LookSmart, Limited

625 Second Street, San Francisco, California 94107 USA

Appendix 4E
Preliminary Annual Report and Annual Report for the Year Ended 31 December 2006

RESULTS FOR ANNOUNCEMENT TO THE MARKET

	December 31, 2006 $USD '000	December 31, 2005 $USD '000	Change $ '000	Change %
Revenue from ordinary activities	50,627	43,216	7,411	17%
Profit (loss) from ordinary activities after tax	(13,666)	(17,797)	4,131	(23)%
Net profit (loss) after tax	(13,666)	(17,797)	4,131	(23)%

Dividends:

The Company has not proposed to pay dividends in the foreseeable future.

Explanation of results:

Revenue from ordinary activities includes revenue from continuing operating activities and interest income.

Profit (loss) from ordinary activities after tax includes loss on discontinued operations.

Please refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations," included in the Company's Form 10-K for the year ended December 31, 2006, which has been filed with this announcement for additional explanations of results.

Additional information required by the Australian Stock Exchange LTD and not shown elsewhere in this report:

	December 31, 2006	December 31, 2005
Net tangible assets per security	$1.63	$2.05

All other information required by ASX listing rule 4.3A is included in the attached Form 10-K. The accounts therein have been prepared in accordance with Generally Accepted Accounting Principles in the United States.

All figures are reported in United States dollars.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2006

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, CA 94107
(415) 348-7000
(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

NASDAQ Stock Market LLC
Securities registered pursuant to Section 12(b) of the Act:
Common Stock, par value $0.001 per share
Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated ☒ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, based upon the closing price of common stock on the last business day of the most recently completed second fiscal quarter, June 30, 2006, was approximately $74,314,697. Shares of voting stock held by each executive officer, director and person who owns 5% or more of the outstanding voting stock have been excluded from this calculation. This determination of affiliate status is not necessarily a conclusive determination for other purposes. As of March 9, 2007, 23,001,260 shares of the registrant's common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The information called for by Part III of this Form 10-K is incorporated by reference to the definitive proxy statement for the annual meeting of stockholders of the Company, which will be filed no later than 120 days after December 31, 2006.

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PART I

This Annual Report on Form 10-K 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. Discussions containing forward-looking statements may be found in the material set forth under "Business," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in other sections of the report. All forward-looking statements, including, but not limited to, projections, expectations 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 gross margins and operating results, cost savings, product development efforts, general outlook of our business and industry, future profits or losses, competitive position, share-based compensation, and adequate liquidity to fund our operations and meet our other cash requirements, 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. You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in the forward-looking statements for many reasons, including but not limited to, the possibility that we may fail to preserve our expertise in online advertising, consumer website and social bookmarking product development, the possibility that existing and potential distribution partners may opt to work with, or favor the products of, competitors if our competitors offer more favorable products or pricing terms, we may be unable to grow sources of revenue other than our listings revenue, we may be unable to increase growth in our owned-and-operated sites, we may be unable to license compelling content at reasonable costs, we may be unable to attain or maintain customer acceptance of our publisher solutions products, changes in the distribution network composition may lead to decreases in traffic volumes, we may be unable to maintain or improve our match rate, average revenue per click, conversion rate or other advertiser metrics, we may be unable to achieve operating profitability, we may be unable to attract and retain key personnel, we may have unexpected increases in costs and expenses, and all other risks described below in the section entitled "Risk Factors" and elsewhere in this report. All forward-looking statements in this report are made as of the date hereof, based on information available to us as of the date hereof, and except as required by applicable law, we assume no obligation to update any forward-looking statements.

All share and per share information provided in this Annual Report is presented giving effect to the one-for-five reverse stock split of our common stock effected on October 26, 2005.

ITEM 1. BUSINESS

Overview

LookSmart is an online advertising and technology company that provides relevant solutions for advertisers, publishers and consumers. LookSmart offers advertisers targeted, pay-per-click (PPC) search advertising and banners via a monitored ad distribution network; a customizable set of private-label solutions for publishers; and consumer websites and web tools.

The Company's extensive ad distribution network includes proprietary websites, syndicated publishers, other Ad Networks, and search partners. The Company's application programming interface (API) enables advertisers and agencies to connect any type of marketing or reporting software with minimal effort, for easier access and management of ad campaigns.

LookSmart's customizable publisher solutions consist of a hosted, white-labeled AdCenter for Publishers to help monetize website traffic and foster small and large advertiser relationships, as well as Furl for Publishers, a social bookmarking tool to increase site traffic.

For consumers, the Company's web sites and web tools offer essential search results with the ability to find, save and share articles and other web content and link to them.

Products and Services

LookSmart's revenue sources are divided into three categories:

1. Advertiser Solutions
2. Publisher Solutions
3. Consumer Sites

Advertiser Solutions

LookSmart's vertically focused consumer web properties enable advertisers to reach demographically relevant audiences through keyword-targeted products, banners and other ad units.

Advertisers can reach customers with our sponsored search products, also known as pay-per-click "PPC" advertising. Our sponsored search products give advertisers complete control of their campaigns with different keyword matching options (Smart, Broad, Negative) and targeting options (Keyword, or "run of site") to maximize advertiser Return on Investment ("ROI"). Advertisers can also choose to display advertising on our vertical sites to reach their targeted demographic.

Ads are distributed on FindArticles.com and our vertical search sites, reaching a segmented, demographically focused audience. Our sponsored search products are also distributed through an extensive network of top-tier syndication partners.

LookSmart actively pursues relationships with portals, internet service providers, media companies, Ad Network, search services and other websites to maintain and increase the distribution of our online advertising. These relationships are key drivers of our growth because more distribution typically results in more clicks and online advertising revenues. We derive the majority of our traffic from our distribution network partners. Each click goes through LookSmart ® TrueLead ™, our network traffic monitoring process.

LookSmart's AdCenter allows multiple users to upload keywords, manage daily budgets, set CPCs and view reports—including spend data that is updated hourly. Advertisers can also access keyword suggestions, price and traffic estimates, online help and FAQs.

An API is available for advertisers and agencies that use third-party or in-house systems to analyze and manage their search campaigns.

Publisher Solutions

LookSmart offers a suite of customizable tools and solutions that help publishers grow their audience, control advertiser relationships and enhance the monetization of their sites. Our Publisher Solutions can be used alone or as a package—and can be branded according to publishers' needs. We offer publishers:

- Enhanced control via the AdCenter for Publishers. We provide a complete private-labeled ASP solution that provides publishers the ability to own and grow their advertiser relationships. Our AdCenter for Publishers offers a customizable set of content, services and technology to help publishers grow their audiences and build their revenue. We offer our publishers a "backfill" of advertisers so they can quickly ramp their online operation and not lose time while establishing their advertiser relationships.

- Audience retention and growth via Furl for Publishers, an online, personal/customized filing cabinet. This tool helps publishers grow their audience by serving as an archiving tool that acts as a constant reminder of valuable content.
- An ad network to augment revenues by helping publishers monetize traffic on their websites.

Consumer Sites

LookSmart has various consumer sites that include both search and content sites, as well as a unique social bookmarking and tagging tool that enables consumers to archive webpages:

- FindArticles.com—LookSmart's FindArticles.com website enables consumers to search a large database of quality content from more than 10 million articles. This service is accessible to consumers at *www.FindArticles.com* .
- Vertical search sites—LookSmart's vertical search sites select appropriate resources by category and deliver more relevant search results, including health, finance, entertainment and auto. We continue to refine our vertical offering and further define what will be the most compelling user experience combining the right mix of search, content and site tools.
- Furl.net—Furl.net is an online, social bookmarking service. Furl enables members to simply and securely save webpages in their entirety. Unlike some other social bookmarking tools, Furl captures the original content of the page so that consumers do not lose their content to a dead link. As a result, users can instantly find what they have historically saved by searching their online personalized categories from any computer. In addition, Furl users can publicly share links to bookmarked webpages and help other users find those pages.

Technology

LookSmart's principal assets include our software and systems for storing and indexing webpage information, updating the index, handling search queries, serving search results, creating and updating our vertical search sites and integrating third-party content, features and functionality into such sites, and tracking, analyzing and reporting on customer campaigns. We rely on a combination of trade secret, copyright and trademark laws and contractual provisions to protect our intellectual property and proprietary rights. Our trademarks include LookSmart ®, WiseNut ®, Ad Solutions ®, Furl ™ and Zeal ®. We also have patents pending on various aspects of our ad delivery and search technologies.

We have developed a proprietary system, the AdCenter, to create, track, analyze, report and optimize customers' advertising campaigns. The AdCenter collects click data for each listing that we manage for our customers, filters out invalid clicks and provides customer billing. In addition, we provide each of our advertising customers with a password-protected online account that enables them to track, analyze and optimize their search marketing campaigns using online reports. The platform also includes an interface for publishers to access ad syndication feed reports and revenue information.

Search Technology

Our commercial search technology includes software for providing high-volume search results, building and updating indexes, and incorporating maximum CPC and click-through-rate in the placement of advertisements in search results, updated throughout the day. We utilize this search technology primarily in support of our other consumer sites initiatives.

We also continue to develop Furl.net with respect to search technologies. If a Furl user archives a webpage, our servers automatically crawl that page and include it in our updated web search index. Our unique ranking algorithm also makes use of proprietary Furl data to improve the relevance of these web search results.

Competition

The online advertising industry is constantly evolving, changes rapidly and is highly competitive.

One of the major factors contributing to this competitive environment is that providers of all online advertising formats compete for a share of the advertisers' limited advertising budgets. The large search engines often receive the biggest portion of the search marketing budget. With greater capital and technical resources, and greater brand recognition, the larger search engines are often first priority in the mind of the advertiser, agency or buyer.

We compete on four main fronts, 1) attracting and growing our base of advertisers to purchase our online advertising products, 2) attracting and maintaining distribution network partners to join our network, 3) attracting and maintaining publishers to utilize our technology assets, and 4) attracting and maintaining consumers to our consumer sites. The basis on which we compete differs amongst the four fronts. In addition, while internet advertising continues to grow year over year, we are still challenged by marketing budgets that include traditional media such as television, radio and print.

Government Regulations

We are subject to a number of domestic state and federal laws that affect companies conducting business on the Internet. In addition, because of the increasing popularity of the Internet and the growth of online services, laws relating to user privacy, freedom of expression, content, advertising, information security and intellectual property rights are being debated and considered for adoption by many countries throughout the world.

In the U.S., state and federal laws relating to the liability, of providers of online services for activities of their consumers, and the liability of providers of online advertisers ads and activities, are currently being tested by a number of claims, which include actions for defamation, libel, invasion of privacy and other data protection claims, tort, unlawful activity, copyright or trademark infringement, or other theories based on the nature and content of the materials searched and the ads posted or the content generated by consumers. Likewise, other federal laws could have an impact on our business. For example, the Digital Millennium Copyright Act has provisions that limit, but do not eliminate, our liability for listing or linking to third-party web sites that include materials that infringe copyrights or other rights, so long as we comply with the statutory requirements of this Act. The Children's Online Protection Act and the Children's Online Privacy Protection Act restrict the distribution of materials considered harmful to children and impose additional restrictions on the ability of online services to collect information from minors. In addition, the Protection of Children from Sexual Predators Act of 1998 requires online service providers to report evidence of violations of federal child pornography laws under certain circumstances.

In addition, the application of existing laws regulating or requiring licenses for certain businesses of our advertisers, including, for example, distribution of pharmaceuticals, adult content, online gambling, financial services, alcohol or firearms, can be unclear. Application of these laws in an unanticipated manner could expose us to substantial liability and restrict our ability to deliver services to our consumers.

International Operations

Following the termination of our distribution network partner contract with Microsoft in the first quarter of 2004, we concluded that our international businesses were no longer strategically or financially viable. As a result, we closed our foreign offices and sold the remaining assets of these businesses in the first half of 2004. We are still in the process of finalizing certain transactions relating to these operations. We expect to finalize the dissolution of these entities during 2007, which may result in minor adjustments to the current balance sheet estimates related to the final closure of these entities.

Marketing

We use both traditional and non-traditional means and media types to grow our business. In addition to advertising and public relations programs, we seek to retain customers through a mix of informative marketing communications, helpful account tools, continual customer support and an optimal user experience.

LookSmart provides relevant content, advertising and technology solutions to consumers, advertisers and publishers. Marketing activities are designed to support and grow our business by targeting:

- Advertisers—We deliver online ads to a network of syndicated publishers and search engine partners, as well as through owned and operated sites.
- Publishers—We offer a suite of customizable tools and solutions that help publishers grow their revenues and audience. We also help them effectively grow and manage advertiser relationships.
- Consumers—Our consumer websites are where consumers look for what they need, coupling search results with the ability to save content and share links using Furl.net.

Employees

Our future success is substantially dependent on the performance of our senior management and key technical and sales personnel, and our continuing ability to attract and retain highly qualified technical and managerial staff. As of December 31, 2006, we had 120 employees.

See Item 1A. "Risk Factors" for a further discussion on some of the risks we face related to our employees.

Available Information

Our website, *www.looksmart.com* , provides access, without charge, to our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission ("SEC").

Materials we file with the SEC may be read and copied at the SEC's Public Reference Room at 100 Fifth Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website at *www.sec.gov* that contains reports, proxy and information statements, and other information regarding our company that we file electronically with the SEC.

ITEM 1A. RISK FACTORS

You should carefully consider the risks described below before making an investment decision regarding our common stock. If any of the following risks actually occur, our business, financial condition and results of operations could be harmed. In that case, the trading price of our common stock could decline and our investors could lose all or part of their investment. Additional risks not presently known to us or that we currently deem immaterial may also impair our business operations.

Risks Related to our Business

Our financial results are highly concentrated in the online advertising business; if we are unable to grow online advertising revenues and find alternative sources of revenue, our financial results will suffer

The display of listings advertisements accounted for substantially all of our revenues for the year ended December 31, 2006. Our success depends upon advertisers choosing to use, and distribution network partners choosing to distribute, our listings products. Advertisers and distribution network partners may not adopt our listings products at projected rates, or changes in market conditions may adversely affect the use or distribution of listings advertisements. Because of our revenue concentration in the online advertising business, such shortfalls or changes could have a negative impact on our financial results. Also, many of our products are offered to website publishers who use them to display or generate revenue from their online advertisements. If we are unable to generate significant revenue from our online advertising business, or if market conditions adversely affect the use or distribution of online advertisements generally, our results of operations, financial condition and/or liquidity will suffer.

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

The success of our online advertisement products depends in large part on the size and quality of our distribution network. We may be unable to maintain or add distribution network partners of satisfactory quality in our distribution network at reasonable revenue-sharing rates, or at all. Our distribution network is concentrated, with our three largest distribution network partners accounting for approximately 28% of our revenues for the year ended December 31, 2006. In the fourth quarter of 2006, no one individual distribution partner accounted for more than 10% of revenue. In 2005 our three largest distribution network partners accounted for approximately 46% of our revenues. If we lose any significant portion of our distribution network, we would need to find alternative sources of quality click traffic to replace the lost paid clicks. In the past, we have lost portions of our distribution network, such as when our contract with Microsoft's MSN expired in the first quarter of 2004. Although alternate sources of click traffic are currently available in the market, they may not be available at reasonable prices, they will likely be subject to competition from various paid search providers, and they may be of lower quality. There is fierce competition among search providers to sign agreements with traffic providers. We may be unable to negotiate and sign agreements with quality traffic providers on favorable terms, if at all. If we are unsuccessful in maintaining and expanding our distribution network, then our ability to generate revenues may be seriously harmed.

We rely on our AdCenter for Publisher customers to generate paid clicks; if we are unable to maintain these relationships or add additional customers, our ability to generate revenue may be seriously harmed

Our success depends in large part on our ability to sign and maintain license and revenue share arrangements with our AdCenter for Publisher customers. We may be unable to maintain or add AdCenter for Publisher customers of satisfactory quality at reasonable revenue-sharing rates, or at all. Our overall revenue is concentrated, with one AdCenter for Publisher customer accounting for approximately 10% of our revenue for the year ended December 31, 2006. If we lose this AdCenter for Publisher customer, we would need to find alternative sources of revenue to replace the lost revenue share on paid clicks. Other publishers who become our

customers may not be available at reasonable revenue share rates, will likely be subject to competition from various other online advertising service providers, and may have smaller audiences or viewers that respond less to online advertisements. If we are unable to maintain or generate new AdCenter for Publisher arrangements, then our ability to generate revenue may be seriously harmed.

We have generated significant losses in the past and we may be unable to achieve operating profitability in the foreseeable future, and if we achieve profitability, we may be unable to maintain it, which could result in a decline in our stock price

We had a net loss of $13.7 million in the year ended December 31, 2006 and as of December 31, 2006 our accumulated deficit was $217.5 million. We may be unable to achieve profitability in the foreseeable future and, if we regain profitability, we may be unable to maintain it. Our ability to achieve and maintain profitability will depend on our ability to generate additional revenues and contain our expenses. To generate additional revenues, we will need to expand our network of distribution network partners, expand our proprietary traffic sources such as our owned-and-operated websites, offer our publisher products to publisher customers and expand our advertiser base. We may be unable to accomplish some or any of these goals because of the risks identified in this report or for unforeseen reasons. Also, we may be unable to contain our costs due to the need to make revenue sharing payments to our distribution network partners, to invest in product development, marketing and search technologies (exemplified by our renewed focus on our vertical search business), and enhance our search services. Because of the foregoing factors, and others outlined in this report, we may be unable to achieve profitability in the future, which could result in a decline in our stock price.

If we experience downward pressure on our revenue per click and/or match rate, or we are unable to rebuild our revenue per click and/or match rate, our financial results will suffer

We have experienced, and may in the future experience, downward pressure on our average revenue per click and average match rate, or rate at which paid listings are matched against search queries, due to various factors. In the year ended December 31, 2006, for example, our average revenue per click decreased to $0.11 in 2006 compared to $0.12 in 2005, this represents an 8% decrease. We may experience decreases in revenue per click or average match rate in the future for many reasons, including the erosion of our advertiser base, the reduction in average advertiser spend, the reduction in the number of listings purchased by advertisers, or for other reasons. If our revenue per click or average match rate falls for any reason, or if we are unable to grow our revenue per click and average match rate, then we may be unable to achieve our financial projections and our stock price would likely suffer.

Our growth depends on our ability to retain and grow our advertiser base; if our advertiser base and average advertiser spend falls, our financial results will suffer

Our growth depends on our ability to build an advertiser base that corresponds with the characteristics of our distribution network. Our distribution network, which currently consists of a diversified network of small distribution sources, may change as new distribution sources are added and old distribution sources are removed. Advertisers may view these changes to the distribution network negatively, and existing or potential advertisers may elect to purchase fewer or no listings advertisements for display on our distribution network. If this occurs, it is likely that our average revenue per click and average match rate may decline, we may be unable to meet our financial guidance, and our stock price would likely suffer.

Our growth depends upon our ability to retain and grow our audience for our consumer sites, and there are risks associated with introducing new products and services

To maintain and grow our revenue, part of our strategy is to increase the amount, frequency and page views by consumers of our consumer sites. Our development, testing and implementation efforts for these products and services have required, and are expected to continue to require, substantial investments of our time. We recently

began owning and operating our own websites, and we may not gain enough of an audience for our consumer sites to generate any, or sufficient, revenue to justify our efforts, or we may gain a sufficient audience but be unable to gain advertiser acceptance of our consumer sites. Also, if we do not improve and enhance our consumer sites in a timely manner, we may lose existing customers to our competitors or fail to attract new customers, which may adversely affect our performance and results of operations.

If we are unable to license or acquire compelling content at reasonable costs, we may be unable to increase traffic to and revenue from our vertical search sites

Our future success depends in part upon our ability to aggregate compelling content and search results and deliver them through our online properties. We license much of the content on our online properties, such as journal articles and news items, from third parties. Our ability to maintain and build relationships with third-party content providers will be important for our success. Also, as competition for compelling content increases both domestically and internationally, our content providers may increase the prices at which they offer their content to us and potential content providers may not offer their content on terms agreeable to us. An increase in the prices charged to us by third-party content providers could harm our operating results and financial condition. If we are unable to license or acquire compelling content at reasonable prices, if other companies broadcast content that is similar to or the same as that provided by us, the number of consumers of our services may not grow at all or may grow at a slower rate than anticipated, which could harm our operating results.

Our growth depends upon our ability to offer and support our technology services to online publishers, and there are risks associated with introducing new products and services

To maintain and grow our revenue, part of our strategy is to offer and host syndicated technology services to online publishers. Our development, testing and implementation efforts for these products and services have required, and are expected to continue to require, substantial investments of our time. Also, we do not have significant experience offering services to online publishers, and we may not gain publisher acceptance of our offerings. We may be unable to successfully implement syndicated publisher solutions, or our implementation of a solution may interfere with our ability to operate our other products and services or other implementations, or a publisher customer may decide not to use or continue to use our solution. These failures could have an adverse effect on our business and results of operations.

If we do not introduce new and upgraded products and services and successfully adapt to our rapidly changing industry, our financial condition may suffer

The Internet search industry is rapidly evolving and very turbulent, and we will need to continue developing new and upgraded products and services, adapt to new business environments and competition, and generate traffic to our consumer sites to maintain and grow revenue and reach our profitability goals. New search and advertising technologies could emerge that make our services comparatively less useful or new business methods could otherwise emerge that divert web traffic away from our search network and consumer web properties. Competition from other web businesses may prevent us from attracting substantial traffic to our services. Also, we may inaccurately predict the direction of search technologies or the advertising market, which could lead us to make investments in technologies and products that do not generate sufficient returns. We may face platform and resource constraints that prevent us from developing upgraded products and services. We may fail to successfully identify new products or services, or fail to bring new products or services to market in a timely and efficient manner. Rapid industry change makes it difficult for us to forecast our results accurately, particularly over longer periods. We face the risk that we may be unable to adapt to new developments in the search industry, or that our new consumer products and services may not be broadly adopted by customers, in which case we would eventually need to obtain additional financing or cease operations.

We face intense competitive pressures, which could materially and adversely affect our financial results

We compete in the relatively new and rapidly evolving paid search industry, which presents many uncertainties that could require us to further refine our business model. We compete with companies that provide paid placement products, paid inclusion products, and other forms of search marketing. 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. We also compete for distribution network partners and for ad placement on those partners' sites on the basis of the relevance of our search results and the price per click charged to advertisers. We also experience competition for our owned-and-operated websites and for offering our technology to website publishers. Some of our competitors have larger distribution networks and proprietary traffic bases, longer operating histories, greater brand recognition, higher prices per click, better relevance and conversion rates, or better products and services than we have.

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

From time to time we evaluate corporate development opportunities, and when appropriate, 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, record impairment of goodwill in connection with future or past acquisitions, or divest non-performing assets at below-market prices, which would adversely affect our operating results.

We have acquired businesses and technologies in recent years, including the acquisition of Net Nanny from BioNet Systems, LLC in the second quarter of 2004, and from Furl, LLC in the third quarter of 2004. Integration of acquired companies and technologies into LookSmart is likely to be expensive, time-consuming and a strain on 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 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 on our ability to identify, attract, retain and motivate highly skilled development, technical, sales, and management personnel. We have a limited number of key development, technical, sales and management personnel performing critical company functions, and the loss of the services of any of our key employees, particularly any of our executive team members or key technical personnel, could adversely affect our business. In recent years, we have experienced significant turnover in our management team. For example, our Chief Financial Officer joined us in November 2005. Other members of management have joined us in the last year, and the management team as a whole has had only a limited time to work together. 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.

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

We use proprietary and licensed software to crawl the web and index web pages, create and edit listings, compile and distribute our search results, track paid clicks, and detect click fraud. 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 website or the websites of our distribution network partners:

- customization of our search results for distribution to particular distribution network partners,
- substantial increases in the number of search queries to our database,
- substantial increases in the number of listings in our search databases, or
- the addition of new products or new features or changes to our products.

If we experience difficulties with our software and infrastructure systems or we fail to address these issues in a timely manner, we may lose the confidence of advertisers and distribution network 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.

Risks Related to Operating in our Industry

If we fail to prevent, detect and remove invalid clicks, we could lose the confidence of our advertisers, thereby causing our business to suffer

Invalid clicks, most often due to "click fraud", are an ongoing problem for the Internet advertising industry, and we are exposed to the risk of invalid clicks on our paid listings and our publisher solutions customers' listings. Invalid clicks occur when a person or robotic software causes a click on a paid listing to occur for some reason other than to view the underlying content. We invest significant time and resources in preventing, detecting and eliminating invalid traffic from our distribution network. However, the perpetrators of click fraud have developed sophisticated methods to evade detection, and we are unlikely to detect and remove all invalid traffic from our search network. We are subject to advertiser complaints and litigation regarding invalid clicks, and we may be subject to advertiser complaints, claims, litigation or inquiries in the future. We have from time to time credited invoices or refunded revenue to our customers due to suspicious traffic, and we expect to continue to do so in the future. If our systems to detect invalid traffic are insufficient, or if we find new evidence of past invalid clicks, we may have to issue credits or refunds retroactively to our advertisers, and we may still have to pay revenue share to our distribution network partners. This could negatively affect our profitability and hurt our brand. If traffic consisting of invalid clicks is not detected and removed from our search network, the affected advertisers may experience a reduced return on their investment in our online advertising because the invalid clicks will not lead to actual sales for the advertisers. This could lead the advertisers to become dissatisfied with our products, which could lead to loss of advertisers and revenue and could materially and adversely affect our financial results.

Any failure in the performance of our key operating systems could materially and adversely affect our revenues

Any system failure that interrupts our hosted products or services, including our search service, whether caused by computer viruses, software failure, power interruptions, intruders and hackers, or other causes, could harm our financial results. For example, our system for tracking and invoicing clicks is dependent upon a proprietary software platform. If we lose key personnel or experience a failure of software, this system may fail. In such event, we may be unable to track paid clicks and invoice our customers, which would materially and adversely affect our financial results and business reputation.

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, which is located at our San Francisco, California office. An interruption in our ability to serve search results, track paid clicks, and provide customer support would materially and adversely affect our financial results.

Our business and operations depend on Internet service providers and third party technology providers, and any failure or system downtime experienced by these companies could materially and adversely affect our revenues

Our consumers, distribution network partners and customers depend on Internet service providers, online service providers and other third parties for access to our 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 agreements with third-party click tracking and ad-serving technology providers. We also have an agreement with AboveNet Communications, Inc. to provide network connectivity services. 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 their data centers 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 developed a 30-day disaster recovery plan to respond in the event of a catastrophic loss of our critical, revenue-generating systems. We have an agreement with Raging Wire, Inc. in Sacramento, California to provide co-location and networking services for our critical systems in such an event. 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. Also, if our third-party click tracking or ad-serving technology providers experience service interruptions, errors or security breaches, our ability to track, realize and record revenue would suffer.

We may face liability for claims related to our products and services, and these claims may be costly to resolve

Companies in the Internet, technology and media industries own large numbers of patents, copyrights, trademarks and trade secrets and frequently enter into litigation based on allegations of infringement or other violations of intellectual property rights. These claims might, for example, be made for trademark, copyright or patent infringement, defamation, negligence, personal injury, breach of contract, unfair advertising, unfair competition, invasion of privacy or other claims. As we face increasing competition and expand the number of websites that we publish, the possibility of intellectual property rights claims against us grows, and we cannot guarantee that our services do not infringe the intellectual property rights of others. Lawsuits are filed against us from time to time, and we are currently subject to two purported class action lawsuits in connection with our listings services. In addition, we are obligated in some cases to indemnify our customers or distribution network partners in the event that they are subject to claims that our services infringe on the rights of others.

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. Our insurance may not adequately cover claims of this type, 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. For any of the foregoing reasons, litigation involving our listings business and technology could have a material adverse effect on our business, operating results and financial condition.

We could be subject to infringement claims that may be costly to defend, result in the payment of settlements or damages or lead us to change the way we conduct our business

Internet, technology, media companies and patent holding companies often possess a significant number of patents. Further, many of these companies and other parties are actively developing search, indexing, electronic commerce and other web-related technologies, as well as a variety of online business models and methods. We believe that these parties will continue to take steps to protect these technologies, including, but not limited to, seeking patent protection. As a result, we may face claims of infringement of patents and other intellectual property rights held by others. Also, as we expand our business, license or acquire content and develop new technologies, products and services, we may become increasingly subject to intellectual property infringement claims. In the event that there is a determination that we have infringed third-party proprietary rights such as patents, copyrights, trademark rights, trade secret rights or other third party rights such as publicity and privacy rights, we could incur substantial monetary liability, be required to enter into costly royalty or licensing agreements or be prevented from using the rights, which could require us to change our business practices in the future and limit our ability to compete effectively. We may also incur substantial expenses in defending against third-party infringement claims regardless of the merit of such claims. In addition, many of our agreements with our customers or affiliates require us to indemnify them for certain third-party intellectual property infringement claims, which could increase our costs in defending such claims and our damages. The occurrence of any of these results could harm our brand and negatively impact our operating results.

Litigation, regulation, legislation or enforcement actions directed at or materially affecting us may adversely affect the commercial use of our products and services and our financial results

New lawsuits, laws, regulations and enforcement actions applicable to the online industry may limit the delivery, appearance and content of our advertising or websites or otherwise adversely affect our business. If such laws are enacted, or if existing laws are interpreted to restrict the types and placements of advertisements we can carry, it could have a material and adverse effect on our financial results. For example, in 2002, 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 consumers and issued guidance on what disclosures are necessary to avoid misleading consumers about the possible effects of paid placement or paid inclusion listings on the search results. In 2003, the United States Department of Justice issued statements indicating its belief that displaying advertisements for online gambling might be construed as aiding and abetting an illegal activity under federal law. In 2004, the United States Congress considered new laws regarding sale of pharmaceutical products over the Internet and the use of adware to distribute advertisements on the Internet, any of which could, if enacted, adversely affect our business. If any new law or government agency were to require changes in the labeling, delivery or content of our advertisements, or if we are subject to legal proceedings regarding these issues, it may reduce the desirability of our services or the types of advertisements that we can run, and our business could be materially and adversely harmed.

In addition, legislation or regulations, including compliance with Section 404 of the Sarbanes-Oxley Act of 2002 ("Section 404"), present ongoing compliance risks, and a failure to comply with these new laws and regulations could materially harm our business. For example, in the course of the general evaluation of internal controls and the 2006 close process, six significant deficiencies in the design and operation of our internal controls were identified. We have addressed and are now in the process of remedying these deficiencies. It is possible that as we continue our Section 404 compliance efforts we will identify significant deficiencies, or material weaknesses, in the design and operation of our internal controls. We may be unable to remedy any of these matters in a timely fashion, and/or our independent registered public accounting firm may not agree with our remediation efforts in connection with their Section 404 attestation. Such failures could impact our ability to record, process, summarize and report financial information, and could impact market perception of the quality of our financial reporting, which could adversely affect our business and our stock price.

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 United States Congress is considering new legislation to regulate Internet privacy, and 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 consumers 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.

Our consumer sites place information, known as cookies, on a user's hard drive, generally without the user's knowledge or consent. This technology enables website operators to target specific consumers with a particular advertisement, to limit the number of times a user is shown a particular advertisement, and to track certain behavioral data. Although some Internet browsers allow consumers 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 distribution network partners or advertisers retain information about our consumers. If others were able to penetrate the network security of these user databases and access or misappropriate this information, we and our distribution network 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.

Online commerce security risks, including security breaches, identity theft, service disrupting attacks and viruses, could harm our reputation and the conduct of our business, which could have a material adverse effect on our financial results

A fundamental requirement for online commerce and communications is the secure storage and transmission over public networks of confidential information. Although we have developed and use systems and processes that are designed to protect consumer information and prevent fraudulent credit card transactions and other security breaches, our security measures may not prevent security breaches or identity theft that could harm our reputation and business. Currently, a significant number of our consumers provide credit card and other financial information and authorize us to bill their credit card accounts directly for all transaction fees charged by us. We rely on encryption and authentication technology to provide the security and authentication to effect secure transmission of confidential information, including customer credit card numbers. Advances in computer capabilities, new discoveries in the field of cryptography or other developments may result in a compromise or breach of the technology used by us to protect transaction data. In addition, any party who is able to illicitly obtain a user's password could access the user's transaction data. An increasing number of websites have reported breaches of their security. Any compromise of our security could damage our reputation and expose us to a risk of litigation and possible liability. The coverage limits of our insurance policies may not be adequate to reimburse us for losses caused by security breaches.

Additionally, our servers are vulnerable to computer viruses, physical or electronic break-ins, and similar disruptions, and we have experienced "denial-of-service" type attacks on our system that have made all or portions of our websites unavailable for periods of time . We may need to expend significant resources to protect against security breaches or to address problems caused by breaches. Disruptions in our services and damage caused by viruses and other attacks could cause a loss of user confidence in our systems and services, which could lead to reduced usage of our products and services and materially adversely affect our business and financial results.

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.

Risks Related to Accounting Matters

Accounting for employee stock options using the fair value method could significantly reduce (increase) our net income (loss)

As described in Note 1 (Summary of Significant Accounting Policies) to the Consolidated Financial Statements in this report, we adopted Statement of Financial Accounting Standards No. 123R, *Share-Based Payment* ("SFAS 123R") starting January 1, 2006. Under SFAS 123R, we are required to account for the fair value of stock options granted to employees as compensation expense, which is likely to have a significant adverse impact on our results of operations, as determined in accordance with GAAP, and net income (loss) per share. If we reduce or alter our use of share-based compensation to minimize the recognition of these expenses, our ability to recruit, motivate and retain employees may be impaired, which could put us at a competitive disadvantage in the marketplace. To prevent any net decrease in their overall compensation packages, we might decide to make corresponding increases in the cash compensation we pay to current and prospective new employees. An increase in employee wages and salaries would diminish our cash available for marketing, product development and other uses and might adversely impact our results of operations.

Risks Related to the Capital Markets

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 will likely fluctuate significantly from quarter to quarter as a result of a variety of factors, including:

- change in the composition of our AdCenter customer base,
- change in composition of our AdCenter for Publishers customer base,
- changes in our distribution network, particularly the gain or loss of key distribution network partners, or changes in the implementation of search results on partner websites,
- changes in the number of advertisers who purchase our listings, or the amount of spending per customer,
- changes in the amount, frequency and page views by consumers of our consumer sites,
- the revenue-per-click we receive from advertisers, or other factors that affect the demand for, and prevailing prices of, Internet advertising and marketing services,
- systems downtime on our AdCenter, our website or the websites of our distribution network partners,
- fluctuations in audience and page impressions, or
- the effect of SFAS 123R, which became effective January 1, 2006, and requires that we account for the fair value of stock awards granted to employees as compensation expense.

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 past financial results as an indicator 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 stock price is extremely volatile, and such volatility may hinder investors' ability to resell their shares for a profit or avoid a loss

The stock market has experienced significant price and volume fluctuations in recent years, and the stock prices of Internet companies have been extremely volatile. The low trading volume of our common stock may adversely affect its liquidity and reduce the number of market makers and/or large investors willing to trade in our common stock, making wider fluctuations in the quoted price of our common stock more likely to occur. Also, because of the significant changes we experienced as a result of the expiration of our contractual relationship with Microsoft's MSN in the first quarter of 2004, 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 fluctuate, 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,
- the relatively thinly traded volume of our publicly traded shares, which means that small changes in the volume of trades may have a disproportionate impact on our stock price,
- the loss of key personnel, or our inability to recruit experienced personnel to fill key positions,
- changes in ratings or financial estimates by analysts or the inclusion/removal of our stock from certain stock market indices used to drive investment choices,
- announcements of new distribution network 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 our stockholders, or the perception that such sales could occur,
- the exchange by Chess Depositary Interest (CDI) holders of CDIs for shares of common stock at a ratio of 1:1, and resale of such shares in the Nasdaq National Market (as of March 9, 2007, the CDIs registered for trading on the Australian Stock Exchange were exchangeable into an aggregate of approximately 1.4 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 operations and, if such additional financing is not available to us, on reasonable terms or at all, our 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 the additional 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 beyond current plans,
- 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.

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 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our headquarters are located in approximately 135,000 square feet of leased office space in San Francisco, California. The lease term for this office space extends to October 15, 2009. The lease provides us with an option to renew for two additional five-year periods after the initial term expires. We currently have three primary subtenants at our headquarters facility in San Francisco. We have subleased approximately 51,250 square feet of space through October 2009 at a rate less than our obligation under the original lease.

In 2004, we also leased office space in London, Los Angeles, Melbourne, Montreal, New York, Sydney and Tokyo. All of these office leases have expired and these branches were closed in 2004 except for our Los Angeles office lease, which terminated and closed in 2005. There is therefore no on-going cash requirement for these facilities.

ITEM 3. LEGAL PROCEEDINGS

Cisneros v. Yahoo! Inc

On August 3, 2004, Mario Cisneros and Michael Voight filed a private attorney general lawsuit on behalf of a proposed class in Superior Court in San Francisco County, California. The complaint names thirteen search engines or web publishers as defendants, including us, and alleges unfair business practices, unlawful business practices, and other causes of action in connection with the display of advertisements from Internet gambling companies. The complaint seeks restitution, unspecified compensatory damages, declaratory and injunctive relief, and attorneys' fees. Plaintiffs also filed a motion for preliminary injunction on August 3, 2004.

On January 3, 2005, we filed a demurrer to the complaint, which was overruled on January 27, 2005. On January 3, 2005, we also filed a motion to strike certain allegations regarding claims for restitution, which was denied in part and granted in part on May 9, 2005. We filed an answer to the complaint on February 28, 2005, consisting of a general denial of all allegations. On October 11, 2005, the court conducted a trial on two of our affirmative defenses. The court held that California public policy bars the plaintiffs from receiving a portion of their requested damages.

On December 2, 2005, plaintiffs filed a renewed motion for a preliminary injunction. Defendants responded on or around February 27, 2006. The court allowed certain discovery to proceed with respect to plaintiffs' renewed motion. On or about May 23, 2006, plaintiffs were granted leave to amend their complaint to name additional plaintiffs. On or about September 8, 2006, plaintiffs served an amended complaint naming additional plaintiffs. The Company has since filed a general denial to the amended complaint. A Case Management Conference was held on January 3, 2007. At the Conference, the court stayed plaintiffs' pending discovery requests and ordered additional briefing on two legal issues. A hearing on the issues is scheduled for April 13, 2007.

Lane's Gifts and Collectibles, L.L.C., v. Yahoo! Inc

On March 14, 2005 we were served with the Second Amended Complaint in a class action lawsuit in the Circuit Court of Miller County, Arkansas. The complaint names eleven search engines and web publishers as defendants, including us, and alleges breach of contract, restitution/unjust enrichment/money had and received, and civil conspiracy claims in connection with contracts allegedly entered into with plaintiffs for Internet pay-per-click advertising. The named plaintiffs on the Second Amended Complaint are Lane's Gifts and Collectibles, L.L.C., U.S. Citizens for Fair Credit Card Terms, Inc., Savings 4 Merchants, Inc., and Max Caulfield d/b/a Caulfield Investigations.

On March 30, 2005 the case was removed to United States District Court for the Western District of Arkansas. On April 4, 2005 plaintiffs U.S. Citizens for Fair Credit Card Terms, Inc. and Savings 4 Merchants, Inc. filed a motion of voluntary dismissal without prejudice. The motion was granted on April 7, 2005. Plaintiffs Lane's Gifts and Collectibles, L.L.C. and Max Caulfield d/b/a Caulfield Investigations filed a motion to remand the case to state court on April 13, 2005, which was granted in June 2005. In July 2005, defendants, including us, petitioned the Eighth Circuit Court of Appeals for an appeal of the remand order, and moved to stay the proceedings while the appeal was pending. The petition was denied on September 8, 2005 and the case was remanded to the Circuit Court of Miller County, Arkansas. We were served with discovery requests on October 7, 2005. We have filed and/or joined motions to dismiss on the basis of failure to state a claim upon which relief can be granted, lack of personal jurisdiction, and improper venue. Pursuant to the court's initial

scheduling order, plaintiffs had until January 27, 2006 to respond to the motions to dismiss for lack of personal jurisdiction and improper venue; and until June 9, 2006 to respond to the motion to dismiss on the basis of failure to state a claim upon which relief can be granted. However, the court entered an order staying all proceedings for a period of 60 days on January 9, 2006. On March 8, 2006, the court entered an order extending the stay until March 31, 2006. On April 1, 2006, the Court further extended the stay until April 20, 2006. On April 20, 2006, the Court preliminarily approved a class settlement among plaintiffs, defendant Google, Inc., and certain defendants who display Google advertisements on their networks (the "Google Settlement"). The Google Settlement purports to release Google of all claims and also purports to release certain defendants, including us, for any claims associated with the display of Google advertisements on their networks. On July 24 and 25, 2006, the court had a final settlement hearing on the Google Settlement, and on July 26, 2006 the Court approved the settlement. On April 21, 2006, the Court ordered the remaining defendants, including us, to mediation and further stayed the proceedings to June 21, 2006. The Court further extended the Stay as to us until August 16, 2006. The parties thereafter stipulated that the stay would remain in effect while the parties continue to comply with the Court's order regarding mediation. On January 10, 2007, the Court further extended the stay until May 1, 2007.

We are also involved from time to time in various legal proceedings arising from the normal course of business activities. Although the results of litigation and claims cannot be predicted with certainty, we do not expect resolution of these matters to have a material adverse impact on our consolidated results of operations, cash flows or financial position. However, an unfavorable resolution of a matter could, depending on its amount and timing, materially affect our future results of operations, cash flows or financial position in a future period. Regardless of the outcome, litigation can have an adverse impact on us because of defense costs, diversion of management resources and other factors.

Additionally, pursuant to Section 17.06A(e) of the Internal Revenue Code we note that we have not been required to pay a penalty to the Internal Revenue Service for failing to make disclosures required with respect to certain transactions that have been identified by the IRS as abusive or that have a significant tax avoidance purpose.

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

None

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

LookSmart, Ltd. common stock is quoted on the Nasdaq National Market under the symbol "LOOK". Chess Depositary Interests, or CDIs, which are freely exchangeable with shares of common stock at a ratio of 1:1, are quoted on the Australian Stock Exchange under the symbol "LOK". The following table sets forth the range of high and low sales prices of the common stock on the Nasdaq National Market for each period indicated adjusted to reflect, for all periods shown, the effect of a one-for-five reverse stock split which became effective at the close of business on October 26, 2005:

	HIGH	LOW
2005		
First quarter	$10.55	$4.00
Second quarter	$ 4.75	$3.05
Third quarter	$ 4.65	$2.95
Fourth quarter	$ 4.50	$3.40
2006		
First quarter	$ 5.64	$3.87
Second quarter	$ 5.43	$3.24
Third quarter	$ 3.48	$2.25
Fourth quarter	$ 5.09	$2.78
2007		
First quarter (through March 9, 2007)	$ 5.38	$4.26

LookSmart had approximately 156 holders of record of common stock as of March 9, 2007. We have not declared or paid any cash dividends on the common stock and presently intend to retain our future earnings, if any, to fund the development and growth of our business and, therefore, do not anticipate paying any cash dividends in the foreseeable future.

Information about our outstanding stock options, weighted average exercise prices, and number of stock options available for future grant, under both stockholder-approved stock plans and non-stockholder-approved stock plans is included in our proxy statement for the 2007 annual meeting of stockholders, and is hereby incorporated by reference into this Annual Report.

Recent Sales of Unregistered Securities; Uses of Proceeds from Registered Securities

We had no sales of unregistered securities in 2005 and 2006.

In 2004, we sold and issued the following unregistered securities:

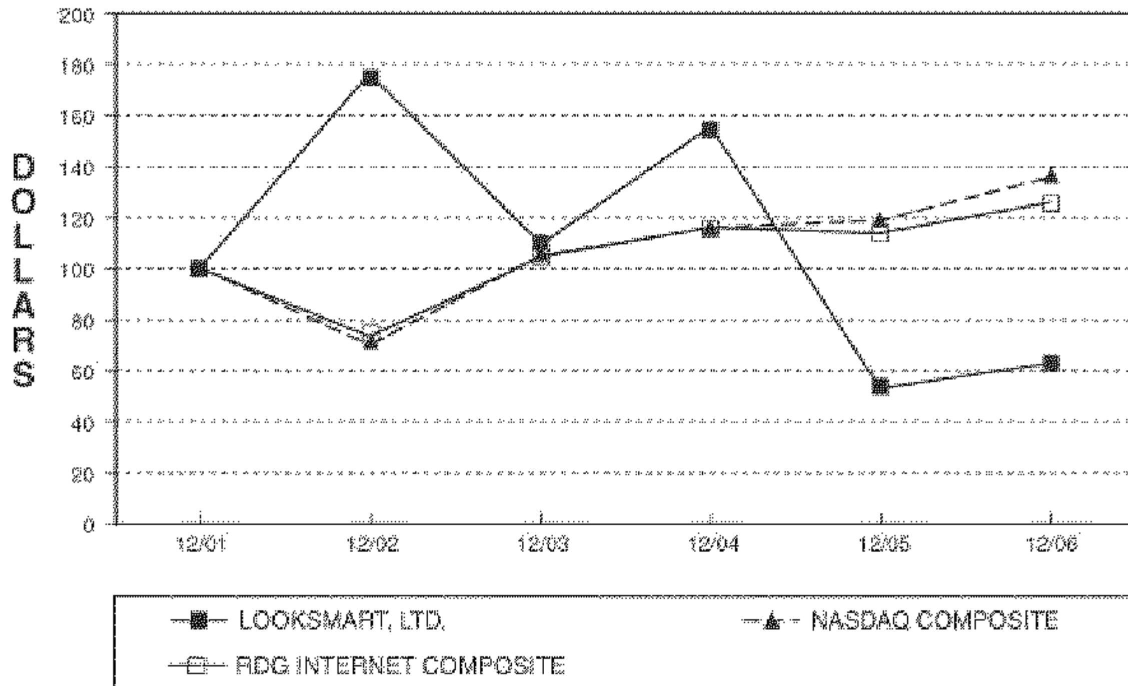
(1) On April 22, 2004, in connection with the acquisition of the Net Nanny business assets of BioNet, LLC, we issued to BioNet LLC an aggregate of 394,477 shares of common stock.

(2) On July 29, 2004, in connection with the acquisition of substantially all of the assets of Furl, LLC, we issued to Furl, LLC an aggregate of 107,209 shares of common stock.

There were no underwriters employed in connection with any of the foregoing transactions. The issuances of securities described above were deemed to be exempt from registration under the Securities Act in reliance on Section 4(2) of the Securities Act and/or Regulation D, hereunder, as transactions by an issuer not involving a public offering. The recipients of securities in each such transaction acquired the securities for investment only and not in connection with any distribution thereof and appropriate legends were affixed to the share certificates and other instruments issued in such transactions. All recipients either received adequate information about the Registrant or had access, through employment or other relationships, to such information.

STOCK PERFORMANCE GRAPH

The following graph compares the cumulative total stockholder return on LookSmart common stock to the Nasdaq Stock Market (U.S.) Index and RDG Internet Composite Index. The graph covers the period from December 31, 2001 through December 31, 2006. The graph assumes that $100 was invested on December 31, 2001 in LookSmart common stock and in each index, and that all dividends were reinvested. LookSmart has not paid or declared any cash dividends on its common stock. Stockholder returns over the indicated period should not be considered indicative of future stockholder returns.



The dollar values for total stockholder return plotted in the graph above are shown in the table below:

	Cumulative Total Return					
	12/01	12/02	12/03	12/04	12/05	12/06
LookSmart, Ltd.	$100.00	$177.14	$110.71	$156.41	$ 53.71	$ 63.74
Nasdaq Stock Market (U.S.)	100.00	71.97	107.18	117.07	120.50	137.02
RDG Internet Composite	100.00	74.19	104.93	116.40	114.29	126.71

The information provided in the graph and table above is presented giving effect to the one-for-five stock split of the Company's common stock effected on October 26, 2005.

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ITEM 6. SELECTEDCONSOLIDATED FINANCIAL DATA

The following selected financial data should be read in conjunction with the Consolidated Financial Statements and Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this report.

	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(in thousands, except per share amounts)				
Statements of Operations Data:					
Revenues	$ 48,673	$ 41,359	$ 76,996	$134,832	$93,174
Gross profit [1]	18,184	13,738	32,216	64,611	53,126
Income (loss) from continuing operations* [1]	(13,633)	(17,907)	(11,043)	7,307	30,079
Net income (loss)* [1]	(13,666)	(17,797)	(9,638)	5,786	27,932
Net income (loss) per share—Basic** [1]					
Income (loss) from continuing operations	$ (0.60)	$ (0.79)	$ (0.49)	$ 0.35	$ 1.55
Net income (loss)	$ (0.60)	$ (0.78)	$ (0.43)	$ 0.28	$ 1.44
Net income (loss) per share—Diluted** [1]					
Income (loss) from continuing operations	$ (0.60)	$ (0.79)	$ (0.49)	$ 0.34	$ 1.46
Net income (loss)	$ (0.60)	$ (0.78)	$ (0.43)	$ 0.27	$ 1.35

(1) Includes the impact of Statement of Financial Accounting Standards No. 123R , "Share-Based Payment." For additional information, refer to Footnote 10 (Stockholders' Equity) to our Consolidated Financial Statements under "Financial Statements and Supplementary Data."

	December 31,				
	2006	2005	2004	2003	2002
Balance Sheet Data:					
Cash, cash equivalents and short and long-term investments	$41,156	$51,307	$ 63,900	$ 69,934	$ 51,264
Working capital	33,520	45,029	49,063	59,270	40,282
Total assets	72,557	83,008	101,088	126,092	100,554
Long-term debt and capital lease obligations, net of current portion	126	184	236	283	1,904
Total stockholders' equity	$57,549	$68,451	$ 86,100	$ 86,297	$ 67,902

* Income (loss) from continuing operations included a restructuring charge (benefit) of the following amounts:

- $(0.3) million in 2006,
- $1.0 million in 2005,
- $4.2 million in 2004,
- $4.0 million in 2003.

* Income (loss) from continuing operations included our share of joint venture income (losses) of the following amounts:

- $0.2 million in 2006,
- $(0.1) million in 2004,
- $(0.6) million in 2003,
- $(3.7) million in 2002.

* In 2003, net income included an extraordinary gain from the purchase of joint venture entities of $0.2 million.

* In 2002, income from continuing operations included a gain from the extinguishment of debt of $32.6 million.

** Per share amounts have been retroactively adjusted for the effects of the one-for-five reverse stock split effected in October 2005.

In the first quarter of 2004, we signed agreements to sell certain of the assets and activities of our Australian, British and Japanese subsidiaries. Accordingly, the selected consolidated financial data set forth above has been recast to remove the results of those international operations from continuing operations for all periods presented. Results of the international operations are included in the Consolidated Financial Statements, as presented in Item 8, herein, in the separate line item gain (loss) from discontinued operations, net of tax, for all periods presented. For further information, see Note 16 (Discontinued Operations) in our Notes to Consolidated Financial Statements.

ITEM 7. 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 that appear elsewhere in this Annual Report on Form 10-K.

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. Discussions containing forward-looking statements may be found in the material set forth under "Business," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in other sections of the report. All forward-looking statements, including, but not limited to, projections, expectations or estimates concerning our business, including demand for our products and services, mix of revenue sources, ability to control and/or reduce operating expenses, anticipated gross margins and operating results, cost savings, product development efforts, general outlook of our business and industry, future profits or losses, competitive position, share-based compensation, and adequate liquidity to fund our operations and meet our other cash requirements, 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. You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in the forward-looking statements for many reasons, including but not limited to, the possibility that we may fail to preserve our expertise in online advertising, consumer website and social bookmarking product development, the possibility that existing and potential distribution partners may opt to work with, or favor the products of, competitors if our competitors offer more favorable products or pricing terms, we may be unable to grow sources of revenue other than our listings revenue, we may be unable to increase growth in our owned-and-operated sites, we may be unable to license compelling content at reasonable costs, we may be unable to attain or maintain customer acceptance of our publisher services products, changes in the distribution network composition may lead to decreases in traffic volumes, we may be unable to maintain or improve our match rate, average revenue per click, conversion rate or other advertiser metrics, we may be unable to achieve operating profitability, we may be unable to attract and retain key personnel, we may have unexpected increases in costs and expenses, and the other risks described above in the section entitled "Risk Factors" (Item 1A of this Annual Report on Form 10-K) and elsewhere in this report. All forward-looking statements in this report are made as of the date hereof, based on information available to us as of the date hereof, and except as required by applicable law, we assume no obligation to update any forward-looking statements.

All share and per share information provided in this Annual Report is presented giving effect to the one-for-five reverse stock split of our common stock effected on October 26, 2005.

BUSINESS OVERVIEW

LookSmart is an online advertising and technology company that provides relevant solutions for advertisers, publishers and consumers. LookSmart offers advertisers targeted, pay-per-click (PPC) search advertising and banners via a monitored ad distribution network; a customizable set of private-label solutions for publishers; and consumer websites and web tools.

The Company's extensive ad distribution network includes proprietary websites, syndicated publishers and search partners. The Company's application programming interface (API) enables advertisers and agencies to connect any type of marketing or reporting software with minimal effort, for easier access and management of ad campaigns.

LookSmart's publisher solutions consist of a hosted, white-labeled AdCenter for Publishers to help monetize website traffic and foster small and large advertiser relationships and Furl for Publishers, a social bookmarking tool to increase site traffic.

For consumers, the Company's vertical search sites and web tools offer essential search results with the ability to find, save and share articles and other web content.

Critical Accounting Policies and Estimates

Our financial condition and results of operations are based upon certain critical accounting policies, which include estimates, assumptions, and judgments on the part of management. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented. The following discussion highlights those policies and the underlying estimates and assumptions, which we consider critical to an understanding of the financial information in this report.

Revenue Recognition

Online Advertising

Our online advertising revenue is primarily composed of per-click fees that we charge customers. Customers set the per-click fee charged for inclusion-targeted listings when their account is established. The per-click fee charged for keyword-targeted listings is calculated based on the results of online bidding on keywords or page content, up to a maximum cost per keyword or page content set by the customer. Revenue also captures impression-based revenue from banner advertisements, as well as revenue share from licensing of private-labeled versions of our products.

Revenues associated with online advertising products, including Advertiser Solutions, FindArticles, our other consumer sites, and banner advertisements are generally recognized once collectibility is established, delivery of services has occurred, all performance obligations have been satisfied, and no refund obligations exist. We pay distribution network partners based on clicks on the advertiser's ads that are displayed on the websites of these distribution network partners. These payments are called traffic acquisition costs and are included in cost of revenues. In accordance with Emerging Issues Task Force Issue No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent (* "EITF 99-19"), the revenue derived from these arrangements that involve traffic supplied by distribution network partners is reported gross of the payment to the distribution network partners. This revenue is reported gross due to the fact that we are the primary obligor to the advertisers who are the customers of the advertising service.

Affiliate revenue is included in online advertising revenue and is 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 revenue when Internet consumers make a purchase from a participating merchant's website 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 sales rather than a per-click basis. Revenue is recognized in the period in which a merchant finalizes a sale and reports to us via our affiliate network.

We also enter into agreements to provide private-labeled versions of our products, including the AdCenter for Publishers. These arrangements include multiple elements, primarily revenue-sharing based on the publishers' customers' monthly revenue generated through the AdCenter application, as well as upfront fees, and license fees. We recognize revenue in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104, *Revenue Recognition in Financial Statements* ("SAB 104"), and Financial Accounting Standards Board Emerging Issues Task Force No. 00-21, *Revenue Arrangements with Multiple Deliverables* ("EITF 00-21"). We recognize upfront fees over the term of the arrangement or the expected period of performance, license fees over the term of the license, and revenue-sharing portions over the period in which such revenue is earned. In all cases, revenue is recognized only when the price is fixed or determinable, persuasive evidence of an arrangement exists, the service is performed, and collectibility of the resulting receivable is reasonably assured.

We provide a provision against revenue for estimated reductions resulting from billing adjustments and customer refunds. The amounts of these provisions are evaluated periodically based upon customer experience and historical trends.

Deferred revenue is recorded when payments are received in advance of performance in underlying agreements. Customer deposits are recorded when customers make prepayments for online advertising.

Licensing

Revenues associated with our former licensing agreement with Microsoft were recognized in the period in which URLs were added to the database and the database was delivered to Microsoft. We did not recognize any license revenue related to Microsoft in 2005 and 2006.

Allowance for Doubtful Accounts

Determination of collectibility of payments requires significant judgment on the part of management and includes performing initial and ongoing credit evaluations of customers. We maintain 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. We will record a reduction of our allowance for doubtful accounts if there is a significant improvement in collection rates or economic conditions are more favorable than we anticipated. Additional allowances for doubtful accounts may be required if there is deterioration in past due balances, if economic conditions are less favorable than we 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.

Valuation of 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, fair value and recoverability of these assets. The majority of intangible assets are amortized over three to seven years, the period of expected benefit. Goodwill is not amortized. In accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* ("SFAS 142"), we periodically re-assess the valuation and asset lives 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 and as a result of any event that significantly changes our business. The Company uses market capitalization, as well as cash flow forecasts and other market value indicators to review goodwill for impairment. Cash flow forecasts used in evaluation of goodwill are based on trends of historical performance and management's estimate of future performance.

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. We regularly review our deferred tax assets for recoverability and establish 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.

Internal Use Software Development Costs

We account 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, we have 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 costs in accordance with SOP 98-1.

Restructuring Charges

We have recorded a restructuring accrual related to closing certain leased facilities in accordance with Statement of Financial Accounting Standards No. 146, *Accounting for Costs Associated with Exit or Disposal of Activities* ("SFAS 146"). Management's judgment is required when estimating when the redundant facilities will be subleased and at what rate they will be subleased.

Share-Based Compensation

Effective January 1, 2006, we adopted Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004) ("SFAS 123R"), *Share-Based Payment* , which revised SFAS 123, *Accounting for Stock-Based Compensation* . SFAS 123R requires all share-based payment transactions with employees, including grants of employee stock options and employee stock purchases related to the Employee Stock Purchase Plan to be recognized as compensation expense over the requisite service period based on their relative fair values. SFAS 123R is a new and very complex accounting standard, the application of which requires significant judgment and the use of estimates, particularly surrounding Black-Scholes assumptions such as stock price volatility and expected option lives, as well as expected option forfeiture rates, to value equity-based compensation. SFAS 123R

requires the recognition of the fair value of stock compensation in net income (loss). In connection with the adoption of SFAS 123R, stock-based compensation expense of approximately $2.3 million was recorded in the Consolidated Statements of Operations for the year ended December 31, 2006 associated with the fair value and initial vesting of employee stock options granted and employee stock purchases related to the Employee Stock Purchase Plan during the period. There was no cumulative effect of adoption. For additional information refer to Footnote 10 (Stockholders' Equity) to our Consolidated Financial Statements under "Financial Statements and Supplementary Data."

Recent Accounting Pronouncements

For a description of recent accounting pronouncements, see Note 1 (Summary of Significant Accounting Policies) in the Notes to the Consolidated Financial Statements.

RESULTS OF OPERATIONS

Overview of 2006

Revenues for 2006 were $48.7 million, with a net loss of $13.7 million. The following developments during 2006 were key to our business:

- ***Growing our ad network.*** Total paid clicks for the year-ended December 31, 2006 were 365.5 million compared to 306.4 million during the same period of 2005, an increase of 19%. On a year-to-year basis, our average revenue per click ("RPC") for 2006 was $0.11 compared to $0.12 in the same period of 2005. Our average RPC began to decline as we added a low priced Run-of-Site advertising product in the third quarter of 2005 that helps us generate revenue from our ad network more quickly. We continue to drive growth and efficiency through our ongoing ad network optimization efforts as well as growth in our advertiser base.
- ***Developing syndicated solutions for publishers.*** We continued to focus on improving our private-labeled AdCenter for Publishers, providing web search, and providing a tailored version of our Furl online book marking system for publishers. We obtained 9 new AdCenter for Publisher customers during 2006.
- ***Focusing on developing a consumer audience.*** We leveraged our core expertise in directories, database structures, algorithmic searches and communities by integrating Furl and other LookSmart technologies to provide a compelling environment for both customers and advertisers. We focused on aggregating these, and newly developed or licensed products, to provide a compelling user experience on the web to allow users to find, save and share articles and other web content and links to them.

Revenues

	Year Ended December 31,				
	2006	Change	2005	Change	2004
			(in thousands)		
Revenues	$48,673	18%	$41,359	(46)%	$76,996

Online Advertising

Online advertising revenues are derived from Advertiser Solutions, Publisher Solutions, and Consumer Sites sources. Revenues from Advertiser Solutions increased in 2006 by approximately $1.4 million, primarily as a result of increased volume of total paid clicks, 365.5 million in 2006 as compared 306.4 million in 2005. In 2006, average RPC declined to $0.11 per click, from $0.12 per click for 2005. The decline in average RPC is primarily due to an increase in low-RPC advertisers during 2006, as compared to 2005, as a result of the introduction of a

new Run-of-Site advertising product during Q3 2005. In 2005, we began removing low-converting traffic from our distribution network. During this time, our RPC decreased as advertisers were less willing to pay our previous rates for low-quality traffic.

In Q3 2005 we launched the AdCenter for Publishers, which is the primary source of our revenues from our Publisher Solutions, which contributed to the approximately $4.5 million increase in revenues during 2006.

Revenues from our Consumer Sites are driven by our FindArticles product. In 2006, revenues from our Consumer Sites increased to $4.2 million from $2.9 million in 2005. This increase was primarily due to revised strategic positioning of our advertisement banners, as well as our text advertisements through third party ad serving.

In 2005, online advertising revenue primarily decreased as compared to 2004, as a result of the elimination of low converting traffic as we continued our efforts to improve traffic quality and optimize traffic flow from our distribution network partners. Further, revenues also decreased due to the winding down of our distribution network partner agreement with Microsoft, which began in January of 2004. This decrease was partially offset by a 94% increase in revenue from the sale of our consumer products, driven by our FindArticles product. In 2005, we improved our content, which subsequently increased page view and FindArticles revenue. We also began generating revenue from our AdCenter for Publishers agreements during the second half of 2005, which further offset the overall decrease in revenue.

Prior to 2004 we exclusively licensed our database content to Microsoft and customized it for their use. Revenues from this agreement were $188 thousand for 2004 and have been included in total revenues for reporting purposes.

Revenues for 2007 are expected to increase 20% to 25% compared to 2006 as a result of revenue growth across all three revenue sources.

Cost of Revenues

	Year Ended December 31,				
	2006	Change	2005	Change	2004
			(in thousands)		
Traffic acquisition costs	$24,600	14%	$21,560	(45)%	$39,234
Percentage of advertiser solutions revenues	64%		56%		52%
Content costs	1,356	29%	1,049	178%	377
Other costs	4,533	(9)%	5,012	(3)%	5,169
Total cost of revenues	$30,489	10%	$27,621	(38)%	$44,780
Percentage of total revenues	63%		67%		58%

During 2006, in accordance with SFAS 123R, we accounted for stock options and employee stock purchases related to the Employee Stock Purchase Program as share-based compensation expense which was included in our Consolidated Statements of Operations. For the year ended December 31, 2006, approximately $13 thousand of share based compensation was included in cost of revenues.

Gross margin of 37% for the year ended December 31, 2006 was higher than gross margin of 33% for the same period in 2005. Traffic acquisition costs, the costs paid to our distribution network partners, increased in 2006 compared to 2005, which coincides with our increase in online advertising revenue.

Content costs represent amounts paid to license searchable content that is displayed on our network of owned-and-operated consumer sites. Content costs increased in 2006 as compared to 2005, due to higher content costs in 2006 caused by the overall traffic increase on the Company's consumer sites.

Other costs of revenues consist of connectivity costs, personnel costs of our operations employees including share-based compensation, equipment depreciation, expenses relating to hosting advertising operations, commissions paid to advertising agencies and amortization of intangible assets. These costs decreased in 2006 compared to the same period of 2005 primarily due to reduction in bank and credit card fees, as well as a continuous, slight decline in connectivity costs of approximately $0.2 million resulting from cost efficiency efforts.

Traffic acquisition costs, the costs paid to our distribution network partners, decreased in 2005 compared to 2004, which coincides with our decrease in Advertiser Solutions revenues. These costs increased as a percentage of Advertiser Solutions revenue as we began paying a slightly higher revenue sharing percentage to our distribution network partners for higher converting traffic.

In 2005, other costs of revenues included content costs. In 2005, the increase in content costs, as compared to 2004, was due to an increase in fees related to one of our FindArticles content providers.

In 2005, other costs were relatively consistent as compared to 2004.

We expect gross margin to remain at approximately 42% to 44% throughout 2007 as improvements in revenue mix are expected to be offset by slightly higher TAC levels throughout 2007.

Operating Expenses

Operating expenses consist of sales and marketing, product development, general and administrative, restructuring charges and share-based compensation.

Sales and Marketing

	Year Ended December 31,				
	2006	Change	2005	Change	2004
			(in thousands)		
Sales and marketing	$7,930	19%	$6,641	(12)%	7,541
Percentage of total revenues	16%		16%		10%

During 2006, in accordance with SFAS 123R, we accounted for stock options and employee stock purchases related to the Employee Stock Purchase Program as share-based compensation expense which was included in our Consolidated Statements of Operations. For the year ended December 31, 2006, approximately $266 thousand of share-based compensation was included in sales and marketing expenses.

Sales and marketing expenses include salaries, commissions, share-based compensation and other costs of employment for our sales force, sales administration and customer service staff and marketing personnel, overhead, facilities, allocation of depreciation and the provision for and reductions of the allowance for doubtful trade receivables. Sales and marketing expenses also include the costs of advertising, trade shows, public relations activities and various other activities supporting our customer acquisition efforts.

Sales and marketing expenses increased in 2006 compared to 2005 primarily due to increased advertising efforts of approximately $0.4 million and increased sales personnel related to efforts to obtain new advertising accounts and publisher customers of approximately $0.1 million. We acquired nine new publishers in 2006.

Sales and marketing expenses decreased in 2005 compared to 2004 primarily due to a reduction in headcount and therefore salaries and benefits of approximately $1.4 million as a result of our restructuring activities in 2004, and lower commissions and bonuses due to the decrease in revenues. The decrease was partially offset by an approximately $0.6 million increase in marketing and promotional expenses in an effort to drive consumers to our sites.

In 2007 sales and marketing expenses are expected to stay relatively consistent with 2006 levels, as we support further investment in sales and marketing.

Product Development

	Year Ended December 31,				
	2006	Change	2005	Change	2004
			(in thousands)		
Capitalized software development costs	$ (1,920)	160%	$ (738)	258%	$ (206)
Other product development costs	17,909	(5)%	18,929	(19)%	23,358
Total product development costs	$15,989	(12)%	$18,191	(21)%	$23,152
Percentage of total revenues	33%		44%		30%

During 2006, in accordance with SFAS 123R, we accounted for stock options and employee stock purchases related to the Employee Stock Purchase Program as share-based compensation expense which was included in our Consolidated Statements of Operations. For the year ended December 31, 2006, approximately $607 thousand of share-based compensation was included in product development expenses.

Product development expenses include all costs related to the continued development and enhancement of our core technology products such as the Ad Center for Publishers, Furl.net and FindArticles.com. These costs include salaries and associated costs of employment, including share-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 after certain milestones have been achieved. Software licensing and computer equipment depreciation related to supporting product development functions are also included in product development expenses.

Capitalized software development costs include the costs to develop software for internal use, excluding costs associated with research and development, training and testing. During 2006 compared to 2005, the increase in capitalized software development costs was due to more work on the new version of the AdCenter implemented during May 2006. In addition, we developed projects to further enhance other core assets, such as Furl and vertical search technologies, associated with our network of owned-and-operated consumer sites. The adoption of SFAS 123R also partially contributed to the increase in capitalized software costs.

The decrease in other product development expenses during 2006 compared to 2005 primarily relates to the decrease in depreciation and amortization of approximately $1.0 million due to end of life for certain fixed assets, as well as lower facilities cost allocations of approximately $13 thousand. Facilities costs declined in 2005 due to an increase in acquisition of sub-tenants to offset rent expense. This is partially offset by an increase in temporary staffing costs to meet requirements of current development efforts.

During 2005 compared to 2004, the increase in capitalized development costs was due to projects related to developing our vertical sites and our proprietary software platform for tracking and invoicing clicks, totaling approximately $0.9 million. Offsetting the increase in capitalized costs from 2005 to 2004 was a write down of previously capitalized software of approximately $0.2 million during the third quarter of 2005. These increases in 2005 compared to 2004 were partially outweighed by an approximate $0.8 million write down in 2004 of software costs previously capitalized for projects that were cancelled in the second quarter of 2004. These projects were canceled because they were not aligned with our future operating plan.

The decrease in other product development expenses during 2005 compared to 2004 was due primarily to a reduction in salaries and benefits of approximately $3.5 million as part of our restructuring activities in 2004. Further, allocations of overhead expenses, which are based on headcount, decreased by approximately $0.8 million as headcount decreased 21% from December 31, 2004.

In 2007, we expect both capitalized software development costs and other product development costs to stay relatively consistent with 2006 levels.

General and Administrative

	Year Ended December 31,				
	2006	Change	2005	Change	2004
			(in thousands)		
General and administrative	$10,324	32%	$7,835	(14)%	$9,095
Percentage of total revenues	21%		19%		12%

During 2006, in accordance with SFAS 123R, we accounted for stock options and employee stock purchases related to the Employee Stock Purchase Program as share-based compensation expense which was included in our Consolidated Statements of Operations. For the year ended December 31, 2006, approximately $1,436 thousand of share-based compensation was included in general and administrative expenses.

General and administrative expenses include costs of executive management, human resources, finance, legal and facilities personnel. These costs include salaries and associated costs of employment, including share-based compensation, overhead, facilities and an allocation of depreciation. General and administrative expenses also include legal, insurance, tax and accounting, consulting and professional service fees.

The increase in general and administrative expenses during 2006 compared to 2005 was primarily driven by an approximate $0.9 million increase in labor costs due to various staffing requirements and share-based compensation costs.

General and administrative expenses decreased for the year ended December 31, 2005 compared to the year ended December 31, 2004 primarily from renegotiating certain of our insurance policies, which resulted in a cost savings of approximately $0.7 million in 2005. Also, salaries decreased by approximately $0.3 million from 2005 to 2004 as a result of non-restructuring separation payments. These payments were approximately $0.2 million in 2005 compared to approximately $0.5 million in 2004. We also had decreases related to employee benefits and payroll taxes of approximately $0.2 million and a loss on disposal of assets in 2004 of approximately $0.3 million. The total decrease in general and administrative expenses was partially outweighed by an increase in legal fees of approximately $0.3 million related to outstanding litigation, patent applications and legal fees related to our reverse stock split.

In 2007, we expect general and administrative expenses to stay relatively consistent with 2006 levels.

Restructuring Charges

	Year Ended December 31,				
	2006	Change	2005	Change	2004
			(in thousands)		
Restructuring charges	$(290)	(128)%	$1,024	(76)%	$4,185
Percentage of total revenues	(1)%		2%		5%

Employee Severance Costs

In November 2003, we implemented a restructuring plan to eliminate 77 positions in the United States due to the loss of the ongoing business agreement with Microsoft. The severance charges associated with the reduction in force were approximately $0.8 million. In the first and second quarters of 2004, we eliminated an additional 43 positions in the United States, which included a reduction in our sales force of 11 positions, a

reduction in our general and administrative departments of five positions, a reduction in our product development department of 14 positions and a reduction in our editorial team of 13 positions. This reduction resulted in approximately $1.0 million restructuring charges recognized in 2004 and is included in operating expenses on the Consolidated Statement of Operations. All employee severance costs were paid by December 31, 2004. No additional restructuring charges related to employee severance costs were incurred in 2005 and 2006.

Lease Restructuring Costs

In connection with the restructuring activities noted above, we incurred costs related to closing of redundant leased facilities in 2003 and 2004, including a charge of approximately $3.2 million in the first quarter of 2004.

During the first half of 2005, we had limited success in subleasing our unused space since the establishment of the restructuring liability, and we modified our original estimates. This resulted in additional restructuring charges of approximately $1.9 million in the second quarter of 2005, reflecting the reduced probability of subleasing the available space. However in October 2005, we executed an agreement to sublease an additional portion of the unused space. A further reduction of the restructuring liability of approximately $0.6 million was recorded in the fourth quarter of 2005 based on an agreement with a new sublessee, which was executed in February 2006.

In the fourth quarter of 2006 we recorded a restructuring benefit of approximately $290 thousand related to the extension of sublease arrangements for portions of our additional unused space.

The lease restructuring liability is amortized using the interest method through the life of the lease, which terminates in 2009.

Non-Operating Income (Expense)

Interest and Other Non-Operating Income, net

	Year Ended December 31,				
	2006	Change	2005	Change	2004
			(in thousands)		
Other income (expense), net	$ 51	(77)%	$ 220	76%	$ 125
Interest income	$1,954	5%	$1,857	120%	$ 844
Interest expense	$ (29)	0%	$ (29)	(3)%	$ (30)
Share of joint venture income (loss)	$ 165	100%	$ —	(100)%	$(115)

Other income (expense), net includes foreign exchange gains and losses, realized gains or losses on investments, and other non-operating items. In 2006, other income decreased primarily due to a decrease in foreign exchange. In 2005, we recovered $137 thousand of previously written off receivables, which caused the overall increase in other income (expense), net.

Interest income includes income from our cash, cash equivalents and investments. The increase in 2006 from 2005 was primarily due to higher overall interest rates earned by our investment portfolio. The increase in 2005 from 2004 was due to higher overall interest rates earned by our investment portfolio.

Interest expense primarily includes interest due on our note payable and was comparable for 2006, 2005, and 2004.

We own 50% of the equity shares of BT LookSmart, Ltd., a Bermuda company that is a joint venture with British Telecommunications. We recognized a share of joint venture income of $165 thousand in the fourth quarter of 2006 due to the settlement of certain prior claims. We expect that we will record income or loss from our share of the joint venture as it moves to finalize its wind-down activities in 2007.

Income Tax Expense

	Year Ended December 31,				
	2006	Change	2005	Change	2004
			(in thousands)		
Income tax expense	$ (5)	150%	$ (2)	(98)%	$(110)

The effective tax rate in upcoming years and for the year ended December 31, 2006 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 and any non-deductible items related to acquisitions or other non-recurring charges.

During 2006, 2005, and 2004, we incurred a net loss. We recorded minimum state income tax expense of approximately $4,800 and $2,000 in 2006 and 2005, respectively. The decrease in 2005 from 2004 was a result of revisions to estimated 2003 taxes recorded in 2004, primarily relating to federal alternative minimum tax.

Gain (Loss) from Discontinued Operations, net of tax

	Year Ended December 31,				
	2006	Change	2005	Change	2004
			(in thousands)		
Gain (loss) from discontinued operations, net of tax	$(33)	(130)%	$110	(92)%	$1,405

In January 2004, we agreed to sell certain of the assets of our Australian subsidiary, and related intellectual property rights, to a subsidiary of Telstra Corporation Limited for approximately $0.7 million. In March 2004, we agreed to sell certain of the assets of our Japanese subsidiary, and related intellectual property rights to Value Commerce for approximately $0.7 million. Also in March 2004, we agreed to sell certain assets of our British subsidiary, and the related intellectual property rights to Crystal for approximately $0.1 million. The gain on disposal of the operations of $1.0 million recorded in 2004 is shown net of $0.4 million for transitional expenses.

We recorded an additional gain of $0.1 million in 2005 as a result of additional disposal activities and an increased tax benefit.

In August 2006, we completed the liquidation of our German subsidiary and incurred a loss of $31 thousand on disposal of this subsidiary.

Revenue and pretax net income (loss) from the discontinued international operations (excluding gain on disposal), previously included in the online advertising segment of the business, reported in discontinued operations were as follows (in thousands):

	Year Ended December 31,		
	2006	2005	2004
Revenues	$—	$—	$6,036
Pretax net income (loss) (excluding gain on disposal)	—	—	407
Tax impact	—	67	(25)
Gain (loss) on disposal	(33)	43	1,023
Net gain (loss) from discontinued operations	$ (33)	$110	$1,405

Pretax income from discontinued operations in 2004 includes approximately $0.4 million related to the reduction of the allowance for doubtful accounts in the second quarter of 2004, as substantially all accounts were collected in certain locations, and approximately $1.7 million related to the disposition and write down of certain international assets and the reduction of estimated liabilities in 2004, offset by expenses related to the operations

of the entities during the periods and the reversal of cumulative translation adjustments of $0.4 million related to both the United Kingdom and Japan, which had been substantially liquidated as of December 31, 2004. As we finalize the liquidation process of our Australian subsidiary, we expect to record additional income related to the reversal of the cumulative translation adjustment of $0.5 million in 2007. We also expect that we will record additional minor amounts relating to the finalization of the liquidation of various foreign operations in 2007.

Liquidity and Capital Resources

The following table presents our cash flows provided by (used in) operating, investing and financing activities for the years ended December 31, 2006, 2005, and 2004 (in thousands).

	Year ended December 31, 2006	Year ended December 31, 2005	Year ended December 31, 2004
Cash flows used in operating activities	$ (6,312)	$ (7,467)	$ (6,771)
Cash flows provided by (used in) investing activities	$ 5,614	$ (2,470)	$ (18,031)
Cash flows provided by financing activities	$ 163	$ 111	$ 4,561

Our primary source of cash is receipts from revenues. The primary uses of cash are labor costs (salaries, benefits, and other employee compensation), general operating expenses (office rent, utilities, insurance and supplies), payments to distribution network partners related to traffic acquisition and content costs associated with our consumer sites, and professional services fees related to legal and audit costs. We ended 2006 with $41.2 million in cash, cash equivalents, and short and long-term investments, a decrease of $10.1 million from $51.3 million at December 31, 2005.

The decrease in cash used in operating activities in 2006 compared to 2005 was primarily due to the decrease in net loss of $4.1 million, a decrease in cash paid for accrued liabilities of $2.5 million and a decrease in depreciation and amortization of $1.5 million, offset by an increase in accounts receivable due to increased revenues and a shift from self-service customers to managed customers. Managed service customers have a dedicated account manager and therefore are invoiced. Self-service customers are supported by a customer service team and make payments with credit cards. Managed service accounts represented less than 50% of revenues at the beginning of 2006, and more than 50% of revenues by the end of 2006. During 2005, net cash used in operations increased $0.7 million from 2004. A net loss of $17.8 million in 2005 compared to a net loss of $9.6 million in 2004 was the primary reason for the increase. Further, a decrease in revenues caused a corresponding decrease in cash paid for accrued liabilities of $15.6 million primarily due to lower accruals for partner payments related to cost of revenues.

Net cash provided by investing activities in 2006 of $5.6 million resulted primarily from the maturities of investments of $20.2 million, partially offset by purchases of short-term investments of $9.5 million and long-term investments of $1.0 million. Further, we purchased equipment and capitalized costs related to internally developed software of $4.1 million compared to $3.9 million in 2005. In 2005 compared to 2004, net cash used in investing activities decreased $15.6 million primarily due to the proceeds from the sale of short-term investments of $9.9 million.

Net cash provided by financing activities in 2006 of $0.2 million resulted primarily from the proceeds related to our employee stock plans of $0.2 million, which remained relatively constant from 2005. We also made payments against our outstanding note payable of approximately $53 thousand. In 2005, net cash provided by financing activities decreased $4.5 million primarily due to a decrease in proceeds from our employee stock plans of $4.5 million.

We have outstanding standby letters of credit ("SBLC") related to security of building leases and security for payroll processing services of $1.1 million at December 31, 2006. The SBLC contains two financial covenants. As of December 31, 2006, we were in compliance with all required covenants.

While we expect cash to decrease in 2007, we believe that our working capital will provide adequate liquidity to fund our operations and meet other cash requirements for at least the next 12 months. 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, 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 be certain 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, investments in special-purpose entities or undisclosed borrowings or debt. 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. The following table summarizes our significant contractual obligations and commercial commitments as of December 31, 2006, and the effect such obligations are expected to have on our liquidity and cash flows in future periods (in thousands):

	Total	Less than 1 year	1-3 years	4-5 years	Thereafter
Note obligation (principal and interest)	$ 209	$ 71	$ 138	$ —	$ —
Operating leases	13,847	4,684	9,163	—	—
Purchase obligations	541	541	—	—	—
Total	$14,597	$ 5,296	$9,301	$ —	$ —

Indemnification

During the normal course of business, we have made certain guarantees, indemnities and commitments under which we may be required to make payments in relation to certain transactions. These indemnities include intellectual property and other indemnities to our customers and distribution network partners in connection with the sales of our products, and indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease. Further, we have agreements whereby we indemnify our officers and directors for certain events or occurrences while the officer or director is, or was, serving, at our request, in such capacity, to the maximum extent permitted under the laws of the State of Delaware. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited. However, we maintain directors and officers insurance coverage that may contribute, up to certain limits, a portion of any future amounts paid for indemnification of directors and officers. We believe the estimated fair value of these indemnification agreements in excess of applicable insurance coverage is minimal. Historically, we have not incurred any losses or recorded any liabilities related to performance under these types of indemnities.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

Our exposure to market risk for interest rate changes relates primarily to our cash equivalents, short-term and long-term investments. We had no derivative financial instruments as of December 31, 2006 or 2005. We invest our excess cash in debt and equity instruments of high-quality corporate issuers with original maturities greater than three months and effective maturities less than two years. The amount of credit exposure to any one issue, issuer and type of instrument is limited. These securities are subject to interest rate risk and vary in value as market interest rates fluctuate. During the year ended December 31, 2006, the effects of changes in interest rates on the fair market value of our marketable investment securities and our earnings were not material. Further, we believe that the impact on the fair market value of our securities and our earnings from a hypothetical 10% change in interest rates would not be significant.

Foreign Currency Risk

International revenues from our foreign subsidiaries were 0%, 0%, and 7% of total revenues in 2006, 2005, and 2004, respectively, and were derived from our Australian, British and Japanese operations. Such revenues have been classified as discontinued operations. Our international business was 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 rates between the Australian Dollar, the British Pound, the Japanese Yen and the United States Dollar. In the first quarter of 2004, we signed agreements to sell the assets and activities of our international subsidiaries and are in the process of liquidating all of our international entities. As of December 31, 2006, our exposure to foreign currency risk was not significant.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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LOOKSMART, LTD.

CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	December 31, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 32,901	$ 33,436
Short-term investments	7,257	17,871
Total cash, cash equivalents and short-term investments	40,158	51,307
Trade accounts receivable, net of allowance for doubtful accounts of $323 and $240 at December 31, 2006 and 2005 and allowance for returns of $14 and $14 at December 31, 2006 and 2005	4,639	2,781
Prepaid expenses	516	443
Other current assets	339	569
Total current assets	45,652	55,100
Long-term investments	998	—
Property and equipment, net	4,588	5,503
Security deposits and other assets, net	3,533	2,464
Intangible assets, net	3,364	5,519
Goodwill	14,422	14,422
Total assets	$ 72,557	$ 83,008
LIABILITIES & STOCKHOLDERS' EQUITY		
Current liabilities:		
Trade accounts payable	$ 2,576	$ 1,629
Accrued expenses and other accrued liabilities	5,624	4,830
Deferred revenue and customer deposits	2,541	2,082
Current portion of long-term liabilities	1,391	1,530
Total current liabilities	12,132	10,071
Long-term debt, net of current portion	126	184
Other long-term liabilities, net of current portion	2,750	4,302
Total liabilities	15,008	14,557
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Convertible preferred stock, $0.001 par value; Authorized: 5,000 at December 31, 2006 and 2005; Issued and Outstanding: none at December 31, 2006 and 2005	—	—
Common stock, $0.001 par value; Authorized: 200,000 at December 31, 2006 and 2005; Issued and Outstanding: 22,974 and 22,912, at December 31, 2006 and 2005	23	23
Additional paid-in capital	274,484	271,851
Other equity	517	386
Accumulated deficit	(217,475)	(203,809)
Total stockholders' equity	57,549	68,451
Total liabilities and stockholders' equity	$ 72,557	$ 83,008

The accompanying notes are an integral part of these Consolidated Financial Statements.

LOOKSMART, LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Year Ended December 31,		
	2006	2005	2004
Revenues	48,673	41,359	76,996
Cost of revenues	30,489	27,621	44,780
Gross profit	18,184	13,738	32,216
Operating expenses:			
Sales and marketing	7,930	6,641	7,541
Product development	15,989	18,191	23,152
General and administrative	10,324	7,835	9,095
Restructuring charges	(290)	1,024	4,185
Total operating expenses	33,953	33,691	43,973
Loss from operations	(15,769)	(19,953)	(11,757)
Non-operating income (expense):			
Other income (expense), net	51	220	125
Interest income	1,954	1,857	844
Interest expense	(29)	(29)	(30)
Share of joint venture income (loss)	165	—	(115)
Loss from continuing operations before income taxes	(13,628)	(17,905)	(10,933)
Income tax expense	(5)	(2)	(110)
Loss from continuing operations	(13,633)	(17,907)	(11,043)
Gain (loss) from discontinued operations, net of tax	(33)	110	1,405
Net loss	$(13,666)	$(17,797)	$ (9,638)
Net loss per share—Basic			
Loss from continuing operations	$ (0.60)	$ (0.79)	$ (0.49)
Gain from discontinued operations, net of tax	—	0.01	0.06
Net loss per share	$ (0.60)	$ (0.78)	$ (0.43)
Weighted average shares outstanding used in computing basic net income (loss) per share	22,822	22,765	22,266
Net loss per share—Diluted			
Loss from continuing operations	$ (0.60)	$ (0.79)	$ (0.49)
Gain from discontinued operations, net of tax	—	0.01	0.06
Net loss	$ (0.60)	$ (0.78)	$ (0.43)
Weighted average shares outstanding used in computing diluted net income (loss) per share	22,822	22,765	22,266

The accompanying notes are an integral part of these Consolidated Financial Statements.

LOOKSMART, LTD.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands)

	Common Stock		Additional Paid-in	Other	Accumulated	Total Stockholders'	Comprehensive
	Shares	Amount	Capital	Equity	Deficit	Equity	Income (Loss)
Balance at December 31, 2003	21,561	16	261,882	773	(176,374)	86,297	$ 6,516
Common stock issued upon exercise of stock options	750	4	4,376	—	—	4,380	
Common stock issued for acquisitions	502	3	5,074	—	—	5,077	
Common stock issued for employee stock purchase plan	41	—	276	—	—	276	
Stock-based compensation	—	—	86	68	—	154	
Comprehensive loss:							
Unrealized loss on securities, net	—	—	—	(83)	—	(83)	$ (83)
Translation adjustment	—	—	—	(2)	—	(2)	(2)
Reversal of CTA due to liquidation of foreign subsidiaries	—	—	—	(361)	—	(361)	(361)
Net loss	—	—	—	—	(9,638)	(9,638)	(9,638)
Balance at December 31, 2004	22,854	23	271,694	395	(186,012)	86,100	$ (10,084)
Common stock issued upon exercise of stock options	27	—	92	—	—	92	
Common stock issued for employee stock purchase plan	31	—	103	—	—	103	
Stock-based compensation	—	—	(38)	38	—	—	
Comprehensive loss:							
Unrealized loss on securities, net	—	—	—	(47)	—	(47)	$ (47)
Net loss	—	—	—	—	(17,797)	(17,797)	(17,797)
Balance at December 31, 2005	22,912	$ 23	$271,851	$ 386	$ (203,809)	$ 68,451	$ (17,844)
Common stock issued upon exercise of stock options	33	—	116	—	—	116	
Common stock issued for employee stock purchase plan	29	—	100	—	—	100	
Stock-based compensation	—	—	2,417	—	—	2,417	
Comprehensive loss:							
Unrealized gain on securities, net	—	—	—	131	—	131	$ 131
Net loss	—	—	—	—	(13,666)	(13,666)	(13,666)
Balance at December 31, 2006	22,974	$ 23	$274,484	$ 517	$ (217,475)	$ 57,549	$ (13,535)

The accompanying notes are an integral part of these Consolidated Financial Statements.

LOOKSMART, LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2006	2005	2004
Operating activities			
Net loss	$(13,666)	$(17,797)	$ (9,638)
Adjustments to reconcile net loss to net cash used in operating activities:			
Share of joint venture (income) loss	(165)	—	115
Depreciation and amortization	6,430	7,957	8,186
Stock based compensation	2,322	—	154
(Gain) loss from sale of assets and other non-cash charges	82	622	(653)
Changes in operating assets and liabilities, net of effects of acquisitions and disposals:			
Trade accounts receivable, net	(1,858)	1,099	18,385
Prepaid expenses	(72)	598	1,266
Other assets	111	402	216
Trade accounts payable	947	1,269	(3,240)
Other accrued liabilities	795	(1,721)	(19,844)
Other long term liabilities	(1,697)	(419)	2,119
Deferred revenue and customer deposits	459	523	(3,837)
Net cash used in operating activities	(6,312)	(7,467)	(6,771)
Investing activities			
Acquisitions, net of cash acquired	—	(750)	(2,116)
Purchase of short-term investments	(9,514)	(4,055)	(7,676)
Proceeds from sale of short-term investments	20,179	9,904	4,304
Proceeds from sale of long-term investments	—	—	5,392
Purchase of long-term investments	(998)	(3,731)	(16,677)
Payments for property, equipment and capitalized software development	(4,053)	(3,854)	(2,824)
Proceeds from the sale of property and equipment	—	16	82
Proceeds from the sale of assets of foreign entities	—	—	1,484
Net cash provided by (used in) investing activities	5,614	(2,470)	(18,031)
Financing activities			
Repayment of notes	(53)	(84)	(95)
Proceeds from issuance of common stock	216	195	4,656
Net cash provided by financing activities	163	111	4,561
Effect of exchange rate changes on cash	—	—	(363)
Decrease in cash and cash equivalents	(535)	(9,826)	(20,604)
Cash and cash equivalents, beginning of period	33,436	43,262	63,866
Cash and cash equivalents, end of period	$ 32,901	$ 33,436	$ 43,262
Supplemental disclosures of cash flow information:			
Issuance of stock for acquisitions	$ —	$ —	$ 5,077
Interest paid	$ 29	$ 30	$ 27
Income taxes paid	$ 33	$ 42	$ 158

The accompanying notes are an integral part of these Consolidated Financial Statements.

LOOKSMART, LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Nature of Business and Principles of Consolidation

LookSmart is an online advertising and technology company that provides relevant solutions for advertisers, publishers and consumers. LookSmart offers advertisers targeted, pay-per-click (PPC) search advertising banners via its consumer web properties; a monitored ad distribution network; and a customizable set of private-label solutions for publishers, consumer sites and web tools for consumers.

In October 2005, the Company effected a one-for-five reverse stock split of its common stock. All share and per share information included in these Consolidated Financial Statements has been retroactively adjusted to reflect the reverse stock split. Shares authorized and par value were not adjusted as they were not affected by the reverse stock split.

In the first quarter of 2004, the Company signed agreements to sell certain of the assets and activities of its Australian, British and Japanese subsidiaries. Accordingly, the consolidated results of operations have been recast to remove the results of the international operations from continuing operations for all periods presented in these Consolidated Financial Statements. Results of discontinued international operations are included in the separate line item labeled gain (loss) from discontinued operations, net of tax, for all periods presented. The results of the discontinued operations are summarized in Note 16 (Discontinued Operations).

The Consolidated Financial Statements include the accounts of the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The Consolidated 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, revenues, expenses, and contingent assets and liabilities during the reporting period. The Company bases its estimates on various factors and information which may include, but are not limited to, history and prior experience, experience of other enterprises in the same industry, new related events, current economic conditions and information from third party professionals that is believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates.

Reclassifications

The Company previously disclosed licensing revenues of $188 thousand for the year ended December 31, 2004 as a separate component of revenues. These revenues were derived from its licensing agreement with Microsoft. In 2006, the Company reclassified these amounts to total revenues.

Certain other prior years' balances have been reclassified to conform to the current year's presentation. The reclassifications had no material impact on net loss or stockholders' equity.

Fair Value of Financial Instruments

The Company's financial instruments, including cash and cash equivalents, trade accounts receivable, trade accounts payable, and other accrued liabilities are carried at cost, which approximates fair value due to the

LOOKSMART, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

relatively short maturity of those instruments. Short-term investments and long-term investments are carried at fair value. Based upon borrowing rates with similar terms currently available to the Company, the carrying value of notes payable approximates fair value.

Foreign Currencies

The balance sheets of the Company's foreign subsidiaries, whose functional currency is their local currency through substantial completion of liquidation, are translated into United States Dollars at year-end rates of exchange. Revenues and expenses are translated at average rates for the year. The resulting translation adjustments are shown as a separate component of stockholders' equity and as a component of comprehensive income (loss). Where substantial liquidation has occurred, the cumulative translation adjustment has been reversed and reported in gain (loss) from discontinued operations. Beginning in the fourth quarter of 2004, the functional currency of the Company's foreign subsidiaries was changed to the US Dollar and all translation adjustments thereafter are included in the Consolidated Statements of Operations. See Note 16 (Discontinued Operations) for complete discussion of discontinued international operations.

Exchange gains and losses arising from transactions denominated in a foreign currency other than the functional currency of the entity involved are included in other income (expense), net. Such exchange income (loss) amounted to $0, $84,000, and $(35,000) for 2006, 2005, and 2004 respectively. The Company has not entered into foreign currency forward exchange contracts or any other derivative instruments.

Cash and Cash Equivalents

Cash and cash equivalents are stated at cost. The Company considers all highly liquid investments with an original maturity or maturity at date of purchase of ninety days or less to be cash equivalents.

Investments

The Company accounts for investments in securities under Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* ("SFAS 115"). SFAS 115 requires the classification of investments in debt and equity securities with readily determinable fair values as "held-to-maturity," "available-for-sale," or "trading."

The Company invests its excess cash primarily in debt instruments of high-quality corporate and government issuers. All highly liquid instruments with maturities at the date of purchase greater than ninety days are considered investments. All instruments with maturities greater than one year from the balance sheet date are considered long-term investments unless management intends to liquidate such securities in the current operating cycle. Such securities are classified as short-term investments. These securities are classified as available-for-sale and carried at fair value, based on quoted market prices. At December 31, 2006, the Company's short-term investments were primarily commercial paper and U.S. government agency notes with maturities in excess of 90 days. Long-term investments at December 31, 2006, were primarily commercial paper with maturities in excess of one year. Fair values were determined for each individual security in the investment portfolio.

Changes in value of these investments are primarily related to changes in interest rates and are considered to be temporary in nature. Except for declines in fair value that are not considered temporary, net unrealized gains or losses on these investments are reported as a component of accumulated comprehensive income (loss) in stockholders' equity. The Company recognizes realized gains and losses upon sale of investments using the specific identification method.

LOOKSMART, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Concentrations, Credit Risk and Credit Risk Evaluation

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash equivalents, short-term investments, long-term investments and accounts receivable. As of December 31, 2006 and 2005, substantially all of the Company's cash, cash equivalents and investments were managed by one financial institution. The fair value of these investments is subject to fluctuation based on market prices.

Credit Risk, Customer and Vendor Evaluation

Accounts receivable are typically unsecured and are derived from revenues earned from customers. The Company performs ongoing credit evaluations of its customers and maintains allowances for estimated credit losses. The Company applies judgment as to its ability to collect outstanding receivables based primarily on management's evaluation of the customer's financial condition and past collection history and records a specific allowance. In addition, the Company records an allowance based on the length of time the receivables are past due. Historically, such losses have been within management's expectations.

As of December 31, 2006, one customer accounted for 22% of accounts receivable. As of December 31, 2005 one customer accounted for 28% of accounts receivable and another customer accounted for 13% of accounts receivable.

The Company derives its revenue primarily from its relationships with significant distribution network partners. For the year ended December 31, 2006, three vendors each accounted for more than 10% of total traffic acquisition costs, with these three vendors accounting for a total of 42% of the total traffic acquisition costs. For the year ended December 31, 2005, three vendors each accounted for more than 10% of the total traffic acquisition costs, with these three vendors accounting for a total of 53% of the total traffic acquisition costs.

Revenue Concentrations

One customer represented 10% of total revenues for the year ended December 31, 2006. For the year ended December 31, 2005, the same customer represented 5% of the total revenues for that period. For the year ended December 31, 2004, no customer represented over 10% of total revenues.

Property and Equipment

Property and equipment are stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets as follows:

Computer equipment	3 years
Furniture and fixtures	5 to 7 years
Software	2 to 3 years

Leasehold improvements are amortized on a straight-line basis over the shorter of their estimated useful lives or the lease term.

When assets are retired or otherwise disposed of, the cost and accumulated depreciation and amortization are removed from their respective accounts, and any gain or loss on such sale or disposal is reflected in operating expenses. Maintenance and repairs are charged to expense as incurred. Expenditures that substantially increase an asset's useful life are capitalized.

LOOKSMART, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Internal Use Software Development Costs

The Company accounts for internal use software development costs in accordance with American Institute of Certified Public Accountants 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 for employees who are directly associated with and who devote time to developing the internal-use computer software.

The Company's capitalized software development costs were $8.7 million and $6.7 million with related accumulated amortization of $6.3 million and $5.1 million at December 31, 2006 and 2005, respectively. Amortization expense was $1.2 million, $1.8 million and $1.8 million for the years ended December 31, 2006, 2005 and 2004, respectively. Capitalized software development costs are included in other assets and are amortized over two to three years.

Goodwill and Intangible Assets

In accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* ("SFAS 142"), goodwill and other intangibles with indefinite useful lives are not amortized but are reviewed periodically for impairment.

The provisions of SFAS 142 require that a two-step test be performed to assess goodwill for impairment. First, the fair value of each reporting unit is compared to its carrying value. If the fair value exceeds the carrying value, goodwill is not impaired and no further testing is performed. The second step is performed if the carrying value exceeds the fair value. The implied fair value of the reporting unit's goodwill must be determined and compared to the carrying value of the goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, an impairment loss equal to the difference will be recorded.

The Company reviews goodwill for potential impairment as of December 31 each year and was not required to record a goodwill impairment charge as a result of the reviews in 2006, 2005 or 2004. The Company will continue to perform the goodwill impairment review annually or more frequently if facts and circumstances warrant a review.

The Company uses market capitalization, as well as cash flow forecasts and other market value indicators to review goodwill for impairment. Cash flow forecasts used in evaluation of goodwill were based on trends of historical performance and management's estimate of future performance.

SFAS 142 also requires that intangible assets with definite lives be amortized over their estimated useful life and reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"). The Company is currently amortizing acquired intangible assets with definite lives over periods from two to seven years and the amortization expense is primarily classified as cost of revenues in the Company's Consolidated Statements of Operations.

Impairment of Long-Lived Assets

In accordance with the provisions of SFAS 144, the Company reviews long-lived assets, including property and equipment, for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. Under SFAS 144, an impairment loss would be recognized

LOOKSMART, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

when estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Impairment, if any, is measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value. Through December 31, 2006, there have been no such impairments.

Revenue Recognition

Online Advertising

Online advertising revenue is primarily composed of per-click fees that the Company charges customers. Customers set the per-click fee charged for inclusion-targeted listings when their account is established. The per-click fee charged for keyword-targeted listings is calculated based on the results of online bidding on keywords or page content, up to a maximum cost per keyword or page content set by the customer.

Revenues associated with online advertising products, including Advertiser Solutions, FindArticles, the Company's other consumer sites, and banner advertisements are generally recognized once collectibility is established, delivery of services has occurred, all performance obligations have been satisfied, and no refund obligations exist. The Company pays distribution network partners based on clicks on the advertiser's ads that are displayed on the websites of these distribution network partners. These payments are called traffic acquisition costs and are included in cost of revenues. In accordance with Emerging Issues Task Force Issue No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent* ("EITF 99-19"), the revenue derived from these arrangements that involve traffic supplied by distribution network partners is reported gross of the payment to the distribution network partners. This revenue is reported gross due to the fact that the Company is the primary obligor to the advertisers who are the customers of the advertising service.

Affiliate revenue is included in online advertising revenue and is 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, the Company generates revenues when Internet consumers make a purchase from a participating merchant's web site after clicking on the merchant's listing in the Company's search results. Revenues from affiliates are earned on a per-sale basis or as a percentage of sales 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.

The Company also enters into agreements to provide private-labeled versions of its products, including the AdCenter for Publishers. These arrangements include multiple elements such as upfront fees, license fees, and revenue-sharing based on the publishers' customer's monthly revenue generated through the AdCenter application. The Company recognizes revenue in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104, *Revenue Recognition in Financial Statements* ("SAB 104"), and Financial Accounting Standards Board Emerging Issues Task Force No. 00-21, *Revenue Arrangements with Multiple Deliverables* ("EITF 00-21"). The Company recognizes upfront fees over the term of the arrangement or the expected period of performance, license fees over the term of the license, and revenue-sharing portions over the period in which such revenue is earned. In all cases, revenue is recognized only when the price is fixed or determinable, persuasive evidence of an arrangement exists, the service is performed, and collectibility of the resulting receivable is reasonably assured.

The Company provides a provision against revenue for estimated reductions resulting from billing adjustments and customer refunds. The amounts of these provisions are evaluated periodically based upon customer experience and historical trends.

LOOKSMART, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Deferred revenue is recorded when payments are received in advance of performance in underlying agreements. Customer deposits are recorded when customers make prepayments for online advertising.

Licensing

Revenues associated with the Company's former licensing agreement with Microsoft were recognized in the period in which URLs were added to the database and the database was delivered to Microsoft. The Company did not recognize any license revenue related to Microsoft in 2005 and 2006. Revenue from this agreement was $188 thousand for the year ended December 31, 2004 and has been included in total revenues for reporting purposes.

Traffic Acquisition Costs

The Company enters into agreements of varying durations with its distribution network partners that display the Company's listings ads on their sites in return for a percentage of the revenue-per-click that the Company receives when the ads are clicked on those partners' sites.

The Company also enters into agreements of varying durations with third party affiliates that integrate the Company's pay-for-performance search service into their websites. There are generally three economic structures of the affiliate agreements: guaranteed fixed payments which often carry reciprocal performance guarantees from the affiliate, variable payments based on a percentage of the Company's revenue or based on a certain metric, such as number of searches or paid clicks, or a combination of the two.

The Company expenses, as cost of revenues, traffic acquisition costs under two methods; agreements with fixed payments are expensed pro-rata over the term the fixed payment covers, and agreements based on a percentage of revenue, number of paid introductions, number of searches, or other metrics are expensed based on the volume of the underlying activity or revenue, multiplied by the agreed-upon price or rate.

Share-Based Compensation

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* ("SFAS 123R"), which requires all share based payment transactions with employees and directors, including employee stock options and employee stock purchases related to the Employee Stock Purchase Plan ("employee stock purchases"), to be recognized as compensation expense over the requisite service period based on their relative fair values. SFAS 123R supersedes the Company's previous accounting under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB No. 25") for periods beginning in fiscal 2006. In March 2005, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulleting No. 107 ("SAB 107") relating to SFAS 123R. The Company has applied the provisions of SAB 107 in its adoption of SFAS 123R.

The Company adopted SFAS 123R using the modified prospective transition method, which requires the application of accounting standard as of January 1, 2006, the first day of the Company's fiscal year 2006. The Company's Consolidated Financial Statements for the year ended December 31, 2006 reflect the impact of SFAS 123R. In accordance with the modified prospective transition method, the Company's Consolidated Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123R. Share-based compensation expense recognized under SFAS 123R for the year ended December 31, 2006 was approximately $2.4 million, which was related to stock options and employee stock purchases. In connection with the grant of certain stock options to employees and members of the Board of Directors and in connection with certain acquisitions, the Company recorded share-based compensation expense under APB No. 25 of approximately $0 and $154 thousand during the years ended December 31, 2005 and 2004, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

SFAS 123R requires companies to estimate the fair value of share-based payment awards on the grant date using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense in the Company's Consolidated Statements of Operations over the requisite service periods. Prior to the adoption of SFAS 123R, the Company accounted for share-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under SFAS 123. Under the intrinsic value method, no share-based compensation expense related to stock options had been recognized in the company's Consolidated Statements of Operations for fiscal year 2005 because the exercise price of the Company's stock options granted to employees and directors equaled the fair market value of the underlying stock at the grant date.

Share-based compensation expense recognized during the current period is based on the value of the portion of share-based payment awards that is ultimately expected to vest. SFAS 123R requires forfeitures to be estimated at the time of grant in order to estimate the amount of share-based awards that will ultimately vest. The forfeiture rate is set at the beginning of each fiscal year and reviewed on an annual basis. Share-based compensation expense recognized in the Company's Consolidated Statements of Operations for the year ended December 31, 2006 includes (i) compensation expense for share-based payment awards granted prior to, but not yet fully vested as of December 31, 2005, based on the grant-date fair valued estimated in accordance with the pro forma provisions of SFAS 123 and (ii) compensation expense for the share-based payment awards granted subsequent to December 31, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R.

Upon adoption of SFAS 123R, the Company continued its use of the Black-Scholes method of valuation for share-based awards granted beginning in fiscal 2006, which was previously used for the Company's pro forma information required under SFAS 123. On November 10, 2005, the Financial Accounting Standards Board ("FASB") issued FASB Staff position No. SFAS 123R-3, *Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards* ("SFASR-3"). The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool ("APIC pool") related to the tax effects of employee share-based compensation, and to determine the subsequent impact on the APIC pool and Consolidated Statements of Cash Flows of the tax effects of employee share-based compensation awards that are outstanding upon adoption of SFAS 123R. The Company has elected to adopt the alternative transition method provided in this FASB Staff Position for calculating the tax effects of share-based compensation pursuant to SFAS 123R-3.

Advertising Costs

Advertising costs are charged to sales and marketing expenses as incurred and amounted to $0.8 million, $0.4 million, and $0.2 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Product Development Costs

Research and development of new product ideas and enhancements to existing products are charged to expense as incurred.

Income Taxes

The Company accounts for income taxes using the liability method in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* ("SFAS 109"). Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

Comprehensive Income (Loss)

The Company has adopted the accounting treatment prescribed by Statement of Financial Accounting Standards No. 130, *Comprehensive Income* ("SFAS 130"). Items of comprehensive income that the Company currently reports are unrealized gains and losses on marketable securities categorized as available-for-sale and foreign currency translation adjustments.

Net Income (Loss) Per Share

Statement of Financial Accounting Standards No. 128, *Earnings per Share* ("SFAS 128"), establishes standards for computing and presenting net income (loss) per share. Basic net income (loss) per share is calculated using the weighted average shares of common stock outstanding. Diluted net income (loss) per share is calculated using the weighted average number of common and potentially dilutive common shares outstanding during the period, using the treasury stock method for stock options and warrants.

Segment Information

As of January 1, 2004, the Company changed to one operating segment, online advertising, due to the expiration of the Company's only licensing agreement with Microsoft in January of 2004.

As of December 31, 2006, 2005, and 2004, all of the Company's accounts receivable, intangible assets, goodwill and deferred revenue related to the online advertising segment. All of the Company's revenues included in continuing operations were generated in the United States. See Note 16 (Discontinued Operations) regarding foreign revenues reported as discontinued operations. All long-lived assets are located in the United States.

Recently Issued Accounting Pronouncements

In July 2006, FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109* ("FIN 48"), which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that the Company recognize in its financial statements the impact of a tax position if that position is more likely than not of being sustained on audit, based on the technical merits of the position. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. The provisions of FIN 48 will be effective for the Company on January 1, 2007 (the first day of the Company's 2007 fiscal year), with the cumulative effect, if any, of the change in accounting principle recorded as an adjustment to retained earnings at January 1, 2007. The Company is currently evaluating the impact of adopting FIN 48 on its Consolidated Financial Statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108 , *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* ("SAB 108"), which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 is effective as of the Company's 2006 fiscal year, allowing a one-time transitional cumulative effect adjustment to beginning retained earnings for errors that were not previously deemed material, but are material under the guidance in SAB 108. The adoption of SAB 108 did not have a material impact on the Company's Consolidated Financial Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measures* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value and enhances disclosures about fair value measures required under other accounting pronouncements, but does not change existing guidance as to whether or not an instrument is carried at fair value. SFAS No. 157 is effective as of the beginning of the Company's 2008 fiscal year. The Company is currently evaluating the impact of adopting SFAS 157 on its Consolidated Financial Statements.

2. Acquisitions and Dispositions

Acquisitions

The transactions below were recorded using the purchase method of accounting and the operating results of these acquisitions have been included in the Company's results of operations since the acquisition dates. The purchase prices have been allocated to assets acquired and liabilities assumed based on their fair values on the acquisition dates.

Net Nanny

On April 22, 2004, the Company acquired the business and certain assets of Net Nanny, a division of BioNet Systems LLC, a privately held company, for $850,000 in cash, 394,477 shares of common stock valued at $4.2 million and $27,000 of costs related to completing the transaction. Net Nanny is a software application that is loaded on a user's desktop computer and provides online parental control and content filtering of web search results.

The common stock issued was valued at $10.75 per share in accordance with Emerging Issues Task Force Issue No. 99-12, *Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination* ("EITF 99-12") using the average of the closing prices of the Company's common stock for the two days prior to and including April 22, 2004, which was prior to the announcement date of April 29, 2004.

Purchased technology and other intangible assets acquired are being amortized over their estimated useful lives of two to six years. The Consolidated Financial Statements include the operating results of Net Nanny from the date of purchase. Pro forma results of operations have not been presented because the effect of this acquisition was not material to the results of prior periods presented.

The following table summarizes the purchase price allocation. These amounts were determined through established valuation techniques in the technology industry (in thousands):

Accounts receivable, net of provisions	$ 171
Inventory	34
Purchased technology	510
Goodwill	3,490
Other intangible assets	940
Total assets acquired	5,145
Less: current liability assumed	34
Net assets acquired	$5,111

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

On January 22, 2007, the Company sold Net Nanny to Content Watch. See Note 17, Subsequent Events for further disclosure.

Furl.net

During the third quarter of 2004, the Company acquired the assets of Furl.net, which consisted primarily of intangible assets related to technology, customer lists, trade name and employees. The asset acquisition did not have a significant impact on total assets of the Company.

Dispositions

The Company entered into a letter of intent ("LOI") dated December 8, 2006 to sell the Net Nanny ("NN") brand and technology and all intellectual property related to the NN product. The LOI does not specify any minimum consideration to be received by the Company and the consideration is capped at $3.5 million over the course of up to four years. NN was acquired by the Company in April, 2004 and was accounted for as a purchase business combination with $3.5 million of goodwill assigned by the purchase price allocation. Because the Company is a single operating segment and reporting unit, there is no goodwill allocated as "assets held for sale".

At December 31, 2006, the NN net assets have been accounted for under the guidance of SFAS 144 as "assets held for sale," and are included on the Company's Consolidated Balance Sheet under the following captions (in thousands):

Other current assets	$ 31
Intangible assets, net	539
Deferred revenue and customer deposits	(263)

The NN transaction will be accounted for as an asset sale in first quarter of the Company's fiscal year 2007. See Note 17, Subsequent Events for further discussion.

LOOKSMART, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

3. Cash, Cash Equivalents, Short-Term Investments and Long-Term Investments

Cash, cash equivalents, short-term and long-term investments consisted of the following as of December 31, 2006 and 2005 (in thousands):

December 31, 2006	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash and cash equivalents				
Cash	$ 4,246	$ —	$ —	$ 4,246
Cash equivalents				
Money market mutual funds	95	—	—	95
Corporate debt securities	28,553	7	—	28,560
Total cash equivalents	28,648	7	—	26,655
Total cash and cash equivalents	32,894	7	—	32,901
Short-term investments				
Corporate debt securities	6,261	—	(4)	6,257
United States government agency notes	1,000	—	—	1,000
Total short-term investments	7,261	—	(4)	7,257
Long-term investments				
United States government agency notes	999	—	(1)	998
Total long-term investments	999	—	(1)	998
Total cash, cash equivalents, and short-term investments	$41,154	$ 7	$ (5)	$ 41,156

December 31, 2005	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash and cash equivalents				
Cash	$ 2,013	$ —	$ —	$ 2,013
Cash equivalents				
Money market mutual funds	376	—	—	376
Corporate debt securities	31,047	—	—	31,047
Total cash equivalents	31,423	—	—	31,423
Total cash and cash equivalents	33,436	—	—	33,436
Short-term investments				
Corporate debt securities	10,596	—	(105)	10,491
State and municipal bonds and notes	5,404	—	(17)	5,387
United States government agency notes	2,000	—	(7)	1,993
Total short-term investments	18,000	—	(129)	17,871
Total cash, cash equivalents, short-term and long-term investments	$51,436	$ —	$ (129)	$ 51,307

At December 31, 2006, gross unrealized losses on investments were all in loss positions for less than 12 months.

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Market values were determined for each individual security in the investment portfolio. Any declines in values were primarily related to changes in interest rates and are considered to be temporary in nature.

4. Property and Equipment

Property and equipment consisted of the following (in thousands):

	December 31,	
	2006	2005
Computer equipment	$ 17,393	$ 15,652
Furniture and fixtures	1,126	1,126
Software	3,761	3,334
Leasehold improvements	2,718	2,718
Total	24,998	22,830
Less accumulated depreciation and amortization	(20,410)	(17,327)
Property and equipment, net	$ 4,588	$ 5,503

Depreciation and amortization expense was $3.1 million, $3.6 million, and $4.5 million for 2006, 2005, and 2004, respectively.

5. Goodwill and Intangible Assets

The Company's intangible assets consist primarily of purchased technology and have estimated useful lives of two to seven years.

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

	December 31,	
	2006	2005
Goodwill	$14,422	$14,422
Intangible assets		
Purchased technology	$10,179	$10,179
Less accumulated amortization	(7,743)	(6,365)
Net purchased technology	2,436	3,814
Trade names	1,743	1,743
Less accumulated amortization	(912)	(516)
Net trade names	831	1,227
Other intangibles	2,170	2,170
Less accumulated amortization	(2,073)	(1,692)
Net other intangibles	97	478
Intangible assets, net	$ 3,364	$ 5,519

During the third quarter of 2005, the Company revised its estimate of the remaining useful life of one of the intangibles assets, which resulted in an accelerated amortization of $0.2 million.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Intangible asset amortization expense was $2.2 million, $2.5 million, and $1.9 million for 2006, 2005, and 2004, respectively and was recorded primarily in cost of revenues.

Estimated future intangible amortization expense, net of intangible assets of $539 thousand classified as assets held for sale related to the Net Nanny disposition (see Note 2) is as follows (in thousands):

Year	Estimated Remaining Amortization of Intangibles
2007	1,503
2008	1,091
2009	231
Total	$ 2,825

6. Other Accrued Liabilities

Accrued expenses and other current liabilities consisted of the following (in thousands):

	December 31,	
	2006	2005
Accrued compensation and related expenses	$1,620	$1,487
Accrued distribution and partner costs	2,631	1,936
Accrued professional service fees	497	723
Customer refunds	93	47
Accrued equipment purchases	336	343
City business and personal property taxes payable	136	78
Other	311	216
Total	$5,624	$4,830

7. Notes Payable

Future principal and interest payments under notes payable at December 31, 2006 are as follows (in thousands):

Year	Principal Payments	Interest Payments
2007	57	14
2008	63	9
2009	63	3
Total	$ 183	$ 26

In January 2000, the Company issued an unsecured promissory note in the principal amount of $472 thousand to its landlord to finance tenant improvements. The note bears interest at 9% per annum and is payable in equal monthly installments over a term of 10 years. As of December 31, 2006, the balance of this note was $183 thousand.

LOOKSMART, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

8. Income Taxes

The Company was in a net loss position in 2006, 2005, and 2004. The income tax provision for 2006, 2005, and 2004 relates to minimum state tax, federal alternative minimum tax ("AMT") and revisions of prior years' estimated taxes.

The primary components of the net deferred tax asset are as follows (in thousands):

	December 31,	
	2006	2005
Deferred tax asset:		
Net operating losses	$ 69,870	$ 66,229
Depreciation and amortization	6,159	6,798
Accruals and reserves	2,469	3,019
Compensation	498	498
SFAS 123R expense	925	—
Total deferred tax assets	79,921	76,544
Less: valuation allowance	(79,921)	(76,544)
Deferred tax asset, net	$ —	$ —

As of December 31, 2006, the Company has net operating loss ("NOL") carryforwards of approximately $188.0 million and $100.0 million for federal and state purposes, respectively. The Company also has an AMT credit carryforward of approximately $100 thousand. The NOL carryforwards will expire at various dates beginning in 2006 through 2025, if not utilized. The AMT tax credit carryforward may be carried forward indefinitely. Included in the NOL carryforwards are losses resulting from the exercise of stock options totaling $47.0 million and $24.0 million for federal and state purposes, respectively.

A valuation allowance existed as of December 31, 2006 and 2005 due to the uncertainty of net operating loss utilization based on the Company's history of losses. The valuation allowance increased by $3.4 million, $10.3 million, and $2.4 million for the years ended December 31, 2006, 2005, and 2004, respectively.

The difference between the Company's effective income tax rate and the federal statutory rate is reconciled below:

	Year Ended December 31,		
	2006	2005	2004
Federal statutory rate	34.0%	34.0%	34.0%
Permanent differences	(2.8)	(2.8)	(6.4)
State taxes, including permanent differences	—	—	0.1
Change in valuation allowance	(17.0)	(31.3)	(21.6)
Expiration of net operating loss carryforwards	(14.0)	—	—
Other	(0.2)	0.1	(7.1)
Total	— %	— %	(1.0)%

9. Commitments and Contingencies

Operating Leases

The Company leases office space under a non-terminable operating lease that expires in 2009.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Future minimum payments under this operating lease and minimum sublease rental income, at December 31, 2006 are as follows (in thousands):

	Operating Lease	Minimum Sublease Rental Income
Year		
2007	4,684	892
2008	4,751	931
2009	4,412	846
Total	$13,847	$ 2,669

Rent expense under all operating leases for 2006, 2005, and 2004, amounted to $2.4 million, $3.9 million, and $4.0 million (net of sublease income of $0.8 million, $0.6 million, and $0.6 million), respectively. Rent expense is net of lease restructuring adjustments related to certain leased facilities. See Note 13 (Restructuring Charges). Under the terms of the office lease agreement for the Company's headquarters, the Company has two consecutive options to extend the term, each for a five-year period.

The Company has outstanding standby letters of credit ("SBLC") related to security of building leases and security for payroll processing services of $1.1 million at December 31, 2006. The SBLC contains two financial covenants. As of December 31, 2006, the Company was in compliance with all required covenants.

Guarantees and Indemnities

During its normal course of business, the Company has made certain guarantees, indemnities and commitments under which it may be required to make payments in relation to certain transactions. These indemnities include intellectual property and other indemnities to the Company's customers and distribution network partners in connection with the sales of its products, and indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease. Further, the Company has agreements whereby it indemnifies its officers and directors for certain events or occurrences while the officer or director is, or was, serving, at the Company's request, in such capacity, to the maximum extent permitted under the laws of the State of Delaware. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. However, the Company maintains directors and officers insurance coverage that may contribute, up to certain limits, a portion of any future amounts paid, for indemnification of directors and officers. The Company believes the estimated fair value of these indemnification agreements in excess of applicable insurance coverage is minimal. Historically, the Company has not incurred any losses or recorded any liabilities related to performance under these types of indemnities.

Legal Proceedings

The Company is involved, from time to time, in various legal proceedings arising from the normal course of business activities. Although the results of litigation and claims cannot be predicted with certainty, the Company does not expect resolution of these matters to have a material adverse impact on its consolidated results of operations, cash flows or financial position. However, an unfavorable resolution of a matter could, depending on its amount and timing, materially affect its future results of operations, cash flows or financial position in a future period. Regardless of the outcome, litigation can have an adverse impact on the Company because of defense costs, diversion of management resources and other factors.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Cisneros v. Yahoo!, Inc

On August 3, 2004, Mario Cisneros and Michael Voight filed a private attorney general lawsuit on behalf of a proposed class in Superior Court in San Francisco County, California. The complaint names thirteen search engines or web publishers as defendants, including the Company, and alleges unfair business practices, unlawful business practices, and other causes of action in connection with the display of advertisements from Internet gambling companies. The complaint seeks restitution, unspecified compensatory damages, declaratory and injunctive relief, and attorneys' fees. Plaintiffs also filed a motion for preliminary injunction on August 3, 2004.

On January 3, 2005, the Company filed a demurrer to the complaint, which was overruled on January 27, 2005. On January 3, 2005, the Company also filed a motion to strike certain allegations regarding claims for restitution, which was denied in part and granted in part on May 9, 2005. The Company filed an answer to the complaint on February 28, 2005, consisting of a general denial of all allegations. On October 11, 2005, the court conducted a trial on two of the Company's affirmative defenses. The court held that California public policy bars the plaintiffs from receiving a portion of their requested damages.

On December 2, 2005, plaintiffs filed a renewed motion for a preliminary injunction. Defendants responded on or around February 27, 2006. The court has allowed certain discovery to proceed with respect to plaintiffs' renewed motion. On or about May 23, 2006, plaintiffs were granted leave to amend their complaint to name additional plaintiffs. On or about September 8, 2006, plaintiffs served an amended complaint naming additional plaintiffs. The Company has since filed a general denial to the amended complaint. A Case Management Conference was held on January 3, 2007. At the Conference, the Court stayed plaintiffs' pending discovery requests and ordered additional briefing on two legal issues. A hearing on the issues is scheduled for April 13, 2007.

The nature of litigation is inherently uncertain and therefore the Company cannot predict the outcome of these proceedings or estimate the possible effects on our financial position and results of operations.

Lane's Gifts and Collectibles, L.L.C., v. Yahoo! Inc

On March 14, 2005 the Company was served with the Second Amended Complaint in a class action lawsuit in the Circuit Court of Miller County, Arkansas. The complaint names eleven search engines and web publishers as defendants, including the Company, and alleges breach of contract, restitution/unjust enrichment/money had and received, and civil conspiracy claims in connection with contracts allegedly entered into with plaintiffs for Internet pay-per-click advertising. The named plaintiffs on the Second Amended Complaint are Lane's Gifts and Collectibles, L.L.C., U.S. Citizens for Fair Credit Card Terms, Inc., Savings 4 Merchants, Inc., and Max Caulfield d/b/a Caulfield Investigations.

On March 30, 2005 the case was removed to United States District Court for the Western District of Arkansas. On April 4, 2005 plaintiffs U.S. Citizens for Fair Credit Card Terms, Inc. and Savings 4 Merchants, Inc. filed a motion of voluntary dismissal without prejudice. The motion was granted on April 7, 2005. Plaintiffs Lane's Gifts and Collectibles, L.L.C. and Max Caulfield d/b/a Caulfield Investigations filed a motion to remand the case to state court on April 13, 2005, which was granted in June 2005. In July 2005, defendants, including the Company, petitioned the Eighth Circuit Court of Appeals for an appeal of the remand order, and moved to stay the proceedings while the appeal is pending. The petition was denied on September 8, 2005 and the case was remanded to the Circuit Court of Miller County, Arkansas. The Company was served with discovery requests on October 7, 2005. The Company has filed and/or joined motions to dismiss on the basis of failure to state a claim upon which relief can be granted, lack of personal jurisdiction, and improper venue. Pursuant to the court's initial scheduling order, plaintiffs had until January 27, 2006 to respond to the motions to dismiss for lack of personal

LOOKSMART, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

jurisdiction and improper venue; and until June 9, 2006 to respond to the motion to dismiss on the basis of failure to state a claim upon which relief can be granted. However the court entered an order staying all proceedings for a period of 60 days on January 9, 2006. On March 8, 2006, the Court entered an order extending the stay until March 31, 2006. On April 1, 2006, the Court further extended the stay until April 20, 2006. On April 20, 2006 the Court preliminarily approved a class settlement among plaintiffs, defendant Google, Inc., and certain defendants who display Google advertisements on their networks (the "Google Settlement"). The Google Settlement purports to release Google of all claims and also purports to release certain defendants, including us, for any claims associated with the display of Google advertisements on their networks. On July 24 and 25, 2006, the Court had a final settlement hearing on the Google Settlement, and on July 26, 2006 the Court approved the settlement. On April 21, 2006, the Court ordered the remaining defendants, including us, to mediation and further stayed the proceedings to June 21, 2006. The Court further extended the Stay as to us until August 16, 2006. The parties thereafter stipulated that the stay would remain in effect while the parties continue to comply with the Court's order regarding mediation. On January 10, 2007, the Court further extended the stay until May 1, 2007.

The nature of litigation is inherently uncertain and therefore the Company cannot predict the outcome of these proceedings or estimate the possible effects on our financial position and results of operations.

JV Funding

Pursuant to a settlement agreement with British Telecommunications ("BT") for the dissolution of the joint venture, LookSmart and BT are jointly liable for the costs incurred to shut down operations of the joint venture. The Company recognized a share of joint venture income of $165 thousand in the fourth quarter of 2006 due to the settlement of certain prior claims. The Company does not expect to incur significant additional expenses to shut down the joint venture. The Company expects to record income or loss from its share of the joint venture as it moves to finalize its wind-down activities in 2007.

10. Stockholders' Equity

In October 2005, the Company effected a one-for-five reverse stock split of the Company's common stock.

Convertible Preferred Stock

The Company's charter authorizes the board of directors to issue up to 5,000,000 shares of $0.001 par value preferred stock. At December 31, 2006, no shares of preferred stock were issued or outstanding.

Chess Depositary Interests

On February 25, 2000, the Company completed the listing of approximately 90 million Chess Depositary Interests, or CDIs, on the Australian Stock Exchange, or ASX, under the trading symbol "LOK". The Company completed the listing in order to enable investors that prefer to invest in ASX-listed companies to acquire an equity interest in LookSmart. All of the shares of LookSmart common stock exchangeable for the CDIs were offered by selling stockholders. The Company did not issue any new securities in connection with, or receive any proceeds from, the listing of the CDIs. In November 2004, the Company completed a 20 for 1 consolidation of the CDIs listed on the Australian Stock Exchange. A total of 282 million CDIs were exchanged for 14 million CDI's as a result of the consolidation. At December 31, 2006, each CDI was freely exchangeable with shares of LookSmart common stock at the option of the holder at a ratio of 1:1. The number of CDIs outstanding as of December 31, 2006 was 1,457,696.

LOOKSMART, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Stock Option Plans

In December 1997, the Company approved the 1998 Stock Option Plan (the "Plan"). In October 2000, the Company acquired Zeal and assumed all the stock options outstanding under the 1999 Zeal Media, Inc. Stock Plan (the "Zeal Plan"). In April 2002, the Company acquired WiseNut, Inc. and assumed all the stock options outstanding under the WiseNut, Inc. 1999 Stock Incentive Plan (the "WiseNut Plan"). The Company has reserved 4,624,158 and 4,157,611 shares of common stock for issuance under its stock option plans at December 31, 2006 and December 31, 2005, respectively. Outstanding stock options generally become exercisable over a three or four year period from the grant date and have a term of ten years. Under the Plan, the Company may grant incentive stock options, nonqualified stock options and stock purchase rights to employees, directors and consultants.

As of December 31, 2006, 2,741,036 options were outstanding and 1,883,122 shares remained available for grant under the Company's plans.

Employee Stock Purchase Plan

In July 1999, the stockholders approved the 1999 Employee Stock Purchase Plan (the "ESPP"). At December 31, 2006, a total of 480,000 shares of common stock were reserved for issuance under the ESPP. As of December 31, 2006, 424,701 shares have been issued under the ESPP and 55,299 shares remain available for issuance.

Share-Based Compensation

For 2005 and 2004, the Company accounted for employee stock options under APB 25 and related interpretations. Under APB 25, the Company recorded deferred compensation of $0 and $0.1 million, respectively, for stock option grants related to the options assumed in acquisitions. The Company recorded stock compensation expense as follows (in thousands):

	Year Ended December 31,	
	2005	2004
Amortization of deferred stock compensation	$ 38	$ 77
Stock compensation related to modified options	—	67
Stock compensation related to variable options	(38)	10
Total stock-based compensation	$ —	$ 154

LOOKSMART, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

For the years ended December 31, 2005 and 2004, the following table illustrates the effect on net loss and net loss per share as if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* , as amended by Statement of Financial Accounting Standards No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure* , to share-based employee compensation (in thousands, except per share data):

	Year Ended December 31,	
	2005	2004
Net loss as reported	$ (17,797)	$ (9,638)
Add: Stock-based employee compensation (expense) benefit included in reported net loss, net of related tax effects	—	154
Deduct: Total share-based employee compensation expense determined under fair value method for all awards, net of tax	(2,185)	(4,718)
Pro forma net loss	$ (19,982)	$ (14,202)
Net loss per share (basic and diluted):		
As reported	$ (0.78)	$ (0.43)
Pro forma	$ (0.88)	$ (0.64)

For the years ended December 31, 2005 and 2004, the Company used the Black-Scholes option-pricing model to estimate the pro forma fair value of option grants and ESPP awards using the following weighted average assumptions:

	Year Ended December 31,	
	2005	2004
Volatility	97%	70%
Risk-free interest rate	4.19%	3.43%
Expected term of stock options (years)	4.5	5.0
Expected term of ESPP awards (years)	0.5	—
Expected dividend yield	—	—

The weighted average fair value for options granted was $3.37 and $9.80 for 2005 and 2004, respectively. The fair value of options granted to independent contractors has been determined using the Black-Scholes model with the same assumptions as options granted to employees, except the expected option life, which was the duration of the consulting agreement.

The effect on net loss and net loss per share from the adoption of SFAS 123R for the year ended December 31, 2006 is as follows (in thousands):

	Year Ended December 31, 2006
Share-based compensation expense by award type:	
Employee stock options	$ 2,371
Employee stock purchase plan	46
Total share-based compensation	$ 2,417
Capitalized software	95
Effect on net loss	$ (2,322)
Effect on basic and diluted net loss per common share:	
Basic and diluted	$ (0.10)

LOOKSMART, LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The adoption of SFAS 123R did not have a material impact on income tax expense or cash flows.

Share-based compensation expense recorded during the year ended December 31, 2006 was included in the Company's Consolidated Statement of Operations as follows (in thousands):

	Year Ended December 31, 2006
Cost of revenues	$ 13
Sales and marketing	266
Product development	607
General and administrative	1,436
Total share-based compensation, net of capitalized software	$ 2,322

For the year ended December 31, 2006, the Company recorded stock based compensation of approximately $2.4 million. Of that amount, approximately $95 thousand was capitalized related to the development of 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").

Valuation Assumptions

As share-based compensation expense recognized in the Consolidated Statement of Operations for the year ended December 31, 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company's pro forma information required under SFAS 123 for periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred.

For the year ended December 31, 2006, the fair value of each option grant was estimated on the grant date using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Year Ended December 31, 2006
Employee stock options:	
Volatility	80.6%
Risk-free interest rate	4.6%
Expected term (years)	3.6
Expected dividend yield	—
Annual forfeiture rate	10.3%
Employee stock purchase plan:	
Volatility	58.0%
Risk-free interest rate	4.90%
Expected term (years)	0.7
Expected dividend yield	—
Annual forfeiture rate	—

Volatility: The volatility factor was based on the Company's historical stock prices over the most recent period commensurate with the estimated expected term of the stock options and ESPP awards.

LOOKSMART, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Risk-Free Interest Rate: The Company bases the risk-free interest rate used in the Black-Scholes valuation method on the implied yield currently available on U.S. Treasury issues with an equivalent remaining term.

Expected Term: The Company's expected term represents the period that the Company's stock-based awards are expected to be outstanding and was determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior as influenced by changes to the terms of its stock-based awards.

Expected Dividend: The Black-Scholes valuation model calls for a single expected dividend yield as an input. The Company has not issued any dividends, and does not expect to issue dividends in the foreseeable future.

Annual Forfeiture Rate: When estimating pre-vesting forfeitures, the Company considers voluntary termination behavior as well as potential future workforce reduction programs.

The weighted average grant-date fair value of options granted in the year ended December 31, 2006 was $2.83.

The aggregate intrinsic value of options exercised for the year ended December 31, 2006 was approximately $35 thousand. The Company issues new shares of common stock upon exercise of stock options. No income tax benefits have been realized from exercised stock options.

Total unrecognized share-based compensation cost was approximately $7.7 million as of December 31, 2006, and the weighted average period over which it is expected to be recognized is 3 years.

Stock option activity under the plans during the periods indicated is as follows (in thousands, except per share data):

	Outstanding Options Number of Shares	Weighted Average Exercise Price Per Share
Balance at December 31, 2003	3,446	$ 10.00
Granted	922	$ 9.85
Exercised	(750)	$ 5.85
Cancelled	(1,653)	$ 11.70
Balance at December 31, 2004	1,965	$ 10.15
Granted	932	$ 3.81
Exercised	(27)	$ 3.45
Cancelled	(1,046)	$ 9.42
Balance at December 31, 2005	1,824	$ 7.31
Granted	1,703	$ 4.39
Exercised	(33)	$ 3.49
Cancelled	(753)	$ 6.24
Balance at December 31, 2006	2,741	$ 5.84

LOOKSMART, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes information about stock options outstanding at December 31, 2006 (in thousands, except per share data):

	Outstanding				Exercisable		
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual life (in years)	Weighted Average Exercise Price	Aggregate Intrinsic Value	Number Exercisable	Weighted Average Exercise Price	Aggregate Intrinsic Value
$ 1.25–$ 4.60	872	8.90	$ 3.47	$ 869	414	$ 3.42	$ 431
$ 4.61–$ 4.61	897	9.18	$ 4.61		282	$ 4.61	
$ 4.69–$10.40	696	7.85	$ 7.40		384	$ 7.72	
$10.55–$85.31	276	6.88	$ 13.40		222	$ 13.63	
$ 1.25–$85.31	2,741	8.52	$ 5.84		1,302	$ 6.69	

Aggregate intrinsic value represents the total pretax intrinsic value, based on the Company's closing stock price on December 31, 2006 ($4.46), which would have been received by option holders had all option holders exercised their options on that date.

As of December 31, 2006 and 2005, there were 1,302,216 and 763,079 options exercisable, respectively.

11. Other Equity

Other equity consists of the following (in thousands):

	December 31,		
	2006	2005	2004
Unearned stock-based compensation	$—	$ —	$ (38)
Unrealized gain (loss) on securities, net	2	(129)	(82)
Translation adjustments	515	515	515
Total other equity	$517	$ 386	$395

12. Net Income (Loss) per Share

In accordance with the requirements of Statement of Financial Accounting Standards No. 128, *Earnings per Share* ("SFAS 128"), a reconciliation of the numerator and denominator of basic and diluted net income (loss) per share is provided as follows (in thousands, except per share amounts):

	Year Ended December 31,		
	2006	2005	2004
Numerator—Basic and diluted:			
Net loss from continuing operations	$(13,633)	$(17,907)	$(11,043)
Denominator			
Weighted average common shares outstanding:			
Shares used to compute basic net income (loss) per share	22,822	22,765	22,266
Net loss from continuing operations per share:			
Basic	$ (0.60)	$ (0.79)	$ (0.49)
Diluted	$ (0.60)	$ (0.79)	$ (0.49)

LOOKSMART, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Options and warrants to purchase common stock are not included in the diluted loss per share calculations if their effect is antidilutive. The antidilutive securities which include potential common stock relating to stock options for the years ended December 31, 2006, 2005 and 2004 were 26,371, 68,181 and 310,173, respectively.

For the years ended December 31, 2006, 2005, and 2004, 2,104,288, 1,274,104 and 958,792, respectively, of potential common stock related to outstanding stock options and warrants have been excluded from the calculation of diluted net loss per share as their respective exercise prices were more than the average market value for the respective periods.

13. Restructuring Charges

Employee Severance Costs

In November 2003, the Company implemented a restructuring plan to eliminate 77 positions in the United States due to the loss of the ongoing arrangement with Microsoft. The severance charges associated with the reduction in force were $0.8 million in 2003.

In the first and the second quarters of 2004, the Company eliminated an additional 43 positions in the United States, which included a reduction in its sales force of 11 positions, a reduction in its general and administrative departments of five positions, a reduction in its product development department of 14 positions and a reduction in its editorial team of 13 positions. This reduction resulted in $1.0 million restructuring charges recognized in 2004, which are included in operating expenses on the Consolidated Statements of Operations. All severance costs were paid by December 31, 2004. No restructuring charges related to employee severance costs were incurred in 2005 and 2006.

Lease Restructuring Costs

In connection with the restructuring activities noted above, the Company closed certain leased facilities and incurred lease restructuring costs related to closing these facilities of $3.2 million in the fourth quarter of 2003 and costs related to closing of further redundant leased facilities of $3.2 million in the first quarter of 2004. These costs are classified as restructuring charges on the Consolidated Statements of Operations, and are included in operating expenses. The lease restructuring liability is amortized using the interest method through the life of the lease, which terminates in 2009.

As of December 31, 2004 the restructuring liability was $5.7 million. Of this amount, $1.3 million was included in current portion of long-term liabilities and $4.4 million was included in other long-term liabilities on the Consolidated Balance Sheets.

During the first half of 2005, the Company had limited success in subleasing its unused space since the establishment of the restructuring liability, and modified its original estimates. This resulted in additional restructuring charges of $1.9 million in the second quarter of 2005, reflecting the reduced probability of subleasing the available space. However in October 2005, the Company and one of its sublessees executed a letter of intent to sublease an additional portion of the unused space, which resulted in a reduction of the restructuring liability by $0.3 million, which was recorded in the third quarter of 2005. Further, in February 2006, the Company and another sublessee executed a letter of intent to sublease an additional portion of the unused space, which resulted in a further reduction of the restructuring liability by $0.6 million, which was recorded in the fourth quarter of 2005.

LOOKSMART, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

As of December 31, 2005, the lease restructuring liability was $5.4 million. Of this amount, $1.5 million was included in current portion of long-term liabilities and $3.9 million was included in other long-term liabilities on the Consolidated Balance Sheets.

In 2006, the Company recorded a restructuring benefit of approximately $290 thousand related to the extension of sublease arrangements for portions of our unused space.

As of December 31, 2006, the lease restructuring liability was $3.8 million. Of this amount, $1.3 million was included in current portion of long-term liabilities and $2.5 million was included in other long-term liabilities on the Consolidated Balance Sheets.

The following table sets forth restructuring activity during the years ended December 31, 2006, 2005 and 2004 (in thousands):

	Employee Severance Costs	Lease Restructuring Costs	Total
Balance at December 31, 2003	977	3,326	4,303
Adjustments	76	—	76
Additional restructuring costs	1,061	3,191	4,252
Reclassification of deferred rent	—	185	185
Amortization of lease restructuring costs	—	(1,040)	(1,040)
Cash payments	(2,114)	—	(2,114)
Balance at December 31, 2004	—	5,662	5,662
Additional restructuring costs	—	1,024	1,024
Amortization of lease restructuring costs	—	(1,288)	(1,288)
Balance at December 31, 2005	$ —	$ 5,398	$ 5,398
Additional restructuring costs (benefits)	—	(290)	(290)
Amortization of lease restructuring costs	—	(1,250)	(1,250)
Balance at December 31, 2006	$ —	$ 3,858	$ 3,858

14. Related Party Transactions

The Company has a related-party investment in the BT LookSmart joint venture, which both the Company and British Telecommunications agreed to dissolve in December 2002. The remaining investment balance is $0.4 million at December 31, 2006 and $0.3 million at December 31, 2005, which reflects the current estimated value upon final liquidation of the joint venture. The Company recognized income (loss) from its share of the joint venture relating to the wind-down activities of the entity.

15. Employee Benefit Plan

The Company has a 401(k) retirement plan covering all eligible employees. Employees may contribute amounts ranging from 1% to 50% of annual salary, up to the maximum limits established by the Internal Revenue Service. The Company matches these contributions in cash up to 5% of annual salary up to a total match of $3 thousand per year. Employees vest 100% immediately in their own contributions and 50% per year in Company matching contributions. Any employer contributions that are not vested are forfeited if an employee leaves the Company, but are reinstated if the employee returns to service within five years. The Company made matching contributions totaling $0.2 million, $0.3 million, and $0.6 million for 2006, 2005, and 2004, respectively.

LOOKSMART, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

16. Discontinued Operations

In January 2004, the Company agreed to sell certain of the assets of its Australian subsidiary and related intellectual property rights to a subsidiary of Telstra Corporation Limited for approximately $0.7 million. In March 2004, the Company agreed to sell certain of the assets of its Japanese subsidiary and related intellectual property rights to Value Commerce for approximately $0.7 million. In March 2004, the Company agreed to sell certain assets of its United Kingdom subsidiary and related intellectual property rights to Crystal for approximately $0.1 million. The gain on disposal of the operations in 2004 of $1.0 million is shown net of $0.4 million for transitional expenses.

In 2005, the Company recognized an additional gain of $0.1 million related to additional disposal activities and an increased tax benefit.

In August 2006, the Company liquidated its German subsidiary and incurred a loss of $31 thousand on the liquidation of this subsidiary.

Revenue and pretax net income (loss) from the discontinued international operations (excluding gain on disposal), previously included in the online advertising segment of the business, reported in discontinued operations were as follows (in thousands):

	Year Ended December 31,		
	2006	2005	2004
Revenue	$—	$—	$6,036
Pretax net income (loss) (excluding gain on disposal)	—	—	407
Tax impact	—	67	(25)
Gain (loss) on disposal	(33)	43	1,023
Net gain (loss) from discontinued operations	$(33)	$110	$1,405

As the Company finalizes the liquidation process of its Australian subsidiary, it expects to record additional income related to the reversal of the cumulative translation adjustment of approximately $0.5 million. The Company also expects to record additional amounts relating to the finalization of the liquidation of various foreign operations in 2007. The Company expects to finalize the dissolution of these entities during 2007.

Net assets related to the discontinued operations are included in current assets and were approximately $163 thousand and $199 thousand as of December 31, 2006 and 2005, respectively.

17. Subsequent Events

In December 2006, the Company entered into a letter of intent to sell the assets and liabilities of the Net Nanny product. These assets met the definition of "assets held for sale" in accordance with the provision of SFAS 144. See Note 2 for further disclosure. The Company will record a loss on the closing of the transaction on January 22, 2007 of approximately $248 thousand. The sale proceeds are comprised of contingent purchase consideration of up to $3.5 million, which may be realized at future dates based on the amount of revenue of the buyer; however, the letter of intent does not specify any minimum consideration to be received by the Company.

LOOKSMART, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

18. Quarterly Results of Operations (Unaudited)

The following tables set forth certain unaudited statements of operations data for the eight quarters ended December 31, 2006. This data has been derived from the unaudited interim financial statements prepared on the same basis as the audited Consolidated Financial Statements contained in this Annual Report and, in the opinion of management, include all adjustments consisting only of normal recurring adjustments that are considered necessary for a fair statement of such information when read in conjunction with the Consolidated Financial Statements and Notes thereto appearing elsewhere in this Annual Report.

The table below presents quarterly data for the years ended December 31, 2006 and 2005 (in thousands, except per share data):

	Fourth Quarter*	Third Quarter*	Second Quarter*	First Quarter*
2006				
Revenues	$14,850	$12,150	$11,130	$10,543
Gross profit	$ 6,268	$ 4,582	$ 3,879	$ 3,455
Loss from operations	$ (1,561)	$ (4,330)	$ (4,881)	$ (4,997)
Loss from continuing operations	$ (886)	$ (3,829)	$ (4,399)	$ (4,519)
Gain (loss) from discontinued operations, net of tax	$ (2)	$ (31)	$ —	$ —
Net loss	$ (888)	$ (3,860)	$ (4,399)	$ (4,519)
Basic net loss per share	$ (0.04)	$ (0.17)	$ (0.19)	$ (0.20)
Diluted net loss per share	$ (0.04)	$ (0.17)	$ (0.19)	$ (0.20)
2005				
Revenues	$ 9,968	$ 9,165	$10,225	$12,001
Gross profit	$ 3,362	$ 3,062	$ 3,605	$ 3,709
Loss from operations	$ (4,252)	$ (4,944)	$ (5,859)	$ (4,898)
Loss from continuing operations	$ (3,772)	$ (4,269)	$ (5,444)	$ (4,422)
Gain from discontinued operations, net of tax	$ —	$ —	$ 28	$ 82
Net income (loss)	$ (3,772)	$ (4,269)	$ (5,416)	$ (4,340)
Basic net income (loss) per share	$ (0.16)	$ (0.19)	$ (0.24)	$ (0.19)
Diluted net income (loss) per share	$ (0.16)	$ (0.19)	$ (0.24)	$ (0.19)

* Adjusted for the effects of a one-for-five reverse split of the Company's common stock effective October 26, 2005.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, the Company conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this Annual Report.

Changes in Internal Control over Financial Reporting

During the most recent fiscal quarter covered by this report, there were no changes in the Company's internal control over financial reporting that have materially affected, or could be reasonably likely to materially affect, the registrant's internal control over financial reporting. During 2006, we remedied significant deficiencies identified during the general evaluation of internal controls and the 2005 close process. During the course of the general evaluation of internal controls and the 2006 close process, there were six significant deficiencies identified in the design and operation of our internal controls. We have addressed and are now in the process of remediating these deficiencies.

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and concluded that we maintained effective internal control over financial reporting as of December 31, 2006.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Our assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting

Please see the Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting under Item 8 of this Form 10-K, which report is incorporated herein by reference.

ITEM 9B. OTHER INFORMATION

On February 8, 2007, the Company renewed its AdCenter for Publishers licensing agreement with IAC Search & Media ("IAC") through December 31, 2009. Under the Agreement, IAC uses the Company's AdCenter for Publishers product as a component of its Ask.com sponsored listings advertising program that allows advertisers to purchase, manage and optimize pay per click advertising campaigns on the Ask.com network. The Agreement allows IAC to continue to license the Company's AdCenter for Publishers product through the end of 2009.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by this item is incorporated herein by reference to the Company's definitive proxy statement relating to the 2007 annual meeting of stockholders (the "2007 Proxy Statement"), which the Company intends to file with the Securities and Exchange Commission within 120 days of the end of the Company's fiscal year ended December 31, 2006.

ITEM 11. EXECUTIVE COMPENSATION

The information required under this item may be found in the 2007 Proxy Statement and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required under this item may be found in the 2007 Proxy Statement and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required under this item may be found in the 2007 Proxy Statement and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required under this item may be found in the 2007 Proxy Statement and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) *Financial Statements* . The following are filed as part of Item 8 of this Annual Report on Form 10-K:

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(2) *Financial Schedules.* Schedule II "Valuation and Qualifying Accounts" appears below. All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission have been omitted because the information required to be set forth therein is not applicable or is shown in our Consolidated Financial Statements or Notes thereto. The financial statement schedule below should be read in conjunction with the Consolidated Financial Statements in Item 8 of this Annual Report on Form 10-K.

LOOKSMART, LTD. AND SUBSIDIARIES

SCHEDULE II
VALUATION AND QUALIFYING ACCOUNTS
(In thousands)

Description	Balance at Beginning of Period	Charged to Costs and Expenses	Deductions	Balance at End of Period
Year ended December 31, 2004:				
Allowance for doubtful accounts	1,927	—	1,430	497
Allowance for returns	577	—	(388)	965
Deferred tax valuation allowance	63,841	2,432	—	66,273
Total	66,345	2,432	1,042	67,735
Year ended December 31, 2005:				
Allowance for doubtful accounts	497	100	357	240
Allowance for returns	965	(18)	933	14
Deferred tax valuation allowance	66,273	10,271	—	76,544
Total	67,735	10,353	1,290	76,798
Year ended December 31, 2006				
Allowance for doubtful accounts	240	296	213	323
Allowance for returns	14	106	106	14
Deferred tax valuation allowance	76,544	3,377	—	79,921
Total	$76,798	$ 3,779	$ 319	$80,258

(b) *Exhibits.* The exhibits listed on the Exhibit Index (following the Signatures section of this report) are included, or incorporated by reference, in this Annual Report.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized in San Francisco, California, on March 16, 2007:

LOOKSMART, LTD.

By: /s/ JOHN SIMONELLI
John Simonelli, Chief Financial Officer
(Principal Financial and Accounting Officer)

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints David B. Hills and John Simonelli, jointly and severally, as his or her attorneys-in-fact, each with the full power of substitution, for him or her, in any and all capacities, to sign any amendment to this Annual Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting to said attorneys-in-fact, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact or any of them, or their or his or her substitute or substitutes, may lawfully do or cause to be done by virtue hereof. Pursuant to the requirements of the Securities Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

Signature	Title	Date
/s/ DAVID B. HILLS David B. Hills	Chief Executive Officer (Principal Executive Officer)	March 16, 2007
/s/ JOHN SIMONELLI John Simonelli	Chief Financial Officer (Principal Financial and Accounting Officer)	March 16, 2007
/s/ EDWARD WEST Edward West	Chair of the Board	March 16, 2007
/s/ TERESA DIAL Teresa Dial	Director	March 16, 2007
/s/ ANTHONY CASTAGNA Anthony Castagna	Director	March 16, 2007
/s/ MARK SANDERS Mark Sanders	Director	March 16, 2007
/s/ TIMOTHY J. WRIGHT Timothy J. Wright	Director	March 16, 2007

EXHIBIT INDEX

Exhibit Number	Description of Document
3.1	Restated Certificate of Incorporation (Filed with the Company's Quarterly Report on Form 10-Q filed with the SEC on November 14, 2005).
3.2	Bylaws (Filed with the Company's Quarterly Report on Form 10-Q filed with the SEC on August 14, 2000).
4.1	Form of Specimen Stock Certificate (Filed with the Company's Quarterly Report on Form 10-Q filed with the SEC on November 14, 2005).
4.2	Forms of Stock Option Agreement used by the Registrant in connection with grants of stock options to employees, directors and other service providers in connection with the Amended and Restated 1998 Stock Plan (Filed with the Company's Current Report on Form 8-K filed with the SEC on October 22, 2004).
4.3	Form of cover sheet for use with Stock Option Agreement for grants of stock options to executives in connection with the Company's Executive Team Incentive Plan, Plan Year 2006 (Filed with the Company's Quarterly Report on Form 10-Q file with the SEC on May 10, 2006).
4.4	Form of cover sheet for use with stock option agreement for grants of stock options to executives in connection with the Company's Executive Team Incentive Plan, Plan Year 2007 (Filed with the Company's Current Report on Form 8-K filed with the SEC on March 2, 2007).
10.1	Form of Indemnification Agreement entered into between the Registrant and each of its directors and officers (Filed with the Company's Registration Statement on Form S-1 (File No. 333-80581) filed with the SEC on June 14, 1999).
10.2	Amended and Restated 1998 Stock Plan (Filed with the Company's Registration Statement on Form S-1 (File No. 333-80581) filed with the SEC on June 14, 1999).
10.3	1999 Employee Stock Purchase Plan as amended (Filed with the Company's Registration Statement on Form S-8 (File No. 333-129987) filed with the SEC on November 29, 2005).
10.4	LookSmart, Ltd. Executive Team Incentive Plan, Plan Year 2006 (Filed with the Company's Quarterly Report on Form 10-Q filed with the SEC on May 10, 2006).
10.5	LookSmart, Ltd. Executive Team Incentive Plan, Plan Year 2007 (Filed with the Company's Current Report on Form 8-K filed with the SEC on March 2, 2007).
10.7	Zeal Media, Inc. 1999 Stock Plan (Filed with the Company's Registration Statement on Form S-8 filed with the SEC on December 7, 2000).
10.8	WiseNut, Inc. 1999 Stock Incentive Plan (Filed with the Company's Registration Statement on Form S-8 filed with the SEC on April 18, 2002).
10.12	Lease Agreement with Rosenberg SOMA Investments III, LLC for property located at 625 Second Street, San Francisco, California, dated May 5, 1999 (Filed with the Company's Registration Statement on Form S-1 (File No. 333-80581) filed with the SEC on June 14, 1999).
10.34+	Co-Location Services Agreement between the Registrant and Savvis Communications Corporation dated February 19, 2004 (Filed with the Company's Quarterly Report on Form 10-Q/A filed with the SEC on November 7, 2003).
10.35+	Second Addendum to AdCenter License, Hosting and Support Agreement between the Registrant and IAC Search & Media dated May 16, 2006 (Filed with the Company's Form 10-Q with the SEC on August 8, 2006).
10.36‡*	Third Addendum to AdCenter License, Hosting and Support Agreement between the Registrant and IAC Search & Media dated January 1, 2007.

Exhibit Number	Description of Document
10.37+	AdCenter License, Hosting and Support Agreement between the Registrant and Ask Jeeves, Inc. dated May 16, 2005 (Filed with the Company's Quarterly Report on Form 10-Q filed with the SEC on May 10, 2006).
10.38+	Addendum to AdCenter License, Hosting and Support Agreement between the Registrant and Ask Jeeves, Inc. dated January 20, 2006 (Filed with the Company's Quarterly Report on Form 10-Q filed with the SEC on May 10, 2006).
10.39+	Paid Listings License Agreement between the Registrant and SearchFeed.com dated April 15, 2006 (Filed with the Company's Quarterly Report on Form 10-Q filed with the SEC on May 10, 2006).
10.40+	License Agreement between the Registrant and SearchFeed.com dated November 23, 2003, as Amended on March 29, 2004 and March 21, 2005 (Filed with the Company's Annual Report on Form 10-K filed with the SEC on March 15, 2006).
10.41	Separation Agreement and General Release between the Registrant and its former General Counsel dated August 20, 2005 (Filed with the Company's Annual Report on Form 10-K filed with the SEC on March 15, 2006).
10.42	Discretionary cash bonus awarded to the Company's CFO (Described in the Company's Current Report on Form 8-K filed with the SEC on February 21, 2007).
10.56	Employment offer letter between the Registrant and its Senior Vice President, Business Development dated April 18, 2005 (Filed with the Company's Current Report on Form 8-K filed with the SEC on April 25, 2005).
10.57	Employment offer letter between the Registrant and its Senior Vice President and Chief Technology Officer dated April 18, 2005 (Filed with the Company's Current Report on Form 8-K filed with the SEC on April 25, 2005).
10.58	Amendment to employment offer letter between the Registrant and its Chief Executive Officer dated June 21, 2005 (Filed with the Company's Current Report on Form 8-K filed with the SEC on June 21, 2005).
10.59	Employment offer letter between the Registrant and its General Counsel and Senior Vice President dated as of July 11, 2005 (Filed with the Company's Current Report on Form 8-K filed with the SEC on July 14, 2005).
10.60	Employment offer letter between the Registrant and its Vice President, Publisher Products dated as of August 8, 2005 (Filed with the Company's Current Report on Form 8-K filed with the SEC on August 10, 2005).
10.61	Employment offer letter between the Registrant and its Chief Financial Officer dated October 20, 2005 (Filed with the Company's Current Report on Form 8-K filed with the SEC on October 27, 2005).
10.62	Employment offer letter between the Registrant and its Vice President, Marketing dated as of December 4, 2005 (Filed with the Company's Current Report on Form 8-K filed with the SEC on December 23, 2005).
10.63	Promotion letter between the Registrant and its Vice-President, Advertising Sales dated November 15, 2006 (Filed with the Company's Current Report on Form 8-K filed with the SEC on November 21, 2006).
21.1*	List of Subsidiaries
23.1*	Consent of Independent Registered Public Accounting Firm

Exhibit Number	Description of Document
24.1	Power of Attorney (please see the signature page of this report)
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

(*) Filed herewith

(‡) Material in the exhibit marked with a "‡" has been omitted pursuant to a request for confidential treatment filed with the Securities and Exchange Commission. Omitted portions have been filed separately with the Securities and Exchange Commission.

(+) Confidential treatment has been granted with respect to portions of the exhibit. Omitted portions have been filed separately with the Securities and Exchange Commission.

Exhibit 10.36

THIRD ADDENDUM TO
ADCENTER LICENSE, HOSTING AND SUPPORT AGREEMENT

This Third Addendum is entered into by and between IAC Search & Media, a Delaware corporation ("Partner") and LookSmart, Ltd., a Delaware corporation ("LookSmart") and is the third addendum to that certain AdCenter License, Hosting and Support Agreement by and between Partner and LookSmart entered into as of May 16, 2005, as amended by the parties in two addenda effective January 2006 and May 2006, respectively (the "Agreement").

This Third Addendum is effective as of January 1, 2007 (the "Third Addendum Effective Date").

Partner and LookSmart wish to extend the term of their relationship and amend certain terms and conditions of the Agreement. Therefore, for good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, Partner and LookSmart agree as follows:

1. Subscription Payment. Section 3a) is revised to delete the table and the text following it and replace it with the following:

Time Period	LookSmart *** Share of Partner ***
***	***
***	***
***	***

***

***

***

Confidential

*** Material in the exhibit marked with a "***" has been omitted pursuant to a request for confidential treatment filed with the Securities and Exchange Commission. Omitted portions have been filed separately with the Securities and Exchange Commission.

2. Term . The phrase "two years after the Version 1.0 Launch Date" in Section 8a) is deleted and replaced with the following: "December 31, 2009".

3. Termination. Section 8) c) is deleted in its entirety and replaced with the following: "8) c) Termination by Partner . Partner may terminate this Agreement by giving LookSmart not less than ninety (90) days' prior written notice. Notwithstanding Partner's right to terminate under this Section 8c), in the event of such a termination by Partner, Partner shall ***

****

4. Partner will not, directly or indirectly, solicit for employment or for providing services to Partner, nor hire, any LookSmart employee or consultant who works on or is involved with the AdCenter for the shorter of a) one (1) year after the time such employee or consultant ceases working on or involvement with the AdCenter or b) one (1) year after the termination or expiration of the Agreement (as modified). Notwithstanding anything to the contrary herein, Partner shall not be prohibited from hiring persons who respond to general advertisements or who have been terminated by LookSmart. This provision will survive any termination or expiration of the Agreement in accordance with its terms.

5. Partner agrees to issue a joint press release with LookSmart announcing the extension of the relationship represented by the Agreement.

6. Except as expressly modified by this Third Addendum, the Agreement shall remain in full force and effect.

Partner		**LookSmart**	
By:	/s/ Daniel E. Caul	**By:**	/s/ David Bard Hills
Name:	Daniel E. Caul	**Name:**	David Bard Hills
Title:	Senior Vice President & General Counsel	**Title:**	CEO

Confidential
*** Material in the exhibit marked with a "***" has been omitted pursuant to a request for confidential treatment filed with the Securities and Exchange Commission. Omitted portions have been filed separately with the Securities and Exchange Commission.

Exhibit 21.1

List of Subsidiaries

Name of Entity	Jurisdiction
BTLookSmart Pty Ltd.	Australia
LookSmart (Barbados), Inc.	Barbados
LookSmart Holdings (Delaware), Ltd.	Delaware
LookSmart International Pty Ltd.	Australia
LookSmart Netherlands B.V.	Netherlands
LookSmart United Kingdom Ltd.	United Kingdom
WiseNut, Inc.	Delaware

Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statement on Form S-8 (Nos. 33-129987, 333-120295, 333-112070, 333-100228, 333-86436, 333-65986, 333-51408, 333-45634, 333-89653) and Form S-3 No. 333-121327 of LookSmart, Ltd. of our report dated March 15, 2007 relating to the financial statements, financial statement schedule, management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

/s/ PRICEWATERHOUSECOOPERS LLP

San Jose, California
March 15, 2007

CERTIFICATION

I, David B. Hills, certify that:

1. I have reviewed this Annual Report on Form 10-K 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c. 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
   d. 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: March 16, 2007

/s/ DAVID B. HILLS

David B. Hills
Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, John Simonelli, certify that:

1. I have reviewed this Annual Report on Form 10-K 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. 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

   d. 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: March 16, 2007

/ S / J OHN S IMONELLI

John Simonelli
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, David B. Hills, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Annual Report of LookSmart, Ltd. on Form 10-K for the fiscal year ended December 31, 2006 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 Annual Report on Form 10-K fairly presents in all material respects the financial condition and results of operations of LookSmart, Ltd.

Date: March 16, 2007

By: /s/ DAVID B. HILLS

Name: David B. Hills
Title: Chief Executive Officer

I, John Simonelli, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Annual Report of LookSmart, Ltd. on Form 10-K for the fiscal year ended December 31, 2006 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 Annual Report on Form 10-K fairly presents in all material respects the financial condition and results of operations of LookSmart, Ltd.

Date: March 16, 2007

By: /s/ JOHN SIMONELLI

Name: JOHN SIMONELLI
Title: CHIEF FINANCIAL OFFICER