

QUOTESMITH COM INC  
Form 10-Q  
November 12, 2003

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**  
for the quarterly period ended September 30, 2003.

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**  
for the transition period from to .

## **QUOTESMITH.COM, INC.**

(Exact name of Registrant as specified in its charter)

Delaware

36-3299423

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(State or other jurisdiction  
of incorporation or organization)

(I.R.S. Employer  
Identification Number)

**8205 South Cass Avenue, Suite 102**  
**Darien, Illinois 60561**  
**(630) 515-0170**

(Address and telephone number, including  
Area Code, of Registrant's principal executive offices)

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

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

The number of outstanding shares of the registrant's common stock was 4,930,998 net of treasury shares, on October 31, 2003.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

**QUOTESMITH.COM, INC.  
BALANCE SHEETS**

**September 30,  
2003  
(Unaudited)**

**December 31,  
2002**

**ASSETS**





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Cash and equivalents	\$	543,007	\$	1,639,909
Fixed maturity investments available for sale at fair value		3,056,350		8,823,890
Commissions receivable, less allowances (2003 \$170,000; 2002 \$197,000)		1,212,752		1,125,544
Other assets		450,149		324,686
<b>Total current assets</b>		<b>5,262,258</b>		<b>11,914,029</b>
Fixed maturity investments - available for sale at fair value		11,610,625		5,843,988
Furniture, equipment, and computer software at cost, less accumulated depreciation (2003 \$2,725,000; 2002 \$2,284,000)		488,576		885,469
Intangible assets at cost, less accumulated amortization (2003 \$876,000; 2002 \$517,000)		557,150		915,317
<b>Total assets</b>	<b>\$</b>	<b>17,918,609</b>	<b>\$</b>	<b>19,558,803</b>

**LIABILITIES AND STOCKHOLDERS EQUITY**





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Accounts payable and accrued liabilities	\$	964,257	\$	1,428,601
Total current liabilities		964,257		1,428,601
Long-term capital lease obligations				35,018
Total liabilities		964,257		1,463,619
Commitments and contingencies				
Stockholders' equity:				
Common stock, \$.003 par value; shares authorized: 60,000,000; shares issued: 2003 7,279,239; 2002 7,268,072		21,838		21,804
Additional paid-in capital		63,997,189		63,972,732
Retained-earnings deficit		(43,227,911)		(42,187,861)
Treasury stock at cost: 2,359,341 shares		(3,793,985)		(3,793,985)
Accumulated other comprehensive income (loss)		(42,779)		82,494
Total stockholders' equity		16,954,352		18,095,184
Total liabilities and stockholders' equity	\$	17,918,609	\$	19,558,803

See accompanying notes.

**QUOTESMITH.COM, INC.**  
**STATEMENTS OF OPERATIONS**

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2003 (unaudited)	2002	2003 (unaudited)	2002
<b>Revenues:</b>				
Commissions and fees	\$ 2,427,146	\$ 2,644,410	\$ 7,495,510	\$ 8,292,263
Other	2,494	22,636	16,051	140,717
Total revenues	2,429,640	2,667,046	7,511,561	8,432,980
<b>Expenses:</b>				
Selling and marketing	1,076,034	622,638	3,734,994	1,877,091
Operations	834,593	2,279,225	2,644,621	6,226,904
General and administrative	929,014	780,811	2,545,702	2,444,504
Total expenses	2,839,641	3,682,674	8,925,317	10,548,499
Operating loss	(410,001)	(1,015,628)	(1,413,756)	(2,115,519)
Interest Income	91,137	83,634	280,632	261,463
Realized gains on sale of securities			93,074	
Net loss	\$ (318,864)	\$ (931,994)	\$ (1,040,050)	\$ (1,854,056)
Net loss per common share, basic and diluted	\$ (0.06)	\$ (0.19)	\$ (0.21)	\$ (0.37)
Weighted average common shares and equivalents outstanding, basic and diluted	4,913,165	4,917,562	4,910,757	4,986,212

See accompanying notes.

**QUOTESMITH.COM, INC.**  
**STATEMENTS OF STOCKHOLDERS EQUITY**

	Common Stock						Accumulated	Total
	Number of	Par	Additional	Retained-	Treasury	Other	Comprehensive	Stockholders
	Shares	Value	Paid-In	Earnings	Stock	Income (Loss)	Income (Loss)	Equity
	Issued		Capital	Deficit				
2002:								
Balance at January 1	7,253,570	\$ 21,761	\$ 63,930,061	\$ (39,461,293)	\$ (2,595,343)	\$ 20,096	\$	21,915,282
Net loss				(2,726,568)				(2,726,568)
Other comprehensive gain unrealized gain on investments						62,398		62,398
Total comprehensive loss								(2,664,170)
Purchase of 446,050 treasury shares					(1,198,642)			(1,198,642)
Proceeds from sale of common stock:								
-exercise of stock options	14,502	43	26,711					26,754
Employee stock compensation			15,960					15,960
Balance at December 31	7,268,072	21,804	63,972,732	(42,187,861)	(3,793,985)	82,494		18,095,184
Nine months ended September 30, 2003 ( <i>unaudited</i> )								
Net loss				(1,040,050)				(1,040,050)
Other comprehensive loss- unrealized loss on investments						(125,273)		(125,273)
Total comprehensive loss								(1,165,323)
Proceeds from sale of common stock:								
-exercise of stock options	11,167	34	24,457					24,491
Balance at September 30, 2003 ( <i>unaudited</i> )	7,279,239	\$ 21,838	\$ 63,997,189	\$ (43,227,911)	\$ (3,793,985)	\$ (42,779)	\$	16,954,352

See accompanying notes.

**QUOTESMITH.COM, INC.**  
**STATEMENTS OF CASH FLOWS**

	Nine Months Ended September 30,	
	2003	2002
	(unaudited)	
<b>Cash flows from operating activities:</b>		
Net loss	\$ (1,040,050)	\$ (1,854,056)
Adjustments to reconcile to net cash used by operating activities:		
Depreciation expense	441,851	753,868
Amortization	441,572	196,945
Accounts payable and accrued liabilities	(462,945)	299,181
Commissions receivable	(87,208)	(126,316)
Loss on disposal of equipment and computer software		371,516
Other assets	(125,463)	(103,460)
Net cash used by operating activities	(832,243)	(462,322)
<b>Cash flows from investing activities:</b>		
Purchases of investments	(12,220,675)	(16,810,664)
Proceeds from investment maturities	7,800,000	16,300,000
Proceeds from sales of investments	4,212,900	
Purchases of furniture, equipment, and computer software	(44,958)	(55,016)
Net cash used by investing activities	(252,733)	(565,680)
<b>Cash flows from financing activities:</b>		
Purchases of treasury stock		(1,198,642)
Issuance of common stock	24,491	
Payment of capital lease obligation	(36,417)	(32,199)
Net cash used by financing activities	(11,926)	(1,230,841)
<b>Net decrease in cash and cash equivalents</b>	<b>(1,096,902)</b>	<b>(2,258,843)</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>1,639,909</b>	<b>4,033,192</b>
<b>Cash and cash equivalents at at end of period</b>	<b>\$ 543,007</b>	<b>\$ 1,774,349</b>

See accompanying notes.

**QUOTESMITH.COM, INC.  
NOTES TO FINANCIAL STATEMENTS**

**(Unaudited)**

**1. Description of Business**

Quotesmith.com, Inc. (the Company) is an Internet-based insurance agency and brokerage. The Company owns and operates a comprehensive, online consumer insurance information service, Insure.com, which caters to the needs of self-directed insurance shoppers. The Company provides a large array of comparative auto, life, homeowners and health insurance quotes, combined with information and decision-making tools. Since its inception in 1984, the Company has been continuously developing a proprietary and comprehensive insurance price comparison and order-entry system that provides instant quotes from over 200 insurance companies and allows any user to purchase insurance from the company of their choice. The Company generates revenues from the receipt of commissions and fees paid by various sources, that are tied directly to the volume of insurance sales or traffic that it produces. The Company conducts its insurance agency and brokerage operations using salaried, non-commissioned personnel, and it generates prospective customer interest using traditional direct response advertising methods conducted primarily offline.

**2. Summary of Significant Accounting Policies**

**Basis of Presentation**



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The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, (consisting of normal recurring accruals), considered necessary for a fair presentation have been included. Operating results for the nine-month period ended September 30, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003.

The balance sheet at December 31, 2002 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements.

### **Stock Options**





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The Company accounts for stock option grants in accordance with Accounting Principles Board Opinion 25, Accounting for Stock Issued to Employees and related interpretations, and, accordingly, recognizes no compensation expense for stock options granted to employees where the exercise price is equal to or greater than the market price at the date of the grant. SFAS 123, Accounting for Stock Based Compensation, requires disclosure of pro forma information regarding net income (loss) per share, using pricing models to estimate the fair value of stock option grants. Had compensation expense for the Company's stock option plans been determined based on the estimated fair value at the date of grant consistent with the methodology prescribed under SFAS 123, approximate net loss and net loss per share would have been as follows:

	Quarter Ended September 30,		Nine Months Ended September 30	
	2003	2002	2003	2002
Net loss	\$ (318,864)	\$ (931,994)	\$ (1,040,050)	\$ (1,854,056)
Less pro forma stock compensation using fair value method	(54,562)	(54,911)	(153,799)	(164,732)
Pro forma net loss	\$ (373,426)	\$ (986,905)	\$ (1,193,849)	\$ (2,018,788)
Net loss per common share, basic and diluted:				
as reported	\$ (0.06)	\$ (0.19)	\$ (0.21)	\$ (0.37)
pro forma	\$ (0.08)	\$ (0.20)	\$ (0.24)	\$ (0.40)

### 3. Commitments and Contingencies

The Company is subject to legal proceedings and claims in the ordinary course of business. The Company is not aware of any legal proceedings or claims that are believed to have a material effect on the Company's financial position.

### 4. Comprehensive Loss

For the Company, comprehensive loss includes net loss and net unrealized investment gain (loss), as follows:

	Quarter Ended September 30		Nine Months Ended September 30	
	2003	2002	2003	2002
Net loss	\$ (318,864)	\$ (931,994)	\$ (1,040,050)	\$ (1,854,056)
Unrealized gain (loss) on investments	(21,149)	8,946	(125,273)	(18,900)
Comprehensive loss	\$ (340,013)	\$ (923,048)	\$ (1,165,323)	\$ (1,872,956)



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

Because we want to provide you with more meaningful and useful information, this Quarterly Report on Form 10-Q includes forward-looking statements that reflect our current expectations and projections about our future results, performance, prospects, and opportunities. We have attempted to identify these forward-looking statements by using words such as may, will, expects, anticipates, believes, intends, or similar expressions. These forward-looking statements are based on information currently available to us and are subject to a number of risks in 2003 and beyond to differ materially from those expressed in, or implied by, these forward-looking statements. These risks, uncertainties, and other factors include, without limitation: our ability to achieve and sustain profitability; demand for life insurance; effects of the hostilities in Iraq and elsewhere on the purchasing decisions of consumers; consumer acceptance of purchasing insurance on the Internet; significant fluctuations in our quarterly results; our ability to develop our brand recognition; our number of agency contracts; our ability to generate revenue from our strategic relationships; our ability to manage our growth; providing accurate insurance quotes; our ability to manage our expenses, quickly respond to changes in our marketplace, and meet consumer expectations; the complexity of our technology and our use of new technology; our ability to hire and retain senior management and other qualified personnel; intense competition in the insurance industry; the rate of acceptance and use of the Internet as a means for commerce; our ability to keep pace with technological changes and future regulations affecting our business; the implementation of the Internet generally; constraints of the systems we employ; and our ability to raise additional capital. See the section entitled "Factors That May Affect Our Future Operating Results" for a description of these and other risks, uncertainties and factors.

You should not place undue reliance on any forward-looking statements. Except as required by the federal securities laws, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, changed circumstances, or any other reason after the date of this quarterly report. All references to we, us, our, Quotesmith, and the Company refer to Quotesmith.com, Inc. and its subsidiary.

### Overview

We generate revenues primarily from the receipt of commissions paid to us by insurance companies based upon the policies sold to consumers through our service. These revenues come in the form of first year, bonus and renewal commissions that vary by company and product. We recognize the full first year commission revenues on term life insurance after the insurance company approves the policy and accepts the initial premium payment. At the time revenue is recognized, an allowance is recorded based on historical information for estimated commissions that will not be received due to the non-payment of installment first year premiums. We recognize commissions on all other lines of business after we receive notice that the insurance company has received payment of the related premium. First year commission revenues per policy can fluctuate due to changing premiums, commission rates, and types or amount of insurance sold. We occasionally receive bonuses based upon individual criteria set by insurance companies. We recognize bonus revenues when we receive notification from the insurance company of the bonus due to us. Bonus revenues are typically higher in the fourth quarter of our fiscal year due to the bonus system used by many life insurance companies. Revenues for renewal commissions are recognized after we receive notice that the insurance company has received payment for a renewal premium. Renewal commission rates are significantly less than first year commission rates and may not be offered by every insurance company. To a lesser extent, we also generate revenues from the receipt of fees paid by various sources, that are tied directly to the volume of insurance sales or traffic that we produce for such third-party entities.

The timing between when we submit a consumer's application for insurance to the insurance company and when we generate revenues has varied over time. The type of insurance product and the insurance company's backlog are the primary factors that impact the length of time between submitted applications and revenue recognition. Over the past three years, the time between application submission and revenue recognition has averaged approximately four months. Any changes in the amount of time between submitted application and revenue recognition, of which a significant portion of time is not under our control, will create fluctuations in our operating results and could harm our business, operating results and financial condition.

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Operations expenses are comprised of both variable and semi-variable expenses, including wages, benefits, and expenses associated with processing insurance applications and maintaining our database and Web sites. The historical lag between the time an application is submitted to the insurance companies and when we recognize revenues significantly impacts our operating results as most of our variable expenses are incurred prior to application submission.

Selling and marketing expenses consist primarily of direct advertising costs. The costs of communicating the advertising are expensed in the period the advertising is communicated.

Intangible assets acquired in 2001 are being amortized on a straight-line basis over three years.

No income tax credits have been recognized relating to our tax loss carryforwards due to uncertainties relating to future taxable income.

## **Results of Operations**

### **Comparison of the Quarters and Nine Months Ended September 30, 2003 and September 30, 2002**

#### *Revenues*

Revenues for the quarter totaled \$2.43 million, a decrease of \$237,000 from the same quarter in the prior year. Commissions and fees decreased \$217,000, or 8.2% in the third quarter of 2003 compared 2002. Although policies sold decreased 21% to 4,228 in 2003 from 5,378 in 2002, average revenue per policy sold increased to \$575 from \$496 in the third quarter of 2002, an increase of 16%. Advertising and content sale revenue declined \$20,000 in the third quarter of 2003 when compared to the third quarter of 2002, as we no longer sell advertising on our web sites and do not sell our content to others. Revenues for the nine months ended September 30, 2003 totaled \$7.51 million, a decrease of \$921,000 from revenues recorded during the same period in the prior year. Total policies sold declined 4,405, or 26%, from 16,778 during the first nine months of 2002 to 12,373 this year. The effect of this decrease was somewhat mitigated by an increase in total revenue per policy sold of \$104, to \$607 in 2003 from \$503 in the first nine months of last year. In total, commissions and fees decreased \$797,000, while advertising and content sales declined \$125,000.

#### *Expenses*

*Selling and Marketing.* We decided to increase selling and marketing expenses in 2003 in an effort to support our new Insure.com brand name and to increase our traffic. As a result, selling and marketing expenses increased \$453,000, or 73% during the third quarter of 2003 when compared to the same period in 2002, and increased \$1,858,000, or 99%, in the nine months ended September 30, 2003 compared to the first nine months of 2002. This included the placement of several new radio advertisements, a medium we were not using during 2002. We believed that we were in a position to make this investment in marketing because of reduced operations costs, as described below.

*Operations.* Operations expenses decreased 63% to \$835,000 for the quarter ended September 30, 2003, compared to \$2.3 million for the same period in 2002, and decreased \$3.6 million, or 58%, for the nine months ended

September 30, 2003. The decrease in operations expenses is the result of our previously announced cost reduction measures, including the use of our new online order fulfillment technology, which has significantly reduced our handling costs per policy. Third quarter 2002 costs were also impacted by a write off of \$329,000 of computer software resulting from our decision to discontinue our California automobile insurance quoting engine. The operations costs per paid policy decreased to \$197 for the quarter ended September 30, 2003 from \$424 per paid policy for the quarter ended September 30, 2002, a decline of 53%. Year to date, our operations costs per policy sold were \$214, a decrease of \$157 from the same period in the prior year.

*General and Administrative.* General and administrative expenses increased approximately \$148,000 or 19%, from \$780,000 for the quarter ended September 30, 2002, to \$929,000 for the quarter ended September 30, 2003, and increased \$101,000, or 4%, during the first nine months of 2003, compared to the same period in 2002.

*Investment Income*

Interest income was \$91,000 in the third quarter of 2003 compared to \$84,000 in the third quarter of 2002. For the nine months ended September 30, 2003, interest income was \$281,000, an increase of \$19,000 over the prior year. The increase in interest income reflects a larger fixed income investment portfolio, primarily as a result of better cash management. During the

second quarter, we sold fixed income investments in order to realize gains of \$93,000. The proceeds were reinvested in fixed income securities.

#### *Income Taxes (Credit)*

We had no income tax credit for 2003 and 2002 due to valuation allowances provided against net deferred tax assets.

#### **Liquidity and Capital Resources**

We currently expect that the cash and fixed maturity investments of \$15.2 million at September 30, 2003 will be sufficient to meet our anticipated cash requirements for at least the next 12 months. The timing and amounts of our working capital expenditures are difficult to predict, and should we decide to purchase more shares of our common stock, engage in acquisitions of companies or their assets, or begin new projects requiring additional resources, we may require additional financing. If we require additional equity financing, it may be dilutive to our stockholders and the equity securities issued in a subsequent offering may have rights or privileges senior to the holders of our common stock. If debt financing is available, it may require restrictive covenants with respect to dividends, raising capital, and other financial and operational matters, which could impact or restrict our operations. If we cannot obtain adequate financing on acceptable terms, we may be required to reduce the scope of our marketing or operations, which could harm our business, results of operations, and our financial condition.

Our sources of funds will consist primarily of commissions and fee revenue generated from the sale of insurance products, investment income, and sales and maturity proceeds from our fixed income portfolio. The principal uses of funds are selling and marketing expenses, operations, general and administrative expenses, purchases of furniture, equipment and software, and the acquisition of treasury stock.

Cash used by operating activities was approximately \$832,000 for the first nine months of 2003, compared with cash used by operating activities of \$462,000 for the same period in 2002. Cash was used by operating activities in the first nine months of 2003 primarily to fund the net loss for the period, as well as to decrease accounts payable and accrued liabilities. In the first nine months of 2002, cash was used to fund the net loss and an increase in commissions receivable. Non-cash charges for depreciation and amortization totaled \$883,000 in 2003 and \$951,000 in 2002, and 2002 also included a non-cash charge of \$329,000 for the write off of computer software resulting from our decision to discontinue our California automobile insurance quoting engine.

Cash used by investing activities was \$253,000 in the first nine months of 2003, compared with cash used by investing activities of approximately \$566,000 in the same period of 2002. During both periods, the purchase of investments exceeded maturities and sales, as we have reduced our cash balance in favor of having more funds invested in fixed income securities.

Cash used by financing activities was \$12,000 in the first nine months of 2003, compared with approximately \$1.2 million used by financing activities for the same period in 2002. The cash used by financing activities in the first nine months of 2002 represents primarily funds used to purchase our common stock under our share repurchase programs. No shares were repurchased during the same period of 2003.





## **Factors That May Affect Our Future Operating Results**

### **Risks Related to Our Business**

#### **Our Internet-based insurance service has not been profitable and may not become profitable in the future**

Our first complete year of focusing on our Internet-based insurance service was 1997. We incurred operating losses each year subsequent to 1997, and through the quarter ended September 30, 2003. Because of our overhead structure, including the ongoing costs of employing highly skilled technical personnel, we need to generate significantly higher revenues in order to achieve profitability. Even if we achieve profitability, we may not be able to maintain profitability in the future. In addition, as our business model evolves, we may introduce a number of new products and services that may or may not be profitable for us.

#### **If the term life insurance industry declines, our business will suffer because a substantial portion of our revenues are currently derived from consumers purchasing term life insurance through us**

For the nine months ended September 30, 2003, approximately 67% of our revenue was derived from the sale of new individual term life insurance policies. Because of this high concentration of revenue from one line of insurance, our current financial condition is largely dependent on the economic health of the term life insurance industry. If sales of term life insurance decline for any reason, our business would be substantially harmed. In addition, in recent years, term life insurance premiums have been declining and may continue to decline in 2003 and 2004. This decline has caused our average commissions per equivalent face amount of a policy to decrease and has contributed to our operating losses since 1997. If term life insurance premiums continue to decline, it will become even more difficult for us to become profitable.

#### **If the purchase of insurance over the Internet or our service offerings do not achieve widespread consumer acceptance, our business will be harmed**

Our future success will depend in large part on widespread consumer acceptance of purchasing insurance via the Internet. The development of an online market for insurance has only recently begun, is rapidly evolving, and likely will be characterized by an increasing number of market entrants. Therefore, there is significant uncertainty with respect to the viability and growth potential of this market. Our future growth, if any, will depend on the following critical factors:

the growth of the Internet as a commercial medium generally, and as a market for consumer financial products and services specifically;

the continued participation and interest of major, brand-name insurers, and, in particular, their willingness to have their insurance products distributed on an e-commerce platform without the involvement of a face-to-face

agent or broker;

consumers' willingness to conduct self-directed insurance research;

our ability to successfully and cost-effectively market our services to a sufficiently large number of consumers;

our ability to consistently fulfill application requests on an efficient and timely basis; and

our ability to overcome a perception among many consumers that obtaining insurance online is risky.

We cannot assure you that the market for our services will develop, that our services will be adopted or that consumers will significantly increase their use of the Internet for obtaining insurance. If the online market for insurance fails to develop or develops more slowly than we expect, or if our services do not achieve widespread market acceptance, our business would be significantly harmed.

**We may generate limited revenues because consumers can obtain free quotes and other information without purchasing insurance through our Web sites**

We generate commission revenues only if a consumer purchases insurance through our service. Consumers can access our Web sites and obtain quotes and other information free of charge without any obligation to purchase insurance through us. Because all of the insurance policies quoted at our Web sites can be purchased through sources other than us, consumers may take the quotes and other information that we provide to them and purchase one of our quoted policies from the agent or broker of their choice. If consumers only use our Web sites for insurance quote information purposes, we will not generate revenues and our business would be significantly harmed.

**We may experience significant fluctuations in our quarterly results, which makes it difficult for investors to make reliable period-to-period comparisons and may contribute to volatility in our stock price**

Our quarterly revenues and operating results have fluctuated widely in the past and we expect them to continue to fluctuate widely in the future. Causes of these fluctuations could or have included, among other factors:

changes in selling and marketing expenses, as well as other operating expenses;

dramatic swings in monthly unique visitors from one month to the next without any forewarning;

the length of time it takes for an insurance company to verify that an applicant meets the specified underwriting criteria this process can be lengthy, unpredictable, and subject to delays over which we have little or no control, including underwriting backlogs of the insurance company and the accuracy of information provided by the applicant; we tend to place a significant number of policies with the most price-competitive insurance companies, which, due to volume, have longer and more unpredictable underwriting time frames;

volatility in bonus commissions from insurance companies, which typically are highest in the fourth quarter;

volatility in renewal commission income;

the conversion and fulfillment rates of consumers applications, which vary according to insurance product;

new sites, services and products by our competitors;

price competition by insurance companies in the sale of insurance policies; and

the level of Internet usage for insurance products and services.

In addition, we have a very long revenue cycle. As a result, substantial portions of our expenses, including selling and marketing expenses, are incurred well in advance of potential revenue generation. If revenues do not meet our expectations as a result of these selling and marketing expenses, our results of operations will be negatively affected.

Any one or more of the above-mentioned factors could harm our business and results of operations, which makes quarterly predictions difficult and often unreliable. As a result, we believe that quarter-to-quarter comparisons of our operating results are not necessarily meaningful and not good indicators of our future performance. Due to the above-mentioned and other factors, it is possible that in one or more future quarters our operating results will fall below the expectations of securities analysts and investors. If this happens, the trading price of our common stock would likely decrease.

**We must further develop our brand recognition in order to remain competitive**

There are a number of Web sites that offer services that are competitive with our services. Therefore, we believe that broader recognition and a favorable consumer perception of the Insure.com brand is essential to our future success. Accordingly, we intend to continue to pursue an aggressive, brand-enhancement strategy consisting of advertising, online marketing, and promotional

efforts. If these expenditures do not result in a sufficient increase in revenues to cover these additional selling and marketing expenses, our business, results of operations, and financial condition would be harmed.

**We do not have agency contracts with all of the insurance companies we quote on our Web sites and some insurance companies may refuse to participate in our database or refuse to do business with us or cancel existing agency contracts**

While we obtain the information contained in our database directly from over 200 insurance companies being quoted and listed at our Web sites, we currently hold agency contracts with 193 of these insurance companies. The contracts we do hold can generally be cancelled by the insurance company at any time for any reason or for no reason. We typically seek formal agency appointment from an insurance company after we receive a purchase request for that insurance company's product from a consumer. In the past a number of insurance companies quoted on our Web sites have refused to appoint us as an agent or refused to permit us to publish their quotes for various reasons, including:

we do not meet with our customers on a face-to-face basis;

some insurance companies may have exclusive relationships with other agents;

we publicly market our service on a price-oriented basis which is not compatible with the insurance company's branding efforts; and

a formal business relationship with us might be perceived negatively by the insurance company's existing distribution channels.

We do not intentionally include in our database insurance companies who object to their inclusion. If a significant number of insurance companies object to the inclusion of their information in our database, the breadth of our database would be limited. If consumers purchase a material number of policies from insurance companies with whom we are not appointed as an agent, and these insurance companies refuse to enter into agency contracts with us, or if a significant number of insurance companies with which we presently hold agency contracts decide to cancel them, it could harm our business and results of operations.

**Our strategic relationships and agreements may not generate a material amount of revenues for us**

As part of our marketing strategy, we have entered into certain strategic relationships and agreements with third-party Web sites and companies in order to increase the realized revenue from visitors to our Web sites. During the first nine months of 2003, we generated fee revenues totaling \$1,306,000 from these sources. Most of these strategic agreements permit either party to terminate the agreement with short notice. As a result, we cannot assure you that any of these relationships or agreements will be profitable or generate any material amount of revenues in the future.

If our strategic relationships and agreements do not meet our expectations regarding revenues and earnings, our business could be harmed.

**If we do not manage our growth effectively, our business could be harmed**

We have expanded our operations significantly since May 1996 and anticipate that further expansion may be required to realize our growth strategy. Our operations growth has placed significant demands on our management and other resources, which is likely to continue. To manage our future growth, we will need to attract, hire and retain highly skilled and motivated officers, managers, and employees and improve existing systems and/or implement new systems for:

transaction processing;

operational and financial management; and

training, integrating, and managing our employee base.

We may not be successful in managing or expanding our operations or maintaining adequate management, financial, and operating systems and controls.

**If we lose any of our key executive officers our business may suffer because we rely on their knowledge of our business**

We believe that our success is significantly dependent upon the continued employment and collective skills of our executive officers, including Founder and Chief Executive Officer, Robert S. Bland, and Executive Vice President and Chief Operating Officer, William V. Thoms. We maintain key man life insurance policies on Messrs. Bland and Thoms, and both of these officers have entered into employment contracts with us. The loss of either of these two executives or any of our other key executive officers could harm our Company.

**If our quotes are inaccurate and we must pay out cash reward guarantees, our business could be harmed**

We offer consumers a \$500 cash reward guarantee that we provide an accurate quote. In 1999 we paid \$12,000, in 2000 we paid \$11,500, in 2001 we paid \$7,500 and for the year ended December 31, 2002, we paid \$10,000 in such cash rewards. During the first nine months of 2003, we paid \$7,500 in cash rewards. If our quotes or those of services with respect to which we have click-through arrangements are inaccurate and we are required to pay a material number of cash reward guarantees, it could have a negative effect on our operating results.

**Risks Related to the Insurance Industry**

**Our bonus commission revenues are highly unpredictable which may cause fluctuations in our operating results**

Our bonus commission revenues relate to the amount of premiums paid for new insurance policies to a single insurance company. In other words, if consumers purchase policies from a fewer number of insurance companies our bonus commissions will be higher than if the same policies were purchased from a larger number of insurance companies. The decision to purchase a policy from a particular insurance company typically relates to, among other factors, price of the policy and rating of the insurance company, both factors over which we have no control. Insurance companies often change their prices during the year for competitive reasons. This may reduce the number of policies placed with that insurance company which may then reduce our potential bonus commissions. In addition, we have no control over the bonus commission rates that are set by each individual insurance company. As a result of these factors, we are unable to control the amount of bonus commission we receive in any particular quarter or year, and these amounts may fluctuate significantly.

**The insurance sales industry is intensely competitive, and if we fail to successfully compete in this industry our market share and business will be harmed**

The markets for the products and services offered on our site are intensely competitive and characterized by rapidly changing technology, evolving regulatory requirements, and changing consumer demands. We compete with traditional insurance distribution channels, including insurance agents and brokers, new non-traditional channels such as commercial banks and savings and loan associations, and a growing number of direct distributors including other online services, such as InsWeb Corporation and SelectQuote Insurance Services.



We also potentially face competition from a number of large online services that have expertise in developing online commerce and in facilitating a high volume of Internet traffic for or on behalf of our competitors. For instance, some of our competitors have relationships with major electronic commerce companies. Other large companies with strong brand recognition, technical expertise and experience in online commerce and direct marketing could also seek to compete in the online insurance market.

There can be no assurance that we will be able to successfully compete with any of these current or potential insurance providers.

**Insurance companies that have appointed us as agents may cancel those appointments**

Most of our agency contracts allow the insurance company to cancel our agency appointment at any time. Should any of the companies with which we place significant amounts of business decide to cancel our appointments, our business could be harmed.

**Risks Related to Regulation**

**Our compliance with the strict regulatory environment applicable to the insurance industry is costly, and if we fail to comply with the numerous laws and regulations that govern the industry we could be subject to penalties**

We must comply with the complex rules and regulations of each jurisdiction's insurance department, which impose strict and burdensome guidelines on us regarding our operations. Compliance with these rules and regulations imposes significant costs on our business. Each jurisdiction's insurance department typically has the power, among other things, to:

authorize how, by which personnel, and under what circumstances an insurance premium can be quoted and published;

approve which entities can be paid commissions from insurance companies;

license insurance agents and brokers;

monitor the activity of our non-licensed customer service representatives;

regulate the methods by which we conduct our sales efforts; and

approve policy forms and regulate some premium rates.

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Due to the complexity, periodic modification, and differing statutory interpretations of these laws, we may not have always been and we may not always be in compliance with all these laws. Failure to comply with these numerous laws could result in fines, additional licensing requirements, the revocation of our license in the particular jurisdiction or limits on our ability to operate in some states. These penalties could significantly increase our general operating expenses and harm our business. In addition, even if the allegations in any regulatory action against us turn out to be false, negative publicity relating to any allegations could result in a loss of consumer confidence and significant damage to our brand. We believe that because many consumers and insurance companies are not yet comfortable with the concept of purchasing insurance online, the publicity relating to any such regulatory or legal issues could harm our business.

### **Regulation of the sale of insurance over the Internet and other electronic commerce is unsettled, and future regulations could force us to change the way we do business or make operating our business more costly**

As a company involved in the sale of insurance over the Internet, we are subject to additional regulatory risk as insurance regulations have not been fully modified to cover Internet transactions. Currently, many state insurance regulators are exploring the need for specific regulation of insurance premium quoting and/or sales over the Internet. Any new regulation could dampen the growth of the Internet as a means of providing insurance services. Moreover, the laws governing general commerce on the Internet remain largely unsettled, even in areas where there has been some legislative action. It may take years to determine whether and how existing laws such as those governing intellectual property, privacy, and taxation apply to the Internet. In addition, the growth and development of the market for electronic commerce may prompt calls for more stringent consumer protection laws that may impose additional burdens on companies conducting business over the Internet. Any new laws or regulations or new interpretations of existing laws or regulations relating to the Internet could harm our business.

**If we become subject to legal liability for the information we distribute on our Web sites or communicate to our customers, our business could be harmed**

Our customers rely upon information we provide regarding insurance quotes, coverage, exclusions, limitations and ratings. To the extent that the information we provide is not accurate, we could be liable for damages from both consumers and insurance companies. These types of claims have been brought, sometimes successfully, against agents, online services, and print publications in the past. These types of claims could be time-consuming and expensive to defend, divert management's attention, and could cause consumers to lose confidence in our service. As a result, these types of claims, whether or not successful, could harm our business, financial condition, and results of operations.

In addition, because we are appointed as an agent for only 193 of the over 200 insurance companies quoted on our Web site, we do not have contractual authorization to publish information regarding the policies from insurance companies for whom we are not appointed. Several of these insurance companies have in the past demanded that we cease publishing their policy information and others may do so in the future. In some cases we have published information despite these demands. If we are required to stop publishing information regarding some of the insurance policies that we track in our database, it could harm us.

**Risks Related to the Internet and Electronic Commerce**

**Any failures of, or capacity constraints in, our systems or the systems of third parties on which we rely could reduce or limit visitors to our Web sites and harm our ability to generate revenue**

We use both internally developed and third-party systems to operate our service. If the number of users of our service increases substantially, we will need to significantly expand and upgrade our technology, transaction processing systems, and network infrastructure. We do not know whether we will be able to accurately project the rate or timing of any of these increases, or expand and upgrade our systems and infrastructure to accommodate these increases in a timely manner. Our ability to facilitate transactions successfully and provide high quality customer service also depends on the efficient and uninterrupted operation of our computer and communications hardware systems. Our service has experienced periodic system interruptions, and it is likely that these interruptions will continue to occur from time to time. Additionally, our systems and operations are vulnerable to damage or interruption from human error, natural disasters, power loss, telecommunication failures, break-ins, sabotage, computer viruses, acts of vandalism, and similar events. We may not carry sufficient business interruption insurance to compensate for losses that could occur. Any system failure that causes an interruption in service or decreases the responsiveness of our service would impair our revenue-generating capabilities, and could damage our reputation and our brand name.

**Our success depends, in part, on our ability to protect our proprietary technology**

We believe that our success depends, in part, on protecting our intellectual property. Other than our trademarks, most of our intellectual property consists of proprietary or confidential information that is not subject to patent or similar protection. Competitors may independently develop similar or superior products, software or business models.

We cannot guarantee that we will be able to protect our intellectual property. Unauthorized third parties may try to copy our products or business model or use our confidential information to develop competing products. Legal standards relating to the validity, enforceability and scope, of protection of proprietary rights in Internet-related businesses are uncertain and still evolving. As a result, we cannot predict the future viability or value of our proprietary rights and those of other companies within the industry.

**We may be subject to claims of infringement that may be costly to resolve and, if successful, could harm our business**

Our business activities and products may infringe upon the proprietary rights of others. Parties may assert valid or invalid infringement claims against us. Any infringement claims and resulting litigation, should it occur, could subject us to significant liability for damages and could result in invalidation of our proprietary rights. Even if we eventually won, any resulting litigation could be time-consuming and expensive to defend and could divert our management's attention.

**If we are unable to adapt to the rapid technological change in our industry, we will not remain competitive and our business will suffer**

Our market is characterized by rapidly changing technologies, frequent new product and service introductions, and evolving industry standards. The recent growth of the Internet and intense competition in our industry exacerbate these market characteristics. Our future success will depend on our ability to adapt to rapidly changing technologies by continually improving the features and reliability of our database and service. We may experience difficulties that could delay or prevent the successful introduction or marketing of new products and services. In addition, new enhancements must meet the requirements of our current and prospective customers and must achieve significant market acceptance. We could also incur substantial costs if we need to modify our service or infrastructures or adapt our technology to respond to these changes.

**Demand for our services may be reduced if we are unable to safeguard the security and privacy of our customers' information**

A significant barrier to electronic commerce and online communications has been the need for secure transmission of confidential information over the Internet. Our ability to secure the transmission of confidential information over the Internet is essential in maintaining consumer and insurance company confidence in our service. In addition, because we handle confidential and sensitive information about our customers, any security breaches would damage our reputation and could expose us to litigation and liability. We cannot guarantee that our systems will prevent security breaches.

**Our business assumes the continued dependability of the Internet infrastructure**

Our success will depend upon the development and maintenance of the Internet's infrastructure to cope with its significant growth and increased traffic. This will require a reliable network backbone with the necessary speed, data capacity, and security, and the timely development of complementary products, such as high-speed modems, for providing reliable Internet access and services. The Internet has experienced a variety of outages and other delays as a result of damage to portions of its infrastructure and could face outages and delays in the future. Outages and delays are likely to cause a loss of business by affecting the level of Internet usage and the processing of insurance quotes and applications requests made through our Web site. We are unlikely to make up for this loss of business.

**Risks Related Ownership of Our Common Stock**

**Our stock could become delisted if we fail to meet the minimum financial requirements for continued listing on the Nasdaq SmallCap Market**

In March 2001, the staff of the Nasdaq Stock Market (Nasdaq), notified our Company that it was not in compliance with one of its maintenance standards, requiring at least \$5.0 million in value of public float over the previous 30 consecutive trading days, defined as total shares outstanding less any shares held by officers, directors, or beneficial owners of 10 percent or more. In March 2001, Nasdaq gave the Company 90 calendar days to comply with this standard. Although in compliance with all other Nasdaq National Market maintenance requirements, our public float was unable to sustain a value in excess of \$5.0 million for 30 consecutive trading days, making its shares ineligible for continued

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Nasdaq National Market listing. Effective the opening of business on July 20, 2001, our stock listing was transferred from the Nasdaq National Market to the Nasdaq SmallCap Market, retaining its existing symbol, QUOT.

The requirements for listing on the Nasdaq SmallCap Market are listed below:

Nasdaq SmallCap Market Listing Considerations:

- (1) either (a) net tangible assets of \$2,000,000, (b) net income in two of the last three years of \$500,000, or (c) a market capitalization of \$35,000,000;
  
- (2) a public float of 5,000,000 shares;

- (3) a market value of public float of \$1,000,000;
- (4) a minimum bid price of \$1 per share;
- (5) two market makers;
- (6) 300 round lot shareholders; and
- (7) compliance with Nasdaq corporate governance rules.

We believe that the current per price share level of the common stock has reduced the effective marketability of our shares of common stock because of the reluctance of many leading brokerage firms to recommend low-priced stock to their clients. Certain investors view low-priced stock as speculative and unattractive, although certain other investors may be attracted to low-priced stock because of the greater trading volatility sometimes associated with such securities. In addition, a variety of brokerage house policies and practices tend to discourage individual brokers within those firms from dealing in low-priced stock. Such policies and practices pertain to the payment of brokers commissions and to time-consuming procedures that function to make the handling of low-priced stocks unattractive to brokers from an economic standpoint.

In addition, because brokerage commissions on low-priced stock generally represent a higher percentage of the stock price than commissions on higher-priced stock, the current share price of the common stock can result in individual stockholders paying transaction costs (commissions, markups, or markdowns), that represent a higher percentage of their total share value than would be the case if the share price were substantially higher. This factor also may limit the willingness of institutions to purchase the common stock at its current low share price.

In addition, as the common stock is not listed on the Nasdaq National Stock Market, were the trading price of the common stock to fall below \$1.00 per share, trading in the common stock would also be subject to the requirements of certain rules promulgated under the Exchange Act which require additional disclosures by broker-dealers in connection with any trades involving a stock defined as a penny stock (generally, a non-Nasdaq equity security that has a market price of less than \$5.00 per share, subject to certain exceptions). In such event, the additional burdens imposed upon broker-dealers to effect transactions in the common stock could further limit the market liquidity of the common stock and ability of investors to trade the common stock.

There can be no assurance that we will continue to satisfy all of the listing requirements of the Nasdaq Small-Cap Market. In the event that we do not qualify for listing on the Nasdaq SmallCap Market, sales of our common stock would likely be conducted only in the over-the-counter market or potentially in regional exchanges. This may have a negative impact on the liquidity and price of the common stock and investors may find it more difficult to purchase or dispose of, or to obtain accurate quotations as to the market value of, the common stock.



**Our stock price may have wide fluctuations and Internet-related stocks have been particularly volatile**

The market price of our common stock is highly volatile and is subject to wide fluctuations. The Nasdaq Small-Cap Stock Market has experienced significant price and volume fluctuations and the market prices of securities of technology companies, particularly Internet-related companies, have been highly volatile. Market fluctuations, as well as general political and economic conditions, such as a recession or interest rate fluctuations, war or other hostilities could adversely affect the market price of our common stock. In addition, the market prices for stocks of Internet-related and technology companies frequently reach levels that bear no relationship to the operating performance of such companies. These market prices generally are not sustainable and are subject to wide variations. If our common stock trades to unsustainably high levels, it likely will thereafter experience a material decline.

In the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of their securities. We may in the future be the target of similar litigation. Securities litigation could result in substantial costs, divert management's attention and resources, and harm our financial condition and results of operations.

**Two of our officers and directors own a significant portion of our stock and continue to control our Company and their interests may not be the same as our public stockholders**

As of October 31, 2003, Robert Bland, our Chairman, President and Chief Executive Officer directly or indirectly controls 48.1% of our outstanding common stock, and William Thoms, our Executive Vice President and Chief Operating Officer, directly controls 14.6% of our outstanding common stock. As a result, if Messrs. Bland and Thoms act together, they will be able to take any of the following actions without the approval of additional public stockholders:

elect our directors;

amend several provisions of our certificate of incorporation;

approve a merger, sale of assets, or other major corporate transaction;

defeat any takeover attempt, even if it would be beneficial to our public stockholders; and

otherwise control the outcome of all matters submitted for a stockholder vote.

This control could discourage others from initiating a potential merger, takeover, or another change of control transaction that could be beneficial to our public stockholders. As a result, the market price of our common stock could be harmed.

**Our charter documents and Delaware law contain provisions that may discourage takeover attempts that could preclude our stockholders from receiving a change of control premium**

Our certificate of incorporation and bylaws and Delaware law contain anti-takeover provisions that could have the effect of delaying or preventing changes in control that a stockholder may consider favorable. The provisions in our charter documents include the following:

a classified board of directors with three-year staggered terms;

the ability of our board of directors to issue shares of preferred stock and to determine the price and other terms, including preferences and voting rights, of those shares without stockholder approval;

stockholder action to be taken only at a special or regular meeting; and

advance notice procedures for nominating candidates to our board of directors.

Our preferred stock purchase rights would cause substantial dilution to any person or group who attempts to acquire a significant interest in our Company without advance approval of our Board of Directors. In addition, our executive officers have employment agreements that may entitle them to substantial payments in the event of a change of control.

The foregoing could have the effect of delaying, deferring, or preventing a change in control of our Company, discourage bids for our common stock at a premium over the market price, or harm the market price of, and the voting and other rights of the holders of, our common stock. We also are subject to Delaware laws that could have similar effects. One of these laws prohibits us from engaging in a business combination with any significant stockholder for a period of three years from the date the person became a significant stockholder unless specific conditions are met.

**Continued terrorist attacks or war could lead to further economic instability and adversely affect our stock price, operations, and profitability.**

The terrorist attacks that occurred in the United States on September 11, 2001 caused periodic major instability in the U.S. and other financial markets. Possible further acts of terrorism and current and future war risks could have a similar impact. The United States continues to take military action against terrorism and has recently taken military action in Iraq. Terrorist attacks and war in the Middle East may lead to additional armed hostilities or to further acts of terrorism and civil disturbance in

the United States or elsewhere, which may further contribute to economic instability. Any such attacks could, among other things, cause further instability in financial markets and could directly, or indirectly through reduced demand, negatively affect our facilities and operations or those of our customers or suppliers.

### **ITEM 3. Quantitative and Qualitative Disclosures About Market Risk**

The primary objective of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we maintain a portfolio of cash and equivalents and investments in a variety of securities including both government and corporate obligations and money market funds.

Substantially all of our investments are subject to interest rate risk. We consider all investments as available-for-sale, and unrealized losses on those investments totaled \$42,779 at September 30, 2003, and there were unrealized gains of \$82,494 at December 31, 2002.

We did not hold any derivative financial instruments as of September 30, 2003, and have never held such instruments in the past. Additionally, all our transactions have been denoted in U.S. currency, and do not have any risk associated with foreign currency transactions.

Due to the short-term nature of our investments, a 1% increase in interest rates would decrease the fair value of our investments by an immaterial amount.

### **ITEM 4. Controls and Procedures**

The Chief Executive Officer and Chief Financial Officer of Quotesmith.com, Inc, have reviewed and evaluated the disclosure controls and procedures of the Company and found them to be both adequate and effective. This review was conducted within 90 days of the filing date of this quarterly report.

There have been no significant changes in internal controls or in other factors that could significantly affect these controls subsequent to the date of the aforementioned evaluations.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

Not applicable.

**Item 2. Changes in Securities and Use of Proceeds**

*Use of Initial Public Offering Proceeds.* On August 3, 1999, our registration statement on Form S-1 (File No. 333-79355), relating to the initial public offering of our common stock, was declared effective by the Securities and Exchange Commission. After payment of underwriting discounts and expenses of approximately \$5.3 million, we received net proceeds of approximately \$57.5 million from the offering. As of September 30, 2003, our balance sheet reflected approximately \$14.7 in investments and \$500,000 in cash and cash equivalents with respect to proceeds received from the initial public offering. Proceeds from the initial public offering have been used for the repayment of a loan from Intuit, Inc. totaling \$2.0 million, for cash payments of approximately \$1.4 million in connection with the December 2001 purchase of selected assets of Insurance News Network, LLC, for the repurchase of 1,514,659 shares of our common stock at a cost of approximately \$3.5 million, and for general operating activities.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Submission of Matters To a Vote of Security Holders**

None

**Item 5. Other Information**

Not applicable.

**Item 6. Exhibits and Reports on Form 8-K**

(a). Exhibits

<b>Exhibit Number</b>	<b>Description</b>
31.1	Statement of Chief Executive Officer Pursuant to Section 302
31.2	Statement of Chief Financial Officer Pursuant to Section 302
32.1	Statement of Chief Executive Officer Pursuant to Section 1350
32.2	Statement of Chief Financial Officer Pursuant to Section 1350

(b). Reports on Form 8-K

The Company filed its second quarter, 2003 earnings press release on Form 8-K, dated July 30, 2003.

The Company filed a press release revising previously-issued earnings guidance on Form 8-K, dated October 2, 2003

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

QUOTESMITH.COM, INC.

Date: November 7, 2003

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By: /s/ PHILLIP A. PERILLO

Phillip A. Perillo

Senior Vice President and Chief Financial Officer