GURUNET CORP
Form 10KSB/A
April 04, 2005

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-KSB/A
AMENDMENT NO. 1

(Mark One)

x ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: December 31, 2004

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____ to _____

Commission File Number 001-32255

GURUNET CORPORATION
(Name of small business issuer in its charter)

Delaware	**98-0202855**
(State of other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

Jerusalem Technology Park
Building 98
Jerusalem 91481 Israel
(Address of principal executive offices)

Issuer's telephone number, including area code: 972-2-649-5123

Securities registered under Section 12(b) of the Exchange Act:

Title of Each Class	Name of exchange on which registered
Common Stock, $0.001 par value	**American Stock Exchange**

Securities registered under Section 12(g) of the Exchange Act: **NONE**

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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. oYes x No

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy of information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. o

State issuer’s Revenues for its most recent fiscal year: $193,283

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked price of such common equity, as of a specified date within the past 60 days:

6,172,173 shares of $0.001 par value common stock at $18.30 per share as of March 1, 2005 for a market value of $112,950,766. Shares of common stock held by any executive officer or director of the issuer and any person who beneficially owns 10% or more of the outstanding common stock have been excluded from this computation because such persons may be deemed to be affiliates. This determination of affiliate status is not a conclusive determination for other purposes.

State the number of shares outstanding of each of the issuer's class of common equity, as of the latest practicable date: 6,940,619 shares of common stock, $0.001 par value (as of March 24, 2005.)

Transitional Small Business Disclosure Format (Check one): Yes o; No x

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Amendment No. 1
Explanatory Note

This amendment is filed to amend Part II Item 5. Market for Common Equity and Related Stockholder Matters and Part II Item 6 Management's Discussion and Analysis in order to more accurately describe the duration of certain lock-up agreements. We have also corrected a minor discrepancy between the amount of proceeds received in our initial public offering disclosed in Item 5 and the amount disclosed in Item 6. In addition, this amendment amends Part II Item 7. Financial Statements to include the date of March 31, 2005 on the signed Report of Independent Registered Public Accounting Firm, which date was inadvertently not included in the original filing. Lastly, we are amending Exhibit 10.13 Agreement Between GuruNet Corporation and Maxim Group LLC dated January 31, 2005 to correct the exercise price of a warrant granted to Maxim, which was inadvertently stated as $11.10, rather than $11.00 in the original filing.

Except for the foregoing, no attempt has been made in this Form 10-KSB/A to modify or update other disclosures as presented in the original Form 10-KSB.

PART II

Item 5. Market for Common Equity and Related Stockholder Matters

Market Information

Our common stock is quoted on the American Stock Exchange under the symbol “GRU”. During the fourth quarter of 2004, the only quarter in 2004 during which our stock had a liquid trading market, the range of high and low per share sale prices, as reported, were $9.43 and $4.40, respectively.

Number of Stockholders

As of March 24, 2005, there were 54 holders of record of our common stock.

Dividend Policy

Historically, we have not paid any dividends to the holders of our common stock and we do not expect to pay any such dividends in the foreseeable future as we expect to retain our future earnings for use in operation and expansion of our business.

Recent Sales of Unregistered Securities

Bridge Notes

On January 30, 2004 and February 17, 2004, we completed our bridge financing, consisting of $5.0 million aggregate principal amount of bridge notes bearing interest at an annual rate of 8%. The aggregate principal amount of the bridge notes includes $200,000 previously advanced to us by investors that was converted into bridge notes in connection with the bridge financing. The bridge notes were due on the earlier of January or February 2005 and the consummation of our initial public offering (“IPO”).

As our IPO was not consummated by (i) July 28, 2004, with respect to the bridge notes issued on January 30, 2004, or (ii) August 15, 2004, with respect to the bridge notes issued on February 17, 2004, we paid each purchaser a cash amount equal to 1% of the aggregate purchase price paid by such purchaser for the first month and 1.5% for each month thereafter on every monthly anniversary thereof until the applicable securities underlying the bridge securities were registered. Interest from the date of issuance through September 30, 2004 was paid in cash on July 1, 2004, August 1, 2004, September 1, 2004, October 1, 2004 and October 13, 2004. In aggregate, we paid at the foregoing dates $287,136 due to interest and $161,124 due to penalties.

Of the aggregate bridge notes outstanding, $3,160,000 principal amount of the bridge notes was repaid in cash from the net proceeds of our IPO and $1,840,000 of the principal amount of the bridge notes was converted on the date of our IPO into shares of common stock at a conversion price of $3.75. The shares issued upon conversion of the bridge notes are locked up until October 13, 2005 or earlier, subject to certain conditions.

Bridge Warrants

In connection with the issuance of the bridge notes, we issued bridge warrants to purchase an aggregate of 1,700,013 shares of common stock exercisable at $7.20 per share. The bridge warrants became exercisable commencing December 31, 2004 and for a period ending on the seventh anniversary of their respective dates of issuance. In the third quarter of 2004, our board of directors authorized the issuance of an aggregate of 750,002 additional warrants to the bridge noteholders. On the date of our IPO, each noteholder received a pro rata share of these additional warrants (approximately 0.44 warrant for each bridge warrant held). These additional warrants contained terms identical to the bridge warrants except for certain expiration provisions. Any shares issued upon their exercise will be locked up until October 13, 2005 or earlier, subject to certain conditions.

In addition, Vertical Ventures, LLC, the lead purchaser in the bridge financing received a warrant to purchase 265,837 shares of common stock at an exercise price of $3.75 per share. This warrant is identical to the bridge warrants except for the exercise price.

In October 2004, the National Association of Securities Dealers, Inc. determined that shares issuable upon conversion of bridge notes and exercise of bridge warrants held by certain bridge noteholders in our bridge financing constituted underwriter’s compensation, because of the relationship between these noteholders and one of our underwriters. As a result, these noteholders were contractually obligated to surrender their 648,534 warrants to us without consideration and have their $1,350,000 aggregate principal amount of bridge notes entirely repaid instead of partially or completely converted into common stock.

Lock-Up Agreements

All of the holders of the bridge notes and bridge warrants have entered into lock-up agreements under which they have agreed not to sell or otherwise dispose of their shares of common stock underlying their bridge notes and bridge warrants without the consent of the underwriters except as follows: sales of the shares underlying the bridge notes and bridge warrants until April 11, 2005 may be made at per share prices of no less than $7.50 and sales of the shares underlying the bridge notes and bridge warrants made following April 11, 2005 through October 13, 2005 may be made at per share prices of no less than $5.00. The underwriters have advised us that in determining whether to give or withhold their consent to any sale within the applicable lock-up period, they will consider the market price and volume of our stock at such time and whether such sale would have an adverse effect on the market for our common stock. The underwriters have advised us that they will examine each request for a consent on a case by case basis using the factors enumerated above, which may result in disparate treatment for stockholders that may be otherwise similarly situated.

Warrant Reload

On February 4, 2005, we entered into an agreement (the “Warrant Reload Agreement”) with certain holders of the bridge warrants, under which the holders of the bridge warrants exercised an aggregate of 1,871,783 bridge warrants at the exercise price of $7.20 per share (with the exception of Vertical Ventures, LLC, which held a warrant exercisable at $3.75 per share) for aggregate proceeds to us of approximately $12,220,000, net of fees and expenses. As an incentive to the holders to exercise their respective bridge warrants, we issued to the holders 1,029,488 new warrants to purchase such number of shares of common stock (equal to 55% of the number of shares of common stock underlying their respective bridge warrants) at an exercise price of $17.27 per share. The warrants are presently exercisable and expire on February 4, 2010.

Pursuant to an amendment to the Warrant Reload Agreement, we are obligated to file a registration statement with the Securities and Exchange Commission on or prior to April 6, 2005. Our failure to either file the registration statement by April 6, 2005 or have the registration statement declared effective by the Securities and Exchange Commission on or prior to May 5, 2005, will result in our obligation to pay to the holders of the warrants, liquidated damages in the amount of equal to 1% of the aggregate exercise price of the exercised warrants, for the first month, and 1.5% for each month thereafter, prorated for any partial month. We incurred fees aggregating $298,214 in connection with the Warrant Reload Agreement.

Maxim Warrant

On January 20, 2005, we entered into an agreement with Maxim Group LLC for the provision of general financial advisory and investment banking services. The agreement, with a minimum term of 6 months, is for a monthly retainer fee of $5,000. In connection with the foregoing agreement, we agreed to grant Maxim Group LLC a warrant to purchase 100,000 shares of our common stock, exercisable for 5 years following the date of the agreement at an exercise price equal to $11.00.

Consultant Stock Options

On March 5, 2005, we entered into an agreement with a consultant for the provision of services in the areas of public relations and strategic planning. The agreement, which terminates on January 5, 2006, is for an aggregate cash amount of $50,000. In connection with the foregoing agreement, we agreed to grant the consultant, David Epstein, stock options to purchase up to 20,000 shares of common stock. 3,333 options vested immediately upon entering into the agreement and the remaining 16,667 options will vest ratably over the ten-month service period.

Common Stock Issuance

On December 13, 2004 we entered into an agreement with Barretto Pacific Corporation for the provision of investor relations consulting services. The agreement, which terminates on December 13, 2005, is for an aggregate cash amount of $100,000. In connection with the foregoing agreement, we issued Barretto Pacific Corporation 7,800 shares of our common stock, bearing a restrictive legend.

Comerica Warrant

A warrant was issued to Comerica Bank — California (“Comerica”) in connection with a Loan and Security Agreement dated as of April 1, 2002. The warrant entitles Comerica to purchase 2,172 shares of our common stock at a price of $34.53 per share. The Comerica Warrant will expire in April 1, 2009, at which time, if the Comerica Warrant has not been exercised, it shall be deemed to have been automatically exercised on the expiration date by “cashless” conversion.

With respect to each of the issuances described in the foregoing section, Recent Sales of Unregistered Securities, the securities were issued to investors in reliance upon the exemption from the registration requirements of the Securities Act, as set forth in Section 4(2) under the Securities Act and Rule 506 of Regulation D promulgated thereunder relative to sales by an issuer not involving any public offering. All purchasers of shares of the Registrant's bridge notes and warrants described above represented to the Registrant in connection with their purchase that they were accredited investors and were acquiring the shares for investment and not distribution, that they could bear the risks of the investment and could hold the securities for an indefinite period of time. The purchasers received written disclosures that the securities had not been registered under the Securities Act and that any resale must be made pursuant to a registration or an available exemption from such registration.

IPO

On October 13, 2004, our registration statement on Form SB-2 (Registration No. 333-115424) was declared effective for our IPO, pursuant to which we registered 2,702,500 shares of common stock to be sold by us, including 352,500 shares subject to the underwriters' over-allotment option. The stock was offered at a price of $5.00 per share. The offering closed on October 18, 2004 after the sale of a total of 2,350,000 shares of our common stock and the over-allotment was exercised, in full, on November 18, 2004. Total proceeds of this offering, including the exercise of the over-allotment option, were approximately $10,800,000, net of underwriters' discounts and commissions and other offering expenses. The underwriters of the offering were Maxim Group LLC and EarlyBirdCapital, Inc. No offering expenses were paid directly or indirectly to directors, officers (or their associates), or to persons owning 10% or more of any of our equity securities, or to our affiliates. The Registration Statement also registered (a) 490,678 shares of common stock that were issued to investors in our 2004 bridge financing, (b) 2,067,318 shares of common stock underlying warrants issued to those investors; and (c) 117,500 shares of common stock underlying the purchase option issued to the underwriters.

Use of Proceeds of Initial Public Offering

Our IPO became effective on October 13, 2004. To date, of the net proceeds from the offering, we applied $3,160,000 towards the repayment of our entire bridge note debt and we estimate that through March 31, 2005, we will have applied $1.2 million towards funding our day to day operations. We intend to use the remaining net proceeds from the offering of approximately $6,440,000 as follows:

		Application of Net Proceeds	Percentage of Net Proceeds
Sales and Marketing	$	1,630,000	25%
Research and Development	$	1,520,000	24%
Product Support	$	1,250,000	19%
Working capital and general corporate purposes (1)	$	2,040,000	32%
Total:	$	**6,440,000**	**100%**

(1) Includes an aggregate of $795,280 for salaries and directors' fees representing all payments to officers and directors anticipated over the next 12 months.

Pending use of the net proceeds from our IPO, we have invested the funds in short-term, interest bearing investments.

Purchases of Equity Securities

We have not purchased any equity securities during the three-month period ending December 31, 2004.

Item 6. Management's Discussion and Analysis

MANAGEMENTS DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND

RESULTS OF OPERATIONS

The following discussion of our financial condition and results of operations should be read in conjunction with the financial statements and the notes to those statements included elsewhere in this filing. This discussion includes forward-looking statements that involve risks and uncertainties. As a result of many factors, such as those set forth under "Risk Factors" and elsewhere in this filing, our actual results may differ materially from those anticipated in these forward-looking statements.

General

We possess technology that helps integrate and retrieve online information from disparate sources and delivers the result in a single consolidated browser view. Our answer engine delivers snapshot, multi-faceted definitions and explanations from attributable reference sources about numerous topics in our database. We seek to differentiate ourselves by providing our users with relevant reference information that enhances results achieved through traditional search engines. Most search engines respond to an Internet user's query with a long list of links to more Websites that in some way relate to the query term. Our answer engine automatically displays relevant, narrative responses to a user's query without requiring the user to review a list of hyperlinks sequentially. Our answer engine also directly displays information in various formats such as charts, graphs and maps.

During 2003, we sold lifetime subscriptions to our answer engine product, GuruNet, generally for $40.00. In December 2003, we decided to alter our pricing model and moved to an annual subscription model, generally, $30.00 per year. In conjunction with selling subscriptions, we also offered free access to dictionary, thesaurus, encyclopedia and other basic reference information through our products. Under our business model during those years, our ability to generate revenues was dependent upon our ability to increase the number of subscribers and increase the number of users who used our basic free product. Usage of our basic free product was our means of encouraging users to upgrade to our subscription product and increase our subscription revenue. Although we earned some advertising revenue during those years from pay-per-click keyword advertising in our subscription and free products, such amounts were not significant. Our business model at the time strongly encouraged subscriptions, and thus we limited the amount of content available in our free product. This approach did not facilitate the amount of traffic we needed to earn significant amounts of revenue from advertising. Further, the aforesaid business model required us to maintain an infrastructure for billing and subscriptions, and we met resistance from customers to pay for "information freely accessible on the Internet". A desire to gain more expansive, ubiquitous growth led to our current implementation, in January 2005, of a free-to-customer product, Answers.com and "1-Click Answers" software, containing practically all the content that we used to sell via subscriptions.

On January 3, 2005 the Company announced the release of Answers.com, a website that had been launched in August 2004 in beta version. The Company also released "1-Click Answers" software - allowing users to click anywhere on the screen for instant facts about a word or phrase. 1-Click Answers allows users working in any application such as e-mail, spreadsheet, word processing, database or other program or application to "alt-click" on a word or phrase within a document and access our online library and display information about that word or phrase in a pop-up window. While Web users enjoy our integrated reference information, our Web-based product does not provide the "alt-click" command, and context analysis that we include in our software. Our revenue model for these products is based solely on advertising revenue. When a user searches sponsored keywords, a link to an advertiser's Website is displayed in a premium position and identified as a sponsored result to the search. In contrast to the GuruNet product, we do not plan

to generate revenues from selling subscriptions.

In conjunction with the release of Answers.com, GuruNet.com began functioning primarily as a corporate site. We are no longer offering new subscriptions to GuruNet or offering downloads of GuruNet software to users who do not have existing subscriptions. Notwithstanding, users who purchased GuruNet subscriptions prior to January 3, 2005, will continue to be fully supported through their subscription periods, and can access GuruNet services through GuruNet software or at GuruNet.com.

Revenues

Revenues in 2004 were $193,283 compared to $28,725 in 2003, an increase of $164,558 or 572.9%. Revenues in 2004 resulted primarily from recognition of deferred subscriptions license revenues, amounting to approximately $154,000, maintenance contracts on our corporate enterprise software of approximately $23,000, and advertising revenues of approximately $17,000. In contrast, revenues during 2003 resulted primarily from maintenance contracts on the corporate enterprise systems that we sold in 2002. Subscriptions sold in January 2003 through November 2003 had no impact on 2003 revenues because at that time we sold lifetime subscriptions. Since the obligation to continue serving content had no defined termination date and we could not estimate the time period over which the service would be provided, we did not recognize revenue from those sales. Beginning December 2003, we began offering GuruNet subscriptions to the public on an annual subscription basis, rather than a lifetime fee basis. Revenues from such subscriptions are recognized over the life of the related subscription. Further, during the second quarter of 2004, we began offering selected users who purchased lifetime licenses the opportunity to exchange their lifetime license for an initial free defined-term license to a newer enhanced version of GuruNet. The cash received from previous sales of lifetime subscriptions is being recognized over the new defined-term subscription period for users who agreed to this offer. With the onset of Answers.com, in January 2005, we have ceased making this offer.

Cash received from subscriptions sold in 2004 was approximately $182,000, compared to approximately $537,000 in 2003. The decrease is due to a number of factors, including our offering one-year subscriptions, generally at $30 per year, rather than lifetime subscriptions, generally for $40, beginning December 2003; and that we are in development stage and still testing various marketing approaches, which caused variability in subscription volume. Additionally, in October 2002, we began charging a fee for our individual reference product, now known as GuruNet. Prior to such time, our individual reference product was available to the public for free. During 2003, we converted a significant number of users of our free product, which had been available to the public between 1999 and October 2002, to a paid subscription of our upgraded GuruNet product. This contributed significantly to the amount we sold in 2003.

Cost of Revenues

Cost of revenues in 2004 was $647,055 compared to $723,349 in 2003, a decrease of $76,294 or 10.5%. The net decrease is primarily attributable to higher content costs incurred in the first quarter of 2003 than we typically incur each quarter, offset by additional web hosting costs approximating $40,000.

Cost of revenues is comprised of fees to third party providers of content, web hosting services and technical and customer support salaries, benefits and overhead costs.

Gross Margin

Gross margin in 2004 was ($453,772) compared to ($694,624) in 2003, a decrease in the negative margin of $240,852 or 34.7%. The decrease was due to increased revenues and decreased cost of revenues, as discussed above.

Research and Development Expenses

Research and development expenses in 2004 were $1,033,521 compared to $910,114 in 2003, an increase of $123,407 or 13.6%. The increase is due primarily to compensation-related expense increases as our research and development team grew in order to develop and test newer versions of GuruNet. The salaries, benefits and overhead costs of personnel, conducting research and development of software and Internet products comprise research and development expenses.

Sales and Marketing Expenses

Sales and marketing expenses in 2004 were $932,455 compared to $478,942 in 2003, an increase of $453,513 or 94.7%. The increase is due primarily to increases in advertising, promotion and marketing consulting costs by approximately $280,000 due to our increased focus on promoting our product, and an increase in sales and marketing compensation related expenses of approximately $70,000, due to the addition of sales and marketing employees and agents. Salaries, benefits and overhead costs of personnel, and public relations services and advertising programs, comprise sales and marketing expenses.

General and Administrative Expenses

General and administrative expenses in 2004 were $1,125,064 compared to $678,645 in 2003, an increase of $446,419 or 65.8%. The increase relates primarily to increases in the number of personnel, and salaries of personnel, which resulted in an increase, in aggregate, of approximately $128,000; increased travel of approximately $70,000; increased legal, accounting and other professional costs of $160,000; increased director fees and expenses of approximately $75,000; and increases in our insurance costs of approximately $25,000. The increases in the line expenses that comprise General and Administrative Expenses, including those mentioned previously, are mostly related, directly or indirectly, to the increased costs associated with being a public company. Further, some of those costs actually began, in anticipation and prior to our IPO.

General and administrative expenses consist primarily of salaries, benefits and overhead costs for executive and administrative personnel, e-commerce fees, insurance, fees for professional services, including consulting, legal, and accounting fees, travel costs, non-cash stock compensation expense for the issuance of stock options and other general corporate expenses. Overhead costs are comprised primarily by rent, utilities and depreciation.

Interest Income (Expense), Net

Interest (expense) income, net in 2004 was ($4,382,583), compared to $719 in 2003, representing a net increase in interest expense of $4,383,302. Interest expense, net in 2004 is comprised of approximately $3,962,000 of amortization of note discounts and deferred charges relating to the convertible promissory notes, which are described in the footnotes to the accompanying financial statements. The remainder is comprised of 8% interest on the face of the $5 million convertible promissory notes and of monthly liquidated damages in the amount of 1% to 1.5% of the aggregate purchase price of the Notes, approximating $450,000, less interest income of approximately $29,000. Interest income, net in 2003 is comprised primarily of interest income earned.

Gain on extinguishment of debt

Gain on extinguishment of debt, in 2004, of $1,493,445 resulted from the following: In conjunction with the $5 million in bridge notes that we issued in the first quarter of 2004, we recorded a note discount, with a corresponding increase in paid-in capital, of approximately $2,476,000, to account for the beneficial conversion terms that the promissory note holders received, in comparison to the expected IPO offering price. Upon repayment of approximately 63% of the bridge notes, in October 2004, the percentage of the intrinsic value of the beneficial conversion feature at the date of extinguishment was reversed in paid-in capital, in the amount of approximately $1,493,000, and interest in the same amount, previously recorded relating to the beneficial conversion feature that was reversed in paid-in capital, was functionally reversed by the recording of a gain on extinguishment of debt.

Other Expense, Net

Other expense, net in 2004 was $116,012 as compared to $12,586 in 2003, an increase of $103,426. When we initially began preparing for our IPO, in 2004, we incurred approximately $90,000 in costs relating to our plan to have us listed on the Nasdaq SmallCap Market and the Boston Stock Exchange. In October 2004, the Company decided to instead

list on the American Stock Exchange, and as a result we wrote off the aforesaid costs in the fourth quarter of 2004. The increase in other expense resulted primarily from such write-off. The remaining balance in other expense, net, in 2004 and 2003, is comprised primarily by foreign exchange gains(losses) and the write-off of tax advances that we do not expect to realize due to our “approved enterprise, ” as discussed below.

Income Tax Expense

Our effective tax rate differs from the statutory federal rate due to differences between income and expense recognition prescribed by the United States and Israeli tax laws and Generally Accepted Accounting Principles. We utilize different methods and useful lives for depreciating property and equipment. The recording of certain provisions results in expense for financial reporting but the amount is not deductible for income tax purposes until actually paid. Our deferred tax assets are mostly offset by a valuation allowance because realization depends on generating future taxable income, which, in our estimation, is not more likely to transpire, than not to transpire.

We had net operating loss carryforwards for federal and state income tax purposes of approximately $35 million at December 31, 2004 and $26 million at December 31, 2003. The federal net operating losses will expire if not utilized on various dates from 2019 through 2024. The state net operating losses will expire if not utilized on various dates from 2009 through 2013. Our Israeli subsidiary has capital loss carryforwards of approximately $604,000 that can be applied to future capital gains for an unlimited period of time under current tax rules.

The Tax Reform Act of 1986 imposed substantial restrictions on the utilization of net operating losses and tax credits in the event of an ownership change of a corporation. Thus, in accordance with Internal Revenue Code, Section 382, our recent Initial Public Offering and other ownership changes that have transpired, will significantly limit our ability to utilize net operating losses and credit carryforwards.

Our subsidiary had income in 2004 and 2003, resulting from its cost plus agreement with the parent company, whereby it charges us for research and development services it provides to us, plus 12.5%. However, the subsidiary is an “approved enterprise” under Israeli law, which means that income arising from the subsidiary’s approved activities is subject to zero tax under the “alternative benefit” path for a period of ten years. In the event of distribution by the subsidiary of a cash dividend out of retained earnings which were tax exempt due to the “approved enterprise” status, the subsidiary would have to pay a 10% corporate tax on the amount distributed, and the recipient would have to pay a 15% tax (to be withheld at source) on the amounts of such distribution received.

As of December 31, 2004, we accrued approximately $75,000, net, to reflect the estimated taxes that our subsidiary would have to pay if it distributed its accumulated earnings to us. Should the subsidiary derive income from sources other than the approved enterprise during the relevant period of benefits, this income will be taxable at the tax rate in effect at that time (currently 35%, gradually being reduced to 30% in 2005-2008). Through December 31, 2004, our Israeli subsidiary received tax benefits of approximately $700,000.

Net Loss

Our net loss increased to $6,590,519 in 2004, from $2,808,783 in 2003, as a result of the changes in our revenues, cost of sales and expenses as described above.

Critical Accounting Estimates

While our significant accounting policies are more fully described in the notes to the Company's audited consolidated financial statements for the year ended December 31, 2004, we believe the following accounting policies to be the most critical in understanding the judgments and estimates we use in preparing our consolidated financial statements.

Use of Estimates

Our discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an ongoing basis, we evaluate our

estimates and judgments, including those related to revenue recognition, accrued expenses and the fair value of our common and preferred stock, so long as we were a private company, particularly as it relates to stock-based compensation. We base our estimates on historical experience and on various other assumptions that we believe 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 may differ from these estimates under different assumptions or conditions and could have a material impact on our reported results.

Revenue Recognition

In 2003, the Company sold lifetime subscriptions to its consumer product and did not recognize revenue from those sales since the obligation to continue serving such content had no defined termination date and adequate history to estimate the life of the customer relationship was not available. Cash received from such lifetime licenses is reflected as long-term deferred revenues on the accompanying balance sheets. Beginning December 2003 and throughout 2004, the Company, generally, sold consumers one-year subscriptions to GuruNet. We recognize the amounts we received from those subscriptions over the life of the related subscription. Beginning April 2004, certain users who purchased lifetime subscriptions in 2003 exchanged their lifetime subscriptions for free two-year subscriptions to a newer, enhanced version of the GuruNet product. The cash previously received from such users is being recognized as revenues over the new two-year subscription. Beginning January 2005, we no longer offer subscriptions to our consumer products and/or websites. Rather, our consumer business model is now an advertising-only model. Notwithstanding, we have not terminated fixed-term and lifetime subscriptions to GuruNet that we previously sold. This means that those users will continue to receive content and will not have to upgrade their software. The software they downloaded in conjunction with their subscription will be supported. Our accounting treatment relating to those subscriptions has not changed, since we continue to honor those subscriptions.

Accounting for Stock-based Compensation

In January 2003, FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure, an amendment of FASB Statement No. 123" ("SFAS 148"), which provides alternative methods of transition for a voluntary change to a fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent disclosures in annual financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. We have determined that until required otherwise, we will continue to account for stock-based compensation for employees under APB 25, and elect the disclosure-only alternative under SFAS 123 and provide the enhanced disclosures as required by SFAS 148.

We record deferred stock-based compensation expense for stock options granted to employees and directors if the market value of the stock at the date of grant exceeds the exercise price of the option. We recognize expenses as we amortize the deferred stock-based compensation amounts over the related vesting periods. The market value of our stock, so long as we were a private company, was determined by us based on a number of factors including comparisons to private equity investments in us. These valuations are inherently highly uncertain and subjective. If we had made different assumptions, our deferred stock-based compensation amount, our stock-based compensation expense, our net loss and our net loss per share could have been significantly different.

The fair value of stock options granted to non-employees is measured throughout the vesting period as they are earned, at which time we recognize a charge to stock-based compensation. The fair value is determined using the Black-Scholes option-pricing model, which considers the exercise price relative to the market value of the underlying stock, the expected stock price volatility, the risk-free interest rate and the dividend yield, and an estimate of the average time option grants will be outstanding before they are ultimately exercised and converted into common stock. As discussed above, the market value of the underlying stock was based on assumptions of matters that are inherently highly uncertain and subjective. Since, prior to our IPO there had been no public market for our stock, our assumptions about stock price volatility are based on the volatility rates of comparable publicly held companies. These rates may or may not reflect our stock price volatility following the offering. If we had made different assumptions about the fair value of our stock or stock price volatility, the related stock based compensation expense and our net loss and net loss per share amounts could have been significantly different.

We are required in the preparation of the disclosures required under SFAS 148 to make certain estimates when ascribing a value to employee stock options granted during the year. These estimates include, but are not limited to, an estimate of the average time option grants will be outstanding before they are ultimately exercised and converted into common stock. These estimates are integral to the valuing of these option grants. Any changes in these estimates may have a material effect on the value ascribed to these option grants. This would in turn affect the amortization used in the disclosures we make under SFAS 148, which could be material. For disclosure purposes only, the fair value of options granted in the past to employees was estimated on the date of grant using the minimum-value method with the following weighted average assumptions: no dividend yield; risk-free interest rates of 2.18% to 6.68%; and an expected life of three to five years. The fair value of options granted to employees subsequent to May 12, 2004, the date of our first filing with the U.S. Securities and Exchange Commission in connection with our IPO is measured, for disclosure purposes only, according to the Black-Scholes option-pricing model, with the following weighted average assumptions: no dividend yield; risk-free interest rates of 2.17% to 3.78%; volatility between 61.57% and 66.76%; and an expected life of four years. If we had made different assumptions than those noted above, the related disclosures under SFAS 148 could have been significantly different.

Finally, the Financial Accounting Standards Board ("FASB") recently enacted Statement of Financial Accounting Standards 123-revised 2004 ("SFAS 123R"), "Share-Based Payment" which replaces Statement of Financial Accounting Standards No. 123 ("SFAS 123"), Accounting for Stock-Based Compensation". The impact of SFAS 123R on future periods is discussed in the section of this Management’s Discussion & Analysis titled, Recent Accounting Pronouncements.

Accounting For Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves management estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax item in the statement of operations. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We have fully offset our US deferred tax asset with a valuation allowance. Our lack of earnings history and the uncertainty surrounding our ability to generate taxable income prior to the expiration of such deferred tax assets were the primary factors considered by management in establishing the valuation allowance. Deferred tax assets and liabilities in the financial statements result from the tax amounts that would result if our Israeli subsidiary distributed its retained earnings to us. This subsidiary is entitled to a tax holiday, as described above, yet continues to generate taxable income in respect of services provided to us, and therefore were the subsidiary to distribute its retained earning to us, we believe that the deferred tax asset relating to the Israeli subsidiary would be realized. In the event that our subsidiary’s products would not generate such taxable income, we would need to write off the deferred tax asset as an expense in the statement of operations. It should be noted that as the income is derived from us, it is eliminated upon consolidation.

Foreign Currency Translation

Beginning February 2004, our Israeli subsidiary began paying substantially all of its salaries linked to the dollar, rather than the New Israeli Shekel (“NIS”). Based on this change, and in conjunction with all other relevant factors our management has determined that the subsidiary’s functional currency, beginning the first quarter of 2004, is the U.S. dollar (“USD”). SFAS 52, Appendix A, paragraph 42 cites economic factors that, among others, should be considered when determining functional currency. We determined that the cash flow, sales price and expense factors for our subsidiary, which prior to 2004 all indicated functional currency in foreign currency, have changed in 2004 to indicate

the functional currency is the USD.

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Our subsidiary's revenue is derived based on a cost plus methodology. Prior to 2004, salary expense, its primary expense, was determined in the foreign currency resulting in income and expenses being based on foreign currency. However, in 2004, a triggering event occurred that, in our opinion, warranted a change of the functional currency of our subsidiary to that of our currency, USD. Salary expense, the primary expense of our subsidiary, began to be denominated in USD. This led to a change with respect to the currency of the cash flow, sales price and expense economic factors and resulted in a determination that our subsidiary's functional currency had changed to that of our functional currency.

Had we determined that our subsidiary's functional currency was different than what was actually used, whether in 2004 or 2003, we believe that the effect of such determination would not have had a material impact on our financial statements.

Note Discount on Convertible Promissory Notes

In January and February 2004, we issued an aggregate of $5.0 million principal amount of 8% convertible promissory notes. We estimated that approximately $809,000 of the $5.0 million relates to the value of the warrants, resulting in a note discount of $809,000. In accordance with EITF 00-27, such note discount was being amortized over the life of the bridge notes. In October 2004, in conjunction with our IPO, $1,840,000 of the $5 million of promissory notes we owed to Bridge Note holders, converted into 490,678 shares of common stock and the remaining $3,160,000 was repaid. On October 13, 2004, the effective date of our IPO (the "IPO Effective Date"), the unamortized discount relating to the portion of the notes that converted into shares was immediately recognized as interest expense. To the extent that the notes were repaid, the intrinsic value of the beneficial conversion feature at the date of extinguishment was decreased in equity and a gain on extinguishment of debt was recorded.

Further, in July 2004, we decided to grant the holders of the Convertible Promissory Notes and Warrants an aggregate of 750,002 additional warrants, of which 198,530 were cancelled prior to the IPO. Each holder received approximately 0.44 warrants for each bridge warrant previously held. In connection therewith, we recorded an additional deferred charge with a corresponding increase in paid-in capital, of approximately $262,000, (net of effect of cancellation of shares,) to account for the additional benefit that the convertible promissory holders received. The aforesaid deferred charge was amortized to interest expense over the remaining life of the promissory notes. On the IPO Effective Date, the unamortized balance of such deferred charges was immediately recognized as interest expense.

The fair value of the warrants was determined by us based on a number of factors including the exercise price, and the expected volatility in the share price. Such valuation is inherently highly uncertain and subjective. Furthermore, the discount on the beneficial conversion feature of the convertible promissory notes was calculated taking into consideration our estimate of the fair value of these warrants. If we had made different assumptions, our note discounts, additional paid in capital, interest expense in respect of the amortization, our net loss and our net loss per share could have been significantly different.

Recently Issued Accounting Pronouncements

In March 2004, the Emerging Issues Task Force ("EITF") reached a consensus on Issue No. 03-01, "*The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments*" ("EITF 03-1"). EITF 03-1 provides guidance on other-than-temporary impairment models for marketable debt and equity securities accounted for under SFAS No. 115, "*Accounting for Certain Investments in Debt and Equity Securities*" ("SFAS No. 115"), and non-marketable equity securities accounted for under the cost method. The EITF developed a basic three-step model to evaluate whether an investment is other-than-temporarily impaired. On September 30, 2004, the FASB issued FSP 03-1-1, "Effective Date of Paragraphs 10-20 of EITF Issue 03-1, 'The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments'," delaying the effective date for the recognition and measurement guidance of EITF 03-1, as contained in paragraphs 10-20, until certain implementation issues are addressed and a final FSP

providing implementation guidance is issued. Until new guidance is issued, companies must continue to comply with the disclosure requirements of EITF 03-1 and all relevant measurement and recognition requirements in other accounting literature. We do not expect the adoption of EITF 03-1 to have a material effect on its financial statements.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets - an amendment to APB No. 29." This Statement amends Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. Adoption of this statement is not expected to have a material impact on our results of operations and financial condition.

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards 123-revised 2004 ("SFAS 123R"), "Share-Based Payment" which replaces Statement of Financial Accounting Standards No. 123 ("SFAS 123"), Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees." SFAS 123R requires the measurement of all employee share-based payments to employees, including grants of employee stock options, using a fair-value-based method and the recording of such expense in our consolidated statements of income. The accounting provisions of SFAS 123R are effective for us for reporting periods beginning after December 15, 2005. We are required to adopt SFAS 123R in the first quarter of fiscal 2006. The pro forma disclosures previously permitted under SFAS 123 no longer will be an alternative to financial statement recognition. See Note 2 in our Notes to the Consolidated Financial Statements for the pro forma net loss and net loss per share amounts, as if we had used a fair-value-based method similar to the methods required under SFAS 123R to measure compensation expense for employee stock incentive awards. Although we have not yet determined the method of adoption and whether the adoption of SFAS 123R will result in amounts that are similar to the current pro forma disclosures under SFAS 123, we are evaluating the requirements under SFAS 123R and the impact their adoption will have on our consolidated statements of operations and net income (loss) per share.

Liquidity and Capital Resources

General

From our inception through December 31, 2004, our operations have been funded almost entirely through the proceeds we received from issuance of four series of convertible preferred stock, convertible promissory notes in the first quarter of 2004, and our IPO in last quarter of 2004. The amounts raised were used primarily to fund research and development, sales and marketing, business development and general and administrative costs.

As of December 31, 2004, we had $8,907,183 of assets consisting of $1,565,415 in cash and cash equivalents, $5,850,000 in investment securities, $277,819 in other current assets and the remaining balance in property and equipment, long-term deposits, domain name, capitalized software development costs and deferred tax asset. Total liabilities as of December 31, 2004, reflect current liabilities of $1,004,513, consisting primary of accounts payable and accrued expenses and compensation. Long-term liabilities of $1,078,548, is comprised primarily by liabilities in respect of employee severance obligations and deferred revenues, long-term.

Cash flows in 2004 and 2003 were as follows:

		2004		**2003**
Net cash used in operating activities	$	(4,269,514)	$	(1,361,028)
Net cash used in investing activities	$	(6,181,856)	$	(35,913)
Net cash provided by financing activities	$	11,904,779	$	45,884

The increase in net cash used in operating activities during 2004 compared to 2003, of $2,908,486, is the result of a number of factors, the most significant of which, are as follows: Firstly, our operating loss in 2004 was $3,544,812, approximately, $782,000 more than 2003. We also incurred approximately $450,000 of cash interest, in 2004, while

interest expense was insignificant in 2003. Finally, changes in our operating assets and liabilities impacted favorably on cash, in 2003, by approximately $1,137,000, while in 2004, changes in our operating assets and liabilities caused cash to decrease approximately $337,000. The aforesaid decrease to cash resulting from changes in operating assets and liabilities in 2004 was driven by many factors, the largest of which is an increase in our prepaid content at December 31, 2004, of approximately $238,000 over the balance of that account at December 31, 2003. The increase to cash resulting from changes in operating assets and liabilities in 2003 was driven by many factors the largest of which were the increase in long-term deferred revenue due to the sale of lifetime subscriptions, and decreases to accounts receivable that resulted from the collection of accounts relating to 2002 enterprise sales, in early 2003.

Cash used in investing activities of $6,181,856 in 2004 is attributable primarily to purchases of investment securities of $5,850,000, capital expenditures of $209,875, the purchase of a domain name for $80,200, and capitalized software development costs of $39,736. Cash used in investing activities of $35,913 in 2003, is attributable to capital expenditures of $48,454 offset by a decrease in long-term deposits.

Cash and cash equivalents and investment securities at December 31, 2003 were insufficient to provide the capital we needed to operate. In January and February 2004, we issued $5.0 million aggregate principal amount of bridge notes, which brought us $4,125,000, net of issuance costs and not including the $200,000 we received from the sale of promissory notes to four investors in 2003. The proceeds of the convertible promissory notes enabled us to continue operating during the first nine months of 2004.

On October 13, 2004, we completed our IPO of 2.35 million shares of our common stock at $5 per share pursuant to a Registration Statement on Form SB-2. Additionally, the underwriters exercised their over-allotment option and purchased an additional 352,500 shares of our common stock, at $5 per share, on November 18, 2004. Total proceeds of the IPO, including the exercise of the over-allotment option, were approximately $10,786,000, net of underwriting fees and offering expenses of approximately $2,726,000. In conjunction with the offering, $1,840,000 of the $5 million of promissory notes we owed to Bridge Note holders, converted into 490,678 shares of common stock and the remaining $3,160,000 was repaid from the net proceeds of the offering.

Cash flow from financing activities during 2003 was comprised primarily of $200,000 we received from the sale of promissory notes to four investors, less approximately $155,000 we expended on costs relating to the $5.0 million of bridge notes issued in 2004.

Current and Future Financing Needs

We have incurred negative cash flow from operations since we started our business. We have spent, and expect to continue to spend, substantial amounts in connection with implementing our business strategy. As noted above, we raised approximately $10,786,000, net of underwriting fees and offering expenses, through our IPO and the over-allotment option. After repaying the portion of the bridge notes that did not convert to common shares, of $3,160,000, approximately $7.6 million remained. Further, in February 2005 the Company entered into an agreement (the "Warrant Reload Agreement"), with certain holders of warrants that were issued by the Company in 2004 in connection with the bridge financing, pursuant to which such holders exercised an aggregate of 1,871,783 Bridge Warrants. As a result, the Company raised approximately $12,225,000, net of costs relating to the exercise. Further, in 2005, to date, we raised additional amounts, in excess of $1 million, from other exercises of options and warrants. Based on our current plans, we believe that the net proceeds of the aforementioned IPO and the over-allotment option, and Warrant Reload Agreement will be sufficient to enable us to meet our planned operating needs for the foreseeable future and to fund possible future acquisitions. Notwithstanding, we may decide to raise funds in the future, via public or private sales of our shares or debt and/or other sources, to finance acquisitions and growth.

Off-Balance Sheet Arrangements

We have not entered into any transactions with unconsolidated entities in which we have financial guarantees, subordinated retained interests, derivative instruments or other contingent arrangements that expose us to material continuing risks, contingent liabilities or any other obligations under a variable interest in an unconsolidated entity that provides us with financing, liquidity, market risk or credit risk support.

Obligations and Commitments

As of December 31, 2004, we had the following known contractual obligations, commitments and contingencies:

Year Ending December 31	Purchase Contracts	Operating Leases	Total
2005	$ 269,516	$ 183,421	$ 364,937
2006	2,500	55,644	58,144
2007	—	20,210	20,210
Total	$ 272,016	$ 259,275	$ 443,291

Factors That May Affect Future Operating Results

You should carefully consider the risks described below and elsewhere in this report, which could materially and adversely affect our business, results of operations or financial condition. In those cases, the trading price of our common stock could decline and you may lose all or part of your investment.

Risk Factors

You should carefully consider the following risks and the other information in this Report and our other filings with the SEC before you decide to invest in our company or to maintain or increase your investment. We believe that the risks and uncertainties described below are all of the material risks that we will face. Our business, operating results and financial condition could be seriously harmed and you could lose your entire investment by the occurrence of any of the following risks. In such case, the trading price of our common stock could decline, and you may lose all or part of your investment.

Risks Related to our Business

Our current business model, based on monetizing visitor traffic to our Website through sponsored links and paid advertisements, was initiated in the beginning of January 2005 and is in its early stages. Our limited experience executing on our new business model and the very short history of metrics available to us, make it difficult to evaluate our future prospects and the risk of success or failure of our business.

Implementation of our current business model, announced on January 3, 2005, is in its early stages. Under the new model, we will be utilizing sponsored links and advertisements to generate revenues. The introductory stage of executing on our current business model means that we have very limited operating history on which to evaluate potential for future success. Additionally, at the present we have limited experience in effectively monetizing Answers.com. The combination of the foregoing factors makes it difficult to evaluate the potential for success or failure of our business.

We have experienced significant and continuing operating losses. If such losses continue, the value of your entire investment may decline.

We incurred operating losses of $2,762,325 in 2003 and $7,549,011 in 2002. Furthermore, we incurred operating losses of $3,544,812 in 2004. From our inception in 1998 through October 2004, our operations had been funded almost entirely through the proceeds of approximately $38,000,000 that we received from the issuance of four series of convertible preferred stock between December 1998 and June 2000, and the issuance of the bridge notes in the bridge financing. On October 13, 2004 we completed our IPO of 2,350,000 shares of common stock at $5.00 per share. Total proceeds of the offering were approximately $10,800,000 net of underwriters discounts and commissions

and other offering expenses. In February 2005, certain holders of the bridge warrants exercised an aggregate of 1,941,215 bridge warrants at the exercise price of $7.20 per share, with the exception of one holder, who held a warrant with an exercise price of $3.75, resulting in aggregate gross proceeds to us of approximately $13,060,000.

If our existing co-branding partnerships and revenue-sharing arrangements with third-party Websites and service providers are not renewed or continued, we will lose advertising revenue, which would have an adverse effect on our business.

We have entered into co-branding agreements and revenue-sharing arrangements with certain entities, including Comet Systems Inc., a leader in connected, intelligent desktop software and A9.com, a new search engine introduced by A9.com, Inc., a subsidiary of Amazon.com, Inc. These agreements may be terminated or discontinued by our co-branding partners and third-party Websites. Termination of such agreements will result in the loss of advertising revenue and may negatively affect our financial condition.

If Google, Inc. decides to discontinue directing user traffic to Answers.com through its "definition link", we will lose a significant portion of our traffic, which would result in a reduction in our advertising revenues and adversely affect our financial condition.

A significant percentage of our direct query traffic is directed to Answers.com by the "definition link" appearing on Google's Website result pages. This arrangement is informal, is not based on a contractual relationship and can be discontinued by Google at its sole discretion, at any given time. Further, as a result of this arrangement, we obtain a significant amount of secondary traffic (i.e. users who visit our site via the "definition link" and perform additional searches on Answers.com.) A decision on Google's part to end this arrangement would significantly reduce our query total as well as damage our branding, and possibly our industry validation. If Google ceases to direct traffic to Answers.com through its "definition link", we will experience a significant reduction in our advertising revenues, which would adversely affect our financial condition.

If search engines were to alter their algorithms or otherwise restrict the flow of consumers visiting our Website, our financial results would suffer.

Search engines and portals serve as origination Websites for consumers in search of information. We rely heavily on search engines for a substantial portion of the users visiting Answers.com. If Google (the primary search engine directing traffic towards our Website), or other search engines were to decide to change the algorithms responsible for directing search queries or if they were to restrict the flow of consumers visiting Answers.com, we would experience a significant decrease in traffic and revenues which would in turn adversely affect our financial condition.

If we are unable to retain current Internet users or attract new Internet users, we will not be able to generate revenues, which would likely result in our inability to continue our business.

Given the wide availability of free search engines and reference sites, we may not be able to retain current Internet users or attract additional Internet users. If the user traffic on our Website and the advertising revenue generated by such Internet users does not increase significantly, our business, results of operations and financial condition could be materially adversely affected.

If we do not continue to develop and provide products and services that are useful to users, we may not remain competitive, and our revenues and operating results could suffer.

Our success depends on developing and providing products and services. Several of our competitors continue to develop innovations in web search, online advertising and providing information to people. As a result, we must continue to invest resources in research and development in order to enhance our web search technology and introduce innovative, easy-to-use products and services. If we are unable to develop useful and innovative products and services, users may become dissatisfied and use our competitors' products.

We seek to generate our revenue mostly from paid advertising, and the reduction in spending by or loss of advertisers could seriously harm our business.

We seek to generate our revenue mostly from sponsored links and paid advertisements. Our advertisement providers may discontinue their arrangements with us at any time. If we are unable to generate sufficient Internet traffic and consumers, advertisers will not continue advertising on our Website, which would negatively affect our financial condition.

Our business depends on our ability to strengthen our brand. If we are not able to enhance public awareness of our answer engine product, we will be unable to increase user traffic and will fail to attract advertisers, which may result in lost revenues.

Expanding and strengthening public awareness of our brand is critical to the success of our business. Strengthening our brand may require us to make substantial investments and these investments may not be successful. We have positioned ourselves as an answer engine rather than a traditional search engine, however, in order to maintain and strengthen the brand, we must continue to develop our reference information and continue to provide quality services. If we are unable to continuously deliver quality services, our brand name will suffer.

We face risks relating to the duration of, and our dependence on, our content provider agreements. Our failure to maintain commercially acceptable content provider relationships would result in a less attractive product to consumers, and therefore subject us to lost revenue as a result of a loss of consumers and advertisers.

We are heavily dependent on license agreements with our content providers, which are generally for one-year terms. There can be no assurance that we will be able to renew these contracts at all or on commercially acceptable terms or that our costs with respect to these contracts will not increase prohibitively following any renewal. If we are unable to contain the costs of these agreements or, if renewal is not possible, or we are unable to develop relationships with alternative providers of content or maintain and enhance our existing relationships, our product will be less attractive to Internet users, which could result in a decrease advertising revenues.

We have little control over the content of third-party Websites, and failure to provide users with quality reference information could result in a less attractive product to consumers, and therefore subject us to lost revenue as a result of a loss of consumers and advertisers.

We have little control over the content displayed by third-party Websites on our Website. If these third-party Websites do not contain quality, current information, the utility of our product to the user will be reduced, which could deter new Internet users from using our search engine.

We face risks relating to our limited use of framing third party Websites inside our gurunet.com Website. If our framing functionality is challenged, we may be subject to litigation which could require us to either cease framing or pay the third party Website owner, either of which could decrease the value of our product to users resulting in lost revenues.

Unauthorized "framing" creates potential copyright and trademark issues as well as potential false advertising claims. Framing occurs when we bring to our Website someone else's Website that is being viewed by an Internet user and the other Website becomes "framed" by our site. Though some lawsuits on framing have been filed against certain entities in the market, to our knowledge none so far has resulted in fully litigated opinions. There can be no assurance that our limited framing functionality used on gurunet.com will not be challenged. In the event of a successful challenge, we may be required to cease this functionality, seek a license from the Website owner, pay damages or royalties or otherwise be required to change the way we connect to certain other Websites. Any of these actions could have an adverse effect on our business.

We are dependent upon maintaining and expanding our computer and communications systems. Failure to do so could result in interruptions and failures of our product which would make our product less attractive to consumers, and therefore subject us to lost revenue as a result of a loss of consumers and advertisers.

Our ability to provide high quality customer service largely depends on the efficient and uninterrupted operation of our computer and communications systems to accommodate the consumers and advertisers using our products. Our failure to maintain high capacity data transmission without system downtime and improve our network infrastructure would adversely affect our business and results of operations. We believe that our current network infrastructure is insufficient to support a significant increase in the use of our products. Although we are enhancing and expanding our network infrastructure, we have experienced periodic interruptions and failures including problems associated with customers downloading our products, which we believe will continue to occur.

If we were to lose the services of our key personnel, we may not be able to execute our business strategy which could result in the failure of our business.

Our future ability to execute our business plan depends upon the continued service of our executive officers and other key technology, marketing, sales and support personnel. Except for Robert S. Rosenschein, our Chief Executive Officer, our employment agreements with our officers and key employees are terminable by either party upon 30-90 days notice. If we lost the services of one or more of our key employees, or if one or more of our executive officers or employees joined a competitor or otherwise competed with us, our business may be adversely affected and our stock price may decline. In particular, the services of key members of our research and development team would be difficult to replace. We cannot assure you that we will be able to retain or replace our key personnel. We have key person life insurance in the amount of $1,000,000 for Robert Rosenschein, but not for any of our other officers.

Risks Related to our Industry

Third parties could claim that our company is infringing on their intellectual property rights, which could result in substantial costs, diversion of significant managerial resources and significant harm to the company's reputation.

The industry in which our company operates is characterized by the existence of a large number of patents and frequent litigation based on allegations of patent infringement. We expect that Internet technologies, software products and services may be increasingly subject to third-party infringement claims as the number of competitors in our industry segment grows and the functionality of products in different industry segments overlaps. From time to time, third parties may assert patent, copyright, trademark and other intellectual property rights to technologies and software products in various jurisdictions that are important to our business. Additionally, third parties may assert claims of copyright infringement with respect to the content displayed on our Website. For example, a third party may claim that data displayed on our Website pursuant to a licensing arrangement with our content provider is in violation of a legitimate copyright.

A successful infringement claim against us by any third party, could subject the combined company to:

· substantial liability for damages and litigation costs, including attorneys' fees;

· lawsuits that prevent the company from further use of its intellectual property and require the company to permanently cease and desist from selling or marketing products that use such intellectual property;

· having to license the intellectual property from a third party, which could include significant licensing and royalty fees not presently paid by us and add materially to the our costs of operations;

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having to develop as a non-infringing alternative, new intellectual property which could delay projects and add materially to our costs of operations; and

- having to indemnify third parties who have entered into agreements with the company with respect to losses they incurred as a result of the infringement, which could include consequential and incidental damages that are material in amount.

Even if we are not found liable in a claim for intellectual property infringement, such a claim could result in substantial costs, diversion of significant resources and management attention, termination of customer contracts and the loss of customers and significant harm to the reputation of the combined company.

Misappropriation of our intellectual property could harm our reputation, affecting our competitive position and costing us money.

Our ability to compete with other software companies depends in part upon the strength of our proprietary rights in our technologies. We believe that our intellectual property will be critical to our success and competitive position. We rely on a combination of U.S. and foreign patents, copyrights, trademark and trade secret laws to establish and protect our proprietary rights. If we are unable to protect our intellectual property against unauthorized use by third parties, our reputation could be damaged and our competitive position adversely affected.

Attempts may be made to copy aspects of our products or to obtain and use information that we regard as proprietary. Accordingly, we may not be able to prevent misappropriation of our technology or deter others from developing similar technology. Our strategy to deter misappropriation could be undermined if:

· the proprietary nature or protection of our methodologies are not recognized in the United States or foreign countries;

· third parties misappropriate our proprietary methodologies and such misappropriation is not detected; and

· competitors create applications similar to ours but which do not technically infringe on our legally protected rights.

If these risks materialize, the combined company could be required to spend significant amounts to defend its rights and divert critical managerial resources. In addition, the combined company's proprietary methodologies may decline in value or its rights to them may become unenforceable. If any of the foregoing were to occur, our business could be materially adversely affected.

New technologies could block the display of our advertisements, which would diminish the likelihood of generating revenues from advertisements and adversely affect our operating results.

Technologies may be developed to block the display of our advertisements. We expect that a portion of our net revenues will be derived from fees paid to us by advertisers in connection with the display of advertisements on our destination Website. As a result, ad-blocking technology could, in the future, adversely affect our operating results.

Government regulation and legal uncertainties may require us to incur significant expenses in complying with any new regulations.

The laws and regulations applicable to the Internet and our products are evolving and unclear and could damage our business. There are currently few laws or regulations directly applicable to access to, or commerce on, the Internet. Due to the increasing popularity and use of the Internet, it is possible that laws and regulations may be adopted, covering issues such as user privacy, pricing, taxation, content regulation, quality of products and services, and intellectual property ownership and infringement. This legislation could expose us to substantial liability as well as dampen the growth in use of the Internet, decrease the acceptance of the Internet as a communications and commercial medium, or require us to incur significant expenses in complying with any new regulations. Because the increased use of the Internet has burdened the existing telecommunications infrastructure and many areas with high Internet usage have begun to experience interruptions in phone services, local telephone carriers have petitioned the FCC to regulate the Internet and to impose access fees. Increased regulation or the imposition of access fees could substantially increase the costs of communicating on the Internet, potentially decreasing the demand for our products. A number of

proposals have been made at the federal, state and local level that would impose additional taxes on the sale of goods and services through the Internet. Such proposals, if adopted, could substantially impair the growth of electronic commerce and could adversely affect us. Moreover, the applicability to the Internet of existing laws governing issues such as property ownership, copyright, defamation, obscenity and personal privacy is uncertain. We may be subject to claims that our products violate such laws. Any new legislation or regulation in the United States or abroad or the application of existing laws and regulations to the Internet could damage our business and cause our stock price to decline.

Due to the global nature of the Internet, it is possible that the governments of other states and foreign countries might attempt to regulate its transmissions or prosecute us for violations of their laws. We might unintentionally violate these laws. Such laws may be modified, or new laws may be enacted, in the future. Any such development could damage our business.

Our long-term financial viability may depend upon the growth and acceptance of Internet advertising as an effective alternative to traditional advertising media. If the market for Internet advertising does not continue to grow, our revenues and operating results could suffer.

Because our revenues are derived from advertisements, we compete with traditional media including television, radio and print, in addition to other Websites, for a share of advertisers' total advertising expenditures. We may face the risk that advertisers might find Internet advertising to be less effective than traditional media at promoting their products or services and may further reduce or eliminate their expenditures on Internet advertising. Many advertisers and advertising agencies have only limited experience advertising on the Internet and have not devoted a significant portion of their advertising expenditures to Internet advertising. Acceptance of the Internet among advertisers will depend, to a large extent, on the perceived effectiveness of Internet advertising and the continued growth of commercial usage of the Internet. Filter software programs that limit or prevent advertising from being displayed on a user's computer are available. It is unclear whether this type of software will become widely accepted, but if it does, it would negatively affect Internet-based advertising. Our business could be seriously harmed if the market for Internet advertising does not continue to grow.

Risks Related to our Common Stock

Our Common Stock May Be Affected By Limited Trading Volume And May Fluctuate Significantly.

Our common stock is traded on the American Stock Exchange. There can be no assurance that an active trading market for our common stock will be sustained. Failure to maintain an active trading market for our common stock may adversely affect our shareholders' ability to sell our common stock in short time periods, or at all. Our common stock has experienced, and may experience in the future, significant price and volume fluctuations, which could adversely affect the market price of our common stock.

There may be substantial sales of our common stock after the expiration of lock-up periods, which could cause our stock price to fall.

Of the 6,940,619 shares of our common stock outstanding on March 24, 2005, 1,551,158 shares are restricted as a result of U.S. federal and state securities laws and various lock-up agreements that holders have signed that restrict their ability to transfer our stock until April 11, 2005 or October 13, 2005. The underwriters may waive or reduce the terms of these lockups. After the lock-up periods, all of foregoing shares will be immediately available for sale in the public market without registration under Rule 144. Sales of a substantial number of shares of our common stock could cause the price of our securities to fall and could impair our ability to raise capital by selling additional securities.

We could issue "blank check" preferred stock without stockholder approval with the effect of diluting then current stockholder interests.

Our certificate of incorporation authorizes the issuance of up to 1,000,000 shares of "blank check" preferred stock with designations, rights and preferences as may be determined from time to time by our board of directors. Accordingly, our board of directors is empowered, without stockholder approval, to issue a series of preferred stock with dividend, liquidation, conversion, voting or other rights which could dilute the interest of, or impair the voting power of, our common stockholders. The issuance of a series of preferred stock could be used as a method of discouraging, delaying or preventing a change in control. Although we do not presently intend to issue any shares of preferred stock, we may

do so in the future.

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Provisions in our charter documents and under Delaware law could discourage a takeover that stockholders may consider favorable.

Provisions of our Amended and Restated Certificate of Incorporation and Bylaws could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. For example, our board of directors is divided into three classes, with one class being elected each year by our stockholders, which generally makes it more difficult for stockholders to replace a majority of directors and obtain control of our board. In addition, stockholder meetings may be called only by our board of directors, the chairman of the board and the president, advance notice is required prior to stockholder proposals and stockholders may not act by written consent. Further, we have authorized preferred stock that is undesignated, making it possible for our board of directors to issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to change control of GuruNet.

Delaware law also could make it more difficult for a third party to acquire us. Specifically, Section 203 of the Delaware General Corporation Law, to which our company is subject, may have an anti-takeover effect with respect to transactions not approved in advance by our board of directors, including discouraging attempts that might result in a premium over the market price for the shares of common stock held by our stockholders.

We are at risk of securities class action litigation.

In the past, securities class action litigation has often been brought against a company following a decline in the market price of its securities. This risk is especially relevant for us because Internet companies have experienced significant stock price volatility in recent years. If we faced such litigation, it could result in substantial costs and diversion of management’s attention and resources, which could adversely affect our business.

Risks Related to our Location in Israel

Conditions in Israel may limit our ability to produce and sell our product, which would lead to a decrease in revenues.

Because our operations are conducted in Israel and our principal offices and sole research and development facilities are located in Jerusalem, Israel, our operations are directly affected by economic, political and military conditions affecting Israel. Specifically, we could be adversely affected by:

- any major hostilities involving Israel;
- a full or partial mobilization of the reserve forces of the Israeli army;
- the interruption or curtailment of trade between Israel and its present trading partners;
- risks associated with the fact that a significant number of our employees and key officers reside in what are commonly referred to as occupied territories; and
- a significant downturn in the economic or financial conditions in Israel.

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors and a state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Despite negotiations to effect peace between Israel and its Arab neighbors, the future of these peace efforts is uncertain. Since October 2000, there has been a significant increase in violence, civil unrest and hostility, including armed clashes between the State of Israel and the Palestinians, and acts of terror have been committed inside Israel and against Israeli targets in the West Bank and Gaza Strip. There is no indication as to how long the current hostilities will last or whether there will be any further escalation. Any further escalation in these hostilities or any future conflict, political instability or violence in the region may have a negative effect on our business, harm our results of operations and adversely affect our share price.

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Furthermore, there are a number of countries that restrict business with Israel or with Israeli companies, which may limit our ability to make sales in those countries.

Our operations could be disrupted as a result of the obligation of personnel to perform military service.

Our key employees and executive officers all reside in Israel, and many of them are obligated to perform annual military reserve duty. Our operations could be disrupted by the absence for a significant period of one or more of our directors, officers or key employees due to military service. Any such disruption could adversely affect our business, results of operations and financial condition.

We may not be able to enforce covenants not-to-compete under current Israeli law which might result in added competition for our products.

We have non-competition agreements with all of our employees, almost all of which are governed by Israeli law. These agreements prohibit our employees from competing with or working for our competitors, generally during and for up to 12 months after termination of their employment. However, Israeli courts are reluctant to enforce non-compete undertakings of former employees and tend, if at all, to enforce those provisions for relatively brief periods of time in restricted geographical areas and only when the employee has obtained unique value to the employer specific to that employer’s business and not just regarding the professional development of the employee.

The change in the exchange rate between the United States dollar and foreign currencies is volatile and may negatively impact our costs which could adversely affect our operating results.

We incur certain of our expenses for our operations in Israel in New Israeli Shekels (NIS) and translate these amounts into United States dollars for purposes of reporting consolidated results. As a result, fluctuations in foreign currency exchange rates may adversely affect our expenses and results of operations as well as the value of our assets and liabilities. Fluctuations may adversely affect the comparability of period-to-period results. In addition, we hold foreign currency balances, primarily NIS, that will create foreign exchange gains or losses, depending upon the relative values of the foreign currency at the beginning and end of the reporting period, which may affect our net income and earnings per share. Although we may use hedging techniques in the future (which we currently do not use), we may not be able to eliminate the effects of currency fluctuations. Thus, exchange rate fluctuations could have a material adverse impact on our operating results and stock price.

The Israeli government tax benefits program in which we currently participate and from which we receive benefits requires us to meet several conditions. These programs or benefits may be terminated or reduced in the future, which may result in an increase in our tax liability.

Our Israeli subsidiary receives tax benefits authorized under Israeli law for capital investments that are designated as “Approved Enterprises.” To be eligible for these tax benefits, we must meet certain conditions. If we fail to meet such conditions, these tax benefits could be cancelled, and we could be required to pay increased taxes or refund the amount of tax benefits we received, together with interest and penalties. Israeli governmental authorities have indicated that the government may in the future reduce or eliminate the benefits of such programs. The termination or reduction of these programs and tax benefits could increase our Israeli tax rates, and thereby reduce our net profits or increase our net losses.

We are subject to certain employee severance obligations, which may result in an increase in our expenditures.

Under Israeli law, employers are required to make severance payments to dismissed employees and employees leaving employment in certain other circumstances, on the basis of the latest monthly salary for each year of service. This obligation may result in an increase in our expenditures. All obligations arising from services rendered through December 31, 2004, have been provided for in the financial statements as of December 31, 2004.

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Item 7. Financial Statements

The full text of our audited consolidated financial statements for the fiscal year ended December 31, 2004 begins on page F-1 of this Annual Report on Form 10-KSB

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

GuruNet Corporation

Date: April 4, 2005

By: /s/ Steven Steinberg
Steven Steinberg
Chief Financial Officer

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GuruNet Corporation (Formerly Atomica Corporation)
and Subsidiary
(A Development Stage Enterprise)

Consolidated Financial Statements as of December 31, 2004

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Report of Independent Registered Public Accounting Firm

To the Stockholders of GuruNet Corporation:

We have audited the accompanying consolidated balance sheets of GuruNet Corporation, formerly Atomica Corporation (a Development Stage Enterprise), and Subsidiary (collectively referred to as "the Company") as of December 31, 2004 and 2003, and the related consolidated statements of operations, changes in stockholders' equity (deficit) and comprehensive income (loss), and cash flows for the years then ended, and the period from December 22, 1998 (inception) to December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the Standards of the Public Company Accounting Oversight Board (United States). Such auditing standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Directors and by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2004 and 2003, and the results of their operations, changes in stockholders' equity (deficit) and comprehensive income (loss), and their cash flows for the years then ended and for the period from December 22, 1998 (inception) to December 31, 2004, in conformity with generally accepted accounting principles in the United States of America.

Somekh Chaikin
Certified Public Accountants (Israel)
A member of KPMG International

Jerusalem, Israel
March 31, 2005

See accompanying notes to the consolidated financial statements

(GuruNet Corporation (Formerly Atomica Corporation)
and Subsidiary
(A Development Stage Enterprise)

Consolidated Balance Sheets

	December 31 2004 $	December 31 2003 $
Assets		
Current assets:		
Cash and cash equivalents (Note 3)	**1,565,415**	123,752
Investment securities(Note 3)	**5,850,000**	-
Receivables (Note 2 e)	**18,145**	11,934
Prepaid expenses	**259,674**	20,481
Deferred charges (Note 4)	**-**	155,116
Total current assets	**7,693,234**	311,283
Long-term deposits (restricted) (Note 5)	**167,304**	165,449
Deposits in respect of employee severance obligations (Note 9)	**462,735**	339,651
Property and equipment, net (Note 6)	**305,804**	206,408
Other assets:		
Intangible assets, net (Note 7)	**111,289**	-
Prepaid expenses, long-term	**147,000**	-
Deferred tax asset, long-term (Note 11)	**19,817**	20,501
Total other assets	**278,106**	20,501
Total assets	**8,907,183**	1,043,292

See accompanying notes to the consolidated financial statements

GuruNet Corporation (Formerly Atomica Corporation)
and Subsidiary
(A Development Stage Enterprise)

Consolidated Balance Sheets

	December 31 2004 $	December 31 2003 $
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	**172,029**	215,684
Accrued expenses	**422,465**	326,186
Accrued compensation	**259,872**	293,113
Advances on account of shares and stock warrants (Note 8)	**-**	200,000
Deferred revenues, short-term (Note 2 g)	**150,147**	29,234
Total current liabilities	**1,004,513**	1,064,217
Long-term liabilities:		
Liability in respect of employee severance obligations (Note 9)	**531,224**	431,025
Deferred tax liability, long-term (Note 11)	**94,965**	55,092
Deferred revenues, long-term (Note 2 g)	**452,359**	537,404
Total long-term liabilities	**1,078,548**	1,023,521
Commitments and contingencies (Note 12)		
Stockholders' equity (deficit) (Note 10)**:**		
Convertible preferred stock:		
Series A; $0.01 par value; 0 shares authorized, issued and outstanding as of December 31, 2004; 130,325 shares authorized, issued, and outstanding as of December 31, 2003; aggregate liquidation preference of $300,000	**-**	1,303
Series B; $0.01 par value; 0 shares authorized, issued and outstanding as of December 31, 2004; 217,203 shares authorized; 181,112 shares issued and outstanding as of December 31, 2003; aggregate liquidation preference of $1,350,000	**-**	1,811
Series C; $0.01 par value; 0 shares authorized, issued and outstanding as of December 31, 2004; 260,643 shares authorized; 238,119 shares issued and outstanding as of December 31, 2003; aggregate liquidation preference of $2,750,000	**-**	2,381

Series D; $0.01 par value; 0 shares authorized, issued and outstanding as of December 31, 2004; 824,646 shares authorized as voting stock and 21,721 shares authorized as non-voting stock; 807,468 shares of voting stock and 15,024 shares of non-voting stock issued and outstanding as of December 31, 2003; aggregate liquidation preference of $28,400,000	**-**	8,225
Common stock; $0.001 par value; 30,000,000 and 2,856,937 shares authorized as of December 31, 2004 and 2003, 4,920,551 and 355,325 shares issued and outstanding as of December 31, 2004 and 2003, respectively	**4,921**	355
Additional paid-in capital	**47,488,072**	33,100,368
Deferred compensation	**(45,146)**	(125,873)
Accumulated other comprehensive loss	**(27,608)**	(27,418)
Deficit accumulated during development stage	**(40,596,117)**	(34,005,598)
Total stockholders' equity (deficit)	**6,824,122**	(1,044,446)
Total liabilities and stockholders' equity (deficit)	**8,907,183**	1,043,292

See accompanying notes to the consolidated financial statements

GuruNet Corporation (Formerly Atomica Corporation)
and Subsidiary
(A Development Stage Enterprise)

Consolidated Statements of Operations

	Years ended December 31		Cumulative from December 22, 1998 (inception) through
	2004	**2003**	**December 31, 2004**
Revenue	**$ 193,283**	$ 28,725	$ 1,421,797
Cost of revenue	**647,055**	723,349	3,551,768
Gross margin	**(453,772)**		

(694,624
)

(2,129,971
)

Operating expenses:

Research and development

1,033,521

910,114

18,579,110

Sales and marketing

932,455

478,942

9,581,042

General and administrative

1,125,064

678,645

7,514,785

Loss in connection with shut-down of operations

-

-

1,048,446

Total operating expenses

3,091,040

2,067,701

36,723,383

Operating loss

	(3,544,812)	(2,762,325)	(38,853,354)
Interest expense, net	**(4,382,583)**	719	(2,574,865)
Gain on extinguishment of debt	**1,493,445**	-	1,493,445
Other expense, net (Note 14)	**(116,012)**	(12,586)	(586,195)
Loss before income taxes	**(6,549,962)**	(2,774,192)	(40,520,969)
Income taxes (Note 11)	**(40,557**		

)

(34,591
)

(75,148
)

Net loss

(6,590,519
)

(2,808,783
)

(40,596,117
)

Basic and diluted net loss per common share

(2.90
)

(7.93
)

(53.81
)

Weighted average shares used in computing basic and diluted net loss per common share

2,273,675

354,112

754,378

See accompanying notes to the consolidated financial statements

GuruNet Corporation (Formerly Atomica Corporation)
and Subsidiary
(A Development Stage Enterprise)

Consolidated Statement of Changes in Stockholders' Equity (Deficit) and Comprehensive Income (Loss)

	Convertible preferred stock		Common stock		Additional paid-in capital	Deferred compensation
	Shares	Amount	Shares	Amount	$	$
Balance as of January 1, 2003	1,372,048	$ 13,720	353,876	$ 354	32,958,424	-
Issuance of stock options to a non-employee for services rendered	-	-	-	-	1,225	(1,225)
Issuance of stock options to employees	-	-	-	-	139,720	(139,720)
Amortization of deferred compensation	-	-	-	-	-	15,072
Exercise of common stock options	-	-	1,449	1	999	-
Loss on foreign currency translation	-	-	-	-	-	-
Net loss for year	-	-	-	-	-	-
Balance as of December 31, 2003	**1,372,048**	**13,720**	**355,325**	**355**	**33,100,368**	**(125,873)**
Conversion of preferred stock into common stock	**(1,372,048)**	**(13,720)**	**1,372,048**	**1,372**	**12,348**	**-**
Discounts on convertible promissory notes and warrants	**-**	**-**	**-**	**-**	**1,577,373**	**-**
	-	**-**	**-**	**-**	**(147,080)**	**-**

Issuance expenses in private placement relating to warrants						
Warrants of common stock issued as finder's fee in private placement	-	-	-	-	**232,202**	-
Warrants of common stock issued to holders of convertible promissory notes	-	-	-	-	**262,488**	-
Issuance of common stock, net of issuance costs of $2,726,209	-	-	**2,702,500**	**2,703**	**10,713,214**	-
Conversion of convertible promissory notes into common stock, net of issuance costs of $134,255	-	-	**490,678**	**491**	**1,705,254**	-
Issuance of stock options to underwriters	-	-	-	-	**70,374**	-
Issuance of stock options to non-employees for services rendered	-	-	-	-	**16,571**	-
Amortization of deferred compensation	-	-	-	-	-	**25,687**
Forfeiture of stock options granted to an employee	-	-	-	-	**(55,040)**	**55,040**
Unrealized loss on securities	-	-	-	-	-	-
Net loss for year	-	-	-	-	-	-

Balance as of December 31, 2004	**-**	**-**	**4,920,551**	**4,921**	**47,488,072**	**(45,146)**

See accompanying notes to the consolidated financial statements

GuruNet Corporation (Formerly Atomica Corporation)
and Subsidiary
(A Development Stage Enterprise)

Consolidated Statement of Changes in Stockholders' Equity (Deficit) and Comprehensive Income (Loss) (cont'd)

	Convertible preferred stock		Common stock		Additional paid-in capital	Deferred compensation	Stock n rec
	Shares	Amount	Shares	Amount	$	$	
December 1998 - Issuance of common stock to founders at $0.023 per share, upon the Company's inception (no issuance costs)	-	$ -	325,805	$ 326	7,174	-	
April 1999 - Issuance of common stock in lieu of loan repayment	-	-	5,649	5	6,495	-	
August 1999 - Issuance of common stock upon exercise of stock options	-	-	21,721	22	49,978	-	
August 1999 - Issuance of common stock at $2.30 per share, for acquisition of domain name	-	-	652	1	1,499	-	
December 1998 and January 1999 - Issuance of Series A convertible preferred stock at $2.30 per share, net of	130,325	1,303	-	-	290,715	-	

issuance costs of $7,982							
April 1999 - Issuance of Series B convertible preferred stock at $7.45 per share, net of issuance costs of $38,678	181,112	1,811	-	-	1,309,511	-	
September 1999 - Issuance of series C convertible preferred stock at $11.55 per share, net of issuance costs of $79,678	238,119	2,381	-	-	2,667,941	-	
February 2000 and June 2000 - Issuance of Series D convertible preferred stock at $34.53 per share, net of issuance costs of $4,359	822,492	8,225	-	-	28,387,416	-	
Exercise of common stock options from inception through December 31, 2004	-	-	268,353	268	1,843,633	-	(1
Repurchase of stockholders' common stock and cancellation of note receivable from inception through December 31, 2004	-	-	(266,855)	(267)	(1,842,633)	-	1
Issuance of stock options and warrants to non-employees	-	-	-	-	683,448	(228,642)	

for services rendered from inception through December 31, 2004						
Revaluation of options issued to non-employees for services rendered from inception through December 31, 2004	-	-	-	-	(126,885)	84,096
Forfeiture of stock options granted for services rendered from inception through December 31, 2004	-	-	-	-	(68,871)	68,871
Issuance of stock options to employees from inception through December 31, 2004	-	-	-	-	139,720	(139,720)
Amortization of deferred compensation from inception through December 31, 2004	-	-	-	-	-	115,209
Loss on foreign currency translation from inception through December 31, 2004	-	-	-	-	-	-
January 2004 - Conversion of preferred stock into common stock	(1,372,048)	(13,720)	1,372,048	1,372	12,348	-

Issuance of warrants of common stock to holders of convertible promissory notes	-	-	-	-	262,488	-
Discounts on convertible promissory notes and warrants	-	-	-	-	1,577,373	-
Issuance expenses in private placement relating to warrants	-	-	-	-	(147,080)	-
October 2004 - Issuance of common stock, net of issuance costs of $2,726,209	-	-	2,702,500	2,703	10,713,214	-
October 2004 - Conversion of convertible promissory notes into common stock, net of issuance costs of $134,255			490,678	491	1,705,254	-
Issuance of stock options to underwriters	-	-	-	-	70,374	-
Forfeiture of stock options granted to employees	-	-	-	-	(55,040)	55,040
Unrealized loss on securities	-	-	-	-	-	-
Net loss from inception through December 31, 2004	-	-	-	-	-	-
Balance as of December 31, 2004	**-**	**-**	**4,920,551**	**4,921**	**47,488,072**	**(45,146)**

See accompanying notes to the consolidated financial statements

GuruNet Corporation (Formerly Atomica Corporation)
and Subsidiary
(A Development Stage Enterprise)

Consolidated Statements of Cash Flows

	Years ended December 31		Cumulative from December 22, 1998 (inception) through December 31
	2004	**2003**	**2004**
	$	**$**	**$**
Cash flows from operating activities:			
Net loss	**(6,590,519)**	(2,808,783)	(40,596,117)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	**119,126**	268,026	2,212,055

Deposits in respect of employee severance obligations	**(123,084)**	(107,871)	(462,735)
Loss on sale and write off of property and equipment in connection with shut-down of operations	-	-	780,475
Other loss on sale and write off of property and equipment	-	-	549,802
Settlement of obligations for other than cash	-	-	225,589
Increase in liability in respect of employee severance obligations	**100,199**	101,380	531,224
Deferred income taxes	**40,557**	34,591	75,148

Stock issued for domain name	-	-	1,500
Issuance of stock options and warrants to non-employees for services rendered	**16,571**	-	222,604
Revaluation of options issued to non-employees for services rendered	-	-	(42,789)
Amortization of deferred compensation	**25,687**	15,072	115,209
Amortization of deferred charges relating to convertible promissory notes	**889,983**	-	889,983
Amortization of discounts on promissory notes	**1,577,373**	-	1,577,373
Exchange rate differences			

	11,746	-	11,746
Changes in operating assets and liabilities:			
(Increase) decrease in accounts receivable and other current assets	**(245,404)**	372,657	(276,263)
(Increase) in long-term prepaid expenses	**(147,000)**	-	(147,000)
(Decrease) increase in accounts payable	**(43,655)**	180,413	172,029
Increase in accrued expenses and other current liabilities	**63,038**	28,849	694,021
Increase in short-term deferred revenues	**64,985**	17,234	94,219

(Decrease) increase in long-term deferred revenues	**(29,117)**	537,404	508,287
Net cash used in operating activities	**(4,269,514)**	(1,361,028)	(32,863,640)
Cash flows from investing activities:			
Capital expenditures	**(209,875)**	(48,454)	(4,112,901)
Proceeds from sale of property and equipment	**-**	-	54,415
Purchase of intangible assets	**(119,936)**	-	(119,936)
Decrease (increase) in long-term deposits			

(1,855
)

12,541

(160,437
)
Purchases of investment securities

(5,850,000
)

-

(5,850,000
)
Other

(190
)

-

(190
)
Net cash used in investing activities

(6,181,856
)

(35,913
)

(10,189,049
)

Cash flows from financing activities:

Repayment of loan

-

-

(20,000
)
Proceeds from loan

-

		-	6,500
Proceeds from issuance of convertible preferred stock, net of $130,697 issuance costs	**-**	-	32,669,303
Proceeds from issuance of common stock, net of $2,726,210 issuance costs	**10,786,290**	-	10,843,790
Proceeds from issuance of promissory notes, net of issuance costs in the amount of $521,511 and $155,116 in 2004 and 2003, respectively	**4,278,489**	44,884	4,323,373
Repayment of convertible promissory notes	**(3,160,000)**	-	(3,160,000)
Exercise of common stock options	**-**	1,000	1,000
Net cash provided by financing activities	**11,904,779**		

		45,884	44,663,966
Effect of exchange rate changes on cash and cash equivalents	**(11,746)**	36,629	(45,862)
Net increase (decrease) in cash and cash equivalents	**1,441,663**	(1,314,428)	1,565,415
Cash and cash equivalents at beginning of period	**123,752**	1,438,180	-
Cash and cash equivalents at end of period	**1,565,415**	123,752	1,565,415

See accompanying notes to the consolidated financial statements

GuruNet Corporation (Formerly Atomica Corporation)
and Subsidiary
(A Development Stage Enterprise)

Consolidated Statements of Cash Flows

	Years ended December 31		Cumulative from December 22, 1998(inception) through December 31,
	2004	**2003**	**2004**
			$
			$
			$
Supplemental disclosures of cash flow information:			
Income taxes paid			
			42,859
			7,661
			91,591
Non-cash investing and financing activities:			
Stock issued for domain name			
			-
			-
			1,500
Issuance of common stock in lieu of loan repayments			
			-
			-
			6,500

Common stock issued in exchange for notes receivable

-

-

1,842,900

Repurchase of stockholders’ common stock and cancellation of notes receivable

-

-

(1,842,900
)

Issuance of warrants and stock options to non-employees

565,065

-

565,065

Amortization of deferred charges relating to warrants

147,080

-

147,080

Discount on convertible promissory notes

1,577,373

1,577,373

Conversion of convertible promissory notes into common stock

1,840,000

1,840,000

Issuance costs related to the converted promissory notes

134,255

134,255

Unrealized loss from securities	**190**
	-
	190

See accompanying notes to the consolidated financial statements

Note 1 - Business

GuruNet Corporation ("the Parent"), formerly Atomica Corporation (a Development Stage Enterprise), was founded as a Texas corporation on December 22, 1998, and reorganized as a Delaware corporation in April 1999. On December 27, 1998 the Parent formed a subsidiary ("the Subsidiary") based in Israel, primarily for the purpose of providing research and development services to the Parent. GuruNet Corporation and the Subsidiary are collectively referred to as "the Company". The Company develops, markets and sells technology that intelligently and automatically integrates and retrieves information from disparate sources and delivers the result in a single consolidated view.

Prior to 2003, the Company focused primarily on enterprise systems for corporate customers and large organizations. Beginning in 2003, the Company's primary product has been its consumer product, which, in 2003 and 2004, was sold to subscribers who paid the Company on a lifetime or annual basis. In January 2005, the Company introduced a free-to-customer product, containing practically all the content that it used to sell via subscriptions and ceased selling subscriptions to individual consumers. The Company plans to generate advertising revenue from the free-to-customer product. Notwithstanding, customers who purchased subscriptions prior to January 2005, will continue to be fully supported through the subscription periods.

As the Company has not yet earned significant revenue from its operations, it considers itself a development stage enterprise, as defined under Statement of Financial Accounting Standards No. 7, *"Accounting and Reporting by Development Stage Enterprises"*.

Note 2 - Summary of Significant Accounting Policies

(a) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of GuruNet Corporation and the Subsidiary. All significant intercompany balances and transactions have been eliminated in consolidation.

(b) Foreign Currency Translation

Prior to January 2004, the financial statements for the Subsidiary were measured using the local currency as the functional currency. Assets and liabilities of foreign operations were translated at the rate of exchange as of the balance sheet date. Expenses were translated using average exchange rates for the year. Stockholders' equity was translated using the historical exchange rates applicable for each line item. Foreign currency translation gains and losses were included as a component of other comprehensive income or loss.

Beginning in the first quarter of 2004, due to significant changes in economic facts and circumstances, the financial statements of the Subsidiary are measured using the U.S. dollar as its functional currency. Transactions in foreign currency (primarily in New Israeli Shekels - "NIS") are recorded at the representative exchange rate as of the transaction date, except for activities relating to balance sheet items, which are recorded at the appropriate exchange rate of the corresponding balance sheet item. Monetary assets and liabilities in foreign currency are stated on the basis of the representative rate of exchange at the balance sheet date. Non-monetary assets and liabilities in foreign currency are stated at historical exchange rates. All exchange gains and losses from remeasurement of monetary balance sheet items denominated in non-dollar currencies are reflected in the statement of operations as they arise.

Note 2 - Summary of Significant Accounting Policies (cont'd)

(c) Use of Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported results of operations during the reporting periods. Actual results could differ from those estimates.

(d) Cash, Cash Equivalents and Investment Securities

All highly liquid investments with an original maturity of three months or less are considered cash equivalents.

Investment securities consist of auction rate securities with auction reset periods less than 12 months, classified as available-for-sale securities and stated at fair value.

Investment securities and marketable securities that are deemed cash and cash equivalents, are classified as available-for-sale, in accordance with SFAS No. 115*, "Accounting for Certain Investments in Debt and Equity Securities"*, and are reported at fair value, with unrealized gains and losses, net of tax, recorded in other comprehensive income (loss). Realized gains or losses and declines in value judged to be other than temporary, if any, on available-for-sale securities are reported in other income, net.

(e) Accounts Receivable

Accounts receivable are recorded at the invoiced amount and do not bear interest. If necessary, the Company records an allowance for doubtful accounts to reflect the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable, computed on a specific basis. No such allowance was deemed necessary as of the balance sheet dates. The Company does not have any off-balance-sheet credit exposure related to its customers.

(f) Property and Equipment

Property and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets. Annual depreciation rates are as follows:

	%
Computer equipment	33
Furniture and fixtures	7 - 15

Leasehold improvements are amortized over the shorter of the estimated useful life or the expected life of the lease.

Note 2 - Summary of Significant Accounting Policies (cont'd)

(g) Revenue Recognition

Revenues from subscription services are recognized over the life of the subscription, which is generally one year, in accordance with Statement of Position (SOP) No. 97-2, *"Software Revenue Recognition"*, issued by the American Institute of Certified Public Accountants (AICPA). Sales that do not yet meet the criteria for revenue recognition, are classified as "Deferred Revenues" on the balance sheet.

In 2003, the Company sold lifetime subscriptions to its consumer product and did not recognize revenue from those sales since the obligation to continue serving such content had no defined termination date and adequate history to estimate the life of the customer relationship was not available. Cash received from such lifetime licenses is reflected as long-term deferred revenues on the accompanying balance sheets.

Beginning April 2004, certain users who purchased lifetime subscriptions in 2003, exchanged their lifetime subscriptions for free two-year subscriptions to a newer enhanced version of the GuruNet product. The cash previously received from such users will be recognized over the new two-year subscription. During the year 2004, the Company recognized approximately $30,000 of such revenues.

The Company's cancellation and refund policies allow a full refund during the first month after purchase, under certain circumstances. However, past history has shown that the amounts actually refunded have been immaterial, as are the current estimated returns, and therefore have no significant effect on revenue recognition.

The Company generates advertising revenues through pay-per-click keyword advertising. When a user searches sponsored keywords, an advertiser's Website is displayed in a premium position and identified as a sponsored result to the search. Generally, the Company does not contract directly with advertisers, but rather, obtains those advertisers through the efforts of a third party that locates advertisers seeking to display sponsored links in our product. The third party is obligated to pay the Company a portion of the revenue it receives from advertisers, as compensation for the Company's sale of promotional space on its Internet properties. Amounts received from such third parties are reflected as revenue on the accompanying statement of operations in the period in which such advertising services were provided.

(h) Research and Development

Statement of Financial Accounting Standards (SFAS) No. 86, *"Accounting for the Cost of Computer Software to Be Sold, Leased, or Otherwise Marketed"*, requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based on the Company's product development process, technological feasibility is established upon completion of a working model. The Company does not incur material costs between the establishment of technological feasibility of its products and the point at which the products are ready for general release. Therefore, research and development costs are charged to the statement of operations as incurred.

Additionally, the Company capitalizes certain internal use software and Website development in accordance with Statement of Position (SOP) 98-1, *"Accounting for the Cost of Computer Software Developed or Obtained for Internal Use",* and EITF 00-2, *"Accounting for Web Site Development Costs"*. The capitalized costs are amortized over their estimated useful lives, which varies between six months and four years.

Note 2 - Summary of Significant Accounting Policies (cont'd)

(i) Accounting for Stock-Based Compensation

As allowed by Statement of Financial Accounting Standards (SFAS) No. 123, *"Accounting for Stock-based Compensation"*, the Company utilizes the intrinsic-value method of accounting prescribed by the Accounting Principles Board (APB) Opinion No. 25, *"Accounting for Stock Issued to Employees"*, and related interpretations, to account for stock option plans for employees and directors. Compensation cost for stock options, if any, would be measured as the excess of the estimated market price of the Company's stock at the date of grant over the amount an employee must pay to acquire the stock.

The fair value of options and warrants granted to non-employees, are measured according to the Black-Scholes option-pricing model with the following weighted average assumptions: . no dividend yield; risk-free interest rates of 1.69% to 4.00%; volatility between 38.00% and 66.76%; and an expected life between one and seven years.

The Company has adopted the disclosure requirements of SFAS No. 123 and SFAS No. 148, *"Accounting for Stock-Based Compensation—Transition and Disclosure"*, for awards to its directors and employees. For disclosure purposes only, the fair value of options granted to employees and directors prior to May 12, 2004, the date of the Company's first filing with the U.S. Securities and Exchange Commission, in connection with it's IPO, was estimated on the date of grant using the minimum-value method with the following weighted average assumptions: no dividend yield; risk-free interest rates of 2.18% to 6.68%; and an expected life of three to five years. The fair value of options granted to employees and directors subsequent to May 12, 2004, are measured, for disclosure purposes only, according to the Black-Scholes option-pricing model with the following weighted average assumptions: . no dividend yield; risk-free interest rates of 2.17% to 3.78%; volatility between 61.57% and 66.76%; and an expected life of four years.

The following illustrates the effect on net loss and net loss per share if the Company had applied the fair value methods of SFAS No. 123 for accounting purposes:

	Years ended December 31		**Cumulative from inception through December 31,**
	2004	**2003**	**2004**
	$	$	**$**
Net loss, as reported	**(6,590,519)**	(2,808,783)	(40,596,117)
Add:			
Stock-based compensation expense to employees and directors included in reported net loss, net of related tax effects	**25,382**	14,995	40,377
Deduct:			
Stock-based compensation expense to employees and directors determined under fair value based method for all awards, net of related tax effects	**(75,363)**	(34,407)	(225,717)
Pro-Forma net loss	**(6,640,500)**	(2,828,195)	(40,781,457)
Net loss per common share, basic and diluted:			
As reported	**(2.90)**	(7.93)	(53.81)

Pro-forma	**(2.92)**	(7.99)	(54.06)

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Note 2 - Summary of Significant Accounting Policies (cont’d)

(j) Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided for the amount of deferred tax assets that, based on available evidence, are not more likely than not to be realized.

(k) Impairment of Long-Lived Assets and Intangible Assets

The Company evaluates its long-lived tangible and intangible assets for impairment in accordance with SFAS No.144, “*Accounting for the Impairment or Disposal of Long-Lived Assets”*, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

(l) Net Loss Per Share Data

Basic and diluted net loss per common share are presented in conformity with the SFAS No. 128, *"Earnings Per Share"*. Diluted net loss per share is the same as basic net loss per share as the inclusion of 3,376,310 common stock equivalents would be anti-dilutive. Share and per-share data presented throughout the financial statements and notes reflect a 1-for-23 reverse stock split that the Company declared in January 2004.

(m) Comprehensive Income (Loss)

Comprehensive income (loss) as defined, includes all changes in equity during a period from non-owner sources. Accumulated other comprehensive income (loss), consists of net unrealized gains and losses on available-for-sale securities, net of tax, and the cumulative foreign currency translation adjustment.

(n) Recently Issued Accounting Standards

In March 2004, the Emerging Issues Task Force (“EITF”) reached a consensus on Issue No. 03-01, “*The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments*” (“EITF 03-1”). EITF 03-1 provides guidance on other-than-temporary impairment models for marketable debt and equity securities accounted for under SFAS No. 115, “*Accounting for Certain Investments in Debt and Equity Securities*” (“SFAS No. 115”), and non-marketable equity securities accounted for under the cost method. The EITF developed a basic three-step model to evaluate whether an investment is other-than-temporarily impaired. On September 30, 2004, the FASB issued FSP 03-1-1, “Effective Date of Paragraphs 10-20 of EITF Issue 03-1, ’The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments’,” delaying the effective date for the recognition and measurement guidance of EITF 03-1, as contained in paragraphs 10-20, until certain implementation issues are addressed and a final FSP providing implementation guidance is issued. Until new guidance is issued, companies must continue to comply with the disclosure requirements of EITF 03-1 and all relevant measurement and recognition requirements in other accounting literature. The Company does not expect the adoption of EITF 03-1 to have a material effect on it’s financial statements.

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Note 2 - Summary of Significant Accounting Policies (cont'd)

(n) Recently Issued Accounting Standards (cont'd)

In December 2004, the FASB issued SFAS No. 153, *"Exchanges of Nonmonetary Assets - an amendment to APB No. 29."* This Statement amends Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. Adoption of this statement is not expected to have a material impact on the results of operations and financial condition of the Company.

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123 (revised 2004), *"Share-Based Payment"*(SFAS No. 123R). This Statement is a revision of SFAS No. 123, *"Accounting for Stock-Based Compensation"*, and it establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. This Statement eliminates the option to use Opinion 25's intrinsic value method of accounting that was provided in SFAS No. 123 as originally issued and it requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award which is usually the vesting period. No compensation cost is recognized for equity instruments for which employees do not render the requisite service. As determined in SFAS No. 123R, the Company will apply its rules as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. SFAS 123R provides two alternative adoption methods. The first method is a modified prospective method whereby a company would recognize share-based employee costs from the beginning of the fiscal period in which the recognition provisions are first applied as if the fair-value-based accounting method had been used to account for all employee awards granted, modified, or settled after the effective date and to any awards that were not fully vested as of the effective date. Measurement and attribution of compensation cost for awards that are unvested as of the effective date of SFAS 123R would be based on the same estimate of the grant-date fair value and the same attribution method used previously under SFAS No. 123, *"Accounting for Stock-Based Compensation"* ("SFAS 123"). The second adoption method is a modified retrospective transition method whereby a company would recognize employee compensation cost for periods presented prior to the adoption of SFAS 123R in accordance with the original provisions of SFAS 123; that is, an entity would recognize employee compensation costs in the amounts reported in the pro forma disclosures provided in accordance with SFAS 123. A company would not be permitted to make any changes to those amounts upon adoption of SFAS 123R unless those changes represent a correction of an error. The Company is currently considering which of the two methods it will adopt, and the effect that the adoption of SFAS 123R will have on its financial statements.

(o) Reclassifications
Certain prior year balances have been reclassified in order to conform to the current year presentation.

Note 3 - Cash and Cash Equivalents and Investment Securities

Cash and cash equivalents consist of the following:

	2004	**2003**
In US dollars	$	$
Cash	**340,762**	68,045
Cash equivalents	**1,107,638**	-
In New Israeli Shekels (Cash only)	**117,015**	55,707
	1,565,415	123,752

The Company’s investment securities consist of investments in auction rate, investment grade, corporate and municipal debt instruments, and auction rate preferred shares of closed-end investment funds that invest in long-term fixed income securities, with auction reset periods of 28 days, classified as available-for-sale securities and stated at fair value.

Note 4 - Deferred Charges

In connection with obtaining the promissory notes and warrants that were issued in January and February, 2004 (see Note 8), the Company incurred, $521,511 and $494,691 of cash and non-cash issuance costs, respectively, in 2004, and $155,116 of cash issuance costs in 2003. The costs incurred in 2003 were recorded as deferred charges on the accompanying balance sheet as of December 31, 2003. The portion of the issuance costs ascribed to the promissory notes was amortized over the life of the notes. On October 13, 2004, upon completion of the IPO, approximately $134,000 of the unamortized balance of the deferred charges relating to the promissory notes that were converted into equity, was deducted from additional paid-in capital. The portion of the charges ascribed to the warrants in the amount of approximately $147,000, was deducted from additional paid-in capital upon issuance of the warrants.

Note 5 - Long-term Deposits

Long-term deposits are comprised of restricted deposits with banks to secure a bank guarantee and credit card debt, and restricted deposits with the Company's merchant bank. The aforesaid deposits with banks are comprised of a deposit which bears interest at a rate of the London Inter-Bank Bid Rate (LIBID) less 0.69% and is automatically renewed on a monthly basis, and a money market account. The merchant bank deposit is non-interest bearing and may be held until such time that the Company terminates its relationship with the merchant bank.

Note 6 - Property and Equipment, Net

Property and equipment as of December 31, 2004 and 2003 consisted of the following:

	2004	**2003**
	$	$
Computer equipment	**1,142,406**	945,831
Furniture and fixtures	**228,646**	216,689
Leasehold improvements	**56,355**	53,162
	1,427,407	1,215,682
Less: accumulated depreciation and amortization	**(1,121,603)**	(1,009,274)
	305,804	206,408

The balances of property and equipment include the effect of foreign currency translation. During the years 2004 and 2003 the Company recorded $110,479 and $268,026 of depreciation expense, respectively.

Note 7 - Intangible Assets, Net

The following table summarizes the Company's intangible assets as of December 31, 2004:

	Gross carrying amount	Accumulated amortization	Net
	$	$	$
Domain name	**80,200**	**(4,010)**	**76,190**
Capitalized software development costs	**39,736**	**(4,637)**	**35,099**
	119,936	**(8,647)**	**111,289**

The intangible assets are all amortizable and have original estimated useful lives as follows: Domain name - ten years; Capitalized software development costs - six months to four years. There were no intangible assets as of December 31, 2003. Based on the current amount of intangibles subject to amortization, the estimated amortization expense for each of the succeeding five years is as follows: 2005 - $25,000; 2006 - $16,000; 2007 - $14,000; 2008 - $12,000; 2009 - $8,000.

Note 8 - Convertible Promissory Notes

On January 30, 2004, and February 17, 2004, the Company issued, in aggregate, $5 million of 8% Convertible Promissory Notes (the "Notes"). The aggregate principal amount of the Notes included $200,000 previously advanced to the Company by investors in 2003 that was converted into Notes in conjunction with the transaction. The Notes were due on the earlier of one year after their issuance or the consummation of an IPO. Upon consummation of an IPO, a minimum of 50% (and up to 100% at the election of each note holder) of the principal amount of the Notes were to be converted into shares of Common Stock at a conversion price equal to 75% of the offering price of the IPO (the "Offering Price").

In connection with the issuance of the Notes, the Company also issued warrants to acquire an aggregate of 1,700,013 shares of Common Stock at an exercise price per share equal to 120% multiplied by the greater of (1) $6.00, and (2) the Offering Price (the "Warrants"). Each note holder received one warrant for every $3 funded through the Notes, with the exception of the note holders who advanced the Company $200,000 in 2003, who received one warrant for every $2 funded. The Company also issued a warrant to the lead purchaser in the financing, to purchase 265,837 shares of common stock at an exercise price equal to 75% of the Offering Price per share. Further, in July 2004, the Company decided to grant each holder of the Convertible Promissory Notes and Warrants 0.44 warrants for each bridge warrant previously held. Following that decision an aggregate of 750,002 additional warrants were issued (see Note 10(f)).

In October 2004, prior to the IPO Effective Date, the National Association of Securities Dealers, Inc. (the NASD) deemed that $1,350,000 of the Convertible Promissory Notes and 648,534 Warrants, received by certain Purchasers, were underwriter's compensation, because of the relationship between those note holders and one of the Company's underwriters. As a result of this finding, such note holders were contractually obligated to surrender such warrants to the Company without consideration, and to surrender their Notes to the Company for repayment.

On October 13, 2004, the Company completed its IPO and $1,840,000 of the Notes converted into 490,678 shares of common stock. The remaining $3,160,000 of the Notes, including the $1,350,000 of the Notes, mentioned above, were repaid subsequent to the IPO closing date. In the Company's estimation,

Note 8 - Convertible Promissory Notes (cont'd)

approximately $809,000 of the Notes related to the value of the warrants that were issued on the same date, resulting in a note discount of $809,000. Following the NASD finding as mentioned above, the Company cancelled warrants valued at approximately $214,000 and adjusted paid-in capital accordingly. The Company also recorded an additional note discount, with a corresponding increase in paid-in capital, of approximately $2,476,000, to account for the beneficial conversion terms that the promissory note holders received, in comparison to the expected IPO offering price.

In accordance with EITF 00-27, the aforesaid note discounts were to be amortized to interest expense over the life of the promissory notes, which was one year. However, upon the IPO, on October 13, 2004, the unamortized discount relating to the portion of the Notes that converted into shares was immediately recognized as interest expense. Upon repayment of approximately 63% of the Notes, the same percentage of the intrinsic value of the beneficial conversion feature at the date of extinguishment was reversed in APIC in the amount of approximately $1,493,000, and interest in the same amount, previously recorded relating to the beneficial conversion feature that was reversed in paid-in capital, was functionally reversed by the recording of a gain on extinguishment of debt.

In connection with the issuance of the Notes and warrants, the Company incurred, $521,511 and $494,691 of cash and non-cash issuance costs, respectively, in 2004, and $155,116 of cash issuance costs in 2003. The amortization of such issuance costs resulted in $889,983 of interest expense and a net decrease of $281,335 to additional paid-in capital, and additional paid-in capital was also increased by $262,489 upon issuance of the 750,002 additional warrants, as described. During 2004, the Company also recorded approximately $2,750,000 of interest expense, in conjunction with the amortization of the Note discounts, and $448,260 of interest expense relating to the face amount of interest of the Notes.

Subsequent to the balance sheet date, 1,941,215 warrants, that were issued in connection with the issuance of the Notes, were exercised (see Note 16).

Note 9 - Deposits and Liability in Respect of Employee Severance Obligations

Under Israeli law, employers are required to make severance payments to dismissed employees and employees leaving employment in certain other circumstances, on the basis of the latest monthly salary for each year of service. This liability is provided for by payments of premiums to insurance companies under approved plans and by a provision in these financial statements.

The Company's employees are entitled to notice periods generally ranging from thirty to ninety days in the event they are terminated. The above liability does not include a provision for such notice periods.

Note 10 - Stockholders' Equity (Deficit)

On October 13, 2004, the Company completed an IPO of 2.35 million shares of its common stock at $5 per share pursuant to a Registration Statement on Form SB-2 (Registration no. 333-115424). Additionally, the underwriters exercised a portion of their over-allotment option and purchased an additional 352,500 shares of the Company's common stock, at $5 per share, on November 18, 2004. Total proceeds of this offering, including the exercise of the over-allotment option, were approximately $10,716,000, net of underwriting fees and offering expenses of approximately $2,796,000. As a result of the offering, $1,840,000 of the promissory notes converted into 490,678 shares of common stock and the remaining $3,160,000 was repaid.

As of December 31, 2003, the Company's share capital was comprised of common stock and four separate classes of convertible preferred stock. In January 2004, the preferred stockholders, as a class, agreed to convert all of the 1,372,048 shares of the Company's issued and outstanding preferred stock into common stock. The amounts as of December 31, 2003 included in this note, describe the composition of the preferred stock, and the rights and preferences of such shares prior to such conversion.

(a) General

The Company's share capital at December 31, 2004 and 2003 is comprised as follows:

	Authorized	**Issued and fully paid**	**Authorized**	**Issued and fully paid**
	December 31, 2004		**December 31, 2003**	
	Number of shares		**Number of shares**	
Series A convertible preferred stock of $0.01 par value	-	-	130,325	130,325
Series B convertible preferred stock of $0.01 par value	-	-	217,203	181,112
Series C convertible preferred stock of $0.01 par value	-	-	260,643	238,119
Series D convertible preferred stock of $0.01 par value	-	-	824,646	807,468
Series D convertible preferred non-voting stock of $0.01 par value	-	-	21,721	15,024
Preferred stock of $0.01 par value	**1,000,000**	-	-	-
Common stock of $0.001 par value	**30,000,000**	**4,920,551**	2,856,937	355,325
	31,000,000	**4,920,551**	4,311,475	1,727,373

The outstanding Series D convertible preferred non-voting shares were identical in all other respects to Series D convertible preferred voting shares.

Note 10 - Stockholders' Equity (Deficit) (cont'd)

(b) Stock Option Plans

The Company provides for direct grants or sales of common stock, and common stock options to employees and non-employees through the following: the 1999 Stock Option Plan (the 1999 Plan), the 2000 Stock Option Plan (the 2000 Plan), the 2003 Stock Option Plan (the 2003 Plan) (thereafter collectively "Prior Option Plans") and the 2004 Stock Option Plan (the 2004 Plan).

In January 2004, the Company adopted the 2004 Stock Option Plan (the 2004 Plan), authorizing 866,000 options for future grants. As of December 31, 2004, 471,304 options were available for grant under the 2004 plan and the Prior Option Plans were closed for future grants. The exercise or purchase price for common stock granted or sold to employees under the Prior Option Plans was equal to or greater than the fair market value per share on the date of grant.

Under all option plans, options generally vest 25%, with respect to the number granted, upon the first anniversary date of the option grant, and the remainder vest in equal monthly installments over the 36 months thereafter. When vested, options are exercisable immediately.

The options generally expire ten years after grant date and are forfeited if not exercised within three months of termination of employment by employees.

(c) Other Stock Options

On October 13, 2004, the Company issued to its underwriters 117,500 options for a total purchase price of $100. These options were issued outside of the Company's stock option plans as compensation for services rendered in connection with the IPO. The options will be exercisable on October 13, 2005, expire 5 years from the date of issuance and have an exercise price of $6.25 per share. The fair value of the options granted to the underwriters was estimated using the Black-Scholes option-pricing model with the following weighted average assumptions: no dividend yield; volatility of 49%; risk-free interest rates of 2.17%; and an expected life of one year. The fair value of the underwriters' options was determined to be $70,374 and was recorded as part of additional paid-capital.

As of December 31, 2004, 153,151 options were issued and outstanding outside of the Company's stock option plans.

Note 10 - Stockholders' Equity (Deficit) (cont'd)

(d) Option Grant Information

A summary of the status of the 1999, 2000, 2003 and 2004 plans, and of the other options, follows:

	Options available for grant	Options outstanding	Weighted average exercise price $
Balance as of December 31, 2002	273,562	251,119	9.90
Granted	(244,367)	244,367	1.84
Exercised	-	(1,449)	0.69
Cancelled *	56,190	(66,801)	10.13
Balance as of December 31, 2003	85,385	427,236	4.37
Additional options authorized (2003 Plan)	**299,305**	**-**	-
Additional options authorized (2004 Plan)	**866,000**	**-**	-
Cancelled (closing of the 2003 Plan)	**(77,126)**	**-**	-
Granted (2004 and 2003 Plans)	**(702,260)**	**702,260**	5.16
Granted (other options)	**-**	**117,500**	6.25
Exercised	**-**	-	-
Expired	**-**	**(43,441)**	2.76
Balance as of December 31, 2004	**471,304**	**1,203,555**	5.06

* Includes cancelled options from closed stock option plans

The following table summarizes information about stock options outstanding as of December 31, 2004:

	Options Outstanding			Options Vested	
Range of exercise prices	**Number outstanding**	**Weighted average remaining contractual life (years)**	**Weighted average exercise price**	**Number outstanding**	**Weighted Average Exercise Price**
$0.69-1.15	169,576	7.71	$ 0.75	146,380	$ 0.76
2.30-2.76	87,135	6.39	2.59	61,895	2.51
4.60-6.91	828,888	9.43	5.33	39,475	5.58
9.21-11.51	117,956	6.52	11.21	108,634	11.18
0.69-11.51	1,203,555	8.68	5.06	356,384	4.78

Note 10 - Stockholders' Equity (Deficit) (cont'd)

(e) Stock Based Compensation

The Company measures compensation expense for its stock-based employee compensation plans using the intrinsic value method. As a result of the stock-based employee compensation, the Company recorded compensation expense in the amount of $25,382 and $14,995, in 2004 and 2003, respectively. As of December 31, 2004, approximately $99,000 remains to be amortized over the remaining vesting periods of the options. If the fair value based method had been applied in measuring stock compensation expense, the pro forma effect on net loss and net loss per share would have been as follows:

	Years ended December 31		**Cumulative from inception through December 31,**
	2004	**2003**	**2004**
	$	$	**$**
Net loss, as reported	**(6,590,519)**	(2,808,783)	(40,596,117)
Add:			
Stock-based compensation expense to employees and directors included in reported net loss, net of related tax effects	**25,382**	14,995	40,377
Deduct:			
Stock-based compensation expense to employees and directors determined under fair value based method for all awards, net of related tax effects	**(75,363)**	(34,407)	(225,717)
	(6,640,500)	(2,828,195)	(40,781,457)
Net loss per common share, basic and diluted:			
As reported	**(2.90)**	(7.93)	(53.81)
Pro-forma	**(2.92)**	(7.99)	(54.06)

The weighted average fair value of options where the exercise price equaled the market price on grant date was $2.69 for grants in the year ended December 31, 2004. No such options were granted in 2003. The weighted average fair value of options where the exercise price exceeded the market price on grant date was $0 for grants in the years ended December 31, 2004 and 2003. The weighted average fair value of options where the exercise price was less than the market price on grant date was $1.92 for grants in the year ended December 31, 2003. No such options were granted in 2004.

Note 10 - Stockholders' Equity (Deficit) (cont'd)

(f) Stock Warrants

(i) In connection with obtaining a line of credit from a bank in 2002, the Company issued warrants to the bank to purchase 2,173 shares of Series D preferred stock for $34.53 per share. The warrants are exercisable immediately and expire in April 2009. In January 2004, these warrants converted to common stock warrants.

(ii) In connection with the issuance of the Notes (see Note 8), the Company issued warrants to acquire an aggregate 1,700,013 shares of common stock at an exercise price per share equal to 120% multiplied by the greater of (1) $6.00, and (2) the Offering Price (the "Bridge Warrants"). Each note holder received one bridge warrant for every $3 funded through the Notes, with the exception of the note holders who advanced the Company $200,000, in 2003, who received one Bridge Warrant for every $2 funded. In July 2004, the Company decided to grant the holders of the Convertible Promissory Notes and Warrants an aggregate of 750,002 additional warrants. These additional warrants contained terms identical to the Bridge Warrants except for certain expiration provisions. In October 2004, following the demand of the NASD, certain note holders were contractually obligated to surrender 648,534 warrants to the Company without consideration (see Note 8).

In connection with the original issuance of the Bridge Notes and warrants in January 2004, the Company also issued a warrant to the lead purchaser in the financing, to purchase 265,837 shares of common stock at an exercise price equal to 75% of the Offering Price per share.

The aggregate fair value of all of the warrants mentioned above was determined to be approximately $1,090,000 using the Black-Scholes option-pricing model with the following assumptions: no dividend yield; volatility of 38%; risk free interest rate of 4%; and an expected life of seven years.

The majority of these warrants were exercised subsequent to the balance sheet date (see Note 16).

Note 11 - Income Taxes

The income tax expense for the years ended December 31, 2004 and 2003, differed from the amounts computed by applying the U.S. federal income tax rate of 34% to pretax income as a result of the following:

	Years ended December 31		Cumulative from inception through December 31,
	2004	2003	2004
	$	$	$
Computed "expected" tax benefit	**2,226,987**	943,225	13,777,129
Effect of State taxes	**329,259**	260,922	3,493,876
Effect of foreign income	**(157,016)**	24,739	439,876
Non-deductible expenses	**(208)**	(55)	(14,002)
Change in valuation allowance	**(2,439,579)**	(1,263,422)	(17,771,617)
	(40,557)	(34,591)	(75,148)

The types of temporary differences that give rise to significant portions of the Company's deferred tax assets and liabilities are set out below:

	Years ended December 31	
	2004	2003
	$	$
Deferred tax asset:		
Miscellaneous accrued expenses	**40,584**	29,017
Property and equipment	**27,348**	419,958
Deferred compensation	**328,222**	303,803
Capitalized start-up costs	**2,418,734**	3,535,073
Foreign deferred tax assets	**19,817**	20,501
Net operating loss	**14,956,729**	11,044,187
Total gross deferred tax asset	**17,791,434**	15,352,539
Less: Valuation allowance	**(17,771,617)**	(15,332,038)
Net deferred tax asset	**19,817**	20,501
Total gross deferred tax liability	**(94,965)**	(55,092)
Net deferred tax liability	**(75,148)**	(34,591)

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Note 11 - Income Taxes (cont'd)

Because of the Company's lack of earnings history, as of December 31, 2004 and 2003, the U.S. deferred tax assets have been fully offset by a valuation allowance. The net change in the total valuation allowance for the years ended December 31, 2004 and 2003 was an increase of $2,439,579 and $1,263,422, respectively.

As of December 31, 2004 and 2003, the Company has net operating loss carryforwards for federal and state income tax purposes of approximately $35 million and $26 million, respectively. The federal net operating losses will expire if not utilized on various dates from 2019 through 2024. The California net operating losses will expire if not utilized on various dates from 2009 through 2013. The Israeli Subsidiary has capital loss carryforwards of approximately $604,000 that can be applied to future capital gains for an unlimited period of time under current tax rules.

The Tax Reform Act of 1986 imposed substantial restrictions on the utilization of net operating losses and tax credits in the event of an ownership change of a corporation. Thus, in accordance with Internal Revenue Code, Section 382, the Company's recent IPO and other ownership changes that have transpired, will significantly limit the Company's ability to utilize net operating losses and credit carryforwards although the Company has not yet determined to what extent..

During the year 2000, the Subsidiary was granted "Approved Enterprise" status under the Israeli Law for the Encouragement of Capital Investments - 1959 under the "alternative benefits" path. As an "Approved Enterprise" the Israeli Subsidiary is entitled to receive future tax benefits, which are limited to a period of ten years from the first year that taxable income is generated from the approved assets. In addition, the benefits must be utilized within: the earlier of 12 years of the year operation (as defined) of the investment program begins or 14 years of the year that approval is granted.

Under its "Approved Enterprise" status, income arising from the subsidiary's approved activities is subject to zero tax under the "alternative benefit" path for a period of ten years. In the event of distribution by the subsidiary of a cash dividend out of retained earnings which were tax exempt due to the "Approved Enterprise" status, the subsidiary would have to pay a 10% corporate tax on the amount distributed, and the recipient would have to pay a 15% tax (to be withheld at source) on the amounts of such distribution received. Should the subsidiary derive income from sources other than the Approved Enterprise during the relevant period of benefits, such income would be taxable at the tax rate in effect at that time (currently 36%). Deferred tax assets and liabilities in the financial statements result from the tax amounts that would result if the Subsidiary distributed its retained earnings to its Parent.

During 2003, the Subsidiary filed a final status report on its investment program. Final approval of the program was received from the Investment Center in March 2004. The approval has yet to be upheld by the Israeli income tax authorities. In addition, in February 2004, the Subsidiary applied for a second (expansion) investment program based on terms similar to the first investment program. Formal approval of the application in respect of the second program was received from the Investment Center in July 2004.

Under its Approved Enterprise status, the Subsidiary must maintain certain conditions and submit periodic reports. Failure to comply with the conditions of the Approved Enterprise status could cause the Subsidiary to lose previously accumulated tax benefits. The Subsidiary began claiming benefits in the 2000 tax year. Cumulative benefits received under the Subsidiary's approved enterprise status amount to approximately $700,000 at December 31, 2004. As of the balance sheet date the Company believes that it is in compliance with the stipulated conditions.

Note 12 - Commitments and Contingencies

(a) Future minimum lease payments under non-cancelable operating leases for office space and cars, as of December 31, 2004 are as follows:

Year ending December 31	$
2005	183,421
2006	55,644
2007	20,210
	259,275

Rental expense for operating leases for the years ended December 31, 2004 and 2003 was $271,099 and $212,680, respectively.

(b) As security for future rental commitments the Subsidiary provided a bank guarantee in the amount of approximately $113,000.

(c) All of the Subsidiary's obligations to its bank, including the bank guarantee that such bank made to the Subsidiary's landlord, are secured by a lien on all of the Subsidiary's deposits at such bank. As of December 31, 2004, deposits at such bank amounted to $364,690 , including a long-term deposit of $101,531 as mentioned in Note 5.

(d) In the ordinary course of business, the Company enters into various arrangements with vendors and other business partners, principally for content, web-hosting, marketing and investor relations arrangements. During 2004, the Company entered into agreements to license content from two providers, through December 2006 and August 2007, for an aggregate amount of $265,000, and entered into an agreement with an investor relations firm to provide services through December 2005 for $8,000 per month and 7,800 shares of its common stock. Regarding commitments entered into subsequent to balance sheet date see Note 16.

(e) In December 2002, the Company implemented a reorganization (the "December 2002 Reorganization ") which substantially reduced the Company's expenditures. The December 2002 Reorganization included staff reductions of fifteen persons, or approximately 52% of the Company's work force, including senior management, professional services, sales and marketing, research and development and administrative staff. The December 2002 Reorganization also included the shutdown of the Company's California office and resulted in a loss on the disposal of fixed assets. In total, the Company incurred a loss of approximately $1,048,000 in connection with the December 2002 Reorganization, of which $780,000 related to the disposal of fixed assets, and $265,000 related to an accrual for salaries, benefits and office and equipment lease obligations that the Company recorded as of December 31, 2002. Of the amount accrued, $22,000 and $218,000 was paid during 2004 and 2003, respectively, and $25,000, which relates to a lease obligation for equipment no longer in use, remains outstanding as of December 31, 2004.

Note 13 - Fair Value of Financial Instruments

The Company's financial instruments at December 31, 2004 and 2003 consisted of cash and cash equivalents, accounts receivables, prepaid expenses, deposits in respect of employee severance obligations, security deposits in respect of the Subsidiary’s office lease and the Company’s merchant bank, accounts payable, accrued expenses, accrued compensation and related liabilities, liability in respect of employee severance obligations and deferred revenues.

The carrying amounts of all the financial instruments noted above, except for liability in respect of employee severance obligations, approximate fair value due to the relatively short maturity of these instruments. The carrying amount of the liability in respect of employee severance obligations reflects the approximate fair value inclusive of future salary adjustments.

Note 14 - Other Expense, Net

In 2004 the Company incurred approximately $90,000 in costs relating to its plan to be listed on the Nasdaq SmallCap Market and the Boston Stock Exchange. In October 2004, the Company decided to instead list on the American Stock Exchange, and as a result the aforesaid costs were written off in the fourth quarter of 2004 and are included as other expenses in the accompanying statement of operations. The remaining balance in other expense, net, in 2004 and 2003, is comprised primarily by foreign exchange gains (losses) and the write-off of tax advances that are not expected to be realized due to the subsidiary’s “approved enterprise” status.

Note 15 - Related Parties

In March 2004, one of the members of the Company’s board of directors purchased the Internet domain name, “www.Answers.com,” from an unrelated third party for $80,200. Immediately following such purchase, the Internet domain name was transferred to the Company and the board member was reimbursed $80,200. The terms of transaction were as favorable to the Company as those generally available from unaffiliated third parties. However, at the time this transaction was entered into, the Company lacked sufficient disinterested independent directors to ratify the transaction.

Note 16 - Subsequent Events

(a) Subsequent to the balance sheet date, 69,432 of the warrants that were issued in connection with the issuance of the convertible promissory notes (see Note 8) were exercised. As a result, the Company issued an aggregate of 69,432 shares of its common stock, $0.001 par value (the "Common Stock"), for a total consideration of approximately $500,000. Additionally, on February 4, 2005 the Company entered into an agreement (the "Agreement"), with certain holders (the "Holders") of warrants that were issued by the Company in January, February and July 2004 in connection with the bridge financing transaction (the "Bridge Warrants") (see Note 8), pursuant to which the Holders exercised an aggregate of 1,871,783 Bridge Warrants at the stated exercise price thereof. As a result, the Company issued an aggregate of 1,871,783 shares of its common stock, $0.001 par value (the "Common Stock"), for aggregate gross consideration of $12,559,700.Under the terms of the Agreement, in order to provide incentive to the Holders to exercise their Bridge Warrants, for every share of Common Stock purchased by the Holders through the exercise of Bridge Warrants, the Company issued to the Holders new warrants, dated February 4, 2005, to purchase such number of shares of Common Stock equal to 55% of the number of shares of Common Stock underlying their respective Bridge Warrants, at an exercise price of $17.27 per share (the "New Warrants"). The exercise price of the New Warrants is equal to 110% of the average of the closing prices of the Common Stock as reported on the American Stock Exchange for the five trading days immediately prior to February 4, 2005. The New Warrants are immediately exercisable and expire on February 4, 2010.

The Company has agreed to file a registration statement with the SEC as promptly as reasonably practicable to register for resale the shares of Common Stock underlying the New Warrants. Upon the occurrence of certain events, including the failure by the Company to file the registration statement on or prior to April 6, 2005 and the failure of the registration statement to be declared effective by the SEC on or prior to May 5, 2005, the Holders will be entitled to certain liquidated damages equal to 1% of the aggregate exercise price of the exercised warrants, for the first month, and 1.5% for each month thereafter, prorated for any partial month.

(b) Subsequent to the balance sheet date, the Company entered into agreements with two consulting firms for the provision of services in the areas of public relations and strategic planning. The agreements, which are all for one year, the latest of which terminates in February 2006, are for an aggregate cash amount of $180,000. In connection with the aforesaid agreements, the Company also agreed to grant one of the consulting firms 20,000 stock options that vest over the twelve-month service period.

GURUNET CORPORATION
(Formerly Atomica Corporation)
AND SUBSIDIARY

(A Development Stage Enterprise)

Consolidated
Financial Statements
December 31, 2004
(With Registered Public Accounting Firm's Report Thereon)