

STAMPS.COM INC
Form 10-K
March 15, 2011

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

FORM 10-K

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2010**
OR

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

Commission file number: 000-26427

Stamps.com Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

77-0454966
(I.R.S. Employer
Identification No.)

**12959 Coral Tree Place
Los Angeles, California 90066**

(Address of Principal Executive Offices and Zip Code)

Registrant's Telephone Number, Including Area Code: **(310) 482-5800**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class Common Stock, \$.001 par value	Name of Each Exchange on Which Registered The NASDAQ Stock Market, LLC
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Securities registered pursuant to Section 12(g) of the Act: **None**

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

Large accelerated filer <input type="radio"/>	Accelerated filer <input checked="" type="radio"/>
Non-accelerated filer <input type="radio"/>	Smaller reporting company <input type="radio"/>

(do not check if smaller reporting company)

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

As of June 30, 2010, the aggregate market value of voting common stock held by non-affiliates of the Registrant was \$122,367,965 (based upon the closing price for shares of the Registrant's Common Stock as reported by The NASDAQ Stock Market on that date). As of February 28, 2011, there were 14,542,481 shares of the Registrant's Common Stock issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for the 2011 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission are incorporated by reference in Part III of this Form 10-K.

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FORM 10-K ANNUAL REPORT FOR THE YEAR ENDED
DECEMBER 31, 2010**

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PART I.

This Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). You can find many (but not all) of these statements by looking for words such as approximates, believes, expects, anticipates, estimates, intends, plans, would, may or other similar expressions in this Report. Our forward-looking statements relate to future events or our future performance and include, but are not limited to, statements concerning our business strategy, future commercial revenues, market growth, capital requirements, new product introductions, expansion plans and the adequacy of our funding. Other statements contained in this Report that are not historical facts are also forward-looking statements.

We claim the protection of the safe harbor contained in the Private Securities Litigation Reform Act of 1995. We caution investors that any forward-looking statements presented in this Report, or that we may make orally or in writing from time to time, are based on beliefs and assumptions made by us and information currently available to us. Such statements are based on assumptions, and the actual outcome will be affected by known and unknown risks, trends, uncertainties and factors that are beyond our control or ability to predict. Although we believe that our assumptions are reasonable, they are not guarantees of future performance, and some will inevitably prove to be incorrect. As a result, our actual future results can be expected to differ from our expectations, and those differences may be material. Accordingly, investors should use caution in relying on forward-looking statements, which are based on known results and trends at the time they are made, to anticipate future results or trends.

For discussion of some of the factors that could affect our results, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 1A. Risk Factors.

This Report and all subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. We do not undertake any obligation to release publicly any revisions to our forward-looking statements to reflect events or circumstances after the date of this Report.

Stamps.com, NetStamps, Stamps.com Internet Postage, PhotoStamps, Hidden Postage and the Stamps.com logo are our trademarks. This Report also references trademarks of other entities. References in this Report to we us our or company are references to Stamps.com, Inc. and its subsidiaries.

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SPECIAL NOTICE REGARDING PURCHASES OF MORE THAN 5% OF OUR STOCK

We currently have federal and state net operating loss (NOL) carry-forwards of approximately \$226 million and \$148 million, respectively. Under Internal Revenue Code Section 382 rules, if a change of ownership is triggered, our NOL asset may be impaired. A change in ownership can occur whenever there is a shift in ownership by more than 50 percentage points by one or more 5% shareholders within a three-year period.

Under our certificate of incorporation, any person or entity, including any company and investment firm, that wishes to become a 5% shareholder (as defined in our certificate of incorporation) must first obtain a waiver from our board of directors. In addition, any person, including any company and investment firm, that is already a 5% shareholder of ours cannot make any additional purchases of our stock without a waiver from our board of directors. The NOL protective provisions contained in our certificate of incorporation (the NOL Protective Measures) are more specifically described in our Definitive Proxy Statement filed with the Securities and Exchange Commission on April 2, 2008.

On July 22, 2010, our Board of Directors suspended the NOL Protective Measures by approving a waiver from the NOL Protective Measures to all persons and entities, including companies and investment firms. As a result, our stockholders are now allowed to become 5% shareholders and existing 5% shareholders are allowed to make additional purchases of our stock each without having to comply with the restrictions contained in the NOL Protective Measures. This waiver may be revoked by our Board of Directors at any time if the Board deems the revocation necessary to protect against a Section 382 change of ownership that would limit our ability to utilize future NOLs. For complete details about this waiver from the NOL Protective Measures, please see our Form 8-K filed on July 28, 2010.

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ITEM 1. BUSINESS.

Overview

Stamps.com® is the leading provider of Internet-based postage solutions. Our customers use our service to mail and ship a variety of mail pieces, including postcards, envelopes, flats and packages, using a wide range of United States Postal Service (the USPS) mail classes, including First Class Mail®, Priority Mail®, Express Mail®, Media Mail®, Parcel Post®, and others. Our customers include individuals, small businesses, home offices, medium-size businesses and large enterprises, and within these segments we target both mailers and shippers. We were the first ever USPS-licensed vendor to offer PC Postage® in a software-only business model in 1999.

Services and Products

We offer the following products and services to our customers:

PC Postage Services. Our USPS-approved PC Postage service enables users to print electronic stamps directly onto envelopes, plain paper, or labels using only a standard personal computer, printer and Internet connection. Our service currently supports a variety of USPS and international mail classes. Customers can also add USPS Special Services such as Delivery Confirmation™, Signature Confirmation™, Registered Mail, Certified Mail, Insured Mail, Return Receipt, Collect on Delivery and Restricted Delivery to their mail pieces. After installing our software and completing the registration process, customers can purchase and print postage 24 hours a day, seven days a week. Our customers can print postage (1) on NetStamps® labels, which can be used just like regular stamps, (2) directly on envelopes, postcards or on other types of mail or labels, in a single-step process that saves time and provides a professional look, (3) on plain 8.5 x 11 paper or on special labels for packages, and (4) on integrated customs forms for international mail and packages. For added convenience, our PC Postage services incorporate address verification technology that verifies each destination address for mail sent using our service against a database of all known addresses in the United States. Our PC Postage service is also integrated with common small business and productivity software applications such as word processing, contact and address management, and accounting and financial applications. We also offer several different versions of NetStamps, such as Themed NetStamps and Photo NetStamps that allow customers to add stock or full custom designs to their mail while still providing the same NetStamps convenience of printing and using postage whenever it is needed.

When a customer purchases postage for use through our service, the customer pays the face value of the postage, and the funds are transferred directly from the customer's account to the USPS's account. In addition to postage purchases, customers pay us a monthly service fee ranging from \$15.99 to \$39.99 depending on the features and capabilities of the particular service. Our Pro Plan offers a basic set of Stamps.com mailing & shipping features with single-user capability. Our Premiere plan for larger small businesses adds multiple-user functionality, automated Certified Mail forms, FedEx label printing, additional reference codes and higher allowable postage balances to our Pro Plan feature set. Our Professional Shipper plan is targeted at higher volume shippers such as fulfillment houses, retailers and e-commerce merchants and features direct integration into a customer's order databases, faster label printing speed, the ability to customize and save shipping profiles, and integrations with many of the industry's leading shipping management systems. We have launched shipping integrations with several of these e-commerce focused companies over the past year. Our Enterprise service is targeted at organizations with multiple geographic locations and features enhanced reporting that allows a central location such as a corporate headquarters greater visibility and control over postage expenditures across their network of locations.

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As part of our PC Postage services, we offer back-end integration solutions where we provide the electronic postage for transactions to partners who manage the front-end process.

Our software integrates directly into the most popular e-commerce platforms, allowing web store managers to completely automate their order fulfillment process by processing, managing, and

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shipping orders from virtually any e-commerce source through a single interface without manual data entry. Managers can retrieve order data and print complete shipping labels for all USPS mail classes including First Class International®.

In July 2010 we launched a partnership with Amazon.com that makes our domestic and international shipping labels available to Amazon.com Marketplace users. The service allows customers to automatically pay for postage using their Marketplace Payments account, to set a default ship-from address so they don't have to type or write it for each shipment, and to automatically populate the ship-to address on the label. Domestic and international mail classes are supported, and Marketplace users may request carrier pickup from USPS. A transaction fee of \$0.07 per label is charged to customers for each label printed.

In February 2011 we were awarded a contract from the USPS to provide the electronic postage for shipping transactions generated by Click-N-Ship®, a web-based service available at USPS.com that allows USPS customers to purchase and print shipping labels for domestic and international Priority and Express packages at no additional mark-up over the cost of postage.

PhotoStamps®. In May 2009, we successfully completed the market test of our PhotoStamps product. PhotoStamps is a patented form of postage that allows consumers to turn digital photos, designs or images into valid US postage. With this product, individuals or businesses can create customized US postage using pictures of their children, pets, vacations, celebrations, business logos and more. PhotoStamps can be used as regular postage to send letters, postcards or packages. The product is available via our separately-marketed website at www.photostamps.com. Customers upload a digital photograph or image file, customize the look and feel by choosing a border color to complement the photo, select the value of postage, and place the order online. Each sheet includes 20 individual PhotoStamps, and orders arrive via US Mail in a few business days.

Mailing & Shipping Supplies Store. Our Mailing & Shipping Supplies Store (our Supplies Store) is available to our customers from within our PC Postage software and sells NetStamps labels, shipping labels, other mailing labels, dedicated postage printers, scales, and other mailing and shipping-focused office supplies. Our Supplies Store features a store catalog, messaging regarding our free or discounted shipping promotions, cross-selling product recommendation during the checkout process, product search capabilities, and same day shipping of orders with expedited and rush shipping options.

Branded Insurance. We offer Stamps.com branded insurance to our customers so that they may insure their mail or packages in a fully integrated, online process that eliminates any trips to the post office or the need to complete any special forms. Our branded insurance is provided in partnership with Parcel Insurance Plan and is underwritten by Fireman's Fund. We also offer official USPS insurance alongside our branded insurance product.

When we refer to our PC Postage business, we are referring to our PC Postage Service, Mailing & Shipping Supplies Store and Branded Insurance offering. We do not include our PhotoStamps business when we refer to our PC Postage business.

Customer Value Proposition for our PC Postage Service

We believe that customers use our PC Postage services to save time and money. Some of the ways our customers save time include: (1) applying postage to letters or packages at home or at the office, avoiding the time that would ordinarily be spent in a trip to the post office; (2) generating mass mailings quickly and easily by printing the address and postage together in a single step process; (3) using our software as an integrated package with most small business productivity applications such as word processors, financial applications and address books; and (4) generating large volumes of shipping labels easily by integrating directly with the database or file system of eCommerce systems.

Some of the ways in which our customers can save money include: (1) receiving a discount versus USPS retail post offices of up to 15% off Priority Mail, up to 21% off Express Mail, 5% off Priority Mail International and 8% off Express Mail International. In addition, Commercial Plus customers who meet certain higher volume requirements receive up to 28% off of Priority Mail and up to 32.5% off Express Mail;

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(2) getting electronic Delivery or Signature Confirmation at 40 to 70 cents less per package than the comparable services at a retail USPS post office; (3) an automatic check of all addresses against the USPS database, so postage is not wasted on undeliverable-as-addressed mail; (4) avoiding wasted postage by calculating the exact amount of postage that is needed depending on mail class, mail form, weight and distance to the destination; (5) tracking and controlling postage expenditures in a small office using cost codes built into our software; and (6) paying a monthly service fee that is up to 75% less than the total cost of an entry-level postage meter, where users typically pay monthly rental fees, maintenance fees, postage purchase surcharges, cleaning fees, and fees for proprietary ink cartridges.

Some of the other benefits of using our service noted by our customers include: (1) mail produced with our service is more professional looking than stamped mail, helping a smaller business resemble a larger business; (2) providing the ability to send USPS packages with Hidden Postage™, which hides the actual amount paid for postage (a useful feature for e-commerce companies that may not want the recipient to see actual shipping cost information); (3) helping a business reduce its customer support costs by automatically generating and sending package delivery status e-mails to its customers; (4) providing a complete record of all mail or packages sent, allowing our customers to easily keep a record of all sent mail; (5) generating a single bar-coded form that represents multiple packages in a single shipment so that the USPS can scan the single form to accept all of the packages at once and the customer gets a record that all the packages were accepted by the USPS; and (6) allowing enterprise customers to track and control postage spending across their distributed network of individual locations centrally from corporate headquarters.

Marketing of PC Postage

We target our PC Postage marketing at small businesses, home offices, medium-size businesses and large enterprises, and within these segments we target both mailers and shippers. We market our PC Postage services through the following channels:

Affiliate Channels. We utilize the traffic and customers of smaller web sites and other businesses or individuals that are too small to qualify for a partnership directly with us by offering financial incentives for these small businesses and individuals to drive traffic to our web site through a third party affiliate management company.

Direct Mail. We send direct mail pieces to prospective customers with prospect lists purchased from third parties or obtained from partners.

Direct Sales. We utilize a direct sales force for higher-priced Enterprise and Professional Shipper versions of our PC Postage service.

Offline Marketing Programs. We utilize various other offline advertising and marketing programs including telemarketing, traditional media advertising, retail and other programs.

Partnerships. We work with strategic partners in order to leverage their web site traffic, marketing programs, and existing customer base to distribute our PC Postage software. For example, these partnerships may result in a link to our website from a partner's website, a copy of our software included along with a partner's software product, the distribution of our software at a retail location, or the bundling of our software with a hardware device. Our partnerships include Microsoft, Avery Dennison, and Hewlett Packard.

Remarketing. We remarket our services to former customers. Our remarketing efforts are generally focused on new features that may relate to the reasons former customers stopped using our service. We utilize e-mail and regular mail to communicate new features of our products to our former customers.

Traditional Online Advertising. We work with companies to advertise our services online through paid searches, banner ads, permission-based emails, and other online advertising vehicles.

USPS Referrals. We utilize the nationwide USPS Account Manager network to market and sell our services to customers. We market to the account managers by attending regional and national meetings and forums, and participating in local vendor calls. We also receive referrals directly from the USPS website at www.USPS.com.

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Enhanced Promotion Online Advertising. We work with various companies to advertise our service in various places across the Internet. This channel typically offers an additional promotion directly to the customer by the partner in order to get the customer to try our service. We reduced our investment in the enhanced promotional channel during recent years.

When we refer to our Non-Enhanced Promotion marketing channels, we are referring to all the marketing channels described above, excluding the Enhanced Promotion Online Advertising channel.

Marketing of PhotoStamps

We target our PhotoStamps marketing at consumers and businesses. We market or have marketed our PhotoStamps product through the following channels:

Online advertising, including paid search, banner ads, permission-based emails, and other online advertising methods;
Partnerships including Apple, Google/Picasa, HP/Snapfish, Adobe and others;
Retail distribution of a boxed PhotoStamps product;
Remarketing to our existing customers; and
Traditional offline methods of consumer advertising.

In recent years, we reduced our consumer-focused marketing spending in order to lower our customer acquisition costs and improve our expected returns and profitability in the PhotoStamps business.

2011 Business Strategy

Our PC Postage Business

Our 2011 strategy for the PC Postage business includes the following major initiatives:

Increase our Small Business Marketing Spending. Based on recent analysis and trends, we believe that improvements in the macro-economic environment are being reflected in our small business acquisition metrics and that the lifetime value of a non-enhanced promotion customer continues to be more than twice the cost of acquiring those customers. Accordingly, we plan to increase customer acquisition spending in our non-enhanced promotion small business marketing channels by an estimated 5% to 10% in 2011 versus 2010.

We also plan to continue increasing our investment in our direct mail channel as well as refining our customer acquisition process through online advertising, affiliates, partners, telemarketing, traditional media, and other areas. Our goal is to modestly increase our investment in our PC Postage business in the current small business economic environment and be well positioned to increase that investment commensurate with continued improvements in the economic environment, especially as it pertains to small businesses.

Although our online enhanced promotion channel tends to attract customers with lower lifetime values, we continue to see an attractive return on our investment, and we plan to continue to run this channel until we no longer find the returns to be attractive. However, based on recent trends, we currently expect to continue to reduce our marketing spending in this area in 2011 versus 2010.

Optimize our Business Model and Improve our Customer Experience. We plan to continue optimizing our registration process and post-registration customer interactions to improve the initial experience a customer has with our service. We plan to continue expanding our presence in social networking sites and continue expanding our customer web portal and multi-media and content on our website. We also plan to launch new features in our software product in 2011 including adding new mailing and shipping capabilities and various other features that we believe

will make mailing easier for our customers.

Enhance our Corporate Enterprise Solution Marketing Efforts. Customers continued to be attracted to our corporate enterprise solution versus a postage meter based on our dramatically lower cost of ownership and visibility into individual employee activity from our sophisticated front-end

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reporting tool with real time data, improved web-based postage management tools, and enhanced web-based financial and administrative controls for central decision makers, which are typically not available with a postage meter. In 2011, we plan to continue increasing and optimizing our enterprise customer lead generation efforts. We also plan to increase our sales team size commensurate with the business prospects that are available and continue working on improving the efficiency of our sales team.

Enhance our High Volume Shipper Solution and Marketing Efforts. In 2010 we made several enhancements to our shipping technology, including: (1) improved batch capability with easier order management, easier order flow, the ability to customize email and the ability to print packing slips, (2) additional shopping cart integrations for easier data export and import from the tools that customers like to use, and (3) a partnership with Amazon.com that makes our domestic and international shipping labels available to Amazon.com Marketplace users.

In 2011 we plan to continue investing in our shipping technology and sales and marketing efforts by (1) continuing to improve the software features to further improve scalability of the product to the largest high-volume customers, (2) adding shopping cart integration for easier data export and import from the tools that customers like to use, (3) adding new integrations into sophisticated high-volume shipping solutions such as multi-carrier shipping software, and (4) scaling our sales effort using our national sales force. Attracting high volume shippers is a strategic focus for us and is also one of the most important strategic initiatives of the USPS. We are focused on helping the USPS as much as we can to be successful in this area.

Our PhotoStamps Business

In 2011 we plan to continue marketing PhotoStamps, but with limited spending and expectations. We will continue our program of focused direct-to-website PhotoStamps marketing spending with a goal of keeping the overall cost per acquisition at a level that provides an attractive financial return. We do not expect to invest heavily in the PhotoStamps area long-term until the economy materially improves, as we believe that there will be opportunities to grow the business in a better economic environment.

Competition

The market for our products is competitive. Some of our current direct competitors in the PC Postage and Customized Postage categories include:

Endicia.com/Dymo. Endicia is a group within Newell Rubbermaid's Office Products division that offers a software-based PC Postage service similar to our PC Postage service under the brand name Endicia, a custom postage offering similar to our PhotoStamps service under the brand name PictureItPostage, and a NetStamps-like service in conjunction with Dymo (an affiliated company also owned by Newell Rubbermaid) under the brand names Dymo Stamps and Dymo Printable Postage. All three of these services are directly competitive with our own services in these areas.

Dymo Stamps is different from our service in the approach it takes to the business model. Its service is offered without a monthly service fee, which is one of its primary marketing messages versus our service. To use the Dymo Stamps feature, however, customers must purchase Dymo Stamps labels through Endicia at a price that is significantly higher per label than our price for our NetStamps labels.

Pitney Bowes, Inc. Pitney Bowes is the current market leader in the U.S. traditional postage meter business, with revenues of \$5.4 billion in 2010. Pitney Bowes launched its initial software-based PC Postage product in 2000 and currently offers a PC Postage product named ShipStream Manager designed for shipping packages. During 2004 Pitney Bowes also began offering an Internet-based service for printing a single label for use in shipping a package

that does not require a monthly subscription fee, in partnership with eBay. Pitney Bowes offers a customized postage offering (branded ZazzleStamps) through a partnership with Zazzle.com, Inc., a small, private U.S. company that specializes in custom products. During 2010 Pitney Bowes launched a PC Postage solution named pbSmartPostage.

We also compete with traditional postage meters offered by Pitney Bowes and others in the U.S. market. We believe that our customers choose our PC Postage service over traditional postage meters primarily to save money. We also believe that our PC Postage service can offer superior capabilities to postage meters in certain

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areas, such as the ability to integrate tightly with small business productivity applications and the ability to easily monitor and track USPS packages. We believe customers choose postage meters over our solutions because of the perceived ease of use of these products versus our current approach of software that runs on a PC.

We believe that our customers choose our PC Postage service over that of other PC Postage competitors because of our superior user interface and our larger breadth of features. For example, we are the only PC Postage service that is tightly integrated into the native capabilities of Microsoft Office for use with Office's mailing capabilities such as mail merge and envelope printing, we are the only PC Postage provider with an integration partnership with Amazon.com serving their Marketplace users, we support more address books than any other PC Postage software, and we are the only company that offers the additional customer choice of our Themed and Photo NetStamps labels. Based on USPS data and our own estimates, we believe that as of the end of 2010 approximately 80% of all PC Postage subscription customers were our customers (excluding estimated customers paying for postage on a pure transaction-based, no-monthly-fee plan).

Based on USPS data and on our own estimates, we believe that PhotoStamps is a leading brand in the USPS's customized postage program. When compared to competitive offerings, we think PhotoStamps offers the best product and overall customer experience in the industry. PhotoStamps was also the first commercially available customized postage product, and we believe it has the best brand recognition among its competitors.

Other Competition. We also compete with traditional methods of accessing US postage, such as postage stamps, USPS retail locations, and USPS online services such as Click-N-Ship and those available through eBay/PayPal. All of these methods are typically available with no additional markup over the face value of postage. We believe that our customers choose our service over these methods of accessing postage because of convenience and the capabilities and features that are not available through these traditional methods. We believe customers choose traditional methods over our solutions as a way to obtain postage without paying additional fees above the face value of postage. In our high volume shipping solution we also compete with alternatives to the US Postal service for package services such as FedEx and UPS.

Industry Overview

Business Market Size

Our PC Postage mailing and shipping service is currently targeted primarily at U.S. small offices, home offices, small businesses, enterprises and high volume shippers, and within these segments we target both mailers and shippers. We believe the number of businesses that we can serve with our current products are as follows: (1) 14 million income-generating home offices; (2) 4.1 million single location small businesses of 5 employees or less (typically using our single user Pro service); (3) 2.3 million single location small businesses of 6 to 100 employees (typically using our Pro or our multi-user Premier service); (4) 1.3 million multi-location small businesses, which represent 3.9 million separate locations; and (5) 107,000 medium and large businesses over 100 employees, which represent 1.5 million separate locations (typically using our Enterprise service). In total we estimate that there are 22 million businesses, which represent 26 million locations that are the primary target for our current service. In addition we believe there are 24 million non-income generating home offices such as those used for corporate after-hours work or telecommuting, and our solution is also applicable to that segment. We also have consumers that use our service.

US Mail Volume

According to the USPS Fiscal 2010 Annual Report, the total US Postal Service revenue was \$67 billion during its fiscal year ended September 30, 2010. Of this amount approximately \$48 billion was represented by mail classes that are addressable using our current solution (First Class, Priority Mail, Express Mail, Media Mail, Parcel Post, international mail, and special services). We believe that some portion of this \$48 billion is a potential market for purchasing and printing postage using PC Postage.

Based on the USPS Fiscal 2009 Household Diary study, consumer-to-consumer personal correspondence mail volume is approximately 5.4 billion pieces per year (1.0 billion personal letters, 2.0 billion holiday greeting cards, 1.4 billion non-holiday greeting cards, and 1.0 billion other). We also estimate that an additional 6.6 billion pieces per year are sent between businesses and consumers as first class primary

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business advertising mail, and an additional 5.5 billion pieces per year are sent from businesses to consumers as First Class correspondence mail. We believe that consumer-to-consumer and business-to-consumer advertising mail are two potential markets for use of PhotoStamps.

The PC Postage Certification and Regulatory Approval Process

Our technology must meet strict U.S. government security standards. Our PC Postage products (including any follow-on technology) must complete extensive USPS testing and evaluation in the areas of operational reliability, financial integrity and security to become certified for commercial distribution, and each additional implementation of a particular product or function requires additional evaluation and approval by the USPS prior to commercial distribution. The USPS certification process to become an USPS approved PC Postage vendor is a standardized, ten-stage process that took the existing approved vendors years to complete. Each stage requires USPS review and authorization to proceed to the next stage of the certification process. The USPS has no published timeline or estimated time to complete each of the ten stages of the program. The most significant stage requires a vendor to complete three phases of beta testing. In 1999 we were approved and launched the first software-only PC Postage service. In May 2009 we successfully completed the market test of our PhotoStamps product.

We continue to ask the USPS for new PC Postage benefits such as additional discounts on the face value of postage and commissions on postage. There are many factors that go into the evaluation of our requests, and we have no guarantee that USPS will grant any of our requests. Our customers currently receive discounted rates relative to prices available at retail post offices for Priority Mail, Express Mail, Priority Mail International and Express Mail International and for electronic confirmation services such as Delivery Confirmation and Signature Confirmation.

Our Technology

Our servers are located in a high-security data center and operate with proprietary security software. These servers create the data used to generate information-based indicia. They also process postage purchases using secure technology that meets USPS security requirements. Our service currently uses a Windows-based client application that supports a variety of label and envelope options and a wide range of printers. In addition, our application employs an internally-developed user authentication mechanism for additional security.

Our transaction processing servers are a combination of secure, commercially available and internally-developed technologies that are designed to provide secure and reliable transactions. Our implementation of system hardware meets government standards for security and data integrity. The performance and scalability of our PC Postage system is designed to allow many users to simultaneously process postage transactions through our system. Our database servers are designed and built with industry-leading database technologies and are scalable as needed.

We rely on a combination of patent, trade secret, copyright and trademark laws and contractual restrictions, such as confidentiality agreements and licenses, to establish and protect our rights in our products, services, know-how and information. We have a portfolio of issued and pending US and international patents. We also have a number of registered and unregistered trademarks. We plan to apply for more patents and trademarks in the future.

See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Research and Development for the amount spent during each of the last three fiscal years on company-sponsored research and development activities.

Section 382 Update

We currently have federal and state NOL carry-forwards of approximately \$226 million and \$148 million, respectively, which when combined with our other tax credits and tax assets have a potential value of up to \$94 million in tax savings over the next 15 years. Under Internal Revenue Code Section 382 rules, if a change of ownership is triggered, our NOL asset may be impaired. A change in ownership can occur whenever there is a shift in ownership by more than 50 percentage points by one or more 5% shareholders within a three-year period. We estimate that as of December 31, 2010 we were at approximately a 22% level compared with the 50% level that would trigger impairment of our NOL asset.

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Under our certificate of incorporation, any person or entity, including any company or investment firm that wishes to become a 5% shareholder (as defined in our certificate of incorporation) must first obtain a waiver from our board of directors. In addition any person or entity, including any company or investment firm that is already a &#