

STAMPS.COM INC  
Form 10-Q  
November 07, 2008

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

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**FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended September 30, 2008**

**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)

**(310) 482-5800**

(Registrant's telephone number, including area code)

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 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  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

As of October 31, 2008, there were approximately 17,997,328 shares of the Registrant's Common Stock issued and outstanding.

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## STAMPS.COM INC.

## FORM 10-Q QUARTERLY REPORT FOR THE QUARTER ENDED SEPTEMBER 30, 2008

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

We currently have significant federal and state net operating loss carry-forwards (NOL). Under applicable law, our NOL assets could be adversely affected by the acquisition by any person, company or investment firm of more than 5% of our outstanding stock or the acquisition of any additional shares by 5% holders. Our articles of incorporation have provisions (the “NOL Protective Measures”) which prohibit transfers of our stock that would create new 5% shareholders or increase the ownership of existing 5% shareholders. **Accordingly, any person, company or investment firm that wishes to become a 5% shareholder must first obtain a waiver of the NOL Protective Measures from our board of directors.** In addition, any person, company or investment firm which is a 5% shareholder can not make any additional purchases of our stock without a waiver from our board of directors. **Failure to do so can mean loss of the shares and responsibility for any damages to the Company, which could be substantial.** Details of the NOL Protective Measures are contained in our definitive Proxy filed on April 2, 2008.

**Accordingly, we strongly urge you to contact us prior to allowing your ownership interest in our stock to exceed 725,000 shares.**

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**PART I - FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****STAMPS.COM INC.  
BALANCE SHEETS**

(In thousands, except per share data)

	<b>September 30, 2008</b>	<b>December 31, 2007</b>
	(unaudited)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 65,835	\$ 43,667
Restricted cash	554	554
Short-term investments	17,009	22,084
Trade accounts receivable, net	2,656	2,519
Other accounts receivable	2,348	1,209
Other current assets	3,717	2,489
Total current assets	92,119	72,522
Property and equipment, net	3,186	3,790
Intangible assets, net	507	871
Long-term investments	10,180	24,518
Deferred income taxes.	3,671	—
Other assets	3,800	3,252
Total assets	\$ 113,463	\$ 104,953
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 12,915	\$ 9,935
Deferred revenue	4,158	2,576
Total current liabilities	17,073	12,511
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$.001 par value		
Authorized shares 47,500 in 2008 and 2007		
Issued shares: 24,369 in 2008 and 24,258 in 2007		
Outstanding shares: 19,190 in 2008 and 19,813 in 2007	47	47
Additional paid-in capital	626,026	622,781
Accumulated deficit	(457,988)	(466,555)
Treasury stock, at cost, 5,179 shares in 2008 and 4,445 shares in 2007	(71,148)	(63,737)
Accumulated other comprehensive loss	(547)	(94)
Total stockholders' equity	96,390	92,442
Total liabilities and stockholders' equity	\$ 113,463	\$ 104,953

*The accompanying notes are an integral part of these financial statements.*



**STAMPS.COM INC.**  
**STATEMENTS OF INCOME**  
(In thousands, except per share data)  
(Unaudited)

	Three Months ended September 30,		Nine Months ended September 30,	
	2008	2007	2008	2007
<b>Revenues:</b>				
Service	\$ 15,435	\$ 14,115	\$ 46,209	\$ 41,282
Product	2,326	2,296	7,392	7,111
Insurance	375	339	1,140	1,068
PhotoStamps	2,020	3,534	7,897	11,345
Other	—	—	—	907
<b>Total revenues</b>	<b>20,156</b>	<b>20,284</b>	<b>62,638</b>	<b>61,713</b>
<b>Cost of revenues:</b>				
Service	2,626	2,369	7,630	7,123
Product	809	760	2,637	2,398
Insurance	124	105	363	331
PhotoStamps	1,489	2,485	5,708	7,626
Other	—	—	—	52
<b>Total cost of revenues</b>	<b>5,048</b>	<b>5,719</b>	<b>16,338</b>	<b>17,530</b>
<b>Gross profit</b>	<b>15,108</b>	<b>14,565</b>	<b>46,300</b>	<b>44,183</b>
<b>Operating expenses:</b>				
Sales and marketing	7,654	7,917	25,057	23,674
Research and development	2,243	2,100	6,288	6,322
General and administrative	3,420	3,114	11,820	9,079
<b>Total operating expenses</b>	<b>13,317</b>	<b>13,131</b>	<b>43,165</b>	<b>39,075</b>
<b>Income from operations</b>	<b>1,791</b>	<b>1,434</b>	<b>3,135</b>	<b>5,108</b>
<b>Other income:</b>				
Interest income	697	1,062	2,350	3,449
Other income	5	—	26	—
<b>Total other income</b>	<b>702</b>	<b>1,062</b>	<b>2,376</b>	<b>3,449</b>
<b>Income before income taxes</b>	<b>2,493</b>	<b>2,496</b>	<b>5,511</b>	<b>8,557</b>
<b>Income tax expense (benefit)</b>	<b>430</b>	<b>50</b>	<b>(3,056)</b>	<b>257</b>
<b>Net income</b>	<b>\$ 2,063</b>	<b>\$ 2,446</b>	<b>\$ 8,567</b>	<b>\$ 8,300</b>
<b>Net income per share (see Note 3):</b>				
Basic	\$ 0.11	\$ 0.12	\$ 0.44	\$ 0.39
Diluted	\$ 0.10	\$ 0.12	\$ 0.43	\$ 0.39
<b>Weighted average shares outstanding</b>				
Basic	19,410	20,243	19,505	21,156
Diluted	19,726	20,575	19,796	21,548

*The accompanying notes are an integral part of these financial statements.*

**STAMPS.COM INC.**  
**STATEMENTS OF CASH FLOWS**

(In thousands)  
(Unaudited)

	Nine Months ended September 30,	
	2008	2007
<b>Operating activities:</b>		
Net income	\$ 8,567	\$ 8,300
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,574	2,295
Stock-based compensation expense	2,562	1,933
Deferred income tax	(3,671)	—
Changes in operating assets and liabilities:		
Trade accounts receivable	(137)	(83)
Other accounts receivable	(1,139)	(2,206)
Prepaid expenses	(1,228)	(684)
Other assets	(548)	(517)
Deferred revenue	1,582	2,081
Accounts payable and accrued expenses	1,243	(906)
Net cash provided by operating activities	8,805	10,213
<b>Investing activities:</b>		
Sale of short-term investments	26,139	32,648
Purchase of short-term investments	(21,536)	(29,984)
Sale of long-term investments	22,052	30,522
Purchase of long-term investments	(7,695)	(7,467)
Acquisition of property and equipment	(606)	(600)
Net cash provided by investing activities	18,354	25,119
<b>Financing activities:</b>		
Proceeds from exercise of stock options	334	838
Issuance of common stock under ESPP	349	477
Repurchase of common stock	(5,674)	(33,308)
Net cash used in financing activities	(4,991)	(31,993)
Net increase in cash and cash equivalents	22,168	3,339
Cash and cash equivalents at beginning of period	43,667	11,740
Cash and cash equivalents at end of period	\$ 65,835	\$ 15,079

*The accompanying notes are an integral part of these financial statements.*



**STAMPS.COM**  
**NOTES TO FINANCIAL STATEMENTS**  
(ALL INFORMATION WITH RESPECT TO SEPTEMBER 30, 2008 AND 2007 IS UNAUDITED)

**1. Summary of Significant Accounting Policies**

*Basis of Presentation*

We prepared the financial statements included herein without audit pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with United States (US) generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. We believe that the disclosures are adequate to make the information presented not misleading. We recommend that these financial statements be read in conjunction with the financial statements and the notes thereto included in our latest annual report on Form 10-K.

In our opinion, these unaudited financial statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly our financial position as of September 30, 2008, the results of operations for the three and nine months ended September 30, 2008 and cash flows for the nine months ended September 30, 2008. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

*Use of Estimates and Risk Management*

The preparation of financial statements in conformity with US generally accepted accounting principles requires us to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates and such differences may be material to the financial statements. Examples include estimates of loss contingencies, promotional coupon redemptions, deferred income taxes and estimates regarding the useful lives of patents and other amortizable intangibles.

We are involved in various litigation matters as a claimant and a defendant. We record any amounts recovered in these matters when received. We record liabilities for claims against us when the loss is probable and estimable. Amounts recorded are based on reviews by outside counsel, in-house counsel and management. Actual results could differ from estimates.

*Revenue Recognition*

We recognize revenue from product sales or services rendered, as well as from licensing the use of our software and intellectual property, when the following four revenue recognition criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the selling price is fixed or determinable, and collectability is reasonably assured.

Service revenue is based on monthly convenience fees and is recognized in the period that services are provided. Product sales, net of return allowances, are recorded when the products are shipped and title passes to customers. Sales of our products, including PhotoStamps, to customers are made pursuant to a sales contract that provides for transfer of both title and risk of loss upon our delivery to the carrier. Return allowances for expected product returns, which reduce product revenue by our best estimate of expected product returns, are estimated using historical experience. We recognize licensing revenue ratably over the contract period. Commissions from the advertising or sale of products by a third party vendor to our customer base are recognized when the revenue is earned and collection is deemed probable.

Customers who purchase postage for use through our NetStamps, shipping label or mailing features, pay face value, and the funds are transferred directly from the customers to the United States Postal Service (USPS). We do not recognize revenue for this postage as it is purchased by our customers directly from the USPS. PhotoStamps revenue includes the price of postage.

On a limited basis, we allow third parties to offer products and promotions to the Stamps.com customer base. These arrangements generally provide payment in the form of a flat fee or revenue sharing arrangements where we receive payment upon customers accessing third party products and services. Total revenue from such advertising arrangements is currently immaterial.

**STAMPS.COM**  
**NOTES TO FINANCIAL STATEMENTS**

(ALL INFORMATION WITH RESPECT TO SEPTEMBER 30, 2008 AND 2007 IS UNAUDITED)

We provide our customers with the opportunity to purchase parcel insurance directly through our software. Insurance revenue represents the gross amount charged to the customer for purchasing insurance and the related cost represents the amount paid to the insurance broker, Parcel Insurance Plan. We recognize revenue on insurance purchases upon the ship date of the insured package.

Revenue from gift cards, which is recognized at the time of redemption, is currently immaterial to our financial statements. Because we do not yet have meaningful historical data upon which to base estimates for gift cards that will never be redeemed (“breakage”), we have not recorded any breakage income related to our gift card program.

## 2. Legal Proceedings

Please refer to "Part II - Other Information - Item 1 - Legal Proceedings" of this report for a discussion of our current legal proceedings.

## 3. Net Income per Share

Net income per share represents net income attributable to common stockholders divided by the weighted average number of common shares outstanding during a reported period. The diluted net income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, including convertible preferred stock and stock options and warrants (commonly and hereafter referred to as “common stock equivalents”), were exercised or converted into common stock. Diluted net income per share is calculated by dividing net income during a reported period by the sum of the weighted average number of common shares outstanding plus common stock equivalents for the period. The following table reconciles share amounts utilized to calculate basic and diluted net income per share (in thousands, except per share data):

	Three Months Ended September 30,		Nine months Ended September 30,	
	2008	2007	2008	2007
Net income	\$ 2,063	\$ 2,446	\$ 8,567	\$ 8,300
Basic - weighted average common shares	19,410	20,243	19,505	21,156
Diluted effect of common stock equivalents	316	332	291	392
Diluted - weighted average common shares	19,726	20,575	19,796	21,548
Earnings per share:				
Basic	\$ 0.11	\$ 0.12	\$ 0.44	\$ 0.39
Diluted	\$ 0.10	\$ 0.12	\$ 0.43	\$ 0.39

The calculation of dilutive shares excludes the effect of the following options that are considered anti-dilutive (in thousands):

Three Months Ended September 30	Nine months Ended September 30,
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	2008	2007	2008	2007
Anti-dilutive stock options shares	2,192	2,371	2,241	1,639

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**STAMPS.COM**  
**NOTES TO FINANCIAL STATEMENTS**  
 (ALL INFORMATION WITH RESPECT TO SEPTEMBER 30, 2008 AND 2007 IS UNAUDITED)

#### 4. Stock-Based Employee Compensation

We account for stock-based awards to employees and directors pursuant to Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), "Share-Based Payment" (SFAS 123R), and related SEC rules included in Staff Accounting Bulletin No. 107 (SAB 107). SFAS 123R requires us to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model and to recognize stock-based compensation expense during each period based on the value of that portion of share-based payment awards that is ultimately expected to vest during the period, reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Compensation expense recognized for all employee stock options granted is recognized using the straight-line single method over their respective vesting periods of three to four years.

The following table sets forth the stock-based compensation expense that we recognized under SFAS 123R for the periods indicated (in thousands):

	Three Months Ended September 30,		Nine months Ended September 30,	
	2008	2007	2008	2007
Stock-based compensation expense relating to:				
Employee and director stock options	\$ 786	\$ 808	\$ 2,438	\$ 1,849
Employee stock purchases	94	37	124	84
Total stock-based compensation expense	\$ 880	\$ 845	\$ 2,562	\$ 1,933
Stock-based compensation expense relating to:				
Cost of revenues	\$ 84	\$ 77	\$ 228	\$ 222
Sales and marketing	204	170	552	326
Research and development	182	191	480	464
General and administrative	410	407	1,302	921
Total stock-based compensation expense	\$ 880	\$ 845	\$ 2,562	\$ 1,933

In our SFAS 123R calculations, we use the Black-Scholes option valuation model, which requires us to make a number of highly complex and subjective assumptions, including stock price volatility, expected term, risk-free interest rates and actual and projected employee stock option exercise behaviors. In the case of options we grant, our assumption of expected volatility was based on the historical volatility of our stock price for the period January 1, 2002 through the date of the option grant. We base the risk-free interest rate on U.S. Treasury zero-coupon issues with a remaining term equal to the expected life assumed at the date of grant. The estimated expected life represents the weighted-average period the stock options are expected to remain outstanding determined based on an analysis of historical exercise behavior.

The following are the weighted average assumptions used in the Black-Scholes valuation model for the periods indicated:

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	Three Months Ended September 30,		Nine months Ended September 30,	
	2008	2007	2008	2007
Expected dividend yield	—	—	—	—
Risk-free interest rate	3.19%	4.59%	3.02%	4.65%
Expected volatility	50%	49%	51%	48%
Expected life (in years)	5	5	5	5
Expected forfeiture rate	16%	16%	16%	16%

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**STAMPS.COM**  
**NOTES TO FINANCIAL STATEMENTS**  
 (ALL INFORMATION WITH RESPECT TO SEPTEMBER 30, 2008 AND 2007 IS UNAUDITED)

**5. Intangible Assets**

Our intangible assets consist of patents, trademarks and other intellectual property with a gross carrying value of \$8.3 million as of September 30, 2008 and December 31, 2007 and accumulated amortization of approximately \$7.8 million as of September 30, 2008 and \$7.4 million as of December 31, 2007. The expected useful lives of our amortizable intangible assets range from 4 to 17 years. During 2007, we assessed whether events or changes in circumstances occurred that could potentially indicate that the carrying amount of our intangible assets may not be recoverable. We concluded that there were no such events or changes in circumstances during 2007 and determined that the fair value of our intangible assets were in excess of their carrying value as of December 31, 2007. Aggregate amortization expense on patents and trademarks was approximately \$3 thousand and \$365 thousand for the three and nine months ended September 30, 2008, respectively and \$270 thousand and \$814 thousand for the three and nine months ended September 30, 2007, respectively.

**6. Comprehensive Income**

The following table provides the data required to calculate comprehensive income (in thousands):

	Three Months Ended		Nine months Ended	
	September 30,		September 30,	
	2008	2007	2008	2007
Net income	\$ 2,063	\$ 2,446	\$ 8,567	\$ 8,300
Unrealized (loss) income on investments	52	218	(453)	302
Comprehensive income	\$ 2,115	\$ 2,664	\$ 8,114	\$ 8,602

**7. Income Taxes**

During the nine months ended September 30, 2008, our income tax benefit consists of alternative minimum federal tax and state income tax netted against a tax benefit relating to the release of a portion of our deferred tax asset valuation allowance. Our effective income tax rate differs from the statutory income tax rate primarily as a result of the partial release of our valuation allowance as well as our use of federal net operating losses to offset current federal tax expense. A valuation allowance was originally recorded against our deferred tax assets as we determined the realization of these assets did not meet the more likely than not criteria in accordance with SFAS No. 109, "Accounting for Income Taxes." During the first quarter of 2008, we determined that a full valuation allowance against our deferred tax assets was not necessary. In making such determination we considered all available positive and negative evidence including our recent earnings trend and expected continued future taxable income. During the first quarter of 2008, we recorded a partial reversal of deferred tax valuation allowance of \$3.7 million primarily consisting of net operating loss carryforwards, research tax credits carryforwards and current tax provision of \$106 thousand for corporate alternative minimum federal and state taxes, resulting in an overall tax benefit of \$3.6 million. We continue to maintain a valuation allowance for the remainder of our deferred tax assets. In September 2008 the State of California passed a new legislation temporarily suspending the use of net operating losses to offset current state income tax expense. As a result, we incurred approximately \$350 thousand of additional California state income tax expense during the third quarter of 2008. During the three and nine months ended September 30, 2008, we recorded a current tax provision for corporate alternative minimum federal taxes and state taxes of approximately \$430 thousand and \$616 thousand, respectively.

We adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109" (FIN 48) on January 1, 2007. Under FIN 48, we are required to determine whether it is more likely than not that a tax position will be sustained upon examination based on the technical merits of the position. A tax position that meets the more likely than not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The adoption of FIN 48 did not have a material effect on our financial statements. We have concluded that there are no significant uncertain tax positions requiring recognition in our financial statements.



**STAMPS.COM**  
**NOTES TO FINANCIAL STATEMENTS**  
 (ALL INFORMATION WITH RESPECT TO SEPTEMBER 30, 2008 AND 2007 IS UNAUDITED)

Our policy is to recognize interest and penalties expense, if any, related to unrecognized tax benefits as a component of income tax expense. As of September 30, 2008, we have not recorded any interest and penalty expense.

Our determination on the analysis of uncertain tax positions are related to tax years that remain subject to examination by the relevant tax authorities. These include the 2005 through 2007 tax years for federal purposes and the 2004 through 2007 tax years for California purposes.

### 8. Fair Value Measurements

We adopted SFAS No. 157, "Fair Value Measurement" (SFAS 157) on January 1, 2008. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosure for each major asset and liability category measured at fair value on either a recurring or nonrecurring basis. The fair value hierarchy for disclosure of fair value measurements under SFAS 157 is as follows:

Level 1 - Valuations based on unadjusted quoted prices for identical assets in an active market

Level 2 - Valuations based on quoted prices in markets where trading occurs infrequently or whose values are based on quoted prices of instruments with similar attributes in active markets

Level 3 - Valuations based on inputs that are unobservable and involve management judgment and our own assumptions about market participants and pricing

The following table summarizes our financial assets measured at fair value on a recurring basis in accordance with SFAS 157 (in thousands):

Description	September 30, 2008	Fair Value Measurement at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	\$ 65,835	\$ 65,835	\$ —	\$ —
Available-for-sale debt securities	27,743	—	27,743	—
Total	\$ 93,578	\$ 65,835	\$ 27,743	\$ —

The fair value of our available-for-sale debt securities included in the Level 2 category is based on the market values obtained from an independent pricing service that were evaluated using pricing models that vary by asset class and may incorporate available trade, bid and other market information and price quotes from well established independent pricing vendors and broker-dealers.

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

*This Quarterly Report on Form 10-Q 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"). These statements relate to expectations concerning matters that are not historical facts. 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. 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 which we may make orally or in writing from time to time, are based on beliefs and assumptions made by, 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 may differ from our expectations, and those differences may be material. We are not undertaking any obligation to update any forward-looking statements. Accordingly, investors should use caution in relying on past forward-looking statements, which are based on known results and trends at the time they are made, to anticipate future results or trends.*

*Please refer to the risk factors under "Item 1A. Risk Factors" as well as those described elsewhere in our public filings. The risks included are not exhaustive, and additional factors could adversely affect our business and financial performance. We operate in a very competitive and rapidly changing environment. New risk factors emerge from time to time and it is not possible for management to predict all such risk factors, nor can it assess the impact of all such risk factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.*

*Stamps.com, NetStamps, PhotoStamps, Hidden Postage, Stamps.com Internet postage and the Stamps.com logo are our trademarks. This report also references trademarks of other entities.*

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

We currently have significant federal and state net operating loss carry-forwards (NOL). Under applicable law, our NOL assets could be adversely affected by the acquisition by any person, company or investment firm of more than 5% of our outstanding stock or the acquisition of any additional shares by 5% holders. Our articles of incorporation have provisions (the "NOL Protective Measures") which prohibit transfers of our stock that would create new 5% shareholders or increase the ownership of existing 5% shareholders. **Accordingly, any person, company or investment firm that wishes to become a 5% shareholder must first obtain a waiver of the NOL Protective Measures from our board of directors.** In addition, any person, company or investment firm which is a 5% shareholder can not make any additional purchases of our stock without a waiver from our board of directors. **Failure to do so can mean loss of the shares and responsibility for any damages to the Company, which could be substantial.** Details of the NOL Protective Measures are contained in our definitive Proxy filed on April 2, 2008.

**As of October 31, 2008 we currently have approximately 18.0 million shares outstanding and therefore ownership of approximately 900 thousand shares or greater would currently constitute a "5% shareholder." Accordingly, we strongly urge you to contact us prior to allowing your ownership interest in our stock to exceed 725 thousand shares.**

We estimate that as of September 30, 2008, we were approximately at 37% compared with the 50% level that would trigger impairment of our NOL asset.

## Overview

Stamps.com<sup>®</sup> 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 (USPS) mail classes including First Class Mail<sup>®</sup>, Priority Mail<sup>®</sup>, Express Mail<sup>®</sup>, Media Mail<sup>®</sup>, Parcel Post<sup>®</sup>, and others. Our customers include home businesses, small businesses, corporations and individuals. We were the first ever USPS-licensed vendor to offer PC Postage<sup>®</sup> in a software-only business model in 1999. On August 10, 2004, we publicly launched a market test of PhotoStamps<sup>®</sup>, a form of postage that allows consumers to turn digital photos, designs or images into valid US postage. Any reference in this document to our PC Postage business does not include our PhotoStamps business.

We were founded in September 1996, incorporated in Delaware as StampMaster, Inc. in January 1998, and changed our name to Stamps.com Inc. in December 1998. We completed our initial public offering in June 1999. Our common stock is listed on the NASDAQ Stock Market under the symbol "STMP."

Our principal executive office is located at 12959 Coral Tree Place, Los Angeles, California, 90066, and our telephone number is (310) 482-5800.

## **Our Services and Products**

We offer the following products and services to our customers:

### *PC Postage Service*

Our USPS-approved PC Postage service enables users to print information-based indicia, or electronic stamps, directly onto envelopes, plain paper, or labels using ordinary laser or inkjet printers. Our service currently supports a variety of USPS classes including First-Class Mail®, Priority Mail®, Express Mail®, Parcel Post®, Media Mail®, Bound Printed Matter, and international mail. 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. Our service requires only a standard PC, printer and Internet connection. Our free software can be downloaded from the Internet or installed from a CD-ROM. After installing the software and completing the registration process, customers can purchase and print postage 24 hours a day, seven days a week. When a customer purchases postage for use through our service, the customer pays face value, and the funds are transferred directly from the customer's account to the USPS's account. Currently the majority of new customers signing up for our service pay a monthly convenience fee of \$17.99.

We offer our customers three primary ways to print PC Postage. First, our NetStamps® feature and Photo NetStamps® feature enable customers to print postage for any value and for most classes of mail on NetStamps or Photo NetStamps labels. Photo NetStamps allow customers to use digital photos, designs or images with NetStamps as compared to the standard designs available with regular NetStamps. After they are printed, NetStamps and Photo NetStamps can be used just like regular stamps. Second, our shipping feature tab allows customers to print postage for packages on plain 8.5" x 11" paper or on special labels, and to add electronic Delivery or Signature Confirmation at discounted prices. Third, our mailing feature tab is typically used to print the postage and address directly on envelopes or on other types of mail or labels, in a single-step process that saves time and provides a professional look. Our PC Postage services also 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. As an added convenience, our PC Postage services have been designed to integrate into common small business and productivity software applications such as word processing, contact and address management, and accounting and financial applications.

### *PhotoStamps®*

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 now 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](http://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. PhotoStamps is currently available under authorization of the USPS for its fourth phase market test, with an authorization for one year through May 2009.

### *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, OEM and private label inkjet and laser toner cartridges, scales, and other mailing and shipping-focused office supplies. Our Supplies Store features a store catalog, same day shipping capabilities, strong messaging of our free or discounted shipping promotions, strong cross sell during checkout, product search capabilities, and new expedited and rush shipping options. We plan to continue to increase the breadth of products offered in our Supplies Store.

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### *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. We also offer official USPS insurance alongside our branded insurance product, which is provided in partnership with Parcel Insurance Plan and is underwritten by Fireman's Fund.

### **Critical Accounting Policies**

#### *General*

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements which have been prepared in accordance with US generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to patents, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our financial statements.

#### *Revenue Recognition*

We recognize revenue from product sales or services rendered, as well as from licensing the use of our software and intellectual property, when the following four revenue recognition criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the selling price is fixed or determinable, and collectibility is reasonably assured.

Our service revenue is based on monthly convenience fees and is recognized in the period that services are provided. Product sales, net of return allowances, are recorded when the products are shipped and title passes to customers. Sales of our products, including PhotoStamps, to customers are made pursuant to a sales contract that provides for transfer of both title and risk of loss upon our delivery to the carrier. Return allowances for expected product returns, which reduce product revenue, are estimated using historical experience. We recognize licensing revenue ratably over the contract period. Commissions from the advertising or sale of products by a third party vendor to our customers are recognized when the revenue is earned and collection is deemed probable. We recognize revenue on insurance purchases upon the ship date of the insured package.

#### *Intangibles*

We make an assessment of the estimated useful lives of our patents and other amortizable intangibles. These estimates are made using various assumptions that are subjective in nature and could change as economic and competitive conditions change. If events were to occur that would cause our assumptions to change, the amounts recorded as amortization would be adjusted.

#### *Contingencies and Litigation*

We are involved in various litigation matters as a claimant and as a defendant. We record any amounts recovered in these matters when collection is certain. We record liabilities for claims against us when the losses are probable and estimable. Any amounts recorded would be based on reviews by outside counsel, in-house counsel and management. Actual results may differ from estimates.

*Promotional Expense*

New PC Postage customers are typically offered promotional items that are redeemed using coupons that are qualified for redemption after a customer is successfully billed beyond an initial trial period. This includes free postage and a free digital scale and is expensed in the period in which a customer qualifies using estimated redemption rates based on historical data. Promotional expense that is included in the cost of service is incurred as customers qualify and thereby may not correlate directly with changes in revenue as the revenue associated with the acquired customer is earned over the customer's lifetime.

## Recent Accounting Pronouncements

In October 2008, the FASB issued Financial Statement Position No. SFAS 157-3, "Determining the Fair Value of a Financial Assets When the Market for That Asset is Not Active" (FSP SFAS 157-3). FSP SFAS 157-3 clarifies the application of FASB Statement No. 157, "Fair Value Measurements", in a market that is not active and provides an example to illustrate key consideration in determining the fair value of a financial asset when the market for that financial asset is not active. FSP SFAS 157-3 is effective upon issuance and its adoption will not have a material impact to our financial statements.

## Recent Development

Our Board of Directors approved a share repurchase program on July 16, 2008, authorizing us to purchase up to 2 million shares of our common stock through February 2009, and on October 16, 2008 increased the authorization by an additional 1 million shares. We purchased approximately 248 thousand shares for a total cost of approximately \$2.9 million under that program during the third quarter of 2008; as of October 31, 2008, we had approximately 1.6 million shares of common stock still authorized for repurchase through February 2009 under that program. We have no commitments to make any purchases, and the timing of purchases, if any, and the number of shares to be bought at any one time will depend on market conditions and our assessment of risk that our NOL asset could be impaired if such repurchases were undertaken. Share purchase may be made from time to time on the open market or in negotiated transactions at our discretion in compliance with Rule 10b-18 under the Securities Exchange Act of 1934. Our purchase of any of our shares is subject to limitations that may be imposed on such purchases by applicable laws and regulations and the rules of the Nasdaq Stock Market.

## Results of Operations

Total revenue was \$20.2 million during third quarter of 2008, a decrease of 1% from \$20.3 million in the third quarter of 2007. Total revenue during the nine months ended September 30, 2008 was \$62.6 million, an increase of 1% from \$61.7 million during the nine months ended September 30, 2007. PC Postage subscriber related revenue, including service revenue, product revenue and insurance revenue in the third quarter of 2008 was \$18.1 million, an increase of 8% from \$16.8 million in the third quarter of 2007, and was \$54.7 million in the nine months ended September 30, 2008, an increase of 11% from \$49.5 million in the nine months ended September 30, 2007. PhotoStamps revenue in the third quarter of 2008 was \$2.0 million, a decrease of 43% from \$3.5 million in the third quarter of 2007, and was \$7.9 million in the nine months ended September 30, 2008, a decrease of 30% from \$11.3 million in the nine months ended September 30, 2007.

The PC Postage marketing channels we use to acquire customers include partnerships, online advertising, affiliate channel, direct mail, traditional media advertising, enhanced promotion online channel, and others. We look at our enhanced promotion channel separately from our non-enhanced promotion channels. In the enhanced promotion channel, we work with various companies to advertise our service in a variety of sites on the Internet. These companies typically offer an additional promotion directly to the customer in order to get the customer to try our service. Although our enhanced promotion channel is characterized by lower customer acquisition costs than our other channels, its customer attrition rates are higher. In recent periods, we have decided to decrease our marketing investment in that channel and increase investments in other channels.

As a result, subscriber related revenue for customers acquired through our enhanced promotion channel in the third quarter of 2008 was \$2.1 million, a decrease of 11% from \$2.4 million in the third quarter of 2007, and was \$7.0 million in the nine months ended September 30, 2008, an increase of 1% from \$6.9 million in the nine months ended September 30, 2007. Primarily as a result of our increased investment, we estimate that subscriber related revenue for customers acquired through our non-enhanced promotion channels in the third quarter of 2008 was \$16.0 million, an increase of 11% from \$14.4 million in the third quarter of 2007, and was \$47.7 million in the nine months ended



September 30, 2008, an increase of 12% from \$42.5 million in the nine months ended September 30, 2007.

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We define paid customers as ones from whom we successfully collected service fees at least once during the quarter. Total number of paid customers originally acquired through our non-enhanced promotion channels in the third quarter of 2008 was 312 thousand, an increase of 11% from 281, thousand in the third quarter of 2007. We believe that the increase in paid customers in the third quarter of 2008 was attributable to our increased customer acquisition spending. For customers originally acquired through our non-enhanced promotion channels, our average subscriber related monthly revenue per paid customer in the third quarter of 2008 was \$17.07, compared to \$17.03 in the third quarter of 2007.

The following table sets forth our results of operations as a percentage of total revenue for the periods indicated:

	Three Months Ended September 30,		Nine months Ended September 30,	
	2008	2007	2008	2007
<b>Total Revenues</b>				
Service	76.6%	69.6%	73.8%	66.9%
Product	11.5%	11.3%	11.8%	11.5%
Insurance	1.9%	1.7%	1.8%	1.7%
PhotoStamps	10.0%	17.4%	12.6%	18.4%
Other	0.0%	0.0%	0.0%	1.5%
<b>Total revenues</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
<b>Cost of revenues</b>				
Service	13.0%	11.7%	12.2%	11.5%
Product	4.0%	3.7%	4.2%	3.9%
Insurance	0.6%	0.5%	0.6%	0.5%
PhotoStamps	7.4%	12.3%	9.1%	12.4%
Other	0.0%	0.0%	0.0%	0.1%
<b>Total cost of revenues</b>	<b>25.0%</b>	<b>28.2%</b>	<b>26.1%</b>	<b>28.4%</b>
<b>Gross profit</b>	<b>75.0%</b>	<b>71.8%</b>	<b>73.9%</b>	<b>71.6%</b>
<b>Operating expenses:</b>				
Sales and marketing	38.0%	39.0%	40.0%	38.4%
Research and development	11.1%	10.4%	10.0%	10.2%
General and administrative	17.0%	15.4%	18.9%	14.7%
<b>Total operating expenses</b>	<b>66.1%</b>	<b>64.7%</b>	<b>68.9%</b>	<b>63.3%</b>
<b>Income from operations</b>	<b>8.9%</b>	<b>7.1%</b>	<b>5.0%</b>	<b>8.3%</b>
Other income (expense), net	3.5%	5.2%	3.8%	5.6%
<b>Income before income taxes</b>	<b>12.4%</b>	<b>12.3%</b>	<b>8.8%</b>	<b>13.9%</b>
Income tax expense (benefit)	2.1%	0.2%	(4.9)%	0.4%
<b>Net income</b>	<b>10.2%</b>	<b>12.1%</b>	<b>13.7%</b>	<b>13.4%</b>

### *Revenue*

Our revenue is derived primarily from five sources: (1) service fees charged to customers for use of our PC Postage service; (2) product revenue from the direct sale of consumables and supplies through our Supplies Store (3) insurance revenue from our branded insurance offering; (4) PhotoStamps revenue from our PhotoStamps business; and (5) other revenue, consisting of licensing revenue and advertising revenue derived from advertising programs with our existing customers.

Service revenue increased 9% to \$15.4 million in the third quarter of 2008 from \$14.1 million in the third quarter of 2007 and increased 12% to \$46.2 million in the nine months ended September 30, 2008 from \$41.3 million in the nine months ended September 30, 2007. These increases in service revenue were primarily due to the increase in our successfully billed customers as a result of the growth in our customer base. As a percentage of total revenue, service revenue increased seven percentage points to 77% in the third quarter of 2008 from 70% in the third quarter of 2007 and increased seven percentage points to 74% in the nine months ended September 30, 2008 from 67% in the nine months ended September 30, 2007, primarily as a result of the increase in service revenue and the decrease in revenue from our PhotoStamps product.

Product revenue was unchanged at \$2.3 million during both the third quarter of 2008 and the third quarter of 2007 and increased 4% to \$7.4 million in the nine months ended September 30, 2008 from \$7.1 million in the nine months ended September 30, 2007. The year to date increase was primarily attributable to the following: (1) growth in our paid customer base; (2) marketing the store to our existing customer base; (3) the additional SKUs we added to our store; and (4) growth in postage printed, which helps drive sales of consumable supplies such as labels. Total postage printed by customers using our service during the third quarter of 2008 was \$77 million, a 13% increase from the \$68 million printed during the third quarter of 2007. As a percentage of total revenue, product revenue remained at approximately 12% during each of the third quarter of 2008 and 2007 and nine months ended September 30, 2008 and 2007.

Insurance revenue increased 11% to \$375 thousand in the third quarter of 2008 from \$339 thousand in the third quarter of 2007 and increased 7% to \$1.14 million in the nine months ended September 30, 2008 from \$1.07 million in the nine months ended September 30, 2007, primarily as a result of an increase in the average of dollar value insured per transaction. As a percentage of total revenue, insurance revenue remained at approximately 2% during each of the third quarter of 2008 and 2007 and nine months ended September 30, 2008 and 2007.

PhotoStamps revenue decreased 43% to \$2.0 million in the third quarter of 2008 from \$3.5 million in the third quarter of 2007 and decreased 30% to \$7.9 million in the nine months ended September 30, 2008 from \$11.3 million in the nine months ended September 30, 2007. As a percentage of total revenue, PhotoStamps revenue decreased seven percentage points to 10% in the third quarter of 2008 from 17% in the third quarter of 2007 and decreased five percentage points to 13% in the nine months ended September 30, 2008 from 18% in the nine months ended September 30, 2007. Total PhotoStamps sheets shipped during the third quarter of 2008 was approximately 120 thousand, a 47% decrease compared to 225 thousand in the third quarter of 2007. Average revenue per sheet shipped in the third quarter of 2008 was \$16.8 compared to \$15.7 in the third quarter of 2007. The decrease in sheets shipped was primarily attributable to our decision this year to reduce our PhotoStamps sales and marketing spending.

Because of the expiration of a licensing agreement in June 2007, we did not have any other revenue in the third quarter of 2008 and nine months ended September 30, 2008, compared to \$907 thousand in the nine months ended September 30, 2007.

### *Cost of Revenue*

Cost of revenue principally consists of the cost of customer service, certain promotional expenses, system operating costs, credit card processing fees, the cost of postage for PhotoStamps, image review, printing and fulfillment costs for PhotoStamps, parcel insurance offering costs, customer misprints and products sold through our Supplies Store and the related costs of shipping and handling. Cost of revenue decreased 12% to \$5.0 million in the third quarter of 2008 from \$5.7 million in the third quarter of 2007 and decreased 7% to \$16.3 million in the nine months ended September 30, 2008 from \$17.5 million in the nine months ended September 30, 2007. As a percentage of total revenue, cost of revenue decreased three percentage points to 25% in the third quarter of 2008 from 28% in the third quarter of 2007 and decreased two percentage points to 26% in the nine months ended September 30, 2008 from 28% in the nine months ended September 30, 2007.

Cost of service revenue increased 11% to \$2.6 million in the third quarter of 2008 from \$2.4 million in the third quarter 2007 and increased 7% to \$7.6 million in the nine months ended September 30, 2008 from \$7.1 million in the nine months ended September 30, 2007. The increase during the three and nine months ended September 30, 2008 is primarily attributable to higher customer support related expenses resulting from expanding our support personnel and efforts to improve the overall customer experience. Promotional expenses are included in cost of service revenue. This includes free postage and a free digital scale offered to new customers and was approximately \$287 thousand and \$399 thousand in the third quarter of 2008 and 2007, respectively, and approximately 486 thousand and 1.2 million in the nine months ended September 30, 2008 and 2007, respectively. The decrease in promotional expense is primarily attributable to a change in our estimate of future coupon redemptions. As a percentage of total revenue, cost of service revenue was up one percentage point to 13% in the third quarter of 2008 from 12% in the third quarter of 2007 and was 12% in each of the nine months ended September 30, 2008 and 2007.

Cost of product revenue increased 6% to \$809 thousand in the third quarter of 2008 from \$760 thousand in the third quarter 2007 and increased 10% to \$2.6 million in the nine months ended September 30, 2008 from \$2.4 million in the nine months ended September 30, 2007. As a percentage of total revenue, cost of product revenue was approximately 4% in each of these periods.

Cost of insurance revenue increased 18% to \$124 thousand in the third quarter of 2008 from \$105 thousand in the third quarter of 2007 and increased 10% to \$363 thousand in the nine months ended September 30, 2008 from \$331 thousand in the nine months ended September 30, 2007. The increase is mainly attributable to the higher average insurance sales price as a result of the increase in the dollar value insured per transaction. As a percentage of total revenue, cost of insurance revenue was approximately 1% in each of these periods.

Cost of PhotoStamps revenue decreased 40% to \$1.5 million in the third quarter of 2008 from \$2.5 million in the third quarter of 2007 and decreased 25% to \$5.7 million in the nine months ended September 30, 2008 from \$7.6 million in the nine months ended September 30, 2007, primarily due to the decrease in PhotoStamps revenue during those periods. As a percentage of total revenue, cost of PhotoStamps revenue decreased five percentage points to 7% in the third quarter of 2008 from 12% in third quarter of 2007 and decreased three percentage points to 9% in the nine months ended September 30, 2008 from 12% in the nine months ended September 30, 2007. The gross margin from PhotoStamps revenue is significantly lower than that of our other sources of revenue because we include the stated value of USPS postage as part of our cost of PhotoStamps revenue.

We did not incur other revenue costs after the expiration of one of our licensing agreements in June 2007.

### *Sales and Marketing*

Sales and marketing expense principally consists of spending to acquire new customers and compensation and related expenses for personnel engaged in sales, marketing and business development activities. Ongoing marketing programs include the following: traditional media advertising, partnerships, customer referral programs, customer re-marketing efforts, telemarketing, direct mail and online advertising. Sales and marketing expense decreased 3% to \$7.7 million in the third quarter of 2008 from \$7.9 million in the third quarter 2007 and increased 6% to \$25.0 million in the nine months ended September 30, 2008 from \$23.7 million in the nine months ended September 30, 2007. As a percentage of total revenue, sales and marketing expenses decreased one percentage point to 38% in the third quarter of 2008 from 39% in the third quarter of 2007 and increased two percentage points to 40% in the nine months ended September 30, 2008 from 38% in the nine months ended September 30, 2007. During the three and nine months ended September 30, 2008, PC Postage marketing expenditure increased compared to 2007 in those periods. During the three and nine months ended September 30, 2008, PhotoStamps marketing expenditure decreased compared to 2007 in those periods. The total net marketing expenditure during the third quarter of 2008 compared to 2007 resulted in a decrease, both on an absolute basis and as a percentage of total revenue; the total net marketing expenditure during the nine months ended September 30, 2008 increased compared to 2007 both on an absolute basis and as a percentage of

total revenue. The increase in our PC Postage marketing expenditure is primarily due to our decision to increase various marketing program expenditures relating to the acquisition of customers for our PC Postage business, offset by a decrease in marketing expenditures related to our PhotoStamps business, in order to improve profitability in the PhotoStamps business.

*Research and Development*

Research and development expense principally consists of compensation for personnel involved in the development of our services, depreciation of equipment and software and expenditures for consulting services and third party software. Research and development expense increased 7% to \$2.2 million in the third quarter of 2008 from \$2.1 million in the third quarter of 2007 and was approximately \$6.3 million in the nine months ended September 30, 2008 and 2007, respectively. The increase during the third quarter of 2008 is primarily due to headcount and compensation related expenses. As a percentage of total revenue, research and development expense increased one percentage point to 11% in the third quarter of 2008 from 10% in the third quarter of 2007 and remained at approximately 10% during the nine months ended September 30, 2008 and 2007.

*General and Administrative*

General and administrative expense principally consists of compensation and related costs for executive and administrative personnel, fees for legal and other professional services, depreciation of equipment and software used for general corporate purposes and amortization of intangible assets. General and administrative expense increased 10% to \$3.4 million in the third quarter of 2008 from \$3.1 million in the third quarter of 2007 and increased 30% to \$11.8 million in the nine months ended September 30, 2008 from \$9.1 million in the nine months ended September 30, 2007. As a percentage of total revenue, general and administrative expense increased two percentage points to 17% in the third quarter of 2008 from 15% in the third quarter of 2007 and increased four percentage points to 19% in the nine months ended September 30, 2008 from 15% in the nine months ended September 30, 2007. The increase, both on an absolute basis and as a percentage of total revenue, is primarily due to the increase in legal expenses for litigation of the Kara Technologies lawsuit and an increase in our stock compensation expense relating to SFAS 123R.

*Other Income, Net*

Other income, net consists of interest income from cash equivalents and short-term and long-term investments. Other income, net decreased 34% to \$697 thousand in the third quarter of 2008 from \$1.1 million in the third quarter of 2007 and decreased 32% to \$2.4 million in the nine months ended September 30, 2008 from \$3.4 million in the nine months ended September 30, 2007. As a percentage of total revenue, other income, net decreased one percentage point to approximately 4% in the third quarter of 2008 and decreased two percentage points to approximately 4% in the nine months ended September 30, 2008. The decrease, both on an absolute basis and as a percentage of total revenue, is primarily due to lower interest income rates and lower investment balances as we sold certain investments and used the cash to repurchase shares of our common stock.

**Liquidity and Capital Resources**

As of September 30, 2008 and December 31, 2007 we had approximately \$93.5 million and \$90.8 million, respectively, in cash, restricted cash and short-term and long-term investments. We invest available funds in short and long-term securities including money market funds, corporate bonds, asset backed securities, and government and agency bonds, and do not engage in hedging or speculative activities.

In November 2003, we entered into a facility lease agreement commencing in March 2004 for our corporate headquarters with aggregate lease payments of approximately \$4 million through February 2010.

The following table is a schedule of our contractual obligations and commercial commitments, which is comprised of the future minimum lease payments under operating leases at September 30, 2008 (in thousands):

**Operating**

Three months ending December 31, 2008	\$	189
Years ending December 31:		
2009		794
2010		134
	\$	1,117

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Net cash provided by operating activities was \$10.5 million and \$10.2 million during the nine months ended September 30, 2008 and 2007, respectively.

Net cash provided by investing activities was \$18.4 million and \$25.1 million during the nine months ended September 30, 2008 and 2007, respectively. The decrease in net cash provided by investing activities is mainly due to the decrease in sale of investments to fund the repurchase of stock. We did not repurchase any stock in the second quarter of 2008.

Net cash used in financing activities was \$6.7 million and \$32.0 million during the nine months ended September 30, 2008 and 2007, respectively. The decrease is mainly due to cash used to fund our stock repurchase program.

We believe our available cash and marketable securities, together with the cash flow from operations, will be sufficient to fund our business for the foreseeable future.

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

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. We have not used derivative financial instruments in our investment portfolio. Our cash equivalents and investments are comprised of money market, U.S. government obligations and public corporate debt securities with weighted average maturities of 110 days at September 30, 2008. Our cash equivalents and investments, net of restricted cash, approximated \$93.0 million and had a related weighted average interest rate of approximately 3.0%. Interest rate fluctuations can impact the carrying value of our portfolio. We do not believe that the future market risks related to the above securities will have a material adverse impact on our financial position, results of operations or liquidity.

As we do not have any operations outside of the United States, we are not exposed to foreign currency risks.

### **ITEM 4. CONTROLS AND PROCEDURES**

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

We maintain disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

As of the end of the period covered by this Report, our management evaluated, with the participation of our Principal Executive Officer and Principal Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our Principal Executive Officer and Principal Financial Officer have concluded, as of that time, that our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in reports filed or submitted under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) is accumulated and communicated to our management including our Principal Executive Officer and our Principal Financial Officer, to allow timely decisions regarding required disclosure.

#### *Changes in Internal Controls*

During the third quarter ended September 30, 2008, there has been no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



## **PART II – OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

On October 22, 2004, Kara Technology Incorporated filed suit against us in the United States District Court for the Southern District of New York, alleging, among other claims, that we infringed certain Kara Technology patents and that we misappropriated trade secrets owned by Kara Technology, most particularly with respect to our NetStamps feature. Kara Technology seeks an injunction, unspecified damages, and attorneys' fees. The suit was transferred to the United States District Court for the Central District of California which granted judgment in our favor. Kara Technology has recently filed a notice of appeal.

On November 22, 2006, we filed a lawsuit against Endicia, Inc. and PSI Systems, Inc. in the United States District Court for the Central District of California for infringement of eleven of our patents covering, among other things, Internet postage technology. On January 8, 2007, Endicia, Inc. and PSI Systems, Inc. filed counterclaims asking for a declaratory judgment that all eleven patents are invalid, unenforceable and not infringed. The Court has scheduled a trial commencement date of May 12, 2009.

On August 8, 2008, PSI Systems, Inc. filed a lawsuit against us in the same court, alleging that we infringed three PSI Systems patents related to Internet postage technology. PSI Systems seeks an injunction, unspecified damages, and attorneys' fees. On September 16, 2008, we filed counterclaims for infringement of four more of our patents. This lawsuit is in the early stages.

In May and June 2001, we were named, together with certain of our current and former board members and/or officers, as a defendant in 11 purported class-action lawsuits, filed in the U.S. District Court for the Southern District of New York. The lawsuits allege violations of the Securities Act and the Exchange Act in connection with our initial public offering and a secondary offering of our common stock. Plaintiffs seek damages and statutory compensation, including interest, costs and expenses (including attorneys' fees). We reached a proposed settlement which would not have required us to make any payments, which was ultimately terminated in June 2007 after the U.S. Court of Appeals for the Second Circuit determined that the class could not be certified as defined. Plaintiffs have filed an amended complaint and proposed an alternative class definition in related litigation. If such a class definition does not receive final court approval and/or a later settlement is not consummated for any reason, we intend to defend the lawsuits vigorously.

We are subject to various other routine legal proceedings and claims incidental to our business, or which involve primarily a claim for damages that does not exceed 10% of our consolidated assets. We believe that the ultimate results from these actions will not have a material adverse effect on our financial position, results of operations or cash flows.

### **ITEM 1A. RISK FACTORS**

We are not aware of any material changes to the risk factors included in Item 1A "Risk Factors" in our 2007 Annual Report on Form 10-K.

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

We did not have any unregistered sales of common stock during the quarter ended September 30, 2008.

#### **Issuer Purchases of Equity Securities**

During the third quarter of 2008, we purchased our common stock as described in the following table:

Period	Total Number of shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet be Purchased Under the Plans or Programs (in 000's)
July 1, 2008 – July 31, 2008	—	—	—	—
August 1, 2008 – August 31, 2008	—	—	—	—
September 1, 2008 – September 30, 2008	248,000	\$ 11.75	248,000	\$ 17,000

On October 16, 2008 our Board of Directors amended our current share repurchase program to cover a total of 3.0 million shares of our common stock; as of October 31, 2008, we had approximately 1.6 million shares of common stock still authorized for repurchase through February 2009 under that program.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

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

None.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

3.1 Amended and Restated Certificate of Incorporation of Stamps.com Inc.

31.1 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

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**SIGNATURES**

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

STAMPS.COM INC.  
(Registrant)

November 7, 2008

By: /s/ KEN MCBRIDE  
**Ken McBride**  
**Chief Executive Officer**

November 7, 2008

By: /s/ KYLE HUEBNER  
**Kyle Huebner**  
**Chief Financial Officer**

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