|---------------|
|                              | Shares       | Amount     | Paid-in<br>Capital | Deficit         |               |
| Balances, December 31, 2003  | 15,114,371   | \$ 151,144 | \$ 66,091,014      | \$ (41,317,194) | \$ 24,924,964 |
| Stock options exercised      | 191,771      | 1,918      | 414,383            | -               | 416,301       |
| Net income for the period    | -            | -          | -                  | 2,370,395       | 2,370,395     |
| Balances, March 31, 2004     | 15,306,142   | 153,062    | 66,505,397         | (38,946,799)    | 27,711,660    |
| Stock options exercised      | 13,559       | 136        | 20,170             | -               | 20,306        |
| Net income for the period    | -            | -          | -                  | 2,110,098       | 2,110,098     |
| Balances, June 30, 2004      | 15,319,701   | 153,198    | 66,525,567         | (36,836,701)    | 29,842,064    |
| Stock options exercised      | 352,934      | 3,529      | 350,215            | -               | 353,744       |
| Net income for the period    | -            | -          | -                  | 2,052,818       | 2,052,818     |
| Balances, September 30, 2004 | 15,672,635   | \$ 156,727 | \$ 66,875,782      | \$ (34,783,883) | \$ 32,248,626 |

## Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. If it is more likely than not that some portion or all of a deferred tax asset will not be realized, a valuation allowance is recorded. The valuation allowance is based on management's judgment as to future taxable income in light of historical results, the current environment, forecasted performance and other factors.

## Comprehensive Income

Comprehensive income is the same as net income for the three and nine months ended September 30, 2004 and 2003.

## Recent Accounting Pronouncements

In May 2003, the FASB issued SFAS No. 150 *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* ( Statement 150 ). Statement 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. Statement 150 requires that

an issuer classify a financial instrument that is within the scope of Statement 150 as a liability. Statement 150 is effective for financial instruments entered into or modified after May 31, 2003, is otherwise effective for the Company beginning September 1, 2003, and did not have a material impact on the Company's financial statements.

In December 2003, the FASB issued a revised Interpretation No. 46, "*Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51*", ("FIN 46R"). FIN 46R requires the consolidation of entities in which an enterprise absorbs a majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity. Currently, entities are generally consolidated by an enterprise when it has a controlling financial interest through ownership of a majority voting interest in the entity. The provisions of FIN 46R are generally effective for existing (prior to February 1, 2003) variable interest relationships of a public entity no later than the end of the first reporting period that ends after March 15, 2004. However, prior to the required application of this interpretation a public entity that is not a small business issuer shall apply FIN 46R to those entities that are considered to be special-purpose entities no later than the end of the first reporting period that ends after December 15, 2003. The Company applied the portion of FIN 46R that is applicable to special purpose entities effective December 31, 2003, with no material effect, applied the remainder of FIN 46R to its first quarter 2004 financial statements, also with no material effect.



**Reclassification**

Certain prior year amounts have been reclassified to conform with the current year presentation.

**NOTE 2 - SEGMENT INFORMATION**

The Company currently operates in two reportable business segments: online publishing, and print publishing and licensing. The online publishing division is primarily engaged in the sale of advertising, sponsorships, and hyperlinks in connection with the Company's Internet site, Bankrate.com. The print publishing and licensing division is primarily engaged in the sale of advertising in the *Consumer Mortgage Guide* rate tables, newsletter subscriptions, and licensing of research information. The Company evaluates the performance of its operating segments based on segment profit (loss).

No single customer accounted for more than 10% of total revenue for the three and nine months ended September 30, 2004. The Company had one online customer that accounted for approximately 8% and 11% of total revenue for the three and nine months ended September 30, 2003, respectively. No revenues were generated outside of the United States.

Summarized segment information as of, and for, the three and nine months ended September 30, 2004 and 2003 is presented below.

|  | Online<br>Publishing | Print<br>Publishing<br>and<br>Licensing | Other         | Total         |
|--|----------------------|---|---------------|---------------|
| <b>Three Months Ended September 30, 2004</b> |                      |   |               |               |
| Revenue                                      | \$ 8,158,241         | \$ 1,310,911                            | \$ -          | \$ 9,469,152  |
| Cost of revenue                              | 1,337,122            | 1,089,374                               | -             | 2,426,496     |
| Gross margin                                 | 6,821,119            | 221,537                                 | -             | 7,042,656     |
| Sales  | 915,102              | -                                       | -             | 915,102       |
| Marketing                                    | 1,357,660            | -                                       | -             | 1,357,660     |
| Product development                          | 420,195              | 180,083                                 | -             | 600,278       |
| General and administrative expenses          | 1,446,063            | 232,361                                 | -             | 1,678,424     |
| Legal settlement                             | -                    | -                                       | 390,000       | 390,000       |
| Depreciation and amortization                | 130,673              | 56,003                                  | -             | 186,676       |
| Other income                                 | -                    | -                                       | 138,302       | 138,302       |
| Segment profit (loss)                        | \$ 2,551,426         | \$ (246,910)                            | \$ (251,698)  | \$ 2,052,818  |
| Total assets                                 | \$ 7,626,655         | \$ 1,926,824                            | \$ 26,906,083 | \$ 36,459,562 |

|  | Online<br>Publishing | Print<br>Publishing<br>and<br>Licensing | Other         | Total         |
|--|----------------------|---|---------------|---------------|
| <b>Three Months Ended September 30, 2003</b> |                      |   |               |               |
| Revenue                                      | \$ 8,113,959         | \$ 1,346,983                            | \$ -          | \$ 9,460,942  |
| Cost of revenue                              | 1,047,608            | 1,032,213                               | -             | 2,079,821     |
| Gross margin                                 | 7,066,351            | 314,770                                 | -             | 7,381,121     |
| Sales  | 1,340,958            | -                                       | -             | 1,340,958     |
| Marketing                                    | 1,437,215            | -                                       | -             | 1,437,215     |
| Product development                          | 434,376              | 186,161                                 | -             | 620,537       |
| General and administrative expenses          | 1,233,484            | 204,768                                 | -             | 1,438,252     |
| Depreciation and amortization                | 113,124              | 48,481                                  | -             | 161,605       |
| Interest income (expense), net               | -                    | -                                       | 65,327        | 65,327        |
| Segment profit (loss)                        | \$ 2,507,194         | \$ (124,640)                            | \$ 65,327     | \$ 2,447,881  |
| Total assets                                 | \$ 3,911,740         | \$ 828,323                              | \$ 19,602,421 | \$ 24,342,484 |

|   | Online<br>Publishing | Print<br>Publishing<br>and<br>Licensing | Other         | Total         |
|---|----------------------|---|---------------|---------------|
| <b>Nine Months Ended September 30, 2004</b> |                      |   |               |               |
| Revenue                                     | \$ 25,835,196        | \$ 4,019,518                            | \$ -          | \$ 29,854,714 |
| Cost of revenue                             | 4,181,027            | 3,118,284                               | -             | 7,299,311     |
| Gross margin                                | 21,654,169           | 901,234                                 | -             | 22,555,403    |
| Sales                                       | 3,289,232            | -                                       | -             | 3,289,232     |
| Marketing                                   | 4,912,736            | -                                       | -             | 4,912,736     |
| Product development                         | 1,410,300            | 604,414                                 | -             | 2,014,714     |
| General and administrative expenses         | 4,199,647            | 695,184                                 | -             | 4,894,831     |
| Legal settlement                            | -                    | -                                       | 390,000       | 390,000       |
| Severance charge                            | -                    | -                                       | 260,000       | 260,000       |
| Depreciation and amortization               | 386,749              | 165,749                                 | -             | 552,498       |
| Other income                                | -                    | -                                       | 291,919       | 291,919       |
| Segment profit (loss)                       | \$ 7,455,505         | \$ (564,113)                            | \$ (358,081)  | \$ 6,533,311  |
| Total assets                                | \$ 7,626,655         | \$ 1,926,824                            | \$ 26,906,083 | \$ 36,459,562 |

|   | Online<br>Publishing | Print<br>Publishing<br>and<br>Licensing | Other | Total         |
|---|----------------------|---|-------|---------------|
| <b>Nine Months Ended September 30, 2003</b> |                      |   |       |               |
| Revenue                                     | \$ 23,645,492        | \$ 3,914,128                            | \$ -  | \$ 27,559,620 |
| Cost of revenue                             | 3,305,365            | 3,002,474                               | -     | 6,307,839     |
| Gross margin                                | 20,340,127           | 911,654                                 | -     | 21,251,781    |
| Sales                                       | 3,830,400            | -                                       | -     | 3,830,400     |
| Marketing                                   | 4,006,940            | -                                       | -     | 4,006,940     |
| Product development                         | 1,197,564            | 513,242                                 | -     | 1,710,805     |
| General and administrative expenses         | 3,746,736            | 620,212                                 | -     | 4,366,948     |

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|                                |              |              |               |               |
|--------------------------------|--------------|--------------|---------------|---------------|
| Depreciation and amortization  | 360,840      | 154,645      | -             | 515,485       |
| Interest income (expense), net | -            | -            | 166,599       | 166,599       |
| Segment profit (loss)          | \$ 7,197,647 | \$ (376,444) | \$ 166,599    | \$ 6,987,802  |
| Total assets                   | \$ 3,911,740 | \$ 828,323   | \$ 19,602,421 | \$ 24,342,484 |

## NOTE 3 - COMMITMENTS AND CONTINGENCIES

### Legal Proceedings

In July 2000, the Company sold its former wholly-owned subsidiary, Professional Direct Agency, Inc. ( Pivot ), for \$4,350,000 in cash. In connection with the sale, the Company agreed to indemnify the buyer for liability of up to \$1,000,000 in connection with a litigation matter between Pivot and its co-founders and former owner. In March 2001, the case was dismissed based on a technical deficiency. In August 2001, the plaintiff re-filed the complaint. On October 8, 2004, the Company was notified that the buyer settled the litigation matter, effective as of October 1, 2004, and the Company reimbursed the buyer \$390,000 under the indemnity. The \$390,000 was recorded in the quarter ended September 30, 2004 as a legal settlement charge.

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

The following discussion may contain forward-looking statements, including statements about our beliefs, plans, objectives, goals, expectations, estimates, projections and intentions. These statements are subject to significant risks and uncertainties and are subject to change based on various factors, many of which are beyond our control. For information concerning these factors and related matters, see the following sections of our Annual Report on Form 10-K for the year ended December 31, 2003 (the 2003 Form 10-K ): (a) Risk Factors in Item 1, Business, and (b) Introduction in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, in addition to the other information set forth herein.

### Overview

Bankrate, Inc. (the Company ) owns and operates an Internet-based consumer banking marketplace. Our flagship site, Bankrate.com, is the Web's leading aggregator of information on more than 310 financial products including mortgages, credit cards, new and used automobile loans, money market accounts, certificates of deposit, checking and ATM fees, home equity loans and online banking fees. Additionally, we provide financial applications and information to a network of distribution partners and also through national and state publications. Bankrate.com provides the tools and information that can help consumers make better financial decisions. We regularly survey approximately 4,800 financial institutions in all 50 states in order to provide the most current objective, unbiased rates. Hundreds of print and online partner publications depend on Bankrate.com as the trusted source for financial rates and information.

Over two decades ago, we began as a print publisher of the newsletter *Bank Rate Monitor*. Our rate tables provide, at no cost to the consumer, a detailed list of lenders by market and include relevant details to help consumers compare loan products.

We continue to enhance our offerings in order to provide Bankrate.com users with the most complete experience. Features such as financial calculators and email newsletters allow users to interact with our site. Our *Rate Trend Index* is a weekly poll of industry insiders designed to help consumers forecast interest rate trends. We also broadened our offerings to include channels on investing, taxes, small business and financial advice. Each channel offers a unique look at its particular topic. Bankrate.com users can find advice and tips from the Tax channel, obtain business ideas from the Small Business channel and ask a financial expert a question in the Advice channel.

We believe that the recognition of our research as a leading source of independent, objective information on banking and credit products is essential to our success. As a result, we have sought to maximize distribution of our research to

gain brand recognition as a research authority. We are seeking to build greater brand awareness of our Web site and to reach a greater number of online users.

We operate a traditional media business on the Internet. We are a central marketplace for financial institutions to acquire customers. We have a high quality, poised-to-transact audience that has been educated by us and is ready to do business with our advertisers. We are ranked the number one site for unique visitors in the financial information and advice category, according to comScore Media Metrix. We sell graphic advertisements and hyperlinks on our Web site, we publish rates and sell advertisements in metropolitan newspapers, and we license our rates and editorial content.

Financial institutions are still in the early stages of adopting the Internet for advertising products and customer acquisition. Their online advertising spending is still a very small percentage of their overall advertising budgets.

We compete for advertising dollars with the large portals like AOL and Yahoo! and with some of the print brand franchises like Forbes.com and SmartMoney.com. We also compete for traffic with brands like these. Our traffic has grown from approximately 700,000 unique visitors per month in early 2000 to approximately 4 million unique visitors a month according to comScore Media Metrix.

The key drivers to our business are the number of advertisers on our Web site and the number of consumers visiting our Web site or page views. We added over 260 new unique advertisers in the nine months ended September 30, 2004, and we added over 100 new unique advertisers in 2003. We served over 137 million more pages in 2003 than in 2002. Page views grew from 134 million in 2000 to over 400 million in 2003. We served 302 million pages during the first nine months of 2004 compared to 329 million in the first nine months of 2003. During the quarter ended September 30, 2004, we served 92 million page views compared to 100 million in the same period in 2003. These declines are primarily attributable to unusually high traffic in the second and third quarters of 2003 due to consumer demand for re-finance and other mortgage-related product information.

We have improved our gross margin from 37% in 2000 to 76% in 2004, and have reduced other operating expenses (excluding barter expense, the severance charge of \$260,000 recorded in the second quarter, and the legal settlement charge of \$390,000 recorded in the third quarter) as a percentage of total revenue (excluding barter revenue) from 140% in 2000 to 48% in 2004. Our net income (excluding the severance charge of \$260,000, and the legal settlement charge of \$390,000) as a percentage of total revenue has grown to 24% in 2004, and we have increased cash and cash equivalents by approximately \$18 million since December 31, 2000.

#### Other Operating Expenses and Total Revenue Excluding Barter

|                          | 12 Months |           |           |           | Nine Months |
|--------------------------|-----------|-----------|-----------|-----------|-------------|
|                          | 2000      | 2001      | 2002      | 2003      | 2004        |
| Total revenue            | \$ 15,205 | \$ 18,257 | \$ 26,571 | \$ 36,621 | \$ 29,855   |
| Barter revenue           | (757)     | (2,558)   | (2,912)   | (3,163)   | (2,395)     |
|                          | 14,448    | 15,699    | 23,659    | 33,458    | 27,460      |
| Other operating expenses | 20,915    | 13,724    | 15,334    | 19,301    | 16,314      |
| Barter expense           | (757)     | (2,750)   | (2,920)   | (3,163)   | (2,395)     |
| Severance charge         | -         | -         | -         | -         | (260)       |
| Legal settlement charge  | -         | -         | -         | -         | (390)       |
|                          | \$ 20,158 | \$ 10,974 | \$ 12,414 | \$ 16,138 | \$ 13,269   |

Other operating expenses as a percentage  
of total revenue

|   |     |
|---|-----|
| % | 140 |
| % | 70  |
| % | 52  |

%

%

## **Overview of Revenue and Expenses and Critical Accounting Policies, Estimates and Practices**

The following is our analysis of the results of operations for the periods covered by our financial statements, including a discussion of the accounting policies and practices (revenue recognition, allowance for doubtful accounts and valuation of deferred tax assets) that we believe are critical to an understanding of our results of operations and to making the estimates and judgments underlying our financial statements. This analysis should be read in conjunction with our interim condensed financial statements, including the related notes. See *Results of Operations and Critical Accounting Policies* in Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, in our 2003 Form 10-K for additional information concerning the revenue and expense components of our online and print publishing operations.

### **Results of Operations**

#### **Three and Nine Months Ended September 30, 2004 Compared to Three and Nine Months Ended September 30, 2003**

##### **Revenue**

##### ***Online Publishing Revenue***

We sell graphic advertisements on our Web site (including co-branded sites) consisting of banner, badge, billboard, poster and island advertisements. These advertisements are sold to advertisers according to the cost per thousand impressions, or CPM, the advertiser receives. The amount of advertising we sell is a function of (1) the number of advertisements per Web page, (2) the number of visitors viewing our Web pages, and (3) the capacity of our sales force. Advertising sales are invoiced monthly based on the number of advertisement impressions or the number of times the advertisement is viewed by users of our Web site. Revenue is recognized monthly based on the percentage of actual impressions to the total number of impressions contracted. Revenue for impressions invoiced but not delivered is deferred. Additionally, we generate revenue on a *per action* basis (i.e., a purchase or completion of an application) when a visitor to our Web site transacts with one of our advertisers after viewing an advertisement. Revenue is recognized monthly based on the number of actions reported by the advertiser. We are also involved in revenue sharing arrangements with our online partners where the consumer uses co-branded sites hosted by us. Revenue is effectively allocated to each partner based on the percentage of advertisement views at each site. The allocated revenues are shared according to distribution agreements. Revenue is recorded at gross amounts and revenue payments are recorded in cost of revenue. We also sell hyperlinks to various third-party Internet sites that generate a fixed monthly fee, which is recognized in the month earned.

Online publishing revenue also includes barter revenue, which represents the exchange of advertising space on our Web site for reciprocal advertising space or traffic on other Web sites. Barter revenues and expenses are recorded at the fair market value of the advertisements delivered or received, whichever is more determinable in the circumstances. We follow the accounting literature provided by the Emerging Issues Task Force ( EITF ) 99-17, *Accounting for Advertising Barter Transactions*. In accordance with EITF 99-17, barter transactions have been valued based on similar cash transactions which have occurred within six months prior to the date of the barter transaction. Revenue from barter transactions is recognized as income when advertisements are delivered on our Web site. Barter expense is recognized when our advertisements are run on the other companies Web sites, which is typically in the same period barter revenue is recognized. If the advertising impressions are received from the customer prior to our delivering the advertising impressions, a liability is recorded. If we deliver advertising impressions to the other companies Web sites prior to receiving the advertising impressions, a prepaid expense is recorded. No prepaid expense or liability was recorded at September 30, 2004 and December 31, 2003. Barter revenue was approximately \$637,000, and \$835,000, and represented approximately 7% and 9% of total revenue for the three months ended September 30, 2004 and 2003, respectively, and was approximately \$2,395,000 and \$2,312,000, and represented 8% of total revenue, respectively, for the nine months ended September 30, 2004 and 2003.

|                    | Quarterly Online Publishing Revenue |           |           |           |           |           |           |
|--------------------|-------------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|
|                    | Q1 03                               | Q2 03     | Q3 03     | Q4 03     | Q1 04     | Q2 04     | Q3 04     |
|                    | \$                                  | \$        | \$        | \$        | \$        | \$        | \$        |
| <b>Graphic ads</b> | 3,769,522                           | 3,983,042 | 3,567,978 | 3,115,744 | 4,188,189 | 3,923,813 | 4,033,213 |
| <b>Hyperlinks</b>  | 2,814,272                           | 3,488,025 | 3,710,862 | 3,755,200 | 3,856,381 | 3,950,737 | 3,487,527 |
| <b>Barter</b>      | 750,399                             | 726,272   | 835,119   | 851,956   | 937,835   | 820,000   | 637,501   |
|                    | \$                                  | \$        | \$        | \$        | \$        | \$        | \$        |
|                    | 7,334,193                           | 8,197,339 | 8,113,959 | 7,722,900 | 8,982,405 | 8,694,550 | 8,158,241 |

Excluding barter revenue, online publishing revenue of \$7,521,000 for the three months ended September 30, 2004 was \$242,000, or 3%, higher than the \$7,279,000 reported for the same period in 2003. This increase was primarily due to a \$465,000, or 13%, increase in graphic ad sales as CPM s remained strong, offsetting an 8.3 million, or 8%, decline in page views. We also sold 16.7 million, or 5%, more ads in the third quarter of 2004 compared to 2003. Hyperlink sales were down \$223,000, or 6%, due to a decline in the total number of hyperlink advertisers during the quarter as a result of lower post re-finance mortgage demand.

Excluding barter revenue, online publishing revenue of \$23,440,000 for the nine months ended September 30, 2004 was \$2,106,000, or 10%, higher than the same period in 2003. This increase was due to a \$1,281,000, or 13%, increase in hyperlink sales as we expanded the number of markets our hyperlinks were sold in, introduced new products, increased product pricing, and continued to benefit from lower mortgage rates and re-finance demand through the end of the second quarter. Graphic ad revenue of \$12,145,000 for the nine months ended September 30, 2004 was up \$825,000, or 7%, over the same period in 2003 due to higher CPM s, offsetting a 27 million, or 8%, decline in page views in the comparable periods. We also sold 76.4 million, or 8%, more ads during the nine months ended September 30, 2004 compared to the same period in 2003.

A majority of our advertising customers purchase advertising under short-term contracts. Customers have the ability to stop, and have on occasion stopped, advertising on relatively short notice. Online publishing revenue would be adversely impacted if we experienced contract terminations, or if we were not able to renew contracts with existing customers or obtain new customers. The market for Internet advertising is intensely competitive and has, in the past, experienced significant downturns in demand that could impact advertising rates. Future revenue could be adversely affected if we were forced to reduce our advertising rates or if we were to experience lower CPM s.



Historically, our first calendar quarter has been our highest in terms of page views, and we have typically experienced a slowdown in traffic during our third and fourth quarters. During 2002 and 2003, certain traffic initiatives and expanded commitments from our distribution partners as well as the activity in mortgage lending caused increases in traffic inconsistent with our historical trends. Based on those historical trends, we could experience a decline in traffic and online publishing revenue during the fourth quarter of 2004 in relation to the first three quarters of 2004.

|      | Page Views<br>(Millions) |       |       |       |       |
|------|--------------------------|-------|-------|-------|-------|
|      | 2004                     | 2003  | 2002  | 2001  | 2000  |
| Q1   | 117.2                    | 106.7 | 58.4  | 70.5  | 37.0  |
| Q2   | 92.6                     | 121.8 | 48.0  | 52.2  | 34.1  |
| Q3   | 92.0                     | 100.3 | 82.1  | 47.3  | 30.5  |
| Q4   | -                        | 75.8  | 79.3  | 66.5  | 32.8  |
| Year | 301.8                    | 404.6 | 267.8 | 236.5 | 134.4 |

### *Print Publishing and Licensing Revenue*

Print publishing and licensing revenue represents advertising revenue from the sale of advertising in *Consumer Mortgage Guide* rate tables, newsletter subscriptions, and licensing of research information. We charge a commission for placement of the *Consumer Mortgage Guide* in a print publication. Advertising revenue and commission income is recognized when the *Consumer Mortgage Guide* runs in the publication. Revenue from our newsletters is recognized ratably over the period of the subscription, which is generally up to one year. Revenue from the sale of research information is recognized ratably over the contract period.

We also earn fees from distributing editorial rate tables that are published in newspapers and magazines across the United States, from paid subscriptions to three newsletters, and from providing rate surveys to institutions and government agencies. In addition, we license research data under agreements that permit the use of rate information we develop to advertise the licensee's products in print, radio, television and Web site promotions. Revenue for these products is recognized ratably over the contract/subscription periods.

|                                | Quarterly Print Publishing & Licensing Revenue |           |           |           |           |           |           |
|--------------------------------|--|-----------|-----------|-----------|-----------|-----------|-----------|
|                                | Q1 03  | Q2 03     | Q3 03     | Q4 03     | Q1 04     | Q2 04     | Q3 04     |
|                                |  | \$        | \$        | \$        | \$        | \$        | \$        |
| <b>Consumer Mortgage Guide</b> | \$ 984,747                                     | 1,143,404 | 1,143,442 | 1,131,148 | 1,085,490 | 1,224,200 | 1,073,519 |
| <b>Editorial</b>               | 227,646  | 211,348   | 203,541   | 207,823   | 206,337   | 192,580   | 237,392   |
|                                | \$   | \$        | \$        | \$        | \$        | \$        | \$        |
|                                | 1,212,393                                      | 1,354,752 | 1,346,983 | 1,338,971 | 1,291,827 | 1,416,780 | 1,310,911 |

Print publishing and licensing revenue for the quarter ended September 30, 2004 was down \$36,000, or 3%, compared to the comparable period in 2003 primarily due to a \$70,000, or 6%, decrease in *Consumer Mortgage Guide* revenue. This decrease was primarily the result of approximately 13% fewer *Consumer Mortgage Guide* advertisers during the quarter ended September 30, 2004 than in the comparable quarter in 2003, reflecting lower post re-finance consumer demand. Editorial sales were up \$34,000, or 17%, in the three months ended September 30, 2004 primarily due to higher licensing revenue.

Print publishing and licensing revenue for the nine months ended September 30, 2004 was up \$105,000, or 3%, over the same period in 2003 due to a \$112,000, or 3%, increase in *Consumer Mortgage Guide* revenue. This increase was a result of higher advertising rates and more *Consumer Mortgage Guide* contracts during the period ended September 30, 2004 than in the comparable period in 2003. Editorial sales were down \$6,000, or 1%, in the first nine months of 2004 due to newspaper efforts to cut costs and reduce their editorial content advertising spending.

### **Cost of Revenue**

***Online Publishing Costs***

Online publishing costs represent expenses directly associated with the creation of online publishing revenue. These costs include contractual revenue sharing obligations resulting from our distribution arrangements (distribution payments), editorial costs, research costs and allocated overhead. Distribution payments are made to Web site operators for visitors directed to our Web site; these costs increase proportionately with gains in traffic to our site. Editorial costs relate to writers and editors who create original content for our online publications and associates who build Web pages; these costs have increased as we have added online publications and co-branded versions of our site under distribution arrangements. These sites must be maintained on a daily basis. Research costs include expenses related to gathering data on banking and credit products and consist primarily of compensation and benefits and allocated overhead.

Online publishing costs for the three months ended September 30, 2004 were \$290,000, or 28%, higher than the comparable period in 2003 primarily due to higher revenue sharing payments (\$257,000, or 79%) to our distribution partners due to higher associated revenue. For the first nine months of 2004, online publishing costs were \$876,000, or 26%, higher than the first nine months of 2003 due to higher revenue sharing payments (\$742,000, or 74%) to our distribution partners due to higher associated revenue; \$57,000, or 34%, higher freelance writer expenses due to expanded products and coverage; and \$71,000 higher other professional fees supporting market research on new product initiatives.

### ***Print Publishing and Licensing Costs***

Print publishing and licensing costs represent expenses associated with print publishing and licensing revenue. These costs include contractual revenue sharing obligations with newspapers related to the *Consumer Mortgage Guide*, compensation and benefits, printing and allocated overhead. These costs vary proportionately with the related revenues and increased \$57,000, or 6%, for the three months ended September 30, 2004 compared to the same period in 2003 due to higher *Consumer Mortgage Guide* revenue sharing payments related to higher contractual payment terms and higher human resources costs for business development initiatives. Print publishing and licensing costs were \$116,000, or 4%, higher in the first nine months of 2004 compared to 2003 primarily due to higher *Consumer Mortgage Guide* revenue sharing payments (\$151,000, or 6%) resulting from higher revenue and higher contractual payment terms in 2004.

### **Other Expenses**

#### ***Sales***

Sales costs represent direct selling expenses, principally for online advertising, and include compensation and benefits, sales commissions, and allocated overhead. Sales costs for the three months ended September 30, 2004 were down \$426,000, or 32%, from the comparable period in 2003 primarily due to a \$360,000, or 54%, reduction in sales commissions. We implemented a new commission plan in the second quarter and actual results fell short of target goals. Human resource costs were also \$30,000 lower due to open positions yet to be hired. For the first nine months of 2004, sales expenses were \$541,000, or 14%, lower than the first half of 2003 due to a \$724,000, or 39%, decline in commission expense, offset by higher human resource costs related to new hires, and recruiting costs related to hiring our new Chief Revenue Officer in the first quarter.

#### ***Marketing***

Marketing costs represent expenses associated with expanding brand awareness of our products and services to consumers and include print and Internet advertising and marketing and promotion costs. Marketing costs also include barter expense, which represents the non-cash cost of our advertisements that are run on other companies' Web sites in our barter transactions. Barter expense was \$638,000 and \$847,000 for the quarters ended September 30, 2004 and 2003, respectively. Excluding barter expense, marketing expenses for the quarter ended September 30, 2004 of \$720,000 were \$130,000, or 22%, higher than the comparable quarter in 2003. This increase primarily reflects our efforts to improve search engine results with key word (pay per performance) campaigns as traffic acquisition becomes more competitive. For the first nine months of 2004, marketing expenses excluding barter of \$2,395,000 were \$833,000, or 49%, higher than the first nine months of 2003 due to the key word search campaigns. We anticipate having to spend at comparable levels for key word campaigns in the foreseeable future.

#### ***Product Development***

Product development costs represent compensation and benefits related to site development, network systems and telecommunications infrastructure support, programming, new product design and development and other technology costs. Product development costs for the three months ended September 30, 2004 were \$20,000, or 3%, lower than the same period in 2003 due to the achievement of certain development goals and the curtailment of design and development of other products. Product development costs for the nine months ended September 30, 2004 were \$304,000, or 18%, higher than the same period in 2003 due to expenses associated with the design and development of new products, and higher human resource and training costs.

***General and Administrative***

General and administrative expenses represent compensation and benefits for executive, finance and administrative personnel, professional fees, non-allocated overhead and other general corporate expenses. General and administrative expenses for the three months ended September 30, 2004 were \$240,000, or 17%, higher than the comparable amount reported in the same period in 2003 primarily due to the following: \$86,000 higher human resource costs and recruiting fees related to merit increases and new hire searches; \$25,000 higher Internet hosting service fees due to increased traffic levels and bandwidth utilization; \$64,000 higher consulting and outside professional service fees; and \$275,000 in bad debt expense to increase the allowance for doubtful accounts supporting higher sales levels and receivable balances. These higher costs were offset by a decrease in incentive plan accruals based on mid-year forecasts and measurements to plan, lower travel and entertainment expenses and various decreases in other expenses.

For the first nine months of 2004, general and administrative expenses were \$528,000, or 12%, higher than the first nine months of 2003 due to the following: \$202,000 higher human resource costs and recruiting fees related to merit increases and new hire searches; \$71,000 higher Internet hosting service fees due to increased bandwidth utilization; \$82,000 higher consulting and outside professional service fees; \$395,000 in bad debt expense to increase the allowance for doubtful accounts supporting higher sales levels and receivable balances; and \$30,000 higher bank service charges and merchant fees related to credit card payments on accounts receivable. These higher costs were offset by a decrease in incentive plan accruals based on mid-year forecasts and measurements to plan, and various other operating costs.

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability or unwillingness of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Any additions to the allowance for doubtful accounts are recorded as bad debt expense and included in general and administrative expenses.

#### ***Severance and Legal Settlement Charges***

August 10, 2004, we entered into a Separation and General Release (the Agreement) with Elisabeth DeMarse (DeMarse), our former President and CEO, pursuant to the terms of an Executive Employment Agreement by and between the Company and DeMarse dated April 27, 2002 (the Executive Employment Agreement). The Agreement provided, among other things, that (i) DeMarse resign as a director of the Company as of August 10, 2004, (ii) DeMarse release and forever discharge the Company from any and all claims DeMarse has or may have against the Company, (iii) DeMarse's last day as an employee of the Company will be extended until October 21, 2004; (iv) on August 19, 2004, the Company pay DeMarse \$125,000, subject to standard withholdings and deductions for the payment of certain of DeMarse's legal fees, (v) on August 19, 2004, the Company pay DeMarse \$54,207.40, subject to standard withholdings, for accrued vacation pay, (vi) on August 19, 2004, the Company pay \$10,000 to a third party for outplacement and transitional counseling services for DeMarse, (vii) on August 19, 2004, the Company pay DeMarse for her unpaid and reasonably approved business expenses, (viii) the Company provide DeMarse certain health insurance benefits in accordance with the terms of the Executive Employment Agreement, and (ix) on October 21, 2004, the Company pay DeMarse \$125,000, subject to standard withholdings and contingent upon DeMarse executing a second General Release of Claims. Accordingly, we recorded a severance charge of \$260,000 in the quarter ended June 30, 2004.

In July 2000, we sold our former wholly-owned subsidiary, Professional Direct Agency, Inc. (Pivot), for \$4,350,000 in cash. In connection with the sale, we agreed to indemnify the buyer for liability of up to \$1,000,000 in connection with a litigation matter between Pivot and its co-founders and former owner. In March 2001, the case was dismissed based on a technical deficiency. In August 2001, the plaintiff re-filed the complaint. On October 8, 2004, we were notified that the buyer settled the litigation matter, effective as of October 1, 2004, and we reimbursed the buyer \$390,000 under the indemnity. The \$390,000 was recorded in the quarter ended September 30, 2004 as a legal settlement charge.

#### ***Depreciation and Amortization***

Depreciation and amortization was \$25,000, or 16%, higher for the three months ended September 30, 2004 compared to 2003 due to assets placed in service in the third quarter. For the first nine months of 2004, depreciation and amortization was \$37,000, or 7%, higher than the first nine months of 2003 due to assets purchased in the first nine months of the year, offset by the first quarter impact of assets becoming fully depreciated during the third and fourth quarters of 2003.

***Other Income***

Other income consists of interest income generated from invested cash and cash equivalents. Interest income for the three and nine months ended September 30, 2004 was higher than the amounts reported in the same periods in 2003 due to higher cash balances during 2004. Other income for the three months ended September 30, 2004 includes a non-refundable cash advance, net of commissions, of \$42,000 from a book authored by the Company's Chief Operating Officer.

### **Income Taxes**

We have not recognized a provision for income taxes during the nine-month periods ended September 30, 2004 and 2003 as we have sufficient net operating loss carryforwards to offset any income taxes payable on our pre-tax income.

As required by Statement of Financial Accounting Standards No. 109, we recognize deferred tax assets on the balance sheet if it is more likely than not that they will be realized. Through the third quarter of 2003, we provided a full valuation allowance against accumulated deferred tax assets, reflecting the uncertainty associated with our future profitability. In the fourth quarter of 2003 we reassessed the valuation allowance previously established against deferred tax assets. Factors considered by us included: our historical results of operations, volatility of the economic and interest rate environment and projected earnings based on current operations. Based on this evidence, we concluded that it is more likely than not that a portion of the deferred tax assets would be realized. Accordingly, we released \$3,400,000 of the valuation allowance.

The valuation allowance at December 31, 2003 was approximately \$9.4 million. We will continue to evaluate the need for a valuation allowance on deferred tax assets based on the actual results of operations and projected earnings for future periods. It is possible that all or part of the valuation allowance will be reversed during 2004 resulting in an income tax credit for the amount reversed. As of September 30, 2004, we had \$3,400,000 in deferred tax assets. The realization of deferred tax assets will depend on our ability to continue to generate taxable income in the future.

### **Liquidity and Capital Resources**

Our principal source of liquidity is the cash generated by our operations. As of September 30, 2004, we had working capital of \$30,742,000, and our primary commitments were approximately \$1,406,000 in operating lease payments over the next five years, as well as capital expenditures and recurring payables and accruals arising during the course of operating our business, estimated at approximately \$3,933,000 through September 30, 2005. We generally establish payment terms with our vendors that extend beyond the amount of time required to collect from our customers. There are no other significant commitments or any off-balance sheet arrangements.

### **Contractual Obligations**

The following table represents the amounts due under the specified types of contractual obligations.

| <b>Contractual obligations</b>  | <b>Payments Due<br/>(In thousands)</b> |                           |                            |                             |
|---------------------------------|--|---------------------------|----------------------------|-----------------------------|
|                                 | <b>Less than one year</b>              | <b>One to three years</b> | <b>Three to five years</b> | <b>More than five years</b> |
| Long-term debt obligations      | \$ -                                   | \$ -                      | \$ -                       | \$ -                        |
| Capital lease obligations (1)   | -                                      | -                         | -                          | -                           |
| Operating lease obligations (1) | 646,903                                | 759,394                   | -                          | -                           |
| Purchase obligations (2)        | 521,474                                | 152,230                   | -                          | -                           |
| Other long-term obligations     | -                                      | -                         | -                          | -                           |

(1) Includes our obligations under existing operating leases.

(2) Represents base contract amounts for Internet hosting, co-location content distribution and other infrastructure costs.



During the nine months ended September 30, 2004, we generated \$6,007,000 of net cash from operating activities. Our net income of \$6,533,000 was adjusted for depreciation and amortization of \$552,000, bad debt expense of \$395,000, and a net negative change in the components of operating assets and liabilities of \$1,473,000. Of this negative change, \$1,300,000 resulted from an increase in accounts receivable, and \$326,000 resulted from an increase in other assets. Accounts receivable balances were higher at September 30, 2004 supporting higher sales levels. The increase in other assets was primarily due to an increase in prepaid expenses related to the purchase of software licenses and maintenance agreements. During the nine months ended September 30, 2004, net cash of \$767,000 was used to purchase equipment and other fixed assets, and \$790,000 was provided by financing activities, primarily the result of stock option exercises.

### **Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

#### **Interest Rate Risk**

The primary objective of our investment strategy is to preserve principal while maximizing the income we receive from investments without significantly increasing risk. To minimize this risk, to date we have maintained our portfolio of cash equivalents in short-term and overnight investments which are not subject to market risk, as the interest paid on such investments fluctuates with the prevailing interest rates. As of September 30, 2004, all of our cash equivalents matured in less than three months.

#### **Exchange Rate Sensitivity**

Our exposure to foreign currency exchange rate fluctuations is minimal to none as we do not have any revenues denominated in foreign currencies. Additionally, we have not engaged in any derivative or hedging transactions to date.

### **Item 4. CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended, are recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that the information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired objectives, and management was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. Management, with the participation of the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based upon the evaluation and subject to the foregoing, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective to accomplish their objectives.

#### **Changes in Internal Controls**

In addition, management, including our Chief Executive Officer and our Chief Financial Officer, reviewed our internal controls, and there have been no significant changes in our internal controls or in other factors that could significantly affect those controls during the period covered by this report.

## **Part II - OTHER INFORMATION**

### **Item 1. LEGAL PROCEEDINGS**

In July 2000, the Company sold its former wholly-owned subsidiary, Professional Direct Agency, Inc. ( Pivot ), for \$4,350,000 in cash. In connection with the sale, the Company agreed to indemnify the buyer for liability of up to \$1,000,000 in connection with a litigation matter between Pivot and its co-founders and former owner. In March 2001, the case was dismissed based on a technical deficiency. In August 2001, the plaintiff re-filed the complaint. On October 8, 2004, the Company was notified that the buyer settled the litigation matter, effective as of October 1, 2004,

and the Company reimbursed the buyer \$390,000 under the indemnity. The \$390,000 was recorded in the quarter ended September 30, 2004 as a legal settlement charge.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**Item 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

**Item 5. OTHER INFORMATION**

None.

**Item 6. EXHIBITS**

(a) Exhibits

- 31.1 Certification of Thomas R. Evans, Chief Executive Officer and President of Bankrate, Inc., Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
- 31.2 Certification of Robert J. DeFranco, Senior Vice President and Chief Financial Officer of Bankrate, Inc., Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
- 32.1 Certification of Thomas R. Evans, Chief Executive Officer and President of Bankrate, Inc., Pursuant to 18 U.S.C. Section 1350.
- 32.2 Certification of Robert J. DeFranco, Senior Vice President and Chief Financial Officer of Bankrate, Inc., Pursuant to 18 U.S.C. Section 1350.

**SIGNATURES**

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.

**Bankrate, Inc.**

Dated: November 8, 2004

By: /s/ ROBERT J. DEFRANCO  
Robert J. DeFranco  
Senior Vice President Chief Financial Officer

