STAMPS.COM INC
Form 10-K
March 16, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ý 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 ________

Commission file number 000-26427

Stamps.com Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**77-0454966**
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)

12959 Coral Tree Place
Los Angeles, California 90066

(Address of principal executive office)

(310) 482-5800

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act:
Title of each class
Common Stock, $.001 par value

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

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

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 ý 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 ý Non-accelerated Filer ¨

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

As of June 30, 2006, the approximate aggregate market value of voting common stock held by non-affiliates of the Registrant was $658,057,201 (based upon the closing price for shares of the Registrant s Common Stock as reported by The Nasdaq National Market System on that date). As of February 28, 2007, there were approximately 21,868,552 shares of the Registrant s Common Stock issued and outstanding.

Documents Incorporated By Reference

Portions of the Registrant s Proxy Statement for the Annual Meeting of Stockholders currently expected to be held on June 6, 2007, to be filed with the Securities and Exchange Commission, are incorporated by reference in Part II and Part III of this Form 10-K.

STAMPS.COM INC.

FORM 10-K ANNUAL REPORT FOR THE YEAR ENDED DECEMBER 31, 2006

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PART I.

This Annual Report on Form 10-K, including information incorporated herein by reference, 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 relate to expectations concerning matters that are not historical facts. Words such as projects, believes, anticipates, estimates, plans, expects, intends, and similar words and expressions are intended to identify forward-looking statements. We cannot assure you that the expectations of future events will prove to be correct. Some of the factors that could cause actual results to differ materially from those expectations are disclosed in this document including, without limitation, in the Risk Factors section of this report. All forward-looking statements attributable to Stamps.com are expressly qualified in their entirety by this cautionary statement and you should not place undue reliance on any forward-looking statement. Stamps.com does not undertake any obligation to update any forward-looking statements. You are also urged to carefully review and consider the various disclosures we have made which describe factors which affect our business, including the Risk Factors . Stamps.com registration filings pursuant to the Securities Exchange Act of 1934 are available via the company website at www.stamps.com.

Stamps.com, NetStamps, Stamps.com Internet Postage, PhotoStamps, Hidden Postage and the Stamps.com logo are our trademarks. This Report also includes trademarks of entities other than Stamps.com.

Item 1. Business

Overview

Stamps.com® is the leading provider of Internet-based postage solutions. Customers use our service to mail and ship a variety of mail pieces including postcards, envelopes, flats and packages, using a wide range of USPS mail classes including First Class Mail®, Priority Mail®, Express Mail®, Media Mail®, Parcel Post®, and others. Our customers include home businesses, small businesses, corporations and individuals. Stamps.com was the first ever USPS-licensed vendor to offer PC Postage® in a software-only business model in 1999. On August 10, 2004, we publicly launched a market test of PhotoStamps®, a new form of postage that allows consumers to turn digital photos, designs or images into valid U.S. postage. Throughout this document and in general when we refer to the PC Postage business, we mean excluding the PhotoStamps business.

Stamps.com Inc. (the Company or Stamps.com) was founded in September 1996 to investigate the feasibility of entering into the U.S. Postal Service s Information-Based Indicia Program and to initiate the certification process for our PC Postage service. In January 1998, we were incorporated in Delaware as StampMaster, Inc. and we changed our name to Stamps.com Inc. in December 1998. We completed our initial public offering in June 1999. Our common stock is listed on the Nasdaq stock market under the symbol STMP.

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

Mission and Business Strategy

Stamps.com was founded with the mission to allow anyone to print valid U.S. postage using just a personal computer, an ordinary printer, and an internet connection. In August 1999, Stamps.com became the first company approved under the U.S. Postal Service s PC Postage program utilizing a software-only business model. As of the fourth quarter of 2006, we provided our PC Postage service to approximately 319,000 paying customers that include small businesses, large businesses, home offices, and consumers.

Our 2007 strategy for the PC Postage business includes at least six major initiatives. First in our 2007 PC Postage strategy, we plan to increase our investments in all of our existing profitable marketing channels wherever we can. In particular, we continue to refine our understanding of our return-on-investment from the direct mail channel, and based on the most recent returns we plan to increase our investment in the direct mail channel by 50% or more during 2007. This may cause some depression to 2007 earnings, but we believe that is a good long term investment that we expect will pay dividends for several years to come. We also plan to continue increasing and refining our customer acquisitions through online advertising, affiliates, partners, telemarketing and other areas. For the online enhanced promotion channel, we continue to see attractive returns, and we plan to continue to run this channel until we no longer find the returns to be attractive; however, based on recent trends, we currently expect to see overall acquisition in this area decline in 2007 versus 2006.

Second, we plan to continue working on developing new acquisition channels. While we are happy with the performance of our existing marketing channels, we are constantly looking to expand our portfolio of acquisition strategies that we employ. As a result, we will be testing several new channels throughout the year, focusing on identifying new channels that can bring in customers at a low cost per acquisition relative to the lifetime value of the customer. We use the phrase lifetime value to mean the total gross profits earned by customers for the duration that they are with our service. We are also focused on finding channels that allow us to increase the spend rate while maintaining reasonable per customer economics.

Third, we will continue our focus on optimizing our conversion rate from prospect to customer. The optimizations of our website and registration process pay dividends across all of our marketing programs. We added some new tools in the fourth quarter of 2006 to help us optimize these areas, and those tools have already shown some initial improvement to conversion rates. We plan to continue working on this area in 2007.

Fourth, we are going to focus on improving our overall customer experience. Over the past five years we have made dramatic strides in improving our product, and the majority of those improvements could be categorized as new features that broaden our product s usefulness in more areas and in more ways. We believe that the new features added over the past few years have resulted in clear increased lifetime values for our customers acquired in 2006 versus those acquired a few years ago. During 2007 we plan to invest less in feature expansion and more on improving our overall product usability and overall customer experience. To accomplish this, we will focus on the initial experience a customer has with our product, and we will also explore building more usable interfaces for accessing the power of our product on an ongoing basis.

Fifth, we plan to launch and market a multi-user capability in our service. This new capability will allow multiple users to access a single account balance. The majority of our small business customers today have fewer than 10 employees, and the fact that we haven t had this capability historically has limited our ability to successfully attract larger businesses. We also find that not having multi-user capability limits our ability to grow with our customers as we typically will lose a small business after they grow to a certain size. The largest technical hurdle to providing multi-user capability which held us back for several years was finally solved and the new technology was successfully launched in 2006. We are now finishing the customer interfaces for this multi user capability. Once we are able to launch the multi-user capability, we will market it both to our existing customer base as well as to new prospects. Additionally, we expect to charge more than our base pricing of $15.99 per month for a multi-user capable service so that may increase our overall customers lifetime value as well.

Sixth, we will continue increasing our efforts around the enterprise area. We feel that we were successful in attracting a good number of enterprise users to our service in 2006 at a low cost per acquisition relative to the lifetime value of the enterprise customers. Enterprise customers continued to be attracted to us versus using a postage meter based on our dramatically lower total cost of ownership and the great visibility into employee activity that isn t available with a postage meter. We plan to increase our sales and marketing efforts throughout the year so long as the cost per acquisition continues to remain attractive relative to the projected lifetime value of the enterprise customers.

At a high level, we estimate that the ratio between lifetime value of a PhotoStamps customer and the cost per new customer acquisition is reasonably good, but it is not as good as we experience in our PC Postage business. A lower ratio between lifetime value and customer acquisition costs results in a business model that moves into profitability more slowly and that is what we have experienced so far. Our sales and marketing expenses directly related to PhotoStamps exceeded our gross profits in the fourth quarter of 2006 and for fiscal 2006 as a whole. Our 2007 strategy for our PhotoStamps business is to increase the ratio of lifetime value to cost per acquisition while continuing to grow our marketing budget at a reasonable rate. We plan to accomplish this in at least three major ways.

First in our 2007 PhotoStamps strategy, we plan to work on increasing the lifetime value of a PhotoStamps customer. We plan to test the pricing and business model of the PhotoStamps product and work to optimize it to achieve higher overall lifetime values. We also plan to intensify our efforts to increase repeat traffic and word of mouth referrals.

Additionally, we plan to continue adding licensed products like the products we added in 2006 of NFL®, collegiate, and NASCAR® images as those types of products provide us with a great cross sell and re-marketing opportunities. We will also look at additional ways to monetize our PhotoStamps traffic more effectively.

Second, we will expand our customer acquisition programs while keeping our cost per acquisition low. We will continue to run our traditional PhotoStamps marketing programs while testing new programs. We will also continue to pursue partnerships like our existing partnerships with Apple, CafePress, Google (Picassa), Hewlett-Packard (Snapfish), Adobe and others. These partnerships provide a cost effective way to manage acquisition costs through a revenue share or bounty arrangement that aligns the interests of the partnership.

Third, we will continue to focus on growing our high volume business orders. During 2006 we developed a sales channel for high volume PhotoStamps business orders that took orders for approximately $1 million in fiscal 2006 revenue. However, we believe the lack of pre-sort discount rates continues to be a barrier to acceptance of the product to businesses. We are continuing to work on convincing the USPS that it makes sense to add pre-sort rates to our PhotoStamps capabilities. We expect to continue to increase our efforts in the business area of PhotoStamps in 2007, especially if the USPS authorizes some type of discounted rate.

Services and Products

We offer or have offered the following products and services to our customers:

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PC Postage Service. Our U.S. Postal Service-approved PC Postage service enables users to print information-based indicia, or electronic stamps, directly onto envelopes, plain paper, or labels using ordinary laser or inkjet printers. Our service currently supports USPS classes including First-Class Mail®, Priority Mail®, Express Mail®, Parcel Post®, Media Mail®, Bound Printed Matter, and international mail. Customers can also add USPS Special Services such as Delivery Confirmation™, Signature Confirmation™, Registered Mail, Certified Mail, Insured Mail, Return Receipt, Collect on Delivery ("COD") and Restricted Delivery to their mail pieces. Our service requires only a standard PC, printer and Internet connection. Our free software can be downloaded from the Internet or installed from a CD-ROM. After installing the software and completing the registration process, customers can purchase and print postage 24 hours a day, seven days a week. When a customer purchases postage for use through our service, the customer pays face value, and the funds are transferred directly from the customer s account to the U.S. Postal Service s account. The majority of new customers currently signing up for our service pay a monthly convenience fee of $15.99. Our current customer mix includes monthly convenience fees ranging from $4.49 to $24.99 or more based on individual pricing and promotions.

Stamps.com offers its customers three primary ways to print PC Postage. First, our NetStamps® feature and Photo NetStamps® feature enables customers to print postage for any value and most classes of mail on NetStamps or Photo NetStamps labels. After they are printed, NetStamps and Photo NetStamps can be used just like regular stamps. Second, our shipping feature tab allows customers to print postage for packages on plain 8.5 x 11 paper or on special labels, and to add electronic Delivery or Signature Confirmation at discounted prices. Third, our mailing feature tab is typically used to print the postage and address directly on envelopes or on other types of mail or labels, in a single-step process that saves time and provides a professional look. Our PC Postage services also incorporate address verification technology that verifies each destination address for mail sent using our service against a database of all known addresses in the U.S. In addition, our PC Postage services have been designed to integrate into common small business and productivity software applications such as word processing, contact and address management, and accounting and financial applications.

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PhotoStamps®. On May 17, 2006, we publicly launched our third market test of PhotoStamps, a patented form of postage that allows consumers to turn digital photos, designs or images into valid U.S. postage. With this product, people can now create customized U.S. postage using pictures of their children, pets, vacations, celebrations and more. PhotoStamps is used as regular postage to send letters, postcards or packages. The product is available via our separately-marketed website at www.photostamps.com. Customers upload a digital photograph or image file, customize the look and feel by choosing a border color to complement the photo, select the value of postage, and place the order online. Each sheet includes 20 individual PhotoStamps, and orders arrive via U.S. Mail in a few business days.

Since the beginning of the second market test on May 17, 2005, PhotoStamps has been prominently featured in the national media. For example, in its December 19, 2005 issue, BusinessWeek named PhotoStamps one of the best products of 2005. From May 2005 to December 2006, we shipped more than 1.5 million sheets, or more than 30 million individual PhotoStamps.

PhotoStamps is currently available under authorization of the USPS for its third phase market test, with an initial authorization for one year through May 16, 2007 and an option for the USPS to extend the test for a second year.

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Mailing & Shipping Supplies Store. With the launch of NetStamps in July 2002, we began selling NetStamps labels directly to our customers via our Supplies Store (previously also referred to as our Online Store) which is available to our customers from within our PC Postage software. Our Supplies Store has since expanded to sell themed NetStamps labels, shipping labels, other mailing labels, dedicated postage printers, OEM and private label inkjet and laser toner cartridges, scales, and other mailing and shipping-focused office supplies.

In September 2006 we launched a brand new Mailing & Shipping Supplies Store within version 6.0 of the PC Postage client software. This new store features a totally overhauled and reorganized store catalog, same day shipping capabilities, strong messaging of our free or discounted shipping promotions, strong cross sell during checkout, SKU search capabilities, and new expedited and rush shipping options. We plan to continue to increase the breadth of products offered in our Supplies Store, in order to enhance our customer convenience.

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

Customer Value Proposition for our PC Postage Service

We believe that customers use our PC Postage service to save time and money. Our service saves customers time in at least three ways: (1) our service allows a customer to apply postage to letters or packages at home or at the office, avoiding the time that would ordinarily be spent in a trip to the post office; (2) our service has the ability to generate mass mailings quickly and easily, in a single step process; and (3) our service saves customers time because of its ability to integrate seamlessly with most small business productivity applications such as word processors, financial applications and address books.

Our service also saves customers money in at least five ways: (1) our service automatically cleanses all addresses so postage is not wasted on undeliverable-as-addressed mail; (2) our service helps customers avoid wasted postage by calculating the exact amount of postage that is needed depending on mail class, mail form, weight and distance to the destination; (3) our service provides the ability to track and control postage expenditures in a small office using cost codes built into our software; (4) customers using our service to ship packages with electronic Delivery or Signature Confirmation save approximately 50 cents per package versus comparable services at a retail USPS post office; and (5) our service fee of $15.99/month is up to 75% less than the total cost of an entry-level postage meter, where users typically pay monthly rental fees, maintenance fees, postage purchase surcharges, cleaning fees, and fees for proprietary ink cartridges.

Customers also cite several other additional benefits in using our service, including at least five additional items: (1) mail produced with our service is more professional looking than stamped mail and it helps a small business look more like a big business; (2) our service provides the ability to send U.S. Postal Service packages with Hidden Postage™, which hides the actual amount paid for postage (a useful feature for e-commerce companies that may not want the recipient to see actual shipping cost information); (3) our software can help a business reduce its customer support costs by automatically generating and sending package delivery status e-mails to its customers; (4) our software can be incorporated into an existing workflow process for a small business as it integrates into most popular address books and is tightly integrated with Microsoft® Office® 2003 and later versions; and (5) our service provides a complete record of all mail or packages sent so that a business can easily keep a complete record of all mail it has sent.

Marketing of PC Postage

Our PC Postage marketing has traditionally been targeted primarily at small businesses and home offices. We have marketed, and plan to continue marketing, our PC Postage service in several ways, including the following channels:

- *Partnerships.* We work with strategic partners in order to leverage their web site traffic, marketing programs, and existing customer base to distribute our PC Postage software. For example, these partnerships may provide a link to our website from a partner s website, may provide a copy of our software along with a partner s software product, may distribute our software at a retail location, or may bundle our software with a hardware device. An example of this type of relationship is our partnership with Microsoft where our software is available for download from the Office Update section of Microsoft s website. Other examples include Peachtree® and EarthLink.

- *Traditional Online Advertising.* We work with companies to advertise our service in a number of ways across the Internet including paid search, banner ads, permission-based emails, and other online advertising vehicles.

- *Enhanced Promotion Online Advertising.* We work with various companies to advertise our service in various places across the Internet. This channel typically offers an additional promotion directly to the customer by the partner in order to get the customer to try our service.

- *Affiliate Channel.* We utilize the traffic and customers of smaller web sites and other businesses or individuals that are too small to qualify for a partnership directly with Stamps.com. Our affiliate channel is currently managed by a third party. We offer financial incentives for these small businesses and individuals to drive traffic to our web site.

- *Direct Mail.* We send direct mail pieces to prospective small business, small office, and home office customers. We purchase targeted prospect lists from third parties or obtain prospect lists from partners.

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

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

Marketing of PhotoStamps

Our PhotoStamps marketing has traditionally been targeted primarily at consumers. Our marketing strategy includes the following types of programs: (1) traditional offline methods of consumer advertising; (2) online advertising including paid search, banner ads, permission-based emails, and other online advertising methods; (3) press-relations; (4) remarketing to our existing customers; and (5) partnerships. We plan to continue to pursue partnerships like our existing partnerships with Apple, CafePress, Google/Picassa, HP/Snapfish, Adobe and others, as they provide a cost effective way to manage acquisition costs through a revenue share or bounty arrangement that aligns the interests of the partnership.

Competition

The following is a summary of our current direct competitors in the PC Postage and Customized Postage categories.

Endicia.com Endicia.com is a small, private US company that launched a software-based PC Postage service commercially in 2000. The company also sometimes goes by the names Envelope Manager Software, or PSI Inc. Endicia offers a PC Postage solution that has traditionally been targeted at shipping-focused customers. During 2005 they also launched a feature like our NetStamps feature called InstaPostage. Also in May 2005, Endicia launched a custom postage offering under the brand name PictureItPostage.

In April 2006, Endicia announced a deal with Dymo, a company that offers PC-compatible professional label writers, to offer Endicia s InstaPostage product through Dymo-branded professional label writers. Dymo and Endicia are offering the InstaPostage product, which they brand DymoStamps, without a monthly service fee. However, the customer must first purchase a high end Dymo labelwriter, which sells for $140 or more, before they can print DymoStamps. If a customer owns an older Dymo labelwriter, they must upgrade to a newer printer. Once the customer buys the printer, they then purchase the InstaPostage labels from Endicia at a cost of $20.49 for a roll of 200, or about 10.2 cents per label so printing a single $0.39 stamp ends up costing almost $0.50. With the

DymoStamps service, we believe Endicia and Dymo are targeting lower end customers with a transaction model versus our subscription model which tends to attract larger volume small business mailing & shipping customers. Note also that the DymoStamps software does not print shipping labels or print directly on envelopes-the other two features our software supports.

Pitney Bowes, Inc. Pitney Bowes is the current market leader in the U.S. traditional postage meter business, with revenues of approximately $5.7 billion in fiscal 2006. Pitney Bowes launched a software-based PC Postage product called ClickStamp Online in April 2000. In the third quarter of 2004, Pitney Bowes appeared to discontinue marketing ClickStamp Online at the monthly fee of $4.99, and began marketing an entirely new PC Postage offering by the name of ShipStream for a monthly fee of $18.99. During 2004, Pitney Bowes also began offering an Internet-based service for printing a single label for use in shipping a package that does not require a monthly subscription fee, in partnership with eBay.

In July 2005, Pitney Bowes introduced a customized postage offering which it branded ZazzleStamps through a partnership with Zazzle.com, Inc., a small, private US company that specializes in custom products. In January 2007 Pitney Bowes also launched a product by the name of YourStamps in partnership with FujiFilm and in direct competition with Pitney s current offering through its other partnership with Zazzle.

We compete with traditional postage meters, such as those offered by Pitney Bowes. We believe that customers choose the Stamps.com PC Postage service over traditional postage meters primarily to save money. We also believe that Stamps.com s PC Postage service offers superior capabilities to postage meters in certain areas, such as the ability to integrate tightly with small business productivity applications, and the ability to easily monitor and track USPS packages.

We also compete with traditional methods of accessing U.S. postage, such as postage stamps, U.S. Postal Service retail locations, and U.S. Postal Service online services such as Click-N-Ship. All of these methods are typically available with no additional markup over the face value of postage. We believe that customers choose our service over these methods of accessing postage as a matter of convenience because of the breadth of the services we offer.

We believe that customers choose Stamps.com s PC Postage service over that of other PC Postage competitors because of our more complete and sophisticated overall service offering. For example, Stamps.com is the only PC Postage service that is tightly integrated into Microsoft Office for use with Office s mailing capabilities such as mail merge or envelope printing. Based on U.S. Postal Service data and our own estimates, we believe that as of the end of 2006 approximately 85% of all PC Postage subscription customers were Stamps.com customers (excluding any customers paying for postage on a pure transaction-based, no-monthly-fee plan).

We believe that PhotoStamps is the category leader in the U.S. Postal Services s customized postage program. Based on U.S. Postal Service data and on our own estimates, we believe that approximately 78% of all customized postage sold in the U.S. during 2006 was PhotoStamps. When compared to competitive offerings, we think PhotoStamps offers the best product and overall customer experience in the industry. PhotoStamps was also the first commercially available customized postage product and we believe it has the best brand recognition among all of the competitive products.

Industry Overview

Growth of Internet Commerce

Stamps.com s PC Postage mailing and shipping service is currently targeted primarily to U.S. small offices, home offices and small businesses. The small office, home office and small business market represent a large and growing customer segment. According to reports from market research firm International Data Corporation (IDC), there were a combined 47 million small businesses and home offices in the United States in 2005. For 2005, IDC estimated that small businesses with less than 100 employees numbered 8.1 million of which 84% had fewer than 10 employees. In addition, income generating home offices numbered 14.7 million, and home offices used for corporate after-hours work or telecommuting numbered 24.3 million. In addition to small office, home office and small business customers, consumers and corporations are also currently customers of Stamps.com s service.

US Mail Volume

According to the U.S. Postal Service Annual Report, the total postage market was approximately $73 billion in 2006, of which approximately $51 billion was represented by mail classes other than standard mail and periodicals. We believe that some portion of this $51 billion is a potential market for purchasing and printing postage using PC Postage.

The U.S. Postal Service processed over 213 billion pieces of mail during its fiscal year 2006. Based on the USPS 2005 Household Diary study, consumer-to-consumer mail volume is approximately 5.9 billion pieces per year, made up of the following segments: 2.2 billion holiday/season greeting cards; 1.4 billion other greeting cards; 1.2 billion letters to friends or relatives; 0.8 billion invitations; and 0.3 billion other. We also estimate that an additional 10.5 billion pieces per year are sent between businesses and consumers as business advertising mail, and an additional 8.6 billion pieces per year are sent from businesses to consumers as First Class correspondence mail. We believe that consumer-to-consumer and business-to-consumer-advertising mail are two potential markets for use of PhotoStamps.

Traditional Postage Industry and the Emergence of PC Postage

The U.S. Postal Service has experienced public demand for more convenient access to U.S. Postal Service products and services, and has faced strong competition from overnight delivery services and online transaction services. The U.S. Postal Service also has historically experienced lost revenue owing to fraud committed using traditional postal meters. In response to these challenges, in 1995 the U.S. Postal Service announced the Information Based Indicia (IBI) program, its first new form of postage since the approval of the postage meter in 1920. The information based indicia was a new type of U.S. Postal Service postage mark that contained an information rich two dimensional bar code. Each bar code is unique and contains technology that reduces the fraud risk to the U.S. Postal Service. The IBI Program is commonly referred to today as the PC Postage program.

The goals of the PC Postage program were to enhance user convenience with a new access channel for postage that was available 24 hours a day, seven days a week, while also enhancing the inherent security of the postage to reduce postage fraud. All PC Postage products, including any subsequent enhancements or additional implementation of an existing product, must complete U.S. Postal Service testing and evaluation to ensure operational reliability, financial integrity, and security, before becoming certified for commercial distribution. The IBI program also aims to produce mail that is processed in a more automated manner in order to reduce U.S. Postal Service costs.

We believe that the IBI program has created an attractive alternative channel for the sale of postage, particularly to small offices, home offices and small businesses. We believe that our current customers have chosen our service over other forms of postage such as postage stamps or postage meters primarily to save time and to save costs.

The PC Postage Certification and Regulatory Approval Process

Our technology meets strict US government security standards. All US PC Postage products must complete extensive U.S. Postal Service testing and evaluation in the areas of operational reliability, financial integrity and security to become certified for commercial distribution. Each additional implementation of a particular product or function requires additional evaluation and approval by the U.S. Postal Service prior to commercial distribution.

The U.S. Postal Service certification process for PC Postage is a standardized, ten-stage process. Each stage requires U.S. Postal Service review and authorization to proceed to the next stage of the certification process. The U.S. Postal Service has no published timeline or estimated time to complete each of the ten stages of the program. The most significant stage is the ninth stage, which requires a vendor to complete three phases of beta testing.

The entire approval process for Stamps.com took approximately two and one half years. In March 1997, we submitted our letter of intent to join the IBI program. From March 1997 through August 1998, we progressed through the first eight stages of the U.S. Postal Service certification process. On August 24, 1998, the U.S. Postal Service announced that we were approved for beta testing and our PC Postage service became the first software-only postage solution approved by the U.S. Postal Service for market testing. Between August 24, 1998 and August 9, 1999, we successfully completed the three-phase beta testing required by the U.S. Postal Service s certification process. On August 9, 1999, we became the first software-only PC Postage solution approved for commercial release by the U.S. Postal Service.

Approval of follow-on technology also requires U.S. Postal Service approval. On July 17, 2002, we successfully launched NetStamps and became the first provider of this technology. Approval for NetStamps followed years of development efforts, including a six-month beta field test. On November 29, 2002, we launched our shipping label capability after significant development efforts. In 2003, we improved our shipping features by adding Hidden Postage™, Stamps.com package insurance, the ability to send shipment notification e-mails with a tracking link, the ability to print shipping labels for Express Mail® and Bound Printed Matter, and support for additional USPS services such as COD. Additionally, we enhanced the integration with Microsoft® Office System 2003.

In July 2004, we received authorization from the USPS to proceed with an initial, limited market test of a new form of postage called PhotoStamps that coupled the technology of PC Postage with the simplicity of a web-based image upload and order process to allow consumers and businesses to order fully customized postage. In September 2004, the USPS asked us to conclude our market test effective on October 1, 2004, to allow the USPS to conduct a review of the limited market test results. We concluded the first market test with more than 138,000 total sheets, or approximately 2.8 million individual PhotoStamps, ordered.

In May 2005, we launched our second market test of PhotoStamps after receiving authorization from the USPS, and in May 2006 we launched our third market test of PhotoStamps. Between May 2005 and December 31, 2006, we shipped more than 1.5 million total sheets, or more than 30 million individual PhotoStamps to customers. The first year of the third market test will conclude on May 17, 2007 with an option for the USPS to extend the test for a second year. We are hopeful that the U.S. Postal Service will ultimately approve the continuation of the PhotoStamps offering. There are, however, many risks related to this offering.

On January 5, 2006, President Bush signed a new law which clarified a longstanding law around advertising on U.S. currency, known as 18 US Code Section 475. The new law amends Section 475 to clarify that the earlier law does not apply to products that are officially approved by the U.S. Postal Service. In compliance with the original law, the Postal Service restricted our ability to accept business advertising for usage on PhotoStamps during the second market test. This amendment cleared the way for the Postal Service to remove the restriction as it relates to PhotoStamps, upon the start of our third market test which began on May 17, 2006.

In September 2006, we launched Photo NetStamps on our new ecommerce platform. This new product brings the customization of PhotoStamps to our PC Postage customers through a combination with our existing NetStamps product.

Our Technology

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

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

During 2006 our technology development effort was focused on building out and unifying our software platform for continued and future growth in all parts of our business. We built a single web presentation and e-commerce system for all Stamps.com products and services by moving our current homegrown technology onto commercial software.

During 2007, we plan to add the capability of letting multiple users access a single account balance in a single geographic location in our PC Postage solution. We also plan to continue to add on to our current enterprise reporting systems with enhanced features such as centralized administration and control. During 2007 and beyond, we also plan to implement a highly flexible billing system and then integrate that system with our new e-commerce platform.

Section 382 Update

Under Internal Revenue Code Section 382 rules, a change in ownership can occur whenever there is a shift in ownership by more than 50 percentage points by one or more five-percent shareholders within a three-year period. When a change of ownership is triggered, the NOLs may be impaired. We estimate that, as of December 31, 2006 we were approximately at 30% compared with the 50% level that would trigger impairment of our NOL asset. As part of our ongoing program to preserve future use of our NOL assets, *Stamps.com requests that all of our investors contact us prior to allowing their ownership interest to reach a five-percent level.*

Employees

As of December 31, 2006, we had 165 employees not including temporary or contract workers. Our employees work in various departments including customer support, research and development, sales and marketing, information technology and general administration. None of our employees are represented by a labor union. We believe that our relationship with our employees is good.

Recent Developments

On November 3, 2006 Stamps.com s Board of Directors approved a one-year share repurchase program authorizing our Company to purchase up to $20 million of Stamps.com stock as market and business conditions warrant (the November 2006 Program). During the fourth quarter and in the first quarter of 2007 to date, our Company purchased approximately 0.8 million shares for a total amount of $12.0 million under the November 2006 Program.

On February 8, 2007, Stamps.com s Board of Directors approved an additional share repurchase program authorizing our Company to purchase up to $20 million of Stamps.com stock as market and business conditions warrant (the February 2007 Program). The February 2007 Program will commence when the November 2006 Program is completed and will expire one year from its commencement date.

Share purchases may be made from time to time on the open market or in negotiated transactions in compliance with Rule 10b-18 of the Securities and Exchange Act of 1934. Our Company s purchase of any of our shares is subject to limitations that may be imposed on such purchases by applicable securities laws and regulations and the rules of the Nasdaq Stock Market. Purchases may be made in the open market, or in privately negotiated transactions from time to time at our Company s discretion. The timing of purchases, if any, and the number of shares to be bought at any one time will depend on market conditions.

In February 2007, Stamps.com announced our plan to change our publicly available customer metrics starting with the fourth quarter 2006 earnings release and continuing forward into fiscal 2007. The new metrics will be based primarily on paid subscribers whereas our prior customer metrics were based primarily on registered subscribers. We believe that the new metrics will provide a simpler and clearer depiction of our business while also providing an improved means of comparing our metrics to those of other subscription-based Internet companies. A complete set of the old and new quarterly customer metrics is available currently at http://investor.stamps.com.

Item 1A. Risk Factors

You should carefully consider the following risks and the other information in this Report and our other filings with the SEC before you decide to invest in our company or to maintain or increase your investment. The risks and uncertainties described below are not the only ones facing Stamps.com. Additional risks and uncertainties may also adversely impact and impair our business. If any of the following risks actually occur, our business, results of operations or financial condition would likely suffer. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment.

This Report contains forward-looking statements based on the current expectations, assumptions, estimates and projections about Stamps.com and the Internet. These forward-looking statements involve risks and uncertainties. Our actual results could differ materially from those discussed in these forward-looking statements as a result of many factors, including those described in this section and elsewhere in this Report. Stamps.com does not undertake to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

Risks Related to Our Business

We may not successfully implement strategies to increase the adoption of our services and products which would limit our growth, adversely affect our business and cause the price of our common stock to decline.

Our continuing profitability depends on our ability to successfully implement our strategy of increasing the adoption of our services and products. Factors that might cause our revenues, margins and operating results to fluctuate include the factors described in the subheadings below as well as:

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The costs of our marketing programs to establish and promote the Stamps.com brands;

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The demand for our services and products;

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Our ability to develop and maintain strategic distribution relationships;

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The number, timing and significance of new products or services introduced by us and by our competitors;

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Our ability to develop, market and introduce new and enhanced products and services on a timely basis;

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The level of service and price competition;

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Our operating expenses;

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U.S. Postal Service regulation and policies relating to PC Postage and PhotoStamps; and

•

General economic factors.

We implemented pricing plans that may adversely affect our future revenues and margins.

Our ability to generate gross margins depends upon the ability to generate significant revenues from a large base of active customers. In order to attract customers in the future, we may run special promotions and offers such as free trials, discounts on fees, postage and supplies, and other promotions. We cannot be sure that customers will be receptive to future fee structures and special promotions that we may implement. Even though we have established a sizeable base of users, we still may not generate sufficient gross margins to remain profitable. In addition, our ability to generate revenues or sustain profitability could be adversely affected by the special promotions or additional changes to our pricing plans.

If we do not successfully attract and retain skilled personnel for permanent management and other key personnel positions, we may not be able to effectively implement our business plan.

Our success depends largely on the skills, experience and performance of the members of our senior management and other key personnel. Any of the individuals can terminate his or her employment with us at any time. If we lose key employees and are unable to replace them with qualified individuals, our business and operating results could be seriously harmed. In addition, our future success will depend largely on our ability to continue attracting and retaining highly skilled personnel. As a result, we may be unable to successfully attract, assimilate or retain qualified personnel. Further, we may be unable to retain the employees we currently employ or attract

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additional qualified personnel to replace those key employees that may depart. The failure to attract and retain the necessary personnel could seriously harm our business, financial condition and results of operations.

The success of our business will depend upon the continued acceptance by customers of our service.

We must minimize the rate of loss of existing customers while adding new customers. Customers cancel their subscription to our service for many reasons, including a perception that they do not use the service sufficiently. that the costs for service are too high, because they are going out of business, or other issues that are not satisfactorily resolved. We must continually add new customers both to replace customers who cancel and to continue to grow our business beyond our current customer base. If too many of our customers cancel our service, or if we are unable to attract new customers in numbers sufficient to grow our business, our operating results will be adversely affected. Further, if excessive numbers of customers cancel our service, we may be required to incur significantly higher marketing expenditures than we currently anticipate to replace these customers with new customers.

If we fail to effectively market and sell our services and products, our business will be substantially harmed and could fail.

In order to acquire customers and achieve widespread distribution and use of our services and products, we must develop and execute cost-effective marketing campaigns and sales programs. We currently rely on a combination of marketing techniques to attract new customers including direct mail, online marketing and business partnerships. We may be unable to continue marketing our services and products in a cost-effective manner. If we fail to acquire customers in a cost-effective manner, our results of operations will be adversely affected.

If we fail to meet the demands of our customers, our business will be substantially harmed and could fail.

Our services and products must meet the commercial demands of our customers, which include home businesses, small businesses, corporations and individuals. We cannot be sure that our services will appeal to or be adopted by an ever-growing range of customers. If we are unable to ship products such as items from our Supplies Store or PhotoStamps in a timely manner to our customers, our business may be harmed. Moreover, our ability to obtain and retain customers depends, in part, on our customer service capabilities. If we are unable at any time to address customer service issues adequately or to provide a satisfactory customer experience for current or potential customers, our business and reputation may be harmed. If we fail to meet the demands of our customers our results of operations will be adversely affected.

A failure to further develop and upgrade our services and products could adversely affect our business.

Any delays or failures in developing our services and products, including upgrades of current services and products, may have a harmful impact on our results of operations. The need to extend our core technologies into new features and services and to anticipate or respond to technological changes could affect our ability to develop these services and features. Delays in features or upgrade introductions could cause a decline in our revenue, earnings or stock price. We cannot determine the ultimate effect these delays or the introduction of new features or upgrades will have on our revenue or results of operations.

Increases in payment processing fees would increase our operating expenses and adversely affect our results of operations.

Our customers pay for our services predominately using credit cards and debit cards and, to a lesser extent, by use of automated clearing house, (ACH). Our acceptance of these payment methods requires our payment of certain fees. From time to time, these fees may increase, either as a result of rate changes by the payment processing companies or as a result in a change in our business practices which increase the fees on a cost-per-transaction basis. If these fees for accepting payment methods increase in future periods, it may adversely affect our results of operations.

A decline in our ability to effectively bill our customers by credit card and debit card would adversely affect our results of operations.

Our ability to effectively charge our customers through credit cards and debit cards is subject to many variables, including our own billing technology and practices, the practices and rules of payment processing companies, and the practices and rules of issuing financial institutions. If we do not effectively charge and bill our customers in future periods through credit cards and debit cards, it would adversely affect our results of operations.

Third party assertions of violations of their intellectual property rights could adversely affect our business.

Substantial litigation regarding intellectual property rights exists in our industry. Third parties may currently have, or may eventually be issued, patents upon which our products or technology infringe. Any of these third parties might make a claim of infringement against us. We may become aware of, or we may increasingly receive correspondence claiming, potential infringement of other parties intellectual property rights. We could incur significant costs and diversion of management time and resources to defend claims against us regardless of their validity. Any associated costs and distractions could have a material adverse effect on our business, financial condition and results of operations. In addition, litigation in which we are accused of infringement might cause product development delays, require us to develop non-infringing technology or require us to enter into royalty or license agreements, which might not be available on acceptable terms, or at all. If a successful claim of infringement were made against us and we could not develop non-infringing technology or license the infringed or similar technology on a timely and cost-effective basis, our business could be significantly harmed or fail. Any loss resulting from intellectual property litigation could severely limit our operations, cause us to pay license fees, or prevent us from doing business.

A failure to protect our own intellectual property could harm our competitive position.

We rely on a combination of patent, trade secret, copyright and trademark laws and contractual restrictions, such as confidentiality agreements and licenses, to establish and protect our rights in our products, services, know-how and information. We have 59 issued US patents, 86 pending US patent applications, 9 international patents and 19 pending international patent applications. We also have a number of registered and unregistered trademarks. We plan to apply for more patents in the future. We may not receive patents for any of our patent applications. Even if patents are issued to us, claims issued in these patents may not protect our technology. In addition, a court might hold any of our patents, trademarks or service marks invalid or unenforceable. Even if our patents are upheld or are not challenged, third parties may develop alternative technologies or products without infringing our patents. If our patents fail to protect our technology or our trademarks and service marks are successfully challenged, our competitive position could be harmed. We also generally enter into confidentiality agreements with our employees, consultants and other third parties to control and limit access and disclosure of our confidential information. These contractual arrangements or other steps taken to protect our intellectual property may not prove to be sufficient to prevent misappropriation of technology or deter independent third party development of similar technologies. Additionally, the laws of foreign countries may not protect our services or intellectual property rights to the same extent as do the laws of the United States.

System and online security failures could harm our business and operating results.

Our services depend on the efficient and uninterrupted operation of our computer and communications hardware systems. In addition, we must provide a high level of security for the transactions we execute. We rely on internally-developed and third-party technology to provide secure transmission of postage and other confidential information. Any breach of these security measures would severely impact our business and reputation and would likely result in the loss of customers. Furthermore, if we are unable to provide adequate security, the U.S. Postal Service could prohibit us from selling postage over the Internet.

Our systems and operations are vulnerable to damage or interruption from a number of sources, including fire, flood, power loss, telecommunications failure, break-ins, earthquakes and similar events. Our Internet host provider does not guarantee that our Internet access will be uninterrupted, error-free or secure. Our servers are also vulnerable to computer viruses, physical, electrical or electronic break-ins and similar disruptions. We have experienced minor system interruptions in the past and may experience them again in the future. Any substantial interruptions in the future could result in the loss of data and could completely impair our ability to generate revenues from our service.

We do not presently have a full disaster recovery plan in effect to cover the loss of facilities and equipment. In addition, we do not have a fail-over site that mirrors our infrastructure to allow us to operate from a second location. We have business interruption insurance; however, we cannot be certain that our coverage will be sufficient to compensate us for losses that may occur as a result of business interruptions.

A significant barrier to electronic commerce and communications is the secure transmission of confidential information over public networks. Anyone who is able to circumvent our security measures could misappropriate confidential information or cause interruptions in our operations. We may be required to expend significant capital and other resources to protect against potential security breaches or to alleviate problems caused by any breach. We rely on specialized technology from within our own infrastructure to provide the security necessary for secure transmission of postage and other confidential information. Advances in computer capabilities, new discoveries in security technology, or other events or developments may result in a compromise or breach of the algorithms we use to protect customer transaction data. Should someone circumvent our security measures, our reputation, business, financial condition and results of operations could be seriously harmed. Security breaches could also expose us to a risk of loss or litigation and possible liability for failing to secure confidential customer information. As a result, we may be required to expend a significant amount of financial and other resources to protect against security breaches or to alleviate any problems that they may cause.

Risks Related to Our Industry

U.S. Postal Service regulations or fee assessments may cause disruptions or discontinuance of our business.

We are subject to continued U.S. Postal Service scrutiny and other government regulations. The availability of our services is dependent upon our service continuing to meet U.S. Postal Service performance specifications and regulations. The U.S. Postal Service could change its certification requirements or specifications for PC Postage or revoke or suspend the approval of one or more of our services at any time. If at any time our service fails to meet U.S. Postal Service requirements, we may be prohibited from offering this service and our business would be severely and negatively impacted. In addition, the U.S. Postal Service could suspend or terminate our approval or offer services which compete against us, any of which could stop or negatively impact the commercial adoption of our service. Any changes in requirements or specifications for PC Postage could adversely affect our pricing, cost of revenues, operating results and margins by increasing the cost of providing our service.

The U.S. Postal Service could also decide that PC Postage should no longer be an approved postage service due to security concerns or other issues. Our business would suffer dramatically if we are unable to adapt our services to any new requirements or specifications or if the U.S. Postal Service were to discontinue PC Postage as an approved postage method. Alternatively, the U.S. Postal Service could introduce competitive programs or amend PC Postage requirements to make certification easier to obtain, which could lead to more competition from third parties or the U.S. Postal Service itself. If we are unable to compete successfully, particularly against large, traditional providers of postage products like Pitney Bowes who enter the online postage market, our revenues and operating results will suffer.

The U.S. Postal Service could decide to suspend or cancel the current market test of PhotoStamps, and may do so in the event that there is sufficient cause to believe that the market test presents unacceptable risk to U.S. Postal Service revenues, degrades the ability of the U.S. Postal Service to process or deliver mail produced by the test participants, exposes the U.S. Postal Service or its customers to legal liability, or causes public or political embarrassment or harm to the U.S. Postal Service in any way. If the U.S. Postal Service decides to suspend or cancel the market test of PhotoStamps, our revenues and operating results will likely suffer.

Additionally, the U.S. Postal Service could decide to amend, renegotiate or terminate our credit card cost sharing agreement, which is a key agreement that governs the allocation of credit card fees paid by the U.S. Postal Service and us for the postage purchased by our customers. If the U.S. Postal Service decides to amend, renegotiate or terminate our credit card cost sharing agreement, our revenues and operating results will likely suffer.

In addition, U.S. Postal Service regulations may require that our personnel with access to postal information or resources receive security clearance prior to doing relevant work. We may experience delays or disruptions if our personnel cannot receive necessary security clearances in a timely manner, if at all. The regulations may limit our ability to hire qualified personnel. For example, sensitive clearance may only be provided to US citizens or aliens who are specifically approved to work on U.S. Postal Service projects.

If we are unable to compete successfully, particularly against large, traditional providers of postage products such as Pitney Bowes, our revenues and operating results will suffer.

The PC Postage segment of the market for postage is relatively new and is competitive. At present, Pitney Bowes and Endicia.com are authorized PC Postage providers with commercially available software and Zazzle.com and FujiFilm offer a competitive product to PhotoStamps using Pitney Bowes technology. If any more providers become authorized, or if Pitney Bowes or Endicia.com provide enhanced offerings, our operations could be adversely impacted. We also compete with other forms of postage, including traditional postage meters provided by companies such as Pitney Bowes, postage stamps and permit mail.

We may not be able to establish or maintain a competitive position against current or future competitors as they enter the market. Many of our competitors have longer operating histories, larger customer bases, greater brand recognition, greater financial, marketing, service, support, technical, intellectual property and other resources than us. As a result, our competitors may be able to devote greater resources to marketing and promotional campaigns, adopt more aggressive pricing policies and devote substantially more resources to web site and systems development than us. This increased competition may result in reduced operating margins, loss of market share and a diminished brand. We may from time to time make pricing, service or marketing decisions or acquisitions as a strategic response to changes in the competitive environment. These actions could result in reduced margins and seriously harm our business.

We could face competitive pressures from new technologies or the expansion of existing technologies approved for use by the U.S. Postal Service. We may also face competition from a number of indirect competitors that specialize in electronic commerce and other companies with substantial customer bases in the computer and other technical fields. Additionally, companies that control access to transactions through a network or Web browsers could also promote our competitors or charge us a substantial fee for inclusion. In addition, changes in postal regulations could adversely affect our service and significantly impact our competitive position. We may be unable to compete successfully against current and future competitors, and the competitive pressures we face could seriously harm our business.

If we do not respond effectively to technological change, our services and products could become obsolete and our business will suffer.

The development of our services, products and other technology entails significant technical and business risks. To remain competitive, we must continue to enhance and improve the responsiveness, functionality and features of our online operations. The Internet and the electronic commerce industry are characterized by rapid technological change; changes in user and customer requirements and preferences; frequent new product and service introductions embodying new technologies; and the emergence of new industry standards and practices.

The evolving nature of the Internet or the postage markets could render our existing technology and systems obsolete. Our success will depend, in part, on our ability to license or acquire leading technologies useful in our business; enhance our existing services; develop new services or features and technology that address the increasingly sophisticated and varied needs of our current and prospective users; and respond to technological advances and emerging industry and regulatory standards and practices in a cost-effective and timely manner.

Future advances in technology may not be beneficial to, or compatible with, our business. Furthermore, we may not be successful in using new technologies effectively or adapting our technology and systems to user requirements or emerging industry standards on a timely basis. Our ability to remain technologically competitive may require substantial expenditures and lead time. If we are unable to adapt in a timely manner to changing market conditions or user requirements, our business, financial condition and results of operations could be seriously harmed.

Our operating results could be impaired if we or the Internet become subject to additional government regulation and legal uncertainties.

Due to the increasing popularity and use of the Internet, it is possible that a number of laws and regulations may be adopted with respect to the Internet, relating to user privacy, pricing, content, copyrights, distribution, characteristics and quality of products and services, and export controls.

The adoption of any additional laws or regulations may hinder the expansion of the Internet. A decline in the growth of the Internet could decrease demand for our products and services and increase our cost of doing business.

Moreover, the applicability of existing laws to the Internet is uncertain with regard to many issues, including property ownership, export of specialized technology, sales tax, libel and personal privacy. Our business, financial condition and results of operations could be seriously harmed by any new legislation or regulation. The application of laws and regulations from jurisdictions whose laws do not currently apply to our business, or the application of existing laws and regulations to the Internet and other online services could also harm our business.

We have employees and offer our services in multiple states, and we may in the future expand internationally. These jurisdictions may claim that we are required to qualify to do business as a foreign corporation in each state or foreign country. Our failure to qualify as a foreign corporation in a jurisdiction where we are required to do so could subject us to taxes and penalties. Other states and foreign countries may also attempt to regulate our services or prosecute us for violations of their laws. Further, we might unintentionally violate the laws of foreign jurisdictions and those laws may be modified and new laws may be enacted in the future.

Risks Related to Our Stock

Changes in stock option accounting rules will have an adverse affect on our operating results.

We use options to acquire our common stock to attract, incentivize and retain our employees in a competitive marketplace. Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation , allowed companies the choice of either using a fair value method of accounting for options that would result in expense recognition for all options granted, or using an intrinsic value method, as prescribed by Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees, with a pro forma disclosure of the impact on net income (loss) of using the fair value option expense recognition method. Prior to our adoption of SFAS No. 123 (revised 2004), Share Based Payment , or Statement 123R, on January 1, 2006, we had elected to apply APB No. 25 and accordingly we generally did not recognize any expense with respect to employee options to acquire our common stock in periods ended on or prior to December 31, 2005 as long as such options were granted at exercise prices equal to the fair value of our common stock on the date of grant.

Statement 123R requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. This cost will be measured based on the fair value of the equity instruments issued. We adopted Statement 123R on January 1, 2006, which is the first day of our 2006 fiscal year. We expect the adoption of Statement 123R to have an adverse effect on our operating results, as we continue to use options to attract, incentivize and retain our employees.

The tax value of our net operating losses could be impaired if we trigger a change of control pursuant to Section 382 of the Internal Revenue Code.

Under Internal Revenue Code Section 382 rules, a change in ownership can occur whenever there is a shift in ownership by more than 50 percentage points by one or more five-percent shareholders within a three-year period. When a change of ownership is triggered, the NOLs may be impaired. We estimate that, as of December 31, 2006 we were approximately at 30% compared with the 50% level that would trigger impairment of our NOL asset. As part of our ongoing program to preserve future use of our NOL assets, *Stamps.com requests that all of our investors contact us prior to allowing their ownership interest to reach a five-percent level.*

Our charter documents could deter a takeover effort, which could inhibit your ability to receive an acquisition premium for your shares.

The provisions of our certificate of incorporation, bylaws and Delaware law could make it difficult for a third party to acquire us, even if it would be beneficial to our stockholders. In addition, we are subject to the provisions of Section 203 of the Delaware General Corporation Law, which could prohibit or delay a merger or other takeover of our Company, and discourage attempts to acquire us.

The U.S. Postal Service may object to a change of control of our common stock.

The U.S. Postal Service may raise national security or similar concerns to prevent foreign persons from acquiring significant ownership of our common stock or of Stamps.com. The U.S. Postal Service also has regulations regarding the change of control of approved PC Postage providers. These concerns may prohibit or delay a merger or other takeover of our Company. Our competitors may also seek to have the U.S. Postal Service block

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the acquisition by a foreign person of our common stock or our Company in order to prevent the combined company from becoming a more effective competitor in the market for PC Postage.

Our stock price is volatile.

The price at which our common stock has traded since our initial public offering in June 1999 has fluctuated significantly. The price may continue to be volatile due to a number of factors, including the following, some of which are beyond our control:

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variations in our operating results,

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variations between our actual operating results and the expectations of securities analysts,

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investors and the financial community,

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announcements of developments affecting our business, systems or expansion plans by us or others,

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and market volatility in general.

As a result of these and other factors, investors in our common stock may not be able to resell their shares at or above their original purchase price. In the past, securities class action litigation often has been instituted against companies following periods of volatility in the market price of their securities. This type of litigation, if directed at us, could result in substantial costs and a diversion of management s attention and resources.

Shares of our common stock held by existing stockholders may be sold into the public market, which could cause the price of our common stock to decline.

If our stockholders sell into the public market substantial amounts of our common stock purchased in private financings prior to our initial public offering, or purchased upon the exercise of stock options or warrants, or if there is a perception that these sales could occur, the market price of our common stock could decline. All of these shares are available for immediate sale, subject to the volume and other restrictions under Rule 144 of the Securities Act of 1933.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our corporate headquarters are located in a 36,000 square foot facility in Los Angeles, California under a lease expiring in February 2010. We believe that our existing facility is suitable and adequate for our present purposes.

Item 3. Legal Proceedings

On October 22, 2004, Kara Technology Incorporated filed suit against us in the United States District Court for the Southern District of New York, alleging, among other claims, that Stamps.com infringed certain Kara Technology patents and that Stamps.com misappropriated trade secrets owned by Kara Technology, most particularly with respect to our NetStamps feature. Kara Technology seeks an injunction, unspecified damages, and attorneys fees. On February 9, 2005, the court granted our motion to transfer this suit to the United States District Court for the Central District of California. On August 23, 2006, the court granted our summary judgment motions on the trade secret and other non-patent claims. The court has scheduled a Markman hearing to construe the terms of the Kara Technology patents for May 31, 2007, and has scheduled a trial commencement date of July 31, 2007. We dispute Kara Technology s claims and intend to defend the lawsuit vigorously.

On November 22, 2006, we filed a lawsuit against Endicia, Inc. and PSI Systems, Inc. in the United States District Court for the Central District of California for infringement of 11 Stamps.com patents covering, among other things, Internet postage technology. On January 8, 2007, Endicia, Inc. and PSI Systems, Inc. filed counterclaims asking for declaratory judgment that all 11 patents are invalid, unenforceable and not infringed. We dispute the counterclaims and intend to prosecute the lawsuit vigorously.

In May and June 2001, we were named, together with certain of our current and former board members and/or officers, as a defendant in 11 purported class-action lawsuits, filed in the U.S. District Court for the Southern District of New York. The lawsuits allege violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 in connection with our initial public offering and secondary offering of our common stock. The lawsuits also name as defendants the principal underwriters in connection with our public offerings, and allege that the underwriters engaged in improper commission practices and stock price manipulations in connection with the sale of our common stock. The lawsuits allege that we and/or certain of our officers or directors knew of or recklessly disregarded these practices by the underwriter defendants, and failed to disclose them in our public filings. Plaintiffs seek damages and statutory compensation, including interest, costs and expenses (including attorneys fees). Over 1,000 similar lawsuits have been brought against over 250 companies that issued stock to the public from 1998 until 2000, and their underwriters. All of these lawsuits have been consolidated for pretrial purposes before U.S. District Court Judge Shira Scheindlin.

In October 2002, pursuant to a stipulation and tolling agreement with plaintiffs, our current and former board members and/or officers were dismissed without prejudice. In June 2003, we approved a proposed Memorandum of Understanding among the plaintiffs, issuers and insurers as to terms for a settlement of the litigation against us, which was further documented in a Stipulation and Agreement of Settlement filed with the court. The proposed settlement, which would not require Stamps.com to make any payments, was preliminarily approved by the court in February 2005 and was the subject of a fairness hearing in April 2006, but remains subject to final approval by the court.

We have placed our underwriters on notice of our rights to indemnification, pursuant to our agreements with the underwriters, but under the terms of the proposed settlement, we cannot assert these claims except as a defense to a claim against us by the underwriters. We have also provided notice to our directors and officers insurers who have agreed to fund the proposed settlement.

In October 2004, the court issued an order regarding class certification in certain related matters. In December 2006, the U.S. Court of Appeals for the Second Circuit vacated that order, and determined that the related matters could not be certified as a class. Plaintiffs have filed a petition for rehearing of the appellate court decision. The appellate court s decision renders uncertain whether our proposed settlement can be finally approved and consummated. If the proposed settlement does not receive final approval or is not consummated for any reason, we intend to defend the lawsuits vigorously because we believe that the claims against us and our officers and directors are without merit.

We are not currently involved in any other material legal proceedings, nor are we aware of any other material legal proceedings pending against us.

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.

PART II.

Item 5. Market For The Registrant s Common Equity, Related Stockholder Matters and Issuer Repurchases of Equity Securities

Market Information

Our common stock is traded on The Nasdaq National Market under the symbol STMP . The following table sets forth the range of high and low closing sales prices reported on The Nasdaq National Market for our common stock for the following periods:

	High	Low
Fiscal 2005		
First Quarter	$ 18.27	$ 12.36
Second Quarter	$ 22.54	$ 15.53
Third Quarter	$ 19.73	$ 15.99
Fourth Quarter	$ 23.98	$ 15.98
Fiscal 2006		
First Quarter	$ 35.59	$ 22.70
Second Quarter	$ 38.81	$ 26.98
Third Quarter	$ 27.51	$ 18.05
Fourth Quarter	$ 20.02	$ 14.86

Recent Share Prices

The following table sets forth the closing sales prices per share of our common stock on The Nasdaq National Market on (i) December 31, 2006 and (ii) February 28, 2007.

	Closing Price
December 31, 2006	$ 15.75
February 28, 2007	$