PLANETOUT INC
Form 10-K
March 11, 2008

Table of Contents

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

Form 10-K

(Mark One)

þ	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **For the fiscal year ended December 31, 2007**
	OR
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

Commission File Number: 000-50879

PLANETOUT INC.
(Exact name of registrant as specified in its charter)

DELAWARE *(State or other jurisdiction of Incorporation or organization)*	**94-3391368** *(I.R.S. Employer Identification No.)*
1355 Sansome Street, San Francisco CA *(Address of principal executive offices)*	**94111** *(Zip Code)*

(415) 834-6500
(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, $0.001 Par Value Per Share	The NASDAQ Stock Market LLC

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

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

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

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 filing requirements for the past 90 days. Yes þ No o

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. o

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

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

The aggregate market value of the voting stock held by non-affiliates, computed by reference to the closing price for the common stock as quoted by the Nasdaq Stock Market LLC as of June 30, 2007 and based upon information provided by stockholders on Schedules 13D and 13G filed with the Securities and Exchange Commission, was approximately $16,803,000. Shares of common stock held by each executive officer and director and by each person who owns 5% or more of the registrant s outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of February 29, 2008, there were 4,096,205 shares of the registrant s common stock, $0.001 par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Certain sections of the registrant s definitive Proxy Statement for the 2008 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K to the extent stated herein.

PlanetOut Inc.

Form 10-K
For The Fiscal Year Ended December 31, 2007
Table of Contents

		Page
	PART I	
Item 1.	Business	1
Item 1A.	Risk Factors	9
Item 1B.	Unresolved Staff Comments	19
Item 2.	Properties	19
Item 3.	Legal Proceedings	20
Item 4.	Submission of Matters to a Vote of Security Holders	20
	PART II	
Item 5.	Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	20
Item 6.	Selected Financial Data	22
Item 7.	Management s Discussion and Analysis of Financial Condition and Results of Operations	23
Item 8.	Financial Statements and Supplementary Data	37
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	73
Item 9A.	Controls and Procedures	73
Item 9B	Other Information	74
	PART III	
Item 10.	Directors and Executive Officers and Corporate Governance	74
Item 11.	Executive Compensation	74
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	74
Item 13.	Certain Relationships and Related Transactions, and Director Independence	74
Item 14.	Principal Accounting Fees and Services	74
	PART IV	
Item 15.	Exhibits and Financial Statement Schedules	75
Signatures		79
EXHIBIT 12.1		
EXHIBIT 21.1		
EXHIBIT 23.1		
EXHIBIT 31.1		
EXHIBIT 31.2		
EXHIBIT 32.1		
EXHIBIT 32.2		

Special Note Regarding Forward-Looking Statements

Certain statements set forth or incorporated by reference in this Form 10-K, as well as in our Annual Report to Stockholders for the year ended December 31, 2007, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve known and unknown risks and uncertainties that could cause our results and our industry s results, level of activity, performance or achievements to differ materially from those expressed or implied by the forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as anticipates, believes, continue, estimates, expects, intends, plans, potential, predicts, should, will, or similar terminology. You should consider our forward-looking stateme light of the risks discussed under the heading Risk Factors in Item 1A, as well as our Consolidated Financial Statements, related notes, and the other financial information appearing elsewhere in this report and our other filings with the Securities and Exchange Commission. We assume no obligation to update any forward-looking statements.

PART I

Item 1. *Business*

Company Overview

PlanetOut Inc. (PlanetOut) was incorporated in Delaware in 2000. We are a leading global media and entertainment company serving the worldwide lesbian, gay, bisexual and transgender, or LGBT, community. We classify our businesses into two reporting segments: Online and Publishing.

Our Online segment consists of our LGBT-focused websites, most notably Gay.com, PlanetOut.com, Advocate.com and Out.com which provide revenues from advertising services and subscription services. Our Online segment also includes our transaction-based websites, including BuyGay.com, which generate revenue through sales of products and services of interest to the LGBT community. Our Publishing segment includes the operations of our print media properties including the magazines *The Advocate*, *Out*, *The Out Traveler* and *HIVPlus*. Our Publishing segment also generates revenue from newsstand sales of our various print properties and our book publishing businesses, Alyson and Publishers Distributing Co. (PDC).

With the extensive reach of our brands and multiple media properties, we believe we provide advertisers with unparalleled access to the LGBT community. We generate revenue from multiple forms of online advertising including run-of-site advertising, advertising within specialized content channels and online-community areas, and member-targeted e-mails, as well as more traditional print advertising.

We offer multi-platform advertising opportunities through which advertisers can target the gay and lesbian market using a combination of vehicles such as the Internet, print, e-mail and events. We also offer advertisers data on consumer behavior and the effectiveness of their online advertising campaigns with us through user feedback and independent third-party analysis.

We believe our online user base includes one of the most extensive networks of self-identified gay and lesbian people in the world. Users can access content on our flagship websites for free and without registration, thereby generating page views and potential advertising and transaction services revenue. Those users who wish to access our online member-to-member connection services must register for our general membership services by providing their name, e-mail address and other personal content. Registration for general membership services on our flagship websites, Gay.com and PlanetOut.com, allows access to integrated services, including profile creation and search, basic chat and instant messaging. Members may also subscribe to our paid premium subscription service which enables them to access a number of special features that are not generally available under our free general membership packages.

In addition to premium subscriptions to our Gay.com and PlanetOut.com services, we offer our customers subscriptions to six other online and offline products and services, as well as to various combined, or bundled, packages of these subscription services, including the leading LGBT-targeted magazines in the United States, *Out* and *The Advocate*. We believe *Out* magazine is the leading audited circulation consumer magazine in the United States focused on the gay and lesbian community, while *The Advocate,* a pioneer in LGBT media since 1967, is the second largest.

We also offer our users access to specialized products and services through our transaction-based websites, including BuyGay.com, that generate revenue through sales of products and services of interest to the LGBT community, such as fashion, books, CDs and DVDs. In addition, we generate transaction revenue from third-party websites and partners

for the sale of products and services to our users, as well as through newsstand sales of our various print properties.

Business Segments

Our two business segments are described below. Additional financial information relating to these segments may be found in Note 2 to our Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K.

Table of Contents

Online Segment

Our Online segment accounted for 87%, 54% and 51% of our total net revenue in fiscal 2005, 2006 and 2007, respectively. This segment currently consists of our operations relating to our LGBT-focused websites, most notably Gay.com, PlanetOut.com, Advocate.com and Out.com which provide revenues from advertising services and subscription services. This segment also includes our transaction-based websites, including BuyGay.com, which generate revenue through sales of products and services of interest to the LGBT community, such as fashion, books, CDs and DVDs. In fiscal 2007, revenues from advertising services, subscription services and transactions services represented 35%, 61% and 4% of the segment s net revenues, respectively.

Online Advertising Services

We derive advertising services revenue in our Online segment from advertising contracts in which we typically undertake to deliver a minimum number of impressions, or times that an advertisement appears in pages viewed by users of our online properties. Our advertisers can display graphical advertisements on the pages that are viewed by our users across all our online properties and on our affiliates websites. We work with our advertisers to maximize the effectiveness of their campaigns by optimizing advertisement formats and placement on our websites. We believe that online advertising will continue to grow and diversify as it captures a larger share of total advertising dollars.

During the years ended December 31, 2005, 2006 and 2007, no single advertiser accounted for more than 10% of our domestic online advertising revenue. Our five largest customer industry categories accounted for approximately 69%, 72% and 63%, respectively, of our domestic online advertising revenue for fiscal 2005, 2006 and 2007, respectively.

Online Subscription Services

We have offered Gay.com members a free, real-time chat service since 1996. We launched the PlanetOut.com personals service in 1997, and we believe PlanetOut.com was the first website of significant size to offer free personals specifically tailored to the LGBT community. In 2001, we created our paid premium membership services, Gay.com Premium Services and PlanetOut PersonalsPlus. As of December 31, 2007, we had approximately 131,000 subscribers to these online premium membership services.

We do not charge fees for registering as a member or creating a profile on either Gay.com or PlanetOut.com, but non-subscribers have only limited access to member profile photographs and chat services, and may only perform basic profile searches. By joining our paid premium membership services, a Gay.com Premium Services or PlanetOut PersonalsPlus subscriber may reply to an unlimited number of profiles, bookmark and block profiles, perform advanced profile searches and view all full-sized photographs posted by other members. In addition, we frequently offer other benefits with premium membership, including free subscriptions to our magazines, *The Advocate* and *Out*. We believe these types of additional premium offerings serve as an inducement for free members to convert to paying subscribers and for subscribers to lower-priced, shorter-term plans to convert to higher-priced, longer-term plans.

In addition to the general membership services offered by Gay.com and PlanetOut.com, our Premium Services packages offer members additional enhanced features which include access to live customer and technical support and specialized premium content, as well as the ability to simultaneously enter several of our more than 1,700 chat rooms. Some of these special premium features are not currently available on PlanetOut.com.

While both services are available to anyone, Gay.com s subscriber base is more heavily male and PlanetOut.com s includes a higher percentage of females. As of December 31, 2007, approximately 91% of subscribers on Gay.com identified themselves as male and on PlanetOut.com, 40% of subscribers identified themselves as female. As of December 31, 2007, 11% of our Gay.com paid subscribers identified themselves as residing outside the United States.

We are paid up-front for premium memberships, and we recognize subscription revenue ratably over the subscription period. As of December 31, 2006 and 2007, deferred revenue related to premium membership subscription totaled approximately $4.4 million and $3.9 million, respectively.

Online Transaction Services

Our Online segment generates transactions services revenue by offering products and services of interest to the LGBT community through multiple e-commerce websites, including BuyGay.com. To increase our transactions services revenue, we are also capable of taking mail and phone orders for some products that we offer. The products we sell through these sites include clothing, fashion accessories, CDs and DVDs. We hold inventory for a portion of the products that we sell, such as CDs and DVDs, at our on-site fulfillment center in Los Angeles. For other products, such as fashion products and accessories, we have historically engaged third-party vendors to hold inventory and fulfill orders. We believe these arrangements allow us to reduce buying and fulfillment costs and the risk of holding unwanted inventory. We advertise these transaction services primarily through our own properties, including our websites and magazines.

Online Product Development and Technology

Our product development teams completed extensive consumer research in 2007 to identify key opportunities for us to increase the marketability of our online properties. During 2007 we also established a redevelopment roadmap and timeline to introduce a new user experience for our consumers, completed the key preliminary planning stages and began the redevelopment effort.

We plan to introduce improvements to key features such as chat and profiles, and expanded capabilities related to member-generated content. We also plan to move, over time, toward integration of our technology platforms across all our web properties, beginning with an extensive effort, now underway, to re-architect our core platform, leading to the expansion of core functional capabilities, and including an initiative to implement a company-wide content management system to better leverage all of our organic and acquired content of our print and online properties.

Our capital expenditures are primarily focused on the integration and re-architecture of the core technology platform of our websites and supporting our member services, including the introduction of new features and functions. We strive to concentrate our acquisitions of hardware and software with a single primary vendor when we believe it is feasible and cost-effective to do so. By reducing the number of types of systems we use, we believe we are better able to manage our systems and achieve attractive pricing with vendors with whom we have established relationships.

Our basic network infrastructure primarily resides in virtual machines that are hosted in multi-core servers that leverage their capabilities in order to maximize efficiency and scalability. We primarily utilize open source software and widely scalable, low-cost servers to reduce cost and enable us to easily expand technological capacity to handle increased loads. We track and monitor the growth of traffic on our websites and strive to maintain reserve capacity for extraordinary loads. We attempt to streamline and consolidate our technology as we upgrade our equipment to increase capacity.

We employ several methods to protect our computer networks from damage, power interruption, computer viruses and security breaches that would result in a disruption of service to our members. Our hosted computer network, located in San Jose and operated by a third-party vendor, provides the primary services that we offer to the public on our flagship websites. The computer equipment in our hosted network is located in an industrial-grade server room with on-site security systems and redundant uninterruptible power supply units, as well as smoke detection and fire suppression systems. The equipment is also deployed in a redundant configuration, designed to prevent any single computer failure from interrupting the services available on our websites. This network is protected from security breaches by a firewall, including anti-virus protection.

Publishing Segment

Our Publishing segment accounted for 13%, 46% and 49% of our total net revenue in fiscal 2005, 2006 and 2007, respectively. Our magazine publishing business is conducted by LPI Media Inc. (LPI) and SpecPub, Inc. (SpecPub), our wholly-owned subsidiaries. In addition, these subsidiaries operate certain direct-marketing and direct-selling businesses. In fiscal 2007, revenues from advertising services, subscription services and transactions services represented 62%, 21% and 17% of the segment s net revenues, respectively.

Table of Contents

Magazines

We currently publish seven magazines, five of which are offered on a subscription basis. These magazines are aimed primarily at the LGBT market. LPI and SpecPub also distribute digital editions of some their magazines using Zinio, a leading provider of digital magazine marketing and distribution.

We enhance the reach of our magazine businesses primarily through the development of specialized editions aimed at particular audiences, and the development of new editorial content for different media, such as the Internet and books. Many of our magazine brands have developed websites to publish original content as well as content from the magazines.

Generally, each magazine we publish has an editorial staff under the supervision of an Editor-In-Chief. Advertising sales and marketing, subscription marketing, production and distribution activities are generally centralized. Fulfillment activities are provided by a leading industry vendor.

As the leading magazines targeting the LGBT community in the U.S., *Out* and *The Advocate* include a range of articles targeted to appeal to this demographic. Since our purchase of LPI in November 2005, both magazines have undergone a significant redesign aimed at reaching both older and younger LGBT readers.

Out is a monthly magazine which targets a younger, fashion-oriented readership. *The Advocate*, a bi-weekly, targets an older demographic among gay opinion leaders. Together the two titles speak to a broad range of the gay spectrum, giving them greater reach than smaller and more fragmented competitors. *Out s* rate base (the total subscription and newsstand circulation guaranteed to advertisers) was 175,000 in fiscal 2007, rising 5.7% to 185,000 in fiscal 2008. *The Advocate s* rate base was 165,000 in fiscal 2007 increasing 6.1% to 175,000 in fiscal 2008.

Books

Our book business consists of our Alyson brand operations and Publishers Distributing Co. (PDC) distribution operations. Alyson publishes works targeted to an LGBT audience or to mainstream audiences where there is an overlap or high interest in the subject matter. During 2007, Alyson published 50 books in the categories of fiction, non-fiction, pets, pop culture, erotica, travel, mystery and self-help. PDC markets and sells LGBT-themed books and materials from third party publishers to wholesalers and specialty retailers across the United States primarily for a few foreign owned publishers which utilize PDC as one of their US distributors.

Advertising

Advertising carried in our print publications comes from many of the top advertising categories in consumer magazines, including healthcare, travel, automotive, financial services, fashion/accessories, grooming products and spirits. During the years ended December 31, 2005, 2006 and 2007, no single advertiser accounted for more than 10% of our publishing advertising revenue. Our five largest customer industry categories accounted for approximately 76% and 75% of our publishing advertising revenue for fiscal 2006 and 2007, respectively.

Circulation

During 2007, we grew the total circulation, which includes subscription copies and single copy sales, of our print subscription magazines to 458,000 as of December 31, 2007, which represents an 11% increase over December 31, 2006. We market our print subscription services through a broad spectrum of advertising tools, direct mail, e-mail, contests, online advertising and other promotional activities.

In addition to the revenue generated by the sale of our magazines to consumers, circulation is an important component in determining our print advertising revenues because advertising page rates are based on both circulation and readership. Most of our magazines are sold primarily by subscription and delivered to subscribers through the mail. Subscriptions are sold primarily through direct mail and online solicitation, subscription sales agents, marketing agreements with other companies, contests and insert cards in our magazines.

Table of Contents

Paper and Printing

Paper constitutes a significant component of physical costs in the production of our magazines. During 2007, we purchased all of our paper through our two principal printing vendors.

Printing and binding for our magazines are performed primarily by two North American printers. Magazine printing contracts are typically fixed-term and fixed priced with, in some cases, adjustments based on inflation.

Postal Rates

Postal costs represent a significant operating expense for our magazine publishing and direct-marketing activities. In 2007, we spent over $2.5 million for services provided by the U.S. Postal Service. The U.S. Postal Service implemented a postal rate increase in May 2007 which resulted in approximately a 15% increase in our effective postal rates. These increased costs are not directly passed on to our magazine subscribers. We strive to minimize postal expense through the use of certain cost-saving activities with respect to address quality, mail preparation and delivery of products to postal facilities.

Competitive Strengths

Strong Community Affinity. We believe we have developed a loyal, active community of users, customers, members and subscribers. The word-of-mouth marketing that occurs through these individuals is an important source of past and potential growth, as increasing social interaction among users within our online community and word-of-mouth in the broader LGBT community help us obtain new and retain previous users and customers across our multiple platforms. We believe the Gay.com domain name helps reinforce our position as a leading network of LGBT people in the world.

Critical Mass. We believe we have built a critical mass of users across multiple properties that is attractive to advertisers, vendors, and consumers alike. *Out* and *The Advocate* magazines have the two largest audited paid circulations of any LGBT-focused consumer magazines in the United States, making them attractive vehicles for major national advertisers wishing to reach this audience through print. Similarly, we believe our combined worldwide Gay.com and PlanetOut.com member base constitutes one of the largest online networks of gay and lesbian people in the world. We also believe the size and attractive demographic characteristics of our user base is appealing to advertisers who seek multiple, cost-effective ways to target the LGBT market.

Diversified Revenue Streams. We derive our revenue from a combination of advertising, subscription and transaction services offered through multiple online and print media properties. We believe that having multiple revenue streams allows us to better withstand periodic fluctuations in individual markets, take advantage of cross-selling opportunities to our advertising and consumer customers, and more effectively monetize the audiences and traffic that we have built through our various properties.

Scalable Business Model. We believe we have an overall business model in which additional revenue can be generated with relatively low increases in our expenses. In our online subscription business, we believe the marginal cost to us of providing services to each new subscriber is relatively low. At the same time, much of the content accessible through our flagship websites is generated by members and made available at modest incremental cost. By creating additional web pages or chat screens on which we can place advertisements, each additional user on these websites also generates additional advertising capacity at little incremental cost.

Compelling Content. We offer compelling editorial and programming content to the LGBT community, in print and online, covering topics such as travel, news, entertainment, fashion, business, and health. In addition, we believe our

rich and varied LGBT-focused content, the integration of our chat, profile and instant messaging features and the ability of our online members to generate and share their own content and interact with one another keeps users returning to our websites. These features increase user touchpoints and provide us with more opportunities to generate advertising revenue, grow our subscriber base, both online and offline, and increase product and service sales.

Niche Market Focus. By offering cross-media solutions that combine the power of online media with print, direct mail and other touchpoints, media companies targeting a specific audience segment are well positioned to help advertisers surround and capture a niche market. We believe that we provide advertisers with a number of effective and innovative ways to reach both the larger LGBT community and those segments within the LGBT community that may share a particular affinity for their products or services. Our value proposition to advertisers includes:

Focused Advertising. We believe we deliver access to the largest audience of self-identified gay and lesbian people in the world. Our advertising programs allow both large national and international advertisers as well as smaller, local advertisers to reach the LGBT audience in a cost-effective manner.

Leading LGBT Media Outlets. In addition to the critical mass that we have developed online through the Gay.com, Out.com, Advocate.com, and PlanetOut.com websites, we also publish leading LGBT print publications, including *The Advocate* and *Out* magazines. This combination of leading online and offline media properties is unique in reaching the North America LGBT market.

Targeted Campaigns. In addition to offering advertisers the opportunity to reach the broader LGBT audience across multiple platforms, we offer the opportunity to more closely target specific audiences. For example, advertisers have the potential to reach our entire online user base with run-of-site advertisements or to target only those members who share certain common attributes such as age, gender, geographic location or online behaviors. By dividing our online content offerings into topic sections within channels, we provide our advertisers with the ability to target their marketing efforts further, by sponsoring topic sections or running individual advertisements in channels specifically relevant to their particular products and services or brand strategy. Similarly, through our print properties, we offer advertisers the ability to target members with particular interests such as politics and current events, fashion and entertainment, travel, or specific health issues.

Research and Analysis. We engage third parties to conduct independent research on member panels assembled from our online membership base regarding the effectiveness of specific campaigns as well as other matters of interest to our advertisers. Campaign studies examine the effect the campaign had on brand awareness, brand attributes, message association, brand favorability, purchase intent and advertisement recall and can include an analysis of the research and recommendations for future advertising campaigns. In addition to benefiting the advertiser, this type of research helps educate us on how to more effectively position and manage campaigns for our advertisers.

Growth Strategy

Our goal is to enhance our position as an LGBT-focused market leader by maximizing the growth prospects and profitability of each of our revenue streams across our two segments. We seek to achieve this through the following strategies:

Growing Our User Base Across Multiple Properties. We intend to grow our user base by:

Cross-Promoting Products and Services. We are building on our extensive member base that we have developed online through the Gay.com and PlanetOut.com websites and the print leadership of *The Advocate* and *Out* magazines by cross-promoting our products and services to the LGBT community. We plan to continue marketing directly to consumers through targeted online advertising, keyword buys and affiliate programs.

Creating New Products and Services. We intend to offer new products and services through our multi-platform network. For example, we are currently developing improvements to key features such as chat and profiles, and expanded capabilities related to member-generated content as part of our website and technology re-architecture currently underway. By enhancing website functionality through the development of our technology to expand our products and services, we believe we can enhance the value of our offerings, attract new users and increase our revenue.

Capitalizing on Advertising Growth and Relationships. We believe our large user base across multiple properties provides us with greater reach than other LGBT-focused media providers and that we are well positioned to benefit from the growth in advertisers wishing to target the LGBT community. By promoting packages that include, among others, Internet, print, e-mail, direct mail and events opportunities, we believe we can differentiate our products and more effectively serve our advertising clients. Furthermore, by promoting member-generated content and cross-purposing content across our various properties, we can add new pages to our websites, grow our advertising inventory and direct our website traffic to those areas that generate higher advertising revenue.

Leveraging and Growing Our Subscriber Base. Currently, we offer eight different subscription services across multiple properties. By bundling these subscriptions into new and unique packages, we believe we can attract new subscribers. In some cases, we can also use these bundled packages and special promotions to shift subscribers into longer-term, higher-value plans.

Competition

We operate in a highly competitive environment. Across all three of our revenue streams within our two operating segments, we compete with traditional media companies focused on the general population and the LGBT community, including local newspapers, national and regional magazines, satellite radio, cable networks, and network, cable and satellite television shows. In our advertising business, we compete with a broad variety of online and print content providers, including large media companies such as Yahoo!, Google, MSN, Time Warner, Viacom, Condé Nast and News Corporation, as well as a number of smaller companies focused specifically on the LGBT community. In our online subscription business, our competitors include these companies as well as other companies that offer more targeted online service offerings, such as Match.com and Yahoo! Personals, and a number of other smaller online companies focused specifically on the LGBT community. More recently, we have faced competition from the growth of social networking sites, such as MySpace and Facebook, that provide opportunity for an online community for a wide variety of users, including the LGBT community. In our transaction business, we compete with traditional and online retailers. Most of these transaction service competitors target their products and services to the general audience while still serving the LGBT market. Other competitors, however, specialize in the LGBT market.

We believe that the primary competitive factors affecting our business are quality of content and service, price, functionality, brand recognition, customer affinity and loyalty, ease of use, reliability and critical mass. Some of our current and many of our potential competitors have longer operating histories, larger customer bases and greater brand recognition in other business and Internet markets and significantly greater financial, marketing, technical and other resources than we do. Therefore, these competitors may be able to devote greater resources to marketing and promotional campaigns, adopt more aggressive pricing policies or may try to attract readers, users or traffic by offering services for free and devote substantially more resources to producing content and developing their services and systems than we can.

Intellectual Property

We use a combination of trademark, copyright and trade secret laws and confidentiality agreements to protect our proprietary intellectual property. We have registered several trademarks in the United States, including PlanetOut, PlanetOut and Design, Gay.com and Design, Out, Out Traveler and Advocate. We have registered or applied for additional protection for several of these trademarks in select relevant international jurisdictions. Even if these applications are allowed, they may not provide us with a competitive advantage. To date, we have relied primarily on common law copyright protection to protect the content posted on our websites. Our printed publications are protected by copyrights registered with the U.S. Copyright Office. Competitors may challenge the validity and scope of our trademarks and copyrights. From time to time, we may encounter disputes over rights and obligations concerning our

use of intellectual property. We believe that the services we offer do not infringe the intellectual property rights of any third party. We cannot, however, make any assurances that we will prevail in any intellectual property dispute.

Table of Contents

Employees

As of December 31, 2007, we had 237 full-time employees and eight part-time or temporary employees. We utilize part-time and temporary employees primarily to handle overflow work and short-term projects. None of our employees are unionized, and we believe that we generally have good relations with our employees.

Executive Officers

The following table sets forth information regarding our executive officers as of March 1, 2008:

Name	Age	Position
Executive officers		
Karen Magee	47	Chief Executive Officer
Daniel E. Steimle	59	Interim Chief Financial Officer
William Bain	49	Chief Technology Officer

Karen Magee has served as our Chief Executive Officer since July 2006 and has served on our Board of Directors since September 2003. Ms. Magee served as Senior Vice President of Strategic Planning for Time Warner from April 2004 to March 2006. She served as Vice President of Strategic Planning for Time Inc. from February 2001 until April 2004. From February 1996 until February 2001, she was with TIME magazine where she served as General Manager for four years and more recently as Vice President of Consumer Marketing. Ms. Magee sits on the Princeton University Board of Trustees and previously served as co-chair of The Gay & Lesbian Alliance Against Defamation (GLAAD) board of directors. Ms. Magee holds a B.S.E. from Princeton University and a M.B.A. from the Wharton School of the University of Pennsylvania.

Daniel E. Steimle has served as our Interim Chief Financial Officer since October 2007. Since June 2007, Mr. Steimle has been a member of Tatum, LLC, an executive services firm, prior to which he was with CSL Consulting, a consulting firm, from November 2006 to May 2007, and again from October 2002 to June 2004 where he served as acting CFO and in other advisory capacities for several technology companies. From July 2004 to November 2006, Mr. Steimle served as Vice President, Chief Financial Officer at Turin Networks, Inc., a telecommunications equipment supplier. From August 2000 to September 2002, Mr. Steimle served as Vice President, Chief Financial Officer for LGC Wireless, Inc., a wireless infrastructure equipment supplier. Prior to that, Mr. Steimle served as Chief Financial Officer and in other financial management positions for several public and private technology companies. Mr. Steimle holds a B.S. in Accounting from Ohio State University and an MBA in Management/Marketing from the University of Cincinnati.

William Bain has served as our Chief Technology Officer since February 2007. Prior to joining PlanetOut, Mr. Bain was the owner and general manager of TechPoint Associates, LLC, a San Francisco-based technology consulting firm, positions he had held since April 2006. From October 2004 until March 2006, Mr. Bain was the Chief Technology Officer of HomeGain and from June 2002 to October 2004, Mr. Bain was a general partner in New Vantage Partners, LLC, a technology consulting firm serving emerging and Fortune 1000 companies. Mr. Bain holds a Ph.D., a Master of Science degree and a Bachelor of Science degree in computer science, each from Yale University.

Available Information

Our corporate website is located at http://www.planetoutinc.com. We make available free of charge, on or through the Investor Center on our corporate website, our annual, quarterly and current reports, and any amendments to those

reports, as soon as reasonably practicable after electronically filing such reports with the SEC. Information contained on our corporate website, or on our flagship or other websites, is not part of this report or any other report filed with the SEC.

Table of Contents

Item 1A. *Risk Factors*

We have a history of significant losses. If we do not regain and sustain profitability, our financial condition and stock price could suffer.

We have experienced significant net losses and we expect to continue to incur losses in the future. As of December 31, 2007, our accumulated deficit was approximately $89.5 million. Although we had positive net income in the year ended December 31, 2005, we experienced net losses of $3.7 million and $51.2 million for the years ended December 31, 2006 and 2007, respectively, and we may not be able to regain or sustain profitability in the near future, causing our financial condition to suffer and our stock price to decline.

If we are unable to generate revenue from advertising or if we were to lose our existing advertisers, our business will suffer.

Our advertising revenue is dependent on the budgeting, buying patterns and expenditures of advertisers which in turn are affected by a number of factors beyond our control such as general economic conditions, changes in consumer habits and changes in the retail sales environment. A decline or delay in advertising expenditures caused by such factors could reduce or hurt our ability to increase our revenue. Advertising expenditures by companies in certain sectors of the economy, such as the healthcare and pharmaceutical industry, currently represent a significant portion of our advertising revenue. Any political, economic, social or technological change resulting in a significant reduction in the advertising spending of this sector or other sectors could adversely affect our advertising revenue or our ability to increase such revenue.

Our advertising revenue is also dependent on the collective experience of our sales force and on our ability to recruit, hire, train, retain and manage our sales force. If we are unable to recruit or retain our sales force, we may be unable to meet the demands of our current advertisers or attract new advertisers and our advertising revenue could decrease.

Additionally, advertisers and advertising agencies may not perceive the LGBT market that we serve to be a broad enough or profitable enough market for their advertising budgets, or may prefer to direct their online and print advertising expenditures to larger, higher-traffic websites and higher circulation publications that focus on broader markets. If we are unable to attract new advertisers or if our advertising campaigns are unsuccessful with the LGBT community, our revenue will decrease and operating results will suffer.

In our advertising business, we compete with a broad variety of online and print content providers, including large media companies such as Yahoo!, Google, MSN, Time Warner, Viacom, Condé Nast and News Corporation, as well as a number of smaller companies focused on the LGBT community. If we are unable to successfully compete with current and new competitors, we may not be able to achieve or maintain market share, increase our revenue or achieve profitability.

Our ability to fulfill the demands of our online advertisers is dependent on the number of page views generated by our visitors, members and subscribers. If we are not able to attract new visitors, members or subscribers or to retain our current visitors, members and subscribers, our page views may decrease. If our page views decrease, we may be unable to timely meet the demands of our current online advertisers and our advertising revenue could decrease.

If our advertisers perceive the advertising campaigns we run for them to be unsuccessful or if they do not renew their contracts with us, our revenue will decrease and operating results will suffer.

Our success depends, in part, upon the growth of Internet advertising and upon our ability to accurately predict the cost of customized campaigns.

Online advertising represents a significant portion of our advertising revenue. We compete with traditional media including television, radio and print, in addition to high-traffic websites, such as those operated by Yahoo!, Google, AOL and MSN, for a share of advertisers total online advertising expenditures. We face the risk that advertisers might find the Internet to be less effective than traditional media in promoting their products or services, and as a result they may reduce or eliminate their expenditures on Internet advertising. Many potential advertisers and advertising agencies have only limited experience advertising on the Internet and historically have not devoted

a significant portion of their advertising expenditures to Internet advertising. Additionally, filter software programs that limit or prevent advertisements from being displayed on or delivered to a user s computer are becoming increasingly available. If this type of software becomes widely accepted, it would negatively affect Internet advertising. Our business could be harmed if the market for Internet advertising does not grow.

Currently, we offer advertisers a number of alternatives to advertise their products or services on our websites, in our publications and to our members, including banner advertisements, rich media advertisements, traditional print advertising, email campaigns, text links and sponsorships of our channels, topic sections, directories, sweepstakes, awards and other online databases and content. Frequently, advertisers request advertising campaigns consisting of a combination of these offerings, including some that may require custom development. If we are unable to accurately predict the cost of developing these custom campaigns for our advertisers, our expenses will increase and our margins will be reduced.

If our efforts to attract and retain subscribers are not successful, our revenue will decrease.

Because a significant portion of our revenue is derived from our subscription services, we must continue to attract and retain subscribers. Many of our new subscribers originate from word-of-mouth referrals from existing subscribers within the LGBT community. If our subscribers do not perceive our service offerings or publications to be of high quality or sufficient breadth, if we introduce new services or publications that are not favorably received or if we fail to introduce compelling new content or features or enhance our existing offerings, we may not be able to attract new subscribers or retain our current subscribers. In the years ended December 31, 2006 and 2007, total subscription cancellations exceeded the number of new subscriptions, resulting in a decrease in total online subscribers, or members with a paid subscription plan.

Our current online content and personals platforms may not allow us to maximize potential cross-platform synergies and may not provide the most effective platform from which to launch new or improve current services for our members or market to them. If there is a further delay in our plan to improve and consolidate these platforms, and this delay continues to prevent or delay the development or integration of new features or enhancements to existing features, our online subscriber contraction could accelerate. As a result, our revenue would decrease. Our base of likely potential subscribers is also limited to members of the LGBT community, who collectively comprise a small portion of the general adult population.

While seeking to add new subscribers, we must also minimize the loss of existing subscribers. We lose our existing subscribers primarily as a result of cancellations and credit card failures due to expirations or exceeded credit limits. Subscribers cancel their subscription to our services for many reasons, including a perception, among some subscribers, that they do not use the service sufficiently, that the service or publication is a poor value or that customer service issues are not satisfactorily resolved. We also believe that online customer satisfaction has suffered as a result of the presence in the chat rooms of our websites of adbots, which are software programs that create a member registration profile, enter a chat room and display third-party advertisements. Online members may decline to subscribe or existing online subscribers may cancel their subscriptions if our websites experience a disruption or degradation of services, including slow response times or excessive down time due to scheduled or unscheduled hardware or software maintenance or denial of service attacks. We must continually add new subscribers both to replace subscribers who cancel or whose subscriptions are not renewed due to credit card failures and to continue to grow our business beyond our current subscriber base. If excessive numbers of subscribers cancel their subscription, we may be required to incur significantly higher marketing expenditures than we currently anticipate in order to replace canceled subscribers with new subscribers, which will harm our financial condition.

Our core revenue-generating software applications are written on a technology platform that has become increasingly difficult to support. As we convert our applications onto more stable, supportable platforms a process

that requires time and financial investment we face the risk of not being able to maintain or enhance the functionality of our websites. As a result we may lose market share and our revenue may further decline.

Significant portions of our revenue-generating websites are written in internally developed code that lacks sufficient explanatory documentation, and in some instances, is understood by only a limited number of our

Table of Contents

technology personnel. Our current core website functionality is being converted onto a code base and platform that are generally recognized as industry standard. However, our efforts to execute this conversion have required and will continue to require significant expenditures of personnel and financial resources over an extended period of time. Such an undertaking presents significant execution risks as we seek to maintain and enhance existing customer-facing functionality, while simultaneously building and supporting a new technology infrastructure. If we are unable to convert to a new technology platform or if we encounter technical difficulties during the conversion process, our websites may suffer downtime or may lack the functionality desired by our visitors, members and subscribers. This in turn may result in the loss of those visitors, members and subscribers, and a decline in our revenue.

We expect our operating results to fluctuate, which may lead to volatility in our stock price.

Our operating results have fluctuated in the past and may fluctuate significantly in the future due to a variety of factors, many of which are outside of our control. As a result, we believe that period-over-period comparisons of our operating results are not necessarily meaningful and that you should not rely on the results of one period as an indication of our future or long-term performance. Our operating results in future quarters may be below the expectations of public market analysts and investors, which may result in a decline in our stock price.

Our limited operating history makes it difficult to evaluate our business.

As a result of our limited operating history, it is difficult to forecast our revenue, gross profit, operating expenses and other financial and operating data. Our inability, or the inability of the financial community at large, to accurately forecast our operating results could cause us to grow slower or our net profit to be smaller or our net loss larger than expected, which could cause a decline in our stock price.

Recent and potential future acquisitions and divestitures could result in operating difficulties and unanticipated liabilities.

In November 2005, we significantly expanded our operations by acquiring substantially all of the assets of LPI. In March 2006, we acquired substantially all of the assets of RSVP. In June 2006, we largely completed the integration of the assets we acquired through the LPI and RSVP transactions by executing on a reorganization plan designed to better align our resources with our strategic business objectives that cut our global workforce by approximately 5%. In July 2007, we closed our international offices in Buenos Aires and London to streamline our business operations and reduce expenses. In December 2007, we completed the sale of substantially all of the assets of RSVP. In addition, as part of our July 2007 financing, we were contractually obligated to use reasonable efforts to divest ourselves of our adult businesses by December 31, 2007. Our efforts to divest ourselves of our adult business have continued since December 31, 2007 and we intend to continue these efforts, but to date have not been successful.

We may consider divestitures of businesses that we conclude are likely to impair our future results, or which we deem no longer appropriate for our future business plans. For example, in December 2007, we sold substantially all of the assets of RSVP to a third party. Our prior acquisitions and divestitures and other potential future divestitures may be associated with a number of risks, including:

- potential goodwill write downs associated with acquisitions of businesses where the previously anticipated synergies of the combined entities have not been realized. For example, during fiscal 2007, we recorded an impairment charge of $21.5 million in continuing operations due to lower advertising revenue than expected related to our publishing segment and an impairment charge of $4.0 million in discontinued operations due to lower revenue than expected related to our travel business;

- the difficulty of integrating the acquired assets and personnel of the acquired businesses into our operations;

the potential absorption of significant management attention and significant financial resources for the ongoing development of our business;

the potential impairment of relationships with and difficulty in attracting and retaining employees of the acquired companies or our employees as a result of the integration of acquired businesses;

the difficulty of integrating the acquired company s accounting, human resources and other administrative systems;

the potential impairment of relationships with subscribers, customers and partners of the acquired companies or our subscribers, customers and partners as a result of the integration of acquired businesses or the divestiture of our prior businesses;

the difficulty in attracting and retaining qualified management to lead the combined or retained businesses;

the potential difficulties associated with entering new lines of business with which we have little experience, such as some of the businesses we acquired from LPI;

the difficulty of complying with additional regulatory requirements that may become applicable to us as the result of an acquisition; and

the impact of known or unknown liabilities associated with the acquired businesses.

If we are unable to successfully address these or other risks associated with our acquisition of LPI and divestiture of RSVP or potential future divestitures, we may be unable to realize the anticipated synergies and benefits of our acquisitions or replace the revenue from the divested businesses, which could adversely affect our financial condition and results of operations. In addition, the business we acquired from LPI is in a more mature market than our online businesses. The value of this business to us depends in part on our expectation that by cross-marketing their services to our existing user, member and subscriber bases and advertisers, we can increase revenues in the acquired business. If this cross-marketing is unsuccessful, or if revenue growth in our acquired business is slower than expected, our financial condition and results of operations would be harmed.

If we do not continue to attract and retain qualified personnel, our business may suffer.

Our success depends on the collective experience of our senior executive team and board of directors and on our ability to recruit, hire, train, retain and manage other highly skilled employees and directors. We have recently experienced departures of several executives and key employees, and any disruptions from further departures of our senior executives or key employees could harm our business and financial results or limit our ability to grow and expand our business. Our financial condition may negatively impact our ability to attract and retain qualified personnel. We cannot provide assurance that we will be able to attract and retain a sufficient number of qualified employees or that we will successfully train and manage the employees that we do hire.

We may need additional capital and may not be able to raise additional funds on favorable terms or at all, which could limit our ability to continue operations, dilute the ownership interests of existing stockholders, cause us to seek business dispositions on unfavorable terms, or cause us to consider curtailing or ceasing operations.

In July 2007, we completed a private placement financing, which resulted in significant dilution to our existing stockholders. As a result of our recent and continuing losses, we may need to raise additional capital to fund operating activities. In April 2006, we filed a shelf registration statement with the SEC for up to $75.0 million of common stock, preferred stock, debt securities and/or warrants to be sold from time to time at prices and on terms to be determined by market conditions at the time of offering. In addition, under the shelf registration statement some of our stockholders may sell up to 170,000 shares of our common stock. However, we are not currently eligible to use the shelf registration statement for a primary offering of our securities due to lower than required market capitalization.

We expect that raising additional financing will be very difficult, if it could be obtained at all. If we were to raise additional funds through the issuance of equity, equity-related or debt securities, these securities may have rights, preferences or privileges senior to those of the rights of our common stock, and our stockholders will experience further dilution of their ownership interests. If we are unable to raise additional financing, our business could be harmed, and we could be forced to engage in dispositions of assets or businesses on unfavorable terms, or consider curtailing or ceasing operations.

Any significant disruption in service on our websites or in our computer and communications hardware and software systems could harm our business.

Our ability to attract new visitors, members, subscribers, advertisers and other customers to our websites is critical to our success and largely depends upon the efficient and uninterrupted operation of our computer and communications hardware and software systems. Our systems and operations are vulnerable to damage or interruption from power outages, computer hardware and telecommunications failures, software failures, computer viruses, security breaches, catastrophic events, errors in installation, configuration and usage by our employees, errors in usage by our customers, risks inherent in upgrades and transitions to new hardware and software systems and network devices, or the failure of our third party vendors to perform their obligations for any reason, any of which could lead to interruption in our service and operations, and loss, misuse or theft of data. Our websites could also be targeted by direct attacks intended to cause a disruption in service or to siphon off customers to other Internet services. Among other risks, our chat rooms may be vulnerable to infestation by software programs or scripts that we refer to as adbots. An adbot is a software program that creates a member registration profile, enters a chat room and displays third-party advertisements. Our members email accounts could be compromised by phishing or other means, and used to send spam email messages clogging our email servers and disrupting our members ability to send and receive email. Any successful attempt by hackers to disrupt our websites services or our internal systems could harm our business, be expensive to remedy and damage our reputation, resulting in a loss of visitors, members, subscribers, advertisers and other customers.

If we are unable to compete effectively, we may lose market share and our revenue may decline.

Our markets are intensely competitive and subject to rapid change. Across both of our service lines, we compete with traditional media companies focused on the general population and the LGBT community, including local newspapers, national and regional magazines, satellite radio, cable networks and network, cable and satellite television shows. In our advertising business, we compete with a broad variety of online and print content providers, including large media companies such as Yahoo!, Google, MSN, Time Warner, Viacom, Condé Nast and News Corporation, as well as a number of smaller companies focused specifically on the LGBT community. In our online subscription business, our competitors include these companies as well as other companies that offer more targeted online service offerings, such as Match.com, Yahoo! Personals, and a number of other smaller online companies focused specifically on the LGBT community. More recently, we have faced competition from the growth of social networking sites, such as MySpace and Facebook, that provide opportunity for an online community for a wide variety of users, including the LGBT community. In our transaction business, we compete with traditional and online retailers. Most of these transaction service competitors target their products and services to the general audience while still serving the LGBT market. Other competitors, however, specialize in the LGBT market. If we are unable to successfully compete with current and new competitors, we may not be able to achieve or maintain adequate market share, increase our revenue or regain and maintain profitability.

We believe that the primary competitive factors affecting our business are quality of content and service, price, functionality, brand recognition, customer affinity and loyalty, ease of use, reliability and critical mass. Some of our current and many of our potential competitors have longer operating histories, larger customer bases and greater brand recognition in other business and Internet markets and significantly greater financial, marketing, technical and other resources than we do. Therefore, these competitors may be able to devote greater resources to marketing and promotional campaigns, adopt more aggressive pricing policies or may try to attract readers, users or traffic by offering services for free and devote substantially more resources to developing their services and systems than we can. Increased competition may result in reduced operating margins, loss of market share and reduced revenue. Our ability to continue to offer increasingly competitive functional capabilities on our websites will also depend upon our success in moving onto a more extensible core technology platform which will be costly and time-consuming.

If we are unable to protect our domain names, our reputation and brand could be harmed if third parties gain rights to, or use, these domain names in a manner that would confuse or impair our ability to attract and retain customers.

We have registered various domain names relating to our brands, including Gay.com, PlanetOut.com, BuyGay.com, Out.com and Advocate.com. If we fail to maintain these registrations, a third party may be able

13

to gain rights to or cause us to stop using these domain names, which will make it more difficult for users to find our websites and our service. The acquisition and maintenance of domain names are generally regulated by governmental agencies and their designees. The regulation of domain names in the United States may change in the near future. Governing bodies may designate additional top-level domains, such as .eu or .mobi, in addition to currently available domains such as .biz, .net or .tv, for example, appoint additional domain name registrars or modify the requirements for holding domain names. As a result, we may be unable to acquire or maintain relevant domain names. If a third party acquires domain names similar to ours and engages in a business that may be harmful to our reputation or confusing to our subscribers and other customers, our revenue may decline, and we may incur additional expenses in maintaining our brand and defending our reputation. Furthermore, the relationship between regulations governing domain names and laws protecting trademarks and similar proprietary rights is unclear. We may be unable to prevent third parties from acquiring domain names that are similar to, infringe upon or otherwise decrease the value of our trademarks and other proprietary rights.

If we fail to adequately protect our trademarks and other proprietary rights, or if we get involved in intellectual property litigation, our revenue may decline and our expenses may increase.

We rely on a combination of confidentiality and license agreements with our employees, consultants and third parties with whom we have relationships, as well as trademark, copyright and trade secret protection laws, to protect our proprietary rights. If the protection of our proprietary rights is inadequate to prevent use or appropriation by third parties, the value of our brands and other intangible assets may be diminished, competitors may be able to more effectively mimic our service and methods of operations, the perception of our business and service to subscribers and potential subscribers may become confused in the marketplace and our ability to attract subscribers and other customers may suffer, resulting in loss of revenue.

The Internet content delivery market is characterized by frequent litigation regarding patent and other intellectual property rights. As a publisher of online content, we face potential liability for negligence, copyright, patent or trademark infringement or other claims based on the nature and content of materials that we publish or distribute. For example, we have received, and may receive in the future, notices or offers from third parties claiming to have intellectual property rights in technologies that we use in our businesses and inviting us to license those rights. Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others or to defend against claims of infringement or invalidity, and we may not prevail in any future litigation. We may also attract claims that our print and online media properties have violated the copyrights, rights of privacy, or other rights of others. Adverse determinations in litigation could result in the loss of our proprietary rights, subject us to significant liabilities, require us to seek licenses from third parties or prevent us from licensing our technology or selling our products, any of which could seriously harm our business. An adverse determination could also result in the issuance of a cease and desist order, which may force us to discontinue operations through our website or websites. Intellectual property litigation, whether or not determined in our favor or settled, could be costly, could harm our reputation and could divert the efforts and attention of our management and technical personnel from normal business operations.

Existing or future government regulation in the United States and other countries could limit our growth and result in loss of revenue.

We are subject to federal, state, local and international laws, including laws affecting companies conducting business on the Internet, including user privacy laws, regulations prohibiting unfair and deceptive trade practices and laws addressing issues such as freedom of expression, pricing and access charges, quality of products and services, taxation, advertising, intellectual property rights, display and production of material intended for mature audiences and information security. In particular, we are currently required, or may in the future be required, to:

comply with a law passed in New Jersey in January 2008, or other similar laws which may be passed in the future, requiring us to conduct background checks on our members prior to allowing them to interact with other members on our websites or, alternatively, provide notice on our websites that we have not conducted background checks on our members, which may result in our members canceling their membership or failing to subscribe or renew their subscription, resulting in reduced revenue;

provide advance notice of any changes to our privacy policies or to our policies on sharing non-public information with third parties, and if our members or subscribers disagree with these policies or changes, they may wish to cancel their membership or subscription, which will reduce our revenue;

with limited exceptions, give consumers the right to prevent sharing of their non-public personal information with unaffiliated third parties, and if a significant portion of our members choose to request that we don t share their information, our advertising revenue that we receive from renting our mailing list to unaffiliated third parties may decline;

provide notice to residents in some states if their personal information was, or is reasonably believed to have been, obtained by an unauthorized person such as a computer hacker, which may result in our members or subscribers deciding to cancel their membership or subscription, reducing our membership base and subscription revenue;

comply with current or future anti-spam legislation by limiting or modifying some of our marketing and advertising efforts, such as email campaigns, which may result in a reduction in our advertising revenue; for instance, two states recently passed legislation creating a do not contact registry for minors that would make it a criminal violation to send an email message to an address on that state s registry if the email message contained an advertisement for or even a link to a website that offered products or services that minors are prohibited from accessing;

comply with the European Union privacy directive and other international regulatory requirements by modifying the ways in which we collect and share our users personal information; if these modifications render our services less attractive to our members or subscribers, for example, by limiting the amount or type of personal information our members or subscribers could post to their profiles, they may cancel their memberships or subscriptions, resulting in reduced revenue;

qualify to do business in various states and countries, in addition to jurisdictions where we are currently qualified, because our websites are accessible over the Internet in multiple states and countries, which if we fail to so qualify, may prevent us from enforcing our contracts in these states or countries and may limit our ability to grow our business;

limit our domestic or international expansion because some jurisdictions may limit or prevent access to our services as a result of the availability of some content intended for mature viewing on some of our websites and through some of the businesses we acquired from LPI which may render our services less attractive to our members or subscribers and result in a decline in our revenue; and

limit or prevent access, from some jurisdictions, to some or all of the member-generated content available through our websites, which may render our services less attractive to our members or subscribers and result in a decline in our revenue. For example, in June 2005, the United States Department of Justice (the DOJ) adopted regulations purporting to implement the Child Protection and Obscenity Act of 1988, as amended (the CPO Act), by requiring primary and secondary producers, as defined in the regulations, of certain adult materials to obtain, maintain and make available for inspection specified records, such as a performer s name, address and certain forms of photo identification as proof of a performer s age. Failure to properly obtain, maintain or make these records available for inspection upon request of the DOJ could lead to an imposition of penalties, fines or imprisonment. We could be deemed a secondary producer under the CPO Act because we allow our members to display photographic images on our websites as part of member profiles. In addition, we may be deemed a primary producer under the CPO Act because a portion of one of the businesses we acquired

in the LPI acquisition is involved in production of adult content. Enforcement of these regulations as to secondary producers was stayed pending resolution of a legal challenge on the grounds that the regulations exceed the DOJ s statutory authority to regulate secondary producers, among other grounds. In July 2006, the Adam Walsh Child Protection and Safety Act of 2006 (the Walsh Act) became law, amending the CPO Act by expanding the definition of the adult materials covered by the CPO Act and by requiring secondary producers to maintain and make available specified records under the CPO Act. Additionally, in July 2006, the FBI began conducting CPO Act record inspections, including inspections of businesses that allegedly were secondary producers under the CPO Act. In March 2007, the court

hearing the legal challenge to the CPO Act issued partial summary judgment in favor of the DOJ and requested further briefing on how the Walsh Act affected the stay on enforcement of the CPO Act against secondary producers. In April 2007, the court lifted the stay on enforcement against secondary producers. Additionally, in June 2007, the DOJ issued new proposed regulations to implement the Walsh Act and amended CPO Act. The public comment period for the proposed regulations closed in September 2007. It is anticipated that these new proposed regulations will be challenged in court on various constitutional grounds and that another stay against enforcement of these regulations will be sought. In October 2007, the Sixth Circuit Court of Appeals ruled that the CPO Act was unconstitutional. The DOJ appealed that decision in January 2008. If the FBI continues to inspect businesses that are allegedly secondary producers and there are no legal challenges to the CPO Act, the Walsh Act or the new regulations purporting to implement these acts, or if these challenges are unsuccessful, we may be subject to significant and burdensome recordkeeping compliance requirements and we will have to evaluate and implement additional registration and recordkeeping processes and procedures, each of which would result in additional expenses to us. If our members and subscribers feel these additional restrictions or registration and recordkeeping processes and procedures are too burdensome, this is likely to result in an adverse impact on our subscriber growth which, in turn, will have an adverse effect on our financial condition and results of operations. Alternatively, if we determine that the recordkeeping and compliance requirements would be too burdensome, we may be forced to limit the type of content that we allow our members to post to their profiles, which will result in a loss of features that we believe our members and subscribers find attractive, and in turn could result in a decline in our subscriber growth.

The restrictions imposed by, and costs of complying with, current and possible future laws and regulations related to our business could limit our growth and reduce our membership base, revenue and profit margins.

The risks of transmitting confidential information online, including credit card information, may discourage customers from subscribing to our services or purchasing goods from us.

In order for the online marketplace to be successful, we and other market participants must be able to transmit confidential information, including credit card information, securely over public networks. Third parties may have the technology or know-how to breach the security of our customer transaction data. Any breach could cause consumers to lose confidence in the security of our websites and choose not to subscribe to our services or purchase goods from us. We cannot guarantee that our security measures will effectively prohibit others from obtaining improper access to our information or that of our users. If a person is able to circumvent our security measures, he or she could destroy or steal valuable information or disrupt our operations. Any security breach could expose us to risks of data loss, litigation and liability and may significantly disrupt our operations and harm our reputation, operating results or financial condition.

If we are unable to provide satisfactory customer service, we could lose subscribers.

Our ability to provide satisfactory customer service depends, to a large degree, on the efficient and uninterrupted operation of our customer service operations. Any significant disruption or slowdown in our ability to process customer calls resulting from telephone or Internet failures, power or service outages, natural disasters or other events could make it difficult or impossible to provide adequate customer service and support. Further, we may be unable to attract and retain adequate numbers of competent customer service representatives, which is essential in creating a favorable interactive customer experience. In July 2007, we closed our office in Argentina, as a result of which the number of customer service representatives and the hours of customer service representation were reduced. If due to this reduction or otherwise we are unable to continually provide adequate staffing for our customer service operations, our reputation could be harmed and we may lose existing and potential subscribers. In addition, we cannot guarantee that email and telephone call volumes will not exceed our present system or staffing capacities. If this occurs, we could experience delays in responding to customer inquiries and addressing customer concerns.

Table of Contents

We may be the target of negative publicity campaigns or other actions by advocacy groups that could disrupt our operations because we serve the LGBT community.

Advocacy groups may target our business through negative publicity campaigns, lawsuits and boycotts seeking to limit access to our services or otherwise disrupt our operations because we serve the LGBT community. These actions could impair our ability to attract and retain customers, especially in our advertising business, resulting in decreased revenue, and cause additional financial harm by requiring that we incur significant expenditures to defend our business and by diverting management s attention. Further, some investors, investment banking entities, market makers, lenders and others in the investment community may decide not to invest in our securities or provide financing to us because we serve the LGBT community, which, in turn, may hurt the value of our stock.

Adult content in our media properties may be the target of negative publicity campaigns or subject us to restrictive or costly regulatory compliance.

A portion of the content of our media properties is adult in nature. Our adult content increased significantly as a result of our November 2005 acquisition of assets from LPI, which included several adult-themed media properties. Advocacy groups may target our business through negative publicity campaigns, lawsuits and boycotts seeking to limit access to our services or otherwise disrupt our operations because we are a provider of adult content. These actions could impair our ability to attract and retain customers, especially in our advertising business, resulting in decreased revenue, and cause additional financial harm by requiring that we incur significant expenditures to defend our business and by diverting management s attention. Further, some investors, investment banking entities, market makers, lenders and others in the investment community may decide not to invest in our securities or provide financing to us because of our adult content, which, in turn, may hurt the value of our stock. Additionally, future laws or regulations, or new interpretations of existing laws and regulations, may restrict our ability to provide adult content, or make it more difficult or costly to do so, such as the Walsh Act, which became law in July 2006, and the regulations adopted by the DOJ in June 2005 purporting to implement the CPO Act.

If one or more states or countries successfully assert that we should collect sales or other taxes on the use of the Internet or the online sales of goods and services, our expenses will increase, resulting in lower margins.

In the United States, federal and state tax authorities are currently exploring the appropriate tax treatment of companies engaged in online commerce, and new state tax regulations may subject us to additional state sales and income taxes, which could increase our expenses and decrease our profit margins.

In 2003, the European Union implemented new rules regarding the collection and payment of value added tax, or VAT. These rules require VAT to be charged on products and services delivered over electronic networks, including software and computer services, as well as information and cultural, artistic, sporting, scientific, educational, entertainment and similar services. These services are now being taxed in the country where the purchaser resides rather than where the supplier is located. Historically, suppliers of digital products and services that existed outside the European Union were not required to collect or remit VAT on digital orders made to purchasers in the European Union. With the implementation of these rules, we are required to collect and remit VAT on digital orders received from purchasers in the European Union, effectively reducing our revenue by the VAT amount because we currently do not pass this cost on to our customers.

We also do not currently collect sales, use or other similar taxes for sales of our subscription services or for physical shipments of goods into states other than California and New York. In the future, one or more local, state or foreign jurisdictions may seek to impose sales, use or other tax collection obligations on us. If these obligations are successfully imposed upon us by a state or other jurisdiction, we may suffer decreased sales into that state or jurisdiction as the effective cost of purchasing goods or services from us will increase for those residing in these states

or jurisdictions.

Table of Contents

We are exposed to pricing and production capacity risks associated with our magazine publishing business, which could result in lower revenues and profit margins.

We publish and distribute magazines, such as *The Advocate, Out, The Out Traveler* and *HIVPlus,* among others. The commodity prices for paper products have been increasing over recent years, and producers of paper products are often faced with production capacity limitations, which could result in delays or interruptions in our supply of paper. In addition, mailing costs have also been increasing, primarily due to higher postage rates. If pricing of paper products and mailing costs continue to increase, if we encounter shortages in our paper supplies, or if our third party vendors fail to meet their obligations for any reason, our revenues and profit margins could be adversely affected.

In the event of an earthquake, other natural or man-made disaster, or power loss, our operations could be interrupted or adversely affected, resulting in lower revenue.

Our executive offices and our data center are located in the San Francisco Bay area and we have significant operations in Los Angeles. Our business and operations could be disrupted in the event of electrical blackouts, fires, floods, earthquakes, power losses, telecommunications failures, acts of terrorism, break-ins or similar events. Because our California operations are located in earthquake-sensitive areas, we are particularly susceptible to the risk of damage to, or total destruction of, our systems and infrastructure. We are not insured against any losses or expenses that arise from a disruption to our business due to earthquakes. Further, the State of California has experienced deficiencies in its power supply over the last few years, resulting in occasional rolling blackouts. If rolling blackouts or other disruptions in power occur, our business and operations could be disrupted, and we will lose revenue.

Recent regulations related to equity compensation could adversely affect our ability to attract and retain key personnel.

We have used stock options and other long-term incentives as a component of our employee compensation packages. We believe that stock options and other long-term equity incentives directly motivate our employees to maximize long-term stockholder value and, through the use of vesting, encourage employees to remain with our company. Several regulatory agencies and entities have adopted regulatory changes that could make it more difficult or expensive for us to grant stock options to employees. For example, the Financial Accounting Standards Board has adopted changes to the U.S. generally accepted accounting principles that require us to record a charge to earnings for employee stock option grants. In addition, regulations implemented by the Nasdaq Stock Market generally requiring stockholder approval for all stock option plans could make it more difficult for us to grant options to employees in the future. To the extent that new regulations make it more difficult or expensive to grant stock options to employees, we may incur increased compensation costs, consider changes to our equity compensation strategy or find it difficult to attract, retain and motivate employees, each of which could materially and adversely affect our business.

In the event we are unable to satisfy regulatory requirements relating to internal control over financial reporting, or if these internal controls are not effective, our business and our stock price could suffer.

Section 404 of the Sarbanes-Oxley Act of 2002 requires companies to do a comprehensive and costly evaluation of their internal controls. As a result, our management is required on an ongoing basis to perform an evaluation of our internal control over financial reporting. Our efforts to comply with Section 404 and related regulations regarding our management s required assessment of internal control over financial reporting has required, and will continue to require, the commitment of significant financial and managerial resources. If we fail to timely complete these evaluations, we could be subject to regulatory scrutiny and a loss of public confidence in our internal controls, which could have an adverse effect on our business and our stock price.

Our stock price may be volatile and you may lose all or a part of your investment.

Since our initial public offering in October 2004, our stock price has been and may continue to be subject to wide fluctuations. From October 14, 2004 through February 15, 2008, the closing sale prices of our common stock

on the Nasdaq Stock Market ranged from $3.93 to $136.00 per share, after giving effect to our recently completed one-for-ten reverse stock split. Our stock price may fluctuate in response to a number of events and factors, such as quarterly variations in our operating results, changes in financial estimates and recommendations by securities analysts, the operating and stock price performance of other companies that investors or analysts deem comparable to us, the limited float due to the concentration of shares among our recent equity financing investors and sales of stock by our existing stockholders.

In addition, the stock markets have experienced significant price and trading volume fluctuations, and the market prices of Internet-related and e-commerce companies in particular have been extremely volatile and have recently experienced sharp share price and trading volume changes. These broad market fluctuations may impact the trading price of our common stock. In the past, following periods of volatility in the market price of a public company s securities, securities class action litigation has often been instituted against that company. This type of litigation could result in substantial costs to us and a likely diversion of our management s attention.

The sales of common stock by our stockholders could depress the price of our shares.

If our stockholders sell substantial amounts of our common stock in the public market, the market price of our shares could fall. These sales might also make it more difficult for us to sell equity or equity related securities at a time and price that we would deem appropriate. For example, pursuant to the terms of our July 2007 private placement, we filed a registration statement registering for resale all of the common stock we issued in the private placement. Sales by these stockholders could have an adverse impact on the trading price of our common stock.

Our Stockholder Rights Plan, along with provisions in our charter documents and under Delaware law, could discourage a takeover that stockholders may consider favorable.

Our charter documents may discourage, delay or prevent a merger or acquisition that a stockholder may consider favorable because they:

- authorize our board of directors, without stockholder approval, to issue up to 5,000,000 shares of undesignated preferred stock;
- provide for a classified board of directors;
- prohibit our stockholders from acting by written consent;
- establish advance notice requirements for proposing matters to be approved by stockholders at stockholder meetings; and
- prohibit stockholders from calling a special meeting of stockholders.

As a Delaware corporation, we are also subject to Delaware law anti-takeover provisions. Under Delaware law, a corporation may 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. Additionally, our Stockholder Rights Plan adopted in January 2007 will cause substantial dilution to a person or group that attempts to acquire us on terms not approved by our board of directors. Our board of directors could rely on Delaware law or the Stockholder Rights Plan to prevent or delay an acquisition of us.

Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Properties***

We are headquartered in San Francisco, California and currently lease approximately 56,000 square feet at our headquarters facility. Our lease runs through 2012 and we have an option to terminate the lease effective January 2010 with proper notice for a fee. We also lease additional offices in Los Angeles, out of which we operate many of the functions supporting our publishing segment, and in New York, out of which we operate our advertising sales and support for both of our segments. We believe that our existing facilities are adequate to meet current

requirements. We believe that suitable additional or substitute space will be available as needed to accommodate any further physical expansion of corporate operations and for any additional sales offices.

For a discussion of the accounting treatment of our leased corporate headquarters, see Note 7 Commitments and Contingencies of the notes to our Consolidated Financial Statements, which we incorporate by reference herein.

Item 3. ***Legal Proceedings***

We are involved from time to time in various legal proceedings, regulatory investigations and claims incident to the normal conduct of business, which may include proceedings that are specific to us and others generally applicable to business practices within the industries in which we operate. A substantial legal liability or a significant regulatory action against us could have an adverse effect on our business, financial condition and on the results of operations in a particular quarter or year.

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

No matters were submitted to a vote of security holders during the fourth quarter of 2007.

PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

Market Information

Our common stock is traded on The Nasdaq Global Market under the symbol LGBT. Public trading of our common stock commenced in October 2004 and there was no public market for our stock prior to that time. The following table sets forth, for the periods indicated, the high and low bid prices per share of our common stock as reported on The Nasdaq Global Market:

	High	Low
2006		
First Quarter	$ 102.70	$ 73.70
Second Quarter	100.70	64.70
Third Quarter	79.50	26.60
Fourth Quarter	48.60	30.40
2007		
First Quarter	$ 51.90	$ 33.00
Second Quarter	35.20	8.60
Third Quarter	23.30	11.80
Fourth Quarter	13.24	5.41

On February 29, 2008, the closing sales price of our common stock was $3.88 per share.

As of February 29, 2008, there were approximately 209 holders of record of our common stock. This figure does not include the number of stockholders whose shares are held of record by a broker or clearing agency, but does include each such brokerage house or clearing agency as a single holder of record.

We have never paid cash dividends on our stock and currently anticipate that we will continue to retain any future earnings to finance the growth of our business.

For information on securities authorized for issuance under our equity compensation plans, refer to Item 12, Part III.

Repurchases of Equity Securities

Period	(a) Total Number of Shares Purchased(1)	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
October 1, 2007 October 31, 2007		$		
November 1, 2007 November 30, 2007				
December 1, 2007 December 31, 2007				
Total		$		

(1) PlanetOut does not have any publicly announced plans or programs to repurchase shares of its common stock.

Table of Contents

Item 6. ***Selected Financial Data***

The selected financial data set forth below are derived from our financial statements. The statement of operations data for the years ended December 31, 2005, 2006 and 2007, and the balance sheet data as of December 31, 2006 and 2007 are derived from our audited financial statements included elsewhere in this Form 10-K. The statement of operations data for the years ended December 31, 2003 and 2004, and the balance sheet data as of December 31, 2003, 2004 and 2005 are derived from our audited financial statements not included in this Form 10-K. The historical results are not necessarily indicative of results to be expected for any future period. The data presented below has been derived from financial statements that have been prepared in accordance with accounting principles generally accepted in the United States of America and should be read with our financial statements, including the accompanying notes to the financial statements, and with Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Form 10-K.

	Year Ended December 31,				
	2003	2004	2005	2006(1)	2007(1)
	(In thousands, except per share amounts)				
Revenue:					
Advertising services	$ 4,626	$ 6,541	$ 11,724	$ 26,479	$ 25,555
Subscription services	12,727	16,775	21,135	24,447	21,901
Transaction services	1,746	1,646	2,732	7,830	5,557
Total revenue	19,099	24,962	35,591	58,756	53,013
Operating costs and expenses:(*)					
Cost of revenue	6,696	8,068	11,964	26,744	29,886
Sales and marketing	6,554	8,806	11,088	15,592	16,266
General and administrative	4,242	5,182	7,036	11,690	15,122
Restructuring				791	630
Depreciation and amortization	2,030	2,457	3,460	5,187	6,723
Impairment of goodwill and intangible assets					25,914
Total operating costs and expenses	19,522	24,513	33,548	60,004	94,541
Income (loss) from operations	(423)	449	2,043	(1,248)	(41,528)
Interest expense	(193)	(1,077)	(238)	(1,189)	(1,972)
Other income, net	13	116	1,142	573	531
Income (loss) from continuing operations before income taxes	(603)	(512)	2,947	(1,864)	(42,969)
(Benefit) provision for income taxes	149	25	207	45	(6)
Income (loss) from continuing operations	(752)	(537)	2,740	(1,909)	(42,963)
Accretion on redeemable convertible preferred stock	(1,729)	(1,402)			
Loss from discontinued operations, net of taxes				(1,801)	(8,207)

Net earnings (loss) attributable to common stockholders	$ (2,481)	$ (1,939)	$ 2,740	$ (3,710)	$ (51,170)
Net earnings (loss) per share:					
Basic	$ (15.31)	$ (4.01)	$ 1.60	$ (2.14)	$ (17.79)
Diluted	$ (15.31)	$ (4.01)	$ 1.51	$ (2.14)	$ (17.79)
Weighted-average shares used to compute net earnings:					
Basic	162	484	1,712	1,733	2,876
Diluted	162	484	1,819	1,733	2,876
(*) Stock-based compensation is allocated as follows (see Note 10):					
Cost of revenue	$ 502	$ 565	$ 177	$ 67	$ 198
Sales and marketing	419	556	254	40	40
General and administrative	676	1,013	568	180	506
Total stock-based compensation	$ 1,597	$ 2,134	$ 999	$ 287	$ 744

Table of Contents

	As of December 31,				
	2003	2004	2005	2006(1)	2007(1)
	(In thousands)				
Consolidated balance sheet data:					
Cash and cash equivalents	$ 2,282	$ 43,128	$ 18,461	$ 9,674	$ 8,534
Working capital (deficit)	(2,804)	39,209	14,761	7,144	8,298
Total assets	10,929	59,208	77,338	93,589	41,352
Long-term liabilities	545	2,241	10,636	12,647	4,076
Redeemable convertible preferred stock	41,413				
Stockholders equity (deficit)	$ (37,717)	$ 48,764	$ 53,052	$ 51,145	$ 24,909

(1) 2006 and 2007 data reflects the impact of the acquisition of LPI.

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The following Management s Discussion and Analysis of Financial Condition and Results of Operations summarizes the significant factors affecting our consolidated operating results, financial condition and liquidity for the three-year period ended December 31, 2007, should be read in conjunction with the Consolidated Financial Statements and Notes to the Consolidated Financial Statements included elsewhere in this Form 10-K, and contains forward-looking statements regarding future events and our future results that are subject to the safe harbors created under the Securities Act of 1933 (the Securities Act) and the Securities Exchange Act of 1934 (the Exchange Act). These statements are based on current expectations, estimates, forecasts, and projections about the industries in which we operate and the beliefs and assumptions of our management. Words such as anticipate, believe, continue, could, estimate, expect, goal, intend, may, plan, potential, predict, project, seek, should, target, such words, and similar expressions are intended to identify such forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses, and other characterizations of future events or circumstances are forward-looking statements. Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict, including those identified below and under Risk Factors, and elsewhere in this Annual Report on Form 10-K. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. We undertake no obligation to revise or update any forward-looking statements for any reason.

Overview

We are a leading media and entertainment company serving the worldwide lesbian, gay, bisexual and transgender, or LGBT, community. We serve this audience through a variety of products and services including online and print media properties, and other goods and services.

As a result of further integrating our various businesses, our executive management team, and our financial and management reporting systems during fiscal 2006, we began to operate as three segments effective January 1, 2007: Online, Publishing and Travel and Events. The Travel and Events segment consisted of travel and events marketed through our RSVP Productions, Inc. (RSVP) brand and by our consolidated affiliate, PNO DSW Events, LLC (DSW). We sold substantially all the assets of RSVP in December 2007 and sold our interest in DSW in March 2007. As a result of these divestitures and our decision to exit the Travel and Events business, we have two segments remaining as of December 31, 2007: Online and Publishing. In accordance with Statement of Financial Accounting Standards

No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* we have reported the results of operations and financial position of RSVP and DSW in discontinued operations within the consolidated financial statements.

Our Online segment consists of our LGBT-focused websites, most notably Gay.com, PlanetOut.com, Advocate.com and Out.com which provide revenues from advertising services and subscription services. Our Online segment also includes our transaction-based websites, including BuyGay.com, which generate revenue through sales of products and services of interest to the LGBT community, such as fashion, books, CDs and DVDs.

Our Publishing segment includes the operations of our print media properties including the magazines *The Advocate*, *Out*, *The Out Traveler* and *HIVPlus*, among others. Our Publishing segment also generates revenue from newsstand sales of our various print properties and our book publishing businesses, Alyson and Publishers Distributing Co. (PDC).

In July 2007, we closed a private placement financing with a group of accredited and institutional investors and received an aggregate of approximately $26.2 million in gross proceeds from the sale of approximately 2.3 million shares of our common stock at a price of $11.50 per share. We realized net proceeds of approximately $24.0 million from the private placement after deducting fees payable to the placement agent and other transaction costs.

On January 14, 2008, we announced that we have retained the services of Allen & Company, LLC to assist us in evaluating strategic alternatives, including a possible sale of the Company.

Executive Operating and Financial Summary

Our total revenue was $53.0 million in fiscal 2007, decreasing 10% from our prior year s revenue of $58.8 million, due primarily to decreases in our subscription and transaction services revenue.

Total operating costs and expenses were $94.5 million in fiscal 2007, increasing 58% from the prior year total of $60.0 million. These increases were primarily due to impairment charges to goodwill of $21.5 million and impairment charges to intangible assets of $4.4 million. Operating costs and expenses also increased due to increased marketing costs related to direct-mail campaigns for our print properties, severance charges related to the departure of our former President and Chief Operating Officer and our former Chief Technology Officer, increased legal expenses, increased costs to integrate and re-architect the core technology platform of our websites and increased depreciation on capital expenditures as a result our on-going product development and compliance efforts.

Loss from operations was $41.5 million in fiscal 2007, compared to a loss from operations of $1.2 million in fiscal 2006. This increase in loss from operations was primarily the result of the impairment charges to goodwill and intangible assets, the other increases in operating costs and expenses noted above and the decrease in revenue noted above.

We expect that revenue will decrease slightly in fiscal 2008 in comparison to fiscal 2007, primarily as a result of the planned divestiture of the SpecPub Inc. asset group and an anticipated decrease in online subscription services revenue.

We expect our operating loss will decrease in fiscal 2008 in comparison to fiscal 2007, due to non-recurrence in 2008 of the impairment charges recognized in fiscal 2007. However, we expect to incur additional expenses in re-designing our technological architecture, rewriting our web applications and rebuilding our technology platform and networks during fiscal 2008.

Results of Operations

Segment performance is measured based on contribution margin (loss), which consists of total revenues from external customers less direct operating expenses. Direct operating expenses include cost of revenue and sales and marketing expenses. Segment managers do not have discretionary control over other operating costs and expenses such as general and administrative costs (consisting of costs such as corporate management, human resources, finance and legal), and depreciation and amortization, as such, other operating costs and expenses are not evaluated in the measurement of segment performance.

Online Segment

We derive online advertising revenue from advertising contracts in which we typically undertake to deliver a minimum number of impressions to users over a specified time period for a fixed fee. We derive online subscription services revenue from paid membership subscriptions to our online media properties. Transaction services revenue includes revenue generated from the sale of products through multiple transaction-based websites.

Table of Contents

Comparison of the year ended December 31, 2006 to the year ended December 31, 2007 (in thousands, except percentages):

	Year Ended December 31,		Increase (Decrease)	
	2006	2007	$	%
Online revenue:				
Advertising services	$ 11,116	$ 9,365	$ (1,751)	(16)%
Subscription services	18,378	16,476	(1,902)	(10)%
Transaction services	2,129	1,191	(938)	(44)%
Total online revenue	31,623	27,032	(4,591)	(15)%
Online direct operating costs and expenses:				
Cost of revenue	10,240	12,673	2,433	24%
Sales and marketing	10,236	9,296	(940)	(9)%
Total online direct operating costs and expenses	20,476	21,969	1,493	7%
Online contribution margin	$ 11,147	$ 5,063	$ (6,084)	(55)%

Online revenues decreased as a result of a reduction in the number of online subscribers to our Gay.com website, a decrease in sales of products on our transaction-based website properties and a reduction in our national and local advertising sales due in part to turnover in our digital sales staff. Online cost of revenue increased primarily as a result of increased costs to integrate and re-architect the core technology platform of our websites, and, to a lesser extent, increased severance and other costs related to the departure of our former Chief Technology Officer. Online sales and marketing expenses decreased as a result of decreased spending on advertising during fiscal 2007.

For fiscal 2008, we expect that online revenue will decrease from fiscal 2007 as a result of anticipated additional reductions in the number of online subscribers and reductions in online revenues contributed by the SpecPub Inc. assets group, which we plan to divest ourselves of within the next twelve months. We expect that online cost of revenue will increase as we continue to re-architect our core technology platform of our websites, partially offset by reductions in online cost of revenue contributed by the SpecPub Inc. asset group. For fiscal 2008, we expect that sales and marketing expenses may vary with the comparable prior year period depending on the timing of planned advertising to coincide with certain product development milestones.

Comparison of the year ended December 31, 2005 to the year ended December 31, 2006 (in thousands, except percentages):

	Year Ended December 31,		Increase (Decrease)	
	2005	2006	$	%
Online revenue:				
Advertising services	$ 9,043	$ 11,116	$ 2,073	23%

Subscription services	20,202	18,378	(1,824)	(9)%
Transaction services	1,611	2,129	518	32%
Total online revenue	30,856	31,623	767	2%
Online direct operating costs and expenses:				
Cost of revenue	9,248	10,240	992	11%
Sales and marketing	10,358	10,236	(122)	(1)%
Total online direct operating costs and expenses	19,606	20,476	870	4%
Online contribution margin	$ 11,250	$ 11,147	$ (103)	(1)%

Table of Contents

The increase in online advertising services revenue was due, in part, to growth of the general online advertising industry and the incremental effect of certain online properties gained in the acquisition of LPI. The decrease in online subscription services revenue was primarily due to a reduction in online subscribers. The increase in online transaction services revenue was due primarily to the incremental effect of certain online properties gained in the acquisition of LPI.

The increase in online cost of revenue was primarily due to the incremental effect of certain online properties gained in the acquisition of LPI and an increase in expenses related to site operations and support infrastructure, offset partially by a decrease in stock-based compensation expense. The decrease in online sales and marketing expense was primarily due to a decrease in stock-based compensation expense and decreased advertising expenses related to our premium online subscription services, offset partially by an increase due to the incremental effect of certain online properties gained in the acquisition of LPI.

Publishing Segment

We derive publishing advertising revenue from advertisements placed in our print media properties including the magazines *The Advocate*, *Out*, *The Out Traveler* and *HIVPlus*, among others. We offer our customers five separate subscription services across our print media properties. Our publishing segment also generates revenue from newsstand sales of our various print properties and our book publishing businesses, including Alyson and PDC. We began the operations of our publishing segment with the magazine, book publishing and certain other properties gained in our acquisition of LPI in November 2005.

Comparison of the year ended December 31, 2006 to the year ended December 31, 2007 (in thousands, except percentages):

	Year Ended December 31,		Increase (Decrease)	
	2006	2007	$	%
Publishing revenue:				
Advertising services	$ 15,363	$ 16,190	$ 827	5%
Subscription services	6,069	5,425	(644)	(11)%
Transaction services	5,701	4,366	(1,335)	(23)%
Total publishing revenue	27,133	25,981	(1,152)	(4)%
Publishing direct operating costs and expenses:				
Cost of revenue	16,504	17,213	709	4%
Sales and marketing	5,356	6,970	1,614	30%
Total publishing direct operating costs and expenses	21,860	24,183	2,323	11%
Publishing contribution margin	$ 5,273	$ 1,798	$ (3,475)	(66)%

Publishing revenues decreased principally due to decreased newsstand sales of our magazines and books and decreases in revenue per subscriber in subscriptions to our magazines, partially offset by an increase in advertising services revenue as a result of increased page rates charged to our advertisers as a result of our circulation base

growth. Publishing cost of revenue increased primarily due to increased prices for paper used in producing our magazines and due to increased mailing costs in the delivery of magazines to our subscribers. Publishing sales and marketing expenses increased primarily due to the increase in marketing costs related to direct-mail campaigns on most of our print properties.

For fiscal 2008, we expect that total publishing revenues will decrease from fiscal 2007 primarily as a result of reductions in publishing revenues contributed by the SpecPub, Inc. asset group and the effect of advertising sales migrating from print to online. We expect that publishing direct operating costs for fiscal 2008 will increase from fiscal 2007 primarily as a result of anticipated increases in sales and marketing expenses for direct mail campaigns, increased prices for paper used in producing our magazines and increases in mailing costs due to higher postage rates, partially offset by reductions in publishing direct operating costs contributed by the SpecPub Inc. asset group.

Comparison of the year ended December 31, 2005 to the year ended December 31, 2006 (in thousands, except percentages):

	Year Ended December 31,		Increase (Decrease)	
	2005	**2006**	**$**	**%**
Publishing revenue:				
Advertising services	$ 2,681	$ 15,363	$ 12,682	473%
Subscription services	933	6,069	5,136	550%
Transaction services	1,121	5,701	4,580	409%
Total publishing revenue	4,735	27,133	22,398	473%
Publishing direct operating costs and expenses:				
Cost of revenue	2,716	16,504	13,788	508%
Sales and marketing	730	5,356	4,626	634%
Total publishing direct operating costs and expenses	3,446	21,860	18,414	534%
Publishing contribution margin	$ 1,289	$ 5,273	$ 3,984	309%

The increase in publishing revenue and direct operating costs and expenses in fiscal 2006 over fiscal 2005 resulted primarily from the incremental effect of operating of our publishing segment for a full year in fiscal 2006, compared to two months of operations in fiscal 2005.

Other Operating Costs and Expenses

Other operating costs and expenses include general and administrative costs (such as corporate management, human resources, finance and legal), restructuring, depreciation and amortization and impairment of goodwill and intangible assets. These other operating costs and expenses are not evaluated in the measurement of segment performance since segment managers do not have discretionary control over these costs and expenses.

General and Administrative. General and administrative expense consists primarily of payroll and related benefits for executive, finance, administrative and other corporate personnel, occupancy costs, professional fees, insurance and other general corporate expenses. Our general and administrative expenses were $15.1 million for 2007, up 29% from the prior year. General and administrative expenses as a percentage of revenue were 29% for 2007, up from 20% in the prior year. The increase in general and administrative expenses in both absolute dollars and as a percentage of revenue were due to increased compensation and employee related costs including severance and other costs related to the departure of our President and Chief Operating Officer in March 2007; increased legal expenses; and increased stock-based compensation expenses.

Our general and administrative expenses were $11.7 million for 2006, up 66% from the prior year. This increase was due to the incremental effect of the acquisition of LPI; increased compensation and employee related costs as a result of increases in headcount; other relocation and retention charges; and integration and other expenses associated with the acquisition of LPI such as increased legal and insurance expenses. General and administrative expenses as a percentage of revenue were 20% for both 2006 and 2005.

For fiscal 2008, we expect general and administrative expenses to decrease from fiscal 2007 primarily due to decreased compensation and employee related costs as a result of decreases in headcount and decreased legal costs.

Restructuring. In June 2006, our board of directors adopted and approved a reorganization plan to align our resources with our strategic business objectives. As part of the plan, we consolidated our media and advertising services, e-commerce services and back-office operations on a global basis to streamline our operations as part of continued integration of our acquired businesses. The reorganization, along with other organizational changes, reduced our total workforce by approximately 5%. Restructuring costs of approximately $0.8 million, primarily related to employee severance benefits of approximately $0.6 million and facilities consolidation expenses of approximately $0.2 million, were recorded during 2006. We completed this restructuring in the fourth quarter of

2006, with certain payments continuing beyond 2006 in accordance with the terms of existing severance and other agreements.

In July 2007, our board of directors adopted and approved a reorganization plan to further align our resources with our strategic business objectives. As part of the plan, we closed our international offices located in Buenos Aires and London in order to streamline our business operations and reduce expenses. The reorganization, along with other organizational changes, reduced our total workforce by approximately 15%. Restructuring costs of approximately $630,000, primarily related to employee severance benefits of approximately $500,000 and facilities consolidation expenses of approximately $130,000, were recorded during 2007. We completed this restructuring in the fourth quarter of 2007.

Depreciation and Amortization. Depreciation and amortization expense was $6.7 million for fiscal 2007, up 30% from the prior year, due primarily to an increase in depreciation expense related to capital expenditures we have made in order to support our on-going online product development and compliance efforts. Amortization of intangible assets was $0.9 million due to intangible assets which we capitalized in connection with the acquisition of LPI. Depreciation and amortization as a percentage of revenue was 13% for 2007, up from 9% in the prior year. Depreciation and amortization expense was $5.2 million for fiscal 2006, up 50% from the prior year, due primarily to an increase in the amortization of intangible assets associated with the acquisition of LPI and increased capital expenditures to support our on-going online product development and compliance efforts. Amortization of intangible assets was $1.1 million due to intangible assets which we capitalized in connection with the acquisition of LPI. Depreciation and amortization as a percentage of revenue was 9% for 2006, down from 10% in the prior year.

For fiscal 2008, we expect depreciation and amortization expense will increase over fiscal 2007 as a result of capital investments to support our on-going online product development, and to integrate and re-architect the core technology platform of our websites.

Impairment of Goodwill and Intangible Assets. During 2007, we recorded impairment charges to goodwill and to intangible assets of $21.5 million and $4.4 million, respectively. During the three months ended June 30, 2007, we recorded an estimated goodwill impairment charge of $21.1 million, primarily resulting from lower than expected advertising revenue related to our publishing segment which we believe resulted in a significant decrease in the trading price of our common stock and a corresponding reduction in our market capitalization. During the fourth quarter of 2007, we recorded an additional impairment charge to goodwill of $0.4 million related to the winding down of our international marketing efforts and the closure of our international offices in conjunction with our July 2007 restructuring plan. Also during the fourth quarter of 2007, we revised our second quarter impairment estimate as a result of the completion of an independent business valuation of certain of our intangible assets and recorded an additional impairment charge of $4.4 million to our intangible assets for the year ended December 31, 2007.

Other Income and Expenses

Interest Expense. Interest expense was $2.0 million for fiscal 2007, an increase of 66% from the prior year, due primarily to increased interest expense on the Orix term and revolving loans entered into in September 2006, offset partially by a decrease in interest expense on the LPI note entered into in November 2005. Interest expense was $1.2 million for fiscal 2006, an increase of 400% from the prior year, due primarily to the issuance of the note payable in connection with the acquisition of LPI as well as the Orix term and revolving loans. In July 2007, we used a portion of the proceeds of our equity financing to repay, in full, our indebtedness obligations under loans from Orix, as well as our obligations under the LPI note. Interest expense for the year ended December 31, 2007 includes prepayment fees of $0.3 million, loan deferral fees of $0.2 million and $0.2 million for acceleration of the loan discount.

Other Income, Net. Other income, net consists of interest earned on cash, cash equivalents, restricted cash and short-term investments as well as other miscellaneous non-operating transactions. Other income, net was $0.5 million for fiscal 2007, a decrease of 7% from the prior year, primarily due to decreased interest income during fiscal 2007 on our lower cash balance. Other income, net was $0.6 million for fiscal 2006, a decrease of 50% from the prior year, primarily due to decreased interest income during fiscal 2006 on our lower cash balance as a result of the acquisitions of LPI in November 2005 and RSVP in March 2006.

Table of Contents

Discontinued Operations

In an effort to simplify our business model, we discontinued our Travel and Events businesses during 2007. In March 2007, we sold our membership interest in DSW, a joint venture, to the minority interest partner. In December 2007, we sold substantially all the assets of RSVP. As a result of the sale of our interest in DSW, the sale of substantially all the assets of RSVP and our decision to exit our Travel and Events businesses, we have reported the results of operations and financial position of RSVP and DSW as discontinued operations within the consolidated financial statements for the years ended December 31, 2006 and 2007 in accordance with FAS 144. We have reported the financial position of RSVP and DSW as assets and liabilities of discontinued operations on the consolidated balance sheet as of December 31, 2006. In addition, we have segregated the cash flow activity of RSVP and DSW from the consolidated statements of cash flows for the years ended December 31, 2006 and 2007. The results of operations of RSVP and DSW were previously reported and included in the results of operations and financial position of our Travel and Events segment.

The results of discontinued operations for the years ended December 31, 2006 and 2007 were as follows (in thousands):

	Year Ended December 31, 2006			Year Ended December 31, 2007		
	RSVP	DSW	Total	RSVP	DSW	Total
Total revenue	$ 9,158	$ 730	$ 9,888	$ 17,033	$ 2	$ 17,035
Operating costs and expenses:						
Cost of revenue	8,369	92	8,461	18,737		18,737
Sales and marketing	1,317	435	1,752	1,525	37	1,562
General and administrative	890	131	1,021	262	1	263
Restructuring				19		19
Depreciation and amortization	419		419	286		286
Impairment of goodwill and intangible assets				4,400		4,400
Total operating costs and expenses	10,995	658	11,653	25,229	38	25,267
Income (loss) from operations	(1,837)	72	(1,765)	(8,196)	(36)	(8,232)
Other income (expense), net	8	(44)	(36)	25		25
Income (loss) from discontinued operations	$ (1,829)	$ 28	$ (1,801)	$ (8,171)	$ (36)	$ (8,207)

The current and non-current assets and liabilities of discontinued operations of RSVP and DSW were as follows (in thousands):

	December 31, 2006		
	RSVP	DSW	Total
Current assets of discontinued operations:			
Accounts receivable	$ 374	$	$ 374
Prepaid expenses and other current assets	7,172	27	7,199
	$ 7,546	$ 27	$ 7,573
Long-term assets of discontinued operations:			
Property and equipment, net	$ 186	$	$ 186
Goodwill	3,982		3,982
Intangible assets, net	2,369		2,369
	$ 6,537	$	$ 6,537
Current liabilities of discontinued operations:			
Accounts payable	$ 85	$ 6	$ 91
Accrued expenses and other liabilities	397		397
Deferred revenue, current portion	5,580		5,580
	$ 6,062	$ 6	$ 6,068

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets, liabilities, revenue and expenses and related disclosure of contingent assets and liabilities.

We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis on which we make judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Because this can vary in each situation, actual results may differ from the estimates under different assumptions and conditions.

We believe the following critical accounting policies require more significant judgments and estimates in the preparation of our consolidated financial statements:

Revenue recognition. We derive our revenue principally from the sale of premium subscription services, magazine subscriptions, banner and sponsorship advertisements, magazine advertisements and transactions services. Premium online subscription services are generally for a period of one month to twelve months. Premium online subscription services are generally paid for upfront by credit card, subject to cancellations by subscribers or charge backs from transaction processors. Revenue, net of estimated cancellations and charge backs, is recognized ratably over the

service term. To date, cancellations and charge backs have not been significant and have been within management s expectations. Deferred magazine subscription revenue results from advance payments for magazine subscriptions received from subscribers and is amortized on a straight-line basis over the life of the subscription as issues are delivered. We provide an estimated reserve for magazine subscription cancellations at the time such subscription revenues are recorded. Newsstand revenues are recognized based on the on-sale dates of magazines and are recorded based upon estimates of sales, net of product placement costs paid to resellers. Estimated returns from newsstand revenues are recorded based upon historical experience. In January 2006, we began offering our customers premium online subscription services bundled with magazine subscriptions. In accordance with EITF Issue No. 00-21,

Revenue Arrangements with Multiple Deliverables (EITF 00-21), we defer subscription revenue on bundled subscription service offerings based on the pro-rata fair value of the individual premium online subscription services and magazine subscriptions.

To date, the duration of our banner advertising commitments has ranged from one week to one year. Sponsorship advertising contracts have terms ranging from three months to two years and also involve more integration with our services, such as the placement of buttons that provide users with direct links to the advertiser s website. Advertising revenue on both banner and sponsorship contracts is recognized ratably over the term of the contract, provided that we have no significant obligations remaining at the end of a period and collection of the resulting receivables is reasonably assured, at the lesser of the ratio of impressions delivered over the total number of undertaken impressions or the straight line basis. Our obligations typically include undertakings to deliver a minimum number of impressions, or times that an advertisement appears in pages viewed by users of our online properties. To the extent that these minimums are not met, we defer recognition of the corresponding revenue until the minimums are achieved. Magazine advertising revenues are recognized, net of related agency commissions, on the date the magazines are placed on sale at the newsstands. Revenues received for advertisements in magazines to go on sale in future months are classified as deferred advertising revenue.

Transaction service revenue generated from sale of products held in inventory is recognized when the product is shipped net of estimated returns. We also earn commissions for facilitating the sale of third party products and services which are recognized when earned based on reports provided by third party vendors or upon cash receipt if no reports are provided. In accordance with EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent*, the revenue earned for facilitating the sale of third party merchandise is reported net of cost as agent. This revenue is reported net due to the fact that although we receive the order and collect money from buyer, we are under no obligation to make payment to the third party unless payment has been received from the buyer and risk of return is also borne by the third party.

Advertising Costs. Costs related to advertising and promotion are charged to sales and marketing expense as incurred except for direct-response advertising costs which are amortized over the expected life of the subscription, typically a twelve month period. Direct-response advertising costs consist primarily of production costs associated with direct-mail promotion of magazine subscriptions.

Valuation Allowances. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances might be required.

We accrue an estimated amount for sales returns and allowances in the same period that the related revenue is recorded based on historical information, adjusted for current economic trends. To the extent actual returns and allowances vary from the estimated experience, revisions to the allowance may be required. Significant management judgments and estimates are made and used in connection with establishing the sales and allowances reserve in any accounting period.

We record a full valuation allowance against our deferred tax assets due to uncertainties related to our ability to realize the benefit of our deferred tax assets primarily from our net operating losses. In the future, if we generate sufficient taxable income and we determine that we would be able to realize our deferred tax assets, an adjustment to the valuation allowance would impact the results of operations in that period.

Goodwill and Other Long-lived Assets. Our long-lived assets include goodwill, intangibles, property and equipment. We test goodwill for impairment on an annual basis and between annual tests in certain circumstances. Application of the goodwill impairment test requires judgment in determining the fair value of our reporting units and our enterprise

as a whole. We conduct our annual test as of December 1 each year. Future impairment losses may have a material adverse impact on our financial condition and results of operations.

We record an impairment charge on intangibles or long-lived assets to be held and used when we determine that the carrying value of these assets may not be recoverable and/or exceed their carrying value.

Based on the existence of one or more indicators of impairment, we measure any impairment based on a projected discounted cash flow method using a discount rate that we determine to be commensurate with the risk inherent in our business model. Our estimates of cash flow require significant judgment based on our historical results and anticipated results and are subject to many factors.

Capitalized Website Development Costs. We capitalize the costs of enhancing and developing features for our websites when we believe that the capitalization criteria for these activities have been met and amortize these costs on a straight-line basis over the estimated useful life, generally three years. We expense the cost of enhancing and developing features for our websites in cost of revenue only when we believe that capitalization criteria have not been met. We exercise judgment in determining when to begin capitalizing costs and the period over which we amortize the capitalized costs. If different judgments were made, it would have an impact on our results of operations.

Stock-based compensation. We have granted stock options to employees and non-employee directors. We recognize compensation expense for all stock-based payments granted after December 31, 2005 and prior to but not yet vested as of December 31, 2005, in accordance with Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment* (FAS 123R). Under the fair value recognition provisions of FAS 123R, we recognize stock-based compensation net of an estimated forfeiture rate and only recognize compensation cost for those shares expected to vest on a straight-line basis over the requisite service period of the award (normally the vesting period). Prior to FAS 123R adoption, we accounted for stock-based payments under Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25). In anticipation of the impact of adopting FAS 123R, we accelerated the vesting of approximately 72,000 shares subject to outstanding stock options in December 2005. The primary purpose of the acceleration of vesting was to minimize the amount of compensation expense recognized in relation to the options in future periods following the adoption by us of FAS 123R. Since we accelerated these shares and adopted FAS 123R using the modified prospective method, we did not record any one-time charges relating to the transition to FAS 123R and the consolidated financial statements for prior periods have not been restated to reflect, and do not include any impact of FAS 123R. As a result of FAS 123R, we expect to award restricted stock and restricted stock units or other compensation in lieu of or in addition to stock options.

Determining the appropriate fair value model and calculating the fair value of stock-based payment awards require the input of highly subjective assumptions, including the expected life of the stock-based payment awards and stock price volatility. We use the Black-Scholes model to value our stock option awards. Management uses an estimate of future volatility for our stock based on our historical volatility and the volatilities of comparable companies. The assumptions used in calculating the fair value of stock-based payment awards represent management s best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and management uses different assumptions, stock-based compensation expense could be materially different in the future. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If the actual forfeiture rate is materially different from the estimate, stock-based compensation expense could be significantly different from what has been recorded in the current period. See Notes 1 and 10 of Notes to Consolidated Financial Statements for a further discussion on stock-based compensation.

Income Taxes We adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* (FIN 48) on January 1, 2007. We did not have any unrecognized tax benefits and there was no effect on our financial condition or results of operations as a result of implementing FIN 48.

We file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. We are no longer subject to U.S. federal tax assessment for years before 2004. State jurisdictions that remain subject to assessment range from 2003 to 2007. We do not believe there will be any material changes in our unrecognized tax positions over the next 12 months. We believe that our income tax filing positions and deductions will be sustained on audit and do

not anticipate any adjustments that will result in a material adverse effect on our financial condition, results of operations, or cash flow. Therefore, no reserves for uncertain

---

income tax positions have been recorded pursuant to FIN 48. In addition, we did not record a cumulative effect adjustment related to the adoption of FIN 48.

Our policy is that we recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of the date of adoption of FIN 48, we did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the year. Our effective tax rate differs from the federal statutory rate primarily due to increases in our deferred income tax valuation allowance.

Liquidity and Capital Resources

The following sections discuss the effects of changes in our balance sheet and cash flows, contractual obligations, certain commitments and acquisitions on our liquidity and capital resources.

Cash flow from operating, investing and financing activities, as reflected in the Consolidated Statements of Cash Flows, and cash, cash equivalents and short-term investments, as reflected in the Consolidated Balance Sheets, are summarized in the table below:

	Year Ended December 31,		
	2005	**2006**	**2007**
	(In thousands, except percentage of total assets)		
Net cash provided by (used in):			
Operating activities	$ 5,488	$ (4,726)	$ (7,916)
Investing activities	(29,499)	(14,761)	893
Financing activities	(639)	10,699	5,854
Effect of exchange rate on cash and cash equivalents	(17)	1	29
Net decrease in cash and cash equivalents	$ (24,667)	$ (8,787)	$ (1,140)
Cash, cash equivalents and short-term investments			
Cash and cash equivalents	$ 18,461	$ 9,674	$ 8,534
Short-term investments		2,050	
Total cash, cash equivalents and short-term investments	$ 18,461	$ 11,724	$ 8,534
Percentage of total assets	23.9%	12.5%	20.6%

Cash used in operating activities for 2007 was $7.9 million, due primarily to our loss from continuing operations of $43.0 million and cash used in operating activities of discontinued operations of $1.1 million, partially offset by impairment of goodwill and intangible assets of $25.9 million, depreciation and amortization expense of $6.7 million, loss on disposal or write-off of property and equipment of $0.9 million, stock-based compensation expense of $0.7 million and a net decrease in operating assets and liabilities of $1.0 million. Cash used in operating activities for 2006 was $4.7 million, due primarily to our loss from continuing operations of $1.9 million, cash used in operating activities of discontinued operations of $4.4 million, an increase in accounts receivable of $3.2 million and an increase in prepaid expenses and other current assets of $1.6 million, partially offset by depreciation and amortization of $5.2 million and stock-based compensation expense of $0.3 million. Cash flow from operating activities for 2005 was $5.5 million, driven primarily by growth of our advertising services and subscription services businesses, and the

incremental impact of the acquisition of LPI, offset by a $4.0 million increase in accounts receivable and a $0.7 million decrease in accounts payable.

Cash provided by investing activities for 2007 was $0.9 million, due primarily to sales of short-term investments of $2.1 million and a decrease in restricted cash of $2.7 million, offset partially by purchases of property and equipment of $3.8 million. Cash used in investing activities for 2006 was $14.8 million, due primarily to acquisitions of discontinued operations of $5.5 million, purchases of property and equipment of $4.5 million, purchases of short-term investments of $2.1 million and an increase in restricted cash of $2.9 million. Cash used in investing activities for 2005 was $29.5 million, of which $25.5 million was used for acquisitions of businesses, and

$4.0 million for capital assets. Investments in capital assets were comprised primarily of computer and office equipment and furniture and fixtures.

Net cash provided by financing activities for 2007 was $5.9 million, due primarily to the net proceeds from our equity financing of $24.0 million, partially offset by payment of note obligations of $10.2 million to Orix, payment of the LPI note of $7.1 million and $0.8 million for principal payments under capital lease obligations. Net cash provided by financing activities for 2006 was $10.7 million, due primarily to proceeds from issuance of notes payable of $10.5 million and proceeds from the repayment of a stockholder note receivable of $0.8 million, partially offset by $1.1 million for principal payments under capital lease obligations and notes payable. Net cash used by financing activities for 2005 was $0.6 million, consisting of $1.2 million for principal payments under capital lease obligations, partially offset by cash provided by the issuance of common stock related to employee stock option exercises of $0.6 million.

We expect that net cash provided by operating activities will be negative during 2008 and may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, advertising sales, subscription trends, accounts receivable collections and inventory management.

In November 2005, we acquired substantially all of the assets of LPI for a purchase price of approximately $32.6 million which consisted of $24.9 million paid in cash and approximately $7.1 million in the form of a note to the sellers secured by the assets of SpecPub, Inc. and payable in three equal installments in May, August and November 2007, and the reimbursement of certain prepaid and other expenses of approximately $0.6 million. The LPI note was repaid in connection with the private placement financing in July 2007.

In September 2006, we entered into our Loan Agreement with Orix, which was amended in February 2007, May 2007 and June 2007. Pursuant to the Loan Agreement, we borrowed $7.5 million as a term loan and $3.0 million as a 24-month revolving loan in September 2006. The borrowings under the line of credit were limited to lesser of $3.0 million, which we had already drawn down, or 85% of qualifying accounts receivable. The term loan was payable in 48 consecutive monthly installments of principal beginning on November 1, 2006 together with interest at an initial rate of prime plus 3%. The term loan provided for a prepayment fee equal to 5% of the amount prepaid in connection with any prepayment made prior to September 27, 2007. The revolving loan bore interest at a rate of prime plus 1%. The Loan Agreement contained certain financial ratios, financial tests and liquidity covenants. The loans were secured by substantially all of our assets and all of the outstanding capital stock of all of our subsidiaries, except for the assets and capital stock of SpecPub, Inc., which were pledged as security for the LPI note.

We entered into a waiver and amendment to the Loan Agreement in May 2007 (the May Waiver), pursuant to which Orix waived defaults associated with our failure to meet certain financial tests and liquidity covenants. In consideration of the May Waiver, we, in addition to other commitments, agreed to maintain certain minimum cash balances, increase the interest rate on the term loan to prime plus 5% and committed to raise at least $15.0 million in new equity or subordinated debt. At that time, we also agreed to apply at least $3.0 million of the proceeds from that transaction to pay down the term loan. As part of the amendment in June 2007, the parties agreed to modify the requirement in the May Waiver for the commitment to raise new equity or subordinated debt to be for gross proceeds of at least $25.0 million, which could be completed in one or more closings, with the first closing for not less than $4.2 million in proceeds, if applicable, occurring no later than July 10, 2007, and the entire financing being completed no later than September 30, 2007. In addition, Orix consented to, among other things, certain limited prepayments with respect to our other indebtedness in the event of the first closing and prior to the completion of the entire financing. Orix also agreed to defer the payment of principal installments due on July 1, August 1 and September 1 with respect to its term loan for a deferral fee of $150,000. In July 2007, we completed a private placement financing with a group of investors for approximately $26.2 million in gross proceeds from the sale of approximately 2.3 million shares of our common stock and used a portion of the proceeds to repay, in full, the LPI note, the Orix term loan, the

Orix revolving loan, the deferral fee and $0.3 million in prepayment fees.

During 2007, we invested $4.3 million in property and equipment of which $0.5 million was financed through capital leases. 97% of this investment related to capitalized labor, hardware and software related to enhancements to our website infrastructure and features. For fiscal 2008, we expect to continue investing in our technology

development as we improve our online technology platform and enhance our features and functionality across our network of websites.

Our capital requirements depend on many factors, including the level of our revenues, the resources we devote to developing, marketing and selling our products and services, the timing and extent of our introduction of new features and services, the extent and timing of potential investments or acquisitions and other factors. In particular, our subscription services consist of prepaid subscriptions that provide cash flows in advance of the actual provision of services. We expect to devote substantial capital resources to expand our product development and marketing efforts and for other general corporate activities.

Based on our current operations, we expect that our available funds and anticipated cash flows from operations will be sufficient to meet our expected needs for working capital and capital expenditures for the next twelve months, although we can provide no assurances in that regard. If we do not have sufficient cash available to finance our operations, we may be required to obtain additional public or private debt or equity financing. We cannot be certain that additional financing will be available to us on favorable terms when required or at all. If we are unable to raise sufficient funds, we may need to reduce our planned operations. On January 14, 2008, we announced that we have retained the services of Allen & Company, LLC to assist us in evaluating strategic alternatives, including a possible sale of the Company. We are actively considering such strategic alternatives. We incurred a significant net loss in 2007 and expect to incur additional losses during 2008. We expect that raising additional financing will be very difficult, if it could be obtained at all. Accordingly, if we are unsuccessful in pursuing our strategic alternatives, we could be forced to engage in dispositions of assets or businesses on unfavorable terms, or consider curtailing or ceasing operations. In that event, we cannot provide any assurance that our assets will be sufficient to meet our liabilities.

Off-Balance Sheet Liabilities

We did not have any off-balance sheet liabilities or transactions as of December 31, 2007.

Other Contractual Commitments

The following table summarizes our contractual obligations as of December 31, 2007, and the effect that these obligations are expected to have on our liquidity and cash flows in future periods:

	Payments Due by Period				
	Total	**2008**	**2009-2010**	**2011-2012**	**2013 & After**
	(In thousands)				
Contractual obligations:					
Capital lease obligations	$ 2,206	$ 1,011	$ 1,116	$ 79	$
Operating leases	12,674	2,884	5,837	3,953	
Total contractual obligations	$ 14,880	$ 3,895	$ 6,953	$ 4,032	$

Capital Lease Obligations. We hold property and equipment under noncancelable capital leases with varying maturities.

Operating Leases. We lease or sublease office space and equipment under cancelable and noncancelable operating leases with various expiration dates through December 31, 2012. Operating lease amounts include minimum rental payments under our non-cancelable operating leases for office facilities, as well as limited computer and office equipment that we utilize under operating lease arrangements. The amounts presented are consistent with the contractual terms and are not expected to differ significantly, unless a substantial change in our headcount needs requires us to exit an office facility early or expand our occupied space.

Seasonality and Inflation

We anticipate that our business may be affected by the seasonality of certain revenue lines. For example, print and online advertising buys are usually higher approaching year-end and lower at the beginning of a new year than at other points during the year.

Table of Contents

Inflation has not had a significant effect on our revenue or expenses historically and we do not expect it to be a significant factor in the short-term. However, inflation may affect our business in the medium-term to long-term. In particular, our operating expenses may be affected by a tightening of the job market, resulting in increased pressure for salary adjustments for existing employees and higher cost of replacement for employees that are terminated or resign.

Recent Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (FAS 141R). FAS 141R requires an acquirer to measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. FAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. We have not yet determined the effect on our consolidated financial statements, if any, upon adoption of FAS 141R.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51* (FAS 160). FAS 160 clarifies that a noncontrolling interest in a subsidiary should be reported as equity in the consolidated financial statements. The calculation of earnings per share will continue to be based on income amounts attributable to the parent. FAS 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. We have not yet determined the effect on our consolidated financial statements, if any, upon adoption of FAS 160.

In February 2007, the FASB issued SFAS No. 159 (FAS 159), *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* which is effective for fiscal years beginning after November 15, 2007. This statement permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. We are currently evaluating the potential impact of FAS 159, but do not expect the adoption of FAS 159 to have a material impact on our consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157 (FAS 157), *Fair Value Measurements,* which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. FAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. FAS 157 is effective for fiscal years beginning after November 15, 2007. Earlier adoption is permitted, provided the company has not yet issued financial statements, including for interim periods, for that fiscal year. We are currently evaluating the impact of FAS 157, but do not expect the adoption of FAS 157 to have a material impact on our consolidated financial position, results of operations or cash flows.

Table of Contents

Item 8. *Financial Statements and Supplementary Data*

PlanetOut Inc.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

	Page
Consolidated Financial Statements:	
Report of Independent Registered Public Accounting Firm	38
Consolidated Balance Sheets	39
Consolidated Statements of Operations	40
Consolidated Statements of Stockholders Equity	41
Consolidated Statements of Cash Flows	42
Notes to Consolidated Financial Statements	43
Supplementary Financial Data (unaudited):	
Selected Quarterly Financial Data for each of the years ended December 31, 2006 and 2007	71
Financial Statement Schedule:	
Valuation and Qualifying Accounts for each of the years ended December 31, 2005, 2006 and 2007	72

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of PlanetOut Inc.:

We have audited the accompanying consolidated balance sheets of PlanetOut, Inc. and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2007. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule 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 audit 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PlanetOut, Inc. and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, in 2006 the Company adopted Statement of Financial Accounting Standards No. 123 (Revised 2004), Share-Based Payments.

/s/ Stonefield Josephson, Inc.

San Francisco, California
March 10, 2008

Table of Contents

PlanetOut Inc.

CONSOLIDATED BALANCE SHEETS

	December 31, 2006	December 31, 2007
	(In thousands, except per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 9,674	$ 8,534
Short-term investments	2,050	
Restricted cash	2,854	167
Accounts receivable, net	8,963	6,868
Inventory	1,690	1,113
Prepaid expenses and other current assets	4,137	2,188
Current assets of discontinued operations	7,573	
Current assets held for sale		1,795
Total current assets	36,941	20,665
Property and equipment, net	10,737	8,441
Goodwill	28,590	7,123
Intangible assets, net	9,763	1,870
Other assets	1,021	580
Long-term assets of discontinued operations	6,537	
Long-term assets held for sale		2,673
Total assets	$ 93,589	$ 41,352
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,691	$ 1,338
Accrued expenses and other liabilities	3,310	2,491
Deferred revenue, current portion	8,989	5,760
Capital lease obligations, current portion	694	838
Notes payable, current portion net of discount	8,817	
Deferred rent, current portion	228	264
Current liabilities of discontinued operations	6,068	
Current liabilities related to assets held for sale		1,676
Total current liabilities	29,797	12,367
Deferred revenue, less current portion	1,474	1,089
Capital lease obligations, less current portion	1,504	984
Notes payable, less current portion and discount	8,100	
Deferred rent, less current portion	1,569	1,401
Long-term liabilities related to assets held for sale		602

Total liabilities		42,444		16,443
Commitments and contingencies (Note 7)				
Stockholders equity:				
Common stock: $0.001 par value, 100,000 shares authorized, 1,763 and 4,096 shares issued and outstanding at December 31, 2006 and 2007, respectively		17		40
Additional paid-in capital		89,532		114,406
Accumulated other comprehensive loss		(122)		(85)
Accumulated deficit		(38,282)		(89,452)
Total stockholders equity		51,145		24,909
Total liabilities and stockholders equity	$	93,589	$	41,352

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

Table of Contents

PlanetOut Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2005	2006	2007
	(In thousands, except per share amounts)		
Revenue:			
Advertising services	$ 11,724	$ 26,479	$ 25,555
Subscription services	21,135	24,447	21,901
Transaction services	2,732	7,830	5,557
Total revenue	35,591	58,756	53,013
Operating costs and expenses:(*)			
Cost of revenue	11,964	26,744	29,886
Sales and marketing	11,088	15,592	16,266
General and administrative	7,036	11,690	15,122
Restructuring		791	630
Depreciation and amortization	3,460	5,187	6,723
Impairment of goodwill and intangible assets			25,914
Total operating costs and expenses	33,548	60,004	94,541
Income (loss) from operations	2,043	(1,248)	(41,528)
Interest expense	(238)	(1,189)	(1,972)
Other income, net	1,142	573	531
Income (loss) from continuing operations before income taxes	2,947	(1,864)	(42,969)
(Benefit) provision for income taxes	207	45	(6)
Income (loss) from continuing operations	2,740	(1,909)	(42,963)
Loss from discontinued operations, net of taxes		(1,801)	(8,207)
Net income (loss)	$ 2,740	$ (3,710)	$ (51,170)
Net income (loss) per share from continuing operations:			
Basic	$ 1.60	$ (1.10)	$ (14.94)
Diluted	$ 1.51	$ (1.10)	$ (14.94)
Loss per share from discontinued operations:			
Basic	$	$ (1.04)	$ (2.85)
Diluted	$	$ (1.04)	$ (2.85)

Net income (loss) per share:						
Basic	$	1.60	$	(2.14)	$	(17.79)
Diluted	$	1.51	$	(2.14)	$	(17.79)
Weighted-average shares used to compute income (loss) per share:						
Basic		1,712		1,733		2,876
Diluted		1,819		1,733		2,876
(*) Stock-based compensation is allocated as follows (see Note 10):						
Cost of revenue	$	177	$	67	$	198
Sales and marketing		254		40		40
General and administrative		568		180		506
Total stock-based compensation	$	999	$	287	$	744

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

Table of Contents

PlanetOut Inc.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

	Year Ended December 31,		
	2005	2006	2007
	(In thousands)		
Common stock:			
Balance, beginning of year	$ 17	$ 17	$ 17
Equity financing			23
Balance, end of year	17	17	40
Additional paid-in-capital:			
Balance, beginning of year	88,387	88,333	89,532
Issuance of common stock for cash on exercise of options and warrants	552	461	71
Stock-based compensation, net of cancellations and tax effects of disqualifying dispositions	(687)	293	761
Issuance of common stock warrants in connection with debt issuance		445	
Issuance of common stock warrants in connection with financial advisory services			185
Restricted stock withheld for taxes			(137)
Equity financing			23,994
Stock-based compensation upon acceleration of unvested options	81		
Balance, end of year	88,333	89,532	114,406
Note receivable from stockholder:			
Balance, beginning of year	(603)	(603)	
Repayment of note receivable from stockholder		603	
Balance, end of year	(603)		
Unearned stock-based compensation:			
Balance, beginning of year	(1,619)		
Unearned stock-based compensation, net of cancellations	493		
Amortization of unearned stock-based compensation, net of cancellations	600		
Stock-based compensation upon acceleration of unvested options	526		
Balance, end of year			
Accumulated other comprehensive loss:			
Balance, beginning of year	(106)	(123)	(122)
Foreign currency translation adjustment	(17)	1	37
Balance, end of year	(123)	(122)	(85)

Accumulated deficit:			
Balance, beginning of year	(37,312)	(34,572)	(38,282)
Net income (loss)	2,740	(3,710)	(51,170)
Balance, end of year	(34,572)	(38,282)	(89,452)
Total stockholders equity	$ 53,052	$ 51,145	$ 24,909
Number of shares			
Common stock:			
Balance, beginning of year	1,694	1,725	1,763
Issuance of common stock upon exercise of options and warrants	31	16	14
Issuance of restricted stock		22	48
Forfeitures of restricted stock grants			(4)
Restricted stock withheld for taxes			(3)
Equity financing			2,278
Balance, end of year	1,725	1,763	4,096

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

41

Table of Contents

PlanetOut Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2005	2006	2007
		(In thousands)	
Cash flows from operating activities:			
Net income (loss)	$ 2,740	$ (3,710)	$ (51,170)
Net loss from discontinued operations, net of tax		1,801	8,207
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	3,460	5,187	6,723
Impairment of goodwill and intangible assets			25,914
Non-cash services expense			185
Provision for doubtful accounts	112	219	211
Restructuring		19	203
Stock-based compensation, net of cancellation and tax effects	405	287	744
Stock-based compensation upon acceleration of vesting of unvested options	608		
Amortization of debt discount		55	392
Amortization of deferred rent	256	(43)	(132)
Loss on disposal or write-off of property and equipment	71	46	940
Equity in net loss of unconsolidated affiliate	57		
Changes in operating assets and liabilities, net of acquisition effects and restructuring:			
Accounts receivable	(4,067)	(3,152)	1,987
Inventory	(668)	(341)	263
Prepaid expenses and other assets	1,221	(1,629)	1,489
Accounts payable	(706)	357	(281)
Accrued expenses and other liabilities	1,201	560	(858)
Deferred revenue	798	(24)	(1,602)
Net cash provided by (used in) operating activities of continuing operations	5,488	(368)	(6,785)
Net cash used in operating activities of discontinued operations		(4,358)	(1,131)
Net cash provided by(used in)operating activities	5,488	(4,726)	(7,916)
Cash flows from investing activities:			
Acquisitions, net of issuance of note payable and cash acquired	(25,546)	76	
Acquisitions of discontinued operations, net of cash acquired		(5,479)	
Purchases of property and equipment	(3,953)	(4,454)	(3,844)
(Purchases) sales of short-term investments		(2,050)	2,050
Changes in restricted cash		(2,854)	2,687

Net cash provided by (used in) investing activities	(29,499)	(14,761)	893
Cash flows from financing activities:			
Proceeds from exercise of common stock and preferred stock options and warrants	552	461	71
Proceeds from equity financing, net of transaction costs			24,017
Proceeds from repayment of note receivable from stockholder		843	
Tax withholding payments reimbursed by restricted stock			(137)
Principal payments under capital lease obligations and notes payable	(1,191)	(1,105)	(18,097)
Proceeds from issuance of notes payable		10,500	
Net cash provided by(used in)financing activities	(639)	10,699	5,854
Effect of exchange rate on cash and cash equivalents	(17)	1	29
Net decrease in cash and cash equivalents	(24,667)	(8,787)	(1,140)
Cash and cash equivalents, beginning of period	43,128	18,461	9,674
Cash and cash equivalents, end of period	$ 18,461	$ 9,674	$ 8,534
Supplemental disclosure of cash flow information:			
Cash paid for interest	$ 105	$ 1,189	$ 1,972
Cash paid (refund received) for taxes	$ 172	$ 177	$ (59)
Supplemental disclosure of noncash flow investing and financing activities:			
Property and equipment and related maintenance acquired under capital leases	$ 113	$ 2,525	$ 461
Unearned stock-based compensation	$ 493	$	$
Issuance of note payable in connection with acquisition	$ 7,075	$	$
Issuance of common stock warrants in connection with debt issuance	$	$ 445	$

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

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 The Company and Summary of Significant Accounting Policies

The Company

PlanetOut Inc. (the Company) was incorporated in Delaware in December 2000. The Company, together with its subsidiaries, is a leading media and entertainment company serving the worldwide lesbian, gay, bisexual and transgender, or LGBT, community. The Company serves this audience through a wide variety of products and services, including online and print media properties, and other goods and services.

The Company s online media properties include the leading LGBT-focused websites Gay.com, PlanetOut.com, Advocate.com and Out.com. The Company s print media properties include the magazines *The Advocate, Out, The Out Traveler* and *HIVPlus*, among others. The Company also offers its customers access to specialized products and services through its transaction-based websites, including BuyGay.com, that generate revenue through sales of products and services of interest to the LGBT community, such as fashion, books, CDs and DVDs. The Company also generates revenue from newsstand sales of its various print properties.

In March 2006, the Company acquired substantially all of the assets of RSVP Productions, Inc. (RSVP), which the Company operated as a wholly-owned subsidiary. On December 14, 2007, the Company completed the sale of substantially all the assets of RSVP. As a result of this sale and the Company s decision to exit the Travel and Events business, the results of operations and financial position of RSVP are reported in discontinued operations within the consolidated financial statements. See Note 14, Discontinued Operations.

Principles of Consolidation and Basis of Presentation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries and variable interest entities in which the Company has been determined to be the primary beneficiary. All significant intercompany transactions and balances have been eliminated in consolidation. The Company recognizes minority interest for subsidiaries or variable interest entities where it owns less than 100 percent of the equity of the subsidiary. The recording of minority interest eliminates a portion of operating results equal to the percentage of equity it does not own. The Company discontinues allocating losses to the minority interest when the minority interest is reduced to zero.

Investments in entities over which the Company has significant influence, typically those entities that are 20 to 50 percent owned by the Company, are accounted for using the equity method of accounting, whereby the investment is carried at cost of acquisition, plus the Company s equity in undistributed earnings or losses since acquisition. The Company monitors such investments for impairment by considering current factors including economic environment, market conditions, and operational performance and other specific factors relating to the business underlying the investment, and records reductions in carrying values when necessary. Investments in entities in which the Company holds less than a 20 percent ownership interest and over which the Company does not have the ability to significantly influence the operations of the investee are accounted for using the cost method of accounting.

As a result of the Company experiencing significant losses and net cash used in its operating activities in each of the last two years and its anticipating a significant loss and additional cash to be used in the next twelve months, the Company has carefully assessed its anticipated cash needs for the next twelve months. The Company has adopted an

operating plan to manage the costs of its capital expenditures and operating activities along with its revenues in order to meet its working capital needs. Although the Company believes that it has sufficient working capital to conduct its operations and meet its current obligations for the next twelve months, it makes no assurance that it will be able to do so. Accordingly, the accompanying consolidated financial statements are presented on the basis that the Company is a going concern.

Reverse Stock Split

Following the receipt of stockholder approval for a reverse stock split at the special meeting of stockholders held on August 29, 2007, the Company s board of directors set the ratio of the reverse stock split of the Company s common stock at one-for-ten. The reverse stock split became effective on October 1, 2007, when the Company filed

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

an amendment to its certificate of incorporation. As a result of the reverse stock split, every ten shares of the Company s common stock were combined into one share of common stock. No fractional shares were issued in connection with the reverse stock split, and stockholders who would have been entitled to fractional shares received cash in lieu of fractional shares. The number of shares subject to the Company s outstanding options and warrants was reduced in the same ratio as the reduction in the outstanding shares, and the per share exercise price of those options and warrants will be increased in direct proportion to the reverse stock split ratio. All references to share and per-share data for all periods presented have been adjusted to give effect to the reverse stock split.

Reclassifications

Certain reclassifications have been made in the prior consolidated financial statements to conform to the current year presentation. These reclassifications did not change the previously reported net income (loss) or net income (loss) per share of the Company.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Significant estimates and assumptions made by management include, among others, the assessment of collectibility of accounts receivable, the determination of the allowance for doubtful accounts, the determination of the reserve for inventory obsolescence, the determination of the fair market value of its common stock, the valuation and useful life of its capitalized software and long-lived assets, impairment analysis of goodwill and intangible assets and the valuation of deferred tax asset balances. Actual results could differ from those estimates.

Cash Equivalents and Short-Term Investments

The Company considers all highly liquid investments purchased with original or remaining maturities of three months or less to be cash equivalents. Investment securities with original maturities greater than three months and remaining maturities of less than one year are classified as short-term investments. The Company s investments are primarily comprised of money market funds and certificates of deposit, the fair market value of which approximates cost.

Restricted Cash

Restricted cash as of December 31, 2007 consists of $167,000 of cash that is restricted as to future use by contractual agreements associated with irrevocable letters of credit relating to a lease agreement for one of the Company s offices in New York. Restricted cash as of December 31, 2006 consisted of $160,000 of cash that is restricted as to future use by contractual agreements associated with irrevocable letters of credit relating to a lease agreement for one of the Company s offices in New York and $2,694,000 relating to a lease agreement with a cruise line securing future deposit commitments required under that agreement which was applied against the commitments for future deposits in February 2007.

Fair Value of Financial Instruments

Carrying amounts of certain of the Company s financial instruments including cash and cash equivalents, short-term investments, restricted cash, accounts receivable, accounts payable and borrowings are carried at cost, which approximate fair value due to their short maturities. The reported amount of borrowings approximates fair value due to the market value interest rate.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash, cash equivalents and accounts receivable. Cash and cash equivalents are maintained by financial institutions in

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the United States, Europe and Argentina. Deposits in the United States may exceed federally insured limits. Management believes that the financial institutions that hold the Company s investments are financially credit worthy and, accordingly, minimal credit risk exists with respect to those investments.

The Company s accounts receivable are derived primarily from advertising customers. The Company performs ongoing credit evaluations of its customers, does not require collateral and maintains allowances for potential credit losses when deemed necessary. To date, such losses have been within management s expectations. In 2005, 2006 and 2007, no single customer accounted for 10% or more of the Company s revenue or net accounts receivable.

Foreign Currency Translation

The functional currency for the consolidated foreign subsidiaries is their applicable local currency. Accordingly, the translation from their applicable local currency to U.S. Dollars is performed for balance sheet accounts using current exchange rates in effect at the balance sheet date and for revenue and expense accounts using an average exchange rate during the period. The resulting translation adjustments are recorded as a component of other comprehensive loss. Foreign currency translation gains and losses are reflected in the equity section of the Company s consolidated balance sheets as accumulated other comprehensive loss. Gains or losses resulting from foreign currency transactions are included in other income, net in the consolidated statements of operations and for 2005, 2006 and 2007 have not been significant.

Inventory

Inventory consists of finished goods held for sale and materials related to the production of future publications such as editorial and artwork costs, books, paper, other publishing and novelty products and shipping materials. Inventory is stated at the lower of cost or market. Cost is determined using the weighted-average cost method for finished goods available for sale and using the first-in, first-out method for materials related to future production.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is calculated using the straight line method over the estimated useful lives of the related assets ranging from three to five years. Leasehold improvements are amortized over the shorter of their economic lives or lease term, generally ranging from two to seven years. Maintenance and repairs are charged to expense as incurred. When assets are retired or otherwise disposed of, the cost and accumulated depreciation and amortization are removed from the accounts and any resulting gain or loss is reflected in the consolidated statement of operations in the period realized.

Internal Use Software and Website Development Costs

The Company capitalizes internally developed software costs in accordance with the provisions of American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 98-1, *Accounting for Costs of Computer Software Developed or Obtained for Internal Use* (SOP 98-1) and Emerging Issues Task Force (EITF) Abstract No. 00-02, *Accounting for Web Site Development Costs* (EITF 00-02). SOP 98-1 requires that costs incurred in the preliminary project and post-implementation stages of an internal-use software project be expensed as incurred and that certain costs incurred in the application development stage of a project be capitalized. The Company begins to

capitalize costs when the preliminary project stage has been completed and technological and economical feasibility has been determined. The Company exercises judgment in determining which stage of development a software project is in at any point in time. Capitalized costs are amortized on a straight-line basis over the estimated useful life of the software, generally three years, once it is available for its intended use. For 2005, 2006 and 2007 the Company capitalized $2.0 million, $2.1 million and $2.1 million, respectively.

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Goodwill

The Company accounts for goodwill using the provisions of Statement of Financial Accounting Standards (SFAS) No. 142 (FAS 142), *Goodwill and Other Intangible Assets.* FAS 142 requires that goodwill be tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis and between annual tests in certain circumstances. The Company performs its annual impairment test as of December 1 of each year. The performance of the test involves a two-step process. The first step of the impairment test involves comparing the fair value of the Company s reporting unit with the reporting unit s carrying amount, including goodwill. The Company generally determines the fair value of its reporting unit using the expected present value of future cash flows, giving consideration to the market comparable approach. If the carrying amount of the Company s reporting unit exceeds the reporting unit s fair value, the Company performs the second step of the goodwill impairment test. The second step of the goodwill impairment test involves comparing the implied fair value of the Company s reporting unit s goodwill with the carrying amount of the unit s goodwill. If the carrying amount of the reporting unit s goodwill is greater than the implied fair value of its goodwill, an impairment charge is recognized for the excess in operating expenses.

The Company determined that it had one reporting unit through December 31, 2006. On January 1, 2007, the Company determined that it had four reporting units and began operating in three segments. During the fourth quarter of 2007, the Company divested itself of its Travel and Events business, and is currently operating in two segments, with three reporting units.

The Company evaluates goodwill, at a minimum, on an annual basis and whenever events and changes in circumstances suggest that a reporting unit s carrying amount exceeds its fair value. During the three months ended June 30, 2007, the Company determined that a triggering event had occurred, primarily due to lower advertising revenue than expected related to the Company s publishing segment and lower revenue than expected related to the Company s Travel and Events business which the Company believes resulted in a significant decrease in the trading price of the Company s common stock and a corresponding reduction in its market capitalization. As a result of this triggering event, the Company conducted the first step of its goodwill impairment test and determined that goodwill had been impaired. Accordingly, the Company conducted the second step of its impairment test to measure the impairment and recorded an estimated impairment charge to goodwill in the amount of $21.1 million in operating expenses of continuing operations during the three months ended June 30, 2007.

The Company performed its annual test as of December 31, 2007. The results of Step 1 of the annual goodwill impairment analysis on December 1, 2007 showed that goodwill was not impaired as the estimated market value of its reporting units exceeded their carrying value, including goodwill. Accordingly, Step 2 was not performed. The Company will continue to test for impairment on an annual basis and on an interim basis if an additional triggering event occurs or circumstances change that would more likely than not reduce the fair value of the Company s reporting units below their carrying amounts. As a result of the winding down of the Company s international marketing efforts and the Company s closure of its international offices in conjunction with the July 2007 restructuring plan, the Company recognized an additional goodwill impairment charge of $0.4 million in operating expenses of continuing operations in the fourth quarter of 2007.

An additional impairment charge of $4.0 million related to the Travel and Events business is reflected under discontinued operations during 2007. See Note 14, Discontinued Operations.

Intangible Assets and Other Long-Lived Assets

The Company accounts for identifiable intangible assets and other long-lived assets in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which addresses financial accounting and reporting for the impairment and disposition of identifiable intangible assets and other long-lived assets. The Company evaluates long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of a long-lived asset may not be recoverable. The Company records an impairment

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

charge on intangibles or long-lived assets to be held and used when it determines that the carrying value of these assets may not be recoverable and/or exceed their carrying value. Based on the existence of one or more indicators of impairment, the Company measures any impairment based on a projected discounted cash flow method using a discount rate that it determines to be commensurate with the risk inherent in its business model. These estimates of cash flow require significant judgment based on the Company s historical results and anticipated results and are subject to many factors.

Revenue Recognition

The Company s revenue is derived principally from the sale of premium online subscription services, magazine subscriptions, banner and sponsorship advertisements, magazine advertisements and transactions services. Premium online subscription services are generally for a period of one to twelve months. Premium online subscription services are generally paid for upfront by credit card, subject to cancellations by subscribers or charge backs from transaction processors. Revenue, net of estimated cancellations and charge backs, is recognized ratably over the service term. To date, cancellations and charge backs have not been significant and have been within management s expectations. Deferred magazine subscription revenue results from advance payments for magazine subscriptions received from subscribers and is amortized on a straight-line basis over the life of the subscription as issues are delivered. The Company provides an estimated reserve for magazine subscription cancellations at the time such subscription revenues are recorded. Newsstand revenues are recognized based on the on-sale dates of magazines and are recorded based upon estimates of sales, net of product placement costs paid to resellers. Estimated returns from newsstand revenues are recorded based upon historical experience. In January 2006, the Company began offering its customers premium online subscription services bundled with magazine subscriptions. In accordance with EITF Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF 00-21), the Company defers subscription revenue on bundled subscription service offerings based on the pro-rata fair value of the individual premium online subscription services and magazine subscriptions.

To date, the duration of the Company s banner advertising commitments has ranged from one week to one year. Sponsorship advertising contracts have terms ranging from three months to two years and also involve more integration with the Company s services, such as the placement of buttons that provide users with direct links to the advertiser s website. Advertising revenue on both banner and sponsorship contracts is recognized ratably over the term of the contract, provided that no significant Company obligations remain at the end of a period and collection of the resulting receivables is reasonably assured, at the lesser of the ratio of impressions delivered over the total number of undertaken impressions or the straight-line basis. The Company s obligations typically include undertakings to deliver a minimum number of impressions, or times that an advertisement appears in pages viewed by users of the Company s online properties. To the extent that these minimums are not met, the Company defers recognition of the corresponding revenue until the minimums are achieved. Magazine advertising revenues are recognized, net of related agency commissions, on the date the magazines are placed on sale at the newsstands. Revenues received for advertisements in magazines to go on sale in future months are classified as deferred advertising revenue.

Transaction service revenue generated from the sale of products held in inventory is recognized when the product is shipped, net of estimated returns. The Company also earns commissions for facilitating the sale of third party products and services which are recognized when earned based on reports provided by third party vendors or upon cash receipt if no reports are provided. In accordance with EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent,* the revenue earned for facilitating the sale of third party merchandise is reported net of cost as agent.

This revenue is reported net due to the fact that although the Company receives the order and collects money from buyer, the Company is under no obligation to make payment to the third party unless payment has been received from the buyer and risk of return is also borne by the third party.

Table of Contents

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Advertising

Costs related to advertising and promotion are charged to sales and marketing expense as incurred except for direct-response advertising costs which are amortized over the expected life of the subscription, typically a twelve month period. Direct-response advertising costs consist primarily of production costs associated with direct-mail promotion of magazine subscriptions. As of December 31, 2006 and 2007, the balance of unamortized direct-response advertising costs was $1,540,000 and $952,000, respectively, and is included in prepaid expenses and other current assets. Total advertising costs in 2005, 2006 and 2007 were $3,260,000, $3,086,000 and $2,363,000, respectively.

Sales Returns and Allowances

The Company accrues an estimated amount for sales returns and allowances in the same period that the related revenue is recorded based on historical information, adjusted for current economic trends. To the extent actual returns and allowances vary from the estimated experience, revisions to the allowance may be required. Significant management judgments and estimates are made and used in connection with establishing the sales and allowances reserve in any accounting period. As of December 31, 2006 and 2007, the provision for sales returns and allowances included in accounts receivable, net was $1,049,000 and $541,000, respectively.

Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company determines the adequacy of this allowance by regularly reviewing the composition of its aged accounts receivable and evaluating individual customer receivables, considering (i) the customer s financial condition, (ii) the customer s credit history, (iii) current economic conditions and (iv) other known factors. As of December 31, 2006 and 2007 the allowance for doubtful accounts included in accounts receivable, net was $520,000 and $303,000, respectively.

Stock-Based Compensation

On January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), *Share-Based Payment* (FAS 123R), that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for equity instruments of the enterprise. The statement eliminates the ability to account for share-based compensation transactions, as the Company formerly did, using the intrinsic value method as prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees,* and generally requires that such transactions be accounted for using a fair-value-based method and recognized as expense in its consolidated statements of operations.

The Company adopted FAS 123R using the modified prospective method which requires the application of the accounting standard as of January 1, 2006. The Company s consolidated financial statements as of and for the years ended December 31, 2006 and 2007 reflect the impact of adopting FAS 123R. In accordance with the modified prospective method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of FAS 123R.

Stock-based compensation expense recognized during the period is based on the value of the portion of stock-based payment awards that is ultimately expected to vest. Stock-based compensation expense recognized in the consolidated statements of operations during the years ended December 31, 2006 and 2007 included compensation expense for stock-based payment awards granted prior to, but not yet vested, as of December 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS No. 148, *Accounting for Stock-based Compensation Transition and Disclosure (as amended)* (FAS 148) and compensation expense for the stock-based payment awards granted subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with FAS 123R. As stock-based compensation expense recognized in the consolidated

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

statements of operations for the years ended December 31, 2006 and 2007 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. FAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the pro forma information required under FAS 148 for the periods prior to 2006, the Company accounted for forfeitures as they occurred. When estimating forfeitures, the Company considers historic voluntary termination behaviors as well as trends of actual option forfeitures. In anticipation of the impact of adopting FAS 123R, the Company accelerated the vesting of approximately 72,000 shares subject to outstanding stock options in December 2005. The primary purpose of the acceleration of vesting was to minimize the amount of compensation expense recognized in relation to the options in future periods following the adoption by the Company of FAS 123R. Since the Company accelerated these shares, the impact of adopting FAS 123R was not material, to date, to the Company s results of operations.

Income Taxes

The Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* (FIN 48) on January 1, 2007. The Company did not have any unrecognized tax benefits and there was no effect on its financial condition or results of operations as a result of implementing FIN 48.

The Company files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. The Company is no longer subject to U.S. federal tax assessment for years before 2004. State jurisdictions that remain subject to assessment range from 2003 to 2007. The Company does not believe there will be any material changes in its unrecognized tax positions over the next 12 months. The Company believes that its income tax filing positions and deductions will be sustained on audit and does not anticipate any adjustments that will result in a material adverse effect on the Company s financial condition, results of operations, or cash flow. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to FIN 48. In addition, the Company did not record a cumulative effect adjustment related to the adoption of FIN 48.

The Company s policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of the date of adoption of FIN 48, the Company did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during 2007. The Company s effective tax rate differs from the federal statutory rate primarily due to increases in its deferred income tax valuation allowance.

Comprehensive Loss

Other comprehensive loss includes all changes in equity (net assets) during a period from non-owner sources and is reported in the consolidated statements of stockholders equity. For 2005, 2006 and 2007, other comprehensive loss consists of changes in accumulated foreign currency translation adjustments during the period.

Net Income (Loss) Per Share

Basic net income (loss) per share (Basic EPS) is computed by dividing net income (loss) by the sum of the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per share (Diluted EPS) gives effect to all dilutive potential common shares outstanding during the period. The computation of

Diluted EPS does not assume conversion, exercise or contingent exercise of securities that would have an anti-dilutive effect on earnings. The dilutive effect of outstanding stock options and warrants is computed using the treasury stock method.

Table of Contents

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table sets forth the computation of basic and diluted net income (loss) per share (in thousands, except per share amounts):

	Year Ended December 31,		
	2005	**2006**	**2007**
Numerator:			
Net income (loss)	$ 2,740	$ (3,710)	$ (51,170)
Denominator:			
Weighted-average shares used to compute basic EPS	1,712	1,733	2,876
Effect of dilutive securities:			
Dilutive common stock equivalents	107		
Dilutive potential common shares	107		
Weighted-average shares used to compute diluted EPS	1,819	1,733	2,876
Net income (loss) per share:			
Basic	$ 1.60	$ (2.14)	$ (17.79)
Diluted	$ 1.51	$ (2.14)	$ (17.79)

The potential shares, which are excluded from the determination of basic and diluted net income (loss) per share as their effect is anti-dilutive, are as follows (in thousands):

	Year Ended December 31,		
	2005	**2006**	**2007**
Common stock options and warrants	70	187	216

Recent Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (FAS 141R). FAS 141R requires an acquirer to measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. FAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. The Company has not yet determined the effect on its consolidated financial statements, if any, upon adoption of FAS 141R.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51* (FAS 160). FAS 160 clarifies that a noncontrolling interest in a subsidiary should be reported as equity in the consolidated financial statements. The calculation of earnings per share will continue to be based on income amounts attributable to the parent. FAS 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. The Company has not yet determined the effect on its consolidated financial statements, if any, upon adoption of FAS 160.

In February 2007, the FASB issued SFAS No. 159 (FAS 159), *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* which is effective for fiscal years beginning after November 15, 2007. This statement permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. The Company is currently evaluating the potential impact of FAS 159, but does not expect the adoption of FAS 159 to have a material impact on its consolidated financial position, results of operations or cash flows.

Table of Contents

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In September 2006, the FASB issued SFAS No. 157 (FAS 157), *Fair Value Measurements,* which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. FAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. FAS 157 is effective for fiscal years beginning after November 15, 2007. Earlier adoption is permitted, provided the company has not yet issued financial statements, including for interim periods, for that fiscal year. The Company is currently evaluating the impact of FAS 157, but does not expect the adoption of FAS 157 to have a material impact on its consolidated financial position, results of operations or cash flows.

Note 2 Segment Information

As a result of further integrating the Company s various businesses, its executive management team, and its financial and management reporting systems during fiscal 2006, the Company began to operate as three segments effective January 1, 2007: Online, Publishing and Travel and Events. The Travel and Events segment consisted of travel and events marketed through the Company s RSVP brand and by the Company s consolidated affiliate, PNO DSW Events, LLC (DSW). In March 2007, the Company sold its membership interest in DSW, a joint venture, to the minority interest partner. In December 2007, the Company sold substantially all the assets of RSVP. As a result of the sale of the Company s interest in DSW, its sale of substantially all the assets of RSVP and the Company s decision to exit its Travel and Events business, the Company has reported the results of operations and financial position of RSVP and DSW as discontinued operations within the consolidated financial statements as described more fully in Note 14, Discontinued Operations. As of December 31, 2007, the Company has two segments remaining: Online and Publishing.

Operating segments are based upon the Company s internal organization structure, the manner in which its operations are managed, the criteria used by the Company s Chief Operating Decision Maker to evaluate segment performance and the availability of separate financial information. The Online segment includes the Company s global online properties and websites. The Publishing segment consists of the Company s print properties, primarily magazines and its book publishing businesses.

Segment performance is measured based on contribution margin (loss), which consists of total revenues from external customers less direct operating expenses. Direct operating expenses include cost of revenue and sales and marketing expenses. Segment managers do not have discretionary control over other operating costs and expenses such as general and administrative costs (consisting of costs such as corporate management, human resources, finance and legal), restructuring, depreciation and amortization expense and impairment of goodwill, as such, other operating costs and expenses are not evaluated in the measurement of segment performance.

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes the financial performance of the Company s operating segments (in thousands):

	Year Ended December 31, 2007		
	Online	Publishing	Total
Revenue:			
Advertising services	$ 9,365	$ 16,190	$ 25,555
Subscription services	16,476	5,425	21,901
Transaction services	1,191	4,366	5,557
Total revenue	27,032	25,981	53,013
Direct operating costs and expenses:			
Cost of revenue	12,673	17,213	29,886
Sales and marketing	9,296	6,970	16,266
Total direct operating costs and expenses	21,969	24,183	46,152
Contribution margin	$ 5,063	$ 1,798	6,861
Other operating costs and expenses:			
General and administrative			15,122
Restructuring			630
Depreciation and amortization			6,723
Impairment of goodwill			25,914
Total other operating costs and expenses			48,389
Loss from operations			(41,528)
Other expense, net			(1,441)
Benefit for income taxes			6
Loss from discontinued operations			(8,207)
Net loss			$ (51,170)

Table of Contents

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Year Ended December 31, 2006		
	Online	Publishing	Total
Revenue:			
Advertising services	$ 11,116	$ 15,363	$ 26,479
Subscription services	18,378	6,069	24,447
Transaction services	2,129	5,701	7,830
Total revenue	31,623	27,133	58,756
Direct operating costs and expenses:			
Cost of revenue	10,240	16,504	26,744
Sales and marketing	10,236	5,356	15,592
Total direct operating costs and expenses	20,476	21,860	42,336
Contribution margin	$ 11,147	$ 5,273	16,420
Other operating costs and expenses:			
General and administrative			11,690
Restructuring			791
Depreciation and amortization			5,187
Total other operating costs and expenses			17,668
Loss from operations			(1,248)
Other expense, net			(616)
Provision for income taxes			(45)
Loss from discontinued operations			(1,801)
Net loss			$ (3,710)

	Year Ended December 31, 2005		
	Online	Publishing	Total
Revenue:			
Advertising services	$ 9,043	$ 2,681	$ 11,724
Subscription services	20,202	933	21,135
Transaction services	1,611	1,121	2,732
Total revenue	30,856	4,735	35,591

Direct operating costs and expenses:			
Cost of revenue	9,248	2,716	11,964
Sales and marketing	10,358	730	11,088
Total direct operating costs and expenses	19,606	3,446	23,052
Contribution margin	$ 11,250	$ 1,289	12,539
Other operating costs and expenses:			
General and administrative			7,036
Depreciation and amortization			3,460
Total other operating costs and expenses			10,496
Income from operations			2,043
Other income, net			904
Provision for income taxes			(207)
Net income			$ 2,740

Table of Contents

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Total assets by reportable segments were as follows (in thousands):

	December 31, 2006	December 31, 2007
	(In thousands)	
Total assets by reportable segment:		
Online	$ 33,149	$ 24,105
Publishing	45,409	17,247
Travel and Events	15,031	
	$ 93,589	$ 41,352

Note 3 Goodwill and Intangible Assets

Goodwill

The Company records as goodwill the excess of the purchase price of net tangible and intangible assets acquired over their estimated fair value. Goodwill is not amortized. In accordance with FAS 142, goodwill is subject to at least an annual assessment for impairment, and between annual tests in certain circumstances, applying a fair-value based test. The Company conducts its annual impairment test as of December 1 of each year, and between annual tests if a triggering event occurs. During the three months ended June 30, 2007, the Company determined that a triggering event had occurred in May 2007, primarily due to lower advertising revenue than expected related to the Company s publishing segment and lower than expected revenue related to the Company s Travel and Events business which the Company believes resulted in a significant decrease in the trading price of the Company s common stock and a corresponding reduction in its market capitalization. As a result of this triggering event, the Company conducted the first of its goodwill impairment test and determined that goodwill had been impaired. Accordingly, the Company conducted the second step of its impairment test to measure the impairment and recorded an estimated impairment charge to goodwill in the amount of $21.1 million in operating expenses of continuing operations during the three months ended June 30, 2007.

The Company performed its annual test as of December 31, 2007. The results of Step 1 of the annual goodwill impairment analysis on December 1, 2007 showed that goodwill was not impaired as the estimated market value of its reporting units exceeded their carrying value, including goodwill. Accordingly, Step 2 was not performed. The Company will continue to test for impairment on an annual basis and on an interim basis if an additional triggering event occurs or circumstances change that would more likely than not reduce the fair value of the Company s reporting units below their carrying amounts. As a result of the winding down of the Company s international marketing efforts and the Company s closure of its international offices in conjunction with the July 2007 restructuring plan, the Company recognized an additional goodwill impairment charge of $0.4 million in operating expenses of continuing operations the fourth quarter of 2007.

During the fourth quarter of 2007, the Company divested itself of its Travel and Events business, and is currently operating in two segments, with three reporting units. An additional impairment charge of $4.0 million related to the Travel and Events business is included in the Company s loss from discontinued operations. See Note 14, Discontinued Operations.

Table of Contents

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A summary of changes in the Company s goodwill during the year ended December 31, 2007 by reportable segment is as follows (in thousands):

Acquisition	December 31, 2006	Adjustments	Impairment	December 31, 2007
Online	$ 3,403	$	$ (415)	$ 2,988
Publishing	25,187	48	(21,100)	4,135
	$ 28,590	$ 48	$ (21,515)	$ 7,123

Adjustments to goodwill during the year ended December 31, 2007 resulted primarily from purchase price adjustments related to transaction costs and deferred revenue. Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in each business combination.

Intangible Assets

The components of acquired intangible assets are as follows (in thousands):

	December 31, 2006			December 31, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer lists and user bases	$ 8,678	$ 4,615	$ 4,063	$ 4,809	$ 4,809	$
Tradenames	8,040	2,340	5,700	4,210	2,340	1,870
Other intangible assets	726	726		726	726	
	$ 17,444	$ 7,681	$ 9,763	$ 9,745	$ 7,875	$ 1,870

Intangible assets subject to amortization consist of customer lists and user bases with amortization periods of one to six years. As of December 31, 2006, the weighted-average useful economic life of customer lists and user bases being amortized was 4.8 years. During 2006 and 2007, the Company did not record amortization expense on its tradenames which it considers to be indefinitely lived assets. Aggregate amortization expense for intangible assets totaled $191,000, $1,146,000 and $927,000 for the years ended December 31, 2005, 2006 and 2007, respectively. The net carrying amount of customer lists and user bases and tradenames related to the SpecPub asset group that have been classified as assets held for sale as of December 31, 2007 totaled $1,187,000 and $1,380,000, respectively, as described more fully in Note 4, Assets and Liabilities Related to Assets Held for Sale. The net carrying amount of customer lists and user bases and tradenames related to RSVP that have been classified as discontinued operations

totaled $1,429,000 and $940,000 as of December 31, 2006, respectively, as described more fully in Note 14, Discontinued Operations.

Also during the fourth quarter of 2007, in conjunction with its estimate to measure goodwill impairment in the second quarter of 2007, the Company recorded an impairment charge in operating expenses of continuing operations to its customer lists and user bases and tradenames of $1.9 million and $2.5 million, respectively, as a result of the completion of an independent business valuation of the intangible assets of its LPI reporting unit.

An additional impairment charge of $0.4 million related to the Travel and Events business is included in the Company s loss from discontinued operations. See Note 14, Discontinued Operations.

Note 4 Assets and Liabilities Related to Assets Held for Sale

At such time as management determines that a material long-lived asset or a long-lived asset that is part of a group that includes other assets and liabilities (asset group) is to be disposed of within a twelve-month period and all other criteria required under SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,*

Table of Contents

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(FAS 144) have been met, that material asset or asset group is reclassified on the condensed consolidated balance sheet as held for sale and recorded at the lower of its carrying amount or fair value less cost to sell.

In June 2007, management, with the authority to approve the action, committed to a plan to sell the assets and liabilities related to its SpecPub, Inc. asset group. The Company is actively marketing the asset group and expects to complete the sale within the next twelve months.

In accordance with FAS 144, the assets and liabilities related to the SpecPub, Inc. asset group have been classified as assets held for sale and liabilities related to assets held for sale. The results of the SpecPub, Inc. asset group are not recorded as discontinued operations because the primary operations of the SpecPub, Inc. asset group are part of a larger cash-flow-generating product group in the Company s publishing segment and do not represent a separate reporting unit or component as defined by FAS 144. The carrying amounts of the major classes of assets and liabilities related to assets held for sale as of December 31, 2007 are as follows (in thousands):

Current assets held for sale:	
Accounts receivable, net	$ 977
Inventory	314
Prepaid expenses and other current assets	504
	$ 1,795
Long-term assets held for sale:	
Property and equipment, net	$ 54
Intangible assets, net	2,567
Other assets	52
	$ 2,673
Current liabilities related to assets held for sale:	
Accounts payable	$ 74
Accrued expenses and other liabilities	161
Deferred revenue, current portion	1,434
Capital lease obligations, current portion	7
	$ 1,676
Long-term liabilities related to assets held for sale:	
Deferred revenue, less current portion	$ 578
Capital lease obligations, less current portion	24
	$ 602

Note 5 Other Balance Sheet Components

The Company s other balance sheet components noted in this footnote exclude the assets and liabilities of the SpecPub group that have been classified as assets and liabilities related to assets held for sale on the consolidated balance sheet as of December 31, 2007 as described more fully in Note 4, Assets and Liabilities Related to Assets Held for Sale. The Company s other balance sheet components noted in this footnote also exclude the assets and liabilities of RSVP and DSW which have been reported as discontinued operations on the consolidated balance sheet as of December 31, 2006 as described more fully in Note 14, Discontinued Operations.

Table of Contents

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	December 31,		
	2005	2006	2007
	(In thousands)		
Accounts receivable:			
Trade accounts receivable	$ 7,033	$ 10,532	$ 7,712
Less: Allowance for doubtful accounts	(259)	(520)	(303)
Less: Provision for returns	(744)	(1,049)	(541)
	$ 6,774	$ 8,963	$ 6,868

In 2005, 2006 and 2007, the Company provided for an increase in the allowance for doubtful accounts of $287,000, $1,824,000 and $1,439,000 respectively, and wrote-off accounts receivable against the allowance for doubtful accounts totaling $87,000, $1,563,000 and $1,458,000, respectively. The allowance for doubtful accounts related to the SpecPub asset group that has been classified as assets held for sale as of December 31, 2007 totaled $198,000, as described more fully in Note 4, Assets and Liabilities Related to Assets Held for Sale.

In 2005, 2006 and 2007, the Company provided for an increase in the provision for returns of $839,000, $4,589,000 and $4,309,000, respectively, and wrote-off accounts receivable against the provision for returns totaling $95,000, $4,284,000 and $4,545,000, respectively. The provision for returns related to the SpecPub asset group that has been classified as assets held for sale as of December 31, 2007 totaled $272,000, as described more fully in Note 4, Assets and Liabilities Related to Assets Held for Sale.

	December 31,		
	2005	2006	2007
	(In thousands)		
Inventory			
Materials for future publications	$ 415	$ 370	$ 375
Finished goods available for sale	1,019	1,386	788
	1,434	1,756	1,163
Less: reserve for obsolete inventory	(85)	(66)	(50)
	$ 1,349	$ 1,690	$ 1,113

In 2005, 2006 and 2007, the Company provided for an increase in the provision for obsolete inventory of $87,000, $34,000 and $74,000, respectively, and wrote-off inventory against the reserve for obsolete inventory totaling $2,000, $53,000 and $50,000, respectively. The provision for obsolete inventory related to the SpecPub asset group that has been classified as assets held for sale as of December 31, 2007 totaled $40,000, as described more fully in Note 4,

Assets and Liabilities Related to Assets Held for Sale.

	December 31,	
	2006	2007
	(In thousands)	
Property and equipment:		
Computer equipment and software	$ 13,694	$ 10,364
Furniture and fixtures	1,202	1,082
Leasehold improvements	2,245	2,299
Website development costs	6,855	6,453
	23,996	20,198
Less: Accumulated depreciation and amortization	(13,259)	(11,757)
	$ 10,737	$ 8,441

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In 2005, 2006 and 2007, the Company recorded depreciation and amortization expense of property and equipment of $3,269,000, $4,005,000 and $5,499,000, respectively. In 2005, 2006 and 2007, the Company recorded non-cash impairment charges of zero, zero and $665,000, respectively.

	December 31,	
	2006	2007
	(In thousands)	
Accrued expenses and other liabilities:		
Accrued payroll and related liabilities	$ 1,163	$ 1,422
Other accrued liabilities	2,147	1,069
	$ 3,310	$ 2,491

Note 6 Notes Payable

The Company s notes payable, net of discounts were comprised of the following:

	December 31, 2006 (In thousands)
Notes payable to vendors	$ 47
LPI note	7,075
Orix term loan	7,187
Orix revolving loan	3,000
	17,309
Less: discount	(392)
	16,917
Less: current portion, net of discount	8,817
Notes payable, less current portion and discount	$ 8,100

In November 2005, the Company issued a note payable (the LPI note) in connection with its acquisition of the assets of LPI Media, Inc. and related entities (LPI) in the amount of $7,075,000 to the sellers, secured by the assets of SpecPub, Inc. and payable in three equal installments of $2,358,000 in May, August and November 2007. In July 2007, the Company paid the LPI note in full. The note bore interest at a rate of 10% per year, payable quarterly and in arrears. In 2005, 2006 and 2007 the Company recorded interest expense on the LPI note of $133,000, $708,000 and

$331,000, respectively, in the consolidated statements of operations.

In June 2006, the Company entered into a software maintenance agreement under which $90,000 was financed with a vendor. This amount was payable in four quarterly installments beginning in July 2006. The note was paid in full in June 2007.

In September 2006, the Company entered into a Loan and Security Agreement with ORIX Venture Finance, LLC (Orix), which was amended in February 2007, May 2007 and June 2007 (the Loan Agreement). Pursuant to the Loan Agreement, the Company borrowed $7,500,000 as a term loan and $3,000,000 as a 24-month revolving loan in September 2006. The borrowings under the line of credit were limited to the lesser of $3,000,000, which the Company had already drawn down, or 85% of qualifying accounts receivable. The term loan was payable in 48 consecutive monthly installments of principal beginning on November 1, 2006, together with interest at an initial rate of prime plus 3%. The term loan provided for a prepayment fee equal to 5% of the amount prepaid in connection with any prepayment made prior to September 27, 2007. The revolving loan bore interest at a rate of prime plus 1%. The loans were secured by substantially all of the assets of the Company and all of the outstanding capital stock of all subsidiaries of the Company, except for the assets and capital stock of SpecPub, Inc., which were pledged as

Table of Contents

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

security for the LPI note. In connection with the term loan agreement, the Company issued Orix a 7-year warrant to purchase up to 12,000 shares of the common stock of the Company at an exercise price of $37.40. The warrant vested immediately, had a fair value of approximately $445,000 as of the date of issuance and will expire on September 28, 2013. The value of the warrant was recorded as a discount of the principal amount of the term loan and will be accreted and recognized as additional interest expense using the effective interest method over the life of the term loan.

The Company and Orix entered into a waiver and amendment to the Loan Agreement in May 2007 (the May Waiver), pursuant to which Orix waived defaults associated with the Company s failure to meet certain financial tests and liquidity covenants. In consideration of the May Waiver, the Company, in addition to other commitments, agreed to maintain certain minimum cash balances, increase the interest rate on the term loan to prime plus 5% and committed to raise at least $15.0 million in new equity or subordinated debt. At that time, the Company also agreed to apply at least $3.0 million of the proceeds from that transaction to pay down the term loan. As part of the amendment in June 2007, the Company and Orix agreed to modify the requirement in the May Waiver for the commitment to raise new equity or subordinated debt to be for gross proceeds of at least $25.0 million, which could be completed in one or more closings, with the first closing for not less than $4.2 million in proceeds, if applicable, occurring no later than July 10, 2007, and the entire financing being completed no later than September 30, 2007. In addition, Orix consented to, among other things, certain limited prepayments with respect to the Company s other indebtedness in the event of the first closing and prior to the completion of the entire financing. Orix also agreed to defer the payment of principal installments due on July 1, August 1 and September 1 with respect to its term loan for a deferral fee of $150,000. In July 2007, the Company completed a private placement financing with a group of investors for approximately $26.2 million in gross proceeds from the sale of approximately 2.3 million shares of the Company s common stock and used a portion of the proceeds to repay, in full, the LPI note, the Orix term loan, the Orix revolving loan, the deferral fee and $0.3 million in prepayment fees. As a result of the payment of the loans, the Company accelerated the accretion of the loan discount.

Note 7 Commitments and Contingencies

Operating Leases

The Company leases office space and equipment under noncancelable operating leases with various expiration dates through December 31, 2012. The Company recognizes rent expense on a straight-line basis over the lease period. Rent expense under the Company s operating leases in 2005, 2006 and 2007, was $1,523,000, $2,634,000 and $2,570,000, respectively.

Future minimum payments under noncancelable operating lease agreements are as follows (in thousands):

Year Ending December 31,	Operating Leases
2008	$ 2,884
2009	2,957
2010	2,880

2011	2,887
2012	1,066
	$ 12,674

Table of Contents

PlanetOut Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Capital Leases

As of December 31, 2007, the future minimum lease payments under noncancelable capital leases are as follows (in thousands):