

eHealth, Inc.  
Form 10-K  
March 21, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

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**FORM 10-K**

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

**For the fiscal year ended December 31, 2006**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**001-33071**

**(Commission File Number)**

**EHEALTH, INC.**

**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State of incorporation)**

**56-2357876**  
**(I.R.S. Employer Identification No.)**

**440 EAST MIDDLEFIELD ROAD**

**MOUNTAIN VIEW, CALIFORNIA 94043**

**(Address of principal executive offices, including zip code)**

**(650) 584-2700**

# Edgar Filing: eHealth, Inc. - Form 10-K

(Registrant's telephone number, including area code)

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value \$0.001 per share	The NASDAQ Stock Market LLC
Securities registered pursuant to Section 12(g) of the Act: <b>None</b>	

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

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

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

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

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒

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 June 30, 2006, the last business day of the Registrant's most recently completed second fiscal quarter, our common stock was not listed on any exchange or over-the-counter market. Our common stock began trading on The NASDAQ Global Market on October 13, 2006.

As of February 28, 2007, 21,777,301 shares of common stock were outstanding.

## DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the 2007 Annual Meeting of Stockholders to be held on June 6, 2007 are incorporated by reference into Part III of this Annual Report on Form 10-K to the extent stated herein.

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*In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements include, among other things, statements concerning expectations regarding opportunity to expand our share of the individual, family and small business health insurance markets; growth of the individual and family health insurance market; small businesses providing health insurance benefits to their employees; adoption of a new health insurance distribution medium that harnesses the power of the Internet; our development of an online experience that empowers consumers; our intention to offer a wide selection of health insurance products; our intention to enhance our platform and its capabilities; our exploration of new ways to leverage and enhance our technology; our intention to add new health insurance carriers to our ecommerce platform and expand existing carrier relationships; expansion and development of marketing relationships; investment in member acquisition sources; our plan to serve as a resource to legislature and public policy organizations; our pursuit of international expansion; entering into relationships with carriers to extend our instant membership approval technology; our design of our instant membership approval technology; implementation and adoption of instant membership approval technology; current technology initiatives; future expenditures; factors that will impact the successful promotion of our brand; factors that could influence the rate at which we convert consumers visiting our ecommerce platform into members; factors that could influence the success of our relationship with our marketing partners; plans to expand our Chinese operations; the date of completion of implementation of our commission accounting system; factors that will influence the success of our sponsorship advertising and technology licensing businesses; acquisition of businesses; changes to existing insurance regulations and the impact of those changes; factors that will affect our future success and growth; the adequacy of our existing facilities; payment of dividends; investment of and use of the proceeds from our initial public offering; opportunity to expand our share of the individual family and small business insurance markets; the rate of online adoption being the primary driver of our revenue; our direct channel being our most cost-effective channel; the fluctuation of the cost of acquiring new members and related factors; increase in expenses; critical accounting policies and estimates; increases in types of revenue; transfers of small business members from a certain partner; exploration of new marketing initiatives and their effect; our future effective income tax rate; sufficiency of cash; the absence of collection issues with customers as well as other statements regarding our future operations, financial condition, prospects and business strategies. These forward-looking statements are subject to certain risks and uncertainties that could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this report, and in particular, the risks discussed under the heading **Risk Factors** in Part I, Item 1A of this report and those discussed in our other Securities and Exchange Commission filings. The following discussion should be read in conjunction with our audited financial statements and related notes that appear elsewhere in this report. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.*

**Overview**

We are the leading online source of health insurance for individuals, families and small businesses. We are licensed to market and sell health insurance in all 50 states and the District of Columbia. We have invested significant time and resources in building a scalable, proprietary ecommerce platform, and we have developed partnerships with over 160 health insurance carriers, enabling us to offer more than 7,000 health insurance products online. Our ecommerce platform can be accessed directly through our website addresses ([www.ehealth.com](http://www.ehealth.com) and [www.ehealthinsurance.com](http://www.ehealthinsurance.com)) as well as through our broad network of marketing partners. We organize and present voluminous and complex health insurance information in a user-friendly format and enable consumers to choose from a wide variety of health insurance products. Our platform enables individuals, families and small businesses to research, analyze, compare and purchase health insurance products that best meet their needs. Our technology also enables us to communicate electronically with our insurance carrier

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partners and process consumers' health insurance applications online. As a result, we simplify and streamline the complex and traditionally paper-intensive health insurance sales and purchasing process.

eHealth, Inc., the parent company of eHealthInsurance, was founded in 1997 and is headquartered in Mountain View, California. Our technology was responsible for the nation's first Internet-based sale of a health insurance policy. In October 2006, we completed an initial public offering of 5,750,000 shares of common stock at a price of \$14 per share. Additional information can be found at eHealth's website addresses, [www.ehealth.com](http://www.ehealth.com) and [www.ehealthinsurance.com](http://www.ehealthinsurance.com). We make our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, available free of charge on the Investor Relations page of our web site as soon as reasonably practicable after we file these reports with the Securities and Exchange Commission. The information on or that can be accessed through our websites is not part of this Annual Report on Form 10-K.

Except where the context requires otherwise, eHealth, we, us and our refer to eHealth, Inc. and its wholly-owned subsidiaries on a consolidated basis. eHealth, Inc. is a holding company and our business is primarily conducted through our subsidiary, eHealthInsurance Services, Inc. eHealth and eHealthInsurance are registered trademarks of eHealth in the United States. This Annual Report on Form 10-K also includes other registered and unregistered trademarks of eHealth and other persons.

## **Industry Background**

The Internet has emerged as a highly efficient and cost-effective medium that enables millions of consumers and businesses to research, compare, select and purchase products and services online. The growth of ecommerce has been driven by increased awareness of the product selection and information available online, the convenience of shopping online, continued improvement in network infrastructure and payment security and growing consumer access to high-speed Internet connections. Ecommerce offers the potential to streamline complex processes, lower costs, improve productivity and increase sales. The Internet has revolutionized the distribution of many products and services of large and complex industries, including brokerage, banking and auction services. We believe the Internet is also transforming the distribution of health insurance.

## ***Health Insurance Industry***

The private health insurance market is large and growing. Aggregate private health insurance premiums in the United States were estimated by the U.S. Department of Health and Human Services, Centers for Medicare and Medicaid Services to be \$694 billion in 2005, and have increased over time, largely unaffected by economic cycles. The private health insurance market consists of three primary commercial segments: large employers, small businesses (businesses with fewer than 100 employees) and the individual and family market (direct purchasers of health insurance). Large employers and small businesses have experienced substantial health insurance premium inflation in recent years and, as a consequence, are increasingly seeking to reduce the costs associated with providing health insurance to their employees. Actions taken by employers include offering fewer benefits to employees, reducing or eliminating dependent coverage, increasing employees' health insurance premium contributions, increasing plan deductibles, and eliminating health insurance coverage altogether. A 2005 survey by the Kaiser Family Foundation found that from 2001 to May 2005, the percentage of large and small business employees receiving health insurance benefits from their employers dropped from 69% to 60%. Typically, the only options for individuals who lose coverage are to obtain health insurance in the individual and family market, attempt to qualify for government-subsidized benefits or remain uninsured.

The individual and family segment is a well-established and significant component of the private health insurance market. According to the U.S. Census Bureau, approximately 17 million Americans directly purchased their health insurance coverage from an individual or family health insurance plan in 2004. Many of these individuals are among the approximately 10 million self-employed whose occupations range from gardeners, electricians and plumbers to physicians and attorneys. We believe that the individual and family market will continue to grow as a result of the increasing number of self-employed individuals, growing awareness of the

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availability and affordability of individual and family health plans and rising health benefit cost pressures in the employer segments. Recognizing this market opportunity, many large insurance companies including Aetna, Humana and UnitedHealthcare are offering health insurance products in the individual and family market.

The uninsured represent another significant growth opportunity for the individual and family markets. The U.S. Census Bureau estimated that in 2005 over 46 million Americans did not have health insurance. According to a U.S. Census Bureau report issued in 2006, approximately 17 million of the uninsured population were members of households with annual incomes of \$50,000 or more, including more than 8 million with annual incomes of \$75,000 or more. In addition, the National Center for Policy Analysis reported that households with annual incomes of \$50,000 or more accounted for approximately 90% of the increase in the number of uninsured over the ten years prior to 2004. Based on these statistics, we believe that there is a large population of uninsured individuals who can afford to obtain health insurance in the individual and family market.

Small business health insurance is also a large segment of the private health insurance market. Small businesses employ more than half of the private sector workforce and represent 99% of all businesses in America, according to a 2004 report by the U.S. Small Business Administration Office of Advocacy. The Employee Benefits Research Institute estimated that in 2004 small businesses provided health insurance benefits to 27 million Americans. Furthermore, statistics indicate that many small businesses have not provided health insurance to their employees because they are unaware of the availability of affordable health insurance products. For instance, according to a report released in May 2005 by the National Federation of Independent Business Research Foundation and Wells Fargo Bank, 66% of small businesses surveyed in 2004 stated that the rising cost of health insurance was a critical problem, as compared to 47% of small businesses surveyed in 2000. This same survey found that since 1986, healthcare costs have remained the number one critical problem for small businesses. We believe that these statistics suggest that a large number of small businesses would provide health insurance benefits to their employees if made aware of affordable, high-quality health insurance options.

The large size of the existing individual, family and small business health insurance markets, combined with the growing number of self-employed individuals and small businesses, the large and increasing number of uninsured and declining health benefits offered by employers, create a significant opportunity to provide health insurance to individuals, families and small businesses.

### ***Traditional Distribution of Health Insurance to Individuals, Families and Small Businesses***

The process of selling and purchasing individual, family and small business health insurance is highly localized and has not changed significantly in over 50 years. Individual, family and small business health insurance has historically been sold by independent insurance agents and, to a much lesser degree, directly by insurance companies. Most of these agents are self-employed or part of small agencies, and they typically service only their local communities. In addition, many of these agents sell health insurance from a limited number of insurance carriers (in some cases only one), resulting in a reduced selection of products for the consumer.

Large brokers such as Aon Insurance Services, Arthur J. Gallagher & Co., Marsh, Inc. and Willis Group Limited, as well as many regional brokers and agencies, have not historically addressed the individual, family and small business markets. Instead, they have primarily limited their marketing and sales efforts to large or mid-sized employers, where they can amortize the significant documentation and distribution costs over a large number of plan participants and often charge their clients a broker's fee. We believe that the lack of attention provided to the individual, family and small business health insurance markets by these agencies has left these markets underserved and highly fragmented.

The purchase and sale of health insurance has historically been a complex, time-consuming and paper-intensive process. Health insurance terminology, insurance plan types (e.g., HMO, PPO, POS indemnity plans) and provisions are often confusing and difficult to understand. Each plan is unique, offering different coverage, premiums, co-payment requirements and deductibles, among other provisions. In addition, different kinds of care are covered at different levels within a particular insurance plan, from outpatient care or lab and x-ray work to

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inpatient care related to emergencies and hospitalization. Other services such as maternity, in-home or mental healthcare can all be covered at different rates by different plans. This complexity can make it difficult to make informed health insurance decisions. In addition, the human error that arises from traditional paper-intensive distribution has historically resulted in a high number of incomplete and inaccurate applications being submitted to health insurance carriers. Incomplete and inaccurate paper applications often result in back-and-forth communications, delay and additional cost.

Extensive state government regulation further complicates the health insurance industry and has made the traditional distribution of health insurance on a national basis difficult. State insurance regulators require that carriers and agents be licensed by each state in which they sell and adhere to sales, documentation and administration practices specific to that state. Federal laws govern how carriers and agents collect and use personal health and financial information. These regulations result in high costs of nationwide market entry and high continuing costs associated with ongoing regulatory compliance.

Pricing must also meet state regulatory requirements and, once health insurance pricing is set by the carrier and approved by state regulators, it is fixed and not generally subject to negotiation or discounting by health insurance companies or agents. As a result, the profitability of distributing a particular health insurance product is determined primarily by the costs of marketing, selling and administering that particular product. We believe that the set pricing of health insurance products creates significant competitive advantages for a business with a more efficient distribution process.

For the individual, family and small business health insurance markets, the Internet's convenient, information-rich and interactive nature offers both the opportunity to provide consumers with more organized information and a broader choice of products than are typically available from traditional health insurance distribution channels. The Internet also offers a means of providing up-to-date health insurance information and products 24 hours a day, seven days a week, and reduces the cost and time associated with marketing, selling, underwriting and administering health insurance products. According to a November 2004 survey by the Pew Internet and American Life Project, over 30% of all Internet users had already searched online for information on health insurance. We believe that individuals, families and small businesses will rapidly adopt a new health insurance distribution medium that harnesses the power of the Internet to address the weaknesses in the current distribution channels.

## **Our Solution**

We are the leading online source of health insurance for individuals, families and small businesses. We are licensed to market and sell health insurance in all 50 states and the District of Columbia. We have invested significant time and resources in building a scalable, proprietary ecommerce platform, and as of December 31, 2006 we had developed partnerships with over 160 health insurance carriers as of December 31, 2006, enabling us to offer more than 7,000 health insurance products online. Our ecommerce platform can be accessed directly through our website addresses ([www.ehealth.com](http://www.ehealth.com) and [www.ehealthinsurance.com](http://www.ehealthinsurance.com)) as well as through our broad network of marketing partners. We organize and present voluminous and complex health insurance information in a user-friendly format and enable consumers to choose from a wide variety of health insurance products. Our platform enables individuals, families and small businesses to research, analyze, compare and purchase health insurance products that best meet their needs. Our technology also enables us to communicate electronically with our insurance carrier partners and process consumers' health insurance applications online. As a result, we simplify and streamline the complex and traditionally paper-intensive health insurance sales and purchasing process. We estimate that as of December 31, 2006, we had approximately 393,900 members. We define a member as an individual currently covered by an insurance product for which we are entitled to receive compensation.

Our ecommerce platform provides our health insurance carrier partners access to new and profitable business. For example, based on an analysis of a portion of our membership during 2006, we believe approximately 40% of our members were uninsured prior to obtaining individual and family health insurance

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through us. We are a leading sales originator for many of the nation's leading carriers, including Aetna, Humana, Kaiser Permanente, PacifiCare, Unicare, UnitedHealthcare and a number of leading BlueCross BlueShield carriers. We also enable carriers to reduce their processing costs, expand into new markets and gather and utilize relevant market data.

We serve as a trusted resource for objective information relating to health insurance and its affordability. Beginning in 2002, we have published several reports, including *The Cost and Benefits of Individual Health Insurance Plans* and *Trends in Health Savings Accounts*. We take an active role in health insurance reform by working with government policymakers and legislators to make health insurance more accessible and affordable. We believe that these activities provide greater awareness of the availability and affordability of health insurance and enhance our brand recognition among our members, marketing partners and carrier partners.

Our financial model is characterized by recurring revenue, health insurance pricing that is set by each carrier and approved by state regulators, and members who maintain their health insurance products for an average of more than two years (measured on a weighted-average basis for all products purchased through us, including short-term products, which are held for less than four months on average). We generate revenue primarily from commissions we receive from health insurance carriers whose policies are purchased through us by individuals, families and small businesses. We typically receive commission payments on a monthly basis for as long as a policy remains active. As a result, much of our revenue for a given financial reporting period relates to policies that we sold prior to the beginning of the period and is recurring in nature. Because health insurance pricing is set by the carrier and approved by state regulators, health insurance pricing is fixed. We, therefore, are not generally subject to negotiation or discounting of prices by health insurance carriers or our competitors.

In addition to the revenue we derive from the sale of health insurance products, we derive revenue from our online sponsorship advertising program and from licensing the use of our ecommerce technology. Our sponsorship advertising program allows carriers to purchase advertising space in specific markets in a sponsorship area on our website. Specifically, carriers who have purchased advertising can choose to have specific health insurance plans displayed prominently after a consumer has entered certain census information. In return, we are typically paid a monthly fee and a performance fee based on metrics such as submitted or approved health insurance applications. Our technology licensing business allows carriers to offer their own health insurance policies on their websites and agents to utilize our technology to power their quoting and online content. These parties typically pay us certain guaranteed and performance-based fees.

## **Our Strategy**

Our objective is to continue to strengthen our position as the leading online distribution platform for health insurance sold to individuals, families and small businesses.

Key elements of our strategy are to:

*Increase Our Brand Awareness.* We believe that building greater awareness of our brand is critical for our continued growth. A significant percentage of our website traffic is direct, and we intend to grow our direct website traffic by strengthening our brand awareness through a variety of marketing and public relations efforts that highlight our company as a leading source of objective health insurance information and affordable health insurance plans for individuals, families and small businesses.

*Offer the Best Consumer Experience.* We believe that providing the best consumer experience increases market adoption of our services, builds our brand awareness, drives word-of-mouth referrals and improves our visitor-to-member conversion rates. We intend to continue to further develop an online experience that empowers consumers with the knowledge, choice and services they need to select and purchase health insurance plans that best meet their needs. We also intend to continue to offer a wide selection of health insurance products, including tax-advantaged products such as Health Savings Account-eligible health plans that make health insurance more



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affordable and accessible for consumers. For example, one of our current initiatives is to adapt our ecommerce platform to facilitate defined benefit contributions to Health Savings Accounts by employers.

*Extend Our Technology Leadership.* We believe that our technology infrastructure and online platform give us a significant competitive advantage for the distribution of individual, family and small business health insurance. For example, our Electronic Processing Interchange feature reduces the time between application and enrollment. To extend our leadership position, we plan to continue to enhance our platform and its key capabilities to increase functionality, reliability, scalability and performance. In addition, we intend to continue to explore new ways to leverage and enhance our technology, including by licensing our technology to carriers, enabling them to market and sell their products online, by introducing new products and services, and by entering into new markets.

*Broaden Our Carrier Network.* We intend to continue to add new health insurance carriers to our ecommerce platform and expand our existing carrier relationships. We seek to deepen our technology integration with our carrier partners, allowing us to further streamline the sales process and increase revenue opportunities for us and our carrier partners. In addition, we intend to work closely with our carrier partners to help them more efficiently utilize our ecommerce platform to access previously underserved markets.

*Expand Our Network of Marketing Partners and Other Member Acquisition Programs.* We believe that a balanced member acquisition program is critical to the success of our business. We plan to continue to develop and expand our marketing relationships with banking, insurance, mortgage and other services and association partners. We expect to expand our joint marketing programs with these partners to drive awareness of our online platform to their customer and member bases. We also plan to continue our investments in other member acquisition sources such as paid search and other forms of online advertising.

*Grow Our Online Advertising Sponsorship Business.* We launched our online advertising business during 2006, which allows one or more carriers to purchase advertising space in specific markets in a sponsorship area on our website. Our sponsorship program enables carriers to achieve cost-effective advertising campaigns because their advertisements are targeted directly to consumers shopping for health insurance products in specific markets.

*Continue Our Public Policy and Legislative Assistance and Support.* We plan to continue to serve as a resource regarding the health insurance market to legislative and public policy organizations, without regard to political affiliation, as well as serve as an advocate for affordable and accessible health insurance. As a result of our unique position in the individual, family and small business health insurance market and the information and counsel regarding health insurance that we provide, we have become a trusted authority in the health insurance industry and among key decision makers in the government. We believe these efforts contribute a valuable public service, increase our brand awareness and allow us to work more effectively with our marketing and carrier partners.

*Pursue International Expansion Opportunities.* We believe there may be significant growth opportunities for us internationally and that the benefits of our ecommerce platform can be extended to international markets. We are evaluating opportunities to expand our business outside of the United States and may pursue these opportunities in the future.

## **Our Platform and Services**

Our ecommerce platform organizes and presents voluminous and complex health insurance information in an unbiased and objective format and empowers individuals, families and small businesses to research, analyze, compare and purchase a wide variety of health insurance products. As of December 31, 2006, we offered more than 7,000 health insurance plans from over 160 health insurance carriers, representing the largest health insurance product portfolio available online. The products we offer include major medical health insurance

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coverage such as preferred provider organization, health maintenance organization and indemnity plans, short-term medical insurance, student health insurance and ancillary products such as dental, vision and life insurance.

Key elements of our platform include:

*Online Rate Quoting and Comprehensive Plan Information.* Our ecommerce platform instantly provides consumers online rate quotes and comprehensive plan benefit information from a large number of health insurance carriers. After entering a minimal amount of relevant information on our website, such as zip code, gender, age, smoker or non-smoker and student status, the consumer instantly receives a comprehensive list of applicable health insurance products and benefit information in an easy-to-understand format. This information includes each plan's rates, benefits and features, as well as financial stability ratings of the health insurance carrier. The list also highlights sponsored plans (plans that our carriers pay us for preferred placement on our website) and our best sellers (the most popular plans in the consumer's market). The consumer can sort through the quoted plans based on price, health insurance carrier, deductible amount, or search the list of quoted plans to obtain a subset based on various consumer preferences.

*Plan Comparison and Recommendations.* Our ecommerce platform enables consumers to compare and contrast health insurance plans in a side-by-side format based on plan characteristics such as price, plan type, deductible amount, co-payment amount and in-network and out-of-network benefits. To further assist consumers in choosing a health insurance plan that best meets their needs, our platform can provide consumers with personalized recommendations. Our automated recommendation capability presents a short series of questions and recommends up to four health insurance plans based on the consumer's input.

*Online Application and Enrollment Forms.* Our online application process offers our consumers significant improvements over the traditional, paper-intensive application process. It employs dynamic business logic to help individuals and families complete application and enrollment forms correctly in real-time. This reduces delay resulting from application rework, a significant problem with traditional health insurance distribution, where incomplete applications are mailed back and forth between the consumer, the traditional agent and the carrier. We further simplify the enrollment process by accepting electronic signature and electronic payment from our consumers. More than 70% of our applications submitted for individual, family and short-term health insurance products in 2006 were completed using our electronic payment and signature technology.

*Electronic Processing Interchange.* Our Electronic Processing Interchange (EPI) technology integrates our online application process with health insurance carriers' technology systems, enabling us to electronically deliver our consumers' applications to health insurance carriers. This expedites the application process by eliminating manual delivery and reducing the need for data entry and human review. Through EPI, we also receive automatic alerts and data feeds from carriers, such as notification of underwriting approval or a request from a carrier for a consumer's medical records for underwriting purposes, which we then relay electronically to the consumer. These features of our service help prevent applications from becoming delayed or rejected through inactivity of the consumer or the carrier. EPI accelerates the application process. While the traditional paper-intensive non-EPI application process required approximately 43 days on average from submission through us to approval during 2006, the EPI application process required approximately 17 days on average from submission to approval over the same period. One of our carriers has also implemented instant membership approval with respect to its short-term health insurance. Instant membership is a technology that makes it possible for applicants to be approved immediately upon their online submission of the application.

*Customer Care Center.* At any step of the application process, consumers can obtain help from one of our licensed sales and customer service representatives through email, web-based chat or our toll-free telephone number. Our customer care center, which is divided into three general areas consisting of customer care, enrollment and customer service, had over 123 employees, 77 of whom were licensed agents, as of December 31, 2006. To promote unbiased carrier and plan recommendations, our representatives are compensated irrespective of the health insurance plan we sell. Our representatives use our proprietary consumer relationship management system to provide high-quality service to a much larger number of consumers than a

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local agent can service using traditional sales methods. Our system, which establishes a work queue protocol for each consumer request, enables our representatives to track each application, obtain real-time updates from the carrier, transmit information to the carrier, automatically generate and send emails specific to each consumer and carrier and cross-sell the consumer additional products and services.

We service the special needs of small businesses through our customer care center. Small businesses often do not have dedicated human resources personnel to design and administer a benefits program for their employees. To assist our small business members, we maintain a dedicated staff of small business customer service specialists. These agents are licensed in multiple jurisdictions so that, at any time, we have expertise available to small businesses in all 50 states and the District of Columbia. We also offer our small business members access to an online enrollment center so that their employees have the tools they need to better self-manage their health plan coverage. Because of the knowledge and expertise we have gained from working with hundreds of thousands of members, we believe that we offer our small business members a high level of service and expertise.

### **Carrier Relationships**

As of December 31, 2006, we sold health insurance products for over 160 health insurance carriers, including large national carriers such as Aetna, Humana and UnitedHealthcare, over 40 BlueCross BlueShield carriers, and well-established regional carriers such as Health Net, Kaiser Permanente, PacifiCare and Unicare. We typically enter into contractual agency relationships with health insurance carriers that are non-exclusive and often are or become terminable on short notice by either party for any reason. These agreements provide for the commission revenue that we receive from health insurance carriers, which is based on a percentage of the premium our members have paid to the carrier and in some instances commission override payments. Revenue we derived from our agreement with Golden Rule Insurance Company, which is owned by UnitedHealthcare, represented approximately 16% of our total revenue in 2006. The commission percentage used to calculate our commission revenue under our agreements with Golden Rule is based on the number of Golden Rule health insurance applications issued by us during a twelve-month period. Revenue we derived from our agreements with Blue Cross of California and Unicare, which are owned by WellPoint, represented approximately 12% of our total revenue in 2006. Our agreements with Golden Rule Insurance Company and Blue Cross of California and Unicare are terminable on 90 days written notice by either party for any reason and may be terminated on shorter notice under certain circumstances, such as in the case of a breach of the agreement.

In addition to the revenue we derive from the sale of health insurance products, we derive revenue from our online sponsorship advertising program and from licensing the use of our ecommerce technology. Our sponsorship advertising program allows carriers to purchase advertising space in specific markets in a sponsorship area on our website. Specifically, carriers who have purchased advertising can choose to have specific health insurance plans displayed prominently after a consumer has entered certain census information. In return, we are typically paid a monthly fee and a performance fee based on metrics such as submitted or approved health insurance applications. Our technology licensing business allows carriers to offer their own health insurance policies on their websites and agents to utilize our technology to power their quoting and online content. These parties typically pay us certain guaranteed and performance-based fees.

We offer substantial benefits to health insurance carriers, including:

*Increased New Sales.* A primary benefit that we offer health insurance carriers is the substantial new business that we bring them. Since a significant percentage of our new members were uninsured when they obtained health insurance through us, we believe we are capturing new markets for carriers rather than simply moving market share from one carrier distribution channel to another carrier distribution channel, or from one carrier to another carrier.

*Efficient Access to New Members and Markets.* Our ecommerce platform enables health insurance carriers to efficiently provide their products to new consumers, including the fragmented and geographically dispersed

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individual, family and small business markets. Through our ecommerce platform, carriers can more cost-effectively reach a larger number of potential consumers than they can using traditional distribution channels. In addition, our ability to efficiently distribute health insurance products nationwide allows carriers to quickly enter new regions and introduce new products. Our platform also allows carriers to quickly and cost-effectively test new health insurance products and prices in existing and new markets.

*Reduced Costs.* Our ecommerce platform significantly reduces the costs associated with traditional paper-intensive distribution that is otherwise borne by our carrier partners. Our carrier partners save significant time and expense because our platform reduces the labor involved in reviewing, correcting and reworking applications. Our EPI technology also reduces and often eliminates the need for data entry, paper-intensive communication and human interaction during the sales process.

*Access to Relevant and Timely Market Data.* As a provider of a broad variety of health insurance plans in all 50 states and the District of Columbia, we are a unique source of market data for our carrier partners. We collect, aggregate and report on market trends regarding plan features, pricing, demand and consumer demographics, allowing our carrier partners to quickly react to changing market conditions and optimize their business processes. With our data, carriers can better design plan benefits and pricing to meet consumers' needs.

## **Marketing**

Our marketing strategy is to continue to build a large and loyal member base by providing superior value to our members. We focus on building brand awareness, increasing website visitors and converting visitors into buyers. Our marketing initiatives are varied and numerous. They include:

*Direct Marketing.* Our direct member acquisition channel consists of consumers who access our website addresses ([www.ehealth.com](http://www.ehealth.com) and [www.ehealthinsurance.com](http://www.ehealthinsurance.com)) either directly or through algorithmic search listings on Internet search engines and directories.

*Online Advertising.* Our online advertising channel consists of consumers who access our website through paid keyword search advertising from search engines such as Google, MSN and Yahoo!, as well as various Internet marketing programs such as banner advertising, email marketing and an integrated partnership with MSN.

*Marketing Partners.* Our marketing partner member acquisition channel consists of consumers who access our website through a network of financial services and other companies. We have established a pay-for-performance network, comprised of hundreds of partners that drive consumers to our ecommerce platform. These partners fall into three general categories:

Financial and online services partners in industries such as banking, insurance, mortgage, association and other financial services, including Aetna, Aon, Bank of America, Cargill, Countrywide, Esurance, Gallagher, Insurance.com, LowerMyBills, NFIB, Paychex, Sallie Mae, UnitedHealthcare, Wells Fargo, Willis and Zurich.

Affiliate programs, including our marketing programs managed through Commission Junction and our own established affiliate program. By aggregating hundreds of website publishers, both small and large, through our affiliate programs, we broadly promote our brand and services over the Internet.

Online advertisers and content providers that are specialists in paid and unpaid (algorithmic) search, as well as specialists in other types of Internet marketing. We have established relationships with advertisers who, through keyword search and other strategies, identify consumers seeking health insurance on the Internet.

Many of our partners agree to an initial two-year term contract that contains an automatic renewal clause for subsequent one-year periods. In addition, many of our partners are contractually required to promote our services on an exclusive basis. We generally compensate our partners for their consumer referrals on a submitted health

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insurance application basis. If a partner is a licensed agent, we may share a percentage of the revenue we earn from the carrier for each member referred by that partner.

*Public Relations.* We conduct a broad and comprehensive public relations program that creates awareness and credibility among uninsured and insured individuals, families and small businesses nationwide. We have received national coverage in publications such as Business Week, CBS MarketWatch, Forbes, Kiplinger's Personal Finance and Time, as well as numerous daily newspapers including The New York Times, USA Today and The Wall Street Journal. We have also received coverage on local and national TV and radio in major U.S. cities. Beginning in 2002, we have published several reports each year, including *The Cost and Benefits of Individual Health Insurance Plans* and *Trends in Health Savings Accounts*.

*Government Relations.* We serve as a trusted source of unbiased information about health insurance to government officials and policy makers. Our executives have met with members of Congress and their staffs, with the White House and with other federal agencies. For example, our executives have testified before Congress to support initiatives for the affordability and accessibility of health insurance and in February 2007, our chief executive officer met with President Bush to discuss his health care proposal. We have taken an active role in the debate over new health insurance legislation in Washington, D.C., including Health Savings Account legislation. In June 2006, we provided testimony on Health Savings Accounts to the House Ways and Means Committee. Some examples of legislation on which we are currently working with members of Congress include bills that would provide tax relief for individuals and families who purchase their own health insurance coverage. We promote laws that make health insurance accessible and affordable.

## **Technology**

Since our inception in 1997, we have invested significant financial and human resources in building a unique and scalable, proprietary ecommerce platform. We were the first to bring to consumers several technologies that have streamlined the complex and traditionally paper-intensive health insurance sales process. These technologies include:

*Universal Quoting Engine.* Our proprietary quoting engine aggregates and unifies health insurance policy quotes from a large number of health insurance carriers. Because each carrier's quoting algorithm is unique and there is no industry standard algorithm among carriers, we utilize our proprietary rate entry and management tools and datagate system to unify the rates for each carrier's health insurance plans. This technology allows for rapid implementation of quoting services and direct comparison of different plans.

*Plan Comparison and Selection Tools.* We offer online comparison and recommendation tools that distill voluminous health insurance information and enable consumers to select health insurance plans that best meet their particular needs. Our compare-and-choose functionality, for which a related patent application has been filed, presents benefit information in an easy-to-understand format and highlights certain plans based on various criteria. We also provide consumers with a recommendation tool, for which a related patent application has been filed, that dynamically interacts with the consumer and presents an unbiased list of recommended plans. In addition, we offer a physician finder feature, which allows consumers to compare health insurance plans in which their doctor is a member.

*Application Designer Tool and Runtime Engine.* Health insurance applications vary widely by carrier and state. Our proprietary graphical Application Designer Tool allows us to capture each application's unique business rules and build a corresponding online application in XML format that can be instantly deployed to our website. Our XML-based Runtime Engine is the underlying infrastructure of our online application process. Based on the metadata created through the Application Designer Tool, the Runtime Engine dynamically generates carrier-specific online pages and screen flow controls, and checks and enforces business rules and application underwriting logic.

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*Online Application Process.* Our online applications substantially streamline the traditional, paper-intensive health insurance application process. Because each carrier and each plan require different information, our online applications are dynamic and request only the information required in the particular circumstance. Our system also checks each answer to each question and immediately notifies the applicant of any missing information. This real-time process prevents rework from the health insurance carrier, a serious problem in the paper-intensive insurance process where weeks are lost as incomplete applications are mailed back and forth between carriers, agents and applicants.

*Electronic Processing Interchange.* We have developed an Electronic Processing Interchange (EPI) technology, for which a related patent application has been filed, to simplify the enrollment process and better integrate our technology systems with those of the health insurance carriers whose plans we offer. To implement EPI, we build and host a proprietary extranet that supports both real-time and batch interfaces for carriers. EPI enables carriers to search, retrieve, print, download and update consumers' health insurance applications. Carriers can upload enrollment files in XML format through our extranet. EPI also utilizes XML delivery of status files from health insurance carrier systems to ours, allowing us to monitor and track the status and progress of each application. We then provide this real-time information to our consumers through their private accounts on our website as well as through automatically generated emails.

Our EPI technology leverages eSign and ePayment to enable consumers to complete the entire health insurance purchasing process online. We take advantage of the Electronic Signatures in Global and National Commerce Act of 2000 by permitting applicants to apply for health insurance without the need to print, physically sign and mail the application. We believe that we were the first to apply eSign and ePayment to the distribution of health insurance. More than 70% of our individual, family and short-term health insurance applications in 2006 were completed using our electronic payment and signature technology.

Through EPI, we also offer consumers in certain markets the opportunity to obtain instant approval for short-term health insurance from one carrier without any underwriting delay. At the end of the online application process, we send the application file to the carrier and receive an approval number that we automatically relay to the applicant. Applicants who apply using this instant membership approval feature can be immediately approved and enjoy health insurance coverage on an expedited basis. We hope to enter into relationships with carriers to extend this instant membership approval technology to individual and family health insurance that is not short term. We are designing the application of our EPI technology to shorten the approval process for individual and family insurance EPI applications from an average of 17 days during 2006 to as little as one business day. Given the innovativeness of the idea of instant membership approval and the depth of integration required, we expect gradual implementation of this technology by the carriers that choose to adopt it and for the adoption to occur on a carrier-by-carrier basis.

As of December 31, 2006, approximately 94% of the individual and family plan carriers represented on our website had implemented all or a portion of our EPI technology, and in 2006 more than 70% of the consumers applying for individual and family health insurance products applied using our EPI technology when presented with the opportunity to use it.

*Application Archival.* Our online sales process necessitates the collection of online application data and translation of this data without modification to a fixed version of the application. Each time an online application is submitted on our website, our proprietary archival system collects and merges the application data with a PDF template. The system then creates, encrypts and securely stores the resulting application form. This process ensures that the application generated, stored and reviewed by the consumer at the time of submission is secure and unchangeable.

*Datagate for Electronic Interchange.* Our proprietary datagate system facilitates electronic data interchange with our carrier partners. The types of data transferred include applications, rates and benefits, underwriting statuses and membership information. Our system supports many different methods of communication that are implemented based on the partner's capabilities and preferences, including HTTPS, web services and FTP.

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*Back Office Systems.* Our proprietary back office customer relationship management system enables us to provide a full range of customer service tasks in an efficient, highly scalable and personalized manner. Using these tools, we can track each consumer throughout the application process, obtain real-time updates from the carrier, generate automated emails specific to each consumer and access a cross-sell engine and dashboard to identify and track cross-sell opportunities. Our auto-email system is feature-rich with HTML capability, customizable merge tags, granular segmentation and tracking capability.

*Partner Tools.* We support our marketing partners with customized marketing and management tools. Our partner registration and management tool quickly configures partner portals with various customization options, including branding, email capture, product offering and customized content such as articles and links. Our reporting extranet provides partners with up-to-date information on the performance of their portals, resources for online marketing and search optimization and the ability to generate customized reports.

*Modular Architecture and Deployment Process.* Our system is comprised of four major areas: front office, back office, datagate and various services. Each area is deployed independently into different hosting servers to ensure maximum availability. We release our software periodically (typically weekly) using a vigorous release process that integrates scheduled changes from multiple development code branches into several testing and staging environments. We have developed various deployment tools and regression testing scripts to ensure the quality of our releases.

*Security.* We seek to offer our website visitors, members and insurance carrier partners industry-leading levels of reliability and security. Our ecommerce platform has been designed to handle large and expanding volumes of visitor traffic, health insurance quote requests and health insurance applications. We believe the facilities supporting this platform have ample bandwidth capacity and power and backbone redundancy to support the current and anticipated near-term growth of our business. We rely in part on third-party vendors, including data center and bandwidth providers, to support our ecommerce platform. We use third-party encryption technology to facilitate the secure transmittal of confidential information. Additionally, we incorporate a multi-level firewall infrastructure to help prevent unauthorized access to our systems and data, and have implemented intrusion detection systems.

## **Technology and Content**

We have a large and experienced technology and content team consisting of 125 full-time employees as of December 31, 2006 located in our Mountain View and Gold River locations, as well as our technology center in Xiamen, China. We also operate a separate technology center with Xiamen University where researchers from the University work with us on various ecommerce research projects. We spent \$7.5 million, \$8.1 million and \$10.1 million in 2004, 2005 and 2006 to fund our technology and content activities during those periods. Ongoing enhancements to the features and functionality of our ecommerce platform are critical to maintain our technological leadership position in the industry. Our technology and content team was responsible for the initial development of our ecommerce platform and website user interface as well as the creation of the features and functionality we offer to consumers. These features include our EPI, online rate quoting engine, plan comparison tool and instant membership technology.

Current initiatives include development of technology that collects and analyzes consumer behavior and, based on this data, dynamically modifies the consumer's online experience. We are also seeking to extend our real-time underwriting and instant membership approval technology to more carriers, to add new tools to our platform that further improve its ability to dynamically search for plans and benefits and enhance our platform's features to better meet the needs of businesses. In addition, we are redesigning our platform for the purpose of reducing the time it takes to complete product updates.

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### **Government Regulation and Compliance**

*Government Regulation.* We distribute health insurance products in all 50 states and in the District of Columbia through agency licenses held by us as is required by each state's insurance department (in the case of the state of Florida, we currently conduct insurance business under the individual license of one of our employees, as required by Florida law prior to October 1, 2006, and we are currently awaiting approval of our Florida agency license application). The health insurance industry is heavily regulated. Each state and the District of Columbia has its own rules and regulations pertaining to the offer and sale of health insurance products, typically administered by its Department of Insurance. State insurance departments have broad administrative powers relating to, among other things:

regulating premium prices;

granting and revoking licenses to transact insurance business;

approving individuals and entities to which commissions can be paid;

regulating advertising, marketing and trade practices;

monitoring broker and agent conduct; and

imposing continuing education requirements.

We are required to maintain valid life and/or health agency and/or agent licenses in each jurisdiction in which we transact health insurance business. As of December 31, 2006, we and our employees held a total of over 2,000 agency and individual agent licenses in the 50 states and in the District of Columbia. We have a dedicated licensing group that is responsible for maintaining these licenses and serving as an accredited continuing education provider for our licensed employees. We monitor the regulatory compliance of our sales, marketing and advertising practices and the related activities of our employees.

We have also received a non-business-transacting (Bei An) Internet Content Provider (ICP) registration from the Ministry of Information Industry in China and a business-ancillary (Jian Ye) insurance agency license from the China Insurance Regulatory Commission (CIRC). At this time, we are investigating the viability of marketing and selling insurance online in China.

*Carrier Requirements.* We are required to be appointed by a carrier in order to transact business on the carrier's behalf, typically through an agency contract. As of December 31, 2006, we had relationships with over 160 carriers. Our licensing group is responsible for maintaining our appointments with these carriers.

*Privacy and Privacy Laws.* We are subject to state and federal laws and regulations that require us to maintain the privacy of personal information that we collect from consumers. Because consumers place a high priority on our ability to maintain the privacy, security and integrity of personal information they provide to us, we previously had our information privacy practices certified by an independent, non-profit organization dedicated to promoting Internet information privacy. We also previously engaged a private risk management organization to assess the effectiveness of our internal security, information and technology controls relating to the electronic submission of health insurance applications through our platform. We have also appointed a privacy officer to monitor our compliance with federal and state laws related to privacy, including the Gramm-Leach-Bliley Act's and the Health Insurance Portability & Accountability Act's privacy and security rules.

### **Intellectual Property**

We rely on a combination of trademark, copyright and trade secret laws in the United States and other jurisdictions as well as confidentiality procedures and contractual provisions to protect our proprietary technology and our brand. We also have filed patent applications that relate to certain of our technology and business processes.



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*Trademarks.* Our four registered trademarks in the U.S. are eHealth, eHealthInsurance, eHealthSystems and Online Anytime. Our eHealth and eHealthInsurance marks have reached incontestability status with the U.S.

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Patent and Trademark Office, which means the marks have been in use for over five years and, with certain limited exceptions, no third party can contest the validity of the marks or our ownership of them. We have successfully enforced our rights against cybersquatters (entities using our marks in their domain names) and typosquatters (entities using misspellings of our trademarks in their domain names). In response to our cease and desist letters, cybersquatters and typosquatters have generally assigned the domain names to us.

*Patent Applications.* Our published patent application and other pending patent applications relate to the technology and business processes underlying our core product offerings such as EPI, Fast Quote, Recommendation Tool, Compare and Choose functionality, Application Designer Tool and Runtime Engine. Our EPI system streamlines the enrollment process by seamlessly integrating our technology systems with those of the health insurance carriers whose plans we offer. The patent application relating to the EPI system was published May 1, 2003.

Our Fast Quote system simplifies the search for health insurance quotes on the Internet. Using Fast Quote, a potential consumer, who has already provided a minimum of personal data (i.e., birth date, gender, zip code and tobacco use) on a website other than ours, can merely click on a link on that website and immediately be transferred to our Quote Page. This page is prepopulated with the consumer's information, enabling the consumer to quickly review, compare and apply for a health plan. The patent application relating to the Fast Quote system was filed on April 12, 2005.

Our Recommendation Tool provides guidance as to which product will best suit a consumer's needs. This tool dynamically interacts with the consumer, asking a series of questions, each subsequent question based on the consumer's previous answer, and filters out all of the available health plans until it can present an unbiased recommendation of one to four health insurance plans. The patent application relating to the Recommendation Tool was filed on June 27, 2005.

Our Compare and Choose functionality presents voluminous health insurance information in an easy-to-understand format and helps consumers choose between numerous available plans. For example, it provides mouse-over icons that identify and explain the key benefits in each plan. It also recommends plans to users by identifying sponsored plans (plans for which our carriers pay us to feature on our website), best sellers (top selling insurance plans in the consumer's state for certain categories of applicants), top 25 plans (plans we choose to highlight) and featured plans (plans that are new or plans that have been identified in a previous period as best sellers). The patent application relating to the Compare and Choose system was filed on November 1, 2005.

Our Application Designer Tool allows us to capture each application's unique business rules and build a corresponding online application in XML format that can be instantly deployed to our website. A patent application related to the Application Designer Tool was filed on April 24, 2006.

Our XML-based Runtime Engine is the underlying infrastructure of our online application process. Based on the metadata created through the Application Designer Tool, the Runtime Engine dynamically generates carrier-specific online pages and screen flow controls, and checks and enforces business rules and application underwriting logic. A patent application related to the Runtime Engine was filed on April 24, 2006.

*Copyrights.* Our website is a registered copyright in the United States. In China, we have registered computer software copyrights for an internally developed software system and for a project management tool.

We also incorporate a number of third-party software products into our application server pursuant to relevant licenses. Some of this software is proprietary and some is open source. We use third-party software to, among other things, enhance our XML architecture, generate PDF versions of health insurance applications and improve our graphical layout.

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### **Competition**

The market for selling insurance products is highly competitive and the sale of health insurance over the Internet is new and rapidly evolving. We compete with individuals and entities that offer and sell health insurance products utilizing traditional distribution channels, as well as the Internet. Our current or potential competitors include:

*Traditional local insurance agents.* There are tens of thousands of local insurance agents across the United States who sell health insurance products in their communities. We believe that the vast majority of these local agents offer health insurance without significantly utilizing the Internet or technology other than simple desktop applications such as word processing and spreadsheet programs. Some traditional insurance agents, however, utilize general agents that offer online quoting services and other tools to obtain quotes from multiple carriers and prepare electronic benefit proposals to share with their potential customers. These general agents typically offer their services only for the small and mid-sized group markets (not the individual and family markets) and operate in only one or a few states. Additionally, some local agents use the Internet to acquire new consumer referrals from companies that have expertise in Internet marketing. These lead aggregator companies utilize keyword search, primarily paid keyword search listings on Google, MSN and Yahoo! and other forms of Internet advertising, to drive Internet traffic to the lead aggregator's website. The lead aggregator then collects and sells consumer information to health insurance agents and, to a lesser extent, to health insurance carriers, both of whom endeavor to close the referrals through traditional offline sales methods.

*Health insurance carriers' direct-to-member sales.* Some health insurance carriers directly market and sell their plans to consumers through call centers and their own websites. Although we offer health insurance plans for many of these carriers, they also compete with us by offering their products directly to consumers. Most of these carriers have superior brand recognition, extensive marketing budgets and significant financial resources to influence consumer preferences for searching and buying health insurance online. In addition, some carriers, which we choose not to represent, offer non-comprehensive health insurance at lower rates than the comprehensive major medical health insurance that we generally offer. The carriers we choose to represent, however, do not have a competitive price advantage over us. Because individual and family plan health insurance prices are regulated in all U.S. jurisdictions, a consumer is entitled to pay the same price for a particular plan, whether the consumer purchased the plan directly from one of our carrier partners or from us. Additionally, we have entered into marketing partnerships with some of our carrier partners, such as Aetna and UnitedHealthcare, and these carriers refer consumers to us from states they do not service.

*Online agents.* There are a number of agents that operate websites and provide a limited online shopping experience for consumers interested in purchasing health insurance (e.g., online quoting of health insurance product prices). Most of these online agents operate in only one or very few states, and some represent only one or a limited number of health insurance carriers. Some online agents also sell non-health insurance products such as auto insurance, life insurance and home insurance. We are the leading online source of health insurance products to individuals, families and small businesses and the only online source that is nationwide. We believe our ecommerce platform provides individuals, families and small businesses with the most comprehensive choice of affordable health insurance products. Additionally, we have entered into marketing partnerships with some online agencies and these agents refer consumers to us from states they do not service.

*National insurance brokers.* Although insurance brokers such as Aon Insurance Services, Arthur J. Gallagher & Co., Marsh, Inc. and Willis Group Limited have traditionally not focused on the individual, family and small business market, they may enter our markets and could compete with us. These large agencies have existing relationships with many of our carrier partners, are licensed nationwide and have large customer bases and significant financial, technical and marketing resources to compete in our markets. Some of these large agencies and financial services companies, such as Aon, Arthur J. Gallagher and Willis, have partnered with us in order to offer our services to their customer and member bases.

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We believe the principal factors that determine our competitive advantage in the online distribution of health insurance include the following:

health insurance plan selection;

quality of website content and website tools;

strength of carrier relationships and depth of technology integration with carriers;

high-quality, unbiased customer service;

brand awareness and reputation;

strength of marketing partnerships; and

proven capabilities measured in years of delivering sales and creating and using reliable technology.

The price of a particular health insurance policy is not a competitive factor because a consumer is entitled to pay the same price for a particular individual and family plan, whether the consumer purchased the plan directly from a carrier, from us or from another agent.

## **Legal Proceedings**

In September 2006, we received an order from the Office of the Insurance Commissioner of the State of Washington in connection with our publication of a report in July 2006 entitled *The Most Affordable Cities for Children's and Family Health Insurance*. The Office of the Insurance Commissioner of the State of Washington contends that the report is advertising and that our alleged mischaracterization of the affordability of individual health insurance in Spokane, Washington caused a violation of various Washington laws governing advertising, including prohibitions against false and misleading advertising in the conduct of insurance business. In general terms, the order requires us to cease and desist from further publication, distribution or republication of the report and from granting permission to republish, or assisting in the republication of, the report. We have challenged the order through an administrative proceeding and the order has been stayed pending the resolution of that proceeding.

In the ordinary course of our business, we have received and may continue to receive inquiries from state regulators relating to various matters from time to time, including the order from the Office of the Insurance Commissioner of the State of Washington. We may also become involved in litigation in the future in the ordinary course of our business. If we are found to have violated laws or regulations in the state of Washington or in other states, we could be subject to various fines and penalties, including revocation of our license to sell insurance in those states, and our business and financial results would be harmed. We would also be harmed to the extent that related publicity damages our reputation as a trusted source of objective information relating to health insurance and its affordability. It could also be costly to defend ourselves regardless of the outcome.

## **Facilities**

Our headquarters are located in Mountain View, California and we operate a customer care center in Gold River, California. Our wholly-owned subsidiary eHealth China, Inc. maintains an office in Xiamen, China. All of our facilities are leased. We may require additional space as our business expands.

## **Employees**

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As of December 31, 2006, we had 357 employees, of which 26 were in marketing and advertising, 140 were in customer care and enrollment, 125 were in technology and content and 66 were in general and administrative. None of our employees are represented by a labor union. We have not experienced any work stoppages and consider our employee relations to be good.

**Table of Contents****MANAGEMENT****Executive Officers and Key Employees**

The following table sets forth our executive officers and key employees and their ages and the positions they held as of December 31, 2006.

<b>Name</b>	<b>Age</b>	
<i>Executive Officers:</i>		
Gary L. Lauer	53	President and Chief Executive Officer
Robert L. Fahlman	48	Senior Vice President, Carrier Relations and Chief Operating Officer
Stuart M. Huizinga	44	Senior Vice President and Chief Financial Officer
Bruce A. Telkamp	39	Senior Vice President, Business Development and Marketing, General Counsel and Secretary
Dr. Sheldon X. Wang	47	Senior Vice President and Chief Technology Officer
<i>Key Employees:</i>		
Sam C. Gibbs	49	Senior Vice President and General Manager of Small Business
Robert S. Hurley	47	Vice President, Strategic Initiatives

*Gary L. Lauer. President and Chief Executive Officer.* Gary Lauer has served as our president and chief executive officer since December 1999, and as chairman of our board of directors since March 2002. Prior to joining us, Mr. Lauer was the chairman and chief executive officer of MetaCreations Corporation. Prior to MetaCreations, Mr. Lauer spent more than nine years at Silicon Graphics, Inc., a computing technology company, where he was a member of the senior executive team. Mr. Lauer started his career at IBM in sales and marketing management. Mr. Lauer holds a B.S. degree in finance and marketing from the University of Southern California Business School.

*Robert L. Fahlman. Senior Vice President, Carrier Relations and Chief Operating Officer.* Robert Fahlman has served as our senior vice president, carrier relations and chief operating officer since March 2000. Mr. Fahlman previously served as chief executive officer of Omni Health Care, a California health plan and health insurance company, and vice president of field operations at Healthcon Corporation, a healthcare Internet company now known as WebMD. Mr. Fahlman also previously served as a senior vice president at FHP and senior vice president at TakeCare Health Plan, two California managed healthcare plans. Mr. Fahlman holds a B.S. degree in business administration from Portland State University.

*Stuart M. Huizinga. Senior Vice President and Chief Financial Officer.* Stuart Huizinga has served as our senior vice president and chief financial officer since May 2000. Previously, Mr. Huizinga was a partner at Arthur Andersen LLP, an accounting firm. Mr. Huizinga holds a B.S. degree in business administration from San Jose State University and is a Certified Public Accountant in the state of California.

*Bruce A. Telkamp. Senior Vice President, Business Development and Marketing, General Counsel and Secretary.* Bruce Telkamp has served as our senior vice president, business development and marketing since February 2004 and as our general counsel and secretary since May 2000. Previously, Mr. Telkamp was the vice president of business development and general counsel of MetaCreations Corporation. Prior to MetaCreations, Mr. Telkamp was an attorney with the law firm of Wilson Sonsini Goodrich & Rosati P.C. in Palo Alto, California. Mr. Telkamp holds a B.A. degree in economics with honors from the University of California, Los Angeles and a J.D. degree with honors from the University of California, Hastings.

*Dr. Sheldon X. Wang. Senior Vice President and Chief Technology Officer.* Dr. Sheldon Wang has served as our senior vice president and chief technology officer since August 1999. Dr. Wang also serves as president and chief executive officer of eHealth's subsidiary, eHealth China, Inc. Previously, Dr. Wang was senior vice president of research and development at Eclipsys Corporation, formerly known as HealthVISION, a provider of integrated healthcare enterprise information-technology solutions. Dr. Wang holds a B.S. degree in physics from

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the Fuzhou University of China, an M.S. degree in physics from Idaho State University and a Ph.D. in medical informatics from the University of Utah.

*Sam C. Gibbs. Senior Vice President and General Manager of Small Business.* Sam Gibbs has served as our senior vice president since September 2000. Since November 2004, Mr. Gibbs has served as general manager of our small business products and services business. Mr. Gibbs previously served as the general manager of our technology licensing business from December 2001 to November 2004 and as general manager of product management from September 2000 to December 2001. Mr. Gibbs previously was a vice president and general manager for Rand, an engineering services company. Mr. Gibbs was a founder, president and chief executive officer of AVCOM Systems, Inc., an engineering services and systems integration company, which was acquired by Rand Worldwide. Mr. Gibbs holds a B.S. degree in aeronautical engineering technology from Arizona State University.

*Robert S. Hurley. Vice President of Strategic Initiatives.* Robert Hurley has served as our vice president since April 1999. Since October 2003, Mr. Hurley has been responsible for our public and government relations efforts and has been instrumental in the Health Savings Account-related aspects of our business. From April 1999 to September 2003, Mr. Hurley was responsible for our customer care and enrollment functions. Mr. Hurley served as an associate vice president of sales and operations for the consumer business segment at Health Net, Inc., a managed healthcare company, and in various leadership roles at Foundation Health, a California health plan. Mr. Hurley holds a B.A. degree in law and society from the University of California, Santa Barbara.

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

*In addition to other information in this Annual Report on Form 10-K and in other filings we make with the Securities and Exchange Commission, the following risk factors should be carefully considered in evaluating our business as they may have a significant impact on our business, operating results and financial condition. If any of the following risks actually occurs, our business, financial condition, results of operations and future prospects could be materially and adversely affected. Because of the following factors, as well as other variables affecting our operating results, past financial performance should not be considered as a reliable indicator of future performance and investors should not use historical trends to anticipate results or trends in future periods.*

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

*Our future operating results are likely to fluctuate and could fall short of expectations.*

Our operating results are likely to fluctuate as a result of a variety of factors, including the factors described elsewhere in this Risk Factors section, many of which are outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful and you should not rely on our past results as an indication of our future performance. If our revenue or operating results fall below the expectations of investors or securities analysts, the price of our common stock could decline substantially.

Our business model is characterized primarily by recurring revenue based on commissions we receive from insurance carriers whose policies are purchased by our members. Although our services are complete upon the approval of a member's application, we receive commissions and record related revenue, typically on a monthly basis, until the health insurance policy is cancelled or we otherwise do not remain the agent on the policy. A significant component of our marketing and advertising expenses consists of payments owed to our marketing partners in connection with referrals of potential members in the period during which an application is submitted by the potential member. As a result of this timing difference between expense and associated revenue recognition, our operating results and cash flows may be adversely affected in periods where we experience a significant increase in new applicants. In addition, if we incur other unanticipated or one-time expenses in a particular quarter or if we lose a significant amount of our member base for any reason, we would likely be unable to offset these expenses by increasing sales within that quarter or to replace lost revenue in the quarter.

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with revenue from new members. As a result, our quarterly results may suffer due to unanticipated expenses, one-time charges or significant member turnover.

### ***We have a history of losses and our rate of growth may decline.***

We have a history of net losses and have only achieved net profitability on an annual basis in the year ended December 31, 2006. As of December 31, 2006, our accumulated deficit was \$63.7 million. We may in the future make significant expenditures related to the development of our business, including expenditures relating to marketing, website and technology development and hiring of additional personnel. In addition, we will incur significant legal, accounting and other expenses as a public company that we did not incur as a private company. Maintaining profitability will require us to generate and sustain substantially increased revenue. Although we have experienced revenue growth in prior periods, this growth may not be sustainable, and we may not achieve sufficient revenue to maintain profitability. Our future revenue growth will depend in large part upon our ability to continue to attract new individuals, families and small businesses to purchase health insurance through our ecommerce platform. To the extent that the rate of growth of our net new members slows, our revenue growth is also likely to slow. In addition, the commission rates that we receive for individuals and families are typically higher in the first twelve months of a policy. As a result, to the extent that the rate of growth of new members slows or our commission rates decrease for other reasons, our revenue could decline.

Commission rates we receive from health insurance carriers also affect our revenue growth. The commission rates we receive are impacted by a variety of factors, including the particular health insurance policies chosen by our members, the carriers offering those policies, the location of members and the laws and regulations in that jurisdiction and the amount of time policies have been active. In addition, the growth in our overall commission rate per member could decrease as a result of either reductions in contractual commission rates or unfavorable changes in health insurance carrier override commission programs. To the extent these factors cause our commission rate per member to decline, our rate of growth may decline.

### ***If the purchase of health insurance over the Internet does not achieve and maintain widespread consumer and health insurance carrier acceptance, or if consumers or carriers opt for more traditional channels for the purchase and sale of health insurance, our business will be harmed.***

Our success will depend in large part upon widespread consumer and health insurance carrier acceptance of the Internet as a marketplace for the purchase and sale of health insurance. Consumers and health insurance carriers may choose to depend more on traditional sources, such as individual agents, or alternative sources may develop. Our future growth, if any, will depend in part upon:

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

consumers' willingness to conduct their own health insurance research;

our ability to make the process of purchasing health insurance online an attractive alternative to traditional means of purchasing health insurance;

our ability to successfully and cost-effectively market our services as superior to traditional sources for health insurance to a sufficiently large number of consumers; and

health insurance carriers' willingness to use us and the Internet as a distribution channel for health insurance products.

If consumers and health insurance carriers do not widely adopt the Internet as a source for the purchase and sale of health insurance, or if they determine that other sources for health insurance and health insurance applications are superior, our business will not grow and our business, operating results and financial condition would be harmed.





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***Our business may not grow if consumers are not informed about the availability and accessibility of affordable health insurance.***

Numerous health insurance products are available to consumers in any given market. Most of these products vary by price, benefits and other policy features. Health insurance terminology and provisions are often confusing and difficult to understand. As a result, researching, selecting and purchasing health insurance can be a complex process. We believe that this complexity has contributed to a perception held by many consumers that individual health insurance is prohibitively expensive and difficult to obtain. We attempt to make the health insurance research and application process on our website understandable and user-friendly. We also attempt to use our website to educate consumers about the accessibility and affordability of health insurance. If consumers are not informed about the availability and accessibility of affordable health insurance, our business may not grow and our business, operating results and financial condition would be harmed.

***If we are unable to retain our members, our business and operating results would be harmed.***

We receive revenue from commissions health insurance carriers pay to us for health insurance policies sold through our ecommerce platform. When one of these policies is cancelled, or if we otherwise do not remain the agent on the policy, we no longer receive the related commission revenue. Individuals, families and small businesses may choose to discontinue their health insurance policies for a variety of reasons. For example, individuals and families may replace a health insurance policy purchased through us with a health insurance plan provided by a new or existing employer. In addition, our members may choose to transfer their policies to a different agent if, for example, they are not satisfied with our customer service or the health insurance products that we offer. Health insurance carriers may also terminate health insurance plans offered on our ecommerce platform. If we are not successful in transferring members covered under a terminated plan to another policy that we offer, we will lose these members. Our cost in acquiring a new member is substantially greater than the cost involved in maintaining our relationship with an existing member. If we are not able to successfully retain existing members and limit member turnover to levels we have experienced in the past, our revenue and operating margins will be adversely impacted and our business, operating results and financial condition would be harmed.

***Our business may be harmed if we lose our relationships with health insurance carriers, become dependent upon a limited number of insurance carriers or fail to develop new carrier relationships.***

We typically enter into contractual agency relationships with health insurance carriers that are non-exclusive and terminable on short notice by either party for any reason. Carriers may be unwilling to allow us to sell their health insurance products for a variety of reasons, including for competitive or regulatory reasons, as a result of a reluctance to distribute their products over the Internet or because they do not want to be associated with our brand. For example, one carrier terminated its relationship with us with respect to the policies it offers in a particular state because the carrier decided to sell those policies through agents that exclusively offered that particular carrier's products. In the future, an increasing number of carriers may decide to rely on their own internal distribution channels, including traditional in-house agents and carrier websites, to sell their own products and, in turn, could limit or prohibit us from selling their products on our ecommerce platform. Carriers may also choose not to distribute insurance products in the individual, family and small business markets.

We may decide to terminate our relationship with a carrier for a number of reasons, including as a result of a reduction in a carrier's financial ratings, a carrier determining to pay lower commissions or a carrier demanding a sales process that we believe impairs the value of our service. The termination of our relationship with a carrier could reduce the variety of health insurance products we offer, which could harm our business. We also would lose a source of commissions for future sales, and, in a limited number of cases, future commissions for past sales. Our business could also be harmed if in the future we fail to develop new carrier relationships and are unable to offer consumers a wide variety of health insurance products.

The health insurance industry in the United States has experienced a substantial amount of consolidation over the past several years, resulting in a decrease in the number of health insurance carriers. In the future, we

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may be forced to offer insurance policies from a reduced number of insurance carriers or to derive a greater portion of our revenue from a more concentrated number of carriers as our business and the health insurance industry evolve. Carriers owned by WellPoint and UnitedHealthcare represented 26% and 22% of our total revenue in 2005, respectively, and 22% and 20% of our total revenue in 2006, respectively. Revenue we derived from our agreement with Golden Rule Insurance Company, which is owned by UnitedHealthcare, represented 17% and 16% of our total revenue in 2005 and 2006, respectively. Revenue we derived from our agreements with Blue Cross of California and Unicare, which are owned by WellPoint, represented 15% and 12% of our total revenue in 2005 and 2006, respectively. Our agreements with Golden Rule Insurance Company and with Blue Cross of California and Unicare are terminable on 90 days written notice by either party for any reason and may be terminated on shorter notice under certain circumstances, such as in the case of a breach of the agreement. Should our dependence on fewer carrier relationships increase (whether as a result of the termination of carrier relationships, further carrier consolidation or otherwise), we may become more vulnerable to adverse changes in our relationships with our carriers, particularly in states where we offer health insurance from a relatively smaller number of carriers or where a small number of carriers dominates the market, and our business, operating results and financial condition could be harmed.

***Changes in the quality and affordability of the health insurance products that carriers offer on our ecommerce platform could harm our business and operating results.***

The demand for health insurance marketed through our ecommerce platform is impacted by, among other things, the variety, quality and price of the health insurance products offered on our ecommerce platform. If health insurance carriers do not continue to provide us with a variety of high-quality, affordable health insurance products in the individual, family and small business markets, or if their offerings are limited as a result of consolidation in the health insurance industry or otherwise, our sales may decrease and our business, operating results and financial condition could be harmed.

***Health insurance carriers could determine to reduce the commissions paid to us or to change their underwriting practices in ways that reduce the number of insurance policies sold through our ecommerce platform, which could harm our business and operating results.***

Our commission rates, and the commission override payments we receive from health insurance carriers for achieving sales volume thresholds or other objectives, are either set by each carrier or negotiated between us and each carrier. Carriers have altered, and may in the future alter, the contractual relationships we have with them, either by renegotiation or unilateral action. If these contractual changes result in reduced commissions, our business may suffer and our operating results and financial condition could be harmed. In addition, carriers periodically change the criteria they use for determining whether they are willing to insure individuals. In the past, these changes have resulted in a decrease in the number of insurance policies we would have otherwise sold. Future changes in carrier underwriting criteria could negatively impact sales of insurance policies on our ecommerce platform and could harm our business, operating results and financial condition.

***If we are not able to maintain and enhance our brand, our business and operating results will be harmed.***

We believe that maintaining and enhancing our brand identity is critical to our relationships with existing members, marketing partners and health insurance carriers and to our ability to attract new members, marketing partners and carriers. The promotion of our brand may require us to make substantial investments and we anticipate that, as our market becomes increasingly competitive, these branding initiatives may become increasingly difficult and expensive. The successful promotion of our brand will depend largely upon our marketing and public relations efforts and our ability to continue to offer high-quality products and services in an understandable and objective manner. Our brand promotion activities may not be successful or yield increased revenue, and to the extent that these activities yield increased revenue, the increased revenue may not offset the expenses we incur. If we do not successfully maintain and enhance our brand, our business may not grow and we could lose marketing partners and members, which could, in turn, cause health insurance carriers to terminate their relationships with us, all of which would harm our business, operating results and financial condition.

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***If we are not successful in converting visitors to our website into members, our business and operating results would be harmed.***

Our growth depends in part upon growth in our membership. The rate at which we convert consumers visiting our ecommerce platform and seeking to purchase health insurance into members is a significant factor in the growth of our membership. A number of factors could influence this conversion rate for any given period, some of which are outside of our control. These factors include:

the quality of, and changes to, the consumer experience on our ecommerce platform and with our customer care center;

the variety and affordability of the health insurance products that we offer;

system failures or interruptions in the operation of our ecommerce platform;

changes in the mix of consumers who are referred to us through our direct, marketing partner and online advertising member acquisition channels;

the number, type and identity of the health insurance carriers offering the health insurance products for which consumers have expressed interest, and the degree to which our technology is integrated with those carriers; and

the health insurance carrier underwriting guidelines applicable to applications submitted by consumers and the amount of time a carrier takes to make a decision on that application.

In the event the rate at which we convert consumers visiting our ecommerce platform into members declines, our membership growth rate will decline, which would harm our business, operating results and financial condition. In addition, a decline in the percentage of consumers visiting our ecommerce platform who submit health insurance applications could cause an increase in our cost of acquiring members as a result of increased costs on a per member basis. Such an increase could adversely impact our operating margins and harm our business and operating results.

***System failures or capacity constraints could harm our business and operating results.***

Our revenue depends upon the number of health insurance applications consumers submit utilizing our ecommerce platform that are approved by health insurance carriers. As a result, the performance, reliability and availability of our ecommerce platform and underlying network infrastructure are critical to our financial results, our brand and our relationship with members, marketing partners and health insurance carriers. Although we regularly attempt to enhance our ecommerce platform and system infrastructure, system failures and interruptions may occur if we are unsuccessful in these efforts, if we are unable to accurately project the rate or timing of increases in our website traffic or for other reasons, some of which are completely outside our control. Although we have experienced only minor system failures and interruptions to date, we could experience significant failures and interruptions in the future, which would harm our business, operating results and financial condition.

We rely in part upon third-party vendors, including data center and bandwidth providers, to operate our ecommerce platform. We cannot predict whether additional network capacity will be available from these vendors as we need it, and our network or our suppliers' networks might be unable to achieve or maintain a sufficiently high capacity of data transmission to allow us to process health insurance applications in a timely manner or effectively download data, especially if our website traffic increases. Any system failure that causes an interruption in, or decreases the responsiveness of, our service would impair our revenue-generating capabilities and harm our business and operating results and damage our reputation. In addition, consumers may access our customer care center for assistance in connection with submitting health insurance applications through our ecommerce platform. We depend upon third parties, including telephone service providers, to operate our customer care center. Any failure of the systems that we rely upon in the operation of our customer care center could negatively impact sales of insurance policies through our ecommerce platform and could harm our business, operating results and financial condition.



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In February 2007, we moved our data center operations to San Jose, California from Redwood City, California and completed certain changes to our data center, including moving from a Sun/Solaris to a Linux operating system. We may experience technical difficulties in connection with these changes. If we experience a system failure, loss of data or disruption for any reason, including as a result of changes in our data center location or infrastructure, the performance of our website would be harmed and our service could shut down. In addition, any loss in data could result in loss of customers and subject us to potential liability. Our database and systems are vulnerable to damage or interruption from human error, earthquakes, fire, floods, power loss, telecommunications failures, physical or electronic break-ins, computer viruses, acts of terrorism, other attempts to harm our systems and similar events. Our operations are vulnerable to earthquakes in the San Francisco Bay Area. Although we maintain insurance to cover a variety of risks, the scope and amount of our insurance coverage may not be sufficient to cover our losses resulting from system failures or other disruptions to our online operations. Any system failure or disruption and any resulting losses that are not recoverable under our insurance policies may materially harm our business, operating results and financial condition.

Although we regularly back-up our system and store the system back-ups in a secure third-party offsite location with restricted access near the San Francisco Bay area, we do not have full second-site redundancy. If we were forced to rely on our system back-ups, we would experience significant delays in restoring the functionality of our website and could experience loss of data, which would harm our business and our operating results. We intend to create a fully redundant disaster recovery system for our data center and website. We may face significant technical challenges in successfully replicating our system and database. Any steps that we take to increase the redundancy and reliability of our systems may be expensive and may not be successful in reducing the frequency or duration of system failures or website downtime.

***We depend upon Internet search engines to attract a significant portion of the consumers who visit our website, and if we are unable to advertise on search engines on a cost-effective basis, our business and operating results would be harmed.***

We derive a significant portion of our website traffic from consumers who search for health insurance through Internet search engines, such as Google, MSN and Yahoo!. A critical factor in attracting consumers to our website is whether we are prominently displayed in response to an Internet search relating to health insurance. Search engines typically provide two types of search results, algorithmic listings and paid advertisements. We rely on both algorithmic listings and paid advertisements to attract consumers to our website.

Algorithmic search result listings are determined and displayed in accordance with a set of formulas or algorithms developed by the particular Internet search engine. The algorithms determine the order of the listing of results in response to the consumer's Internet search. From time to time, search engines revise these algorithms. In some instances, these modifications have caused our website to be listed less prominently in algorithmic search results, which has resulted in decreased traffic to our website. Our website may also become listed less prominently in algorithmic search results for other reasons, such as search engine technical difficulties, search engine technical changes and changes we decide to make to our website. In addition, search engines have deemed the practices of some companies to be inconsistent with search engine guidelines and decided not to list their website in search result listings at all. If we are listed less prominently in search result listings for any reason, the traffic to our website likely would decline and we may not be able to replace this traffic, which would harm our operating results. If we decide to attempt to replace this traffic, we may be required to increase our marketing expenditures, which also would harm our operating results.

We also purchase paid advertisements on search engines in order to attract users to our website. We typically pay a search engine for prominent placement of our name and website when particular health insurance-related terms are searched for on the search engine, regardless of the algorithmic search result listings. In some circumstances, such as with Google AdWords, the prominence of the placement of our name and website is determined by a combination of factors, including the amount we are willing to pay and algorithms designed to determine the relevance of our paid advertisement to a particular search term. We bid against our competitors and

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others for the display of these paid search engine advertisements. Many of our competitors, including many insurance carriers, have greater resources with which to bid and better brand recognition than we do. If there is increased competition for the display of paid advertisements in response to search terms related to our business, our advertising expenses could rise significantly or we could reduce or discontinue our paid search advertisements, either of which could harm our business, operating results and financial condition.

***We rely significantly on marketing partners for the sale of health insurance on our ecommerce platform and our business and operating results would be harmed if we are unable to maintain effective relationships with our existing marketing partners or if we do not establish successful relationships with new marketing partners.***

In addition to marketing through Internet search engines, we frequently enter into contractual marketing relationships with other online and offline businesses that promote us to their customers. These marketing partners include financial and online service companies, affiliate programs and online advertisers and content providers. We typically compensate our marketing partners for their referrals on a submitted health insurance application basis and, if they are licensed to sell health insurance, may share a percentage of the commission we earn from the health insurance carrier for each member referred by the marketing partner. Although many of our marketing partners agree to an initial one or two-year term contract, some of our marketing partner agreements are terminable more quickly.

Many factors influence the success of our relationship with our marketing partners, including:

the continued positive market presence, reputation and growth of the marketing partner;

the effectiveness of the marketing partner in marketing our website and services;

the interest of the marketing partner's customers in the health insurance products that we offer on our ecommerce platform;

the contractual terms we negotiate with the marketing partner, including the marketing fee we agree to pay a marketing partner;

the percentage of the marketing partner's customers that submit applications or purchase health insurance policies through our ecommerce platform;

the ability of a marketing partner to maintain efficient and uninterrupted operation of its website; and

our ability to work with the marketing partner to implement website changes, launch marketing campaigns and pursue other initiatives necessary to maintain positive consumer experiences and acceptable traffic volumes.

If we are unable to maintain successful relationships with our existing marketing partners or fail to establish successful relationships with new marketing partners, our business, operating results and financial condition will be harmed.

***The demand for the health insurance products that we market and sell can be significantly impacted by economic and other factors beyond our control.***

Our revenue depends upon demand for health insurance in the individual, family and small business markets, which can be influenced by a variety of factors beyond our control. For instance, we believe that the number of small businesses is growing and that an increasing number of individuals are becoming self-employed. In addition, as a result of substantial health insurance premium inflation in recent years, we believe that many employers are seeking to reduce the costs associated with providing health insurance to their employees, including offering fewer benefits to employees, reducing or eliminating dependent coverage, increasing employee health insurance premium contributions and eliminating health insurance benefits altogether. We also believe that demand in the individual and family health insurance market will increase as the employees of these





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employers look to other sources for their health insurance needs and as the number of small businesses and self-employed individuals increases. We have no control over the economic and other factors that influence these trends, and if these trends reverse, our business, operating results and financial condition would be harmed.

***We rely on health insurance carriers to accurately and regularly prepare commission reports, and if these reports are inaccurate or not sent to us in a timely manner, our business and operating results could be harmed.***

Health insurance carriers typically pay us a specified percentage of the premium amount collected by the carrier during the period that a member maintains coverage under a policy. We rely on carriers to timely and accurately report the amount of commissions earned by us, and we calculate our commission revenue, prepare our financial reports, projections and budgets and direct our marketing and other operating efforts based on the reports we receive from health insurance carriers. It is often difficult for us to independently determine whether or not carriers are reporting all commissions due to us, primarily because the majority of our members terminate their policies by discontinuing their premium payments to the carrier instead of by informing us of the cancellation. To the extent that health insurance carriers understate or fail to report the amount of commissions due to us in a timely manner or at all, we will not collect and recognize revenue to which we are entitled, which would harm our business, operating results and financial condition.

***Our operating results fluctuate depending upon health insurance carrier payment practices and the timing of our receipt of commission reports from health insurance carriers.***

The timing of our revenue depends upon the timing of our receipt of commission reports and associated payments from health insurance carriers. Although carriers typically report and pay commissions to us on a monthly basis, there have been instances where their report of commissions and payment have been delayed for several months. In addition, much of our commission override revenue is not reported and paid to us in accordance with a scheduled pattern, and some is only reported and paid to us once per year. This could result in a large amount of commission revenue from a carrier being recorded in a given quarter that is not indicative of the amount of revenue we may receive from that carrier in subsequent quarters, causing fluctuations in our operating results. We could report revenue below the expectations of our investors or securities analysts in any particular period if a material report or payment from a health insurance carrier were delayed for any reason.

***We may be unsuccessful in competing effectively against current and future competitors.***

The market for selling health insurance products is intensely competitive and the sale of health insurance over the Internet is new and rapidly evolving. Consumers have the ability to use several sources other than our ecommerce platform to research and purchase health insurance. In addition, consumers can research health insurance using our ecommerce platform and purchase their health insurance through one of our competitors. We compete with a large number of local insurance agents across the United States that sell health insurance products in their local communities. Some of these traditional insurance agents utilize the Internet in various ways to acquire their customers. For instance, some local agents use lead aggregator services that find potential consumers and are compensated for referring that consumer to the traditional agent. As we do, lead aggregators often use Internet search engines and other forms of online advertising to drive Internet traffic to the lead aggregator's website.

In addition to traditional agents, a number of agents operate websites that provide some form of online shopping experience for consumers interested in purchasing health insurance. Although most of these online agents only sell health insurance in a limited number of states and/or represent only a limited number of health insurance carriers, these agents could expand their service area and product offerings. Moreover, while national insurance brokers such as Aon Insurance Services, Arthur J. Gallagher & Co., Marsh, Inc. and Willis Group Limited, have traditionally not focused on the individual, family and small business markets, they could enter these markets and compete with us in the future, particularly if these markets continue to grow. We also compete

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directly with health insurance carriers, including many of the carriers that offer health insurance through our ecommerce platform. Many carriers market and sell their health insurance plans directly to consumers using call centers, their own websites and other means. We also believe that we are likely to face increasing competition as the online financial services industry develops and evolves.

We may not be able to compete successfully against our current or future competitors. Some of our current and potential competitors have longer operating histories, larger customer bases, greater brand recognition and significantly greater financial, technical, marketing and other resources than we do. As compared to us, our current and future competitors may be able to:

undertake more extensive marketing campaigns for their brands and services;

devote more resources to website and systems development;

negotiate more favorable commission rates and commission override payments; and

make more attractive offers to potential employees, marketing partners and third-party service providers.

Competitive pressures may result in our experiencing increased marketing costs, decreased traffic to our website and loss of market share, or otherwise may harm our business, operating results and financial condition.

***There are many risks associated with our operations in China.***

A portion of our operations is conducted in China. Among other things, we use employees in China to maintain and update the significant amount of software on our ecommerce platform. This and other information is delivered to us through secured communications over the Internet. Our business would be harmed if this connection temporarily failed, and we were prevented from promptly updating our software or implementing other changes to our database and systems. Our operations in China also expose us to different and unfamiliar laws, rules and regulations, including different intellectual property laws, which are not as protective of our intellectual property as the laws in the United States, and different labor and tax laws. United States and Chinese trade laws may impose restrictions on the importation of programming or technology to or from the United States. These risks could cause us to incur increased expenses and could harm our ability to effectively and successfully manage our operations in China, which in turn could cause our business, operating results and financial condition to suffer. We plan to continue to expand our Chinese operations. These plans will require additional management attention and resources and may be unsuccessful, as we have limited experience with respect to operations in China. In addition, we are currently evaluating whether to market and sell insurance in China. If we determine to do so, there can be no assurance that we will be successful in operating our business in China, since we have no experience marketing or selling insurance in China or in adapting our business to Chinese markets and cultures, legal and regulatory regimes or business customs.

***Our rate of growth may decline if we are unable to increase our revenue relating to sponsorship advertising.***

We sell advertising space to health insurance carriers on our website through our sponsorship advertising program. Our sponsorship advertising program allows carriers to purchase advertising space in specific markets in a sponsorship area on our website. Specifically, carriers who have purchased advertising can choose to have specific health insurance plans displayed prominently after a consumer has entered certain census information. Our revenue to date from the sale of sponsorship advertising has constituted a relatively small percentage of our total revenue. Our sponsorship advertising initiative is relatively new and unproven and, if we do not continue to successfully increase our revenue from the sale of sponsorship advertising, our rate of growth may decline. The success of our sponsorship advertising program is dependent upon a number of factors, including consumer and health insurance carrier adoption of the Internet and our ecommerce platform as a medium for the purchase and sale of health insurance, our ability to attract consumers visiting our ecommerce platform and convert those

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consumers into members, the existence of a relationship between us and a diverse group of carriers that offer a number of health insurance plans in the markets in which we attempt to sell sponsorship advertising, the cost and other features of the health insurance product that is the subject of the sponsorship advertising, the impact the sponsorship advertising has on the sale of the health insurance product that is the subject of the advertising and the effectiveness of the carrier's other means of advertising. In addition, while our practice of selling sponsorship advertising is described on our ecommerce platform, it could cause consumers to perceive us as not objective, which could harm our brand and result in a decline in our health insurance sales. It also could adversely impact our relationship with health insurance carriers that do not purchase our sponsorship advertising. As a result, our business, operating results and financial condition could be harmed.

### ***We may not be successful in licensing our ecommerce technology to health insurance carriers and other third parties.***

We license the use of our ecommerce technology to health insurance carriers and agents. Carriers use our platform to offer their own health insurance policies on their websites, and agents use it to power their quoting and online content. Our revenue to date from the licensing of our ecommerce technology has constituted a relatively small percentage of our total revenue. Our technology licensing initiative is relatively new and unproven and, if we do not continue to successfully increase our revenue from the license of our technology, our rate of growth may decline. The business of licensing the use of our technology to others could facilitate carrier and other third party competition with us in the sale of health insurance over the Internet and is subject to a number of additional risks and uncertainties, including consumer and health insurance carrier adoption of our ecommerce platform as a medium for the purchase and sale of health insurance, our ability to establish relationships with new health insurance carriers, the reliability and performance of our ecommerce platform and the relative cost of developing competing technology. If we are not able to offer health insurance carriers and other third parties a reliable platform to cost-efficiently offer their products over the Internet, our technology licensing business will be unsuccessful.

### ***We may not be able to adequately protect our intellectual property, which could harm our business and operating results.***

We believe that our intellectual property is an essential asset of our business and that our technology infrastructure currently gives us a competitive advantage in the distribution of individual, family and small business health insurance. We rely on a combination of copyright, trademark and trade secret laws as well as confidentiality procedures and contractual provisions to establish and protect our intellectual property rights in the United States. Although we have pending patent applications in the United States, they may not result in issued patents. We have not filed for protection of our intellectual property in any foreign jurisdiction other than China. We have Chinese-registered computer software copyrights for an internally-developed software system and a project management tool and have filed certain trademark applications in China. We have not filed any patent applications in China. The efforts we have taken to protect our intellectual property may not be sufficient or effective, and our trademarks, copyrights and patents if issued, may be held invalid or unenforceable. Moreover, the law relating to intellectual property is not as developed in China, and our intellectual property rights may not be as respected in China as they are in the United States. Any United States or other patents issued to us may not be sufficiently broad to protect our proprietary technologies, and given the costs of obtaining patent protection, we may choose not to seek patent protection for certain of our proprietary technologies. We may not be effective in policing unauthorized use of our intellectual property, and even if we do detect violations, litigation may be necessary to enforce our intellectual property rights. Any enforcement efforts we undertake, including litigation, could be time-consuming and expensive, could divert our management's attention and may result in a court determining that our intellectual property rights are unenforceable. If we are not successful in cost-effectively protecting our intellectual property rights, our business, operating results and financial condition could be harmed.

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***We may in the future be subject to intellectual property rights claims, which are extremely costly to defend, could require us to pay significant damages and could limit our ability to use certain technologies in the future.***

Companies in the Internet and technology industries own large numbers of patents, copyrights, trademarks and trade secrets and frequently enter into litigation based on allegations of infringement or other violations of intellectual property rights. We have received, and may in the future receive, notices that claim we have misappropriated or misused other parties' intellectual property rights, and, to the extent we gain greater visibility, we face a higher risk of being the subject of intellectual property infringement claims. There may be third-party intellectual property rights, including issued or pending patents, that cover significant aspects of our technologies or business methods. Any intellectual property claim against us, with or without merit, could be time consuming, expensive to settle or litigate and could divert our management's attention and other resources. These claims also could subject us to significant liability for damages and could result in our having to stop using technology found to be in violation of a third party's rights. We might be required to seek a license for third-party intellectual property, which may not be available on reasonable terms or at all. Even if a license is available, we could be required to pay significant royalties, which would increase our operating expenses. We may also be required to develop alternative non-infringing technology, which could require significant effort and expense. If we cannot license or develop technology for any infringing aspect of our business, we would be forced to limit our service and may be unable to compete effectively. Any of these results would harm our business, operating results and financial condition.

***Any legal liability, regulatory penalties, or negative publicity for the information on our website or that we distribute will likely harm our business and operating results.***

Our members rely upon information we provide on our website, through our customer care center or otherwise regarding the health insurance plans offered on our website, including information relating to insurance premiums, coverage, benefits, exclusions, limitations, availability, plan comparisons and insurance company ratings. A significant amount of both automated and manual effort is required to maintain the considerable amount of insurance plan information on our website. Separately, from time to time, we use the information provided on our website and otherwise collected by us to publish reports designed to educate consumers, facilitate public debate, and effectuate reform at the state and federal level relating to the accessibility and affordability of health insurance. If the information we provide on our website, through our customer care center or otherwise is not accurate or is construed as misleading, members, health insurance carriers and others could attempt to hold us liable for damages, and state regulators could attempt to subject us to penalties, revoke our license to transact health insurance business in a particular jurisdiction, and/or compromise the status of our licenses to transact health insurance business in other jurisdictions. In the ordinary course of operating our business, we have received complaints that the information we provided was not accurate or was misleading. Although in the past we have resolved these complaints without significant financial cost, we cannot guarantee that we will be able to do so in the future. In addition, these types of claims could be time-consuming and expensive to defend, could divert our management's attention and other resources, and could cause a loss of confidence in our service. As a result, whether or not we are able to successfully resolve these claims, they could harm our business, operating results and financial condition.

In September 2006, we received an order from the Office of the Insurance Commissioner of the State of Washington in connection with our publication of a report in July 2006 entitled *The Most Affordable Cities for Children's and Family Health Insurance*. The Office of the Insurance Commissioner of the State of Washington contends that the report is advertising and that our alleged mischaracterization of the affordability of individual health insurance in Spokane, Washington caused a violation of various Washington laws governing advertising, including prohibitions against false and misleading advertising in the conduct of insurance business. In general terms, the order requires us to cease and desist from further publication, distribution or republication of the report and from granting permission to republish, or assisting in the republication of, the report. We have challenged the order through an administrative proceeding and the order has been stayed pending the resolution of that proceeding.

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In the ordinary course of our business, we have received and may continue to receive inquiries from state regulators relating to various matters from time to time, including the order from the Office of the Insurance Commissioner of the State of Washington. We may also become involved in litigation in the future in the ordinary course of our business. If we are found to have violated laws or regulations in the state of Washington or in other states, we could be subject to various fines and penalties, including revocation of our license to sell insurance in those states, and our business and financial results would be harmed. We would also be harmed to the extent that related publicity damages our reputation as a trusted source of objective information relating to health insurance and its affordability. It could also be costly to defend ourselves regardless of the outcome.

***We rely on insurance to mitigate some risks and, to the extent the cost of insurance increases or we maintain insufficient coverage, our business and operating results may be harmed.***

We contract for insurance to cover potential business risks and liabilities. In the current environment, insurance companies are increasingly specific about what they will and will not insure. It is possible that we may not be able to obtain sufficient insurance to meet our needs, may have to pay very high prices for the coverage we do obtain or may not acquire any insurance for certain types of business risk. This could leave us exposed, and to the extent we incur liabilities and expenses for which we are not adequately insured, our business, operating results and financial condition could be negatively impacted. Also, to the extent the cost of maintaining insurance increases, our operating expenses will rise, which could harm our business, operating results and financial condition.

***Our ability to attract and retain qualified personnel is critical to our success.***

Our success is dependent upon the performance of our senior management and key personnel. Our management and employees can terminate their employment at any time, and the loss of the services of any of our executive officers or key employees could harm our business. Our success is also dependent upon our ability to attract additional personnel for all areas of our organization. Competition for qualified personnel is intense, and we may not be successful in attracting and retaining such personnel on a timely basis, on competitive terms or at all. If we are unable to attract and retain the necessary personnel, our business would be harmed.

Our senior management and key employees are substantially vested in their stock options as of December 31, 2006. While we have in the past, and may in the future, grant these employees additional equity incentives, these employees may be more likely to leave us after their existing stock options fully vest, especially if the shares underlying the options have significantly appreciated in value relative to the option exercise price. Our senior management and key employees work for us on an at-will basis and our business could be harmed if we lose their services.

***If we fail to manage future growth effectively, our business and operating results would be harmed.***

We have expanded our operations significantly and anticipate that further expansion will be required in order for us to grow our business. Our growth has placed, and if our growth continues will continue to place, increasing and significant demands on our management, our operational and financial systems and infrastructure and our other resources. If we do not effectively manage our growth, the quality of our services could suffer, which could harm our business, operating results and financial condition. In order to manage future growth, we will need to hire, integrate and retain highly skilled and motivated employees. We will also be required to continue to improve our existing systems for operational and financial management, including our reporting systems, procedures and controls. These improvements may require significant capital expenditures and will place increasing demands on our management. We may not be successful in managing or expanding our operations or in maintaining adequate financial and operating systems and controls. If we do not successfully implement improvements in these areas, our business, operating results and financial condition will be harmed.

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### ***Seasonality may cause fluctuations in our financial results.***

The number of health insurance applications submitted through our ecommerce platform has generally increased in our first quarter compared to our fourth quarter and in our third quarter compared to our second quarter. Conversely, we have generally experienced a decline in submitted applications in our second quarter compared to our first quarter and in our fourth quarter compared to our third quarter. Because a significant portion of our marketing and advertising expenses are driven by the number of health insurance applications submitted on our ecommerce platform, those expenses generally have increased or decreased in conjunction with these seasonal patterns. We believe that consumer adoption of the Internet is still in its early stages and, therefore, the reasons for these seasonal patterns are not entirely clear. As the use of the Internet for the purchase and sale of health insurance becomes more widely accepted, other seasonality trends may develop and the existing seasonality and consumer behavior that we experience may change. Any seasonality that we experience may cause fluctuations in our financial results.

### ***Future acquisitions could disrupt our business and harm our financial condition and operating results.***

We may decide to acquire businesses, products and technologies. We have not made any acquisitions to date, and our ability as an organization to successfully make acquisitions is unproven. Acquisitions could require significant capital infusions and could involve many risks, including the following:

an acquisition may negatively impact our results of operations because it may require us to incur charges and substantial debt or liabilities, may require the amortization, write down or impairment of amounts related to deferred compensation, goodwill and other intangible assets, or may cause adverse tax consequences, substantial depreciation or deferred compensation charges;

we may encounter difficulties in assimilating and integrating the business, technologies, products, personnel or operations of companies that we acquire, particularly if key personnel of the acquired company decide not to work for us;

an acquisition may disrupt our ongoing business, divert resources, increase our expenses and distract our management;

we may be required to implement or improve internal controls, procedures and policies appropriate for a public company at a business that prior to the acquisition lacked these controls, procedures and policies;

the acquired businesses, products or technologies may not generate sufficient revenue to offset acquisition costs;

we may have to issue equity securities to complete an acquisition, which would dilute our stockholders' ownership and could adversely affect the market price of our common stock; and

acquisitions may involve the entry into geographic or business markets in which we have little or no prior experience.

We cannot assure you that we will be able to identify or consummate any future acquisition on favorable terms, or at all. If we do pursue an acquisition, it is possible that we may not realize the anticipated benefits from the acquisition or that the financial markets or investors will negatively view the acquisition. Even if we successfully complete an acquisition, it could harm our business, operating results and financial condition.

### ***Any additional financing we secure may be subject to terms that are unfavorable to us and our stockholders.***

If we raise additional capital through further issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution in their percentage ownership of us, and any new equity securities



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we issue could have rights, preferences and privileges senior to those of holders of our common stock. Any debt financing secured by us in the future could involve restrictive covenants relating to our capital raising activities and other financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions.

***Issues arising from the implementation of our new commission accounting system and an enterprise data management system could affect our operating results and ability to manage our business effectively.***

We have completed implementation of our new commission accounting system for the majority of our health insurance products. We anticipate completion of the last phase, related to our small business products, in the first half of 2007. In addition, we are in the initial stages of implementing an enterprise data management system. Each of these systems is or will be important to our accounting, financial and operating functions, and the implementation of these systems raises costs and risks associated with the conversion to new systems, including disruption to our normal accounting procedures and problems achieving accuracy in the conversion of electronic data. Failure to properly or adequately address these issues could result in increased costs, and the diversion of management's attention and resources and could harm our operating results and ability to manage our business effectively.

***If we fail to maintain proper and effective internal controls, our ability to produce accurate financial statements could be impaired, which could adversely affect our operating results, our ability to operate our business and our stock price.***

We have a complex business organization. Ensuring that we have adequate internal financial and accounting controls and procedures in place to help ensure that we can produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. We are in the process of documenting, reviewing and improving our internal controls and procedures in connection with Section 404 of the Sarbanes-Oxley Act of 2002. Section 404 requires annual management assessments of the effectiveness of our internal controls over financial reporting and a report by our independent auditors addressing these assessments. Both we and our independent auditors will be testing our internal controls in connection with the Section 404 requirements and could, as part of that documentation and testing, identify areas for further attention or improvement. Implementing any appropriate changes to our internal controls may require specific compliance training of our directors, officers and employees, entail substantial costs in order to modify our existing accounting systems and take a significant period of time to complete. These changes may not, however, be effective in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy, or the consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and could harm our ability to operate our business. In addition, investor perception that our internal controls are inadequate or that we are unable to produce accurate financial statements on a consistent basis may adversely affect our stock price.

***Our net income in future periods could be significantly reduced as a result of employee stock-based compensation expense.***

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share-Based Payment*, or SFAS 123R. SFAS 123R requires measurement of all employee stock-based compensation awards using a fair value method and the recording of such expense in the consolidated financial statements. The adoption of SFAS 123R requires additional accounting related to the income tax effects, and additional disclosure regarding the cash flow effects, resulting from share-based payment arrangements. We adopted SFAS 123R on January 1, 2006. As permitted, we will continue to account for the portion of awards outstanding on or before December 31, 2005 using the provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related interpretative guidance. During the year ended December 31, 2006, we recorded stock-based compensation expense totaling \$283,000 related to stock options, restricted stock awards and restricted stock units granted to employees and accounted for in



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accordance with the provisions of SFAS 123R. Total unamortized stock-based compensation cost related to these stock options, restricted stock awards and restricted stock units at December 31, 2006 was approximately \$3.6 million, net of estimated forfeitures of \$383,000. This amount will be amortized on a straight-line basis over a weighted-average period of approximately 3.5 years and will be adjusted for subsequent changes in estimated forfeitures. Because the amount, terms and fair values of awards to be issued in the future are unknown, we are unable to predict the future impact on our consolidated financial statements of stock-based compensation expense related to future awards. However, we expect that the impact could be material over time as the number of awards issued and outstanding increases.

### ***We will incur increased costs as a result of being a public company.***

As a public company, we have incurred and will continue to incur significant legal, accounting and other expenses that we did not incur as a private company. We will continue to incur auditing, consulting and other costs associated with our public company reporting requirements. We also anticipate that we will continue to incur costs associated with corporate governance requirements, including requirements under the Sarbanes-Oxley Act of 2002, as well as rules implemented by the Securities and Exchange Commission and The NASDAQ Global Market. We expect these rules and regulations to continue to increase our legal and financial compliance costs and to make some activities more time-consuming and costly. Being a public company has made it more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. We cannot predict or estimate the amount of additional costs we may incur or the timing of such costs. Any of these expenses could harm our business, operating results and financial condition.

### ***Any expansion of our business into foreign countries involves significant risks.***

Although we currently do not sell health insurance or license our technology platform outside the United States, we are exploring ways to expand our business into foreign countries, particularly China. We would face significant challenges in connection with expanding our business into a foreign country. Demand for private health insurance is not significant in many foreign countries, including China, as a result of government-sponsored healthcare systems. In addition to facing many of the same challenges we face domestically, we also would have to overcome other obstacles such as:

legal, political or systemic restrictions on the ability of United States companies to market insurance or otherwise do business in foreign countries;

varied, unfamiliar and unclear legal and regulatory restrictions;

less extensive adoption of the Internet as a commerce medium or information source and increased restriction on the content of websites; and

the adaptation of our website and distribution model to fit the particular foreign country.

As a result of these obstacles, we may find it impossible or prohibitively expensive to expand our services internationally or we may be unsuccessful should we attempt to do so, which could harm our business, operating results and financial condition.

## **Risks Related to Insurance Regulation**

***Compliance with the strict regulatory environment applicable to the health insurance industry and the specific products we sell is difficult and costly. If we fail to comply with the numerous laws and regulations that are applicable to our business, our business and operating results would be harmed.***

The health insurance industry is heavily regulated by each state in the United States. For instance, state regulators require us to maintain a valid license in each state in which we transact health insurance business and



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further require that we adhere to sales, documentation and administration practices specific to that state. In addition, each employee who transacts health insurance business on our behalf must maintain a valid license in one or more states. Because we do business in all 50 states and the District of Columbia, compliance with health insurance-related laws, rules and regulations is difficult and imposes significant costs on our business. Each jurisdiction's insurance department typically has the power, among other things, to:

grant and revoke licenses to transact insurance business;

conduct inquiries into the insurance-related activities and conduct of agents and agencies;

require and regulate disclosure in connection with the sale and solicitation of health insurance;

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

approve which entities can be paid commissions from carriers;

regulate the content of insurance-related advertisements, including web pages;

approve policy forms, require specific benefits and benefit levels and regulate premium rates;

impose fines and other penalties; and

impose continuing education requirements.

Due to the complexity, periodic modification and differing interpretations of insurance laws and regulations, we may not have always been, and we may not always be, in compliance with them. Failure to comply could result in significant liability, additional department of insurance licensing requirements or the revocation of licenses in a particular jurisdiction, which could significantly increase our operating expenses, prevent us from transacting health insurance business in a particular jurisdiction and otherwise harm our business, operating results and financial condition. Moreover, an adverse regulatory action in one jurisdiction could result in penalties and adversely affect our license status or reputation in other jurisdictions due to the requirement that adverse regulatory actions in one jurisdiction be reported to other jurisdictions. Even if the allegations in any regulatory or other action against us are proven false, any surrounding negative publicity could harm consumer, marketing partner or health insurance carrier confidence in us, which could significantly damage our brand. Because some consumers, marketing partners and health insurance carriers may not be comfortable with the concept of purchasing health insurance using the Internet, any negative publicity may affect us more than it would others in the health insurance industry and would harm our business, operating results and financial condition.

In addition, we have received, and may in the future receive, inquiries from state insurance regulators regarding our marketing and business practices. We typically respond by explaining how we believe we are in compliance with relevant regulations or may modify our practices in connection with the inquiry. Any modification of our marketing or business practices in response to future regulatory inquiries could harm our business, operating results or financial condition.

***Regulation of the sale of health insurance is subject to change, and future regulations could harm our business and operating results.***

## Edgar Filing: eHealth, Inc. - Form 10-K

The laws and regulations governing the offer, sale and purchase of health insurance are subject to change, and future changes may be adverse to our business. For example, once health insurance pricing is set by the carrier and approved by state regulators, it is fixed and not generally subject to negotiation or discounting by insurance companies or agents. Additionally, state regulations generally prohibit carriers, agents and brokers from providing financial incentives, such as rebates, to their members in connection with the sale of health insurance. As a result, we do not currently compete with carriers or other agents and brokers on the price of the health insurance products offered on our website. If these regulations change, we could be forced to reduce prices or provide rebates or other incentives for the health insurance products sold through our ecommerce platform, which would harm our business, operating results and financial condition.

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Another example of a potentially adverse regulatory change relates to the adoption of guaranteed issue laws and regulations in the individual and family health insurance markets. These requirements, which are currently in effect in a limited number of states such as Massachusetts, New Jersey and New York, and have been proposed in California, prohibit health insurance carriers from denying health insurance coverage to individuals based on their health status. It has been our experience that substantially fewer health insurance carriers offer plans in the individual and family health insurance market in states with guaranteed issue regulations in effect compared to others. Moreover, health insurance carriers that do offer individual and family plans may charge substantially increased premiums and/or pay reduced commissions to agents. We believe that limited choice and high premiums result in less demand for individual and family health insurance plans which, when coupled with reduced commissions to agents, results in substantially less revenue for us in these states. Our business, operating results and financial condition would be harmed if the adoption of guaranteed issue laws or regulations becomes more widespread and results in less demand and/or reduced commissions.

In some states, guaranteed issue laws have or could be coupled with related measures that may impact our business. For example, a recent proposal in California included a combination of a number of items, including a guaranteed issue component, a mandate that requires all individuals to purchase or otherwise obtain health insurance and a requirement that health insurance carriers spend 85% of premium revenue on patient care. We do not know what impact a combination of mandates and other related measures would have on our business, but they could harm our business, operating results and financial condition.

We are subject to additional insurance regulatory risks, because we use the Internet as our distribution platform. In many cases, it is not clear how existing insurance laws and regulations apply to Internet-related health insurance advertisements and transactions. To the extent that new laws or regulations are adopted that conflict with the way we conduct our business, or to the extent that existing laws and regulations are interpreted adversely to us, our business, operating results and financial condition would be harmed.

### ***Changes and developments in the structure of the health insurance system in the United States could harm our business.***

Our business depends upon the private sector of the United States health insurance system, its relative role in financing healthcare delivery and health insurance carriers' use of agents and brokers to market their products. Fundamental changes to this system or in the manner in which health insurance is distributed in the United States could reduce or eliminate the demand for private health insurance for individuals, families and small businesses or increase our competition, which would harm our business. Recently, there has been substantial national and state attention and debate regarding the fairest and most effective method of healthcare reimbursement. For instance, some advocates promote a single-payer healthcare system that would be largely underwritten by the state or federal government. The adoption of state or federal laws that promote or establish a government-sponsored single-payer healthcare system could reduce or eliminate the number of individuals, families and small businesses seeking or permitted to purchase private health insurance or supplemental coverage, which would substantially reduce the demand for our service and harm our business, operating results and financial condition.

Other proposals seek to provide health insurance coverage to all individuals, but do so by maintaining many key aspects of the private sector health insurance system rather than proposing a single-payer system. One example is California, which has proposed a plan that includes guaranteed issue laws, a mandate that requires all individuals to obtain health insurance, incentives for many employers to offer health insurance to workers, and a requirement that health insurance carriers spend 85% of premium revenue on patient care. We do not know what impact the California plan and any related proposals may have on our business, but they could, if implemented, harm our business, operating results and financial condition.

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

***Our business is subject to online commerce security risks and if we are unable to safeguard the security and privacy of confidential data, our business will be harmed.***

Our services involve the collection and storage of confidential information of consumers and the transmission of this information to their chosen health insurance carriers. For example, we collect names, addresses, Social Security and credit card numbers, and information regarding the medical history of consumers in connection with their application for health insurance. We currently rely on encryption technology licensed from third parties to facilitate secure transmittal of confidential information. We incorporate a multi-level firewall infrastructure to help prevent unauthorized access to our systems and data and have implemented intrusion detection systems. While we have not to date experienced any security breaches of which we are aware that has resulted in the theft of information, we cannot guarantee that we will be free of security breaches in the future. We may be required to expend significant capital and other resources to protect against security breaches or to alleviate problems caused by security breaches. Despite our implementation of security measures, techniques used to obtain unauthorized access or to sabotage systems change frequently. As a result, we may be unable to anticipate these techniques or to implement adequate preventative measures. Any compromise or perceived compromise of our security could damage our reputation and our relationship with our members, marketing partners and health insurance carriers, could reduce demand for our service and could subject us to significant liability as well as regulatory action, which would harm our business, operating results and financial condition.

***Government regulation of the Internet could adversely affect our business.***

The laws governing general commerce on the Internet remain unsettled and it may take years to fully determine whether and how existing laws such as those governing intellectual property, privacy and taxation apply to the Internet. In addition, the growth and development of the market for electronic commerce may prompt calls for more stringent consumer protection laws that may impose additional burdens on companies conducting business over the Internet. Any new laws or regulations or new interpretations of existing laws or regulations relating to the Internet could harm our business and we could be forced to incur substantial costs in order to comply with them, which would harm our business, operating results and financial condition.

***Our business could be harmed if we are unable to correspond with our consumers by email.***

We use email to market our service to potential members and as the primary means of communicating with our existing members. The laws and regulations governing the use of email for marketing purposes continue to evolve and the growth and development of the market for commerce over the Internet may lead to the adoption of additional legislation. If new laws or regulations are adopted, or existing laws and regulations are interpreted, to impose additional restrictions on our ability to send email to our members or potential members, we may not be able to communicate with them in a cost-effective manner. In addition to legal restrictions on the use of email, Internet service providers and others attempt to block the transmission of unsolicited email, commonly known as spam. If an Internet service provider or software program identifies email from us as spam, we can be placed on a restricted list that will block our email to members or potential members who maintain email accounts with these Internet service providers or who use these software programs. If we are unable to communicate by email with our members and potential members as a result of legislation, blockage or otherwise, our business, operating results and financial condition would be harmed.

***Consumers depend upon third-party service providers to access our website, and our business and operating results could be harmed as a result of technical difficulties experienced by these service providers.***

Consumers using our website depend upon Internet, online and other service providers for access to our website. Many of these service providers have experienced significant outages, delays and other difficulties in the past and could experience them in the future. Any significant interruption in access to our website or increase

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in our website's response time as a result of these difficulties could damage our relationship with insurance carriers, marketing partners and existing and potential members and could harm our business, operating results and financial condition.

### **Risks Related to the Ownership of Our Common Stock**

#### ***Future sales of shares of our common stock by existing stockholders could depress the market price of our common stock.***

If our existing stockholders sell, or indicate an intent to sell, substantial amounts of our common stock in the public market after the 180-day contractual lock-up they entered into in connection with our initial public offering and other legal restrictions on resale lapse, the trading price of our common stock could decline significantly and could decline below the initial public offering price. As of December 31, 2006, we had 21,748,932 shares of common stock outstanding. Of these shares, only 5,750,000 shares of common stock sold in our initial public offering are freely tradable, without restriction, in the public market. Morgan Stanley & Co. Incorporated and Merrill Lynch may, in their sole discretion, permit our officers, directors, employees and current stockholders to sell shares prior to the expiration of the lock-up agreements on April 11, 2007.

After the lock-up agreements pertaining to our initial public offering expire and based on shares outstanding as of December 31, 2006, an additional 15,998,932 shares will be eligible for sale in the public market. Directors, executive officers and other affiliates held 13,015,759 shares of common stock as of December 31, 2006 and will be subject to volume limitations under Rule 144 under the Securities Act and various vesting agreements. In addition, outstanding options to purchase 5,436,062 shares of our common stock and restricted stock units covering 33,256 shares of common stock under our 2006 Equity Incentive Plan, 2005 Stock Plan and 1998 Stock Plan as of December 31, 2006, plus 2,713,901 shares reserved for future issuance under our 2006 Equity Incentive Plan as of January 1, 2007 will become eligible for sale in the public market in the future, subject to certain legal and contractual limitations. If these additional shares are sold, or if it is perceived that they will be sold, in the public market, the trading price of our common stock could decline substantially.

#### ***A limited number of stockholders have the ability to influence the outcome of director elections and other matters requiring stockholder approval.***

Our directors, executive officers and their affiliated entities beneficially owned approximately 60 percent of our outstanding common stock as of December 31, 2006. These stockholders, if they act together, could exert substantial influence over matters requiring approval by our stockholders, including the election of directors, the amendment of our certificate of incorporation and bylaws and the approval of mergers or other business combination transactions. This concentration of ownership may discourage, delay or prevent a change in control of our company, which could deprive our stockholders of an opportunity to receive a premium for their stock as part of a sale of our company and might reduce our stock price. These actions may be taken even if they are opposed by other stockholders.

#### ***Certain provisions in our charter documents and Delaware law could discourage takeover attempts and lead to management entrenchment.***

Our certificate of incorporation and bylaws contain provisions that could have the effect of delaying or preventing changes in control or changes in our management without the consent of our board of directors. These provisions include:

a classified board of directors with three-year staggered terms, which may delay the ability of stockholders to change the membership of a majority of our board of directors;

cumulative voting in the election of directors is prohibited, which limits the ability of minority stockholders to elect director candidates;

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the exclusive right of our board of directors to elect a director to fill a vacancy created by the expansion of the board of directors or the resignation, death or removal of a director, which prevents stockholders from being able to fill vacancies on our board of directors;

the ability of our board of directors to determine to issue shares of preferred stock and to determine the price and other terms of those shares, including preferences and voting rights, without stockholder approval, which could be used to significantly dilute the ownership of a hostile acquiror;

a prohibition on stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;

the requirement that a special meeting of stockholders may be called only by the chairman of the board of directors, the chief executive officer or the board of directors, which may delay the ability of our stockholders to force consideration of a proposal or to take action, including the removal of directors; and

advance notice procedures that stockholders must comply with in order to nominate candidates to our board of directors or to propose matters to be acted upon at a stockholders' meeting, which may discourage or deter a potential acquiror from conducting a solicitation of proxies to elect the acquiror's own slate of directors or otherwise attempting to obtain control of us.

We are also subject to certain anti-takeover provisions under Delaware law. Under Delaware law, a corporation may, in general, not engage in a business combination with any holder of 15% or more of its capital stock unless the holder has held the stock for three years or, among other things, the board of directors has approved the transaction.

### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

Not applicable.

### **ITEM 2. PROPERTIES**

The following table sets forth the location, approximate square footage and primary use of each of the principal properties we occupied at December 31, 2006:

<b>Location</b>	<b>Approximate Square Footage</b>	<b>Primary Use</b>
Mountain View, California East Middlefield Road	17,740	Corporate headquarters, marketing and advertising, technology and content, and general and administrative
Mountain View, California North Whisman Road	7,744	Marketing and advertising and general and administrative
Gold River, California	28,813	Customer care and enrollment, technology and content and general and administrative
Xiamen, China	29,224	Technology and content and general and administrative

We lease or sublease all of these properties. We believe our existing facilities are adequate to meet our needs for the next twelve months.

### **ITEM 3. LEGAL PROCEEDINGS**



## Edgar Filing: eHealth, Inc. - Form 10-K

In September 2006, we received an order from the Office of the Insurance Commissioner of the State of Washington in connection with our publication of a report in July 2006 entitled *The Most Affordable Cities for Children's and Family Health Insurance*. The Office of the Insurance Commissioner of the State of Washington contends that the report is advertising and that our alleged mischaracterization of the affordability of individual

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health insurance in Spokane, Washington caused a violation of various Washington laws governing advertising, including prohibitions against false and misleading advertising in the conduct of insurance business. In general terms, the order requires us to cease and desist from further publication, distribution or republication of the report and from granting permission to republish, or assisting in the republication of, the report. We have challenged the order through an administrative proceeding and the order has been stayed pending the resolution of that proceeding.

In the ordinary course of our business, we have received and may continue to receive inquiries from state regulators relating to various matters from time to time, including the order from the Office of the Insurance Commissioner of the State of Washington. We may also become involved in litigation in the future in the ordinary course of our business. If we are found to have violated laws or regulations in the state of Washington or in other states, we could be subject to various fines and penalties, including revocation of our license to sell insurance in those states, and our business and financial results would be harmed. We would also be harmed to the extent that related publicity damages our reputation as a trusted source of objective information relating to health insurance and its affordability. It could also be costly to defend ourselves regardless of the outcome.

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

No matters were submitted to a vote of security holders during the quarter ended December 31, 2006.

**Table of Contents****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock has been quoted on The NASDAQ Global Market under the symbol EHTH since our initial public offering on October 13, 2006. Prior to that time, there was no public market for our stock. As of February 28, 2007, there were approximately 144 stockholders of record of our common stock and the closing price of our common stock was \$25.02 per share on February 28, 2007 as reported by The NASDAQ Global Market.

The following table sets forth for the indicated period the closing high and low sales prices for our common stock as reported on The NASDAQ Global Market.

	<b>High</b>	<b>Low</b>
Fourth Quarter 2006 (from October 13, 2006)	\$ 27.10	\$ 20.08
First Quarter 2007 (through February 28, 2007)	\$ 25.25	\$ 20.20
<i>Dividend Policy</i>		

We have never declared or paid any cash dividend on our common stock. We currently intend to retain any future earnings and do not expect to pay any dividends in the foreseeable future.

***Recent Sales of Unregistered Securities***

We registered all of our stock plans pursuant to Form S-8 filed with the Securities and Exchange Commission on October 13, 2006. Prior to this date, we issued to our directors and employees options to purchase 268,771 shares of common stock at an average price of \$12.71 per share and an aggregate exercise price of \$3.4 million during 2006. All of these issuances were from our 2005 Stock Plan. As a result of the exercise of options to purchase common stock, we issued 213,761 shares of common stock with an average exercise price of \$2.15 per share and an aggregate purchase price of \$459,000 during 2006. Of these common shares issued, 212,261 were from our 1998 Stock Plan and 1,500 were from our 2005 Stock Plan. In addition, during 2006 we issued 7,091 shares of restricted stock to our employees at grant-date fair values ranging from \$9.70 to \$13.00 per share and an aggregate fair value of \$89,000 from our 2004 Stock Plan for eHealth China. These issuances were undertaken in reliance upon the exemption from registration requirements of Rule 701 or Section 4(2) under the Securities Act of 1933, as amended.

***Use of Proceeds from our Initial Public Offering***

The Securities and Exchange Commission declared our registration statement, filed on Form S-1 (File No. 333-133526) under the Securities Act of 1933 in connection with the initial public offering of our common stock, \$0.001 par value, effective on October 12, 2006. Under this registration statement, we registered 5,000,000 shares of our common stock, and another 750,000 shares subject to the underwriters over-allotment option. All 5,750,000 shares of common stock registered under the registration statement, including the 750,000 shares covered by the over-allotment option, were sold at a price to the public of \$14.00 per share. All of the shares of common stock were sold by us and there were no selling stockholders in the offering. The offering closed on October 18, 2006. The managing underwriters were Morgan Stanley, Merrill Lynch & Co., Thomas Weisel Partners LLC and JMP Securities.

The offering did not terminate until after the sale of all of the shares registered on the registration statement. The aggregate gross proceeds from the shares of common stock sold by us were \$80.5 million. The aggregate net proceeds to us from the offering were approximately \$70.2 million, after deducting an aggregate of \$5.7 million

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in underwriting discounts and commissions paid to the underwriters and an estimated \$4.6 million in other expenses incurred in connection with the offering.

We have not spent any of the net proceeds from our public offering and currently hold the net proceeds in money market accounts, although we intend to invest a substantial portion of the funds in short-term, investment-grade, interest bearing instruments. In the future, we may use a portion of the net proceeds to acquire or make investments in complementary companies, services and technologies.

### **STOCK PERFORMANCE GRAPH**

The graph below compares the cumulative total stockholder return on our common stock with the cumulative total return on the NASDAQ Composite Index and the RDG Internet Composite Index for the period beginning on October 13, 2006 (the date our common stock commenced trading on The NASDAQ Global Market) through February 28, 2007, assuming an initial investment of \$100. While the initial public offering price of our common stock was \$14.00 per share, the graph assumes the initial value of our common stock on October 13, 2006 was the closing sales price of \$22.90 per share. Data for the NASDAQ Composite Index and the Research Data Group Internet Index assume reinvestment of dividends.

The comparisons in the graph below are based upon historical data and are not indicative of, nor intended to forecast, future performance of our common stock.

	10/13/2006	10/31/2006	11/30/2006	12/29/2006	1/31/2007	2/28/2007
eHealth, Inc.	\$ 100.00	\$ 96.59	\$ 97.86	\$ 87.82	\$ 96.24	\$ 109.26
NASDAQ Composite Index	100.00	104.75	107.62	107.40	109.47	107.58
RDG Internet Composite Index	100.00	106.31	111.68	110.89	114.29	108.89

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The following selected consolidated financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and with our consolidated financial statements and accompanying notes included in this Annual Report on Form 10-K.

We effected a 1-for-2 reverse stock split of our common stock, convertible preferred stock and Class A nonvoting common stock in September 2006. All share and per share amounts contained in our consolidated financial statements have been retroactively adjusted to reflect the reverse stock split.

	Years Ended December 31,				
	2002	2003	2004	2005	2006
	(in thousands, except per share amounts)				
Consolidated Statement of Operations Data:					
Revenue:					
Commission	\$ 16,500	\$ 21,868	\$ 29,783	\$ 41,237	\$ 58,943
Sponsorship, licensing and other	80	368	432	515	2,367
Total revenue	16,580	22,236	30,215	41,752	61,310
Operating costs and expenses:					
Cost of revenue-sharing	542	600	447	614	1,305
Marketing and advertising*	7,472	7,002	12,732	17,786	21,405
Customer care and enrollment*	5,906	6,185	7,577	8,822	10,991
Technology and content*	6,668	6,595	7,461	8,054	10,137
General and administrative*	5,644	5,123	5,385	7,108	9,482
Total operating costs and expenses	26,232	25,505	33,602	42,384	53,320
Income (loss) from operations	(9,652)	(3,269)	(3,387)	(632)	7,990
Other income, net	6	74	60	239	1,326
Income (loss) before income taxes	(9,646)	(3,195)	(3,327)	(393)	9,316
Provision for (benefit from) income taxes				21	(7,161)
Net income (loss)	\$ (9,646)	\$ (3,195)	\$ (3,327)	\$ (414)	\$ 16,477
Net income (loss) per share:					
Basic common stock	\$ (2.18)	\$ (0.74)	\$ (0.74)	\$ (0.09)	\$ 1.91
Basic Class A nonvoting common stock				\$ (0.09)	\$ 1.91
Diluted common stock	\$ (2.18)	\$ (0.74)	\$ (0.74)	\$ (0.09)	\$ 0.80
Diluted Class A nonvoting common stock				\$ (0.09)	\$ 0.80
Net income (loss):					
Allocated to common stock	\$ (9,646)	(3,195)	(3,327)	\$ (414)	\$ 16,391
Allocated to Class A nonvoting common stock					86
Net income (loss)	\$ (9,464)	\$ (3,195)	\$ (3,327)	\$ (414)	\$ 16,477
Weighted-average number of shares used in per share amounts:					
Basic common stock	4,428	4,331	4,473	4,661	8,590
Basic Class A nonvoting common stock				3	45
Diluted common stock	4,428	4,331	4,473	4,661	20,572
Diluted Class A nonvoting common stock				3	45

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\* Includes stock-based compensation as follows:

Includes stock based compensation as follows:						
Marketing and advertising	\$	\$	49	\$	59	\$ 97 \$ 47
Customer care and enrollment			25		7	6 42
Technology and content			9		14	62 226
General and administrative		68	9		19	26 139
Total	\$	68	\$ 92	\$ 99	\$ 191	\$ 454

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	2002	2003	As of December 31, 2004 (in thousands)	2005	2006
<b>Consolidated Balance Sheet Data:</b>					
Cash, cash equivalents and short-term investments	\$ 14,343	\$ 10,646	\$ 8,707	\$ 9,415	\$ 90,316
Working capital	10,588	8,149	4,797	3,636	86,503
Total assets	18,152	14,620	12,898	15,165	104,928
Other non-current liabilities	63	17	59	212	317
Convertible preferred stock	86,351	86,422	86,370	86,319	
Accumulated deficit	(73,196)	(76,391)	(79,718)	(80,132)	(63,655)
Total stockholders' equity (deficit)	(72,383)	(75,452)	(78,396)	(78,181)	95,740

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### **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS** **Overview**

We are the leading online source of health insurance for individuals, families and small businesses. Our ecommerce platform enables individuals, families and small businesses to research, analyze, compare and purchase health insurance products that best meet their needs. Our technology also enables us to communicate electronically with our insurance carrier partners and process consumers' health insurance applications online. As a result, we simplify and streamline the complex and traditionally paper-intensive health insurance sales and purchasing process.

Since our incorporation in November 1997, we have spent approximately \$55 million on technology and content related to our ecommerce platform. We have also invested significant time and resources in obtaining licenses to sell health insurance in all 50 states and the District of Columbia, developing diverse and successful member acquisition programs and establishing relationships with over 160 health insurance carriers, enabling us to offer more than 7,000 health insurance products online. Our first online transaction relating to the sale of a health insurance policy was completed during the fourth quarter of 1998.

Our financial model is characterized by recurring revenue, health insurance pricing that is set by each carrier and approved by state regulators, and members who maintain their health insurance products for an average of more than two years (measured on a weighted-average basis for all products purchased through us, including short-term products, which are held for less than four months on average). We generate revenue primarily from commissions we receive from health insurance carriers whose policies are purchased through us by individuals, families and small businesses. We typically receive commission payments on a monthly basis for as long as a policy remains active. As a result, much of our revenue for a given financial reporting period relates to policies that we sold prior to the beginning of the period and is recurring in nature. Because health insurance pricing is set by the carrier and approved by state regulators, health insurance pricing is fixed. We, therefore, are not generally subject to negotiation or discounting of prices by health insurance carriers or our competitors.

#### ***Sources of Revenue***

##### ***Revenue***

We generate most of our revenue from commissions paid to us by health insurance carriers whose health insurance policies we have sold. Commission revenue represented 98.6%, 98.8% and 96.1% of our total revenue for the years ended December 31, 2004, 2005 and 2006, respectively. The remainder of our revenue is primarily attributable to carrier sponsorship advertising on our website and, to a lesser extent, licensing arrangements related to our technology. Our commission revenue has grown principally as a result of our penetration of the individual, family and small business health insurance markets and corresponding growth in our membership. We estimate that as of December 31, 2006 we had approximately 393,900 members compared to an estimated 277,600 members at December 31, 2005. We define a member as an individual covered by an insurance product for which we are entitled to receive compensation.

We believe that there is significant opportunity to expand our share of the individual, family and small business health insurance markets and thereby increase our revenue. For example, we estimate our share of the individual and family health insurance market as of December 31, 2006 represented approximately 2% of the total market, assuming 17 million individuals in the United States directly purchased their health insurance coverage as reported by the U.S. Census Bureau in 2004. Historically, our revenue and business have been more significantly affected by the rate of growth in the number of consumers using the Internet to research and purchase health insurance than by the rate at which the health insurance industry has grown. We expect that the rate of online adoption will continue to be a primary driver of our revenue.

Our commission revenue generally represents a percentage of the insurance premium a member has paid to his or her insurance carrier and, to a lesser extent, commission override payments that insurance carriers pay us.



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for achieving sales volume thresholds or other objectives. Commission rates vary by carrier and by the type of plan purchased by a member. Commission rates also can vary based upon the amount of time that the policy has been active, with commission rates for individual and family policies typically being higher in the first twelve months of the policy. Individuals, families and small businesses purchasing health insurance through us typically pay their premiums on a monthly basis. Insurance carriers typically pay us our commissions monthly, after they receive the premium payment from the member. We continue to receive the commission payment from the relevant insurance carrier until the health insurance policy is cancelled or we otherwise do not remain the agent on the policy. As a result, the majority of our revenue is recurring in nature and grows in correlation with the growth we experience in our membership base. At the beginning of an accounting period, we have visibility with respect to the majority of our revenue for that accounting period since revenue for that accounting period is primarily attributable to policies previously purchased by our members.

We recognize commission revenue when the commission is reported to us by a carrier, which occurs through our receipt of a cash payment and a commission statement. We report commission revenue net of an allowance for future forfeiture amounts payable to our carriers due to policy cancellations. Commission override payments, which are recognized on the same basis as premium commissions, are generally reported to us in a more irregular pattern than premium commissions. As a result, our revenue for a particular quarter could be higher or lower than expectations due to the timing of the reporting of commission override payments.

Revenue attributable to individual and family product offerings in each of the years ended December 31, 2005 and 2006 represented approximately 80% of our total revenue. We define individual and family product offerings as major medical individual and family health insurance plans, which does not include small business, short-term major medical, stand-alone dental, life and student health insurance product offerings.

In addition to the revenue we derive from the sale of health insurance products, we derive revenue from our online sponsorship advertising program and from licensing the use of our ecommerce technology. Our sponsorship advertising program allows carriers to purchase advertising space in specific markets in a sponsorship area on our website. Specifically, carriers who have purchased advertising can choose to have specific health insurance plans displayed prominently after a consumer has entered certain census information. In return, we are typically paid a monthly fee and a performance fee based on metrics such as submitted or approved health insurance applications. Our technology licensing business allows carriers to offer their own health insurance policies on their websites and agents to utilize our technology to power their quoting and online content. These parties typically pay us certain guaranteed and performance-based fees.

### ***Member Acquisition***

An important factor in our revenue growth is the growth of our member base. Our marketing initiatives are an important component of our strategy to grow our member base and are focused on three primary member acquisition channels: direct, marketing partners and online advertising. Our marketing initiatives are designed to attract consumers to complete an online application for health insurance on our ecommerce platform.

*Direct.* Our direct member acquisition channel consists of consumers who access our website addresses ([www.ehealth.com](http://www.ehealth.com) and [www.ehealthinsurance.com](http://www.ehealthinsurance.com)) either directly or through algorithmic search listings on Internet search engines and directories. For the years ended December 31, 2004, 2005 and 2006, applications submitted through us for individual and family health insurance products from our direct channel constituted approximately 45%, 40% and 40% of all individual and family health insurance applications submitted on our website. We expect our direct channel will continue to be our most cost-effective channel.

*Marketing Partners.* Our marketing partner member acquisition channel consists of consumers who access our website through a network of financial services and other companies. Growth in our marketing partner channel depends upon our expanding joint marketing programs with existing partners and adding new partners to our network. For the years ended December 31, 2004, 2005 and 2006, applications submitted through us for

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individual and family health insurance products for which we paid fees to our marketing partners constituted approximately 26%, 34% and 35%, respectively, of all individual and family health insurance applications submitted on our website. Our marketing partner channel is the primary driver of our small business member acquisition.

*Online Advertising.* Our online advertising channel consists of consumers who access our website through paid keyword search advertising from search engines such as Google, MSN and Yahoo!, as well as various Internet marketing programs such as banner advertising, email marketing and an integrated partnership with MSN. For the years ended December 31, 2004, 2005 and 2006, applications submitted through us for individual and family health insurance products from our online advertising channel constituted approximately 29%, 26% and 25%, respectively, of all individual and family health insurance applications submitted on our website.

## **Operating Costs and Expenses**

### ***Cost of Revenue-Sharing***

Cost of revenue-sharing consists primarily of payments related to health insurance policies sold to members who were referred to our website by marketing partners with whom we have revenue-sharing arrangements. In order to enter into a revenue-sharing arrangement, these marketing partners must be licensed to sell health insurance in the state where the policy is sold. Costs related to revenue-sharing arrangements are expensed as the related revenue is recognized.

### ***Marketing and Advertising***

Marketing and advertising expenses consist primarily of member acquisition expenses associated with our direct, marketing partner and online advertising channels, in addition to compensation and other expenses related to marketing, business development, public relations and carrier relations personnel who support our offerings. Our direct channel expenses primarily consist of print advertising, direct mail, email and other activities that drive consumers directly to our website.

We generally compensate our marketing partners by paying a one-time fee each time a consumer referral from a partner results in a submitted health insurance application on our ecommerce platform, regardless of whether the consumer's application is approved by the health insurance carrier. Many of our marketing partners have tiered volume-incentive arrangements in which the amount of the one-time fee increases as the volume of submitted applications we receive from such marketing partners increases over a particular period. We recognize these expenditures in the period when a marketing partner's referral results in the submission of a health insurance application on our website. The number of health insurance applications submitted through our ecommerce platform has generally increased in our first quarter compared to our fourth quarter and in our third quarter compared to our second quarter. Conversely, we have generally experienced a decline in submitted applications in our second quarter compared to our first quarter and in our fourth quarter compared to our third quarter. Since a significant portion of our marketing and advertising expenses are driven by the number of health insurance applications submitted on our website, those expenses generally have increased or decreased in conjunction with these seasonal patterns. In addition, because the total volume of submitted applications that we receive from our marketing partners is largely outside of our control, particularly during any short-term period, and because of our tiered volume-incentive marketing partner arrangements, we could incur expenses in excess of the amounts we had planned in periods of rapid growth in the volume of submitted applications from marketing partner referrals. Accordingly, an unanticipated increase in submitted applications resulting from marketing partner referrals could cause our net income to be lower than our expectation since the revenue to be derived from submitted applications that are approved by health insurance carriers will not be recognized until future periods.

Paid keyword search advertising on search engines represents the majority of expenses in our online advertising channel. We incur expenses associated with search engine advertising in the period in which the

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consumer clicks on the advertisement. We actively manage our paid keyword search advertising expense, taking into account the anticipated return from referrals. We also take into account the productivity and relative cost of paid keyword search as compared to other marketing channels and the anticipated lifetime revenue from members acquired, to control the amount of expense incurred during a given period.

We believe the cost of acquiring new members will continue to fluctuate based upon various factors, including the mix of health insurance applications submitted through our three marketing channels, the mix of marketing partners referring consumers to our website, the overall trend in costs of online marketing including keywords purchased by us, seasonality patterns, the amounts we pay marketing partners to refer consumers to our website, fluctuations in the percentage of consumers referred to our website who submit health insurance applications and the level of personnel costs required to manage our marketing and advertising programs.

### ***Customer Care and Enrollment***

Customer care and enrollment expenses consist of compensation and related expenses for personnel engaged in pre-sales assistance to applicants who call our customer care center and enrollment personnel who assist applicants during the underwriting process. We expect customer care and enrollment expenses to increase in future periods.

### ***Technology and Content***

Technology and content expenses consist primarily of compensation and related expenses for personnel associated with developing and enhancing our website technology as well as maintaining our website. A portion of our technology and content group is located at our wholly-owned subsidiary in China, where technology development costs are generally lower. Our technology and content expenses incurred in China totaled \$0.4 million, \$0.7 million and \$1.0 million during the years ended December 31, 2004, 2005 and 2006, respectively. We expect our technology and content expenses to increase in absolute dollars in the future due to our increased focus on technology development, including the enhancement of our ecommerce platform. Additionally, our technology and content expenses could increase significantly if we decide to pursue expansion opportunities outside of the United States.

### ***General and Administrative***

General and administrative expenses consist primarily of compensation and related expenses for staff working in our finance, legal, human resources, internal audit, facilities and internal information technology departments. These expenses also include fees paid for outside professional services, mainly for audit, tax, legal and information technology consulting. We expect our general and administrative expenses to continue to increase in 2007 due to the increased costs associated with operating as a public company and the costs necessary to support the growth in our business.

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### Summary of Selected Metrics

The following table shows certain selected metrics relating to our quarterly periods ended March 31, June 30, September 30 and December 31, 2006 and 2005:

2006	1 <sup>ST</sup> Quarter	2 <sup>ND</sup> Quarter	3 <sup>RD</sup> Quarter	4 <sup>TH</sup> Quarter
IFP submitted applications (1)	74,500	71,500	78,200	76,300
Source of IFP submitted applications (as a percentage of total IFP applications for the period):				
Direct (2)	40%	39%	39%	40%
Marketing partners (3)	39%	36%	34%	33%
Online advertising (4)	21%	25%	27%	27%
Total	100%	100%	100%	100%
IFP new members (5)	57,800	60,900	68,000	68,300
Total new members (6)	79,600	87,000	102,400	97,200
Total revenue (7)	\$ 13,035,000	\$ 14,197,000	\$ 16,662,000	\$ 17,416,000
Total revenue per estimated member for the period (8)	\$ 45	\$ 45	\$ 48	\$ 46
Marketing and advertising expenses (9)	\$ 4,860,000	\$ 5,146,000	\$ 5,798,000	\$ 5,601,000
Acquisition cost per individual on IFP submitted applications (10)	\$ 42	\$ 47	\$ 49	\$ 47
IFP estimated membership (11)	248,700	265,900	297,400	319,000
Total estimated membership (12)	305,300	328,100	363,000	393,900
2005	1 <sup>ST</sup> Quarter	2 <sup>ND</sup> Quarter	3 <sup>RD</sup> Quarter	4 <sup>TH</sup> Quarter
IFP submitted applications (1)	50,700	50,900	59,000	61,000
Source of IFP submitted applications (as a percentage of total IFP applications for the period):				
Direct (2)	42%	42%	39%	39%
Marketing partners (3)	30%	33%	34%	36%
Online advertising (4)	28%	25%	27%	25%
Total	100%	100%	100%	100%
IFP new members (5)	37,900	40,400	44,800	48,300
Total new members (6)	58,300	62,300	68,800	68,000
Total revenue (7)	\$ 9,000,000	\$ 10,201,000	\$ 10,844,000	\$ 11,707,000
Total revenue per estimated member for the period (8)	\$ 41	\$ 43	\$ 43	\$ 44
Marketing and advertising expenses (9)	\$ 3,774,000	\$ 4,237,000	\$ 4,967,000	\$ 4,808,000
Acquisition cost per individual on IFP submitted applications (10)	\$ 47	\$ 52	\$ 53	\$ 50
IFP estimated membership (11)	180,500	193,900	206,500	225,000
Total estimated membership (12)	228,400	241,200	258,300	277,600

- (1) Individual and Family Product ( IFP ) applications completed on eHealth's website during the period.
- (2) Percentage of submitted applications from applicants who came directly to the eHealth website through unpaid search engine results or otherwise.
- (3) Percentage of submitted applications from applicants sourced through eHealth's network of marketing partners.
- (4) Percentage of submitted applications from applicants sourced through paid search, portals and related sites.
- (5) New IFP members reported to eHealth as approved during the period. Some members that are approved by a carrier do not accept the approval and therefore do not become paying members.
- (6) New members for all products reported to eHealth as approved during the period. Some members that are approved by a carrier do not accept the approval and therefore do not become paying members.
- (7) Total revenue recognized during the period (all sources) from the profit and loss statements.

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- (8) Calculated as total revenue recognized during the period (see note (7)) divided by average estimated membership for the period (calculated as beginning and ending estimated membership for all products for the period, divided by two).
- (9) Marketing and advertising expenses for the period from the profit and loss statements.
- (10) Calculated as marketing and advertising expenses for the period (see note (9)) divided by the number of individuals on IFP applications completed on eHealth's website during the period.
- (11) Estimated number of members active on IFP insurance policies as of the date indicated.
- (12) Estimated number of members active on all insurance policies as of the date indicated.

### **Initial Public Offering**

In October 2006, we completed an initial public offering in which we issued and sold 5,750,000 shares of our common stock, including 750,000 shares sold pursuant to the full exercise of the underwriters' over-allotment option, at an issuance price to the public of \$14.00 per share. We raised approximately \$70.2 million in net proceeds after deducting underwriting discounts and commissions of \$5.7 million and offering expenses of \$4.6 million. We currently have no specific plans for the use of the net proceeds of this offering although we anticipate that we will use the net proceeds for working capital and other general corporate purposes, including the funding of our marketing activities and the costs of operating as a public company, as well as further investment in the development of our proprietary technologies. We may use a portion of the net proceeds for the acquisition of businesses, products and technologies that we believe are complementary to our own. Pending this use, we are in the process of investing the net proceeds in short-term, interest-bearing, investment-grade securities.

### **Critical Accounting Policies and Estimates**

The discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates, judgments and assumptions that affect the reported amount of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to the useful lives of long-lived assets including property and equipment, fair value of investments, fair value of intangible assets, allowances for commission forfeitures payable to carriers, income taxes, and, prior to our IPO in October 2006, the fair value of our common stock for the purpose of determining stock-based compensation, among others. We based our estimates of the carrying value of certain assets and liabilities on historical experience and on various other assumptions that we believe to be reasonable. In many cases, we could reasonably have used different accounting policies and estimates. In some cases, changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results may differ materially from these estimates.

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

#### ***Revenue Recognition***

We recognize commission revenue when our commission is reported to us by a health insurance carrier, net of an allowance for future forfeiture amounts payable to carriers due to policy cancellations. Commissions are reported to us by a cash payment and commission statement. We use the data in the commission statements to identify the members for which we are receiving a commission payment and the amount received for each member, and to estimate our allowance for forfeitures payable to carriers. We are not obligated with respect to the insurance coverage sold through our ecommerce platform. As a result, we recognize the net amount of compensation earned as the agent in the transaction.

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We rely on health insurance carriers to report accurately and in a timely manner the amount of commissions earned by us, and we calculate our commission revenues, prepare our financial reports, projections and budgets, and direct our marketing and other operating efforts based on the reports we receive from them. Each month we analyze the reports we receive from our carriers by comparing such data to the database we maintain on our members. It is often difficult for us to independently determine whether or not carriers are reporting all commissions due to us, primarily because the majority of our members who terminate their policies do so by discontinuing their premium payments to the carrier instead of by informing us of the cancellation. This results in our having to identify underpayment or non-payment of commissions on a policy and follow up with a carrier to obtain an explanation and/or request correction of the amount of commissions paid to us. To date, we have not had disputes of any significance with our carriers related to reported commissions. To the extent that carriers understate or fail to report the amount of commissions due to us, we will not collect and recognize revenue to which we are entitled, which, if material in amount, would adversely affect our operating results and financial condition.

Commission override revenue, which we recognize on the same basis as premium commissions, is generally reported to us in a more irregular pattern than premium commissions. As a result, our revenues for a particular quarter could be higher or lower than expectations due to the timing of the reporting of commission override revenue to us.

Certain commission amounts are subject to forfeiture in circumstances where a member has prepaid his or her premium for a future period of coverage and subsequently cancels his or her policy before the completion of that period. We estimate and record an allowance for these forfeitures based on historical cancellation experience using data provided on commission statements. The forfeitures are typically reported to us by health insurance carriers one to two months after the commission is reported and paid to us by the carrier. Our estimate of the allowance for forfeitures includes an estimate of both the reporting time lag and the forfeiture amount. Changes in our historical trends would result in changes to our estimated forfeitures in future periods. There were no changes in our average forfeiture rates or reporting time lag during the years ended December 31, 2004, 2005 and 2006, which had a material impact on our allowance for forfeitures. The allowance for forfeitures payable to carriers totaled \$268,000, \$236,000 and \$386,000 at December 31, 2004, 2005 and 2006, respectively.

In addition, we generate sponsorship revenue from carrier advertisements that appear on our website. We generally bill a fixed monthly amount for these advertisements and the related revenue is recognized over the period that the advertising is displayed. Sponsorship arrangements typically include incentive payments made to us based on performance criteria. In instances where the performance criteria are measured based on data that is tracked by us, revenue is recognized in the period of performance. In instances where the performance criteria is measured based on data that is tracked by the carrier, revenue is recognized when the amounts earned are both fixed and determinable and collection is reasonably assured. Typically, this occurs through our receipt of a cash payment from the carrier along with a detailed statement containing the data that is tracked by the carrier.

We also generate revenue from the licensing of our technology to third parties, such as carriers and agents. Typically, we are paid a one-time implementation fee, which we recognize on a straight-line basis over the initial term of the agreement, commencing once the technology is available for use by the third party. In addition, we typically generate revenue based on performance criteria that is either measured based on data that is tracked by us, or based on data that is tracked by the third party. In instances where the performance criteria data is tracked by us, we recognize revenue in the period of performance. In instances where the performance criteria data is tracked by the third party, we recognize revenue when the amounts earned are both fixed and determinable and collection is reasonably assured. Typically, this occurs through our receipt of a cash payment from the third party along with a detailed statement containing the data that is tracked by the third party.

We defer revenue amounts that have been reported to us related to transactions where our services are complete, but where we cannot currently estimate the allowance for future forfeitures related to those amounts, and we defer revenue amounts collected from sponsorship or technology licensing customers in advance of our

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performing our service for such customers. For example, at June 30, 2006, deferred revenue on our consolidated balance sheet included \$0.7 million related to a single health insurance carrier that, effective January 2005, changed its basis for calculating and reporting commission amounts from a percentage of the premium it collected to a percentage of the premium it billed. Since this was the first carrier to calculate and report commission amounts on this basis, we did not have sufficient historical forfeiture experience to estimate and record an appropriate allowance for forfeitures as commission amounts were reported to us by the carrier. Accordingly, all commission amounts reported to us by the carrier since the beginning of 2005 were deferred. During the third quarter ended September 30, 2006, we determined we had sufficient experience to estimate an allowance for forfeitures for this carrier, at which time all amounts previously deferred were recorded as revenue, net of an allowance for forfeitures.

### ***Internal-Use Software and Website Development Costs***

We account for internal-use software and website development costs in accordance with the guidance set forth in Statement of Position No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, and EITF Issue No. 00-2, *Accounting for Web Site Development Costs*. We capitalize costs of materials, consultants and compensation and related expenses of employees who devote time to the development of internal-use software; however, we expense as incurred all website development costs for new features and functionalities since it is not probable that they will result in additional functionality until they are both developed and tested with confirmation that they are more effective than the current set of features and functionalities on our website. Our judgment is required in determining the point at which various projects enter the states at which costs may be capitalized, in assessing the ongoing value of the capitalized costs and in determining the estimated useful lives over which the costs are amortized, which is generally three years. To the extent that we change the manner in which we develop and test new features and functionalities related to our website, assess the ongoing value of capitalized assets or determine the estimated useful lives over which the costs are amortized, the amount of website development costs we capitalize and amortize in future periods would be impacted. As of December 31, 2005, the net book value of capitalized internal-use software totaled \$90,000. At December 31, 2006, our capitalized internal-use software was fully depreciated and had a net book value of zero.

### ***Stock-Based Compensation***

Prior to the adoption of Statement of Financial Accounting Standards ( SFAS ) No. 123R, *Share-Based Payment* ( SFAS 123R ) on January 1, 2006, we accounted for stock option grants in accordance with Accounting Principles Board Opinion No. 25 ( APB 25 ), *Accounting for Stock Issued to Employees*, and complied with the disclosure provisions of Statement of Financial Accounting Standards ( SFAS ) No. 123, *Accounting for Stock Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock Based Compensation Transition and Disclosure*. Under APB 25, deferred stock-based compensation expense is recorded for the intrinsic value of options (the difference between the deemed fair value of our common stock and the option exercise price) at the grant date and is amortized ratably over the option's vesting period.

On January 1, 2006, we adopted the fair value recognition provisions of SFAS 123R, which requires us to measure the cost of employee services received in exchange for an award of equity instruments, based on the fair value of the award on the date of grant, and to recognize the cost over the period during which the employee is required to provide services in exchange for the award. We adopted SFAS 123R using the prospective method, which requires us to apply its provisions only to stock-based awards to employees granted on or after January 1, 2006, and to awards modified, repurchased or cancelled on or after January 1, 2006. In anticipation of the adoption of SFAS 123R, we did not modify the terms of any previously granted stock options or restricted stock awards.

During the year ended December 31, 2006, we recorded stock-based compensation expense totaling \$283,000 related to stock options, restricted stock awards and restricted stock units granted to employees and accounted for in accordance with the provisions of SFAS 123R. At December 31, 2006, total unrecognized stock-based compensation cost related to stock options, restricted stock awards and restricted stock units granted to employees under our stock plans and accounted for in accordance with SFAS 123R was approximately

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\$3.6 million, net of estimated forfeitures of \$383,000. This cost will be amortized on a straight-line basis over a weighted-average period of approximately 3.5 years and will be adjusted for subsequent changes in estimated forfeitures.

Stock-based compensation expense recognized during the year ended December 31, 2006 consisted of stock-based compensation related to stock option and restricted stock awards granted prior to January 1, 2006, which was calculated in accordance with APB 25, and stock-based compensation for all stock-based awards granted on or after January 1, 2006, based on the grant-date fair value estimated in accordance with SFAS 123R. The adoption of SFAS 123R will result in higher amounts of stock-based compensation expense in the future for awards granted after January 1, 2006 than would have been recorded if we had continued to apply the provisions of APB 25. The grant date fair value was determined using the Black-Scholes-Merton pricing model and a single option award approach. The weighted-average expected term for stock options granted was calculated using the simplified method in accordance with the provisions of Staff Accounting Bulletin No. 107, *Share-Based Payment*. The simplified method defines the expected term as the average of the contractual term and the vesting period of the stock option. We have estimated the volatility and forfeiture rates used as inputs to the model based on an analysis of our stock price since our IPO in October 2006, as well as an analysis of the most similar public companies for which we have data. We have used judgment in selecting these companies, as well as evaluating the available historical and implied volatility and forfeiture data for these companies. We will continue to use judgment in evaluating the expected term, volatility and forfeiture rate related to our own stock-based awards on a prospective basis, and incorporating these factors into the model.

The accounting for and disclosure of employee and non-employee equity instruments, primarily stock options, restricted common stock, restricted stock units and Class A nonvoting common stock, and preferred and common stock warrants, requires judgment by management on a number of assumptions. Changes in key assumptions will significantly impact the valuation of such instruments. Because there had been no public market for our stock prior to our initial public offering in October 2006, our board of directors determined the fair value of our common stock based upon internal valuation analyses prepared by management, which considered sales of our common stock to unrelated independent third parties. Beginning in the second quarter of 2005, our board of directors determined the fair value of our common stock using contemporaneous valuations by an unaffiliated valuation specialist, Financial Strategies Consulting Group, LLC. The contemporaneous valuations used the probability-weighted expected return method.

Determining the fair value of our common stock prior to our initial public offering required us to make complex and subjective judgments involving estimates of revenues, earnings, assumed market growth rates and estimated costs as well as appropriate probabilities of future events and discount rates. These estimates were consistent with the plans and estimates that we used to manage our business. There was inherent uncertainty in making these estimates.

The intrinsic value of outstanding vested and unvested stock options at December 31, 2006, was \$88.5 million based on the last reported price for our common stock on The NASDAQ Global Market on December 29, 2006. The intrinsic value of options outstanding does not impact the amount of stock-based compensation expense to be recorded in future periods. Future stock-based compensation expense is dependent upon the fair value of each option at the date each option is granted and the number of awards issued and outstanding during each period. We expect stock-based compensation expense will increase in the future as the number of equity awards issued and outstanding increases.

### ***Accounting for Income Taxes***

We account for income taxes using the liability method as required by SFAS No. 109 ( SFAS 109 ), *Accounting for Income Taxes*. Under SFAS 109, deferred income taxes are determined based on the differences between the financial reporting and tax bases of assets and liabilities, using enacted statutory tax rates in effect for the year in which the differences are expected to reverse.



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Since tax laws and financial accounting standards differ in their recognition and measurement of assets, liabilities, equity, revenues, expenses, gains and losses, differences arise between the amount of taxable income and pretax financial income for a year and between the tax bases of assets or liabilities and their reported amounts in our financial statements. Because we assume that the reported amounts of assets and liabilities will be recovered and settled, respectively, a difference between the tax basis of an asset or a liability and its reported amount in the balance sheet will result in a taxable or a deductible amount in some future years when the related liabilities are settled or the reported amounts of the assets are recovered, which gives rise to a deferred tax asset or liability. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery does not meet the more likely than not criteria, we must establish a valuation allowance.

Management judgment is required in determining any valuation allowance recorded against our net deferred tax assets. In the fourth quarter of 2006, we concluded, based upon recent operating results, expectations of future taxable income, available carryforward periods and other factors, that it is more likely than not that we will realize sufficient earnings to utilize a portion of our deferred tax assets. Accordingly, we reduced the valuation allowance against deferred tax assets and recorded a tax benefit of \$7.4 million in 2006. This benefit was partially offset by a provision for income taxes of \$261,000 for 2006 related to federal and state alternative minimum taxes currently payable due to limits on the amount of net operating losses that may be applied against income earned in 2006 under current tax regulations. To the extent we conclude that future taxable income and ongoing tax planning strategies warrant the release of all or a portion of the remaining valuation allowance, which totaled \$18.9 million as of December 31, 2006, an adjustment to the valuation allowance would result in significant income tax benefit in such period.

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes. This process involves estimating our actual current tax expense together with assessing temporary differences that may result in deferred tax assets. Our effective tax rates in 2004 and 2005 were substantially lower than the statutory federal rate primarily due to our utilization of net operating loss credit carryforwards, which totaled \$64.4 million for federal income tax purposes and \$33.3 million for state income tax purposes at December 31, 2006. Our effective tax rate in 2006 differed from the statutory federal tax rate primarily due to the partial release of our valuation allowance against deferred tax assets in 2006. We expect our effective tax rate will be more in line with statutory federal and state tax rates in 2007; however, due to the large amount of remaining net operating loss credit carryforwards, we expect to continue to pay federal and state taxes at the alternative minimum tax rate in 2007, which is approximately 3% on a cash basis. Future changes in various factors, such as the amount of stock-based compensation we record during the year, potential limitations on the use of our federal and state net operating loss credit carryforwards, pending or future tax law changes including rate changes and the tax benefit from research and development credits, changes in our valuation allowance and state and foreign taxes, would impact our estimates, and as a result, could affect our effective tax rate and the amount of income tax expense we record, and pay, in future periods.

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### Results of Operations

The following table sets forth our operating results and the related percentage of total revenues for the years ended December 31, 2004, 2005 and 2006 (dollars in thousands):

	Year Ended December 31,					
	2004		2005		2006	
Revenue:						
Commission	\$ 29,783	98.6%	\$ 41,237	98.8%	\$ 58,943	96.1%
Sponsorship, licensing and other	432	1.4	515	1.2	2,367	3.9
Total revenue	30,215	100.0	41,752	100.0	61,310	100.0
Operating costs and expenses:						
Cost of revenue-sharing	447	1.5	614	1.5	1,305	2.1
Marketing and advertising	12,732	42.1	17,786	42.6	21,405	34.9
Customer care and enrollment	7,577	25.1	8,822	21.1	10,991	18.0
Technology and content	7,461	24.7	8,054	19.3	10,137	16.5
General and administrative	5,385	17.8	7,108	17.0	9,482	15.5
Total operating costs and expenses	33,602	111.2	42,384	101.5	53,320	87.0
Income (loss) from operations	(3,387)	(11.2)	(632)	(1.5)	7,990	13.0
Other income, net	60	0.2	239	0.6	1,326	2.2
Income (loss) before income taxes	(3,327)	(11.0)	(393)	(0.9)	9,316	15.2
Provision (benefit) for income taxes			21	0.1	(7,161)	(11.7)
Net income (loss)	\$ (3,327)	(11.0)%	\$ (414)	(1.0)%	\$ 16,477	26.9%

Operating costs and expenses include the following amounts related to stock-based compensation (in thousands):

	Year Ended December 31,		
	2004	2005	2006
Marketing and advertising	\$ 59	\$ 97	\$ 47
Customer care and enrollment	7	6	42
Technology and content	14	62	226
General and administrative	19	26	139
Total	\$ 99	\$ 191	\$ 454

### Years Ended December 31, 2004, 2005 and 2006

#### Revenue

The following table presents our commission, sponsorship, licensing and other and total revenue for the years ended December 31, 2004, 2005 and 2006 and the dollar and percentage change from the prior year (dollars in thousands):

Change

Change

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	Year Ended December 31, 2004	\$	%	Year Ended December 31, 2005	\$	%	Year Ended December 31, 2006
Revenue:							
Commission	\$ 29,783	\$ 11,454	38%	\$ 41,237	\$ 17,706	43%	\$ 58,943
Sponsorship, licensing and other	432	83	19%	515	1,852	360%	2,367
Total revenue	\$ 30,215	\$ 11,537	38%	\$ 41,752	\$ 19,558	47%	\$ 61,310

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Total revenue increased \$19.6 million, or 47%, in 2006 compared to 2005, primarily due to an increase in commission revenue as a result of an increase in our membership. Our estimated membership increased approximately 42% to 393,900 at December 31, 2006 from 277,600 at December 31, 2005. Included in commission revenue for 2006 was \$0.5 million of commission revenue we recognized from certain small business members who were transferred to us by a partner with whom we share a percentage of the ongoing commissions we receive on these transferred policies. We expect these transfers to continue to occur into 2007, although at a slower rate than we have previously experienced. Commission revenue for 2006 also included the recognition of \$0.5 million of revenue related to commissions received from a single health insurance carrier during 2005, which were included in deferred revenue at December 31, 2005. Sponsorship, licensing and other revenue increased \$1.9 million in 2006 compared to 2005, primarily due to additional carrier sponsorships on our website and, to a lesser extent, new licensing arrangements related to our technology.

Total revenue increased \$11.5 million, or 38%, in 2005 compared to 2004, primarily due to an increase in commission revenue as a result of an increase in our membership. Our estimated membership increased approximately 31% to 277,600 at December 31, 2005 from 212,400 at December 31, 2004. Sponsorship, licensing and other revenue increased by \$83,000 in 2005 compared to 2004 primarily due to additional carrier sponsorships on our website.

The following table shows the estimated number of members as of the end of each period indicated:

	2004	2005	2006
March 31	173,000	228,400	305,300
June 30	185,300	241,200	328,100
September 30	200,900	258,300	363,000
December 31	212,400	277,600	393,900

All revenue for all periods presented was generated from customers located in the United States. Revenue under separate agreements with individual unaffiliated carriers in excess of 10% of total revenue was as follows:

	Years Ended		
	December 31,		
	2004	2005	2006
Golden Rule	17%	17%	16%
Blue Cross of California and Unicare	17%	15%	12%

We expect commission revenue to increase in absolute dollars as a result of growth in our membership base and our continued spending on our marketing initiatives. We expect sponsorship, licensing and other revenue to increase in absolute dollars and as a percentage of total revenue in the future as we pursue additional carrier sponsorship and technology licensing opportunities.

## Operating Costs and Expenses

### Cost of Revenue-Sharing

The following table presents our cost of revenue-sharing for the years ended December 31, 2004, 2005 and 2006 and the dollar and percentage change from the prior year (dollars in thousands):

	Year Ended December 31, 2004	Change \$ %	Year Ended December 31, 2005	Change \$ %	Year Ended December 31, 2006
Cost of revenue-sharing	\$ 447	\$ 167 37%	\$ 614	\$ 691 113%	\$ 1,305
Percentage of total revenue	1%		1%		2%



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Cost of revenue-sharing increased \$0.7 million, or 113%, in 2006 compared to 2005, primarily due to an increase in the number of health insurance policies sold to members who were referred to our website by marketing partners with whom we have revenue-sharing arrangements. Included in cost of revenue-sharing for 2006 was \$0.3 million of revenue-sharing expense related to commission revenue we recognized during the year associated with a partner who is in the process of transferring certain small business members to us and with whom we share a percentage of the ongoing commissions we receive on these transferred policies. We expect these transfers of small business members to continue into 2007, although at a slower rate than we have previously experienced. As a percentage of total revenue, cost of revenue-sharing increased to 2% in 2006 from 1% in 2005.

Cost of revenue-sharing increased \$0.2 million, or 37%, in 2005 compared to 2004, due to an increase in the number of health insurance policies sold to members who were referred to our website by marketing partners with whom we have revenue-sharing arrangements. As a percentage of total revenue, cost of revenue-sharing remained relatively stable at 1% in both 2005 and 2004.

### Marketing and Advertising

The following table presents our marketing and advertising expenses for the years ended December 31, 2004, 2005 and 2006 and the dollar and percentage change from the prior year (dollars in thousands):

	Year Ended December 31, 2004	Change \$ %	Year Ended December 31, 2005	Change \$ %	Year Ended December 31, 2006
Marketing and advertising	\$ 12,732	\$ 5,054 40%	\$ 17,786	\$ 3,619 20%	\$ 21,405
Percentage of total revenue	42%		43%		35%

Marketing and advertising expenses increased by \$3.6 million, or 20%, in 2006 compared to 2005. This was primarily due to a \$3.8 million increase in marketing partner channel expenses. Additionally, online advertising expenses increased \$0.8 million due to an increase in paid keyword search costs on Internet search engines, partially offset by a \$0.9 million decrease in publicity campaigns during 2006. The growth in our advertising channel expenses was primarily related to an increase in the number of applications submitted on our website from the marketing partner channel and an increase in the volume of click-throughs from the online advertising channel during 2006 compared to 2005. Our acquisition cost per member, which we define as total marketing and advertising expenses for a period divided by the number of members included on applications for individual and family product offerings submitted during the period, decreased 10% to \$46 in 2006 from \$51 in 2005, primarily due to the increased efficiencies in our online marketing programs. As a percentage of total revenue, total marketing and advertising expenses decreased to 35% in 2006 from 43% in 2005.

Marketing and advertising expenses increased by \$5.1 million, or 40%, in 2005 compared to 2004. This was primarily due to a \$4.7 million increase in advertising expense driven by significant growth in marketing partner channel expenses and, to a lesser extent, growth in expenses related to our online advertising channel. The growth in expenses from these channels was primarily related to the growth in the number of applications submitted on our website during 2005 compared to 2004, and, to a lesser extent, an increase in the average cost per submitted member. Additionally, we had a \$0.9 million increase in compensation and related expenses as a result of an increase in personnel and a \$0.5 million increase due to additional publicity and public relations campaigns during 2005. These increases were partially offset by a decrease of \$1.2 million in spending on certain offline advertising initiatives in 2005 as compared to 2004. Our acquisition cost per member increased 9% to \$51 in 2005 from \$47 in 2004. As a percentage of total revenue, marketing and advertising remained relatively stable at 43% and 42% in 2005 and 2004, respectively.

We expect the average cost of acquiring new members to fluctuate based upon several factors, including the mix of health insurance applications submitted through our three marketing channels, the mix of marketing partners referring consumers to our website, the overall trend in costs of online marketing including keywords

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purchased by us, seasonality patterns, the amounts we pay marketing partners to refer consumers to our website, fluctuations in the percentage of consumers referred to our website who submit health insurance applications and the level of personnel costs required to manage our marketing and advertising programs. Additionally, we may explore new marketing initiatives as part of our efforts to drive more consumers to our website. These initiatives may increase our acquisition cost per member if they do not result in a sufficient number of additional members to justify the expenditure.

**Customer Care and Enrollment**

The following table presents our customer care and enrollment expenses for the years ended December 31, 2004, 2005 and 2006 and dollar and percentage change from the prior year (dollars in thousands):

	Year Ended December 31, 2004		Change		Year Ended December 31, 2005		Change		Year Ended December 31, 2006
	\$		\$	%	\$		\$	%	\$
Customer care and enrollment	\$ 7,577		\$ 1,245	16%	\$ 8,822		\$ 2,169	25%	\$ 10,991
Percentage of total revenue	25%				21%				18%

Customer care and enrollment expenses increased by \$2.2 million, or 25%, in 2006 compared to 2005, primarily due to higher compensation and related expenses associated with the increased number of personnel necessary to service the increased volume of health insurance applications submitted through our website. As a percentage of total revenue, customer care and enrollment expenses decreased to 18% in 2006 from 21% in 2005 as a result of economies of scale achieved by our customer care and enrollment operations in 2006.

Customer care and enrollment expenses increased by \$1.2 million, or 16%, for the year ended December 31, 2005 compared to the year ended December 31, 2004. This was primarily due to higher compensation and related expenses associated with an increase in personnel necessary to service the increased volume of submitted applications through our website. As a percentage of total revenue, customer care and enrollment expenses decreased to 21% in 2005 from 25% in 2004 as a result of economies of scale achieved by our customer care and enrollment operations in 2005.

We expect customer care and enrollment expenses to increase in absolute dollars as we hire additional personnel to service the growth in health insurance applications submitted through our website.

**Technology and Content**

The following table presents our technology and content expenses for the years ended December 31, 2004, 2005 and 2006 and dollar and percentage change from the prior year (dollars in thousands):

	Year Ended December 31, 2004		Change		Year Ended December 31, 2005		Change		Year Ended December 31, 2006
	\$		\$	%	\$		\$	%	\$
Technology and content	\$ 7,461		\$ 593	8%	\$ 8,054		\$ 2,083	26%	\$ 10,137
Percentage of total revenue	25%				19%				17%

Technology and content expenses increased by \$2.1 million, or 26%, in 2006 compared to 2005. This increase was primarily due to a \$1.2 million increase in compensation and related expenses associated with an increase in the number of personnel necessary to develop and maintain our technology and website content. Additionally, technology and content expenses increased as a result of a \$0.3 million increase in facility-related expenses due to our new leased data center in San Jose, California and our new office lease in Xiamen, China, a \$0.2 million increase in stock-based compensation expenses as a result of our adoption of SFAS 123R in 2006 and a \$0.1 million increase in service obligation expenses due to an arrangement we entered into in November 2005 for a third-party to provide certain information services for our website. As a percentage of total revenue,

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technology and content costs decreased to 17% in 2006 from 19% in 2005 as a result of economies of scale achieved by our technology and content operations in 2006.

Technology and content expenses increased by \$0.6 million, or 8%, in 2005 compared to 2004, due primarily to higher compensation and related expenses associated with an increase in personnel. As a percentage of total revenue, technology and content expenses decreased to 19% in 2005 from 25% in 2004 as a result of economies of scale achieved in our technology and content operations in 2005.

We expect our technology and content expenses to increase in absolute dollars due to our increased focus on technology development, including the enhancement of our ecommerce platform.

***General and Administrative***

The following table presents our general and administrative expenses for the years ended December 31, 2004, 2005 and 2006 and dollar and percentage change from the prior year (dollars in thousands):

	Year Ended December 31, 2004	Change		Year Ended December 31, 2005	Change		Year Ended December 31, 2006
	\$	\$	%	\$	\$	%	\$
General and administrative	\$ 5,385	\$ 1,723	32%	\$ 7,108	\$ 2,374	33%	\$ 9,482
Percentage of total revenue	18%			17%			15%

General and administrative expenses increased by \$2.4 million, or 33%, in 2006 compared to 2005, primarily due to an increase in compensation and related expenses of \$1.3 million associated with increased personnel in our finance and legal departments. We also incurred additional costs associated with operating as a public company including an increase in accounting and audit service fees of \$0.4 million, an increase in directors and officers insurance costs of \$0.1 million and an increase in director fees of \$0.1 million. In addition, facility-related expenses increased \$0.2 million as a result of the increased general and administrative personnel and we incurred \$0.1 million of stock-based compensation expense in 2006 as a result of our adoption of SFAS 123R. As a percentage of total revenue, general and administrative expenses decreased to 15% in 2006 from 17% in 2005 as a result of our revenue growing at a higher rate than general and administrative expenses.

General and administrative expenses increased by \$1.7 million, or 32%, in 2005 compared to 2004. The largest portion of this increase, \$0.8 million, related to increased compensation and related expenses associated with an increase in personnel in our finance and legal departments. Expenses for outside professional services associated with our accounting, legal and internal information technology departments increased by \$0.7 million during 2005 due to growth in our operations and process improvements in preparation for future operation as a public company. As a percentage of our total revenue, general and administrative expenses remained relatively stable at 17% and 18% in 2005 and 2004, respectively.

We expect our general and administrative expenses to continue to increase in absolute dollars due to the increased costs associated with operating as a public company and the costs necessary to support the growth in our business.



**Table of Contents****Other Income, Net**

The following table presents our other income, net, for the years ended December 31, 2004, 2005 and 2006 and the dollar and percentage change from the prior year (dollars in thousands):

	Year Ended December 31, 2004	Change \$ %	Year Ended December 31, 2005	Change \$ %	Year Ended December 31, 2006
Other income, net	\$ 60	\$ 179 298%	\$ 239	\$ 1,087 455%	\$ 1,326
Percentage of total revenue	0%		1%		2%

Other income, net, primarily consists of interest income earned on cash and cash equivalent balances, offset by administrative bank fees and interest expense on our capital lease obligations. Other income, net, increased \$1.1 million, or 455%, in 2006 compared to 2005 and increased \$0.2 million, or 298%, in 2005 compared to 2004. These increases were primarily due to an increase in interest income as a result of an increase in our cash and cash equivalents. Cash and cash equivalents increased in 2006 from 2005 primarily as a result of the proceeds we received from our initial public offering in October 2006 and from cash generated from operations during 2006. Cash and cash equivalents increased in 2005 from 2004 primarily from cash generated from operations during 2005. Additionally, the average yield earned on our invested cash and cash equivalent balances increased during 2006 compared to 2005 and in 2005 compared to 2004.

We expect other income, net, to increase in absolute dollars in the future as a result of interest earned on the invested net proceeds received from our initial public offering in October 2006.

**Provision (Benefit) for Income Taxes**

The following table presents our provision (benefit) for income taxes for the year ended December 31, 2004, 2005 and 2006 and the dollar change from the prior year (dollars in thousands):

	Year Ended December 31, 2004	Change \$	Year Ended December 31, 2005	Change \$	Year Ended December 31, 2006
Provision (benefit) for income taxes	\$	\$ 21	\$ 21	\$ (7,182)	\$ (7,161)
Percentage of total revenue		%	0%		(12)%

In the fourth quarter of 2006, we concluded, based upon recent operating results, expectations of future taxable income, available carryforward periods and other factors, that it is more likely than not that we will realize sufficient earnings to utilize a portion of our deferred tax assets. Accordingly, we reduced the valuation allowance against deferred tax assets and recorded a tax benefit of \$7.4 million in 2006. This benefit was partially offset by a provision for income taxes of \$0.3 million for 2006 related to federal and state alternative minimum taxes currently payable due to limits on the amount of net operating losses that may be applied against income earned in 2006 under current tax regulations.

We recorded a provision for income taxes in 2005 attributable to federal alternative minimum taxes currently payable due to limits on the amount of net operating losses that may be applied against taxable income earned in 2005 under current tax regulations. In 2004, no provision for income taxes was recorded due to our net loss position.

Our future effective income tax rate will depend on various factors, such as the amount of stock-based compensation we record during the year, potential limitations on the use of our federal and state net operating loss credit carryforwards, pending or future tax law changes including rate changes and the tax benefit from research and development credits, changes in our valuation allowance and state and foreign taxes.

**Table of Contents****Liquidity and Capital Resources**

The following table presents a summary of our cash flows for the years ended December 31, 2004, 2005 and 2006 (in thousands):

	Years Ended December 31,		
	2004	2005	2006
Net cash provided by (used in):			
Operating activities	\$ (599)	\$ 2,617	\$ 11,412
Investing activities	5,447	(1,239)	(2,253)
Financing activities	215	(682)	71,713

Prior to our initial public offering we financed our operations primarily through private sales of equity and internally generated funds. At December 31, 2006, our cash and cash equivalents totaled \$90.3 million. Cash equivalents are comprised primarily of highly liquid financial instruments with an original maturity of three months or less from the date of purchase.

We completed an initial public offering in October 2006 in which we issued and sold 5,750,000 shares of our common stock, including 750,000 shares sold by us pursuant to the underwriters' full exercise of their over-allotment option, at an issuance price to the public of \$14.00 per share. As a result of our initial public offering, we raised a total of \$80.5 million in gross proceeds, or approximately \$70.2 million in net proceeds after deducting underwriting discounts and commissions of \$5.7 million and offering expenses of \$4.6 million. Upon the closing of our initial public offering, all outstanding shares of our convertible preferred stock and Class A nonvoting common stock automatically converted into shares of our common stock.

**Operating Activities**

Cash provided by operating activities primarily consists of net income (loss), adjusted for certain non-cash items including deferred income taxes, depreciation and amortization, stock-based compensation and the effect of changes in working capital and other activities. Our operating activities generated cash of \$11.4 million during the year ended December 31, 2006, primarily due to \$16.5 million of net income, \$1.5 million in non-cash depreciation and amortization expenses, \$0.5 million in non-cash stock-based compensation expense, a \$0.7 million increase in other current liabilities, a \$0.7 million increase in accrued compensation and benefits, a \$0.6 million increase in accrued marketing expenses and a \$0.2 million increase in accounts payable. These items were partially offset by a \$7.4 million benefit from the recognition of deferred income tax assets, a \$1.0 million increase in prepaid expenses and other current assets, a \$0.6 million increase in accounts receivable and a \$0.5 million decrease in deferred revenue.

Our operating activities generated cash of \$2.6 million during the year ended December 31, 2005, primarily due to \$1.1 million of non-cash depreciation and amortization expenses, \$0.2 million of non-cash stock-based compensation expense, \$0.2 million of deferred rent expense, a \$0.6 million increase in accrued compensation and benefits, a \$0.5 million increase in deferred revenue, primarily related to a single health insurance carrier whose commission revenue we deferred during 2005 due to our inability to estimate an allowance for forfeitures and \$0.2 million increases in both accounts payable and other current liabilities. These items were partially offset by a net loss of \$0.4 million.

Our operating activities used cash of \$0.6 million during the year ended December 31, 2004 due to a net loss of \$3.3 million, partially offset by \$1.5 million of non-cash depreciation and amortization expenses, a \$0.5 million increase in accrued compensation and benefits, a \$0.4 million increase in accrued marketing expenses, a \$0.3 million increase in accounts payable and a \$0.2 million decrease in prepaid expenses and other current assets.

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The timing of the recognition of our commission revenue depends upon the timing of our receipt of commission reports and associated commission payments from health insurance carriers. If we were to experience a delay in receiving a commission payment from a health insurance carrier at the end of a quarter, our operating cash flows for that quarter could be negatively impacted. Additionally, commission override payments are reported to us in a more irregular pattern than premium commissions. For example, a carrier may make a commission override payment to us on an annual basis, which would positively impact our cash flows in the quarter the payment is received. The majority of our annual commission override payments are typically received during the first quarter of the year.

Historically, we have experienced a reduction in operating cash flows during the first quarter of the year due to the payment of annual performance bonuses to employees. In addition, a significant portion of our marketing and advertising expenses are driven by the number of health insurance applications submitted on our ecommerce platform. Since our marketing and advertising costs are expensed as incurred and the revenue from approved applications is recognized as commissions are subsequently reported to us, our operating cash flows could be negatively impacted by a substantial increase in the volume of applications submitted during a quarter or positively impacted by a substantial decline in the volume of applications submitted during a quarter.

### ***Investing Activities***

Our investing activities primarily consist of capital expenditures for property and equipment associated with computer hardware and software to enhance our website and to support our growth and sales of short-term investments. Short-term investments generally consist of highly liquid securities that we intend to hold for more than three months, but less than one year. These investments are carried at fair value with unrealized gains and losses, net of taxes, reported as a component of stockholders' equity.

Cash used in investing activities of \$1.2 million and \$2.3 million during the years ended December 31, 2005 and 2006, respectively, were primarily attributable to capital expenditures. Cash provided by investing activities of \$5.4 million in 2004 was primarily attributable to the sale of short-term investments totaling \$7.0 million, partially offset by \$1.6 million in capital expenditures. We expect capital expenditures to increase in 2007 compared to 2006.

### ***Financing Activities***

Cash provided by financing activities of \$71.7 million during the year ended December 31, 2006 was primarily due to \$74.8 million in proceeds received from our initial public offering, plus \$0.5 million of net proceeds received from the issuance of common stock pursuant to stock option exercises, partially offset by \$3.3 million of costs incurred in connection with our initial public offering and \$0.2 million in principal payments on capital leases. Cash used in financing activities of \$0.7 million during the year ended December 31, 2005 was primarily due to \$1.0 million of costs incurred in connection with our initial public offering, less proceeds received from the issuance of common stock pursuant to stock option exercises of \$0.4 million. Cash provided by financing activities of \$0.2 million during the year ended December 31, 2004 was primarily attributable to proceeds received from the issuance of common stock pursuant to stock option exercises.

### ***Future Needs***

We believe that cash generated from operations and our current cash, cash equivalents and investments will be sufficient to fund our operations for at least the next 12 months. Our future capital requirements will depend on many factors, including our level of investment in technology and advertising initiatives. Although we are currently not a party to any agreement or letter of intent with respect to investments in, or acquisitions of, complementary businesses, products or technologies, we may enter into these types of arrangements in the future, which could also require us to seek additional equity or debt financing. Aside from capital lease obligations, we currently do not have any bank debt, line of credit facilities or other borrowing arrangements. To the extent that

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available funds are insufficient to fund our future activities, we may need to raise additional capital through public or private equity or debt financing.

**Contractual Obligations and Commitments**

The following table presents a summary of our future minimum payments under non-cancellable operating lease agreements and certain contractual obligations and commitments as of December 31, 2006 (in thousands):

Years Ending December 31,	Operating Lease Obligations	Capital Lease Obligations	Service and Licensing Obligations	Total Obligations
2007	\$ 1,814	\$ 229	\$ 290	\$ 2,333
2008	1,868		325	2,193
2009	1,478		250	1,728
2010	403			403
2011	30			30
Thereafter				
Total	\$ 5,593	\$ 229	\$ 865	\$ 6,687

**Operating Lease Obligations**

In August 2004, we entered into a lease agreement for our headquarters building in Mountain View, California. This facility is leased under a non-cancellable lease that expires in 2009, with a renewal option at fair market value for an additional five-year period. In December 2004, we moved our customer care center from Folsom, California to Gold River, California and entered into a non-cancellable sixty-five month lease which expires in 2010. In December 2005, we leased additional space in the same facility in Gold River, California under a separate fifty-four month lease which expires in 2010. We entered into a non-cancellable office lease for our subsidiary in China which commenced in April 2006 and is for a term of one year and automatically renews for one-year periods, up to a total term of five years. During June 2006, we also entered into a non-cancellable lease for our data center in San Jose, California. The lease, which commenced in August 2006, is for a term of three years. In September 2006, we entered into a non-cancellable office lease for an additional facility in Mountain View, California. The lease commenced in December 2006 and is for a term of three years. We also lease other facilities in the United States under non-cancellable operating leases that range in terms up to one year. Certain of these leases have free or escalating rent payment provisions. We recognize rent expense on our operating leases on a straight-line basis over the terms of the leases. In addition, we lease equipment under operating leases that range in terms from three to five years, the latest of which expires in August 2009.

**Capital Lease Obligations**

As of December 31, 2006, we had a capital lease obligation for office equipment, which expires in December 2007, and a second capital lease obligation, which expires in July 2007, for computer equipment related to our data center.

**Service and Licensing Obligations**

In November 2005, we entered into an agreement with a third-party service provider to provide certain information services for our website. We record the related service expenses on a straight-line basis although actual cash payment obligations under this agreement escalate over the term of the agreement.

In June 2006, we entered into a three-year software licensing agreement that requires us to make annual licensing payments of \$115,000.

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**Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements, investments in special purpose entities or undisclosed borrowings or debt. Additionally, we are not a party to any derivative contracts or synthetic leases.

**Recent Accounting Pronouncements**

See Note 1 of *Notes to Consolidated Financial Statements* for recent accounting pronouncements that could have an effect on us.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

***Interest Rate Sensitivity***

As of December 31, 2006, we had cash and cash equivalents of \$90.3 million, which consisted primarily of highly liquid money market instruments with original maturities of three months or less. Because of the short-term nature of these instruments, a sudden change in market interest rates would not be expected to have a material impact on our financial condition or results of operations.

The primary objective of our investment activities is to preserve principal while maximizing income without significantly increasing risk. Some of the securities in which we invest may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. To minimize this risk, we intend to maintain our portfolio of cash equivalents and short-term investments in a variety of securities, including commercial paper, money market funds, debt securities and certificates of deposit. We do not use financial instruments for trading or other speculative purposes, nor do we use leveraged financial instruments. If overall interest rates had fallen by 10% in 2006, our interest income would have declined approximately \$139,000, assuming consistent investment levels.

***Foreign Currency Exchange Risk***

To date, all of our revenue has been derived from transactions denominated in United States Dollars. We have exposure to adverse changes in exchange rates associated with operating expenses of our foreign operations, which are denominated in Chinese Renminbi, but we believe this exposure to be limited. We have not engaged in any foreign currency hedging or other derivative transactions to date.

***Credit Risk***

Our financial instruments that are exposed to concentrations of credit risk principally consist of cash, cash equivalents, investments and accounts receivable. We deposit our cash, cash equivalents and investments in accounts with major banks and financial institutions and, at times such investments may be in excess of federally insured limits. We do not require collateral or other security for our accounts receivable. As of December 31, 2006, five customers each represented 10% or more of our total accounts receivable and, in aggregate, represented 65%, or \$468,000, of our total accounts receivable. We do not anticipate any collection issues with any of these customers.

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**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

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<u>Consolidated Statements of Operations and Comprehensive Income (Loss)</u>	66
<u>Consolidated Statements of Convertible Preferred Stock and Stockholders' Equity (Deficit)</u>	67
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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders

eHealth, Inc.

We have audited the accompanying consolidated balance sheets of eHealth, Inc. as of December 31, 2005 and 2006, and the related consolidated statements of operations and comprehensive income (loss), convertible preferred stock and stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of eHealth, Inc. at December 31, 2005 and 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the Consolidated Financial Statements, under the heading Stock-Based Compensation, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, effective January 1, 2006.

/s/ Ernst & Young LLP

Palo Alto, California

March 2, 2007

**Table of Contents****EHEALTH, INC.****CONSOLIDATED BALANCE SHEETS**

(In thousands, except share and per share information)

	December 31, 2005	December 31, 2006
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 9,415	\$ 90,316
Short-term investments		158
Accounts receivable	128	717
Deferred income taxes		2,257
Prepaid expenses and other current assets	908	1,926
Total current assets	10,451	95,374
Restricted investments	153	
Property and equipment, net	2,761	3,936
Deferred initial public offering costs	1,391	
Deferred income taxes		5,165
Other assets	409	453
Total assets	\$ 15,165	\$ 104,928
<b>Liabilities, convertible preferred stock and stockholders' equity (deficit)</b>		
Current liabilities:		
Accounts payable	\$ 1,077	\$ 1,440
Accrued compensation and benefits	3,009	3,743
Accrued marketing expenses	1,027	1,647
Deferred revenue	523	62
Other current liabilities	1,179	1,979
Total current liabilities	6,815	8,871
Other non-current liabilities	212	317
Commitments and contingencies (see <i>Note 8</i> )		
Convertible preferred stock; \$0.001 par value; 23,100,000 shares authorized at December 31, 2005, issuable in series. All convertible preferred shares were converted into shares of common stock (see <i>Note 3</i> )		
Series A; 5,200,000 shares authorized and 2,549,454 shares issued and outstanding at December 31, 2005 (aggregate liquidation preference of \$11,947); no shares authorized, issued or outstanding at December 31, 2006	11,947	
Series B; 4,900,000 shares authorized and 2,122,845 shares issued and outstanding at December 31, 2005 (aggregate liquidation preference of \$42,160); no shares authorized, issued or outstanding December 31, 2006	42,160	
Series C; 13,000,000 shares authorized and 5,615,812 shares issued and outstanding at December 31, 2005 (aggregate liquidation preference of \$32,201); no shares authorized, issued or outstanding December 31, 2006	32,212	
Stockholders' equity (deficit):		
Preferred stock; \$0.001 par value; 10,000,000 shares authorized; no shares issued or outstanding at December 31, 2006		
Common stock; \$0.001 par value; 40,000,000 and 100,000,000 shares authorized at December 31, 2005 and 2006, respectively; 4,788,878 and 21,748,932 shares issued and outstanding at December 31, 2005 and 2006, respectively.	5	22
Class A nonvoting common stock; \$0.001 par value; 1,600,000 shares authorized and 257,050 shares issued and outstanding at December 31, 2005; no shares authorized, issued or outstanding December 31, 2006		
Additional paid-in capital	1,983	159,576
Deferred stock-based compensation	(62)	(254)
Accumulated deficit	(80,132)	(63,655)
Accumulated other comprehensive income	25	51
Total stockholders' equity (deficit)	(78,181)	95,740



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Total liabilities, convertible preferred stock and stockholders' equity (deficit)	\$ 15,165	\$ 104,928
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*The accompanying notes are an integral part of these consolidated financial statements.*

**Table of Contents****EHEALTH, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)****(In thousands, except per share amounts)**

	<b>Years Ended December 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Revenue:</b>			
Commission	\$ 29,783	\$ 41,237	\$ 58,943
Sponsorship, licensing and other	432	515	2,367
<b>Total revenue</b>	<b>30,215</b>	<b>41,752</b>	<b>61,310</b>
<b>Operating costs and expenses:</b>			
Cost of revenue-sharing	447	614	1,305
Marketing and advertising (*)	12,732	17,786	21,405
Customer care and enrollment (*)	7,577	8,822	10,991
Technology and content (*)	7,461	8,054	10,137
General and administrative (*)	5,385	7,108	9,482
<b>Total operating costs and expenses</b>	<b>33,602</b>	<b>42,384</b>	<b>53,320</b>
<b>Income (loss) from operations</b>	<b>(3,387)</b>	<b>(632)</b>	<b>7,990</b>
Other income, net	60	239	1,326
<b>Income (loss) before income taxes</b>	<b>(3,327)</b>	<b>(393)</b>	<b>9,316</b>
Provision (benefit) for income taxes		21	(7,161)
<b>Net income (loss)</b>	<b>\$ (3,327)</b>	<b>\$ (414)</b>	<b>\$ 16,477</b>
<b>Comprehensive income (loss):</b>			
Net income (loss)	\$ (3,327)	\$ (414)	\$ 16,477
Foreign currency translation adjustment		25	26
<b>Total comprehensive income (loss)</b>	<b>\$ (3,327)</b>	<b>\$ (389)</b>	<b>\$ 16,503</b>
<b>Net income (loss) per share:</b>			
Basic common stock	\$ (0.74)	\$ (0.09)	\$ 1.91
Basic Class A nonvoting common stock		\$ (0.09)	\$ 1.91
Diluted common stock	\$ (0.74)	\$ (0.09)	\$ 0.80
Diluted Class A nonvoting common stock		\$ (0.09)	\$ 0.80
<b>Net income (loss):</b>			
Allocated to common stock	\$ (3,327)	\$ (414)	\$ 16,391
Allocated to Class A nonvoting common stock			86
<b>Net income (loss)</b>	<b>\$ (3,327)</b>	<b>\$ (414)</b>	<b>\$ 16,477</b>
<b>Weighted-average number of shares used in per share amounts:</b>			
Basic common stock	4,473	4,661	8,590
Basic Class A nonvoting common stock		3	45
Diluted common stock	4,473	4,661	20,572
Diluted Class A nonvoting common stock		3	45

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(\*) Includes stock-based compensation as follows:

Marketing and advertising	\$	59	\$	97	\$	47
Customer care and enrollment		7		6		42
Technology and content		14		62		226
General and administrative		19		26		139
Total	\$	99	\$	191	\$	454

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

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## EHEALTH, INC.

## CONSOLIDATED STATEMENTS OF CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY (DEFICIT)

(In thousands)

	Convertible Preferred Stock						Common Stock		Class A Nonvoting Common Stock		Deferred Stock-Based Compensation		Accumulated Other Comprehensive Income	Total Stockholders' Equity (Deficit)
	Series A	Series B	Series C	Series A	Series B	Series C	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Accumulated Deficit		
Balance at December 31, 2003	2,549	\$ 11,947	2,123	\$ 42,196	5,616	\$ 32,279	4,389	\$ 4			\$ 1,034	\$ (99)	\$ (76,391)	\$ (75,452)
Issuance of common stock in connection with exercise of common stock options							193	1			231			232
Cancellation of unvested restricted common stock awards in connection with termination of employees							(1)							
Deferred stock-based compensation related to restricted common stock awards to employees, net of reversals for terminated employees											45	(45)		
Amortization of deferred stock-based compensation												40		40
Stock-based compensation related to change in terms of common stock options granted to employees											25			25
											18			18

Stock-based compensation related to non-employees													
Stock-based compensation related to Series B convertible preferred stock and common stock warrants issued in connection with marketing alliances				15					1				1
Expiration of Series C convertible preferred stock warrants					(67)				67				67
Net loss										(3,327)			(3,327)
Balance at December 31, 2004	2,549	11,947	2,123	42,211	5,616	32,212	4,581	5	1,421	(104)	(79,718)		(78,396)

Table of Contents**EHEALTH, INC.****CONSOLIDATED STATEMENTS OF CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS EQUITY (DEFICIT)**  
(Continued)

(In thousands)

	Convertible Preferred Stock				Class A Nonvoting Common Stock				Deferred Stock-Based Compensation		Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders Equity (Deficit)
	Series A	Series B	Series C	Common Stock	Series A	Series B	Series C	Common Stock	Additional Paid-in Capital	Deferred Stock-Based Compensation	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders Equity (Deficit)
Issuance of common stock in connection with exercise of common stock options				208					362				362
Issuance of Class A nonvoting restricted common stock awards to employees, net of reversals for terminated employees								257					
Stock-based compensation related to Class A nonvoting restricted stock awards									49				49
Stock-based compensation related to change in terms of common stock options granted to employees									83				83
Amortization of deferred stock-based compensation										42			42
Stock-based compensation related to non-employees									3				3
Stock-based compensation related to Series		13							1				1

B convertible preferred stock and common stock warrants issued in connection with marketing alliances														
Expiration of Series B convertible preferred stock warrants														
Foreign currency translation adjustment														
Net loss														
Balance at December 31, 2005	2,549	11,947	2,123	42,160	5,616	32,212	4,789	5	257	1,983	(62)	(80,132)	25	(78,181)

**Table of Contents****EHEALTH, INC.****CONSOLIDATED STATEMENTS OF CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS EQUITY (DEFICIT)**  
**(Continued)****(In thousands)**

	Convertible Preferred Stock				Class A Nonvoting Common Stock				Deferred Stock-Based Compensation	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders Equity (Deficit)
	Series A	Series B	Series C	Common Stock	Common Stock	Common Stock	Common Stock	Additional Paid-in Capital				
Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Capital	sation	Deficit	Income	holders Equity (Deficit)
Issuance of common stock in connection with exercise of common stock options					218			476				476
Issuance of Class A nonvoting restricted common stock awards to employees, net of reversals for terminated employees							36					
Stock-based compensation related to employees								283				283
Stock-based compensation related to Class A nonvoting restricted stock awards								108				108
Deferred stock-based compensation related to Class A nonvoting restricted common stock awards granted to employees and accounted for in								255	(255)			



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**Table of Contents****EHEALTH, INC.****CONSOLIDATED STATEMENTS OF CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY (DEFICIT)**  
**(Continued)****(In thousands)**

	Convertible Preferred Stock						Common Stock		Class A Nonvoting Common Stock		Deferred Stock-		Accum-		Total Stock-
	Series A		Series B		Series C						Based	Accumu-	Other		
	Shares	Amount	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Compen-	lated Deficit	Compre-	holders Equity (Deficit)				
Proceeds from initial public offering					5,750	6			70,163						70,169
Foreign currency translation adjustment														26	26
Net income													16,477		16,477
Balance at December 31, 2006	\$		\$		\$	21,749	\$ 22		\$	\$ 159,576	\$ (254)	\$ (63,655)	\$ 51	\$ 95,740	

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

**Table of Contents****EHEALTH, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)**

	<b>Years Ended December 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Operating activities</b>			
Net income (loss)	\$ (3,327)	\$ (414)	\$ 16,477
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Deferred income taxes			(7,422)
Depreciation and amortization	1,484	1,136	1,526
Stock-based compensation expense	99	191	454
Deferred rent	29	168	122
(Gain) loss on disposal of property and equipment	(29)	17	
Changes in operating assets and liabilities:			
Accounts receivable	(1)	(96)	(589)
Prepaid expenses and other current assets	182	15	(954)
Other assets	(270)	13	(44)
Accounts payable	259	163	209
Accrued compensation and benefits	471	649	740
Accrued marketing expenses	367	104	620
Deferred revenue	(8)	520	(461)
Other current liabilities	145	151	734
Net cash provided by (used in) operating activities	(599)	2,617	11,412
<b>Investing activities</b>			
Purchases of property and equipment	(1,582)	(1,337)	(2,248)
Changes in restricted cash		101	
Changes in restricted investments	(2)	(3)	(5)
Sales of short-term investments	7,002		
Net proceeds from the sale of property and equipment	29		
Net cash provided by (used in) investing activities	5,447	(1,239)	(2,253)
<b>Financing activities</b>			
Proceeds from initial public offering			74,752
Costs incurred in connection with initial public offering		(1,022)	(3,309)
Net proceeds from exercise of common stock options	232	362	476
Principal payments in connection with capital leases	(17)	(22)	(206)
Net cash provided by (used in) financing activities	215	(682)	71,713
Effect of exchange rate changes on cash and cash equivalents		12	29
Net increase in cash and cash equivalents	5,063	708	80,901
Cash and cash equivalents at beginning of period	3,644	8,707	9,415
Cash and cash equivalents at end of period	\$ 8,707	\$ 9,415	\$ 90,316
<b>Supplemental disclosure of non-cash activities</b>			
Capital lease obligations incurred	\$ 28	\$	\$ 406
Deferred stock-based compensation expense related to granting of restricted stock awards and stock options to employees	\$ 45	\$	\$ 255

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Conversion of preferred stock into common stock	\$	\$	\$ 86,319
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## Supplemental disclosure of cash flows

Cash paid for interest	\$	5	\$	17	\$	30
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Cash paid for income taxes	\$	\$	\$	30
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*The accompanying notes are an integral part of these consolidated financial statements.*

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**EHEALTH, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Fiscal years ended December 31, 2004, 2005 and 2006**

**Note 1 Summary of Business and Significant Accounting Policies**

**Description of Business** eHealth, Inc. and subsidiaries ( the Company, we or us ), offer Internet-based insurance agency services for individuals, families and small businesses in the United States. Our services enable individuals, families and small businesses to research, analyze, compare and purchase health insurance products from health insurance carriers across the nation. We are licensed to market and sell health insurance in all 50 states and the District of Columbia.

**Fiscal Year** eHealth's fiscal year ends on December 31.

**Initial Public Offering** In October 2006, we completed an initial public offering ( IPO ) of our common stock in which we issued and sold 5,750,000 shares of our common stock, including 750,000 shares sold by us pursuant to the underwriters' full exercise of their over-allotment option, at an issuance price of \$14.00 per share. As a result of our IPO, we raised a total of \$80.5 million in gross proceeds, or approximately \$70.2 million in net proceeds after deducting underwriting discounts and commissions of \$5.7 million and offering expenses of \$4.6 million. Upon the closing of our IPO, all outstanding shares of our previously outstanding convertible preferred stock and Class A nonvoting common stock automatically converted into 10,955,744 and 36,603 shares of common stock, respectively. The consolidated financial statements for the year ended December 31, 2006, including share and per share amounts, include the effects of the offering.

**Reverse Stock Split** We effected a 1-for-2 reverse stock split of our outstanding common stock, convertible preferred stock and Class A nonvoting common stock on September 25, 2006. All share and per share amounts contained in the consolidated financial statements have been retroactively adjusted to reflect the reverse stock split.

**Principles of Consolidation** The consolidated financial statements include the accounts of eHealth, Inc. and our wholly-owned subsidiaries, eHealthInsurance Services, Inc., eHealth China, Inc. and eHealth China (Xiamen) Technology Co., Ltd. All intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ( U.S. GAAP ).

**Segments** We operate in one business segment. See Note 9 for additional information regarding our business segment.

**Use of Estimates** The preparation of consolidated financial statements and related disclosures in conformity with U.S. GAAP requires management to make estimates, judgments and assumptions that affect the amounts reported and disclosed in the consolidated financial statements and accompanying notes. On an ongoing basis, we evaluate our estimates, including those related to, but not limited to, the useful lives of long-lived assets including property and equipment, fair value of investments, fair value of intangible assets, allowances for commission forfeitures payable to carriers, income taxes, and, prior to our IPO in October 2006, the value of our common stock for the purpose of determining stock-based compensation. We base our estimates of the carrying value of certain assets and liabilities on historical experience and on various other assumptions that we believe to be reasonable. Actual results may differ from these estimates.

**Cash Equivalents** We consider all highly liquid investments with an original maturity of three months or less from the date of purchase to be cash equivalents. Cash and cash equivalents, which primarily consist of cash on deposit with banks and money market funds, are stated at cost, which approximates fair value.

**Table of Contents****EHEALTH, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Fiscal years ended December 31, 2004, 2005 and 2006**

**Short-term Investments** We have classified our short-term investments as available-for-sale. Short-term investments generally consist of highly liquid securities that we intend to hold for more than three months, but less than one year. These investments are carried at fair value with unrealized gains and losses, net of taxes, reported as a component of stockholders' equity (deficit) in the accompanying consolidated balance sheets. Realized gains and losses and declines in value that are determined to be other-than-temporary on available-for-sale securities are included in other income, net, in the accompanying consolidated statements of operations and comprehensive income (loss) and are derived using the specific identification method for determining the cost of securities. As of December 31, 2006, our short-term investments comprised two certificates of deposits that will mature in April and October 2007. See *Restricted Investments* below and *Note 2* for additional information regarding these certificates of deposit.

The Company invests in accordance with a policy that seeks to maximize returns while ensuring both liquidity and minimal risk of principal loss. The policy limits investments to certain types of instruments issued by institutions with investment-grade credit ratings and places restrictions on maturities and concentration by type and issue.

**Restricted Investments** Restricted investments consisted of two certificates of deposit, and the interest receivable thereon, securing letters of credit, which acted as collateral for certain of our operating leases. The letters of credit, which totaled \$138,000 at December 31, 2005, were surrendered by the beneficiary during 2006, and accordingly, these certificates of deposit were classified as short-term investments at December 31, 2006.

**Prepaid Expenses and Other Current Assets** Prepaid expenses and other current assets consists of prepaid insurance, interest receivable on invested cash and other prepaid expenses and non-trade receivables.

**Property and Equipment** Property and equipment are stated at cost, less accumulated depreciation and amortization. Capital lease amortization expenses are included in depreciation expense in our consolidated statements of operations and comprehensive income (loss). Depreciation is computed using the straight-line method based on estimated useful lives as follows:

Computer equipment and software	3 to 5 years
Office equipment and furniture	5 years
Leasehold improvements	Lesser of useful life (typically 5 to 7 years) or related lease term

Maintenance and minor replacements are expensed as incurred.

See *Note 2* for additional information regarding our property and equipment.

**Deferred Initial Public Offering Costs** Deferred IPO costs totaled \$1.4 million at December 31, 2005 and consisted of capitalized expenses that were specific incremental costs associated with our IPO. Upon completion of our IPO in October 2006, these costs, which totaled approximately \$4.6 million, were offset against the gross proceeds received from our IPO.

**Other Assets** Other assets consist of security deposits related to capital and operating leases, as well as intangible assets.

**Intangible Assets** In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, intangible assets determined to have an indefinite useful life are not

**Table of Contents****EHEALTH, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Fiscal years ended December 31, 2004, 2005 and 2006**

amortized, but are tested for impairment, at least annually or more frequently if indicators of impairment arise. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets. Intangible assets, which totaled \$245,000 and \$248,000 at December 31, 2005 and 2006, respectively, were deemed to have an indefinite useful life and are included in other assets in the accompanying consolidated balance sheets. No intangible assets were deemed impaired during the three-year period ended December 31, 2006.

**Long-Lived Assets** In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, we evaluate other long-lived assets for impairment on a periodic basis or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. No long-lived assets were deemed impaired during the three-year period ended December 31, 2006.

**Fair Value of Financial Instruments** The carrying amounts of our financial instruments, including cash and cash equivalents, investments, accounts receivable, accounts payable and accrued liabilities (including accrued compensation and benefits, accrued marketing expenses and other current liabilities), approximate fair value because of their short maturities. The carrying amounts of our capital leases approximate the fair value of these obligations based upon our best estimates of interest rates that would be available for similar debt obligations at December 31, 2005 and 2006.

**Concentration of Credit Risk and Significant Customers** Our financial instruments that are exposed to concentrations of credit risk principally consist of cash, cash equivalents, investments and accounts receivable. We deposit our cash, cash equivalents and investments in accounts with major banks and financial institutions and, at times, such investments may be in excess of federally insured limits. We do not require collateral or other security for our accounts receivable. As of December 31, 2006, five customers each represented 10% or more of our total accounts receivable and, in aggregate, represented 65%, or \$468,000, of our total accounts receivable. We do not anticipate any collection issues with any of these customers.

Revenue for all periods presented was generated from customers located solely in the United States. Revenue under separate agreements with individual unaffiliated carriers in excess of 10% of total revenue was as follows:

	Year Ended December 31,		
	2004	2005	2006
Golden Rule	17%	17%	16%
Blue Cross of California and Unicare	17%	15%	12%

**Revenue Recognition** We recognize revenue for our services using the criteria set forth in Staff Accounting Bulletin ( SAB ) No. 104 ( SAB 104 ), *Revenue Recognition*. SAB 104 states that revenue is recognized when each of the following four criteria is met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the seller's price to the buyer is fixed or determinable; and collectibility is reasonably assured.

Our revenue is primarily comprised of compensation paid to us by health insurance carriers related to insurance policies that have been purchased by a member who used our service. We define a member as an individual currently covered by an insurance product for which we are entitled to receive compensation. Our compensation generally represents a percentage of the premium amount collected by the carrier during the period

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**EHEALTH, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Fiscal years ended December 31, 2004, 2005 and 2006**

that a member maintains coverage under a policy (commissions) and, to a lesser extent, override commissions that health insurance carriers pay us for achieving certain objectives. Premium-based commissions are reported to us after the premiums are collected by the carrier, generally on a monthly basis. We determine that there is persuasive evidence of an arrangement when we have a commission agreement with a health insurance carrier and a carrier reports to us that it has approved an application submitted through our ecommerce platform. Our services are complete when a carrier has approved an application. Commissions are deemed fixed or determinable and collectibility is reasonably assured when commission amounts have been reported to us by a carrier. We recognize commission override revenue when reported to us by a carrier based on the actual attainment of predetermined target sales levels or other objectives as determined by the carrier.

We recognize commission revenue when our commission is reported to us by a health insurance carrier, net of an allowance for future forfeiture amounts payable to carriers due to policy cancellations. Commissions are reported to us by a cash payment and commission statement. We generally receive these communications simultaneously. In instances when we receive the cash payment and commission statement separately and in different accounting periods, we recognize revenue in the period that we receive the earliest communication, provided we receive the second communication corroborating the amount reported in the first communication within ten business days. If the second corroborating communication is not received within ten business days, we recognize revenue in the period the second communication is received. We use the data in the commission statement to identify the members for which we are receiving a commission payment and the amount received for each member, and to estimate our allowance for forfeitures.

Certain commission amounts are subject to forfeiture in circumstances where a member has prepaid his or her premium for a future period of coverage and subsequently cancels his or her policy before the completion of that period. We record an allowance for these forfeitures based on historical cancellation experience using data provided on commission statements. The allowance for forfeitures payable to carriers totaled \$236,000 and \$386,000 at December 31, 2005 and 2006, respectively, and is included in other current liabilities in the accompanying consolidated balance sheets.

We also evaluate the criteria outlined in Emerging Issues Task Force ( EITF ) Issue No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent*, in determining whether it is appropriate to record the gross amount of the insurance premiums from our transactions or the net amount earned as commissions. We are not obligated with respect to the insurance coverage sold through our ecommerce platform. As a result, we recognize the net amount of compensation earned as the agent in the transaction.

In addition, we generate sponsorship revenue from carrier advertisements that appear on our website. Sponsorships are generally billed at a fixed monthly amount and revenue is recognized over the period that advertising is displayed. Certain sponsorship arrangements also include incentive payments due to us based on performance criteria. In instances where the performance criteria is measured based on data that is tracked by us, revenue is recognized in the period of performance. In instances where the performance criteria is measured based on data that is tracked by the carrier, revenue is recognized when the amounts earned are both fixed and determinable and collection is reasonably assured. Typically, this occurs through our receipt of a cash payment from the carrier along with a detailed statement containing the data that is tracked by the carrier.

We also generate revenue from the licensing of our technology to third parties, such as carriers and agents. Typically, we are paid a one-time implementation fee, which we recognize on a straight-line basis over the initial term of the agreement, commencing once the technology is available for use by the third party. In addition, these license agreements generally include performance criteria that is either measured based on data that is tracked by



**Table of Contents****EHEALTH, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Fiscal years ended December 31, 2004, 2005 and 2006**

us or based on data that is tracked by the third party. In instances where the performance criteria data is tracked by us, we recognize revenue in the period of performance. In instances where the performance criteria data is tracked by the third party, we recognize revenue when the amounts earned are both fixed and determinable and collection is reasonably assured. Typically, this occurs through our receipt of a cash payment from the third party along with a detailed statement containing the data that is tracked by the third party.

**Deferred Revenue** Deferred revenue consists of amounts that have been reported to us related to transactions where our services are complete, but where we cannot currently estimate the allowance for future forfeitures related to those amounts, or amounts collected from sponsorship or technology licensing customers in advance of our performing our service for such customers. Deferred revenue at December 31, 2005 and 2006 was \$523,000 and \$62,000, respectively.

Included in deferred revenue at December 31, 2005 was \$473,000 of commission reported and paid to us by a carrier that, effective January 2005, changed its basis for calculating and reporting commission amounts from a percentage of the premium it collected to a percentage of the premium it billed. Since this was the first carrier to calculate and report commission amounts on this basis, we initially did not have sufficient historical forfeiture experience to estimate and record an appropriate allowance for forfeitures as commission amounts were reported to us by the carrier. Accordingly, we deferred all commission amounts reported to us by the carrier in 2005. During 2006 we determined that we had sufficient experience to estimate an allowance for forfeitures for this health insurance carrier and, accordingly, all amounts previously deferred for this carrier were recognized as commission revenue during 2006.

**Cost of Revenue-Sharing** Cost of revenue-sharing consists primarily of payments related to health insurance policies sold to members who were referred to our website by marketing partners with whom we have revenue-sharing arrangements. In accordance with EITF No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer (including a Reseller of the Vendor's Products)*, costs related to revenue-sharing arrangements are expensed at the time the related revenue is recognized. Included in cost of revenue-sharing for 2006 was \$268,000 of revenue-sharing expense related to commission revenue we recognized during the year associated with a partner who is in the process of transferring certain small business members to us and with whom we share a percentage of the ongoing commissions we receive on these transferred policies.

**Marketing and Advertising** Marketing and advertising expenses consist primarily of member acquisition expenses associated with our direct, marketing partner and online advertising channels, in addition to compensation, benefits and other expenses related to marketing, business development, public relations and carrier relations personnel who support our offerings. We report the cost of advertising as expense in the period in which costs are incurred.

Our direct channel expenses primarily consist of offline marketing and associated costs. We generally compensate our marketing partners by paying a one-time fee each time a consumer referral from a partner results in a submitted health insurance application on our ecommerce platform, regardless of whether the consumer's application is approved by the health insurance carrier. We recognize these expenditures in the period when a marketing partner's referral results in the submission of a health insurance application on our website. Paid keyword search advertising on search engines represents the majority of expenses in our online advertising channel. We incur expenses associated with search engine advertising in the period in which the consumer clicks on the advertisement.

**Table of Contents****EHEALTH, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Fiscal years ended December 31, 2004, 2005 and 2006**

Advertising costs incurred have been classified as follows (in thousands):

	Year Ended December 31,		
	2004	2005	2006
Contra-commission revenue	\$ 28	\$ 22	\$ 18
Cost of revenue-sharing	383	557	1,286
Marketing and advertising expense	9,340	12,859	16,880
Total advertising costs	\$ 9,751	\$ 13,438	\$ 18,184

Costs associated with revenue-sharing of commissions with a health insurance carrier have been offset against commission revenue in the accompanying consolidated statements of operations and comprehensive income (loss), while costs associated with revenue-sharing of commissions with partners have been included in cost of revenue-sharing.

**Customer Care and Enrollment** Customer care and enrollment expenses consist of compensation and related expenses for personnel engaged in pre-sales assistance to applicants who call our customer care center and enrollment personnel who assist applicants during the underwriting process.

**Technology and Content** Technology and content expenses consist primarily of compensation and related expenses for personnel associated with developing and enhancing our website technology as well as maintaining our website.

**Research and Development** Research and development expenses consist primarily of compensation and related expenses incurred for enhancements to the functionality of our websites. In accordance with EITF Issue No. 00-2, *Accounting for Web Site Development Costs*, we expense as incurred all website development costs for new features and functionalities since it is not probable that they will result in additional functionality until they are both developed and tested with confirmation that they are more effective than the current set of features and functionalities on our website. Research and development costs, which totaled \$3.3 million, \$3.2 million and \$3.7 million for the years ended December 31, 2004, 2005 and 2006, respectively, are included in technology and content expense in the accompanying consolidated statements of operations and comprehensive income (loss).

**Software Developed for Internal Use** In accordance with Statement of Position ( SOP ) No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, and EITF Issue No. 00-2, *Accounting for Web Site Development Costs*, we capitalize costs of materials, consultants and compensation and related expenses of employees who devote time to the development of internal-use software during the application development stage. We expense costs incurred for preliminary project assessment, research and development, re-engineering, training and application maintenance activities. As of December 31, 2005, the net book value of capitalized internal-use software totaled \$90,000. At December 31, 2006, our capitalized internal-use software was fully depreciated and had a net book value of zero. We recorded \$121,000, \$121,000 and \$90,000 of depreciation expense related to capitalized internal-use software for the years ended December 31, 2004, 2005 and 2006, respectively.

**Stock-Based Compensation** Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123R, *Share-Based Payment* ( SFAS 123R ), which requires us to measure the cost of employee services received in exchange for an award of equity instruments, based on the fair value of the award on the date of grant, and to recognize the cost over the period during which the employee is required to provide services in



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**EHEALTH, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Fiscal years ended December 31, 2004, 2005 and 2006**

exchange for the award. Prior to the adoption of SFAS 123R, we accounted for stock option grants in accordance with Accounting Principles Board Opinion No. 25 ( APB 25 ), *Accounting for Stock Issued to Employees*, and complied with the disclosure provisions of SFAS No. 123, *Accounting for Stock Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock Based Compensation Transition and Disclosure*. Under APB 25, deferred stock-based compensation expense is recorded for the intrinsic value of options (the difference between the deemed fair value of our common stock and the option exercise price) at the grant date and is amortized ratably over the option s vesting period. See *Note 4* for information regarding stock-based compensation and the financial impact of adopting SFAS 123R.

We account for equity instruments issued to non-employees in accordance with SFAS 123, EITF Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring or in Conjunction with Selling, Goods or Services*, and the Financial Accounting Standards Board ( FASB ) Interpretation No. 44 ( FIN 44 ), *Accounting for Certain Transactions Involving Stock Compensation*, which is an interpretation of APB 25. All transactions in which equity instruments are issued in consideration for the receipt of goods or services are accounted for based on the fair value of the consideration received or the fair value of the equity instrument issued, whichever is more reliably measurable. The measurement date of the fair value of the equity instrument issued is the earlier of the date on which the counterparty s performance is complete or the date on which it is probable that performance will occur.

**Income Taxes** We account for income taxes using the liability method as required by SFAS No. 109 ( SFAS 109 ), *Accounting for Income Taxes*. Under SFAS 109, deferred income taxes are determined based on the differences between the financial reporting and tax bases of assets and liabilities, using enacted statutory tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

**Foreign Currency Translation** The functional currency of our only foreign subsidiary is its local currency. The financial statements of our foreign subsidiary are translated into U.S. Dollars using month-end rates of exchange for assets and liabilities, and average rates of exchange for revenues, costs and expenses. Translation adjustments are reflected in accumulated other comprehensive income in the accompanying consolidated balance sheets, while gains and losses resulting from foreign currency transactions are included in other income, net in the accompanying consolidated statements of operations and comprehensive income (loss). We did not recognize any material gains or losses resulting from foreign currency transactions during the years ended December 31, 2004, 2005 or 2006.

**Comprehensive Income (Loss)** In accordance with the SFAS No. 130, *Reporting Comprehensive Income*, all components of comprehensive income (loss), including net income (loss), are reported in our consolidated financial statements in the period in which they are recognized. Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources (primarily foreign currency translation gains and losses). Our only element of other comprehensive income is attributable to foreign currency translation adjustments with our wholly-owned subsidiary in China. Statements of comprehensive income (loss) have been included within the accompanying consolidated statements of operations and comprehensive income (loss). Accumulated other comprehensive income was \$25,000 and \$51,000 at December 31, 2005 and 2006, respectively.

**Net Income (Loss) Per Share** We calculate net income (loss) per share in accordance with SFAS No. 128, *Earnings Per Share* ( SFAS 128 ). Under SFAS 128, basic net income (loss) per share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding for the period (excluding

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**EHEALTH, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Fiscal years ended December 31, 2004, 2005 and 2006**

shares subject to repurchase). Diluted net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted-average number of common and common equivalent shares outstanding during the

period. Potentially dilutive securities, composed of incremental common shares issuable upon the exercise of stock options and warrants and the conversion of convertible preferred stock and Class A nonvoting common stock, are included in diluted net income per share to the extent such shares are dilutive. Diluted net income (loss) per share was the same as basic net income (loss) per share for the years ended December 31, 2004 and 2005, since the effect of any potentially dilutive securities was anti-dilutive.

**Recent Accounting Pronouncement** In September 2006, the FASB issued SFAS No. 157 ( SFAS 157 ), *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in U.S. GAAP, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. The measurement and disclosure requirements are effective for us beginning January 1, 2008. We are currently assessing whether adoption of SFAS 157 will have a material impact on our financial statements.

In September 2006, the Securities and Exchange Commission ( SEC ) issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* ( SAB 108 ). SAB 108 provides interpretive guidance on how to evaluate the materiality of uncorrected misstatement in the current year financial statements using both an income statement approach (the rollover approach) and a balance sheet approach (the iron curtain approach). The rollover approach quantifies a misstatement based on the amount of the error originating in the current year income statement while the iron curtain approach quantifies a misstatement based on the effects of correcting the cumulative misstatement existing in the balance sheet at the end of the current year. SAB 108 is effective for periods beginning after November 15, 2006. We do not expect the adoption of SAB 108 to have a material effect on our financial position or results of operations.

In July 2006, the FASB issued Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109. It prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosures. We adopted FIN 48 on January 1, 2007. We are currently evaluating the impact of FIN 48, but do not expect it to have a material effect on our consolidated financial position, results of operations, or cash flows.

**Table of Contents****EHEALTH, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Fiscal years ended December 31, 2004, 2005 and 2006****Note 2 Balance Sheet Accounts*****Cash, Cash Equivalents and Investments***

Cash, cash equivalents and investments consisted of the following (in thousands):

	<b>As of December 31,</b>	
	<b>2005</b>	<b>2006</b>
Cash and cash equivalents:		
Cash	\$ 1,582	\$ 3,050
Money market funds	7,833	87,266
Total cash and cash equivalents	\$ 9,415	\$ 90,316
Short-term investments:		
Certificates of deposit	\$	\$ 158
Restricted investments:		
Certificates of deposit	\$ 153	\$

At December 31, 2005 and December 31, 2006, our cash and cash equivalents consisted primarily of cash and money market funds, which are highly liquid in nature. Since the duration of these securities is short, the risk of fluctuations in market interest rates and yields is not significant.

Our restricted investments consisted of two certificates of deposit and the interest receivable thereon securing letters of credit, which acted as collateral for certain of our operating leases. The letters of credit were surrendered by the beneficiary during 2006, and accordingly, these certificates of deposit were classified as short-term investments at December 31, 2006.

We did not experience any significant realized gains or losses on our investments in the periods presented. Gross unrealized gains and losses at December 31, 2005 and 2006 were not material.

***Prepaid Expenses and Other Current Assets***

Prepaid expenses and other current assets consisted of the following (in thousands):

	<b>As of December 31,</b>	
	<b>2005</b>	<b>2006</b>
Prepaid insurance	\$ 153	\$ 540
Interest receivable	27	396
Other prepaid expenses and current assets	728	990
Prepaid expenses and other current assets	\$ 908	\$ 1,926



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

	<b>As of December 31,</b>	
	<b>2005</b>	<b>2006</b>
Computer equipment and software	\$ 5,103	\$ 7,177
Office equipment and furniture	407	703
Leasehold improvements	273	479
	5,783	8,359
Less accumulated depreciation and amortization	(3,022)	(4,423)
Property and equipment, net	\$ 2,761	\$ 3,936

Depreciation expense, which includes depreciation expense related to assets under capital lease, for the years ended December 31, 2004, 2005 and 2006 amounted to \$1.5 million, \$1.1 million and \$1.5 million, respectively.

In connection with the planned move of our data center operations from Redwood City, California to San Jose, California, which was completed in February 2007, we re-evaluated the estimated useful lives of equipment and software currently in service at the Redwood City location and determined that we needed to reduce the estimated useful lives of certain of these assets, resulting in our recognizing an additional \$274,000 of depreciation expense during the year ended December 31, 2006.

During the years ended December 31, 2004, 2005 and 2006, we wrote-off \$2.2 million, \$0.8 million and \$119,000 of fully-depreciated assets, which were no longer in use. Write-offs by category were as follows (in thousands):

	<b>Year Ended December 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Computer equipment and software	\$ 889	\$ 800	\$ 62
Office equipment and furniture	833	23	
Leasehold improvements	443		57
Property and equipment, net	\$ 2,165	\$ 823	\$ 119

Assets under capital leases were included in the consolidated balance sheets as follows (in thousands):

	<b>As of December 31,</b>	
	<b>2005</b>	<b>2006</b>
Office equipment and furniture	\$ 28	\$ 416
Less accumulated depreciation	(9)	(31)



\$ 19	\$ 385
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Other current liabilities consisted of the following (in thousands):

	As of December 31,	
	2005	2006
Professional fees	\$ 731	\$ 659
Payable to carriers	246	386
Income taxes payable	21	248
Capital lease obligation - current portion	7	221
Other accrued expenses	174	465
Other current liabilities	\$ 1,179	\$ 1,979

**Note 3 Preferred Stock and Preferred Stock Warrants****Convertible Preferred Stock**

All shares of convertible preferred stock were converted into 10,955,744 shares of common stock upon the completion of our IPO in October 2006.

**Classification** Prior to our IPO, our certificate of incorporation provided that a change in control was deemed to be a liquidation event and that any consideration paid in connection with such a transaction be distributed in accordance with the provisions regarding liquidation preferences. As a result, a cash redemption of our convertible preferred stock could have been triggered by a change in control, which was outside our control. Thus, in accordance with EITF Topic D-98, *Classification and Measurement of Redeemable Securities*, all series of our convertible preferred stock were classified outside of permanent equity in the accompanying consolidated balance sheets.

**Preferred Stock**

After the completion of our initial public offering and the filing of our amended and restated certificate of incorporation, the board of directors has the authority, without any further action by our stockholders, to issue up to 110,000,000 shares, par value \$0.001 per share, of which 10,000,000 shares are designated as preferred stock. The board of directors has the authority to issue preferred stock in one or more series and to fix the number of shares, designations, preferences, powers, and rights and the qualification, limitations or restrictions thereof. The preferences, powers, rights and restrictions of different series of preferred stock may differ with respect to dividend rates, amounts payable on liquidation, voting rights, conversion rights, redemption provisions, sinking fund provisions and other matters. The issuance of preferred stock could decrease the amount of earnings and assets available for distribution to holders of common stock or adversely affect the rights and powers, including voting rights, of the holders of common stock, and may have the effect of delaying, deferring or preventing a change in control of our company. At December 31, 2006, no shares of preferred stock were outstanding.

**Preferred Stock Warrants**